

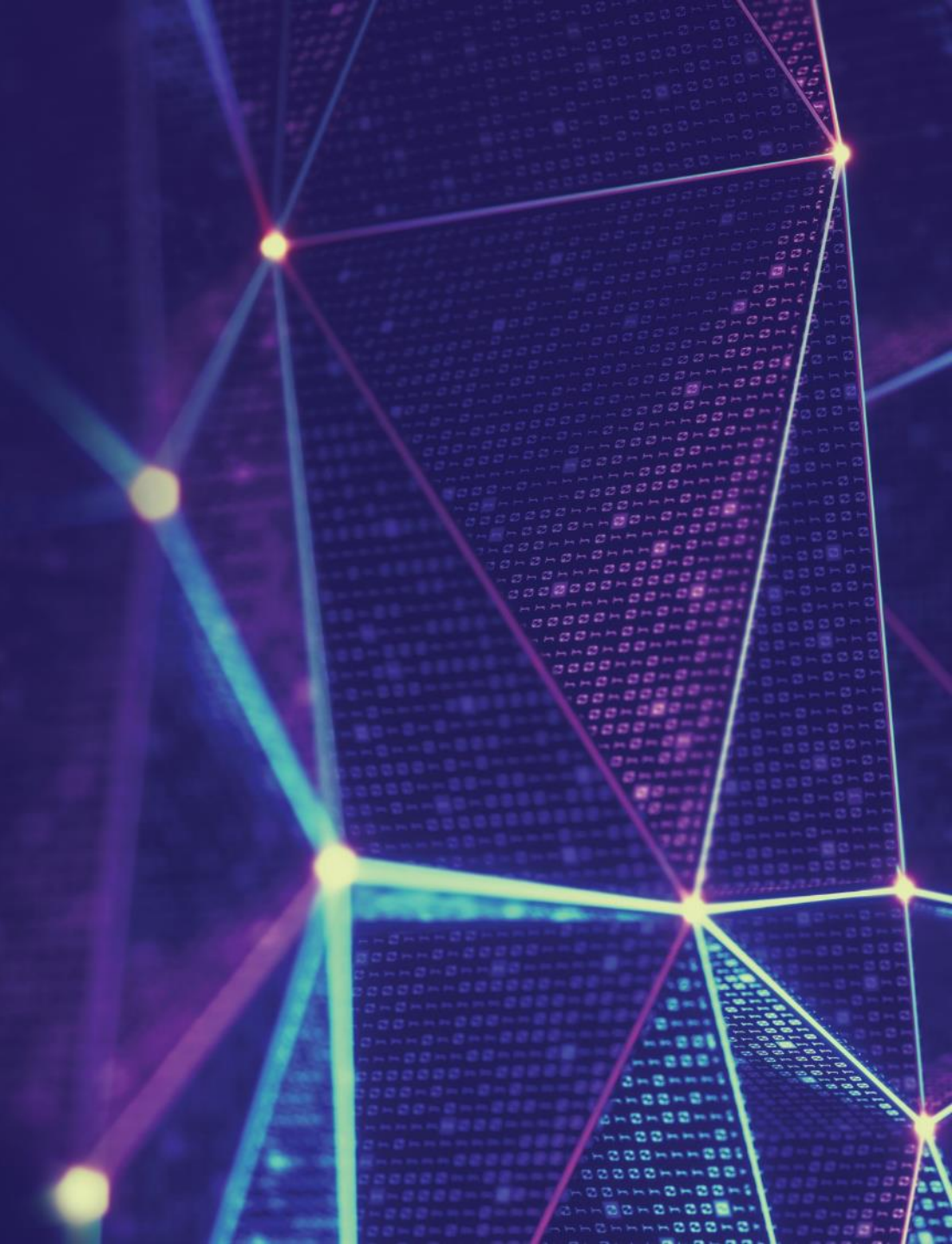


Embracing Change:

Real world examples of
internal audit disruption

IIA – The Atlanta Conference

SEPTEMBER 2019



Session Overview

Details

Title: Embracing Change: Real world examples of internal audit disruption

Duration: 50 Minutes

Facilitator: Presented by KPMG

Audience: Most Audit Professionals

Session Overview

- The convergence of emerging technologies across all industries and business functions is creating new market value and rapidly displacing existing products and services.
- The demonstrations presented will explore specific examples of how internal auditors are leveraging emerging technologies to execute audits more efficiently, expand audit coverage, and deliver higher-value business insight and results to their stakeholders.
- The examples presented compare the results achieved through the use of emerging technologies verses using more antiquated audit procedures to further illustrate the value that disruption offers to internal auditors.

Session Objectives

- Session participants will gain insight into how emerging technologies are currently being leveraged by internal auditors, including the opportunities that they present.
- Participants will learn, through tangible demonstrations, how emerging technologies are both enabling and disrupting the internal audit profession and how emerging technologies can be used to transform their respective organizations.

