



Facing the Unknown: Crisis Management and the Role of Internal Audit

April 11, 2016



A crisis is...

"... a major catastrophic event, or a series of escalating events, that jeopardize the critical assets, reputation, and financial standing of an organization or community."

Crises typically exceed existing mitigation techniques and risk management programs such as Business Continuity, Disaster Recovery, Health and Safety plans, or Emergency Response.



Types of crisis events and triggers

Natural or man-made destructive events that disrupt almost everything

The explosion of a power plant due to a hurricane, led to massive electricity outages. The ensuing investigations revealed poor governance and oversight leading to a fall of nearly \$2B in market value for the utility

Complex systems fail, either through accident, mismanagement or sabotage

A massive explosion for at a chemical plant caused loss of property and infrastructure of over \$100M, and injuring nearly 200 people. It was later discovered that a small fire had spread to a highly combustible stockpile causing the explosion

Fraud or other criminal activity

A leading drug manufacturer was fined around \$3B for bribing and giving kickbacks to doctors for prescribing unsuitable medicines

Legal, commercial, geopolitical, or military conflicts

A healthcare giant faced a massive disruption when more than 2000 employees went on strike to protest against its failure to provide patients with access to health services. The company had to face investigations, regulatory scrutiny, and pay nearly \$5M in fines

Deliberate acts such as identity theft, product tampering, cyber-attacks, or cyber-crime

A bank had significant reputational impact after an unprecedented data breach compromised of over a 100 million accounts of households and small businesses. On investigation, it was revealed that the breach (unnoticed for over a month) could have been avoided by a simple security fix

Unforeseen failures that threaten a company's very existence

A prominent gaming company in the U.S. filed for Chapter 11 bankruptcy protection after failing to meet its covenants on nearly a \$50M debt facility. The company had been posting huge financial losses for multiple years, mainly due to poor sales and failure of products in the market



Crisis examples

Looking back at crisis events in the U.S.



HURRICANE KATRINA - New Orleans, Louisiana

1. Category 3 Hurricane Makes Landing in 2003
2. Billions of Dollars of Damage Caused In The City
3. 2,000 Resident Deaths
4. 100,000 Homes Destroyed



GENERAL MOTORS – Faulty Parts

1. Defective Ignition Switches Placed in GM Cars
2. Linked to 124 Deaths
3. Linked to 275 Injuries
4. 2.6 Million Vehicles Recalled

In 2014, GM had multiple recalls as faulty engineering was exposed. The stock price declined from \$37.86 in February 2014 to \$29.48 in February 2015.



CHIPOTLE MEXICAN GRILL- E. Coli Poisoning

1. 200 People Become Sick in August of 2015
2. Chipotle Forced To Temporarily Close Doors
3. Chipotle Stocks Fall Following News

