RISK IN FOCUS 2021

Board briefing

European Confederation of Institutes of Internal Auditing
ECIIA

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Putting risk into focus for the board

Board members must be aware of their organisations' principal risks (and opportunities) and the external threats to their operations and strategies. They should also have confidence that internal audit is prioritising these. Especially now. The risk landscape has taken a dramatic and unexpected turn. Looking ahead to 2021 we see that the global coronavirus pandemic (GCP) is likely to shape the risk profiles of organisations in many ways.

Rather than posing a novel risk, the pandemic has exacerbated and magnified existing risks as well as opportunities that you as a board member should be mindful of.

This briefing summarises insights from the latest edition of our annual report, Risk in Focus 2021 (RiF21), which this year is a collaborative project between ten institutes of internal auditors from across Europe.

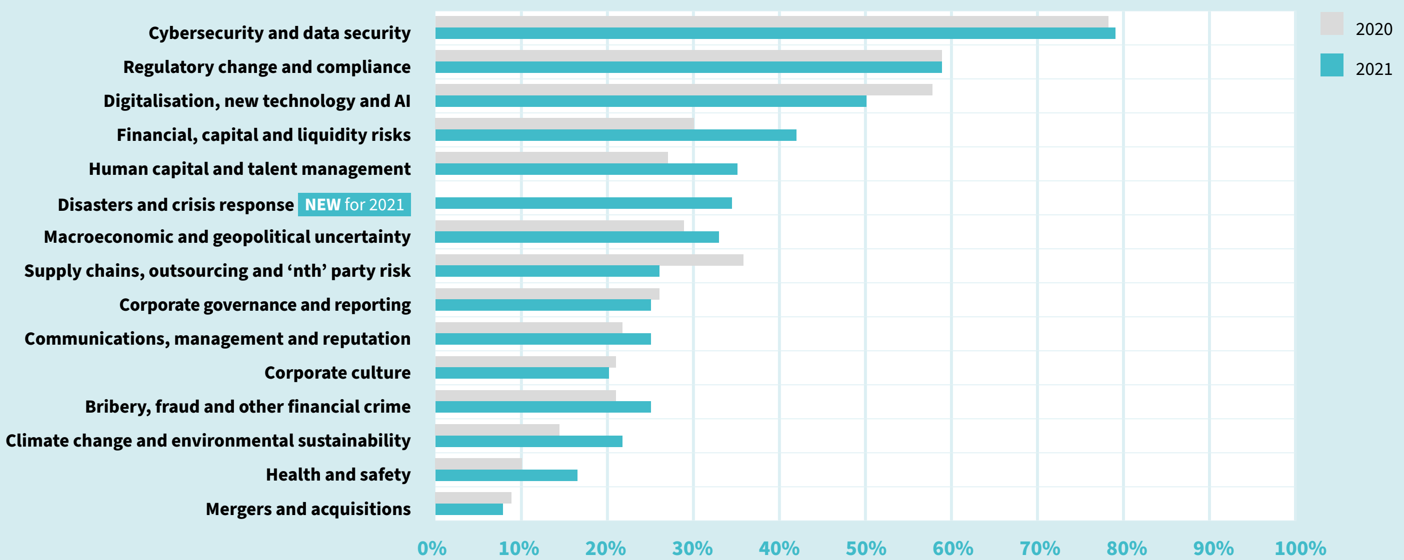
The report spotlights key risk topics by combining a quantitative survey and qualitative interviews. This year the survey received 579 responses from Chief Audit Executives (CAEs), an all-time high, and we interviewed a group of 42 participants that included both CAEs and, for the first time this year, Audit Committee Chairs. A group of 51 subject matter experts were also interviewed using the Delphi method, providing up-to-date insights on how key risks are developing and how internal audit should be thinking about them.

Data ***Snapshot***

The headline results from the flagship annual survey are as follows:

One year on: 2021 vs 2020

What are the top five risks that your organisation faces?



Comparing last year's survey data with this year's data (page 2) we can see which risks have become more or less of a priority in the eyes of CAEs across Europe. A number of risk areas appear to have been impacted by the pandemic, including *Health and safety, Financial, capital and liquidity risks* and *Human capital and talent management,* all three of which have shown notable annual increases.

This latest edition of the survey for the first time includes *Disasters and crisis response*, which 34% of CAEs cited as among their top five risks, putting it in sixth place just behind *Human capital and talent management*. Audits of the business's response to the GCP have clearly been a matter of priority in recent months and most, if not all, organisations will need to undertake lessons-learned exercises and update their crisis continuity protocols. *Climate change and environmental sustainability,* meanwhile, has seen a significant increase, continuing a positive trend seen last year.

By asking CAEs both what they currently view as the biggest risks to their organisation and what risk areas they spend the most time and effort auditing (page 3), we develop a picture of how well aligned the third line's assurance work is. These results give reason for the board and audit executives to discuss whether internal audit's time and resources are being spent wisely and whether they need to be reallocated to overlooked risk areas.

