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Top 10 key risks in 2015

KPMG Internal Audit

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The role of an effective internal audit (IA) function today is much more than simply compliance. Competing in a rapidly changing business world, companies must grapple with emerging challenges seemingly every day: new and complex regulations, cyber threats, increased reliance on data and analytics, mergers and acquisitions, expanding international operations, outsourcing, and more.

IA needs to stay current with these wide-ranging business issues as they emerge so it can remain relevant to the organization. These business trends carry new risks, and IA needs to continually monitor these risks and their potential effects on the organization. To provide the greatest value, IA must find opportunities to challenge the status quo to reduce risk, improve controls, and identify potential efficiencies and cost benefits across the organization.

To help IA functions achieve these goals, KPMG LLP (KPMG) has surveyed its professionals and IA departments from companies in multiple industries. The result is **KPMG Internal Audit: Top 10 key risks in 2015,** which outlines areas where IA can improve its focus so it can more effectively add value across the organization and maximize its influence, including allocating its resources in those areas of highest impact to the organization.

Top 10 key risks in 2015

1	Cybersecurity
2	Regulatory compliance
3	Antibribery/Anticorruption
4	International operations
5	Third-party relationships
6	Mergers, acquisitions, and divestitures
7	Strategic alignment
8	Integrated and continuous risk assessment
9	Data analytics and continuous auditing
10	Talent recruitment and retention

1 Cybersecurity

Drivers:

- Avoiding costly consequences of data breaches such as investigations, legal fines, coverage of customer losses, remediation efforts, loss of executive and mid-level time and focus, and potential loss of customers and business
- Averting reputational damage to the organization, especially with regard to lost customer data
- Preventing loss of intellectual property and capital and other privileged company information

In today's world of constant connectivity, cybersecurity is a key focal point for many companies. Cybersecurity frequently appears on the top of many board agendas, and data security breaches now appear to be headline news almost on a weekly basis. Several factors have driven the increased attention paid to cybersecurity issues, including changes in the threat landscape, rapid changes in technology, changing regulatory environments, social change, and corporate change. The capabilities and techniques used by hackers are continuously growing and evolving, especially concerning targeting specific information or individuals. New methods are constantly being developed by increasingly sophisticated and well-funded hackers who can target companies not only through networks directly but also through connections with key suppliers and technology partners. The consequences of lapses in security can be disastrous as an organization's bottom line and reputation are impacted. It is critical that all companies remain vigilant and up to date regarding recent protection criteria.

How Internal Audit can help:

- Perform a top-down risk assessment around the organization's cybersecurity process using industry standards as a guide, and provide recommendations for process improvements
- Review existing processes to help ensure management considers the threats posed in the constantly evolving environment
- Assess implementation of revised technology security models, such as multilayered defenses, enhanced detection methods, and encryption of data leaving the network
- Assess third-party security providers to evaluate the extent to which they are addressing the most current risks completely and sufficiently

2 Regulatory compliance

Drivers:

- Ensuring compliance with an increasing number of regulations, both domestically and abroad
- Controlling the increasing costs of complying with this growing number of regulations
- Developing a strategy to lessen the restraining effects of compliance activities on business operations
- Ensuring compliance operations are aligned following a merger or acquisition

Companies, regardless of industry, are being inundated with new regulatory requirements, both domestically and abroad. These new regulations are putting increased burdens on chief compliance officers and their staffs, raising the possibility that certain compliance requirements are being missed. In addition, meeting this raft of new regulations is adding considerable cost to a company's compliance budget and complexity to internal structures and information needs. Mergers and acquisitions are also on the rise, which means companies need to combine their compliance function with that of their acquired entity and ensure a holistic approach to corporate compliance.

How Internal Audit can help:

- Inventory regulatory bodies and requirements affecting the company
- Assess the company's approach to managing its global compliance activities, including integration of the requirements of acquired companies
- Evaluate the company's response to any notable instances of noncompliance
- Ensure compliance training programs offered to employees and other stakeholders are appropriate for role and geography

3 Antibribery/Anticorruption

Drivers:

- Identifying emerging regulatory and compliance risk, such as that introduced by organic expansion into new markets, third parties, and acquired businesses
- Providing insight to stakeholders regarding the effectiveness of existing antibribery and corruption compliance activities
- Preserving the company's ability to control when it discloses a potential violation to the regulators

According to some estimates, the average cost related to resolution of a Foreign Corrupt Practices Act (FCPA) matter was more than $80 million in 2013, representing Justice Department and Securities and Exchange Commission fines, penalties, disgorgement, and prejudgment interest. Viewed in this context, it is easy to understand the amount of attention companies have paid to understanding their bribery and corruption exposure and to evaluating their current compliance programs.

