



Issue 1

GLOBAL PERSPECTIVES AND INSIGHTS: Grappling With Geopolitics



The Institute of
Internal Auditors

Global

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Contributors

Gregory T. Grocholski,
Vice President and
Chief Audit Executive, SABIC

Michele J. Hooper,
President and CEO of
The Directors’ Council

Advisory Council

Nur Hayati Baharuddin, CIA,
CCSA, CFSA, CGAP, CRMA –
IIA–Malaysia

Lesedi Lesetedi, CIA, QIAL –
African Federation IIA

Hans Nieuwlands, CIA, CCSA,
CGAP – *IIA–Netherlands*

Karem Obeid, CIA, CCSA,
CRMA – Member of *IIA–
United Arab Emirates*

Ana Cristina Zambrano
Preciado, CIA, CCSA, CRMA –
IIA–Colombia

Reader Feedback

Send questions or comments to
globalperspectives@theiia.org.

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Richard F. Chambers, CIA, QIAL,
CGAP, CCSA, CRMA
President and CEO
The Institute of Internal Auditors

President's Letter

Dear Readers,

There is little debate that demands from internal audit's stakeholders are growing in complexity and scope. The days are long gone when an internal audit function could operate within the relative comfort of financial and internal control assignments.

Indeed, internal audit today does some of its best work and provides the greatest value to organizations when it is asked to provide insight and foresight on issues of risk, governance, and strategic impact.

This new reality for our profession demands a source of timely thought leadership that is powerful, relevant, topical, and responsive to the dynamics of geopolitical and economic influences. In response, I am pleased to introduce the first of an ongoing series: *Global Perspectives and Insights*, The IIA's new global thought-leadership publication.

This new thought-leadership series offers insight and direction on key issues, with perspectives that know no national or regional boundaries. Its content will come from a variety of sources, including: IIA Global, Institutes, regional associations, and advocacy partners such as IFAC and INTOSAI. You may also find repurposed content from other sources that meets the aim of providing discerning thought leadership with global applicability and relevance.

It is my hope that this offering not only enhances the value of your IIA membership, but more importantly also encourages collaboration and information sharing that will help raise the profile of our profession. To ensure *Global Perspectives and Insights* maintains its international flavor and focus, we have created a global content advisory council that will help identify topics, review content, and oversee a timely production calendar.

While we expect to produce *Global Perspectives and Insights* several times a year, the main driver of content will be the need to address global issues of importance to the global profession in a timely manner.

I hope you enjoy and can benefit from this premiere issue and many issues to come.

Sincerely,

Richard F. Chambers, CIA, QIAL, CGAP, CCSA, CRMA
President and CEO
The Institute of Internal Auditors

Global Chairman's Letter

Dear Readers,

Any textbook definition of *internal auditing* must include a discussion of the role our profession plays in promoting good governance, identifying and mitigating risk, and providing assurance on the effectiveness of control measures.

Yet as new and emerging risks increasingly threaten organizations globally in significant, treacherous, and sometimes brazen ways, it seems that now more than ever risk dominates what we do — from identifying it, to understanding it, to mitigating it, to assessing how we ultimately deal with it. By necessity, this requires a laser focus on the risks that directly affect our organizations.

That same laser focus can sometimes create blind spots to larger issues that can indirectly impact our organizations. We must be cognizant of this and the dangers that a myopic view poses to any organization.

This premiere issue of *Global Perspectives and Insights*, The IIA's new thought leadership publication, looks at how risk at the macro level can have substantial and lingering effects at the local level.

This glimpse into how geopolitics and geopolitical risk can affect organizations doesn't take on the broad spectrum that the term implies. Instead, the paper's authors examine how a single geopolitically influenced factor — the price of oil — can disrupt, disturb, or stress seemingly unrelated business functions.

In helping develop this paper, contributors Gregory Grocholski, vice president and CAE at SABIC; and Michele Hooper, president and CEO of The Directors' Council, offered insight not only into how geopolitics can affect different business sectors, but also called out specific actions internal auditors should take. Also, the paper identifies sources for additional information and an opportunity for readers to engage in the conversation as well as provide feedback.

This first offering clearly demonstrates the value that *Global Perspectives and Insights* provides its readers. It is the first of many more thought-provoking, insightful, and useful pieces The IIA plans to produce in the years ahead.

