Risk Management should be Proactive in these Turbulent Times

by Mr Nicodemus Tan, Governor, The Institute of Internal Auditors Singapore

The growth of the global village dictates that traditionally irrelevant risks in other countries are fast affecting individual companies. Notably, the tensions between the US and China, data privacy laws in Europe and cyber security threats in the digital space are forcing companies to rethink and revamp their businesses and growth strategies; starting from expanding supply chain to exploring new distributorship frameworks to outright acquisitions of companies in unfamiliar territories.

While these risks and strategies require vast amounts of resources, including management attention, they offer those who are able to navigate it well a huge competitive advantage over their competitors. As with all good risk management strategies, the foremost focus and starting point is understanding the business objectives and targets before management can identify and assess the risks relevant (or about to become relevant) to its success. Once business strategy and risk prioritisation have been determined, management should actively utilise its internal audit function to proactively support the accomplishment of its strategies.

A great example of how many multinational corporations (MNCs) have done this recently is shown when they diversified their supply base and revenue base to be less exposed to tax tensions between US and China. Many of these MNCs have rapidly embarked on new programmes to secure supplies from new countries, worked with new original equipment manufacturers (OEMs), acquired new subsidiaries or engaged in new joint ventures (JVs). These strategies do not come without risks - the additional supplies may not meet quality requirements or may have originated from US or China; the new OEM may not meet health, safety and workplace standards; the cost of raising the operations of the new acquisition may be exorbitant and the JV arrangement may not have been adequately thought through.

A good internal audit can provide a competitive advantage over these same risks that all companies face, through the management shifting it from being a reactionary after-thought of performing fixed cycle-based audits to that of an independent frontline risk management tool. By conducting detailed supplier audits and OEM audits pre- and post-engagement, the company is able to quickly identify and rectify any key risks and deviations from its business plans.

Similarly, internal audit is able to value add in the life cycle of any JV. While a lawyer is best suited for reviewing legal risks in a JV agreement, the internal audit function can provide an independent and objective operational and financial risk perspective to identify missing elements. Areas that tend to be overlooked include rights to compliance policies and procedures, the operations and resolution of whistleblowing channels, banking arrangements, setting up of new product lines, corporate governance, right of audit, among others. Once the JV is established, the internal audit function can continue to offer useful insights in monitoring the risks and controls of the JV, providing suggestions to improve risks, reducing shocks and helping to ensure the smooth auto pilot of the JV.

CROSS-BORDER LAWS

Many laws enacted these days are increasingly cross-border. Starting from the Foreign Corrupt Practices Act (FCPA) enacted in 1977 by the US to the more recent General Data Protection Regulation implemented by the European Union in 2018, these long-arm laws mean that a company is no longer just bounded by the individual laws within specific locality but is increasingly required to obey the combined lowest permissible actions of all laws across all its geographical areas of operations.

Instead of performing specific investigations along with the legal teams as and when suspected non-compliance occurs, internal audit should be assigned a proactive role by drafting targeted review programmes to assess individual subsidiaries' management of and compliance with these laws.

What may be an acceptable business gift in a country may be questionable under the US FCPA and may unknowingly be provided by the country business leaders who are not familiar with the US regulations. Likewise, while indicating an employee's particulars in certain correspondences may be acceptable in one country, it may not be permissible if that employee happens to be a citizen of the European Union. Through targeted audit programmes, the risks at the subsidiaries are actively assessed and reported and local management are similarly being trained.

Internal audit can also assist management through the use of data analytics programmes to provide insights into risk areas. When used effectively, data analytics allows the auditors to review a full population of transactions, identify trends and outliers and in certain cases, highlight commonalties for root cause identification that management can readily work on. Thereafter, the internal audit function can assist management to set up similar programmes from a continuous monitoring perspective that will allow management to get real-time updates on control breakdowns and high risk transactions. This allows timely resolution of risk events and prevents "fires" from emanating further. Other than a sharp reduction in cost of risk events, management can also better focus their attention on actual strategy execution.

The lines between internal risks and external risks, cross-border risks, legal and operational risks are fast blurring in turbulent times. Very often, it is the structure, governance, risk-managed processes that help the company to weather the storm better than the competitors. A small to medium risk reduction in the company, day by day, transaction by transaction, means that the benefits to the company are compounded. By moving internal audit from the last line of defence to being a proactive tool on risk management in increasingly turbulent times, the company will be able to secure a competitive advantage for itself.

Article was published in The Business Times on 26 June 2019.