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Internal audit: Unlocking value for media companies

Top 10 internal audit considerations for media companies

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This paper outlines the critical role of internal audit in helping media companies manage today's most important risk areas—and unlock underlying value in the process.

As digitization disrupts the media industry, we explore the top 10 focus areas for media company internal audit functions as they strategize and make investments, as informed by:

- KPMG LLP's (KPMG) discussions with chief audit executives at media companies
- Insights from KPMG professionals who work with media companies
- Various KPMG-sponsored industry and technical accounting share forums
- KPMG survey data, including, for example, a recent study, "Seeking value through internal audit," in which KPMG and Forbes surveyed more than 400 chief financial officers and audit committee chairs to identify contributions by internal audit functions as well as opportunities for improvement.

Note: Every media company is unique and it is important that internal audit rely on a company-specific analysis of its risks in developing its internal audit focus areas.

Top 10 internal audit considerations for media companies

1. Advertising revenue
2. Third-party relationships
3. Big data
4. Cybersecurity
5. Data analytics
6. Customer experience
7. Nontraditional competitors
8. Mergers and acquisitions
9. Intellectual property (IP) protection
10. Over-the-top (OTT)

1. Advertising revenue

Drivers:

- Advertisers on media company channels and properties seeking online and mobile distribution channels versus traditional mediums
- New metrics for advertising measurement focused on a very targeted, digital audience
- Evolving advertising revenue models based on these new metrics

As consumers shift away from traditional channels and consume more media on their own personal devices, advertisers on media company channels and properties are following suit. After all, brands want a presence where consumers are most likely to see them. Research by eMarketer projects that in 2017, digital ad spending will surpass TV ad spending, equaling $77.37 billion, or 38.4 percent of total ad spending; smaller percentages of advertising will go toward print, radio, out-of-home, and directories[1].

In this dynamic environment, online and mobile advertising—search ads, banner ads, pay-per-click ads, mobile ads, pop-ups ads, social media ads, and many more—are critical pieces of media company revenue streams. As such, media organizations need to continually reinvent new advertising products and vehicles. They also need to develop new capabilities to track and evaluate the performance of new digital offerings. This can present a greater challenge than for traditional advertising, as the data is available in real time and at an incredibly granular level.

It is also worth noting that media companies are also advertisers themselves. They advertise their own services and content, and as such will need to respond to the same digital trends impacting the advertisers on their own channels and properties.

By monitoring risks and controls around advertising processes and performance metrics, internal audit can assist media organizations in evolving more effective models to quantify and grow digital ad sales, as well as make their own advertising activities more impactful.

Example focus areas for internal audit:

- Evaluating advertising sales department performance, including assessing how sales identifies and executes on new ad metrics and mediums, such as complicated models related to pop-up, click-through, and programmatic ad sales
- Reviewing budgetary processes and controls, including monitoring billing of advertising campaigns and placements against initial estimates and actual outcomes
- Evaluating ad pricing strategies, including how sales allocates and prices ads to the right customers to maximize revenue
- Performing contract compliance audits on advertising and promotional agency agreements
- Assessing innovation processes related to advertising programs

[1] Digital Ad Spending to Surpass TV Next Year (eMarketer, March 8, 2016)

2. Third-party relationships

Drivers:

- Increasing use of third parties to carry out vital business functions
- Securing sensitive data that may be stored and utilized by third-party vendors
- Mitigating risks unique to managing outsourcing relationships
- Cost cutting measures often focused on outsourcing non-core-business functions

Media companies leverage third parties for a variety of services, such as billing, network operations, information technology (IT) support, data center hosting, customer service, pre- and post-production, or ad sales management. Outsourcing these and other activities can free up organizational resources to focus on core competencies and help reduce costs.

Further, media companies enter into third-party partnerships for both revenue generation and market penetration, such as spin-off shows, product placements, product endorsements, and other joint advertising and marketing efforts.

