Creating Closer Ties Between Internal Audit & Compliance
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Founded in 2002, Compliance Week has quickly become one of the most important go-to resources for public companies; Compliance Week now reaches more than 26,000 financial, legal, audit, risk and compliance executives.
Compliance and Audit Getting It Together

By Tammy Whitehouse

The do-more-with-less movement may be inspiring a growing number of companies to merge corporate compliance and internal audit functions into a single reporting structure. Others are encouraging the functions to work more closely together.

Compliance and internal audit experts say they see an increasing number of companies creating closer ties between compliance staff and internal audit staff partly due to economic pressures. They are looking for ways to leverage resources and become more efficient, says Bill Watts, a principal with accounting firm Crowe Horwarth.

They’re also uniting the functions to establish more collaboration and a broader focus on identifying and mitigating risk. Companies want to take a more proactive approach to managing risk and are looking more broadly across the entire enterprise for where there may be unidentified or unmanaged risks, says Watts. Compliance and internal audit both play a role in that effort. They go out into various operational areas of the company, gather information and data, perform assessments, and make recommendations for change. “This is an emerging opportunity we see in risk management,” he says. “It’s becoming a wake-up call to some organizations; maybe they ought to look more closely at what they’re doing.”

Yet, most companies keep the compliance and audit functions separate, sometimes creating redundancies. “What they have not done in the past is share data or information,” says Watts. “So some companies see an opportunity to integrate that under one umbrella.”

Dime Community Bancshares recently formed a risk committee to better gauge risk on the macro level and look for overlaps and gaps in the company’s risk assessment processes. “We don’t want to have internal audit thinking they’re responsible for certain things while compliance is doing it, and the other way around,” says Joe Perry, who chairs the bank’s risk committee and is also a partner for accounting firm Marcum. “We want a coordinated effort with delineated responsibilities for who is doing what.”

Perry says a more integrated effort in compliance and internal audit leads to a better view of risk and a more efficient way to assess and manage it, especially for companies in highly regulated sectors such as financial services. “There are so many more regulations that you need more people to deal with all of them,” he says. “You need people who can adapt to the situation and do it in a more risk-weighted way to cut down on the amount of time you spend on compliance, yet with the same effectiveness. Efficiency is the outcome of our economic times—doing more with less.”

While there is plenty of integration of compliance and audit taking place among larger public companies, some have resisted the idea, says Laura Flippin, a partner with law firm DLA Piper. “I certainly see some companies moving toward convergence, but others are still keeping their functions separate,” she says.

Companies that have chosen to integrate the functions tend to see compliance and internal audit as two sides of the same coin. “They’re both charged with identifying whether certain behaviors have taken place, monitoring on the back end, making changes going forward,” she says. “It makes sense to put them under one roof. Auditing means more than simply doing a string-of-numbers calculation and financial review, and compliance needs to understand the financial implications of the actions taken by the company.”

Of course, there are steps along the way to achieving more cooperation without opting for a wholesale merger of the two functions. In fact, KPMG partner Eric Holt says that it is still somewhat rare to see companies physically merging their compliance and internal audit functions. However, he does see a strong focus on integrating the activities of compliance and internal audit to eliminate existing silos and potential redundancies. “The goal of convergence is to transform operations that incorporate a more integrated and intelligent approach,” says Holt, who is KPMG’s global leader of internal audit, risk, and compliance. “The goal is not to eliminate an entire function or force a function to assume new duties.”

For example, no companies are going so far as to having compliance assume responsibilities that have been performed by internal audit, says Holt. But they are looking to share resources, and technology is the key enabler of such sharing and integration, he adds. By integrating the resources of governance, risk, compliance and even internal audit into a single system, companies can develop a consistent set of information on risks, issues, mitigating actions, enabling timely and consistent analysis and reporting.

Integrated Systems

That’s exactly what companies are looking to buy these days as they consider new systems, says Steve McGraw, president and CEO of technology firm Compliance 360. Currently, the firm is working with a few hundred companies that are looking to upgrade or replace existing systems, and not a single proposal is focused exclusively on internal audit or compliance. “Three years ago, we saw a lot of internal audit- or compliance-only deals,” he says. “That stopped dead in its tracks.”
Where there is resistance to such integration, Flippin said, it often arises because of legacy, institutional structures, and political alignments. “There are some boards and some executives who view audit and compliance as two separate areas,” she says.

