



Audit Committee's Focus on Risk Management Changing Internal Audit Function

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With Section 404 compliance no longer consuming such a large portion of internal audit's resources, some audit committees are asking their internal audit departments to expand their responsibilities beyond financial audits and 404 to include risk management as well.

"As audit committees are focusing more on risk management, many are calling on their internal audit departments to provide periodic assessments of the company's risk management processes and the adequacy of the company's controls for its risks," says Caryn Bocchino, a senior manager of KPMG's Audit Committee Institute (ACI).

However, some audit committees believe their internal audit departments should not take on significant additional responsibilities for risk management. Instead, they say internal audit should remain focused on financial audits and internal controls.

Internal auditors have a number of tools at their disposal, including financial and forensic audits, risk assessments and operational audits that can help audit committees most in their oversight of risk management.

"Management should be telling the audit committee, 'Here are our controls for our top three risks,'" David Richards, president of the Institute of Internal Auditors (IIA), said at the ACI's Audit Committee Issues Conference in January.

Typically, management is asked to describe how effectively risks are being mitigated, Richards said. Then, the audit committee turns to the internal auditor to ask if those controls are working.

In a survey conducted by ACI at its annual Issues Conference in Miami and Phoenix, nearly 160 audit committee members identified risk management oversight as their highest priority for 2007. At last year's conference, they identified it as their second-highest priority.

In addition, 72 percent of people surveyed said their audit committee relied on internal audit to support committees' oversight of risk management.

During a Webcast held by the IIA and The Value Alliance and Corporate

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Governance Alliance, Richards described how operational audits -- an evaluation of the effectiveness and efficiency of a particular business unit in relation to the overall company policies and budgets -- can assist an organization in understanding core strengths and weaknesses.

This understanding is critical in determining corporate strategies and the risks associated with them. "It's a process review," Richards said. "It adds a real value to the organization because it helps that organization figure out how things get done vs. the stated goals and objectives of that process."

A survey of participants in the Webcast found that 55 percent used operational audits to "inform strategic conversations about the core competencies or strengths and weaknesses" of the company.

Operational audits can help audit committees obtain a bigger and clearer picture of their companies' risk portfolio.

James C. Key, an audit committee member of Coastal Banking in South Carolina and principal of consulting firm Shenandoah Group in Beaufort, S.C., believes through operational audits, internal audit departments can focus on assurance responsibilities as well as compliance duties.

"Internal audit should be looking at the near-misses in the newspapers," Key says. "Those are the risks that others are looking at."

James T. Brady, who chairs the audit committees for Constellation Energy Group, McCormick & Co., T. Rowe Price and NexCen Brands, says the collaborative nature of the relationship between the audit committee and the internal audit department makes it a natural to help initiate the risk management oversight process.

"The audit committee can be a catalyst to see that a full risk management inventory is done," Brady said. "Some risks would go to the compensation committee or the risk committee."

Shenandoah Group's Key notes that a major part of the audit committee's role as catalyst is its relationship with the internal auditor, especially in regards to risk management oversight.

"The chief audit executive should use his position and power to have a [risk management] discussion at least annually with the audit committee," Key says. "This way the audit committee can say, 'we have it covered,' or 'we didn't know about that.'"

Eleanor Bloxham, CEO of The Value Alliance and Corporate Governance Alliance, stressed that the internal audit department needs to understand what risk management information the audit committee wants.

"One of the starting places for the audit committee is to be clear about what information they want," Bloxham said during the IIA Webcast. "By clarifying that, it moves the audit committee into a position where they can bridge the internal control disclosure gap."

As internal audit focuses more on operational audits and risk management, audit committees need to review the internal audit's mission and responsibilities and ensure that they are consistent with the charter, Bocchino said.

"As audit committees rely more and more on internal audit to support the committee's oversight activities in areas such as risk and compliance," she said, "it's also important they take a close look at internal audit's resources and ensure that the department's resources are properly aligned with its responsibilities."

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