Internal audit in financial services reimagined

Predictions for success in a fast-changing profession
Thank you to our contributors!

Eduardo J. Ramos  
Executive Vice President and Chief Audit Executive  
American Express

Randy Tripp  
Managing Director and General Auditor  
TD Ameritrade

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Internal audit in financial services reimagined
New thinking for a new era

Rapid technology change. Shifting regulations. Talent shortages. The financial services industry is being disrupted from many fronts, and the effects are trickling down to internal audit functions. The next three to five years will add significant complexity to the business of internal audit, presenting both new challenges to overcome and opportunities to shine.

This new era demands new thinking, new skills, and new capabilities. Given the scope and pace of change, traditional approaches to internal audit will soon prove incapable of providing the level of risk-related assurance and insight financial services organizations need to protect and enhance organizational value.

For internal audit to effectively meet the raised expectations of stakeholders—including the audit committee, executive team, and business line managers—greater speed, agility, business alignment, and future focus will be paramount. Therefore, internal audit will need to become more data-enabled, dynamic and driven than ever before.

In this paper, we combine our collective experience working with leading financial services organizations to improve internal audit with firsthand viewpoints of internal audit leaders from American Express and TD Ameritrade. We feature American Express and TD Ameritrade in this paper because their internal audit functions are challenging traditional thinking and audit approaches. The perspectives of their internal audit leaders help shed light on the future of the profession.

Read the following pages to examine what’s ahead for financial services industry internal audit departments, and gain actionable advice for building next-generation internal audit functions.
Much has been written about the massive disruption of the financial services industry, (including by our colleagues at KPMG\(^1\)). Relentless technology innovation, a shifting regulatory landscape, and a talent shortage are creating massive complexity for internal audit.

**Technology change**

Financial services organizations are operating in a marketplace under siege. Nimble and innovative fintechs such as PayPal and Google Pay are pressuring traditional financial services organizations to raise their game. Some of the world’s most powerful companies—from Amazon to Walmart—are entering the space, too, with potentially revolutionary business models for e-commerce and banking. At the same time, changing consumer preferences and demographics are redefining how customers interact with financial services—and what they expect from their experiences.

These market shifts are converging to make financial services organizations of all shapes and sizes more digital than ever before. A recent KPMG International survey found that almost half of bank CEOs expect major disruption in the sector over the next three years as a result of technological innovation, more than two-thirds see technological disruption as more opportunity than threat, and 63 percent believe they are already actively disrupting the sector.\(^2\)

Operations, from the front office to the back, increasingly rely on emerging technology innovations like intelligent automation, predictive analytics, and blockchain to serve customers faster, smarter, and more effectively.

Such innovations have the potential to drive significant business value and give financial services organizations a critical competitive edge. But they also reshape the enterprise risk landscape, making internal audit’s job far more complex. There will be new processes to audit. There will be new risks to watch out for. There will be new regulations at play.

“Emerging technologies and digital disruption are rapidly changing the way companies do business today,” says Eduardo J. Ramos, Executive Vice President and Chief Audit Executive at American Express. “Digital advancements will bring a lot of positive changes, but also introduce new risks that must be effectively managed by companies, with guidance from internal audit.”

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\(^1\) KPMG LLP Financial Services practice

\(^2\) Reaching the next level of innovation in banking (KPMG International, 2018)
For example, financial services organizations that add automation to operational processes may also need to make changes to the control environment in order to monitor and manage the associated risks, such as business disruption due to bot failure. Meanwhile, financial services organizations that increase their use of data analytics may need new checks in place to make sure they adequately protect sensitive data and remain compliant with wide-ranging privacy rules.

“With all the technology change in the industry, a major challenge is to keep up with auditing the business,” says Randy Tripp, managing director and general auditor for TD Ameritrade. “As different business functions embed new technology, we must understand what’s changing in enterprise-wide processes and what new processes the business is implementing so we can adjust our methodologies to assess any new risks that are introduced as a result.”