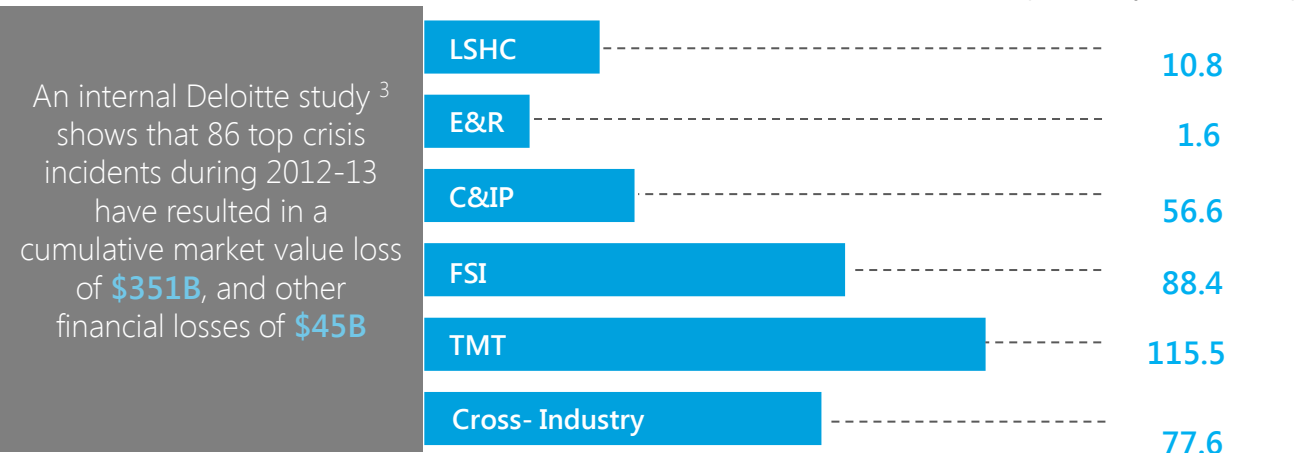
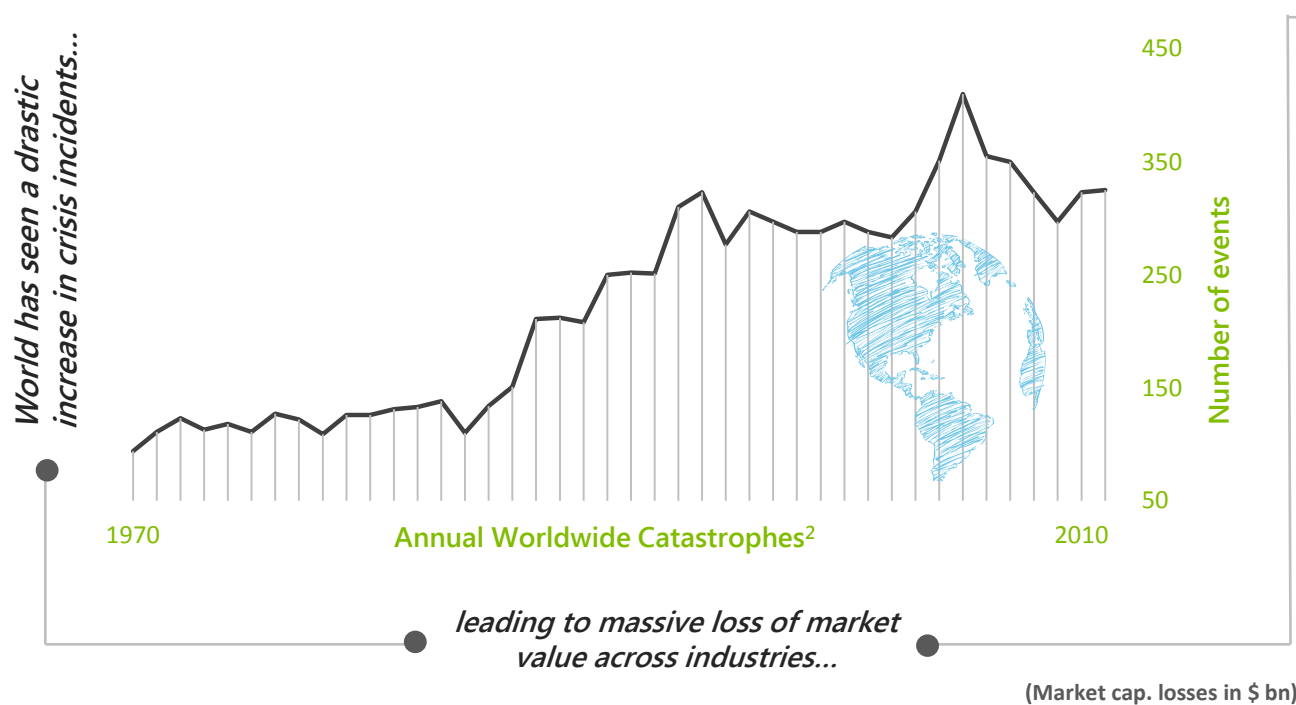
Chipotle's stock value experienced year over year increases but in the last 12 months, the stock has declined nearly 2 %