While third parties provide valuable services and go-to-market strategies, they can expose an organization to financial, compliance, legal, operational, and reputational risks—especially relationships with smaller companies that may not have the same control discipline as larger companies. These risks can be extensive, including revenue loss or penalties, data privacy breaches, service disruption, bribery and corruption, contract non-compliance, or inaccurate reporting and payments. For example, content licensing relationships could potentially enable proprietary media content to be viewed or used by consumers for less than fair market value—or even for free.

Organizations have the ability to outsource a variety of tasks, but they remain accountable for these outsourced activities. An effective third-party management program, such as one that incorporates third-party risk assessment, due diligence, and ongoing monitoring, can help companies manage their exposure to these risks.

Example focus areas for internal audit:

- Evaluating the methodology the organization uses to evaluate, contract and monitor its relationships with third parties
- Executing risk-based third-party reviews

3. Big data

Drivers:

- Managing proprietary programming content
- Leveraging advanced big data tools and techniques to adapt quickly to rapidly evolving business demands
- Validating and maintaining the accuracy, integrity, and versioning of a company's big data
- Increasing usability and metadata comprehension by business owners
- Operationalizing metadata to make it actionable
- Complying with the global business and regulatory data requirements

Media companies own and use a tremendous amount of data—and not just internal data, the kind found in every business. In the media industry, big data platforms capture and store an explosion of customer interaction data that is valuable to advertisers and to the business itself. Companies also use big data for the curation of content. And perhaps most importantly, there is proprietary programming content, which offers competitive advantage.

Big data is an incredibly valuable asset—even a currency for the media business. That's what makes data governance so important in the media industry. Big data that is poorly managed, lost, or leaked will not be available for analysis or monetization. It might even find its way to competitors. Or it might cause the company to suffer legal and regulatory consequences.

Internal audit plays a key role in ensuring big data does not cause big problems by supporting robust data governance across the entire data lifecycle.

Master data management is one key focus area. This involves policies and processes to control how data is created, gathered, centralized, cleaned, warehoused, accessed, and used.

In addition, internal audit must evaluate compliance with global business or regulatory data requirements designed to increase transparency and accountability for the use of data. These data rules vary by jurisdiction across the world. Certain types of sensitive personal data are specifically regulated. There are also rules that require companies to tell customers exactly how their data will be used and shared, as well as obtain customer consent to use their data. And there are data disclosure requirements that require some companies to disclose how they gather data from users and how their algorithms work to prove they are only using allowable data for allowable purposes.

Effective data governance enables a top-down, enterprise-wide view of big data. It addresses questions over data ownership and ensures adherence to policies that govern what data is important and how data is created, stored, aggregated, warehoused, analyzed, and used. Data governance is critical to keeping data private and helping the business turn data into insights.

Example focus areas for internal audit:

- Assisting in the formation or review of data governance policies and processes
- Reviewing the data model and points of control to identify security gaps, including data classification issues
- Reviewing the company's ability to respond to new internal policies and external regulations impacting how the company stores, secures, and uses data
- Evaluating the company's compliance with data privacy regulations, including the General Data Protection Regulation (GDPR) and rules related to Personally Identifiable Information (PII), Protected Health Information, (PHI), and Payment Card Information (PCI)

4. Cybersecurity

Drivers:

— The evolving and expanding cyber threat landscape, with more external and internal threats

— The increasing importance of technology and connectivity to media operations

— The reputational, financial, and legal impact of a cyber breach, including the costs to remediate compromised systems, a loss of customer confidence, brand damage, regulatory fines, and legal liabilities

— The growing number of cybersecurity, privacy, and technology regulations

As the Internet becomes the primary channel for content delivery and customer data becomes more digitized and distributed, cybersecurity is top of mind for media company leaders. Numerous regulations and standards are emerging and changing to adapt to transformative technology as well as the Internet of Things (IoT). The consequences of lapses in cybersecurity can be disastrous, impacting both the bottom line and the company's reputation. A large multinational media company experienced this firsthand in 2014 when hackers infiltrated its network and published embarrassing private emails, employee personal information, and previously unreleased films to the Internet[2].

