

AMERICAN  
**PUBLIC**  
**POWER**™  
ASSOCIATION  
ACADEMY

ACADEMY



# Internal Audit: Can Your Organization Afford to be Without It?

## **Business & Financial Conference**

September 18, 2018

**Speakers: Scott M. McKay, Claire Rogers, Ofelia E. Tamayo**

Chief Audit Executives

Representing SMUD, The Institute of Internal Auditors, & Cherry Bekaert LLP





# Presenters



**Scott M. McKay**  
**CPA, CFE, CIA, CCSA**  
Partner  
Risk Assurance & Advisory Services  
Cherry Bekaert LLP

**Enterprise Risk &  
Internal Audit**



**Claire Rogers**  
**CPA, CIA**  
Director, Audit Services  
Sacramento Municipal Utility District

**Internal Audit: Can  
Your Organization  
Afford to be  
Without It?**



**Ofelia E. Tamayo**  
**CPA, CIA, CRMA**  
Vice Chair of the  
Chapter Relations Committee &  
2019 International Conference  
The Institute of Internal Auditors

**Internal Audit:  
2018 and Beyond**



# Enterprise Risk & Internal Audit

Budget and Financial Conference  
September 18, 2018 Anaheim, California

Scott M. McKay, CPA, CFE, CIA, CCSA  
Partner, National Leader Risk Assurance & Advisory

Cherry Bekaert LLP  
[smckay@cbh.com](mailto:smckay@cbh.com)





# View Toward Risk

Missing Opportunities, Objectives, Errors and Losses Occur Because...

**Unseen risk - blindsided**

**Unmanaged risk**

**Controls failed**

**What is business risk for a Utility?**

# Utility Industry Risk



**February 6, 2014** - Threat to the grid? Details emerge of sniper attack on power station. Newly reported details about a **52-minute sniper attack** on a central California electrical substation last year are raising concerns from Capitol Hill and beyond, amid questions over whether it was the work of terrorists.

FOX - [Sniper-attack-on-power-grid-still-concern-in-washington-and-for-utilities](#)

**On April 6, 2001**, Pacific Gas and Electric (PG&E) filed for Chapter 11 bankruptcy in federal court. During the aftermath from this crisis, **investigators would find that fraudulent practices** in some of PG&E's suppliers were major catalysts for its collapse.

ACFE [fraud-magazine.com](#)

**May 6, 2017** - Former Manager Of Public Utility Arrested For **Defrauding The Public Utility And Its Customers Out Of More Than \$3.8 Million.**

DOJ <https://www.justice.gov/usao>

# Two Views of Risk Management

## Compliance View

- ▶ Regulatory.....So we have to?
- ▶ Reacting can provide wrong motive
  - ▶ people don't "buy in"
  - ▶ Design is "over-controlled"
  - ▶ not sustainable

## Risk View

- ▶ Spend time to clearly see risk
- ▶ Creates the right motive
  - ▶ management "buy in"
  - ▶ better-designed controls
  - ▶ sustainable processes