The benefits of an effective antibribery and corruption compliance program, calibrated for a company's specific risk profile, are clear. Clearly written policies that spell out prohibited activity, the commitment of executive management to antibribery and corruption efforts, periodic training, audit clauses in agreements with third parties, and vigilance by compliance personnel can deter bribery and corruption, thereby reducing the risk of costly and disruptive regulatory enforcement activity and financial loss. Should the unthinkable occur, a well-designed and executed antibribery and corruption compliance program may mean the difference between a prosecution and a nonprosecution agreement and may even reduce the amount of monetary fines and penalties levied.

How Internal Audit can help:

- Conduct a gap assessment of the organization's existing antibribery and corruption procedures in relation to leading practice regulatory guidance
- Provide assurance regarding the design and operating effectiveness of the organization's applicable preventative and detective controls
- Enhance internal audit return on investment by embedding antibribery and corruption procedures into its existing/scheduled audits and third-party oversight activities
- Surface bribery and corruption risk through data analytics and third-party audits
- Lead or lend resources to investigations into matters involving potential noncompliance
- Drive continuous improvement through testing and evaluation of the organization's antibribery and corruption program

4 International operations

Drivers:

- Enhancing oversight and visibility into international operations, especially with regards to regional geopolitical issues
- Achieving greater confidence in the propriety of local business practices and compliance with corporate policies and regulations
- Increasing consistency of business practices and processes across regions
- Reducing risk of noncompliance with export laws and other relevant regulations

As companies expand operations globally, they face a number of unique challenges and risks. International operations require companies to confront a multitude of issues ranging from product quality to complying with complex local regulatory requirements. Geopolitical issues (such as sanctions, embargoes, and cross-border trade regulations) add yet another dimension of complication to dealing with foreign countries, requiring companies to have detailed knowledge around world events and evolving expectations. Additional risks include inconsistency in business practices, inadequate corporate oversight, and complicated and changing legal and regulatory requirements.

How Internal Audit can help:

- Review overall key process areas and control environment, including compliance with U.S. and local requirements (such as import and export regulations)
- Review business practices, potential code of ethics violations, and antibribery and corruption issues among foreign entities or business partners
- Facilitate communication of the company’s risks, controls, and better practices to international employees to support consistent application of corporate policies and procedures

5 Third-party relationships

Drivers:

- Increasing oversight of third-party relationships
- Enhancing revenue and cost reduction
- Improving contract governance
- Creating more effective contractual self-reporting processes
- Preventing or timely detecting risk management failures at third-party business partners

To boost productivity and efficiency, companies are increasingly relying on third parties to carry out vital business functions. But using third parties can expose companies to new risks and potential compliance failures that can lead to fines, lawsuits, operational bans, and reputational damage.

Business partners may not mean to do so deliberately, but they can fall short due to the complexity of the environment or their agreements. Often, third parties can have access to companies' networks, increasing the possibility of data breaches, or companies can be unaware that third parties are employing subcontracts that may be lax in their business and compliance efforts. Finally, third parties can operate in areas of political uncertainty, exposing contracting companies to further risks. Given all these factors, companies need to ensure they are getting the most benefits from these external relationships while having in place appropriate controls to reduce risks.

How Internal Audit can help:

- Review third-party identification, due diligence, selection, and onboarding processes and controls
- Evaluate contract management processes used by management to track third-party relationships
- Monitor regulatory developments related to third parties
- Enforce and ensure consistency of right-to-audit clauses
- Enforce third-party compliance with company's information security standards
- Develop, implement, and calibrate a continuous monitoring system of self-reported data from third-party business partners

6 Mergers, acquisitions, and divestitures

Drivers:

- Assessing the strategic risks of merger and acquisition (M&A) and divestitures activity, including impacts on other parts of business
- Implementing a more rigorous and better-controlled M&A program to identify and manage these risks, as well as obtaining validation of transaction risk and expectations prior to communicating them to shareholders
- Enhancing execution planning, delivery, and performance tracking
- Improving integration (or carve-out) processes across all key functions

M&A activity has been rebounding over the past year and is expected to continue throughout 2015, with dealmakers encouraged by low interest rates, record stock prices, improving employment numbers, and an abundance of cash.[1] This trend puts an added emphasis on companies having the proper due diligence and integration mechanisms in place to ensure they extract the most value from each deal. A need to manage execution risk more effectively is also leading many companies to design additional rigor into their merger, acquisition, and divestiture programs to help ensure a fact-based and well-controlled diligence, valuation, planning, and execution process.