Sincerely,

Anton van Wyk, CIA, QIAL, CRMA
2014–15 IIA Global Chairman



Anton van Wyk, CIA, QIAL, CRMA
2014–15 IIA Global Chairman

War and Conflict

War and conflict are perhaps the oldest and most destructive geopolitical risks. Discussion at the February 2015 World Economic Forum (WEF) in Davos, Switzerland, suggested that war and conflict are the top geopolitical risks impacting industries and economies this year. In takeaways from a WEF session on The Geopolitical Outlook, leading experts suggest that organizations operating in areas of war and conflict should:

- Clearly understand the balance of risk and opportunity — high volatility is the price that organizations pay for high gross opportunities in regions strewn with war and conflict.
- Continually monitor and frequently assess legal risks, reputational risks, and business risks associated with war and conflict.

Grappling With Geopolitics

It can be a daunting task for internal auditors to grapple with how geopolitics impacts their organizations. After all, geopolitics includes broad and complex interrelated topics such as climate change, the outbreak of disease, political instability, economics, war, and conflict, all of which can present risks to the organization with little or no notice.

Geopolitical risks cannot be considered in isolation; these risks are quite interrelated. This paper briefly describes the impact of economics, war, and conflict on one particular topic that has pervaded global business news headlines — the price of oil. The authors consider the impact of the price of oil on multiple industries. Finally, they explore the key considerations for internal audit in addressing geopolitical risks to the organization.

Economics, War, and Conflict

Impacts on the Price of Oil

Widely reported 2014–15 events impacting the global price of oil include:

- At its November 2014 meeting, the Organization of the Petroleum Exporting Countries (OPEC) adopted a market share strategy, agreeing not to cut back oil production. This strategy precipitated a steep decline in the price of oil with major ramifications around the world.
- Russia and Ukraine became locked in a territorial dispute that increased global tension and prompted international sanctions against Russia. A major oil exporter, Russia is expected to dramatically decrease output over the next several years as a result of both the sanctions and low oil prices.
- Rival Libyan forces carried out strikes on the country's oil terminals, causing fear over oil supplies and putting upward pressure on the price of oil.
- Talks over Iran's nuclear program and the possible relaxing of sanctions against Iranian oil exports if a deal is reached spurred discussions over what impact such a deal might have on the future price and supply of oil.
- Saudi Arabia conducted air strikes in Yemen, causing the price of oil to gain back some of its lost ground.

These geopolitical events have potentially far-reaching impacts on public and private sector organizations. To illustrate this point, the authors take a closer look at some of the real and anticipated impacts of the price of oil across multiple industries.

The Price of Oil – Impacts on Organizations

Oil Producers and Support Services

Bloomberg reported more than 100,000 layoffs in the energy sector worldwide from mid-2014 when oil prices began to fall through mid-February 2015, with oil hubs in Scotland, Australia, and Brazil, as well as U.S. shale producers, being particularly hard hit. Oilfield-services companies also have slashed jobs. In January 2015, a large heavy-equipment manufacturer singled out falling crude prices as contributing to reported missed earnings and a disappointing outlook.

Public Sector Organizations

National and local governments may struggle as oil industry tax revenues and royalties slide. At the same time, governments may be moved to grant tax relief to oil companies as a way to bolster energy investments.

Retailers

Lower energy prices are expected to help many consumers save money on heating their homes and fueling their cars. Presumably, consumers will shift some of their savings to retail spending. In addition, lower oil prices may dampen retail transportation costs. However, it will be a mixed bag for retailers dependent on energy industry workers to buy their products.

Hospitality and Travel

Lower oil prices may boost tourism and the economic outlook for hotels and airlines. However, the outlook may be dim for small hotel operators that only recently benefitted from the expanding U.S. shale industry by housing workers in relatively remote locations near hydraulic fracturing wells.

Financial Services

Banks that have been lending, underwriting, and advising oil companies may be hurt by lower oil prices. In late 2014 and early 2015, market analysts predicted a wave of defaults on American oil company debts. As well, financial services institutions and mortgage servicing companies with a concentration of energy worker mortgages may suffer. On the other hand, consumers may be inclined to open new lines of credit, refinance existing debt, or take out a new mortgage.

As these examples illustrate, geopolitical impacts on organizations can be complex and far-reaching. This often presents both risks and opportunities, prompting requests from management and the board for actions that will help the organization assess, respond to, and influence geopolitical risks. Internal auditors can respond to this call to action and prepare to provide geopolitical-related assurance and advisory services by recognizing their role, keeping pace with geopolitical events, thinking broadly, and focusing on competencies and professional development.