A variety of factors serve to create more cyber risks for media companies than companies in other industries. With iconic brands and popular channels, high-visibility media companies are attractive targets for hackers. In addition, media companies often have very diverse technology and systems, due to complex business relationships and creative cultures. New technologies and systems continually enter the enterprise through employees, vendors, and partners in different business segments, and they commonly utilize the same IT infrastructure or even share information assets. More importantly, as the traditional four walls of media companies become porous with mobile computing, outsourcing, and third-party business partners, it is becoming harder to determine who should have access to what systems and data.

Internal audit will play a key role in identifying cybersecurity risks, evaluating business continuity and incident response, assessing the effectiveness of cybersecurity controls, and offering strategies to strengthen the cybersecurity program.

Example focus areas for internal audit:

— Assessing the company's cybersecurity program, guided by media industry standards, cybersecurity standards, and regulations such as ISP 27001

— Performing cybersecurity maturity and penetration testing audits

— Assessing the effectiveness of identity and access controls

— Assessing the business continuity plan and data governance framework to identify priority information assets

— Assessing the cybersecurity incident response plan

— Review the company's vulnerability management and patching programs

[2] A Breakdown and Analysis of the December 2014 Sony Hack (www.riskbasedsecurity.com, Dec. 5, 2014)

5. Data analytics

Drivers:

— Addressing existing and emerging risks related to evolving business models, new technology, and the changing ways in which customers consume media services

— Leveraging big data technology and methodologies to improve audit quality and precision, reduce audit costs, and expand risk coverage and audit scope

— Providing 100 percent coverage of transactions

— Enabling real-time identification or risks and remediation of control weaknesses

— Lowering the cost of failure and increasing confidence and predictability

Using data to perform analytics that identify new and emerging risks or improve the internal audit execution process has helped improve the way internal audit departments assess and monitor risks, especially in terms of enabling expanded risk coverage and audit scope, and improving testing precision. Repeatable and sustainable data analytics can help internal audit departments simplify and improve the audit process, resulting in higher-quality audits, increased value to the business, and more precise control evaluation. Additionally, given that audit committees and stakeholders are asking internal audit to do more for less, it can allow for more controls to be evaluated, resulting in greater coverage.

While internal audit departments can realize significant benefits by employing data analytics techniques, those responsible for operations, compliance, and financial reporting have also generally increased their use of data analytics in executing their responsibilities. Internal audit departments can often leverage these platforms or assist in a consulting role to help improve processes and controls leveraging these capabilities. Although internal audit must maintain an adequate degree of separation from management responsibilities, opportunities exist to work with management to expand the use of data analytics in the business area and within the internal audit process.

Example focus areas for internal audit:

— Assisting in creating automated extract, transform, and load (ETL) processes, along with repeatable and sustainable analytics and dashboards, enabling auditing or monitoring against specified risk criteria

— Using data analytics to identify current and emerging risks as part of the risk assessment process

— Identifying data critical for each internal audit and applying data analytics techniques in the performance of that internal audit in areas such as T&E, advertising revenue reviews, etc.

— Performing automated auditing focused on root cause analysis and management's response to risks

6. Customer experience

Drivers:

— Meeting—and exceeding—consumers' increasingly high expectations for seamless, superior, omnichannel digital experiences

— Linking customer preferences across channels of interaction, such as phone, over-the-top (OTT), in-store and online

— Innovating relevant products and services to increase customer loyalty and profitability

— Reducing customer service costs and increasing process efficiencies

Media content today is being produced, delivered, and digested differently. More consumers view content on multiple mobile devices or "second screens." This changing customer behavior has made omnichannel digital content distribution essential to attracting and retaining customers and is shifting the consumer strategy conversation in the industry.

In this continually evolving landscape, more media organizations are investing in new approaches for predicting customer behavior, targeting sales and marketing, and reaching an online audience more effectively and efficiently. Companies are also seeking to increase their digital footprint; change how they interact with their audience; and create, produce, and distribute content where, when, and how consumers prefer it. Increasingly, that means offering customized content and full-time, on-demand, device agnostic options.

Internal audit, with its overall organizational knowledge and influence, can help media companies transform customer-focused processes, policies, and initiatives to create the superior digital experiences customers expect—not just from a risk, controls, and compliance perspective, but also, significantly, from a process improvement standpoint.