How Internal Audit can help:

- Perform "post mortem" reviews on prior deals or divestitures to assess effectiveness of procedures and playbooks
- Assess adherence to accounting and internal control due diligence checklists that address key deal areas (e.g., quality of earnings and assets, cash flows, unrecorded liabilities) and identify internal control gaps for both the acquired company and on a combined basis
- Understand communication processes between finance, internal audit, and deal teams to assess control implications of executing business process change during active integrations or divestitures
- Perform a project risk assessment review of the business integration or divestiture process, focusing on potential risks, integration success metrics, and information systems

[1] KPMG's 2015 M&A Outlook Survey Report. http://www.kpmgsurvey-ma.com/

7 Strategic alignment

Drivers:

- Ensuring IA aligns to the company's strategic priorities and remains relevant in light of organizational and other transformational change
- Ensuring IA is involved in key strategic initiatives of the company, whether through consultation or reviewing progress/outcomes

Business transformation has taken hold across the broad corporate landscape due to the confluence of several important triggers, including a tipping point in globalization, a major slowdown in Western economies, significant shifts in technology and energy costs, and the challenges of regulatory compliance. When a company's transformational and other goals lead to strategic objectives and initiatives, IA should be an active participant in considering impacts to risk and related governance and controls. Often, efforts to bring about strategic change can sometimes neglect to revise internal controls to conform to new business models. IA brings a unique perspective to strategic change and should be present and active in key strategic initiatives.

How Internal Audit can help:

- Ensure resources are being allocated toward the most important objectives and initiatives of the organization
- Sharpen focus on areas outside of corporate governance that are not as often associated with the internal audit function, e.g., selected management processes, IT and data management, and operational risks
- Determine how the company is assessing risk related to major strategic initiatives and how it is managing change related to those initiatives
- Ensure IA is positioned properly in alignment with the company's strategy

8 Integrated and continuous risk assessment

Drivers:

- Breaking down of silos and creating an environment where all functions understand the risks facing the entire organization
- Developing processes to assess and address changing risks
- Obtaining relevant risk-related metrics in a timely manner to allow for decision making
- Increasing the frequency of risk refresh practices so that resources are allocated appropriately on a real-time basis

In the past, an annual risk assessment by the internal audit department would set a company's internal audit plan for the coming year. However, there likely were uncoordinated risk assessments occurring throughout the organization as other risk oversight functions gathered information to fulfill their mandates. In addition, companies are facing an increasing number of risks, which are evolving all the time.

Organizations have recognized the need to have a more integrated view of risk, which should be informed by a coordinated risk gathering/update exercise. To help ensure an effective integrated risk identification effort, a number of foundational components are key: a common risk language that includes issue ratings, a coordinated risk assessment program to minimize duplication of effort, a coordinated audit execution process to allow for other risk and control functions to participate, and a coordinated reporting regiment.

Combining this integrated risk assessment with the technical ability to gather key risk and performance indicators that inform the risk owners and IA can create a more dynamic planning process. Although this continuous risk assessment process comes with its challenges (e.g., data quality, data availability etc.), it creates the opportunity to not only catapult the value of IA and other risk and control oversight functions to a new level, but it can also ultimately be adopted by management to improve the overall risk and control awareness and environment. Once the latter is achieved, IA can move to a more advanced level of monitoring and continuous risk assessment.