Risk priorities vs. audit's focus

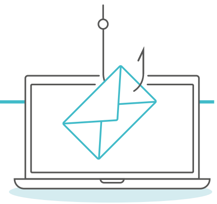
The hot topics

The topics in RiF21, which summarise key risk themes and cover the way that internal audit can think about addressing them, are the result of combining the above results from the quantitative survey with the feedback from the interview process. As mentioned, these risk topics will be familiar; however, the pandemic has forced businesses and their CAEs to assign new levels of priority to these well-established risks, or to think about them in a new light.

Download the full Risk in Focus 2021 report at:
www.ifaci.com/risk-in-focus/

The topics are as follows:

1. Information security in the expanded work environment
2. Regulatory forbearance and the return to normal
3. Strategic relevance and the digital imperative
4. Liquidity risk and cost-cutting amid depressed demand
5. Managing talent, staff wellbeing and diversity challenges
6. Disaster and crisis preparedness: lessons from the pandemic
7. Rising nationalism and social tensions amid unprecedented economic volatility
8. Supply chain disruption and vendor solvency
9. Fraud and the exploitation of operational and economic disruption
10. Climate change: the next crisis?



1. Information security in the expanded work environment

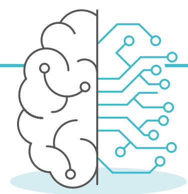
Once again, *Cybersecurity and data security* came out on top in this year's survey, with 79% of CAEs saying it is a top five risk and 27% singling it out as the number one risk their organisation faces.

The rapid widespread shift to homeworking amid national lockdowns in 2020 brought with it a unique cyber and data security challenge. Lacking personal interaction, staff can be more susceptible to social engineering ploys as they cannot immediately sense-check emails with nearby co-workers. Given that many companies are likely to keep a greater degree of remote and flexible working arrangements in place going forward, it is more important than ever that cyber defences are robust and adaptable and that information security culture is promoted throughout every level of the organisation to raise awareness and ensure the integrity of staff behaviour.

2. Regulatory forbearance and the return to normal

For 59% of audit executives in our survey *Regulatory change and compliance* is a top five risk to their organisation, exactly matching the result from last year, a clear indication that compliance is an evergreen risk.

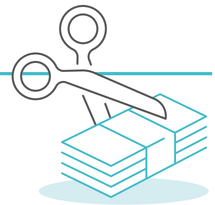
The regulatory burden was eased in the first half of 2020 to give companies breathing space as they contended with the immense challenges posed to their staff and operations by the GCP. Financial reporting deadlines were pushed back, and the European Banking Authority delayed until 2021 its scheduled bank stress tests. Data authorities have taken a less punitive approach by issuing fewer fines related to GDPR violations. But regulatory forbearance is only temporary and is by no means absolute. Existing regulations remain in force, even if they have not been as aggressively enforced in recent months. There may have been a temptation among companies to take their eye off the ball in 2020 causing compliance standards to slip or the organisation to fall behind after regulatory deadlines were postponed until 2021.



3. Strategic relevance and the digital imperative

Half of CAEs (50%) see *Digitalisation, new technology and AI* as one of the top five risks their organisations face, down from 58% a year ago. This fall may reflect the shift in attention to the shorter-term impacts of the coronavirus pandemic as digital transformation projects are disrupted. Indeed, 67% of audit executives expect this to be a top five risk to their organisation in three years' time, indicating an only temporary lull of this risk priority.

The events of 2020 have magnified the digital imperative, making such transformations a more pressing priority by driving home the value of digital products and services and the flexibility companies can achieve by digitalising their operations. Yet the pandemic may have frustrated digital progress, innovation and transformation initiatives by making them more complex and challenging. Lockdown and distancing measures atomised organisations, hindering collaboration efforts for those companies not used to operating under remote conditions. Many businesses will also struggle with their many priorities as they concentrate on managing other crisis-related challenges.



4. Liquidity risk and cost-cutting amid depressed demand

More than two in five (42%) CAEs in our survey cited *Financial, capital and liquidity risks* as being among the top five risks their organisation faces, a full 40% increase on the 30% who said the same just 12 months prior. This is likely a consequence of the timing of the survey in March 2020, when the coronavirus outbreak reached Europe and short-term liquidity risk spiked for most companies.

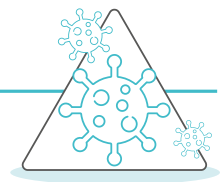
Even companies with strong balance sheets (i.e. high levels of cash versus low liabilities) will have to consider their financial sustainability in a potentially challenging trading environment through 2021. The world may be facing the deepest recession in living memory and the recovery may take a long time. Therefore, there is pressure on companies to use cash wisely and cut costs where necessary.

5. Managing talent, staff wellbeing and diversity challenges

More than one in three (35%) audit executives cited *Human capital and talent management* as a top five risk this year, compared with 27% who said the same a year ago. The demand for digital skills has never been higher and this long-term risk has been compounded by the challenge of resourcing the organisation in what may be a continually challenging environment as a direct consequence of the GCP. Onboarding new staff and making them feel like valued members of the company and contributors to essential projects amid homeworking may be difficult.

