

Focus Areas for Internal Audit



Traditionally, stakeholders perceive Internal Audit (IA) as a function, which helps in mitigating risks by ensuring regulatory and financial reporting compliance with a focus on operational and financial risks. However, accelerating change has redefined the business landscape in the last few years. Increased competition; newer technologies and financial instruments; changing cost structures and evolving regulations; increasingly integrated global economies; and other developments are creating new risks and opportunities for organizations to consider. Hence many IA teams should seek to more broad based and adopt a holistic approach to become business partners supporting an organisation's strategic plans.

Considering this, we have pulled together a summary of emerging focus areas that IA teams may want to monitor as they formulate their plans for the coming fiscal year.

Internal Audit – What should be the key focus areas?

Foreign Exchange Management

Many companies are turning to external commercial borrowings (ECB) or direct lending from foreign lending institutions due to limited sources of domestic financing. But the rising volatility in foreign currencies can exert pressure on debt servicing of such foreign currency loans.

The IA function needs to focus on company's policies and procedures, has to assess foreign exchange management and hedging practices for efficient handling of currency fluctuation risks.

Cost Management

Continued economic uncertainty due to Euro zone debt crisis, political instability in many parts of the world, etc. is pushing companies to focus on cost management programmes. This leads to increased level of risks as processes are streamlined, headcounts are reduced, pressures to produce financial results are increased, and overall morale within the organisation declines.

It is important for the IA Function to review key cost management initiatives to ensure the control environment is not negatively impacted, that strategic initiatives are not undermined, and that the business cases supporting the cost management programmes are tracked to ensure that objectives are met and that new risks that arise are appropriately addressed.

Capital Projects

Large capital projects typically involve thousands of transactions with multiple vendors and incur huge costs, thus creating significant risks for an organisation.

The IA function should play a role in providing assurance to the Board that capital projects are being monitored effectively. It should also ensure project governance and ascertain if adequate project controls are in place for mitigation of various risks (i.e. material price escalation, etc.). Other focus areas for the team include compliance with contractual and regulatory requirements, potential cost recoveries and savings (using data analytics), and process improvements.

International Expansion/Entry Into Emerging Markets

With many companies expanding into emerging markets, the risks associated with these markets such as bribes and other fraudulent behavior, regulatory compliance, supply chain related issues (including business disruptions), and the challenge of attracting and retaining skilled resources increases.

The IA function should proactively help the management and the board to understand the control environment (including anti-bribery, corruption and other forms of fraud), identify opportunities to enhance the environment and ensure appropriate business continuity processes are in place in the event of political instability or natural disasters.

Mergers and Acquisitions (M&A)

Many IA functions, typically are not asked to participate in M&A activity, while some are brought in only to perform a post acquisition review of the acquired company's control environment.

The IA function should provide insights into the control environment of the target before the deal is closed. It should also seek to add significant value in performing process reviews of the key M&A activities, including the due diligence process as well as the overall integration planning process. The IA team can also carry out post acquisition reviews to ensure that the synergies used to justify the acquisition are actually being tracked and accurately reported.

Extended Enterprise/3rd Parties/Joint Ventures

The increasing use of external business relationships which include supply side partners, demand side partners, strategic alliances and joint ventures, etc. lead to significant benefits. But, there are underlying business risks if these relationships are not managed properly.

The IA function should assess adequacy of the contracting process, the level of integration of these third parties into the overall business continuity plan, appropriateness of IT security controls, the adequacy of vendor due diligence performed prior to vendor acceptance, and the effectiveness of the ongoing monitoring of the health of each key third party to ensure continued delivery of the product or service.

Large Scale IT implementations

There are a myriad of emerging risks in the IT area that IA should be focused on. However, the IA function can't lose site of the significant risks associated with the more traditional large scale IT implementations/ transformations. These involve significant capital, result in significant changes to existing processes, and have a number of extended enterprise impacts, all of which potentially increase the risks within the business.

The IA function should be involved up front in the pre-implementation reviews to ensure the stated goals and objectives are being achieved and necessary controls are being embedded into the technology during implementation. Post implementation reviews should also be conducted to ensure the system is actually operating as designed and stated goals and objectives (on which the business plan was based) are being achieved.

Talent Management and Succession Planning

The strategic importance of talent management to every organisation, especially those entering emerging markets is gaining importance.

The IA function should be engaged in assessment of the talent acquisition and management processes within organisations. The IA function should also determine if the succession planning process of the organisation has adequately identified and managed human resources risks to ensure operational continuity. It can also systematically evaluate and monitor the ongoing career development and succession planning policies, programmes and initiatives of the organisation and make recommendations for any necessary changes.

Information Security/Data Privacy

Increasing use of social media, the 'cloud', the need to leverage and protect massive amounts of data, and the reputation risks from high profile breaches have moved information security high on the corporate agenda.

Hence, these risks are high on the list of focus areas for IA.



Cloud Computing

Due to the dynamic nature of cloud computing, the location of the processing facility may change many times throughout the day due to load balancing. The operating facility may be shared with a number of companies including direct competitors. The vendors providing all or part of the cloud service may be immature and the number of external interfaces can significantly increase vulnerabilities to attack and/or loss of data, and users within the organisation can deploy cloud applications without the appropriate support from IT.

The IA team needs to recommend measures that the organisation needs to take to mitigate the various risks that arise out of cloud computing.

Social Media

Lack of defined policies and procedures on how an organisation and its employees interact via social media / social networking can increase the risks of non compliance with regard to existing laws and regulations, loss of productivity due to 'surfing', negative impact on a company's reputation/brand and/or the lack of a coordinated response from the company to negative feedback, unclear or undefined ownership of information on social media sites, and the omission of social media in established data retention and e-discovery requirements.

The IA function should ensure appropriate policies and procedures are in place to mitigate risks arising from use of social media.

Environmental and Sustainability Risks

Risk exposure, competitive advantage and reputation of a business could be affected by environmental and sustainability issues.

The IA team should understand the environmental and sustainability risks, which impact the business and tailor services and projects to target these risks and educate the

business. It should also lead the business to understand and manage all environmental and sustainability risks within the business.

Culture

An organisation's culture is a critical component of the overall control environment.

The IA function should include culture as a part of their annual IA plan. The company's policies should be aligned to the organisation's philosophy and culture. IA can undertake a review of the same by performing behavioral assessments, including organizational culture as a standard element of audit programs and reporting, review of the whistleblower hotline program, etc.

Mobile Devices

The proliferation of laptops, netbooks, tablets, smart phones, USB drives, etc have significantly increased the risks associated with information security and data protection.

The IA function should review the existing policies and procedures to ensure the information security and data protection risks are being appropriately managed and mitigated.

Regulatory Compliance

The need to comply with new a number of new regulatory requirements while at the same time dealing with enhanced enforcement measures on many existing requirements. A recent Thomson-Reuters survey estimates that global organizations had to deal with 60 new regulatory requirements per day in 2011.

The IA function should review how well a company's compliance activities are being performed – how new regulatory requirements are identified, how necessary business changes are identified, how ongoing compliance activities are monitored, etc.

Contact us

Raajeev B Batra

Partner and Co-Head
Governance, Risk and Compliance Services

T: +91 22 3090 1710

M: +91 99670 16363

E: rbbatra@kpmg.com

Romal Shetty

Partner and Co-Head
Governance, Risk and Compliance Services

T: +91 80 3065 4100

M: +91 98450 97097

E: romalshetty@kpmg.com

kpmg.com/in

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2012 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.