Companies might also balk at the upfront costs associated with restructuring or retraining, says Crowe Horwath’s Watts. “You have to spend money to make money,” he says. Companies need to invest in cross-training compliance and internal audit staff to achieve an integrated process. While that will yield an immediate effect on efficiency, he says, it will add cost on the front end.

Consultants who are selling the idea of merging or integrating the functions may not say so, but there are plenty of purists who are willing to assert that the two areas should remain separate. To retain its independence, internal audit in many organizations reports directly to the audit committee, creating a check on management that is important to regulators and Sarbanes-Oxley compliance. Concern abounds that internal audit should not be absorbed into compliance, which is a function of management. “This would effectively keep management from being audited,” one observer recently wrote on the Institute of Internal Auditors blog. “You need to fight for these audits to continue or you’ll end up moving down the food chain into quality control.”

A SUCCESSFUL MERGE

The following excerpt from Nichols, Cauley & Associates’ Website BankAudit.net provides tips on how to merge the internal audit and compliance functions:

Clearly a new approach is called for that brings compliance, risk management and internal audit into a framework that enables management to measure, prioritize and manage them efficiently and effectively. The organization should employ a streamlined framework that integrates compliance and internal audit activities across lines of business and shared service functions which would eliminate redundancies and overlap efforts.

The three major keys in such an approach are:

- **Diagnosis:** An evaluation of current business operations and the compliance implications is the first step. This step identifies compliance resources, internal audit resources, technologies and actively develops an initial baseline cost of compliance and internal audit. Existing risks, compliance resources, internal audit resources, control and technologies are split up and divided into groups to be catalogued.

- **Analysis:** This step involves analyzing the effectiveness of the existing compliance and internal audit programs against existing risks and indentifying any compliance gaps and potential needs for additional controls and elimination of duplicative services. This rationalization can save any organization up to 10-15% over a 6-12 month period according to research performed by a leading accounting firm.

- **Implementation:** The last step involves implementing the new compliance and internal audit operating model that has been developed.

These three steps should generate greater compliance and internal audit effectiveness at a lower cost.

The new compliance and internal audit operating model should differs from the current model with the following differences:

- The organization should now have an integrated compliance and internal audit function which facilitates a more consistent approach across the organization ensuring standards are consistently being met and any duplication and unnecessary activities are reduced, if not eliminated and therefore, costs are reduced.

- Compliance management controls can now be assessed against a common enterprise-wide standard that replaced the individual standards in the old model.

- With the more integrated and compliance efforts, the technology infrastructure can be more closely aligned with compliance and internal audit needs. The institution might be able to automate manual activities and eliminate duplicative applications, potentially further driving down its cost structure.

- The new integrated operating model should help in integrating reporting relationships across risk areas, compliance management functions, and internal audit functions improving communications about any risk and compliance issues. A more integrated structure creates open dialogues and increases awareness of operational risk and compliance issues which fosters a stronger risk and compliance management culture.
Internal Audit Pulled in Two Directions at Once

By Tammy Whitehouse

A new reality has caught internal auditors in a bit of a conundrum.

Even as they strive for the independence required to perform objective assessments, stakeholders are calling on them to partner with business and play a more advisory role. Can they do both? Some internal audit experts view it as a challenge for a profession that has been hinged in different directions over the past decade. Others consider it the natural constitution of internal auditing—or at least what it was meant to be before the Sarbanes-Oxley Act consumed the function.

The Institute of Internal Auditors capped off a substantial global study of the internal audit profession recently and concluded that internal auditors are taking on a more advisory role to help management and audit committees focus more attention on risks. It serves as something of a reminder for internal auditors to get back to their roots and take on the role that the internal audit function has always been meant to serve, says IIA Vice President Hal Garyn. “When you break it down to its core elements, internal auditors are reviewing and recommending,” he says. “The internal audit profession has in some respects always been in an advisory capacity.”

Some internal auditors don’t see a great deal of conflict between being objective and being an adviser. “We are making recommendations either way,” says Sanjay Singh, vice president of internal audit at Starbucks. “When we talk about a consulting approach, it enriches the audit process. It doesn’t dilute it.”