**When risk management makes sense, one of the de facto by-products should be regulatory compliance.**



# Define Risk

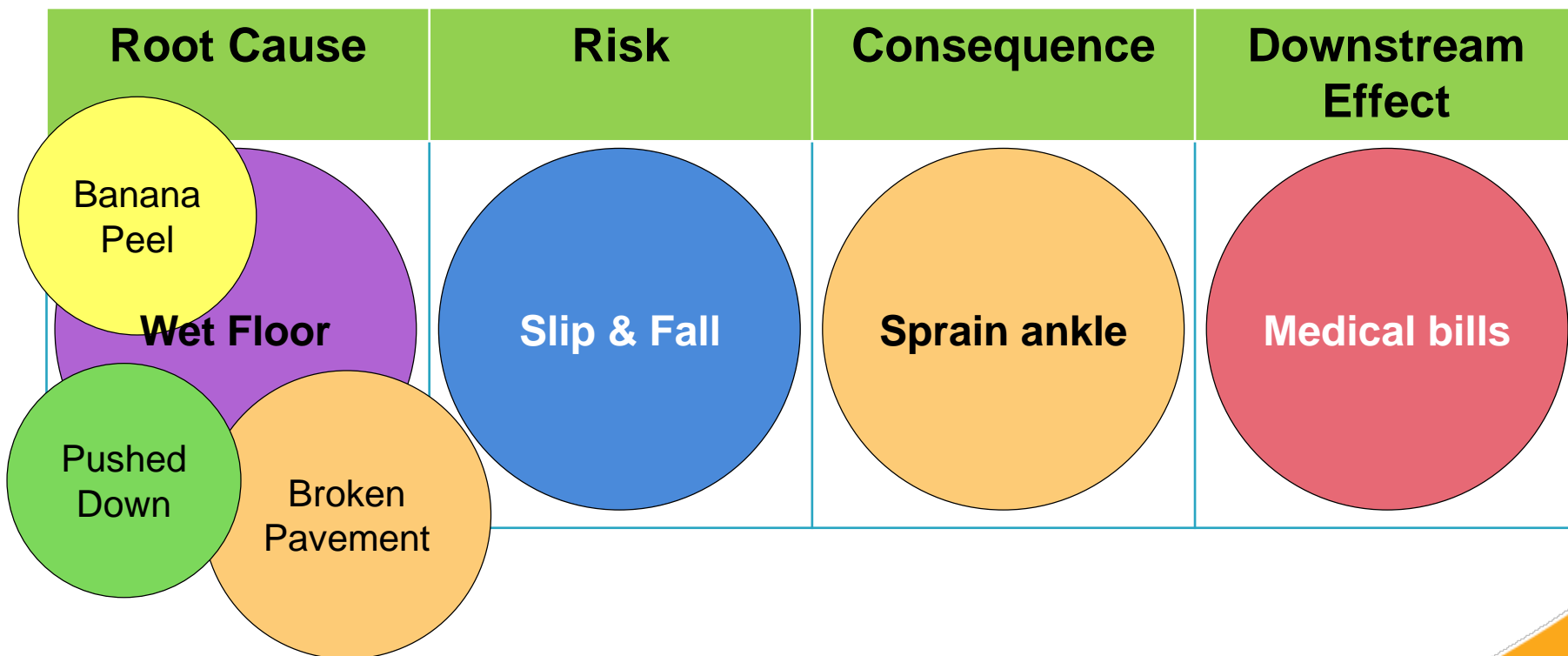
- What is risk?
- What's the Organization's view of risk?
- What's the Organization's view of internal controls?
- Are roles and responsibilities clear related to risk management?
- How many risks should you have and are there benchmarks?
- Are frameworks available and which ones should be considered?
- How do you define likelihood?
- How do you define impact?

**Note:** *A robust risk assessment is a thought leadership exercise and effective way to avoid being blindsided*



# Frameworks & Risk Models

What is the risk?





# Common Enterprise Risks

1. **Business Interruption** - Natural Disasters, Fire, Supply Chain, Infrastructure failure, Labor, **business system failure, terrorism** etc.
2. **New Program Introduction** – Inability to timely transition new products into production and /or new products may not have ready commercial value
3. **Service Delivery risk** - Poor service delivery, quality or cannot balance customer demand
4. **Cybersecurity Risk** – Unauthorized disclosure of proprietary info or data privacy compromise
5. **Political Risk** – Political environment creates potential budget or program constraints etc.
6. **Regulatory Reporting** – Big list here!
7. **Human Capital** – ability to attract, develop and retain qualified employees
8. **Environmental Health & Safety** – Factors such as ineffective incident response
9. **Financial Stewardship** – Poor financial oversight, working capital, liquidity risk, etc.
10. **Fraud Risk** – corruption activities, asset misappropriation, financial fraud



# Risk Roles - Owners & Managers

The Board is responsible for Risk Oversight

Management owns risks and controls.