TARGET – Data Breach

1. The breach cost Target \$148 million in just 2014
2. Target spent nearly \$200 million in 2014 to upgrade systems
3. Over 70 million had personal information compromised
4. Target's stock price recovered in 2014 but sales declined by more than 2%

The dynamic VUCA¹ business environment has led to larger and more frequent crisis events globally



triggered by a host of events with regional/global impact⁴



Financial disruption

More than **47,000** bankruptcies in US alone



Malevolence & cyber

More than **4,000** successful cyber-terrorism attacks globally



Confrontations

500-600 major boycotts, labor disputes and riots globally



Technological & industrial

Nearly **50** major industrial disasters globally



Misdeeds & financial crime

Nearly **700** corporate fraud and **500** embezzlement cases in US



Other catastrophes

More than **300** catastrophes globally

1. VUCA = short for volatility, uncertainty, complexity, ambiguity
 2. Swiss Re: Sigma world insurance database
 3. Source: Crisis management: Analysis of crisis impacted companies
 4. Source: Combination of sources detailed in speaker notes

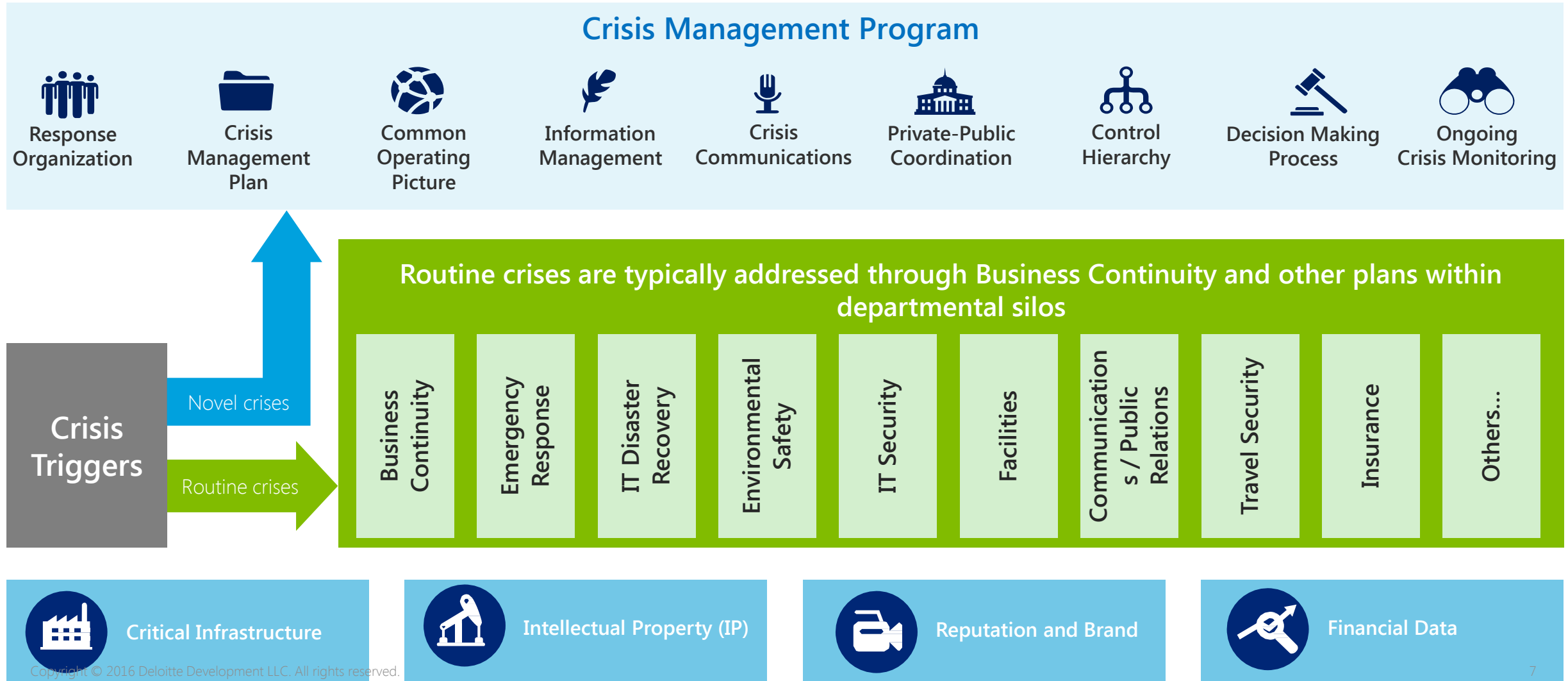
Organizations are faced with various challenges when addressing novel crises