Proposed Agenda

00 – 05:

Speaker introductions and participant instructions

05 – 10:

Session introduction and overview of objectives

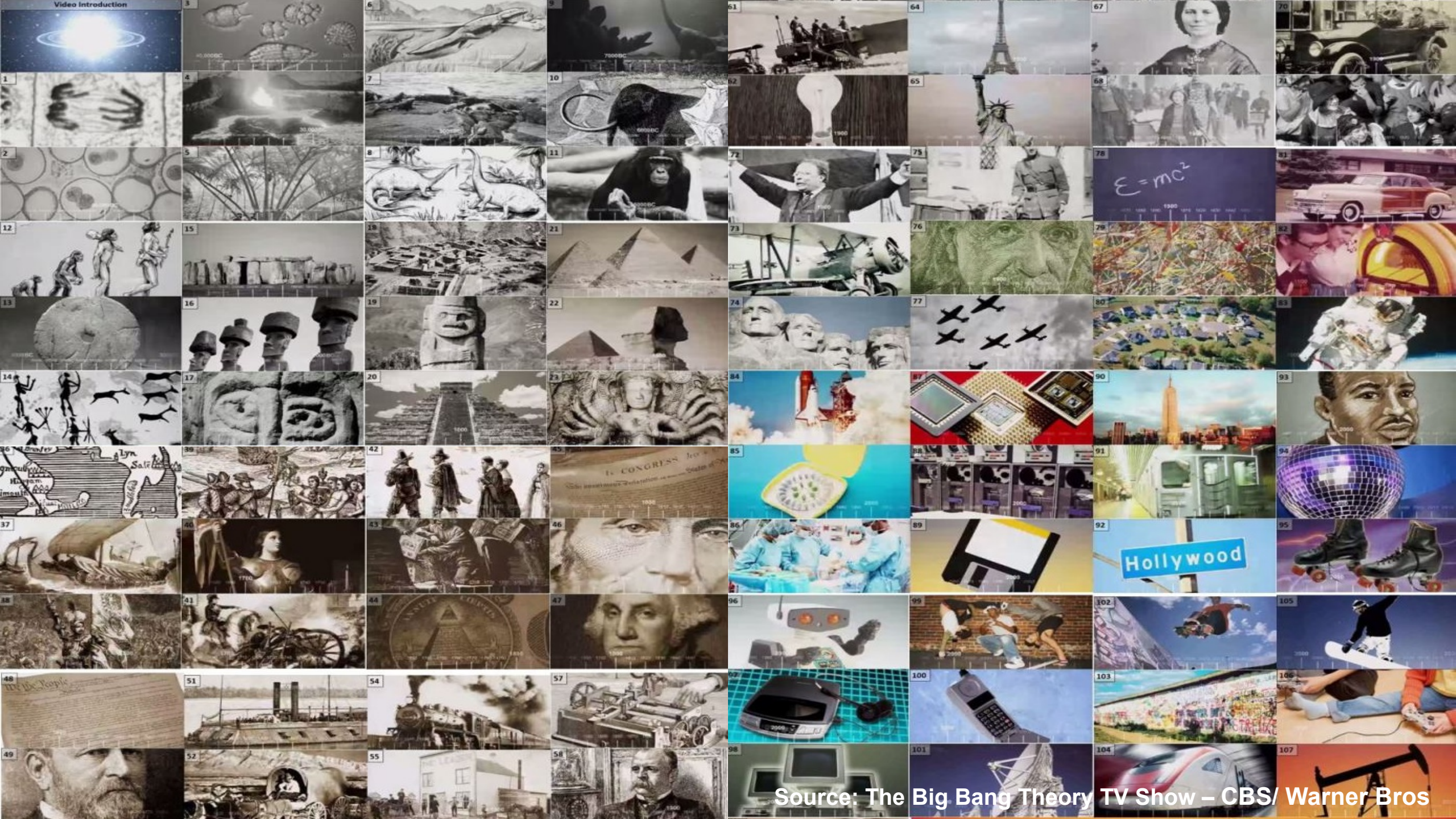
10 – 40:

Demonstrations of emerging technologies:

Illustrated through an engaging walkthrough of a selection of internal audit projects comparing the approach and results using emerging technologies compared to the same project executed using more antiquated methods

40 – 50:

Q&A discussion and session close



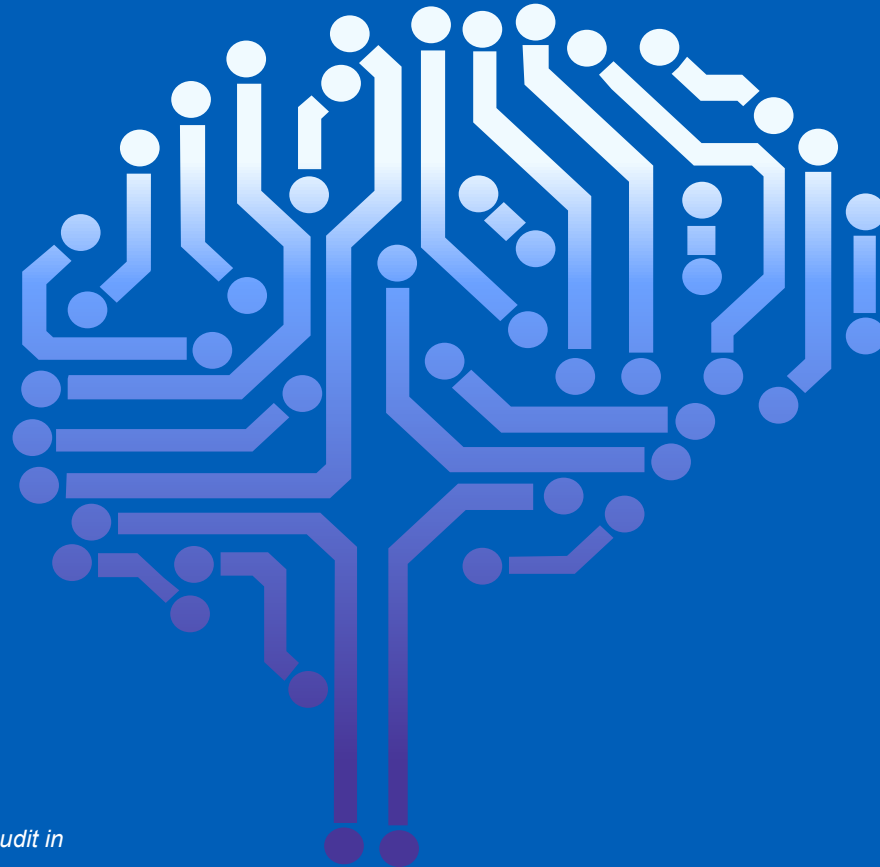
Source: The Big Bang Theory TV Show – CBS/ Warner Bros