Ultimate risk owners are executive management

Risk managers should be identified

# Only 4 Ways to Manage Risk

1

Internal  
Controls

2

Risk  
Transfer

3

Risk  
Avoidance

4

Risk  
Accept



# Irregularities & Defalcations

...are just fancy words for lying and stealing

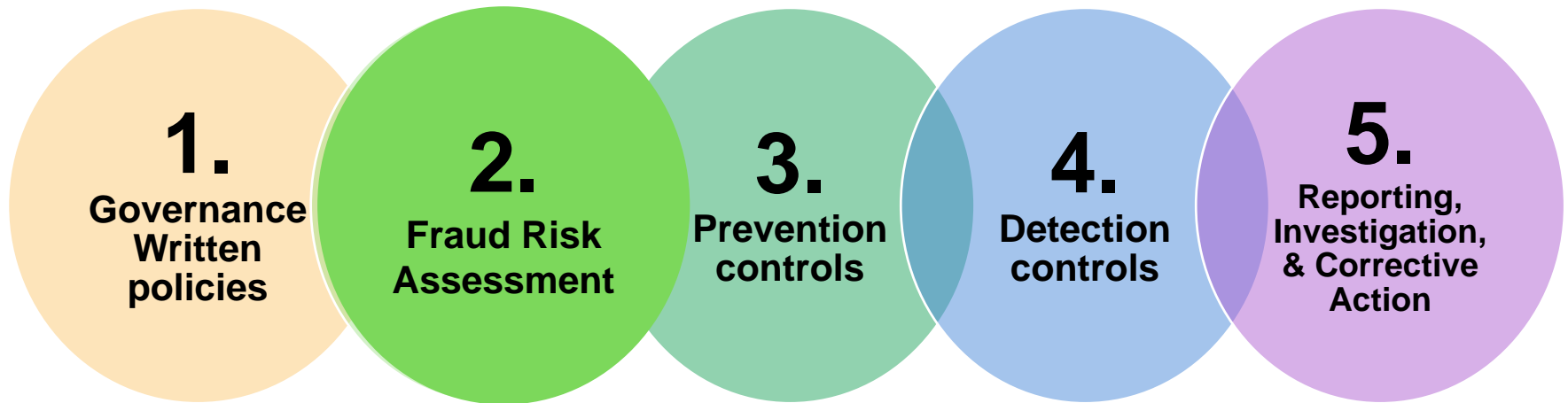
- Corruption and billing schemes greatest risks to organizations
  
- Check Tampering is on the rise
  
- Top 3 Most commonly victimized industries
  1. Banking and financial services
  2. Manufacturing sectors
  3. Government and public administration

# Fraud Risk Statistics



	INDUSTRY	Cases	Billing	Cash larceny	Cash on hand	Check and payment tampering	Corruption	Expense reimbursements	Financial statement fraud	Noncash	Payroll	Register disbursements	Skimming
3	Government and public administration	184	15%	11%	11%	9%	50%	11%	5%	22%	7%	2%	11%
8	Energy	86	20%	2%	10%	12%	53%	10%	3%	27%	7%	2%	10%

# 5 Key Principles to Manage Fraud



If you could only accomplish one principle, which is most impactful?

*FREE* *Managing the Business - Risk of Fraud: A Practical Guide* Joint Study conducted by The Institute of Internal Auditors, the American Institute of CPAs and the Association of Certified Fraud Examiners. Published July 2008

# What About Materiality?



Does your Organization expect auditors to catch fraud?

Does the board expect auditors to catch fraud?

When is fraud Material?





# The Need for Internal Audit?

- Why do we need an Internal Audit function?
  - Regulatory requirement
  - Board mandate
  - Size dictates need
  - Component of risk monitoring
  - Response to an event?
  - Capabilities
  
- Can Internal Audit do more than audit?

# Internal Audit Capabilities



- Risk assessments and use of frameworks
- Internal control reviews
- Performance & compliance audits
- Contact audits (Vendors & Customers)
- Business system technology audits
- Consulting – document controls / flowcharts / data flows
- Staff training and rotation
- Internal investigations?
- Cybersecurity?



# Few Key Take Aways

- Risk Assessments
  - Consider Frameworks & Define Risk
- Evaluating Residual Risk
  - Independent audits
  - Self-Assessment
- Missing Opportunities, Objectives, Errors and Losses Occur Because...

