



KPMG Internal Audit:

Top 10 in 2020

**Considerations for impactful
internal audit departments**

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As companies continue to navigate rapidly changing business models, regulatory requirements, technology disruption, and more, the opportunity for Internal Audit (IA) to identify and help companies respond to risks is ever-increasing. In fact, IA can play an important role in helping organizations manage the risk environment while also making progress on strategic and growth priorities. 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, we present **KPMG Internal Audit: Top 10 in 2020**, which outlines areas where IA should focus so it can effectively add value across the organization and maximize its influence on the company.

Top 10 in 2020

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Drivers:

- **The digitization of labor is rendering some traditional business operations obsolete**
 - **Industry leaders are maintaining or ramping up investment in innovation, particularly digital labor**
 - **Artificial intelligence, cognitive computing, and robotics are among the top technologies that will drive business transformation going forward**
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Intelligent automation—such as robotic process automation (bots), machine learning, and cognitive solutions—is changing the world of business right before our eyes. New technology that both complements and augments human skills has the power to exponentially increase speed, scale, quality, precision and operational efficiency across organizations. Smart machines now perform activities, and even make decisions, that were previously the domain of humans—and they do it fast, more accurately, and at far greater scale. The days when employees clock in to work just to repeat manual tasks over and over will soon be a distant memory.

Given the clear benefits and numerous use cases of intelligent automation, it's no surprise that it has become a mission-critical initiative. But when embarking on such an important digital transformation project, companies must remain cognizant of the risks and governance responsibilities associated with intelligent automation and applications. A well-designed risk and governance function helps ensure that intelligent automation programs are properly implemented and that associated risks are effectively identified, evaluated, mitigated or, where appropriate, accepted.

IA has a critical role in an increasingly digital workplace. Properly defined automation program guidelines can help an organization meet its governance, risk, controls, and compliance requirements and prevent damage to relationships with partners, auditors, and regulators, as well as avoid significant fines.

How internal audit can help:

- **Review alignment of Artificial Intelligence (“AI”) initiative with company’s strategic objectives**
- **Assess suitability of the process for AI implementation and error handling and resolution plan exist when needed**
- **Evaluate AI investments and outcomes aligned to the objectives of the business and its strategy**
- **Ensure AI training during User Acceptance Testing to fully comprehend risks and implications**



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Data analytics and insights

As companies continue to optimize the value of and insights arising from the tremendous amount of data housed in the business environment, ensuring proper controls around the use and storage of data is critical. 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 which data is important and how data is created, stored, aggregated, warehoused, analyzed and used. Data governance is critical to maintaining data privacy and helping the business turn data into insights.

Although IA 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 and within the IA process. Those responsible for operations, compliance, and financial reporting have generally increased their use of data analytics in executing their responsibilities. IA can often leverage these platforms or assist in a consulting role to help improve related processes and controls.

Using data to perform analytics in the internal audit process can enable expanded risk coverage and audit scope as well as improve testing precision. Repeatable and sustainable data analytics can help IA simplify and improve the audit process, resulting in higher quality audits, increased value to the business, and more precise control evaluation. By enabling IA to evaluate a greater number of controls, resulting in greater coverage, data analytics can help IA respond to audit committees and stakeholders that are asking them to do more with less.

How internal audit can help:

- Use data analytics to identify current and emerging risks as part of the risk assessment process
- Perform automated auditing focused on root cause analysis and management's response to risks
- Assist in the formation or review of data governance policies and processes
- Review the data model and points of control, including data classification issues, to identify security gaps
- Assist 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

Drivers:

- Leveraging advanced big data tools and techniques to adapt quickly to rapidly evolving business demands
- Complying with global business and regulatory data requirements
- Leveraging big data technology and methodologies to improve audit quality and precision, reduce audit costs, and expand risk coverage and audit scope
- Enabling real-time identification of risks and remediation of control weaknesses



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Technology transformation

Drivers:

- Identifying priority areas for technological transformation
- Maintaining a technology plan that is connected to your current state rather than your desired future state
- Being an IT bottleneck rather than a catalyst for change
- Spending on applications that you don't need

Too many companies pursue new technological advancements without assessing whether they are right for their business model and customer base. Combined with an inability among many companies to move off of outdated core systems, this approach is more often than not an impediment to growth. Further, technology disruption has had a huge impact on companies, an impact that will continue for the foreseeable future. The response may involve some radical rethinking of the overall approach to technology and how effectively companies address customer expectations. An organization's strategy around technology should be flexible and support the broad business strategy for the next three to five years, but technology should not drive that strategy. That's the part many companies get wrong.