**Shifting regulatory landscape**
Rapid growth in financial markets, products, and services, and the application of innovative technologies have increased the complexity, diversity, and interconnectedness of financial services providers as well as the scope of relevant regulators. States are taking a proactive role in areas where there are not yet comprehensive federal requirements, notably data privacy and cybersecurity, and Congress is separately considering legislation to strengthen these same areas. Federal financial services deregulation has moved to “recalibrate” and “tailor” the application of existing requirements, however, the regulations remain in place and regulators continue their focus on supervision.

Financial services organizations are still expected to strengthen core risk management and governance practices, particularly in the areas of cybersecurity and data privacy. At KPMG, these areas made our “top ten” list of regulatory challenges facing financial services organizations.3

“Privacy, cybersecurity and third party risk management continue to remain critical focus areas from a global regulatory standpoint;” says American Express’ Ramos. “These risk profiles remain persistently elevated due to new and emerging regulation, changing business practices, and the rapid evolution of technology.”

Other regulatory challenges in KPMG’s top ten list are related to ethics and conduct, compliance processes, financial crimes, capital and liquidity, divergent regulation, risk governance and controls, credit management, and consumer protections.3 At American Express, the regulatory environment around consumer and commercial lending is especially top of mind.

“We’re living in a time where the credit market is very competitive,” Ramos says. “Internal audit needs to keep an eye on the growth of the credit portfolio. In what segments is it growing? What contingency plans are in place in case of an economic recession? Is the business engaging in good, responsible lending and collection actions to mitigate potential credit risk?”

For each new exam focus area or rule change in the industry, internal audit must reexamine the effectiveness of the risk assessment and testing processes it relies on to evaluate compliance. The audit committee also increasingly calls on internal audit to provide recommendations on necessary updates to controls, risk management, and governance processes in light of new regulations.

The good news is that internal audit departments can usually plan ahead for regulatory change.

“Regulatory change is always a concern, but at least we typically don’t have to change overnight,” says Tripp of TD Ameritrade. “We usually have some lead time to figure out how to comply and we may even have some input into the rule changes themselves.”

**Talent gap**
Financial services organizations’ internal audit departments are also dealing with a talent shortage.

Today’s strong U.S. economy, featuring low unemployment levels, is one factor. In January 2019, U.S. unemployment levels dipped to 4 percent, leaving hiring managers struggling to fill positions.4

But the bigger factor is how internal audit work is changing—and the required skill sets along with it.

Increasingly, internal auditors are participating in strategic business initiatives and providing opinions on risk management and compliance functions, both of which demand specialized knowledge. People with the ability to effectively interact with the business are increasingly hard to find. At the same time, rapid shifts in technology—and the increased rate of technology adoption across businesses—are requiring internal auditors to take on emerging technology skills such as data mining and analytics.

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3 Ten key regulatory challenges for 2019: Actions to drive effective change in financial services (KPMG LLP, 2018)
4 National unemployment rate at 4.0 percent through January 2019 (National Conference of State Legislatures, Feb. 1, 2019)
In addition, business operations—including risk management, compliance, and governance processes—continue to grow more complex. There is a greater need than ever for an independent review, which means internal audit simply needs more hands on deck (or better ways of doing their work).

Other factors are also contributing to the skills challenge facing internal audit groups. Not only is the workforce increasingly young and inexperienced, but the best people may not stay long in the role. In a recent KPMG survey, 50 percent of IT audit and compliance professionals who described a skill deficiency in their departments attributed it to difficulties in recruiting and retaining staff.5

Creating a culture that’s attractive to the new generation of business professionals is an ongoing challenge, and it might require nontraditional talent management approaches. For example, our research further shows that work life balance is a critically important factor in team engagement, even more than compensation. Further, variety of project experience and professional development are essential for driving excitement at work.

“Our organization values internal audit as a training ground,” says Tripp of TD Ameritrade. “We’re a source of talent for other business groups and we have had significant success over the last few years in transferring talent into the business.”