**Unseen risk - blindsided**

**Unmanaged risk**

**Controls failed**



# Questions?



**Scott M. McKay, CPA, CFE, CIA, CCSA**

*Partner, Practice Leader*

Risk Assurance & Advisory Services

[smckay@cbh.com](mailto:smckay@cbh.com)

Cherry Bekaert LLP

[www.cbh.com/riskadvisory](http://www.cbh.com/riskadvisory)





# Internal Audit: Can Your Organization Afford to be Without It?

Business & Financial Conference  
September 18, 2018 Anaheim, California  
Claire Rogers, CPA, CIA  
Director, Audit Services

Sacramento Municipal Utility District  
Claire.Rogers@SMUD.Org  
916-732-7122





# Agenda

- **Perspective on internal audit**
- **Culture is key**
- **Internal audit at SMUD**
- **Key focus areas**

# Do you need an internal audit team?



# Why is Internal Audit so important?

- Independent and objective
- Identify Risk
- Mitigate Risk
- Improve efficiency and Effectiveness
- Understand the Business





# Culture is Key



Having an internal audit department is not enough

The right culture is just as important

- Partner with the business
- Understand and listen
- Think outside the box

At the end of the day we have the same goals – to help make the business better



*I know internal audit  
is here to help me!*



# Organization & Reporting



# Strategic Alignment



**Board Strategic Directives**



**SMUD 5-Year Strategic Plan**

Value our Customers & Community	Financially Fit	Sustainable Future	Operational Excellence	Treasure Our Employees	Be Safe. Always.
---------------------------------	-----------------	--------------------	------------------------	------------------------	------------------



**Internal Audit Vision**

Valued Business Partner	High performing and risk intelligent team	High quality audits	Influence cultural change
-------------------------	---	---------------------	---------------------------



**Internal Audit Strategic Plan**



**Business Impacts**



# Strategic Plan: Outcomes



The internal audit strategy paves the way forward to successfully deliver future value in alignment with our values and assurance services

**Engaged Employees**



Employees are fully absorbed by and enthusiastic about their work

**Skilled Employees**



Employees are highly skilled and risk intelligent in executing audit services

**Maturity level of Internal Audit**



Internal Audit is optimized allowing for the full realization of our value proposition