Indeed, the notions of objectivity and consultation appear prominently in the IIA’s definition of what it means to be an internal auditor. “Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations,” according to the IIA’s framework for the profession.

But it’s true, Garyn acknowledges, that Sarbanes-Oxley pulled internal auditors away from that advisory function to a large degree. “The pressure to help companies navigate through the challenges of SOX put significant capacity constraints on internal audit functions,” he says. “That was far more operational than something we’d traditionally see as part of internal audit.”

Now internal auditors face the challenge of becoming more like business advisers, but without tainting their objectivity. And the learning curve is especially steep for the increased numbers of younger auditors who joined the profession and cut their teeth on Sarbanes-Oxley implementation. “We have a whole corps of graduates out there who have never done anything but controls and compliance,” says Warren Stippich, a partner with Grant Thornton.

“I don’t see these things as being as violently opposed as some folks might,” says Jeff Browning, senior vice president of corporate audit services at Duke Energy. Because internal audit reports through the audit committee, which is an independent overseer of management, he has little concern about scuttling his objectivity while providing advice. “There’s a tension inherently in internal audit because you’re assessing operations and looking for ways to improve things,” he says. “Although the suggestions we make may not always be palatable to management, many good audit shops serve as advisors in addition to controls experts.”

To serve in a more advisory capacity, internal auditors need to get involved when projects or programs are under consideration and controls are being designed, rather than stepping in after the fact and writing audit memos, says Singh. For example, his audit team might get involved when Starbucks is considering expanding into a new market, he explains. That requires building rapport with management, he says. “It’s really difficult to get aligned on the front end of things if management thinks we’re going to look at a half-baked process and write an audit memo,” he says. “We need to help proactively in the design of the controls, serving in more of a consulting role, rather than opining after the fact.”

And getting involved early can save time and money too, says Singh. “I can make recommendations before we put controls in place, or six months after I can tell them to redesign or modify the controls,” he says. The more cost-effective way is to get internal audit involved before control mistakes may be made, he says. “Then a year down the road, I can audit the effectiveness of the control to see if it is doing what it is supposed to do.”

The key to remaining objective even as internal auditors...
become more strategic minded, says Garyn, is to stay out of the implementation. “As long as you didn’t roll up your sleeves and get operational, you should be independent,” he says. Richard Anderson, a professor at DePaul University and a co-author of the IIA study, says the line in the sand is clear around implementation and decision making. “It’s one thing for internal auditors to give advice and views on things,” he says. “But they should not be involved in making decisions or driving decisions. That’s where you cross the line into what is really management’s responsibility.”

In order to balance the sometimes competing objectives, Gary Sturisky, national leader for business consulting at RSM McGladrey, says internal auditors need to get more collaborative in their working style and break through some existing preconceptions. “They need to migrate away from potentially being labeled as the corporate police officer,” he says.

Bob Hirth, executive vice president for global internal audit at consulting firm Protiviti, sees it as a little more of a tightrope walk. “As an employee of the company, an internal auditor is de facto biased,” he says. “When you provide advice, make it factual. Advice can be factual, and in theory it is then unbiased.” Beyond that, there are degrees or variations of objectivity and independence. It’s up to internal auditors to flag when they think their objectivity may be compromised and allow management or the audit committee to determine if a third-party view might be warranted.

To assure internal auditors preserve their objectivity, Garyn says they need to first make sure they understand the expectations of management and the audit committee and operate within them. To the extent an internal auditor feels like a particular assignment is becoming operational, involving shades of implementation, it’s up to the internal auditor to flag that to management and the audit committee, he says. And when it comes up for internal review, adds Garyn, that same auditor should decline the assignment.

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**SURVEY DETAILS**

What follows is a list of key findings from the IIA’s global internal audit survey:

» Internal auditors are entering the profession at a younger age. The percentage of auditors in the age group of 26 to 36 increased to 30 percent in 2010, compared to 11 percent in 2006.

» More than two-thirds of survey respondents were male and one-third of respondents were female.

» There is a significant increase in the percentage of internal auditors obtaining master’s/graduate and doctoral degrees.

» There is an increase in the percentage of respondents with internal audit majors.

» More than half of the internal audit organizations get their staff from transfers within the organization, followed by employment agencies and referrals from professional affiliations.