The Premise of this Session

“ If the audit function is bogged down with immediate compliance concerns, the CAE can't necessarily devote enough time to pondering disruption and becoming a trusted advisor. ”

– Anna Cristina Zambrano, IIA Member

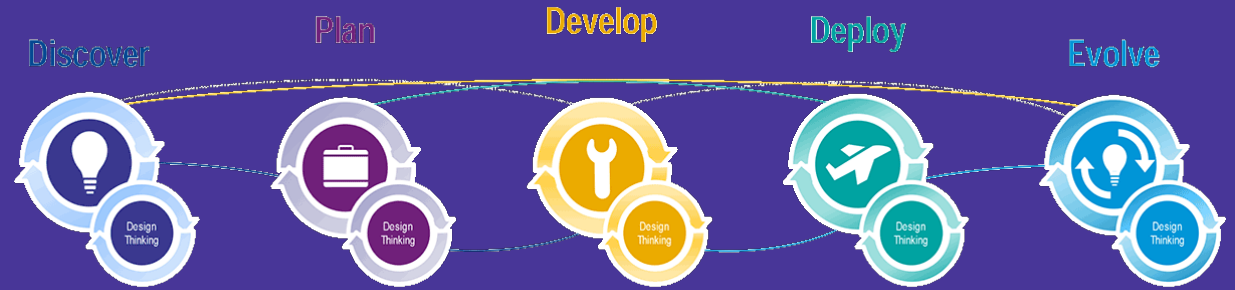
SOURCE: GLOBAL PERSPECTIVES AND INSIGHTS Internal Audit in the Age of Disruption – IIA Publication 2018



“ First you need to make your audit department work strategically, for example with better analytics and smarter use of technology. Then you can start lifting up your head to look at the horizon, to see what disruptions are coming. ”

– Hans Nieuwlands, IIA Member

GET STARTED!



- DISCOVER.** Initiate activities within your IA function to identify, validate, and select innovation ideas
- PLAN.** Create the business case for the ideas to outline what the team will do and the resources required to realize the full potential and maximize outcomes for the function
- DEVELOP.** Design, prototype, build, test and pilot of the idea to validate and refine early planning assumptions. Develop activities are iterative in nature and can vary significantly in formality
- DEPLOY.** Publish and communicate new capabilities across the IA team, Establish standards and guidelines for using the new capability, support adoption
- EVOLVE.** Assess how new innovation capabilities are progressing against their expected commitments to the business. Monitor, maintain & continuously improve capabilities

“Is this real life”

- David DeVore Jr. (After going to the dentist)

Case study examples of tangible “real-world” IA innovation efforts



Data-driven Audit

Case-study #1

Traditional Approach

SCENARIO DETAILS

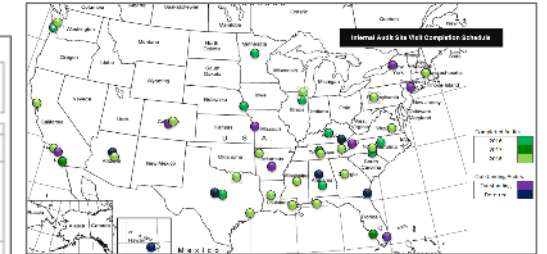
- The Internal Audit plan includes site-visit audits for a selection of the company's operating units (i.e. branches, stores, facilities, plants, etc.)
- The IA team is resource constrained and follows a tight timeline to execute each site-audit with the objective of demonstrating full coverage of all locations over a 36 month timeframe
- Historically, very few audit findings/ observations result from the site-visit audits performed

TRADITIONAL APPROACH

- The selection of site-visit locations are determined solely by revenue materiality and achieving full-coverage of all locations within 36 months
- The IA function maintains standard audit programs for similar operating units that are executed during each site-visit audit
- IA leveraged their risk assessment results to design the standard site-visit audit programs, which they reevaluate annually and update as they deem necessary
- The auditors follow a well-defined schedule across all phases of the site-visit audit (planning, fieldwork, post-fieldwork, & reporting)

OUTCOME

- Internal audit risk assessment and site visit selection process, entirely driven by total revenue contribution, resulted in the company's largest locations being selected for site visits every year
- Internal audit struggles to achieve their stated goal of visiting all locations over the 36-month timeline and consistently defers audits planned for "lower-risk" locations to the following year
- Key management and AC stakeholders seem accepting of IA's messaging that the real value for performing the site visit audits is the IA presence in the field that reinforces the importance of sound corporate governance



AC Messaging: "No material issues to report from site visit audits...continue to experience challenges meeting 36 month rotation coverage. Currently scheduled to achieve 90% coverage of planned locations."