**Trusted Audit Partner**



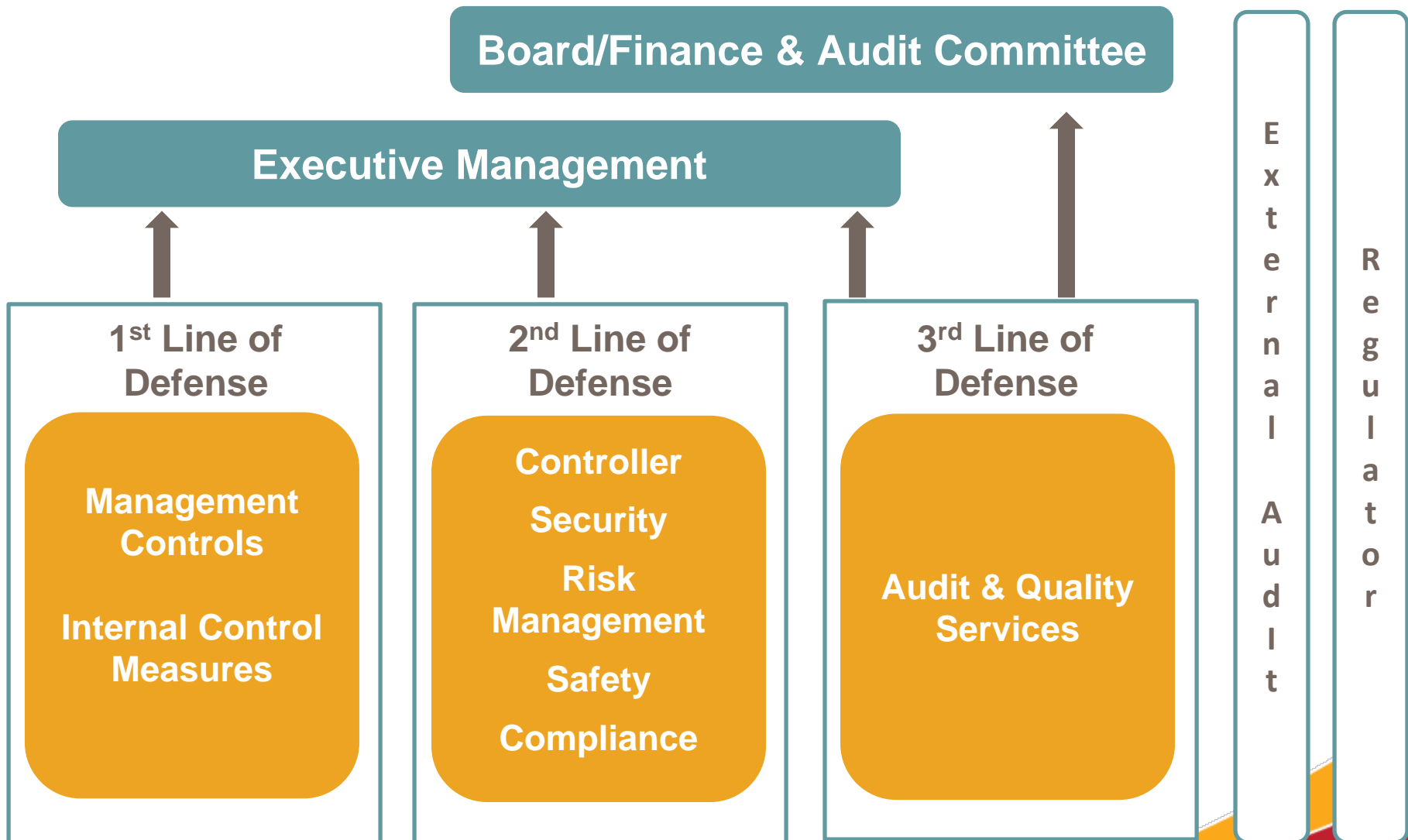
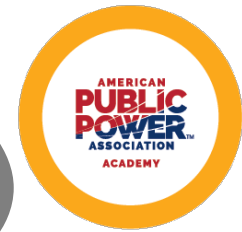
We are a valued partner who provides insight and helps the business

**Demonstrated value to SMUD**



We provide services that are valued by our stakeholders

# Key Focus Areas: Three Lines of Defense (3LOD)



# Key Focus Areas: 3LOD Working Group



Operational Excellence

Directors and representatives from the groups below make up the working group

## *Reinforce risk management activities*

- Sharing information, best practices, collaboration
- Identifying areas of opportunity to work together