War and Conflict Cont.

- Make a strategic, long-term commitment to the region. A long-term commitment can be mutually beneficial for both parties — the organization furthers its business objectives while playing a major role in stabilizing the region by offering good jobs. Eventually, if in it for the long term, increased regional stability will presumably lower risks to the organization.
- Measure risks and put them into perspective. A WEF session panelist noted that over the past several years, his global manufacturing firm lost more people through car accidents in the West than through war in the Middle East or Europe, and it lost more manufacturing plants to fire or electrical accidents than through bombings.
- Make people a priority. Operations can be rebuilt, people cannot.

Internal Audit's Call to Action

Recognize Internal Audit's Role

Internal audit should assess the organization's ability to foresee and respond to geopolitical events and advise the organization regarding geopolitical risks and opportunities. Internal audit can provide assurance in the strategic planning and monitoring processes, and it can potentially identify significant outliers in the external environment. Considerations include:

- Geopolitical risk has the potential to impact all organizations and should be considered in the organization's strategic planning process and as part of the enterprise risk management (ERM) program. Internal auditors should consider the relevance of geopolitical risks when preparing any risk assessment, especially at the entity level, by developing an in-depth awareness of the inner workings of the organization. These inner workings include the components and structure of the organization, and their underlying dependencies and relationships in terms of products, services, and location of operations. An in-depth knowledge of the organization's operations and what makes it successful is paramount. Using manufacturing as an example, internal auditors should think through how raw materials would be affected by the geographies in which their suppliers operate. Is the supply chain dependent upon pipelines or waterways affected by geopolitical instabilities, such as war and conflict?
- The audit committee should look to internal audit as a key reliable and objective professional resource providing assurance that geopolitical risks have been considered in the organization's ERM framework. The audit committee also may look to internal audit to help the committee probe deeper into second- and third-order risks to ensure that these risks are being considered. For example, regarding risks related to suppliers, line management typically focuses on the first-order risks — whether the supplier can deliver in terms of product, quality, and price. Internal audit can add value by assessing the organization's third-party due diligence efforts and determining whether line management has adequately considered variables such as the supplier's prior litigation issues, financial stability, environmental fines and penalties, foreign corrupt practices compliance, and the criminal backgrounds of supplier personnel.
- Internal auditors should understand how the organization can, directly or indirectly, influence or impact geopolitical forces, be engaged early on, and advise the organization on proactive or reactive actions it could take to change the trajectory of a geopolitical risk and its potential impact.

- Internal audit might not be among the organization's first responders to a geopolitical-related event. But after the event, internal audit may very well be called upon to evaluate the performance of the organization's crisis management activities and related controls.

Keep Pace with Geopolitical Events

Experts say that the best way to keep pace with geopolitical events is to “live” in the local political and cultural environments. For global organizations, a regional internal audit footprint that employs staff with local knowledge and experience may be advantageous. In particular, regional forensic auditors can contribute a local perspective while using their analytical approach to help the organization probe deeper into geopolitical issues. Internal audit can contribute as a global leader and global thinker by obtaining sufficient local or regional intelligence to provide management and the board with additional commentary on business conditions and related geopolitical risk considerations.

Communication and continuous education also are important. Internal audit should:

- Gather as much information as possible on geopolitics — subscribe to social media and newsfeeds, use resources provided by professional associations, create links with research institutes, and leverage the tremendous resources available from global external audit and consulting firms.
- Stay engaged with company leadership and participate in strategic planning discussions to the greatest extent possible.
- Regularly connect with internal business partners.
- Network with internal auditors and risk managers in other organizations.
- Participate in peer-to-peer and roundtable activities.
- Attend conferences and engage in training opportunities.

Internal audit also can assess whether the organization is leveraging its social media experts to obtain business intelligence related to geopolitical risks. While it is important for individual internal auditors to subscribe to social media and newsfeeds, highly trained social media experts use powerful advanced technologies to monitor and manage social media content in real time — a process known as social media moderation. Imagine various functions customizing “listening rules” and “listening feeds” using geopolitical keywords important to their operations (e.g., conflict, violence, spying, turmoil, sanctions, nuclear negotiations, climate change, currency crisis, cyber warfare, epidemics, and commodity prices), combining those words with words important to the organization's industry or locality (e.g., retail, energy, health care, manufacturing, transportation, Europe, or Asia), and then having the ability to detect noise or changes in activity at predefined intervals (as short as every 15 minutes), 24 hours a day, seven days a week.