Process Efficiency: Highly standardized site selection and site visit audit program, Significant travel expense

Analysis & Decisioning: Limited to site selection process

Stakeholder Perception: Minimal value, limited to perception of IA presence in the field

Innovative Approach

DISRUPTION OBJECTIVES

- Enhance site selection and audit schedule to prioritize risk coverage over location coverage
- Enhance site visit audit programs to produce more valuable results

INNOVATIVE APPROACH

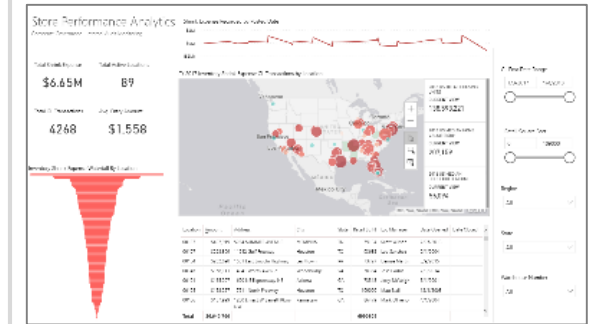
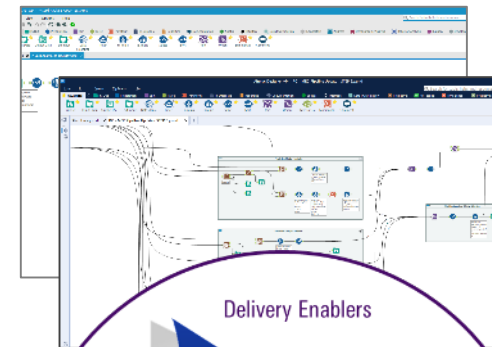
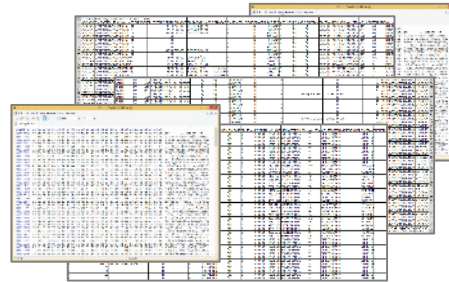
- Proactively engaging the AC and key management stakeholders in “questioning the norm” to gain buy-in/approval to innovate and drive change
- Establish a more comprehensive risk-based site selection methodology that prioritizes quantitative data attributes
- Assess and rationalize the existing site visit audit program to establish the minimum set of mandatory audit requirements
- Expand audit planning and coordinating efforts to other corporate governance functions/ stakeholders

VALUE THROUGH DISRUPTION

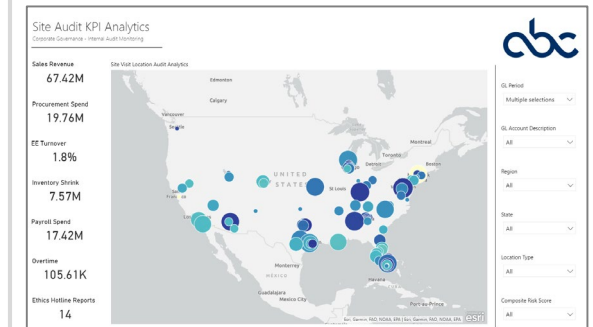
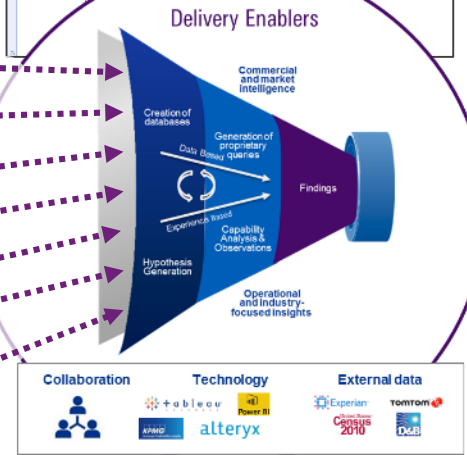
KPI DRIVEN INSIGHT:
Established KPIs across key risk areas related to site operations

WORKFLOW AUTOMATION:
Collect, normalize, and process internal data to monitor KPIs