How Internal Audit can help:

- Coordinate a holistic approach to enterprise risk assessment, one that serves as IA's starting point in building the audit plan
- Facilitate an integrated risk assessment including all relevant functions within an organization to help ensure common risk language and understanding of company-wide risk
- Pilot continuous risk assessment for a small subgroup of risks to demonstrate its benefits
- Evaluate the company's ongoing approach to risk management in light of enterprise risk assessment results

9 Data analytics and continuous auditing

Drivers:

- Enabling real-time, continuous risk management
- Increasing overall efficiency of audits being performed (frequency, scope, etc.)
- Taking a "deeper dive" into key risk areas through analysis of key data
- Reducing costs involved in auditing and monitoring
- Enabling early detection of potential fraud, errors, and abuse

In the past few years, data analytics have helped to revolutionize the way in which companies assess and monitor, especially in terms of efficiently expanding the scope of audits and improving detail levels to which audits can be performed. Data analytics and continuous auditing can help IA departments simplify and improve their audit processes, resulting in higher quality audits and tangible value to the business. Consider the traditional audit approach, which is based on a cyclical process that involves manually identifying control objectives, assessing and testing controls, performing tests, and sampling only a small population to measure control effectiveness or operational performance. Contrast this with today's methods, which use repeatable and sustainable data analytics that provide a more thorough and risk-based approach. With data analytics, companies have the ability to review every transaction—not just samples—which enables more efficient analysis on a greater scale. IA departments should collaborate with their organization to develop and implement a cohesive strategy to leverage data analytics for the benefit of the company as a whole.

How Internal Audit can help:

- Assist in creating automated extract, transform, and load (ETL) processes, along with system-generated analytics and dashboards monitored by the business against specified risk criteria
- Assess the alignment of the strategic goals and objectives of the company to risk management practices and monitoring and prioritization of the strategic objectives and risks on a continuous basis
- Promote data analytics enabled audit programs designed to verify the underlying data analysis and reporting of risk at the business level
- Implement automated auditing focused on root cause analysis and management's responses to risks, including business anomalies and trigger events
- Recommend consistent use of analytics, including descriptive, diagnostic, predictive, and prescriptive elements

10 Talent recruitment and retention

Drivers:

- Increasing participation by IA in company strategic initiatives
- Expanding role of IA to include review of enterprise risk management approaches; governance, risk, and control activities; operational improvement initiatives; and other areas beyond a historical compliance-based scope
- Increasing complexity of business practices and governance programs requiring IA review and challenge
- Shortage of strategic-thinking business professionals to execute IA's mission

Increasingly, IA is being called upon to expand its presence in more areas of the organization and become a strategic partner in the business. If IA is to successfully execute on its growing mission, it will need access to talented professionals and specific subject-matter experts knowledgeable of where the company's risk profile is changing. This need is made even more acute given today's scarcity of high-quality talent. An organization has several options for how to fulfill its needs, including full-time hires, outsourcing, and cosourcing. The challenge is ensuring the right talent is hired, retained, motivated, and developed to help the company achieve its business objectives and strategies. Companies also need to evaluate risk mitigation plans for top talent departures.

How Internal Audit can help:

- Review IA resource needs based on realistic views of executing the IA plan
- Assess new resource needs as IA becomes more involved in the business's strategic initiatives
- Conduct internal competency assessment for current resources to understand gaps in needed skill sets
- Determine areas in which specific subject-matter professionals are needed as IA expands roles beyond compliance
- Build relationships with external service providers to leverage these subject-matter professionals and resources when needed
- Provide IA professionals with training and development programs tied to regulatory developments, as well as wider business objectives beyond compliance
- Ensure company hiring practices actively consider IA needs and stay closely involved in the hiring process for full-time auditors

About the author

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Patty is a managing director in KPMG's Risk Consulting practice focused on delivering risk-based internal audit services. She has extensive experience leading enterprise risk management projects, internal audits, IA quality assessment reviews, controls implementations and assessments, and compliance reviews across multiple industries, including financial services, technology, manufacturing, and transportation.

Patty serves as KPMG's national leader for Internal Audit Quality Assessment Reviews, where she leads teams focused on helping internal audit functions evolve towards world-class status. In this role, Patty sees first-hand the risks and challenges faced by internal audit departments as they serve the needs of their stakeholders.

About KPMG

KPMG's internal audit, risk, and compliance services are designed to help enhance the efficiency and effectiveness of internal audit functions, enterprise risk management programs, reviews of third-party relationships, regulatory compliance, governance, and sustainability initiatives. Our professionals bring both deep technical and industry experience, allowing you to strengthen your key governance, risk management, and compliance efforts while at the same time enhancing your business performance.

Our experienced professionals can help you navigate the complex demands of regulators, directors and audit committees, executive management, and other key stakeholders, and assist you in transforming disruptive marketplace and regulatory forces into strategic advantage.

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