“Our internal audit workforce is changing dramatically,” adds Ramos of American Express. “Just five years ago, we had two people dedicated to data analytics. Now we have a 30-person team dedicated to implementing data-driven auditing techniques throughout every stage of our audit lifecycle.”

5 KPMG IT Audit practice survey of approximately 100 IT audit and compliance professionals attending a national conference in 2018
Financial services industry disruption—and the resulting competitive pressures—are forcing internal audit departments to transform how they work and where they focus. What will spell success in three to five years’ time? Read our predictions.

**Speed and flexibility will reign supreme**
Consider how the activities involved in doing a social media audit have grown in just two years’ time at TD Ameritrade.

“As social media has become much more integral and prevalent in our organization, it has raised the level of risk and changed the regulations that impact us,” says Tripp. “We’ve had to quickly evolve our audit approach to be effective in these new areas.”

Change is relentless in financial services organizations, with technology change the most forceful of all. But as the business evolves, the audit committee and c-suite leaders need to know the control environment continues to be well managed.

To stay current, internal audit must continually advance the audit approach. Successful internal audit functions of the future will be agile—able to change their approach and focus quickly—on a timely basis—in line with current business needs. In fact, the annual audit plan may become a thing of the past.

At TD Ameritrade, the internal audit group views the annual audit plan as a living document. “We continually evaluate and modify our audit plan throughout the year based on changes in the business and risk environment, subject to audit committee approval,” says Tripp.

**Internal audit will put new technology to work**
The digitization of financial services is driving a similar digitization of internal audit itself. For internal audit leaders, it’s not just about evaluating risk management and controls processes that now involve more technology. It’s about embracing many of those same technologies to enable better, smarter audits. In a recent KPMG International survey, bank CEOs told us they were investing in a range of technologies, led by analytics and automation.²

“At TD Ameritrade, we’re very focused on innovation,” says Tripp. “We’re trying to make a quantum leap in our capabilities to assess the businesses, and that leap will be driven in large part by how we, as auditors, leverage emerging technologies.”

Over the next three to five years, internal audit leaders will also look to hire more tech-savvy audit professionals. As technology, data and automation play an ever-greater role in the daily work of the internal audit function, people must become more comfortable using (or working alongside) modern technologies, such as data and analytics (D&A) and artificial intelligence.
Automation will increase audit efficiency, effectiveness

Already positively impacting all kinds of financial services operations, intelligent automation is one technology that will prove critical to improving the efficiency and effectiveness of internal audit—especially in the area of control performance.

Control activities, including monitoring and testing, are typically a significant operational expense for financial services organizations. But now it’s possible to automate these once manual, labor-intensive processes with “bots” and other forms of intelligent automation.

By supplementing team activities with intelligent automation, internal auditors can save time, money and improve bottom-line results.6

“Automating testing to minimize manual labor will free up auditors to be more insightful, devoting more time and energy to areas that demand higher thinking, like analytical assessments,” says TD Ameritrade’s Tripp.

“With our data driven auditing platform, we are applying statistical techniques to drive outcome based control effectiveness conclusions and trigger real-time audit workflows, that connect directly into our audit database, to improve the effectiveness and efficiency of our audit processes,” says American Express’ Ramos. “These analytical dashboards and work-flows will allow our auditors to analyze and discuss the results with functional leaders, and hone in on outliers.”

D&A will advance how financial services organizations assess risk

D&A is poised to become an exceptionally powerful tool for the internal audit function. The majority of bank CEOs (81 percent) plan to increase investment into D&A over the next three years, according to a KPMG International survey.2

D&A tools allow internal audit to provide data-driven insights to assist management decision making on process improvements and control effectiveness. They derive insights from vast volumes of information, drawn from across the enterprise and external sources too, at super-fast speeds—far faster than a single person or even a team of people could. In this way, embedding D&A technologies into audit procedures will help internal audit provide better overall coverage. They’ll reduce how much auditors rely on supposition and judgement drawn from limited samples of data in their evaluations, thereby increasing audit accuracy.