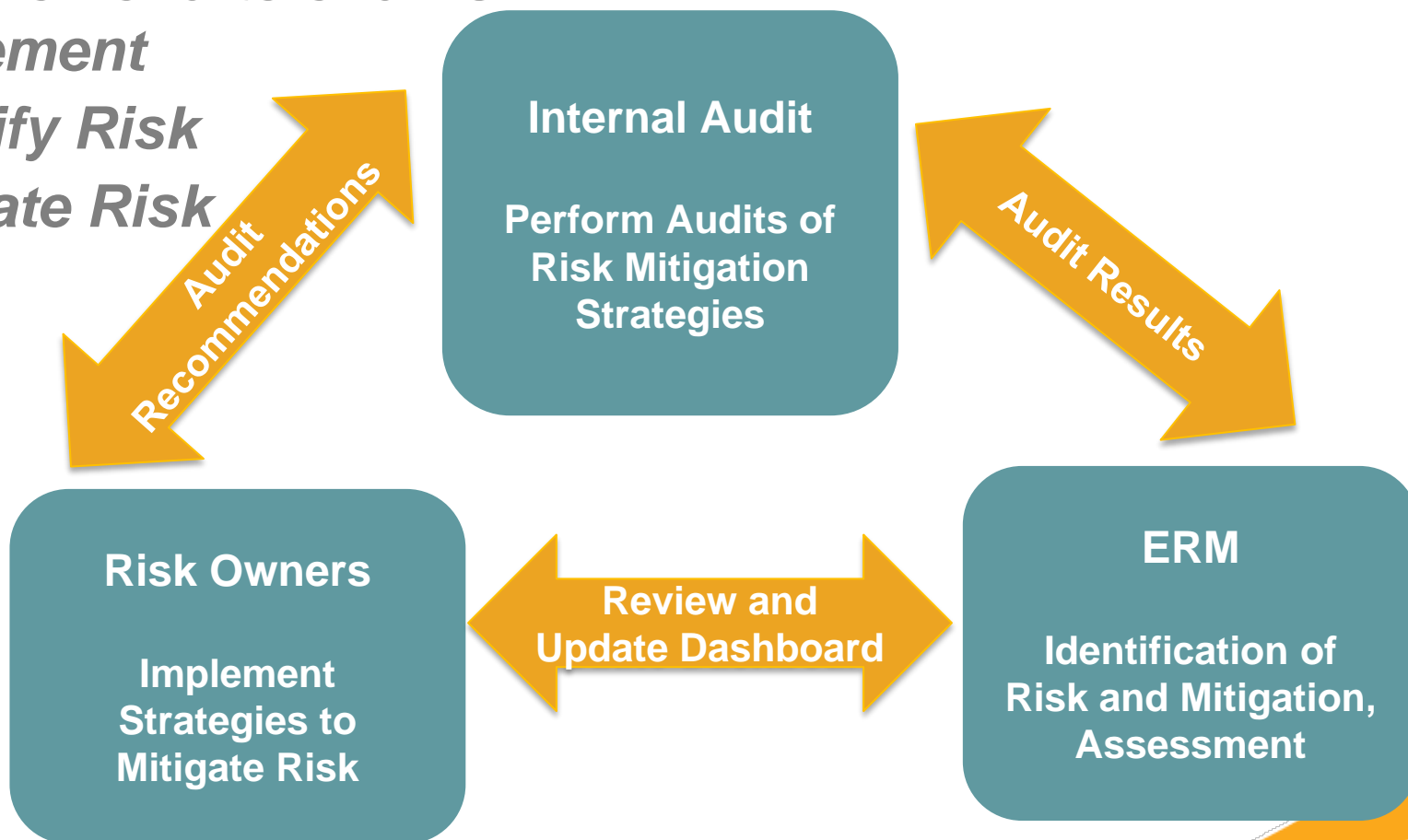


# Key Focus Areas: Enterprise Risk Management



*Strengthen end to end risk management*

- *Identify Risk*
- *Mitigate Risk*







# Key Focus Areas: Quality Assurance Improvement Program (QAIP)



## *Program Implementation*

- Developed QAIP Manual
- Updated audit process and procedures, templates and tools
- Formalized risk assessment for audit planning
- Implemented Post audit quality review
- Developed entrance meeting template to set expectations
- Post audit Survey
- Updated Report Format



# Key Focus Areas: Trusted Audit Partner

*Our goal is to be a valued partner  
who provides insight and helps  
the business*

- Define our Brand
  - *Who we are*
  - *What we do*
- Communicate and Educate
- Get Feedback
- Identify Improvement opportunities



***I look forward to  
working with  
Internal Audit!***

# Key Focus Areas: Staff Development

*Our goal is to have employees who are highly skilled and risk intelligent*

- Identify Initial Competencies
  - Internal Audit Delivery
  - Persuasion and Collaboration
  - Critical Thinking
- Define expectations for staff and senior auditors
- Assess at team and individual levels
- Develop training and development plans



dreamstime.com

# Key Focus Areas: Value Scorecard

*Our goal is to provide services that are valued by our stakeholders*

- Identify Initial measures
  - Customer Satisfaction
  - Audit Maturity
  - Trusted Audit Partner
  - Audit efficiency and effectiveness
  - Quality reviews
  - Staff Utilization
  - Staff Training
- Implement audit management software
- Establish baseline and targets