Another seemingly obvious but often forgotten area to consider in connection with technology is return on investment. What are you spending? What are you getting back? What are the efficiencies? More than ever, companies are being impacted by the rapid pace of digital change. Global and cross-industry collaborations and partnerships are likely going to be crucial. Getting the right mix of talent, capital and entrepreneurial vision to nimbly embrace new technologies is a must for survival.

How internal audit can help:

- Assess whether existing and planned technology initiatives align with the overall company strategy
- Review system implementation to assess considerations of strategy alignment, governance, project management, status reporting and tracking of business readiness
- Perform due diligence for services provided under processes by which management establishes a business case for new technologies, and monitors data and risks
- Real-time assessment of projects and control environment in high-risk areas such as project authorisation, scope changes, status reporting, fraud, contracting and vendor management



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Cybersecurity

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. Additionally, 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 all the recent protection criteria.

How internal audit can help:

- Review the organization's cybersecurity risk assessment, processes, and controls, using industry standards as a guide, and provide recommendations for improvements
- Assess implementation of revised technology security models, such as multilayered defenses, enhanced detection methods and encryption of data leaving the network
- Champion a robust training and education program so that employees play a key role in a comprehensive protection plan
- Assess third-party security providers to evaluate the extent to which they are addressing the most current risks completely and sufficiently

Drivers:

- New and emerging cybersecurity threats and how they affect the entire organization
 - 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
 - The readiness, or lack thereof, of the organization's cybersecurity program
 - Preventing loss of intellectual property and capital and other privileged company information
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Compliance and regulations

Drivers:

- Ensuring compliance with a dramatically increasing number of regulations, both domestically and abroad
- Mitigating the increasing costs of complying with an ever-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

Under the current Hong Kong administration, we are seeing a trend towards more regulations. Additionally, global regulations from the U.S., Europe and China are impacting local companies. Companies operating in Hong Kong must remain focused on maintaining compliance standards to minimize risk.

Worldwide, there is increased focus on regulations pertaining to fraud, cyber and data security, operations, product liability, competition, consumer protection, price controls, and social and environmental considerations. While laws and regulations are being developed and updated, compliance is expensive and requires strong internal business controls and experienced legal-related departments.

Regulatory challenges exist for companies of different sizes. In 2019, regulators will continue to demand companies pay strict attention to core risk management governance, controls, practices and reporting—particularly in the areas of cybersecurity, third-party risk management, and conduct and culture. And with consumer privacy and data security high on the list of regulatory priorities, companies should be aware of the requirements laid down in the EU GDPR and the Personal Data (Privacy) Ordinance in Hong Kong.

Continued adoption of automation and emerging cognitive technologies will likely help drive sustainable and effective change across these regulatory challenges.

How internal audit can help:

- Review the inventory of obligations affecting the company and monitor company's overall compliance
- 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 and review the reporting / escalation mechanism to ensure promptly reporting of non-compliance issue
- Ensure compliance training programs offered to employees and other stakeholders are appropriate for role and geography
- Review processes and controls to collect, analyse, store and share personal information across the business and mechanisms in place to ensure compliance with data regulations





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Distributed enterprise

Drivers:

- **Risks associated with an increasing number of third-party relationships, oversight of those relationships, and the risks related to those activities**
- **Enhancing revenue and cost reduction**
- **Improving contract and vendor governance**
- **Creating more effective contractual self-reporting processes**
- **Preventing or timely detecting risk management failures at third-party business partners**

To boost productivity and adapt to changing business models, companies are increasingly relying on third parties to carry out vital business functions, resulting in broadly distributed business models. However, these expanding distributed enterprises open up companies to numerous 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 the company's networks, increasing the possibility of data breaches, or companies can be unaware that third parties are employing subcontractors that may be wanting 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 putting in place appropriate controls to reduce liabilities.

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 the company's information security standards**
- **Develop, implement and calibrate a continuous monitoring system of self-reported data from third-party business partners**
- **Review and monitor the compliance of third-party contracts including intellectual property rights and distributor/ reseller agreements**



Culture risk has gained the attention of company leaders as the cause of many incidents of misconduct that have impacted the public's trust. Even if a company has a well-defined strategy, if the company culture does not support its execution, success is less likely. Culture can be observed, monitored, and changed over time to mitigate misconduct and encourage strategic behaviors. A broader cultural program, while addressing the specific issues of governance, compliance, and risk management, will also focus on understanding how the organization makes decisions to meet the demands of its various stakeholders, and how these decisions influence culture, both current and desired.