Think Broadly

One of internal audit's biggest challenges related to geopolitics is to think more broadly and expand its universe well beyond finance and IT. Internal auditors should challenge themselves to explore subject matter outside of governance, risk, and control, and apply their new understanding to the risk assessment.

For example, a study of global labor development trends might reveal that, in an effort to build up the middle class, governments in some geographies are offering incentives (such as tax incentives) to attract organizations. Internal auditors should consider the area's work ethic and type of work being performed, the population's training and education needs, and the area's vision for economic development. As economic development progresses, the organization may experience increased turnover rates as somewhat experienced staff receive offers from other organizations newly attracted to the area. The risk cycle continues as new, inexperienced staff join the organization.

At times, the scope of particular audits may need to be expanded to adequately consider geopolitical risks and opportunities. Internal auditors should cast a wide net, solicit information and perspectives from operational management with "feet on the ground," think expansively, realize that geopolitics might apply to multiple components of a governance framework, and be open to the revelations, or "aha" moments.

Focus on competencies and professional development

As discussed, geopolitical issues are broad and complex, and managing geopolitical risks requires a mastery of several professional competencies, most notably governance, risk, and control; business acumen; communication; and critical thinking; not to mention persuasion and collaboration.

- **Governance, risk, and control:** Internal auditors need to find ways to detect and monitor emerging geopolitical risks to the organization and its key suppliers and customers, and to assess their impact on the organization's risk profile.
- **Business acumen:** Deep business acumen is essential to understanding geopolitical risks. Internal auditors should have an in-depth knowledge of business in general and, as previously noted, an in-depth knowledge of their organizations and what makes them successful. This includes considering macroeconomic and microeconomic factors, their relevance to the audit engagement, and their impact on the organization.
- **Communication:** Internal auditors must be able to organize and express their ideas in a way that influences others — they need to explain geopolitical risks, impacts, and opportunities in a simple and engaging way.

- **Critical thinking:** Internal auditors need to identify and analyze appropriate research and business intelligence and apply problem-solving techniques to their organization's situation. Good critical-thinking skills and strong data-analytics capabilities also are needed to ensure that information provided for decision making is relevant, accurate, and sufficient. In addition, internal auditors should have intellectual curiosity, be open-minded, and understand that the impacts of geopolitical risks may alter the scope of an audit engagement.
- **Persuasion and collaboration:** Internal auditors should have the ability to balance diplomacy with assertiveness, and manage the needs and expectations of stakeholders with competing interests.

Internal auditors can develop these competencies through formal study, attending conferences that take a global perspective, listening to different viewpoints, and visiting different geographic sites to better understand geopolitical influences amid diverse cultures. Networking among colleagues across multiple industries and geographies is critical.

Closing Thoughts

The sweeping and multifaceted effects of geopolitics on organizations open myriad considerations and chances for internal audit to contribute to the organization's readiness to manage and respond to geopolitical risks and opportunities ... delivering fresh perspectives and keen insights. Internal auditors can prepare themselves for this role not only by participating in continuing education and conferences that take a global perspective, but also by keeping pace with geopolitical events and engaging with leadership, internal business partners, and peers. Considering how rapidly the geopolitical landscape changes, internal auditors may best gain insights by thinking broadly; gathering information from an array of resources and perspectives; networking with colleagues across industries, cultures, and geographic regions; and working abroad.

For More Information

- The World Economic Forum's 2015 Annual Meeting agenda included several sessions on geopolitical topics, such as The Geopolitical Outlook, Global Financial Security, Global Health Security, and Geo-Economic Competition. For session replays and other information on geopolitics, see weforum.org.
- The IIA Global Internal Audit Competency Framework is a tool that defines the competencies needed to meet the requirements of the International Professional Practices Framework (IPPF). More information on the competency framework, including the competencies mentioned in this article, can be found on The IIA's global website (www.globaliia.org).
- The U.K. Chartered Institute of Internal Auditors' Audit & Risk Insight, How to Protect Business From Geopolitical Risk, is available at auditandrisk.org.uk.

About The IIA

The Institute of Internal Auditors Inc. (IIA) is a global professional association with over 180,000 members across more than 170 countries and territories. The IIA serves as the internal audit profession's chief advocate, international standard-setter, and principal researcher and educator. www.globaliia.org

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