Leaders often have to take charge and rally their troops to avoid some common stumbling blocks such as:

- Excessive focus on fixing the incident, rather than leading the response and addressing the strategic impacts
- Failing to understand or underestimating the scale, breadth, and speed of the crisis and its unanticipated consequences
- Making poor decisions and unintentionally causing harm, due to bad or incorrect information in the first few hours of a crisis
- Not having enough time to make sense of the chaotic inflow of information and answering all of the direct inquiries

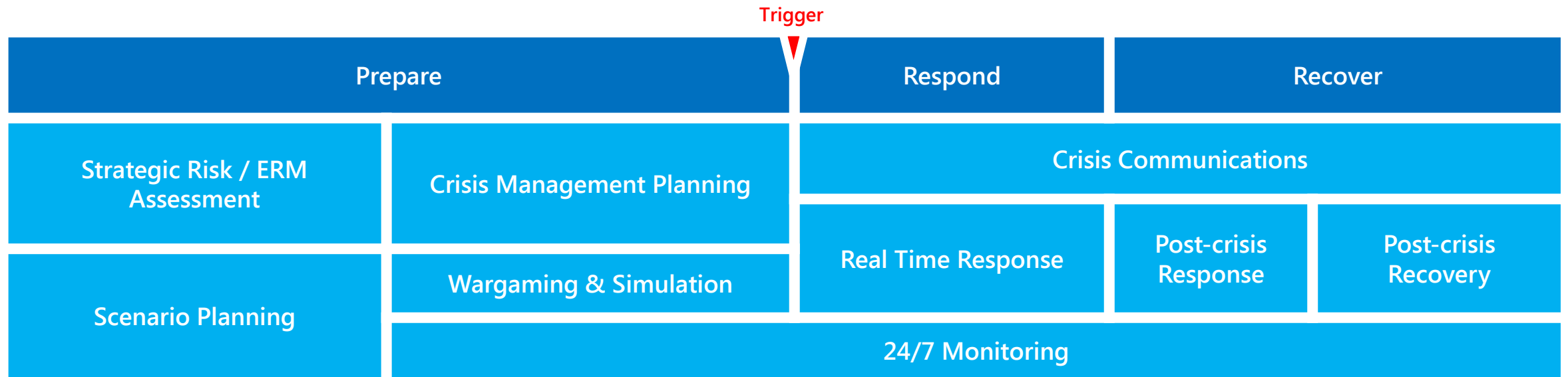


Responding to a crisis requires a broader organization-wide view and a multi-pronged approach



Before, during and after

In order to stay ahead of growing threats and the dynamic nature of crises events, organizations must invest in identifying, preparing for, and responding to the strategic risks



▼ Types of crisis events include, but are not limited to:

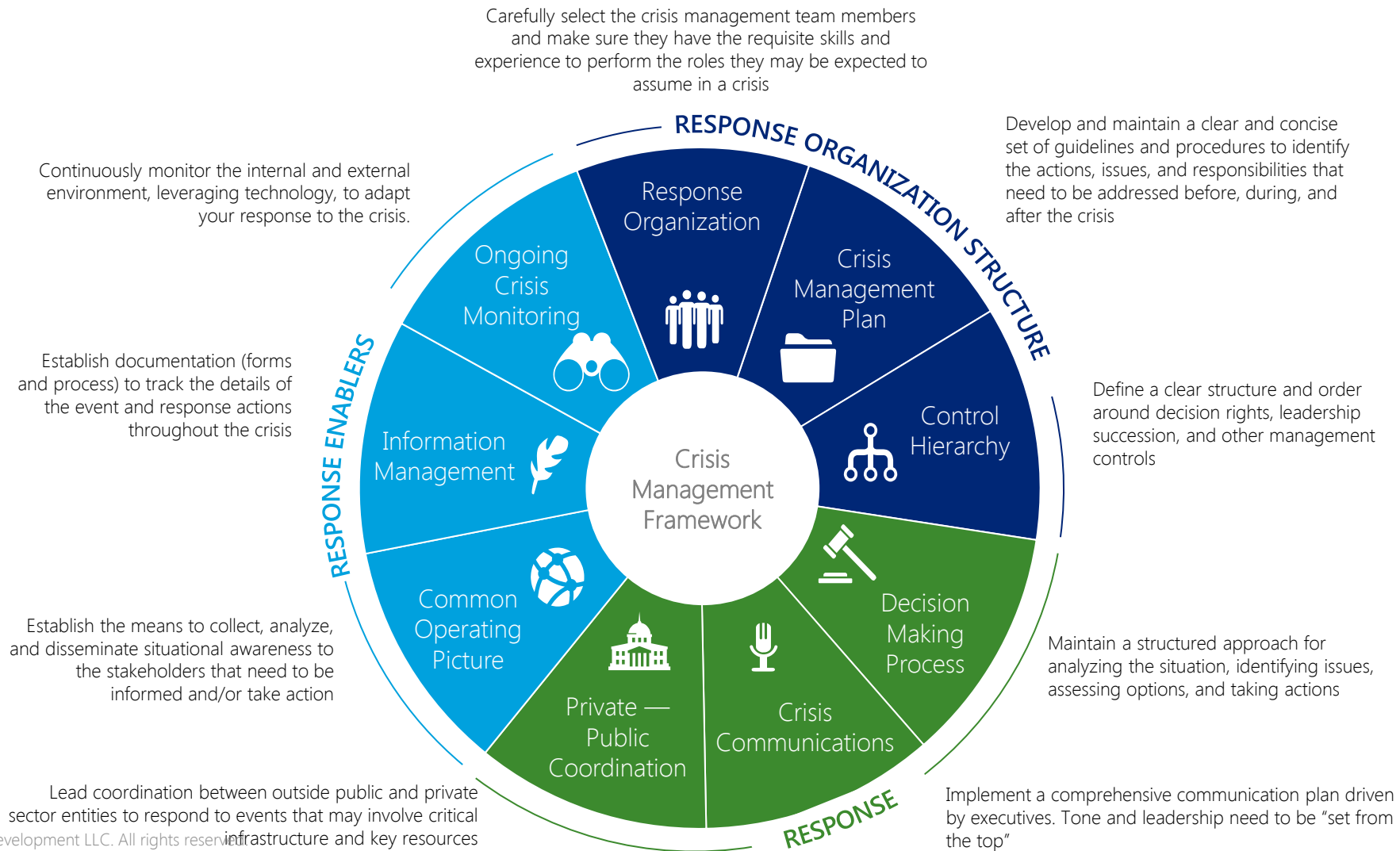
- Technological & industrial, including recalls
- Malevolence & cyber attacks
- Misdeeds & financial crime, including fraud
- Financial disruption and bankruptcy
- Confrontations – Legal, commercial, geopolitical, or military conflicts
- Natural disasters and other catastrophes

The role of internal audit

The IIA definition of internal audit lends itself to a natural role in crisis management