Even more importantly, internal audit's support can help media companies realize value from customer experience transformation, which can be a costly investment. Internal audit's involvement enables the business in staying on strategy, measuring progress, and ensuring accountability for execution.

Example focus areas for internal audit:

— Evaluating customer service processes, policies, and tools against leading industry practices

— Analyzing the organization's use of data analytics and social media monitoring to predict and respond to customer behavior

— Assessing the organization's digital strategy for threats and opportunities

— Reviewing various aspects of the information technology platforms supporting the digital build outs, including pre- and post-implementation reviews

— Evaluating the success of the customer transformation process using the key performance indicators (KPIs) and critical success factors (CSFs) that were part of the business case for investment

7. Nontraditional competitors

Drivers:

- Technology is moving at a very fast pace
- Content producers and content deliverers are converging
- Disruptors like Netflix, YouTube and Facebook have transformed the customer experience and distribution of content
- Nontraditional competitors like Amazon, Faraday Future, AT&T, Instagram, and Twitter are adding complexity in the marketplace and are becoming "media" companies in their own right

Disruption to traditional media players, caused by over-the-top (OTT) content delivery—and driven by consumer consumption habits, especially millennials—is creating a potential seismic shift in the entertainment landscape. Media incumbents are challenged by the pace and economic impact of this market disruption.

Today, digital and mobile disruptors are creating high-quality content at low cost and distributing directly to consumers through social media, mobile apps, and other nontraditional distribution channels. New entrant activity from the likes of Amazon and others has added more complexity. Consumers themselves are even becoming content creators, with a myriad of free publishing resources, like YouTube, available at the touch of a button. Consider Facebook's role as a news source in the 2016 U.S. presidential election[3].

Current incumbents are challenged by this disruption, as the economics of OTT offerings do not compare favorably to current TV economics. As such, to compete with disruptors, many media industry stalwarts are seeking to reinvent their business models, innovation processes, and marketing and branding campaigns. Many are weighing the success of platform businesses in other sectors, such as Airbnb, and are considering options to develop their own platform ecosystems.

Regardless of where a media company is in its OTT strategy development and execution, market fluidity requires continuous assessment of the OTT business and operating model. Internal audit can support these initiatives by providing oversight and assurance that risks related to new strategies, tools, and processes designed to enhance innovation and reach customers more effectively are managed and mitigated.

Example focus areas for internal audit:

- Evaluating the organization's competitor analysis that was used in the strategy process
- Evaluating innovation processes and culture against leading practices or peer organizations
- Evaluating brand or marketing campaigns aimed at retaining and attracting existing and new customers

[3] Facebook, in Cross Hairs After Election, is Said to Question Its Influence (The New York Times, Nov. 12, 2016)

8. Mergers and acquisitions

Drivers:

— Increasing volume of M&A and divestiture activity in the media sector, particularly consolidation

— Supporting and executing due diligence procedures on targets

— Focusing on strategic risks of M&A and divestiture activity

— Improving integration and carve-out processes across all key functions

— Evaluating M&A and divestiture strategies to ensure they are in the best interest of shareholders

— Ensuring the acquired or spun-off entity is SOX 404-compliant

A need to manage execution risk more effectively is leading many media 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.

Transactions involve not only significant costs—often running into the hundreds of millions of dollars—but also a significant amount of involvement from across the enterprise, starting with a strategy group that considers potential targets. Internal audit can play an especially valuable role in evaluating the strategy of transactions, ensuring the proper controls and oversight to ensure strategies put shareholder interests first. This up-front work is critical to the ultimate success of deal.

Internal audit can also contribute to a comprehensive due diligence approach that identifies risks in people, process, and technology, as well as ensuring the transaction meets regulatory requirements and the business metrics and objectives highlighted in the M&A plan.

Finally, for shareholders to ultimately realize the expected value from the deal, the integration process also must be expertly executed. Internal audit can play a key role in assessing controls around the integration process. For example, internal audit can assess whether strategic goals and metrics to measure them are tied into the integration plan, if there is a defined playbook and team to execute the integration, and if processes are in place to correct a failure or delay in the process.