Conceptually, internal auditors could one day gain the ability to audit 100 percent of what is happening.

The internal audit function at American Express is in the midst of a digital transformation program called Audit NextGen which aims to make internal audit as agile and effective as possible through the use of data analytics and audit process automation. A core component of this is the team’s Data-Driven Auditing (DDA) program. The DDA program aims to combine data analytics and automation tools to develop software scripts to instantly review millions of transaction records across disparate company source systems. Its purpose is to drive greater control assurance, broader coverage, and earlier issue identification.

“While many of our audits have relied on some level of analytics over the past 5 years, in 2018 our team developed a new data-driven threshold methodology to formalize using Analytic Control Tests (ACTs) with calculated thresholds to drive quantifiable and consistent control conclusions,” says American Express’ Ramos. “We successfully piloted two data-driven audits using this approach in 2018 and look to have a majority of our audit plan covered this way over the next 3 to 5 years.”

“Data analytics are transforming our traditional work practices in internal audit,” Ramos adds. “We used to randomly sample a subset of 40 to 60 accounts depending on the population or control frequency. Now we can test for exceptions and anomalies across millions of records in one shot, through back-end testing that doesn’t interrupt our clients or disrupt operations. By leveraging a common platform across all three lines of defense, DDA is helping to effectively and independently monitor and control risk. The launch has required partnerships across internal audit, risk, and technologies functions at American Express, and demonstrates the alignment and collaboration across groups.”

6KPMG survey on the impact of intelligent automation on business and operating models (KPMG LLP, 2018)
At TD Ameritrade, 90 percent of audits now rely on D&A and Tripp expects the depth of the team’s analytical capabilities to increase over time.

“With D&A, we can look at more controls, more transactions, and more processes with the same or fewer resources,” says Tripp.

D&A tools also improve internal audit’s ability to quantify results to management. Dashboards and visualizations bring key findings to the forefront in a way that’s quick and easy to explain, explore, drill down, and ultimately act on. By compiling a single view of data and insights from across the audit universe, internal audit will significantly increase reporting value.

Finally, capabilities in predictive analytics support and enhance continuous, real-time auditing. With predictive analytics, internal audit will be able to assess and manage risks outside of the normal, cyclical audit cycle. Rather, internal audit (in collaboration with other risk management and compliance groups) will be able to pinpoint anomalies in the data that may point to potential problems down the road—and may even prevent them. These insights will help auditors identify the highest risk areas and improve audit focus. As a result, audit planning can become far more dynamic, relevant, and effective.

TD Ameritrade’s internal audit group is currently working to gather larger, broader data sets from management, business units, and external sources, such as news outlets and competitive assessments, to stay abreast of business changes and adjust audit focus on a timelier basis.

“With predictive analytics, we can deploy our resources more flexibly and effectively. We can audit the most critical areas where we spot possible risks on the horizon,” says Tripp.

**Internal auditors will take on more strategic roles**

Today, checklist-like testing of processes and controls are too simplistic for the complexities of the current business environment. Increasingly, most financial services internal audit functions are raising the bar, seeking to deliver independent insights and analysis beyond the audit report.

As such, internal auditors will increase their knowledge of the business processes they are evaluating so they can help functions address deficiencies as well as make more strategic recommendations for improving how the organization manages risk. Mastering the ins and outs of the technicalities of internal audit will still be crucial, but practical business knowledge and experience is where internal audit can add real value.
“The cornerstone of an effective internal audit department is strong and open communication, as well as good, old-fashioned relationships across the three lines of defense to successfully mitigate risk. Nothing will replace that,” says Ramos of American Express.