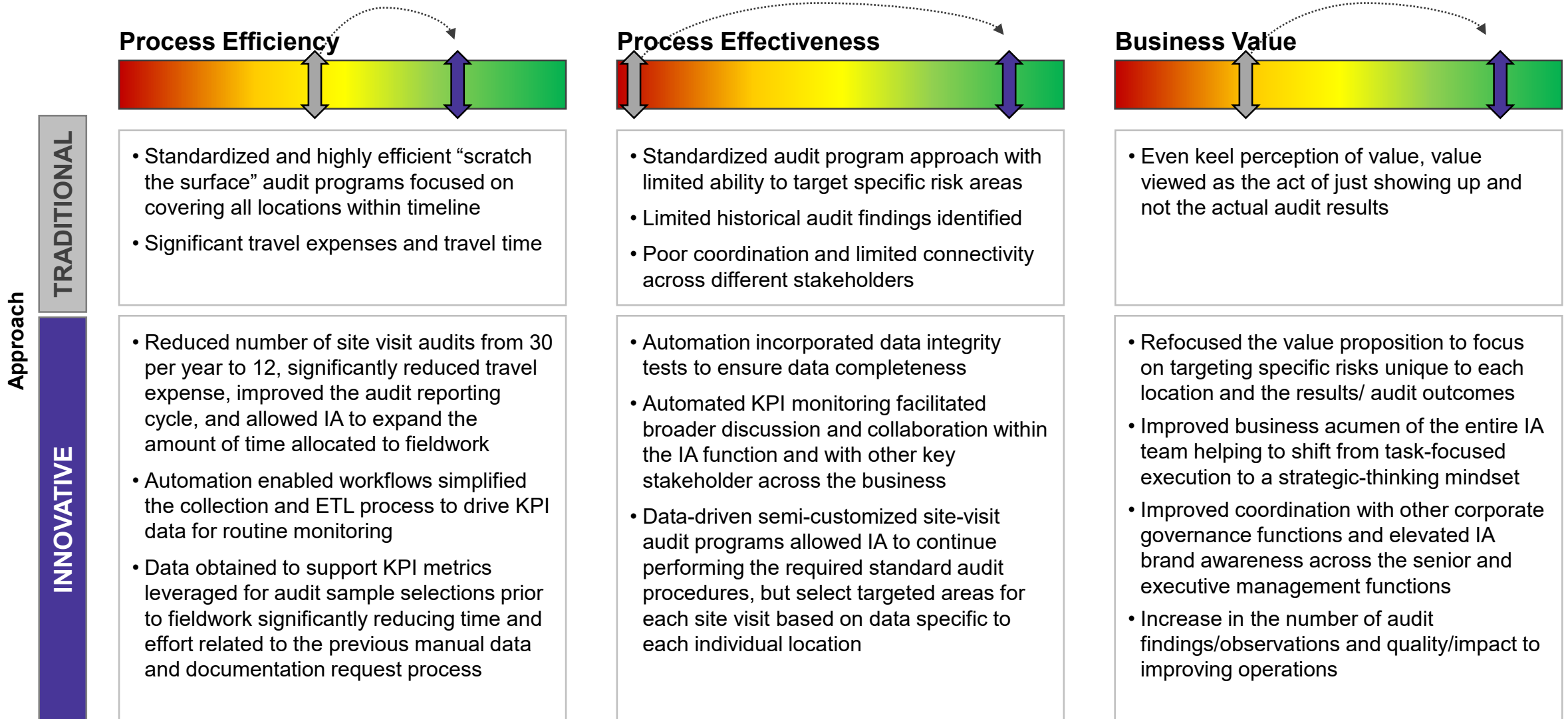
DATA-DRIVEN AUDITING:
Collectively analyze KPIs to customize site visit audit plans



- **Revenue Contribution**
- **Procurement Spend**
- **Payroll Spend/ Overtime**
- **Employee Turnover**
- **Inventory Balances**
- **Inventory Shrink**
- **Ethics Hotline Reports**



Comparing Results





Procure-to-Pay Audit Project

Case-study #2

Traditional Approach

SCENARIO DETAILS

- As part of a growth strategy involving multiple acquisitions, IA was requested to perform multiple operational audits of the company's centralized procurement function
- Internal audit designed the audit work plan to address both ICFR key control testing along with a risk-based selection of operational audit activities
- IA maintains a strong relationship with P2P stakeholders, who requested feedback on improvement opportunities IA identifies

TRADITIONAL APPROACH

- IA developed a standard audit program previously used for P2P audits for historical acquisitions, which they reviewed and revise as required for the following P2P audit project
- The IA function utilizes statically-valid sampling for transaction testing
- For efficiency, IA conducts ICFR testing first and leverages these results where possible for the operational audit effort

OUTCOME

Audit Report Executive Summary:

Internal Audit conducted an audit of the company's Procurement Process. **None of the audit findings identified meet the criteria defined to require escalation to the Audit Committee.** However, IA identified the following areas where internal controls could be strengthened to further improve the overall procurement function

Improvement Recommendations:

- 1. The organization maintains standard operating procedures, but does not maintain a corporate procurement policy**
- 2. Opportunities exist to further update SOPs to reflect current processes and clarify best practices for purchase requisitions including approvals over matching variances , requisition & PO requirements, and negotiated payment discounts**

Detailed Observations & Recommendations:

Sample-based Testing of 25 Disbursement Transactions:

- For 1 of 25 samples, the invoice did not include evidence of approval from the project manager as stated in the SOP
- For 1 of 25 samples, the earned payment discount was not taken resulting in an overpayment of \$128
- For 3 of 25 samples, the Purchase Order was created after the invoice date indicating that the POs were created to process the payment for transactions that did not follow the process defined in the SOP
- Monitoring procedures over past-due orders are not performed consistently across the Procurement team. 2 of 12 procurement leads did not maintain evidence of their weekly monitoring procedures as stated in the SOP

Sample-based Testing of 25 New/Modified Vendor Records:

- 1 of 25 new vendors added to the VMF did not include evidence that background/credit checks were performed
- 2 of 25 VMF modifications did not include evidence of approval for 1. Modifying vendor address, and 2. Modifying vendor phone number
- Management does not review the VMF to identify and deactivate dormant vendors or rationalize VMF records