# The Results are in: What Looks Different

---



## *Execution of our strategy will have positive impacts*

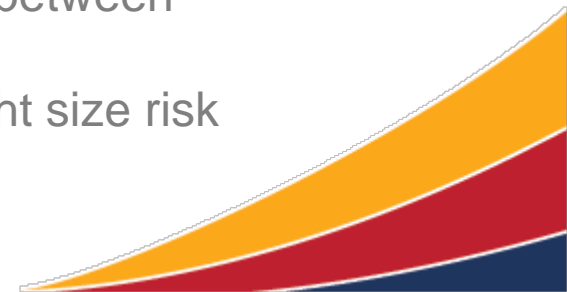
### The Audit Team

- Continue to provide assurance services increasing the value provided through our insight and recommendations
- Help build a stronger culture of governance, accountability, compliance and execution
- Mature brand as a valued and trusted audit partner
- Utilized as a resource in advising on risk mitigation
- Increased involvement in key projects/ initiatives providing insight and perspective



### The Business

- Increased understanding of feedback loops and linkage between enterprise risk management and internal audit
- Increased knowledge of risk identification and how to right size risk mitigation





# Internal Audit: 2018 and Beyond

Budget and Financial Conference  
September 18, 2018 Anaheim, California

Ofelia E. Tamayo, CPA, CIA, CRMA  
Vice Chair, Chapter Relations Committee and 2019 International Conference / District Advisor, West Region

Institute of Internal Auditors  
[ia.otamayo@gmail.com](mailto:ia.otamayo@gmail.com)





# Overview

- Internal Audit in 2018
  - Real-world Risks
  - CAE View of Top Risks
  - Internal Audit Agility
- Imperatives for 2018 and Beyond
- Audit Leader – Next Gen

# Real-world Risks

How the world's CEOs see the world translates to similar threats facing the public sector

Leading Risks	2018	2017
Terrorism	41%	20%
Geopolitical uncertainty	40%	31%
Cyber threats	40%	24%
Availability of key skills	38%	31%
Speed of technological change	38%	29%



Source: PwC's 21<sup>st</sup> CEO Survey: *The Anxious Optimist in the Corner Office* © 2018 PwC



# CAE View of the Top 5 Risks

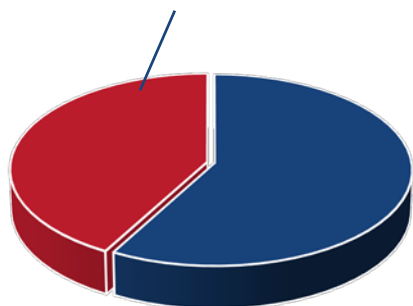
Risks viewed as high or very high by public sector CAEs



Rank	Risk	%
1	Cyber (prevention/recovery)	64%
2	IT (general)	50%
3	Compliance/regulatory	50%
4	Operational	45%
5	ERM programs/processes	33%
5	Cost/expense reduction/containment	33%

# Internal Audit Agility

**42%**



% of Public Sector CAEs who consider their internal audit functions to be **very** or **extremely** agile

## CAE's Perceived Roadblocks to Agility





# Internal Audit Imperatives for 2018 and Beyond

1. Focus on the Horizon
2. Unleash Power for Talent
3. Sharpen and Deploy the Best Power Tools
4. Be the Current for Transformation
5. Confront the Storm

# Focus on the Horizon

## The Challenge for Internal Audit

- Risks are emerging at warp speed.
- Focusing on the horizon is essential to avoiding a post-crisis question:



## The Imperative

- Deploy “Doppler Radar” to identify approaching storms.
- Continuously assess risks.
- Identify and swiftly respond to emerging risks.



# Focus on the Horizon: Strategies for Success

## Understand the challenge

- How dynamic is your sector?
- Open a dialogue with management and the audit committee.
  - You need stakeholder support to focus on the horizon

## Key Indicators of Emerging Risks

- Economic forecasts
- Threats or opportunities facing your organization
- New initiatives being planned
- Regulatory/compliance outlook
- Risks emerging as headlines via traditional or social media

# Unleash Power for Talent

## The Challenge for Internal Audit

- New risks mandate expertise in multiple areas.
- Experts are in high demand . . . and they demand the best opportunities.

## The Imperative

- To engage in the power for talent:
  - Understand stakeholder needs and expectations.
  - Assess existing competencies.
  - Develop and deploy strategies, including
    - Talent sourcing
    - Talent development
    - Succession
  - Continuously motivate and reward talent.