Ramos has worked to evolve the role of internal audit at American Express and ensure that he and his senior team have seats at the table to participate in strategic business and risk management discussions. At American Express, the internal audit function reports directly to the Audit and Risk Committees of the Board of Directors, and administratively to the CEO and Chairman. Members of the team are also included in committee meetings on disclosures, operations, enterprise risk management, fraud, compliance and more. As a result, internal audit leaders are present at the table, and are proactive in their recommendations, which ultimately leads to more thoughtful risk management decisions being made by management.

Not all internal audit departments can rely on such high stature. To move into a more strategic advisory role to management, some departments may adapt the profile of the typical candidate they hire into internal audit. Some may introduce innovative training programs such as cross-skilling and knowledge transfer between different business functions. Others may look to eliminate duplicate work and automate manual and routine tasks so auditors are freed up for higher-level thinking.

For example, Tripp envisions a future at TD Ameritrade in which testing is largely automated and business and IT auditing are more closely integrated to reduce redundant controls. Then, auditors would be able to spend more time doing deeper analytical assessments using advanced technologies.

“We’re working to train our internal audit teams to use analytics and artificial intelligence to connect the dots of different data points to see problems emerging and draw a more complete picture of enterprise risk,” says Tripp.

The internal audit department at American Express has had success recruiting, hiring, training and retaining people to drive its data analytics initiative forward. The internal audit function has relentlessly pursued critical skill-sets, and has even hired a few PhDs who possess strong math and technology skills to go along with business and audit know-how. The company also has a continuous in-house data analytics training program and sponsors employee attendance at industry conferences to pick up best practices in the field, as well as employee pursuits of technical certifications.

Quality of the audit work will still matter most
In the increasingly complex risk environment in which financial services companies operate, management will look to internal audit for assurance that things are working as intended—taking an increased role in independent testing on behalf of the second line of defense. That requires a big picture view of what the risks are (today and tomorrow) and how they are being managed. Piecing together individual audit findings won’t provide the holistic view management needs in order to act.

As such, internal audit groups will change how they measure the effectiveness of the function. Increasing coverage and efficiency is great. But traditional success metrics—the number of audits completed or the number of issues identified—will largely lose their meaning when inevitable changes in the business push audits not included in the audit plan to the top of the priority list.

“If we double the number of audits we do but the quality of our work suffers, there’s no value in that,” says TD Ameritrade’s Tripp. “At the same time, if we issue an audit report that’s “clean,” with no findings or issues, it doesn’t mean it’s not valuable.”

Providing the business with a holistic view that controls are working and risks are being managed effectively comes down to audit quality—the quality of audit work that produces the end result, not the end result itself. And more often than not, that comes down to people.

“Automated processes or not, people will always remain critical to executing our duties as internal auditors,” says Ramos of American Express. “At the end of the day, a machine isn’t enough to truly understand a business. There’s always going to be a human element in the way we operate.”

To evaluate audit quality, TD Ameritrade relies on a feedback program in which the department conducts one-on-one interviews with business managers who went through an audit. The interviewer asks questions like, “What value did you get from the audit?” “Were the auditors knowledgeable?” and “Did the process work for you?”

Similarly, at American Express, the internal audit function has a post-audit client survey program which incorporates both anonymous and direct feedback from stakeholders. Ramos also regularly seeks and expects stakeholder feedback—from senior executives, business partners and the regulatory community—to serve as a guide for improving the audit function.
We’ve provided financial services organizations’ internal audit departments with a vision of the future in three to five years’ time. But how do they make it real? What specific actions should they take today to get ahead of the massive disruption already impacting the industry? Facing a vastly changed future, how do they prepare themselves to be effective risk analysts and advisors tomorrow?

We offer some tips for success, based on our breadth of work transforming internal audit functions in financial services organizations and many other industries.

1. **Establish a strategic vision for internal audit:** Businesses constantly evolve and change and their strategy and objectives shift with it. To provide real-time value to the organization, internal audit must align its activities with the organization’s vision. Get started by creating a vision for the function that meshes with the organization’s vision.