HR functions also face the challenge of creating safe working environments and ensuring the wellbeing of workers in the face of potential coronavirus resurgences and the psychological impact months of isolation may have had; 17% of CAEs in our survey said *Health & safety* is a top five risk, a 70% year-on-year increase on the 10% who said the same a year ago.

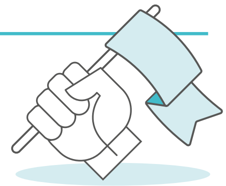
Diversity is another key human capital risk that organisations need to be conscious of. The Black Lives Matter movement has put social equality at the centre of public debate and companies will need to ensure that their hiring and pay policies are fair, representative and do not unintentionally or unconsciously bias against particular demographics.



6. Disaster and crisis preparedness: lessons from the pandemic

For the first time this year, *Disasters and crisis response* was included in our survey and 34% of CAEs put this among their organisation's top five risk priorities; 10% of CAEs highlighted it as the single biggest risk behind only *Cybersecurity and data security* (27%), and broadly on par with *Financial, capital and liquidity* (11%) and *Regulatory change and compliance* (also 11%).

One of the biggest lessons to take from the GCP is the importance of crisis preparedness including the resilience and adaptability of the organisation. All companies will have had business continuity plans in place. But these are more likely to have accounted for short-lived events like power or network outages, earthquakes and data breaches. The pandemic has set a new precedent in crisis management by showing the extensive and simultaneous impact that global events can have. Businesses must address their operational resiliency by identifying and stress testing key processes and assets including the availability of employees and continuity of supply chains.



7. Rising nationalism and social tensions amid unprecedented economic volatility

***Macroeconomic and geopolitical uncertainty* was cited by 33% of CAEs as a top five risk this year, a slight increase on the 29% who said the same a year ago. Political tensions were already running high before the pandemic following two years of protectionism and trade tensions, especially between the West and China. Those tensions have escalated as a direct consequence of the pandemic, evidenced by heightened nationalist rhetoric and an aversion to foreign direct investment, including from the European Union (EU).**

This suggests that even if the US administration changes over following the November 2020 presidential elections, trade and political tensions will remain high. The end of Brexit transition period for UK is also due in January 2021 with the potential to leave the EU without a trade deal in place, creating more uncertainty and cost for businesses.

One of the most obvious impacts of the GCP outside of the threat to public health is one of the deepest economic recessions in recorded history and it is not clear to what extent this will carry over into 2021. Economic challenges and high unemployment may add to already high levels of social unrest and civil disobedience. This makes the macro environment more unforgiving than it has been for decades.

8. Supply chain disruption and vendor solvency

Although supply chains have come under considerable stress, only 26% of CAEs say *Supply chains, outsourcing and 'nth' party risk* is among their companies' top five risks, compared with 36% last year. China overcame its first wave of coronavirus relatively quickly and initial concerns amid the GCP's early weeks quickly turned from supply to demand.

The ability to meet depressed levels of demand with available supply may have given many companies a false sense of security. It should not be forgotten that the financial and liquidity risks that rise in a downmarket apply to key vendors too. Businesses and internal audit should be mindful of the solvency of core suppliers and outsourcing partners, and the ongoing ability to stock appropriate levels of inventory to meet demand.

9. Fraud and the exploitation of operational and economic disruption

One in four (25%) CAEs said that *Bribery, fraud and other financial crime* is one of the top five risks currently faced by their organisation, an increase on the 21% who said the same a year prior. There is certainly cause for paying close scrutiny to financial crime in the current climate.

First, there is an increase in ploys to capitalise on the GCP including fraud and money laundering. Second, the efficacy of the control environment may have been weakened by the transition to remote working and reduced or limited access to parts of the business and its resources.

Economic headwinds and increased pressure on management to remain sufficiently profitable may raise the temptation to do business with parties the organisation should not be engaging with. With the main objective being to keep the business going, priorities and resources may shift away from oversight and due diligence, putting the company at risk.

10. Climate change: the next crisis?

Internal audit increasingly recognises the challenges and risks companies face in achieving their sustainability goals and minimising their environmental impact. Nearly one-quarter (22%) of CAEs cited *Climate change and environmental sustainability* as one of their company's top five risks, a more than 50% increase on the 14% who said the same last year. Further, a full 41% of CAEs anticipate it being a top five risk in three years' time. No other risk area is expected to gain more in priority over this period.

The world's largest investors are calling for companies to take action on climate change or risk being priced out of capital markets and seeing their share prices decline over the long term. The EU recently agreed its Green Deal to make Europe carbon neutral by 2050 and governments are seeking to make their stimulus and recovery efforts as green as possible. Companies have no time to waste in taking action on their sustainability goals.

Download the full Risk in Focus 2021 report at:

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PDF

About the French Institute of Internal Auditors and Controllers (IFACI)

The IFACI is a professional association for internal audit, internal control and risk management actors with more than 6,200 members in all sectors of the economy.

Thanks to its strategic relation with regulators, public authorities, and professional associations, IFACI contributes to the promotion of internal audit and internal control by sharing best practices and ensuring capacity building for all actors from the existing sectors.

IFACI is an affiliate to the IIA network.

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