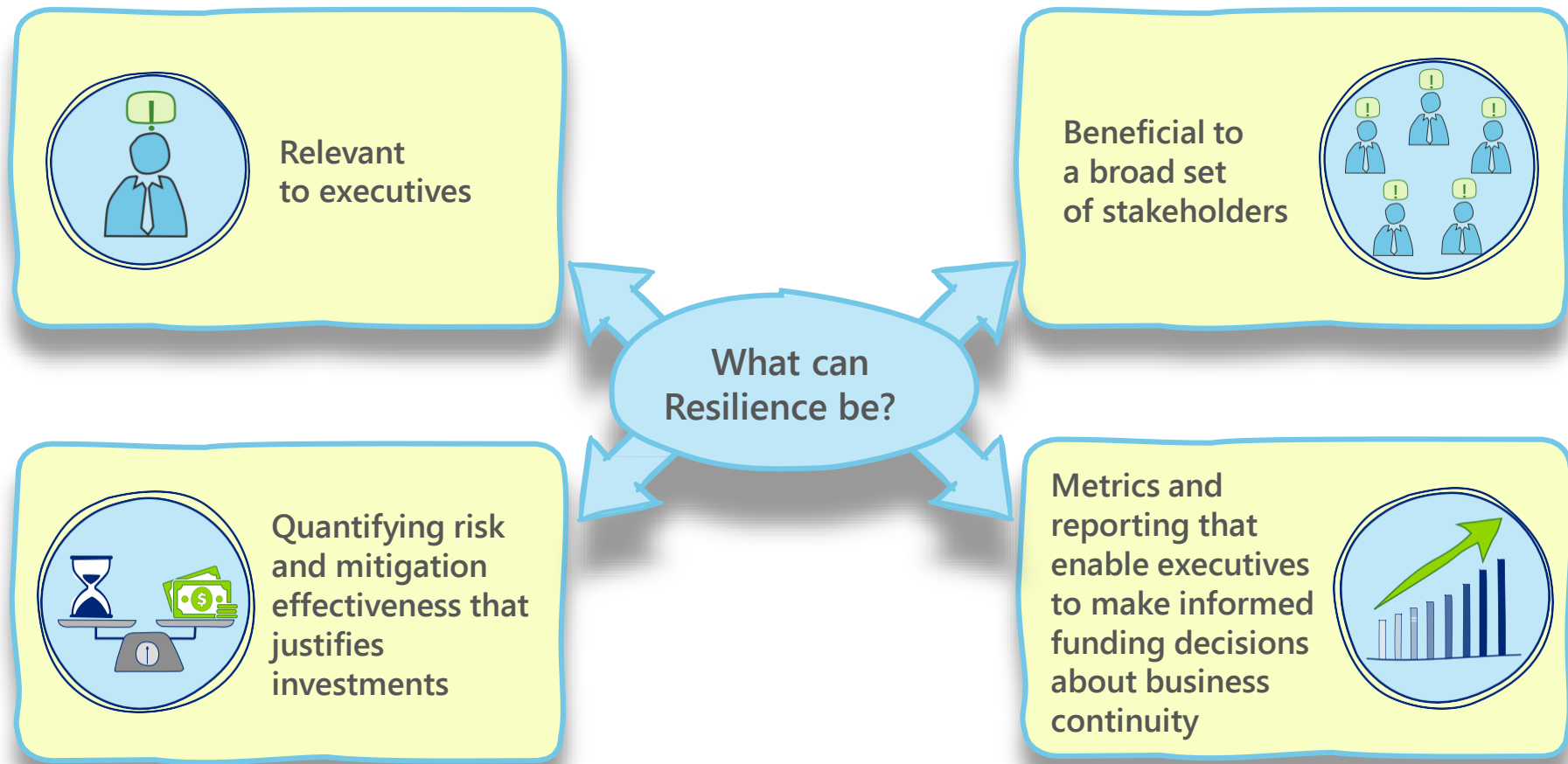
Internal auditing is an independent, objective assurance and consulting activity designed to **add value and **improve an organization's operations**. It helps an organization accomplish its objectives by bringing a **systematic, disciplined approach** to evaluate and **improve the effectiveness of risk management, control, and governance processes**.**

Internal auditors can help provide an organized approach to prepare for, and deal with a crisis via a comprehensive Crisis Management Program



Resilience program

A Resilience program enables an organization to navigate a disruption, it also enables the Board of Directors and executives to confidently maintain their accountability to stakeholders in the event of a crisis. Programs that demonstrate four characteristics generate the greatest value to all stakeholders.