Example focus areas for internal audit:

— Performing "postmortem" reviews on prior deals or divestitures

— Evaluating the organization's preparedness for an integration and performing a post transaction integration review

— Assessing adherence to accounting, internal control, and legal/compliance due diligence checklists

— Identifying internal control gaps for the acquired and combined companies

— Assessing communication controls between finance, internal audit, legal, and deal teams during active integrations or divestitures

— Assessing controls related to deal strategy, integration, and execution

9. Intellectual property (IP) protection

Drivers:

- Complex licensing, royalty, and residual contracts in the media industry
- Aligning IP strategy with business or product strategy, especially for proprietary content assets
- Ensuring IP management processes are aligned with compliance requirements
- Lowering costs related to errors and litigation

Intellectual property is at the heart of media companies' core competencies and business relationships. Media companies create and monetize their own IP in the form of original content. Many also "sell" their own content for other entities to use, in exchange for licensing and royalty fees and residuals. Complicating matters further, many media companies also buy content from other creators to distribute on their own properties, which requires them to pay fees both up front and over time.

Given the complex models for creating, buying, owning, commercializing, and monetizing IP in the media industry, protecting IP assets is a critical challenge.

Additionally, compliance training becomes a central point in making sure employees are aware of policies in place and what information is considered privileged.

Example focus areas for internal audit:

- Assessing compliance to contracts related to licensing, royalties, and protection of IP, including adequacy of contract language for IP protection
- Performing third-party reviews focused on content protection, especially in the production phase
- Evaluating billing activities to ensure third parties are paying appropriate IP licensing and royalty fees and residuals
- Evaluating the consistency of compliance standards including compliance training and awareness
- Conducting a process, gap, and risk assessment of internal IP processes

10. Over-the-top (OTT)

Drivers:

- Disruption caused by OTT has created a potential seismic shift in the entertainment landscape
- The economics of OTT offerings do not compare favorably to current TV economics
- The increasing need to distribute cross-platform content to end users on demand
- Ensuring customers are paying appropriately for the media content subscription services
- Ability to automate the content distribution workflow to increase speed and lower costs

Industry-wide technological advances and consolidation among content creators and platform providers is fueling growth in the market. Existing platform business models in other industries have had a great deal of success, with a few major players—such as Uber and Airbnb—winning the largest share of the pie.

Especially in media, the platform business model has caused a shift from control over supply to control over demand, and in a world of unbundling and numerous OTT options, consumers could begin to demand a consolidated content platform.

In the rapid shift to OTT, multiple players have the opportunity to retake market share by becoming a major platform. But with ongoing market fluidity, strategy development and execution requires continuous assessment of a company's OTT business and operating model.

OTT has a very large and complex process flow, and involves a connected set of processes and technologies. In this complex ecosystem, media companies need to understand the control mechanisms related to content ingestion, content management, content delivery and billing, as well as the underlying processes to support OTT.

Example focus areas for internal audit:

- Evaluate the organization's OTT process/strategy across divisions/business units
- Assess the company's technology plan/readiness to deliver OTT options to customers
- Review the company's network reliability and integrity
- Evaluate the organization's ability to identify and react to customer demand for OTT options

About the authors

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How KPMG Can Help

An experienced team. A global network. KPMG's Internal Audit, Risk and Compliance professionals combine industry knowledge with technical experience to provide insights that help media industry leaders take advantage of existing and emerging opportunities and proactively manage business challenges.

KPMG's Advisory professionals combine technical, market, and business skills that allow them to deliver objective advice and guidance that helps our clients grow their businesses, improve their performance, and manage risk more effectively.

Our professionals have extensive experience working with global media companies. We go beyond today's challenges to anticipate the potential long- and short-term consequences of new technologies, regulatory changes, and evolving customer demands. With a worldwide presence, KPMG continues to build on our member firms' successes thanks to our clear vision, maintained values, and our people in 152 countries. We have the knowledge and experience to navigate the global landscape.

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