» Organizations rely on co-sourcing or outsourcing to compensate for missing skills in the internal audit activity.

» Approximately 50 percent of the respondents’ organizations will recruit more staff during the next five years, with 42 percent indicating that they will maintain current staff levels.

» Survey results indicate that most CAEs report either to the CEO or the audit committee with variation by region. The highest percentage of CAEs reporting to audit committees was noted in the Middle East, the United States and Canada, and Latin America.

» In five years the focus of internal audit activities will significantly differ from current practice. Corporate governance, enterprise risk management, strategic reviews, ethics audits, and migration to International Financial Reporting Standards (IFRS) will be the major focus areas for internal auditing with less emphasis on operational and compliance audits, auditing of financial risks, fraud investigations, and evaluation of internal controls.

Source: IIA Foundation Executive Summary of Global Internal Audit Survey.
Study: Internal Audit Needs to Expand Its Horizons

By Tammy Whitehouse

Internal auditors have long known in their gut that they had to take more initiative in identifying and helping to prevent enterprise risks. Now they have some long-awaited affirmation—you might even call it a mandate—to take their companies and their profession down that new path.

The Institute of Internal Auditors last week unveiled the full results of a global study that declared internal auditors are, or at least should be, broadening their focus from internal controls and traditional assurance tasks to the bigger issues of risk and governance. The study polled 13,000 internal auditors in more than 100 countries plus some of internal audit’s important audiences, such as CEOs and audit committee members. The goal was to determine where the expertise and resources of internal audit can provide the most value, as companies around the world recover from an economic crisis touched off in large part by unidentified, unmanaged risks.

The message was clear, says Richard Anderson, a professor at DePaul University and one of several study co-authors: “Internal audit is shifting its focus and resources to look at more areas around risk, risk management, and corporate governance,” he says. “Internal auditors are not abandoning their very heavy focus on internal controls, but people are starting to think about the different skills and resources they need as they broaden their focus on these other areas.”

The survey found that 80 percent of internal auditors globally expect to spend more time on risk-management activities in the coming five years, and 23 percent expect to give greater attention to corporate governance reviews during the same period. About half of the respondents expect to recruit more staff in the coming years to expand the audit function’s expertise into the operational aspects of the business, risk analysis, and control assessment techniques, especially those relying on technology and automated tools.

The results of the survey prompted the IIA to produce six separate reports, each one giving chief audit executives practical ideas for steering in this new direction. The first five reports cover the characteristics of an internal audit activity, the core competencies of internal auditors, how to measure the value of internal audit, where the profession is headed in the future, and how the profession should adapt itself to the new expectations. The sixth report focuses exclusively on the perceptions of internal audit stakeholders in the United States, to give CAEs some deeper insight into what their bosses are expecting from them.

Internal audit departments in different companies and different cultures are at varying stages of answering the call for more focus on risk management, Anderson says. The six reports will contain something for any audit shop along that continuum, he adds.

“We’re stressing to chief audit executives to sit down, go through this, and focus at a high level on the themes and the imperatives,” he says. “And if you think you’re far along, fine; then move further. Now is not the time to sit back on our laurels and become complacent about what we’ve been doing the last few years.”

Some trends in the internal audit profession could prove challenging to auditors eager to move up the value chain and grab a seat at the executive table. For one, the survey found that internal auditors are getting younger: The portion of internal auditors aged 26 to 36 grew from 11 percent in 2006 to 30 percent in 2010. On the other hand, indications are that internal auditors now enter the profession with more training; a greater percentage have advanced degrees; and more candidates are graduating from college with a major in internal audit.

The Right Direction

Paul Sobel, vice chairman of professional development for the IIA, and a chief audit executive for a global corporation, says the conclusions for him didn’t contain any new revelations, but some affirmation that the profession is heading in the right direction. “It helps reinforce that we really have an opportunity to be a more integral part of our organization’s success,” he says. “It gives me a lot of confidence that we’re headed in the right direction, but we still have a long way to go to optimize the value we can add.”

Sobel was particularly intrigued by the report’s suggestion that internal auditors need to brush up on their networking and communication skills so they can be more engaged with their audit committees and chief executives and take on a more advisory-like role in helping identify and manage risks. It’s a departure from the compliance-driven focus that internal auditors have honed in recent years in response to the Sarbanes-Oxley Act, but it’s not a stretch for the profession, he says.