Tips to successfully engage the organization in crisis management

Tips

Engage executives and other senior leaders:

A successful resilience program begins with buy-in and support from the top. As the first step, we recommend engaging cross-functional executives and other senior leaders to collaborate and agree upon:

- resilience policy
- governance structure including roles and responsibilities
- recovery tiers and impact (risk) tolerances
- crisis management team composition

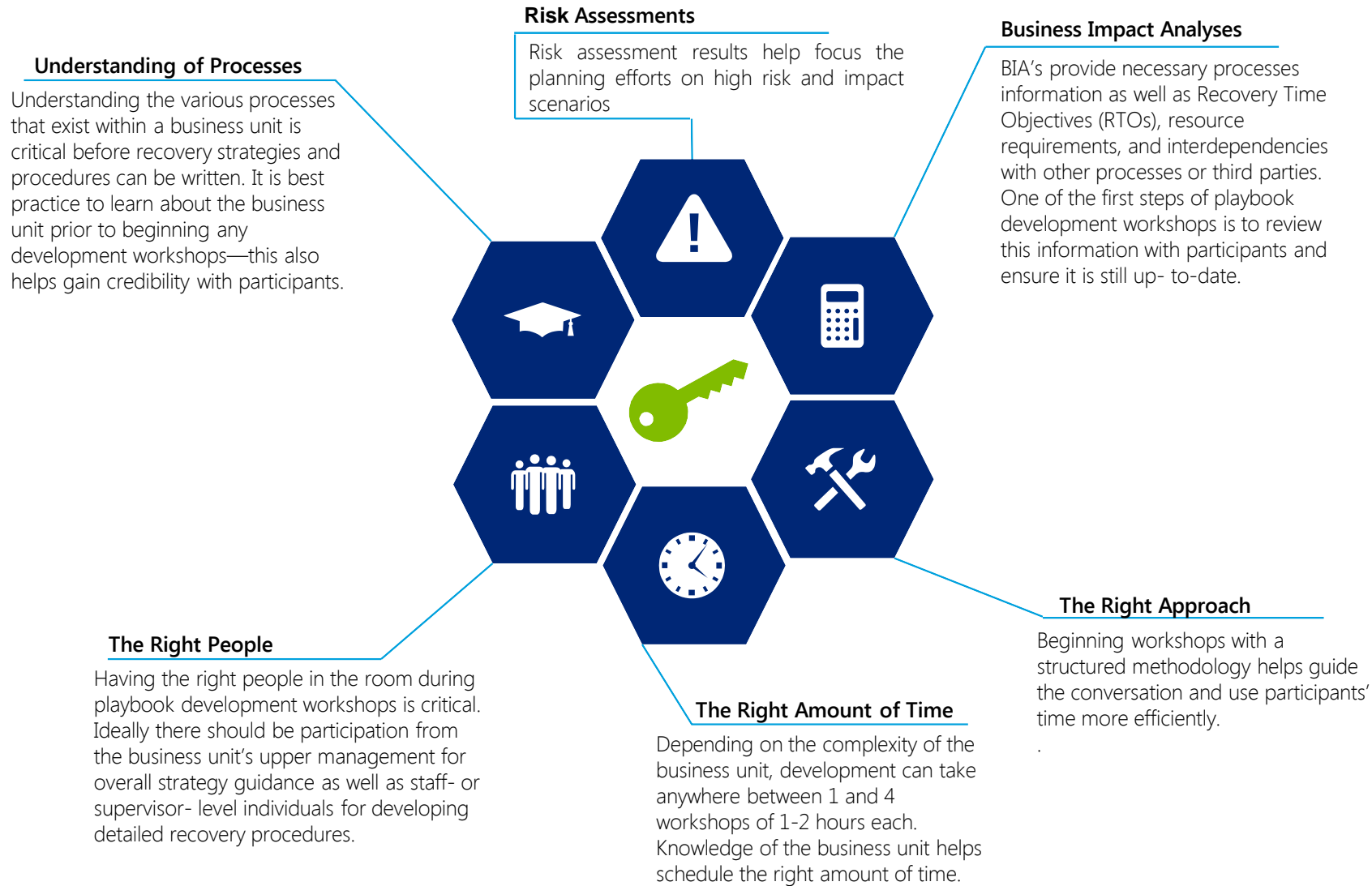
Use a simple design with the business stakeholder in mind:

Resilience activities such as data gathering, planning, and exercising provide valuable touch points with the business and technology resources. If those touch points are complex, time-consuming, boring, and lecture-centric they won't encourage future participation. Additionally:

- consider each business interaction as a time to engage with the business and use it as a selling point to show the value of the program.
- integrate into current day-to-day processes wherever possible for sustainability



Tips for successful planning



Practical

Things You Should Be Doing

To help your organization prepare for the changing face of crisis

Control Environment

Internal audit can help set the organizational tone and influence the crisis management consciousness of its people while providing the required levels of discipline and structure.



Engage the board and executive management in conversations regarding crisis-related risks and potential triggers.



Leverage the board and audit committee's expertise and lessons learned on navigating crises.



Encourage the development a crisis plan and actionable playbook with defined roles and responsibilities for crisis management.



Help management define crisis and distinguish between routine and novel crisis and applicable response mechanisms.

Risk Assessment

Internal Audit can help organizations identify the myriad of external and internal risks that the achievement of strategic and operational objectives.



Expand the audit universe to include non-traditional and strategic risks such as geo-political, environmental, socio-economic, terrorism, etc.



Don't just look at threat risk but also consider missed opportunity risks.



Conduct surveys to assess crisis risk awareness and readiness throughout the organization.



Integrate crisis risk assessment into the annual risk assessment efforts.

Control Activities

Assurance regarding the presence and ongoing effectiveness of crisis management procedures at all levels and in all functions of the organization.



Periodically test the design and operating effectiveness of business continuity, disaster recovery, resilience and crisis management plans.



Conduct regular simulations testing/validation on established crisis approach.



Observe and evaluate the completeness and effectiveness of war gaming and simulation testing.



Consider the prevention, quick response/recovery and resiliency as part of the objectives of internal controls and audit plans.

Information and Communication

Effecting communication to ensure information flows down, across and up the organization as well as with external stakeholders that inform and are impacted by crisis management.



Provide guidance to management in the development of crisis management framework and capabilities.



Engage crisis management personnel in internal audit rotations to facilitate knowledge sharing.



Gather and share crisis management leading practices from outside the organization.



Develop and communicate using standard and consistent crisis management language.

Monitoring

Ongoing monitoring to assess the quality of the crisis management system's performance over time. Continuous improvement via upstream reporting and implementation of applicable corrective actions.



Perform post-crisis reviews and assessments.



Create and roll out a consistent lessons learned approach and methodology for continuous improvement.



Continuously scan operating environment for potential crisis triggers and understand their impact and ramifications.



Perform benchmarking of organizational crisis management capabilities and performance.

Recap



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Appendix: References for slide #2

Numbers under crisis triggers reflect 2014 statistics

Sources:

Financial disruption: Almost **27,000 business** bankruptcies in U.S. alone
<http://www.uscourts.gov/Statistics/BankruptcyStatistics/2014-bankruptcy-filings.aspx>

Cyber-attacks: Nearly **430 cyber-attacks every week** in over 250 companies globally
<http://www.hacksurfer.com/posts/the-cost-and-frequency-of-cyber-attacks-continually-rise>

Confrontations: Nearly **200,000** man-days lost from major work stoppages in the U.S. alone <http://www.bls.gov/news.release/wkstp.nr0.htm>

Technological & industrial: **860,000** occupational incidents everyday globally
http://www.ilo.org/global/about-the-ilo/media-centre/press-releases/WCMS_301233/lang--en/index.htm

Misdeeds & financial crime: Almost **90** corporate fraud and embezzlement cases in U.S. <http://www.irs.gov/uac/Statistical-Data-Corporate-Fraud>

Other catastrophes: More than **980 events** globally
<http://www.iii.org/fact-statistic/catastrophes-global>





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