

Internal control and the transformation of entities – a North America perspective

Effective internal control is one of the essential enablers for entities to grow with confidence and integrity in a multi-stakeholder world filled with volatility, uncertainty, disruption, and complexity. Internal control goes beyond statutory compliance requirements; it helps entities build trust, confidence, and a positive reputation in achieving strategic business outcomes. Entities operating models are being challenged. The need to be responsive to customer needs in shorter timescales and the advances in technology and data have given rise to innovative cultures and transformation initiatives. What has been the impact on internal control?



Role of internal control

The over 225 North American respondents who formed part of the 1,950 global respondents to an ACCA, Internal Audit Foundation and Institute of Management Accountants (IMA) survey placed the prevention of fraud (both for North American respondents and globally 84%) and the minimization of risk (84%, 88% globally) as the main factors that described the purpose of internal control. Enhanced data quality was rated lowest at 56% (54% globally) from the options available. This perspective supports the definition of internal control offered in frameworks such as that developed by the Committee of Sponsoring Organizations (COSO).

A Canadian roundtable participant reminded us that, 'one of the fundamental tenants of an internal control framework is the tone at the top'.

Areas of opportunity and challenge

The respondents were asked how they rated several challenges in relation to their entity. 56% (compared to 50% globally) indicated a shortage of appropriately skilled staff while 41% (compared to 38%) selected technology advances impacting internal control as the two most significant factors. Both themes are central to this research and are areas of action that both individuals and entities need to focus upon.

Many of the interviewees and roundtable participants who contributed to the research indicated that a traditional view of internal control prevailed. It was easier to retain manual controls rather than embrace the drivers of change, even if this approach did not improve process efficiency or control integrity. Ignoring the 'computer' cannot be a response, as some still felt was preferable.

Drivers for change

There are several drivers of change in internal control that entities are facing.

Operating models in entities are **transforming**. Before the pandemic many entities were investing in digitalising their processes, implementing more flexible models and Cloud-based solutions. Many entities have accelerated these initiatives during the pandemic as they needed to understand changing customer behaviours and accommodate different ways of

working. While the nature of the transactional boundary might have physically changed as a result, the use of technology has secured that boundary. Understanding this changing nature has reinforced the shift between manual and automated controls and testing how informality can be evidenced. These fundamental shifts in ways of working are an essential first step.