“Internal auditors get to see an awful lot of aspects of the company, and they do develop insights that can be quite valuable,” he says. “Too many internal audit functions in the past have stayed in their comfort zone. I’m hopeful this is a call to action to get out of that comfort zone.”

On their face, the IIA findings also sounds like a departure from the messages preached in recent years about auditors remaining objective, but Sobel doesn’t see it that way. Professional standards provide some guidance on remaining objective, he says, but don’t prohibit auditors from serving as advisers or consultants. “Management still owns the risk and the actions to mitigate the risks, but when you get into the
standards, there is nothing wrong with giving advice,” he says.

Like Sobel, Kathleen Swain, senior vice president of internal audit at Allstate, finds the results of the study to be affirming. “My first reaction was validation that we had read the environment correctly and we are heading in the right direction,” she says. She too was struck by the emphasis on the importance of better communications and relationship building with the audit committee. “It is important to grow the conversation, not just maintain it at the level it is at,” she says.

Some bad news for internal auditors: They generally believe they’re doing a better job at meeting these new objectives than CFOs and audit committee members do.

Dan Bolger, senior manager with Deloitte, says individual auditors need to better understand what their specific audit committees and chief executives expect; those expectations may not necessarily align exactly with the study results. “The big takeaway is to make it a priority to understand and learn the expectations of your own stakeholders,” he says. “We saw some results where some internal auditors weren’t aware of their stakeholder expectations. That’s not good.”

Rob Kastenschmidt, national leader for risk advisory services at RSM McGladrey, says the focus on communication skills is perhaps most salient for internal auditors in the United States. Internal auditors need the technical skills to identify risks, but even further they need to hone their communication skills to take on a more advisory-type, forward-looking role with audit committees and management. “You need to be able to explain it, frame it, and capture the imagination of the audit committee,” he says, to inspire the higher-ups to act on what you’ve uncovered.

To assure internal auditors preserve their objectivity, Garyn says they need to first make sure they understand the expectations of management and the audit committee and operate within them. To the extent an internal auditor feels like a particular assignment is becoming operational, involving shades of implementation, it’s up to the internal auditor to flag that to management and the audit committee, he says. And when it comes up for internal review, adds Garyn, that same auditor should decline the assignment.

IIA FINDINGS

The IIA Research Foundation provides the following summary of results from its global internal audit poll:

Competence and Skills

1. In the wake of the turbulent global economy and the impact on financial markets and corporate viability, CAEs, internal audit staff, and managers identified three of the top five competencies as:
   - Communication skills (including oral, written, report writing, and presentation).
   - Problem identification and solution skills (including core, conceptual, and analytical thinking).
   - Keeping up to date with industry and regulatory changes and professional standards.

2. Understanding the business ranked as the most important overall technical skill in both the 2006 and 2010 surveys.
   It is the top technical skill for management and CAEs and the third most important technical skill for internal audit staff. This response is consistent with the 2006 and 2010 survey rank of risk analysis and control assessment techniques as important technical skills because a solid understanding of the business is essential for internal auditing to effectively identify emerging risk and control issues.

3. CAEs indicate the ability to promote the value of the internal audit as the most important competency for them to perform their work.

4. The results indicate that keeping up to date is now considered very important at all three professional levels — not just at the CAE level.
   
   Keeping up to date was the third most important competency for CAEs in both the 2006 and 2010 surveys. For internal audit staff and management, keeping up to date moved from about the bottom one-third of competencies in 2006 to the fourth highest ranked competency in 2010.

5. Communication skills ranked as the top overall general competency for both the 2006 and 2010 surveys.

Based on the survey results, the general competency rankings for all industries are consistent with the overall general competency rankings.

Source: The IIA Research Foundation.
A Close Collaboration Between Audit and Compliance
Key for Effective Risk Management

By Colin Campbell and Michael Rasmussen

The role of internal audit is expanding as it guides the enterprise beyond traditional attitudes about financial risk management, risk mitigation, and monitoring and toward evaluating a broader spectrum of compliance activities. Today’s auditor must have a full understanding of the risks the company faces and how they relate to each other, and needs to rely on well-constructed and well-executed risk management, control, and governance processes in order to provide assurance that controls are designed appropriately and operating as designed.