# Talent Power Struggle

## What Skills Are in Demand?

## How Hard Are They to Find?

Skills Being Actively Recruited	Skills Most Difficult to Recruit*
Analytical/Critical Thinking	Cybersecurity and Privacy
Communication	Data Mining and Analytics
Business Acumen	Industry-specific Knowledge
Data Mining and Analytics	Innovative Thinking
Accounting and Finance	Governance and Culture
Innovative Thinking	Analytical/Critical Thinking
Basic IT Knowledge	Business Acumen
Industry-specific Knowledge	Communications

Sources: 2018 North America Pulse of Internal Audit: The Internal Audit Transformation Imperative,

\*Public Sector Knowledge Brief. IIA Audit Executive Center © 2018 The Institute of Internal Auditors

# Sharpen and Deploy the Best Power Tools

## The Challenge for Internal Audit

- Resource pace of growth has slowed.
- Environment is more complex.
- Expectations at an all-time high.

## The Imperative

- Strive to audit smarter, better, and faster – and continuously deliver impact.
- Deploy leading technologies and practices to enhance capacity, effectiveness, and value.





# Power Tools

	Implementation of Technology Solutions	Full or Partial
1	Electronic workpapers	77%
2	Data Analytics	62%
3	Automation of routine internal audit tasks (e.g. robotics, process automation)	18%
4	Automation of analysis of evidence (e.g. automated judgement, artificial intelligence)	13%

- New technologies create agile and future-focused functions
- Today's tools of the trade:
  - Audit management systems
  - Data analytics
- Tomorrow's tools of the trade:
  - Robotics
  - Artificial intelligence (AI)
- Deploy solutions that will yield dynamic results/insights

# Be the Current for Transformation

## The Challenge for Internal Audit

- New market, value networks are disrupting at record pace.
- Established market-leading firms, products, and alliances are facing lethal risks.
- Innovation is often the only path forward.

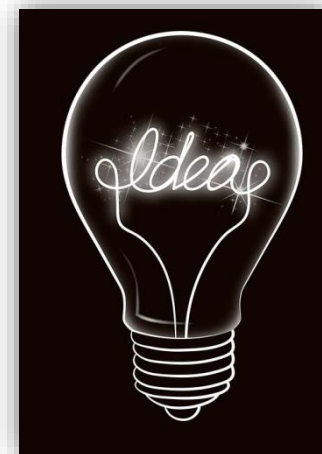
## The Imperative

- Champion transformation built on innovative thinking/actions.
- Provide stakeholders insight into best innovation processes/frameworks.
- Shine a light on:
  - Disruptive threats
  - Targets for transformation
  - Risks and controls throughout transformation processes



# Key Steps to Building an Innovative Mindset

- Empower staff to identify problems, risks, threats.
- Analyze first: Make sure you're solving for the right problem.
- Understand what is driving decision to innovate.
  - Technological disruption
  - Stakeholder, regulatory pressure
  - Disruptive innovation
  - Staying ahead of the competition
- Understand your corporate culture.
- Start small and benchmark.
- Innovation must fit the overall business strategy.



# Confront the Storm

## The Challenge for Internal Audit

- Tendency to avoid controversial topics, such as:
  - Executive compensation
  - Legal compliance
  - Corporate culture
  - Harassment/misconduct (gender, ethnicity, etc.)
- Looking the other way only compounds risks.
- Some internal auditors experience “courage deficit.”

## The Imperative

- Internal auditors must:
  - Follow the risks – wherever they are.
  - Be willing to push on closed doors.
  - Summon the courage to sail toward (and even chase) the storm.



# Six Attributes of Courageous Internal Auditors



- Overcome fear.
- Be passionate.
- Persevere in the face of adversity.
- Stand up for what's right.
- Expand your horizons.
- Face suffering with dignity or faith.

**Speak truth to power.**

# Audit Leader – Next Gen

- **Genetically Risk-centric – *Leading at the Speed of Risk!***
- **Tech Savvy and Tech Fearless**
- **Incessantly Curious and Professionally Skeptical**
- **Ethically Far-sighted**
- **Intellectually Honest**
- **Not Your Grandfather's CPA**
- **Cosmopolitan**