2. **Raise internal audit’s stature:** As internal audit becomes an increasingly critical player in organizational governance, focus, attention, and expectations on the function will continue to increase. For internal audit to meet its new responsibilities, it will need a seat at the table. By demonstrating a deep understanding of organizational needs and delivering greater value with deeper, more relevant and more timely audits, it’s likely to get it.

3. **Change the hiring profile:** Technology skills, especially data analytics, will become critical to future audit work. Internal audit professionals must also have deep business know-how: they must understand the ins and outs of individual business processes and how each ties back to the big picture from a risk perspective in order to tackle risks broadly across the business. These are the skill sets hiring managers should look for to fill roles in the next-generation internal audit function.

4. **Align data needs to internal audit’s assurance objectives:** As internal audit groups embed intelligent automation and data analytics into their operating models, audits may run continuously and coverage may be complete. This is a positive change, but there are challenges. The volume of data needed for testing and analysis within the data-driven audit function can become overwhelming. Develop a plan for obtaining and managing the source data that drives the audit plan forward but remain flexible enough to shift data management strategy as the business—and the audit plan—evolve.
What's next for internal audit?

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<th>Now</th>
<th>Future</th>
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<td>Cyclical and regulatory compliance audits take priority; SOX often demands disproportionate attention and time</td>
<td>Internal audit prioritizes future-focused emerging risk reviews and higher impact operational reviews that drive value to the business</td>
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<td>Annual audit plan quickly becomes irrelevant as the business changes</td>
<td>Audit plan is responsive to disruption and flexes to meet shifting strategic demands</td>
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<td>Audit work is primarily manual</td>
<td>Majority of audit work is enabled via data, analytics and automation, then transitioned to management</td>
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<td>Audits are based on small, random samples</td>
<td>100 percent audit coverage</td>
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<td>Most internal audit professionals have audit expertise only</td>
<td>The internal audit team possesses a mix of business, audit, technology and data analytics skills</td>
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<td>Audit frequency is quarterly at best</td>
<td>Continuous, real-time auditing is a reality</td>
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<td>Internal audit is often left out of strategic discussions</td>
<td>Internal audit is included in high-level conversations with the board and C-suite</td>
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KPMG’s highly experienced and industry-focused internal audit professionals drive meaningful insights to our clients leveraging business and data analysis. With deep technical skills, regulatory knowledge and business acumen, and empowered by technology that employs intelligent automation, we help our clients innovate solutions to achieve their strategic objectives while effectively assessing and managing business risk.

Achieving effective internal audit capabilities requires a significant level of investment in skilled resources, methods, training, and technical infrastructure. With organizations being driven to do more with less, the internal audit function has become a prime candidate for strategic sourcing. Our Strategic Sourcing service offering is designed to assist organizations seeking to improve internal audit quality and oversight, increase value while optimizing costs, enhance risk and controls management, and focus on core competencies.

**How KPMG can help**

**Internal Audit Outsourcing Services:**
We advise companies on critical business risks, implementation of effective controls and compliance processes, identifying better practices, reducing the cost of operations, and realizing profit improvement opportunities. KPMG leverages progressive and innovative approaches to deliver cost efficient assurance and tangible business improvement results, such as Dynamic Risk Assessment, industry-specific audit offerings, automation governance approaches and enablers, and data-driven auditing.

**Internal Audit Cosourcing Services:**
Cosourcing can provide the opportunity to tap into specific skill sets, industry knowledge, and global resources on an “as-needed” basis. We can provide the specific skills needed on demand—achieving a level of flexibility that can be critical in effectively dealing with a range of operational issues.

**IT Internal Audit and Compliance Services:**
As IT becomes more complex, we help organizations transform their IT audit and compliance capabilities so they can understand, prioritize and manage their IT risks and drive value into the business. Leveraging industry leading technology and innovative approaches to service delivery, we serve organizations in all aspects of IT audit and compliance monitoring, testing, control and responsibilities. Clients turn to us for specialized knowledge and assistance in enhancing their IT audit capabilities, creating a more robust IT compliance function, and designing and executing their SOX program.

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