At the same time, the role of compliance is expanding as it goes beyond the traditional roles of building an ethical workplace culture, identifying and managing regulatory and legal obligations, and implementing and monitoring policies, controls, and training. Today’s compliance officer, beyond being devoted to the business and shareholder requirement of building and maintaining an ethical organizational culture, must have an active role in risk identification, management, monitoring, and mitigation.

Audit and compliance—working together—are uniquely positioned to help the board and management understand the importance of an integrated approach to compliance that enables wise resource use, prevents undesirable outcomes, and grasps advantages while achieving business objectives.

The Role of Internal Audit
As a key player at the center of the strategic team of the enterprise, Audit must keep in mind and address the demands and concerns of a wide-ranging group of stakeholders.

» Key external stakeholders including investors, regulators, NGOs, and local communities demand transparency.
» Board and C-Suite executives require clear and reliable information about compliance risks that impact strategic decisions.

Audit drives the overarching need for improved efficiencies and reduced compliance risk throughout the extended enterprise.

» Compliance and legal executives must identify and quantify significant risks and then allocate limited resources to preventive, detective, and corrective controls to mitigate those risks.
» Line executives need to be invested in and consulted about surveys, risk assessments, and audits.

Auditors guide the organization through decisions that will develop and drive compliance strategy and need to be prepared to:

» Articulate to the audit committee and the full board why having a clear and conformed view of compliance risk across the enterprise is critical to providing assurance
» Demonstrate how strong, objective, independent assessments and audits can be used to evaluate all aspects of performance from strategic to financial and operational
» Communicate the benefits of including internal audit on the front-end design of compliance processes
» Influence other key functional executives to support internal audit’s role in compliance and the organization’s achievement of business objectives
» Collaborate with key C-suite executives in developing compliance processes that allow for measurable evaluation of effectiveness and efficiency
» Help the CEO to appreciate how a strong compliance risk management approach can protect and grow value

Audit can best guide the organization when it understands the implications of compliance at both the strategic and operational levels.

The Role of Compliance
Compliance has expertise in creating the structure and culture of compliance needed to achieve the goals of compliance. Compliance has evolved from the days immediately post-SOX enactment when it was merely a ‘department of no’ to a department that operates like any
As risks like the UK Bribery Act and various import/export trade regulations change the regulatory landscape, Audit and Compliance can together assess risk and ensure that compliance processes and controls are operating as designed and are effective in mitigating the most significant compliance risks.

The Close Collaboration Between Audit and Compliance

The close collaboration between audit and compliance activities simply makes sense. Internal auditors have the skill set, interest, and focus to be able to look at things in a measurable way. They have a broad understanding of many facets of the company. Additionally, internal audit departments already have budgets and resources available to assess the effectiveness and efficiency of compliance process. If audit is involved on the front-end design of the compliance capabilities, the organization will be assured that compliance systems are created to enable back-end review, which ultimately improve efficiency.

Audit’s existing relationship with the audit committee can be leveraged to enhance the compliance reporting process; without a consistent and measurable compliance function, audit will have trouble assessing this process and providing assurance to the board that it is operating effectively.

At the same time, compliance understands how multiple regulations impact different business units differently and can help identify places where controls can address multiple requirements and/or obligations. The entire compliance process needs to be audit-ready, with policies in place to deal with inquiries, subpoenas, formal audits, external reviews, and investigations. Working together, audit and compliance can monitor and periodically report to the CEO and board of directors on how compliance and ethics risks are being identified and addressed.

As the board and executive management bring assurance to all stakeholders of the strategic and organizational effectiveness of the enterprise and continue plans to both preserve and create value, an effective standard approach to providing assurance related to compliance and ethical risk is critical.

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But it’s more than just one move. It’s a strategic decision.

Focusing on any one move instead of the relationship between all past and future moves will likely miss hidden opportunities and fail to uncover, quantify and manage what can impede success.

SAI Global’s GRC Platform is built to widen your risk management focus and bring the connections and relationships between all the elements of audit and compliance management to full view - obligations, controls, procedures, processes, policies and training. Audit and compliance working together, globally. Contact us for a demo of our compliance and risk management software today. www.saiglobal.com/compliance