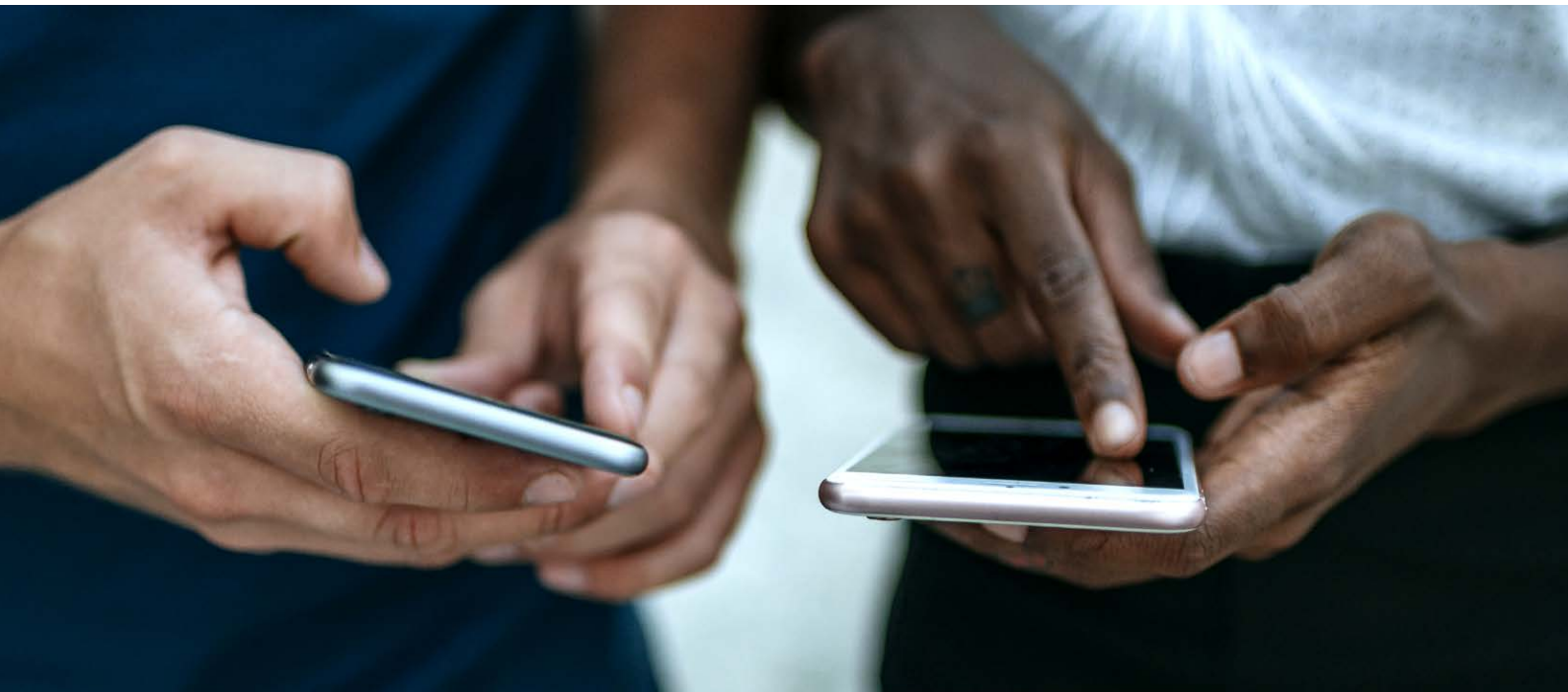
A US based roundtable participant commented that, 'as people deploy technology they find out the best way to deploy it for the business and then they start changing the configurations and they introduce these risks and then we have the problem of control'.

A US based chief audit executive reflected upon the impact of transformation on entity's internal controls by commenting that in their entity, 'the business model is changing and the business processes changing. This has created the need for the audit function to look at how they are going to approach things differently. Part of what has been highlighted is that there is a need to upscale because we are now working in a different world where there's needs to be a lot more discussion on how to approach things up front so that we can provide a relevant appropriate level of assurance'.

Another US based chief audit executive discussed the impact of automated controls as part of a transformation. They commented that in their view 'it is very important that we understand what the process is and then make sure we adapt the controls. If we had a process that was manual, and we are implementing automated controls we need to understand how we need to adjust the control environment to mitigate any risk that this new technology will bring to the company. We really need to move the conversation about control to the beginning of the development cycle'.

Transactional cycles are becoming **shorter**. With Cloud-based solutions data capture occurs on mobile devices and through automated processes. Feedback is expected in an instant. The balance of internal control has moved from traditional cycles of review and approval to authorisation at the point of data capture. This changes the emphasis of internal control to a proactive rather than a reactive activity.

Entities are increasingly focusing on a **broadier definition of performance**. While financial objectives are as relevant as they always have been, regulators and stakeholders are increasingly



looking to disclosures of non-financial information, especially in relation to the sustainability agenda. These are not just external drivers but the need to embrace these in internal decision making is also fundamental. Implementing internal control over such processes is not an insubstantial task. Firstly, much of the data is less structured and comes from a variety of sources. Secondly, many of the processes remain heavily reliant upon manual intervention and end-user solutions which can be challenging to provide assurance over. Finally, interpreting this data requires a broader skill set than the traditional financial one, so implementing internal controls is challenging. Yet over 74% (compared to 80% globally) of the survey respondents felt that internal control should be expanded to cover ESG data flows.