How internal audit can help:

- **Conduct an assessment of the organization's cultural drivers in relation to the organizational norm**
- **Review the alignment of performance measures to strategy to ensure desired behaviors are being incentivized and rewarded**
- **Provide assurance regarding the evolution and alignment of the organization's culture with their compliance activities, as well as their financial objectives and business and operating models**
- **Identify culture risk through data analytics and third-party audits**
- **Lead or participate in investigations into matters involving potential misconduct**
- **Drive continuous improvement through testing and evaluation of the organization's culture change program**

Drivers:

- **Heightening regulatory scrutiny and increasing cultural expectations**
- **Increasingly global organizations with much more varied cultural norms and practices**
- **Social media outlets and the ability for incidents of misconduct to be widely broadcast**
- **Stricter governance, oversight and accountability expectations**



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Corporate responsibility

Drivers:

- Emerging environmental and social issues, such as climate change, water scarcity and human rights, increasingly being seen as financial rather than nonfinancial issues
- Increased expectation for companies to be transparent not only about their own performance on corporate responsibility topics, but also about the financial risks and opportunities they face from them and the likely effects on the business's value creation in both the short and long term
- Rapidly and ever-changing emerging risk environment, including an evolving and increasingly complex regulatory environment
- Increase in mandatory reporting requirements and corporate responsibility commitments

Companies are continuing to face increased stakeholder expectations and regulatory requirements relating to corporate responsibility issues. Businesses today are operating in an ever-more interconnected and globalized world. Issues such as climate change, water scarcity, and human rights are increasingly seen as material risk factors that warrant scrutiny by shareholders, customers and regulators.

For example in Hong Kong, increasing demand from institutional investors to invest in sustainable businesses, coupled with growing public expectations around corporate responsibility, are placing a greater focus on companies to address environmental, social and governance (ESG) concerns that are material to their business.

The demand of increased transparency and disclosure of information means companies are under growing pressure to produce reliable and accurate information, not only for their own operations, but also for their supply chains. IA has a key role in mitigating the risks and enhancing the opportunities that a sustainability focus brings to an organization.

How internal audit can help:

- Assess the company's sustainability strategy, its alignment with the company's corporate strategy and related risks
- Identify the material environmental and social issues that have the potential to impact the company and its stakeholders
- As demands for corporate responsibility disclosure continue to grow, assess the systems in place to collect, analyze and disclose the necessary information



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Protectionism and sanctions

The recent rise of protectionist trade policies poses a significant risk to businesses. The US has engaged in a tit-for-tat with China over the competitiveness of imports and a number of measures have been imposed to target Chinese technology companies, which have spilled over to Europe. Added to this burden is an increase in trade sanctions that carry heavy penalties. As the world's two biggest economies face off with tariffs, Hong Kong, which has for years been a re-export hub between the pair, will inevitably feel the squeeze.

The reactivity of governments is high and it is difficult to predict what goods will be affected and to what extent before formal guidelines are published. However, the ability of a company to respond to the policy changes and put in effect contingency and mitigation strategies is something internal audit can provide assurance on.

How internal audit can help:

- **Assure the company's compliance and procurement function and avoid penalties, also assess impacts on market pricing and competitiveness**
- **Provide insight on the process of evaluating strategic decisions and reacting to political risks and assurance that the operational impacts on the supply chain are being considered**
- **Emphasize the importance of risk assessment activity and provide evidence to management and the board that sufficient time and resources are being directed at these efforts**

Drivers:

- **The escalating US trade deficit with China has led to controversy between the two countries, and US politicians have long complained about how China protects Chinese companies**
- **Political disputes can have significant unintended consequences that go beyond paying heavy penalties for non-compliance**

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Workforce demographics

Drivers:

- **Aging workforce with a large number of baby boomers approaching retirement causing an expected drop in the working population**
- **Increase in robots and other cognitive technologies working side by side with a human labor force**

Knowledge transfer is one of the key elements that enables a company to grow and survive in an increasingly competitive business environment. The information and experience employees gain over the years are of vital importance, especially with the impending retirement of baby boomers. A significant challenge is ensuring that knowledge is being transferred effectively to other employees, in order to guarantee a sustained knowledge level in the organization.

As more and more robots and other cognitive technologies work side by side with a human labor force, leaders are increasingly challenged to integrate and make the most of both kinds of labor. The challenge is significant.

HR leaders will need to identify the new skills and capabilities that will realistically be required in the future. Current employees who are willing to be upskilled and retrained will need to be identified. New talent will need to be attracted, retained, and integrated into the business. Lack of communication with employees may lead to talented people leaving for companies that have transparently addressed the issue. Lastly, competitors may implement a more effective workforce mix leading to greater profitability.

How internal audit can help:

- **Perform a comprehensive review of the Human Resources department's capabilities in light of evolving labor models, including a need for new thinking around behavioral economics, systems, analytics and consultancy skills**
- **Discuss with management the company's future expectations regarding transformation of the workforce and plans to address the coming changes**
- **Assess the company's succession planning strategy to ensure critical positions have appropriate attention**





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