Innovative Approach

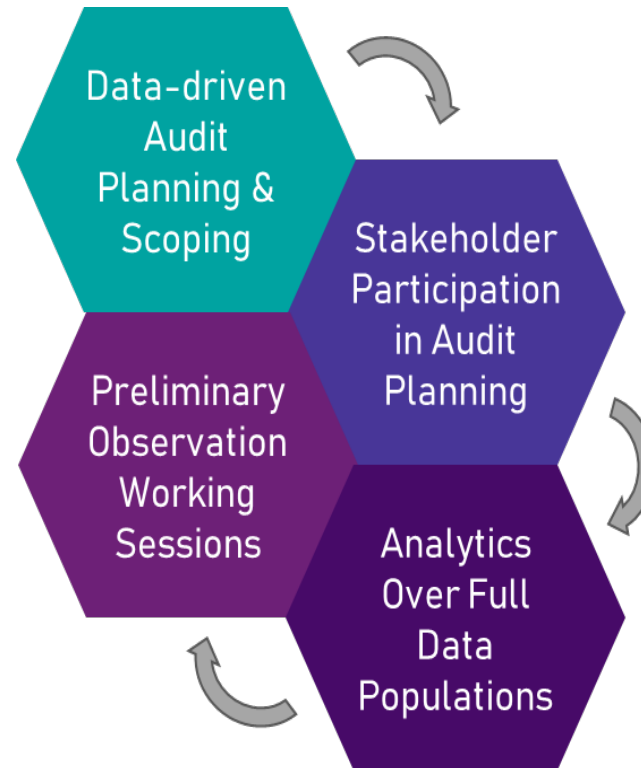
DISRUPTION OBJECTIVES

- Enhance procurement audit procedures to deliver higher-value audit results
- Improve stakeholder participation in audit planning

INNOVATIVE APPROACH

- Proactively engage key management stakeholders to play an active role in planning and scoping the audit
- Leverage the full population for selected datasets to guide audit planning & scoping
- Use analytic tools and techniques to review complete data populations to decrease the level of sample-based testing procedures
- Conduct interim cross-functional review workshops to explore and discuss preliminary observations and/or data anomalies

VALUE THROUGH DISRUPTION



Detailed Observations & Recommendations:

Early Payment Discounts:

Over the entire Q1 & Q2 period, the company received invoices totaling **\$590.13M** and issued disbursements totaling **\$588.02M**. The total early payment discounts taken equaled **\$2.11 M**. The total amount of discounts lost equaled **\$264K** and discounts earned, but not taken equaled **\$47K**

Discounts Lost: **\$98K** in Lost Discounts resulted in invoices being received by AP after the discount period had expired. **\$102K** in discounts were lost as a result of delays in the invoice approval workflow cycle

Discounts Earned/ Not Taken: **\$42K, or 90%**, of the total balance was associated with a single vendor

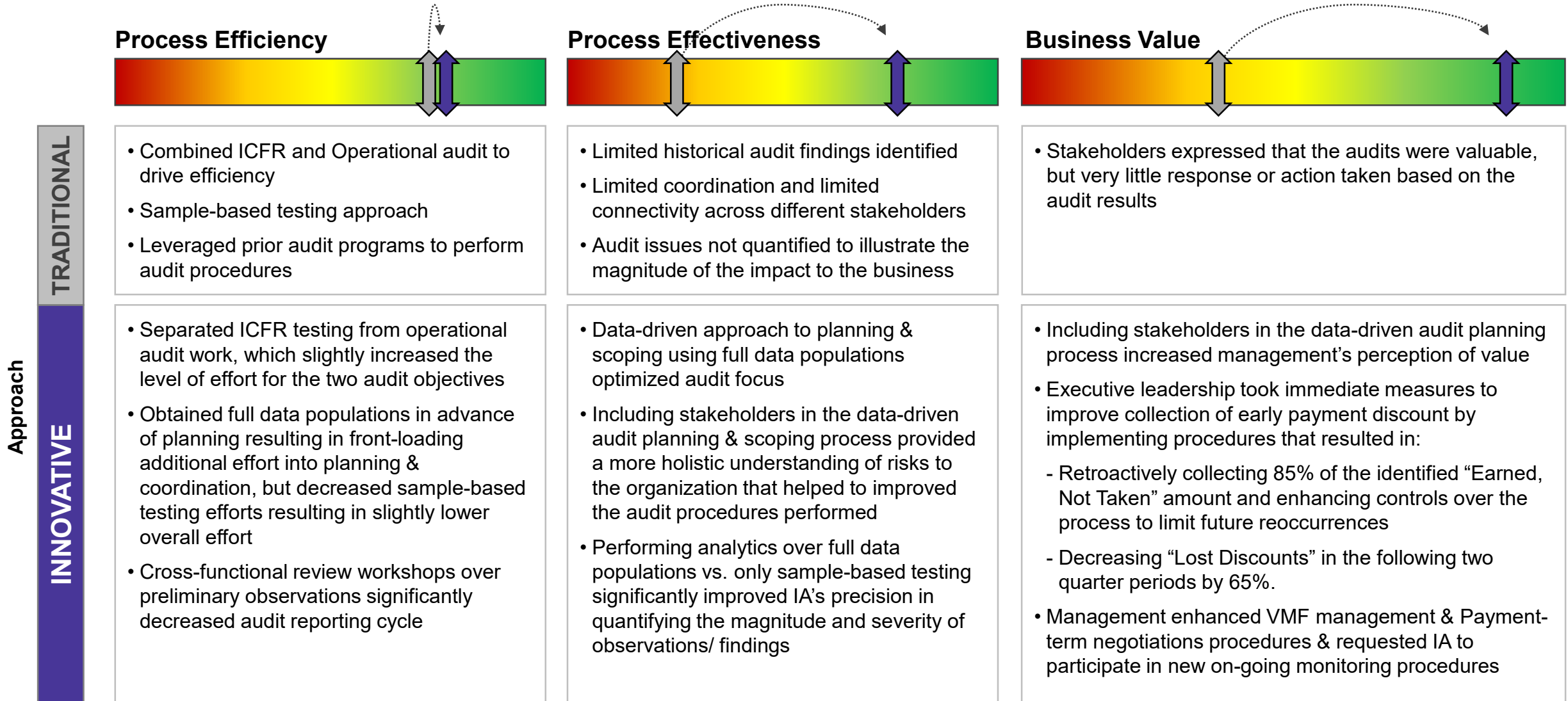
Vendor Masterfile Management:

The Vendor Masterfile contains **14,386** vendor records comprised of **9,832** active vendors and **4,554** inactive vendors. For an 18 month period, IA identified actual activity for **4,387** vendors, or **only 45%** of the total active vendors in the VMF. IA identified and **confirmed 25 duplicated vendor** records from an initial population of **387 suspected duplicates**. Upon confirming 25 duplicates audit work was stopped

Payment Terms:

The company's procurement strategy defines a > 60-day payment term objective. IA identified 5,113 of the 9,832 active vendors, or 52%, reflect terms > 60 days and 559 vendors, or 5%, with Upon Receipt terms

Comparing Results





Ethics Hotline Reporting

Case-study #3

Traditional Approach

SCENARIO DETAILS

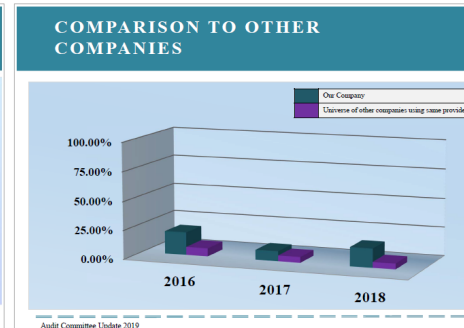
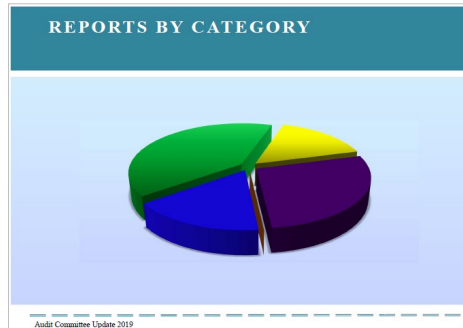
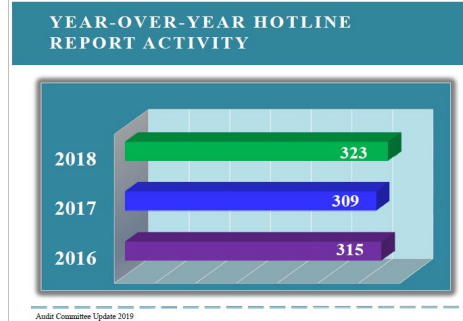
- The organization’s Corporate Compliance function is responsible for operating their ethics reporting program
- The organization uses a leading technology platform and service provider to administer their ethics hotline reporting program
- The compliance function coordinates with internal audit to assess hotline reports and delivers an update to the Audit Committee (AC) on an annual basis

TRADITIONAL APPROACH

- Corporate Compliance reviews hotline reports at the end of each period to determine response activities and subjectively determines whether to escalate a report to internal audit
- Prior to the annual AC update, Corporate Compliance meets with Internal Audit to perform a high-level review of the reporting materials and high-risk cases reported
- The AC reporting materials heavily leverage the reporting information provided by their platform service provider and only call out the reports subjectively defined as “high-risk”

OUTCOME

- Corporate Compliance effectively monitors hotline activity at the case level, but the manual and time-intensive review process limits the function’s ability to identify and evaluate the broader issue themes across the organization
- The effort to prepare the AC reporting materials is manually intensive and requires a substantial amount of re-work as the reporting materials pass through the review and approval process
- The AC criticized the presentation stating that the report only provided data and insufficiently translated the data into actionable information



Process Efficiency: Highly manual, Excel driven, Reporting process required 3 weeks, multiple participants and iterations

Analysis & Decisioning: Limited to Case-level review & Annual Reporting, Limited focus on themes and broader business impact

Stakeholder Perception: Poor, Limited value to the business

Innovative Approach

DISRUPTION OBJECTIVES

- Enhance reporting to translate “data” into valuable information
- Eliminate process inefficiency

INNOVATIVE APPROACH

- Define case-level decisioning guidance that includes evaluation criteria to limit subjectivity in the evaluation
- Leverage automation technology to enhance the effectiveness of the case reviews, enables dynamic reporting, and clearly connect activity at the case-level to the attributes that provide broader perspective across business operations
- Transition reporting from static to dynamic using data visualization technology and implement cross-functional review and analysis working sessions to identify and understand the broader picture across the business. (i.e. forest vs. only the trees)