A US based roundtable participant commented that, 'you are going to have regulations coming down and requirements coming down to report on [on non-financial data]. This is ticking time bomb for all entities'.

A Canada roundtable participant referred to the link between internal control and data governance. They commented, 'data governance is a real issue [for entities] and until you have proper data governance, any internal control framework will not be relevant'.

Another Canadian roundtable participant drew on their experience by commenting, 'as we become more reliant on data science and analytics there needs to be a shift in skill set [of those charged with internal control] to monitor the internal control framework as well, using the same skill set'.

The development and implementation of technology solutions is increasingly **agile**. End-user developments based upon lo-code and no-code development tools are increasingly used. The lifetime of a solution can often be short term, supporting a particular initiative or customer need, rather than a longer scale one. Machine learning plays an increasing role in analysis and prediction yet understanding this is a gap for many. Only 28% (23% globally) of the respondents indicated that they felt that internal control was included in the considerations of transformation initiatives, with the increasing move to agile developments this may well increase. The confidence level in the understanding of the current technologies which are used in transformation was felt to be low, indicating a skill gap which was reinforced by other survey results.

A US based chief audit executive reflected upon the control implications of the use of Cloud based solutions. They commented that: 'there is a difference between on premises

controls and on premises auditing of databases and servers versus Cloud and what is happening in the audit world is business processes are moving, but the audit function isn't moving as quickly'.

Real time insights are essential to entities as they continue to face operational challenges. The expansion of data is a fundamental part of this. Moving towards a more continuous and automated approach to internal control was seen as an important step by 59% of North American respondents (64% globally). Being able to identify transactions which require investigation on a timelier basis is essential. Management reviews are no longer monthly, they are daily in many cases. Internal control needs to recognise this.

Transforming internal control

The activities to transform internal control can be grouped into six areas.

Firstly, embrace technology and data. No longer is auditing around the computer an effective excuse for a lack of skill or understanding. As machine learning and lo-code environments increasingly become embedded in processes and decision making so understanding the box is ever more important.

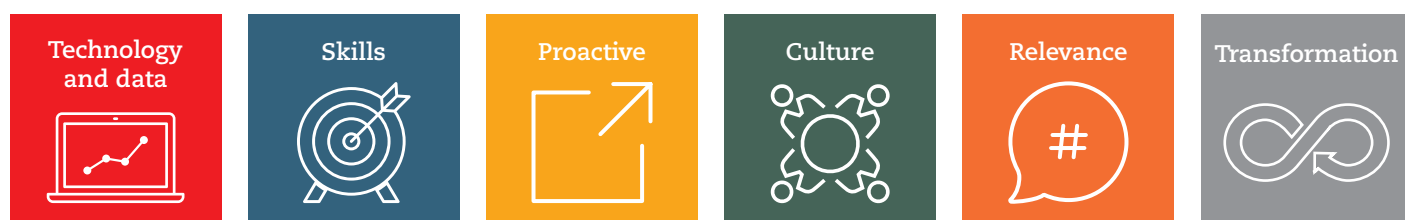
To do this there needs to be a development in the skills of those responsible for the second and third lines on The Institute of Internal Auditors model, at least. These skills need to embrace both technology and data advances, but also reflect that the scope of internal control is increasing. The provision of relevant guidance across the professions as well as investment by both individuals and entities are essential.

The emphasis, especially with the ever-increasing data volumes, must be on proactivity rather than historic reporting. The dynamics of constantly transforming entities mean that lessons learned too late are ever more painful – protecting against fraud is a real time activity.

This engenders relevance for internal control – not just a compliance cost. It needs to add value by being relevant and responsive.

Finally, change is now constant and internal control cannot be an afterthought. The culture of control is ongoing. Internal control needs to be an integral part of transformation, not a side line or implemented after the event. This requires a more proactive stance, but also having the skills and knowledge to play a relevant role.

FIGURE: The activities to transform internal control can be grouped into six areas:



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