VALUE THROUGH DISRUPTION

EXTRACT DATA
 Time Required: <20 min. per update
 Procedure: Manual or scheduled activity

TRANSFORM DATA
 Time Required: <5 minutes once built
 Procedure: Automated schedule or ad-hoc

REPORT DATA
 Time Required: <1 minute to refresh
 Procedure: Automated schedule or ad-hoc

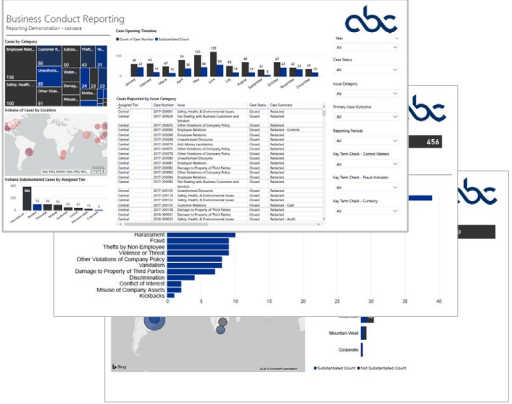
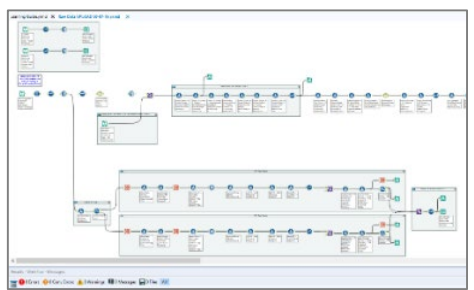
1. Connect to or Extract raw data hotline case detail



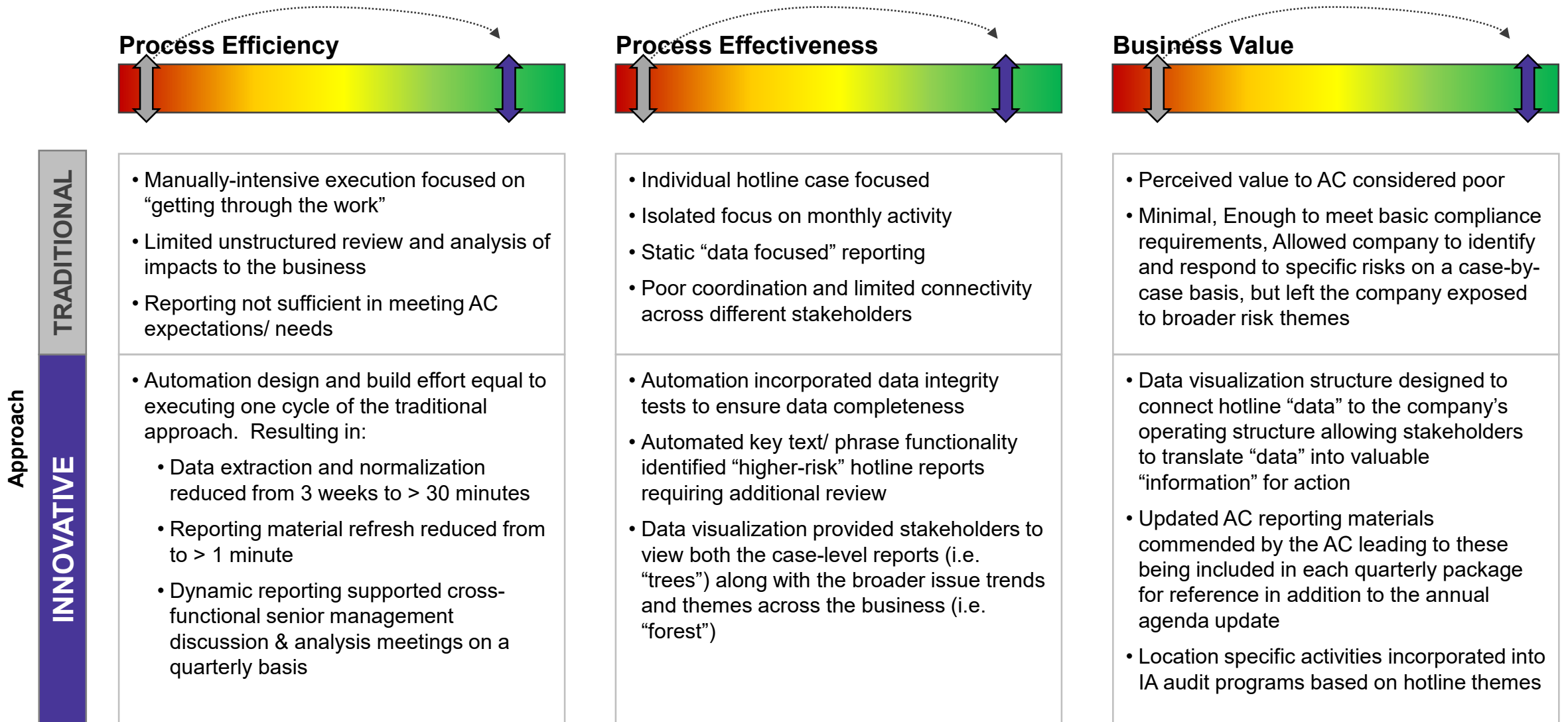
2. Run data through RPA normalization and audit analytics workflow



3. Refresh dynamic-reporting visualization reporting materials



Comparing Results



Q&A



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