Top 12 Internal Audit Focus Areas for 2012

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Our “12 in 2012” list focuses on effectively managing some of the risks technology companies face in today’s environment as the U.S. and world economies continue to demonstrate uncertainty.

Technology executives see a strong appetite for their products and services from companies and consumers globally. Despite macroeconomic challenges and uncertainty, many technology companies plan to take advantage of their favorable liquidity and cash positions by continuing to invest in emerging technologies and new business models, such as cloud, mobility, digital products and services, and M&A to drive revenue growth.

Our selection of risk areas is based on a number of inputs, including:

• Discussions with chief audit executives at technology companies
• Insights from KPMG professionals who work with technology companies
• KPMG survey data.

The projects on the following pages focus on some of the risks technology companies face as they evaluate their strategies and make investments in the following areas:

• New sources of revenue growth (third-party relationships; international operations; and mergers, acquisitions, and integration)
• Managing costs (outsourcing, off-shoring and shared services, supply chain management)
• Information Technology (IT) management (information security and privacy, system implementation and upgrades; business continuity and IT disaster recovery; and cloud, social, and mobile services)
• Risk management and regulatory compliance (Foreign Corrupt Practices Act and Anti-Bribery and Corruption; trade and customs compliance; intellectual property protection; transfer pricing; taxes; and talent management, retention, and succession planning).

These areas highlight the leading exposures companies face, and are working to address, as they invest in innovation and pursue revenue growth.
Third-Party Relationships (e.g., Channel Management, Vendor Management, Royalties, etc.)

Benefits:
- Increased revenue and cost reduction
- Improved contract governance
- More effective contractual self-reporting processes
- Enhanced relationships with business partners.

For many technology companies, revenue can disappear or costs can increase unnecessarily because vendors, distributors, and licensees fail to meet their full contractual obligations. This does not mean that business partners do this deliberately, but may fall short due to the complexity of the environment. Third parties often work under highly complex contracts, where the requirements are not clearly identified or key responsibilities may be overlooked. In addition, contracts may not reflect changed circumstances. No matter the reasons, the need to manage risks related to third-party relationships is critical for technology companies to regain full control over their costs—and revenues.

Example activities for Internal Audit to consider include:
- Reviewing third-party identification, due-diligence, selection, and on-boarding processes and controls
- Conducting a leading practices study on the organization's channel strategy, effectiveness, and compliance
- Conducting vendor audits that focus on compliance and effectiveness
- Reviewing the processes and controls over data that is self-reported by third-parties
- Developing, implementing, and calibrating a continuous monitoring system over vendors and channel partners related to their self-reported data.

International Operations (High-Growth, High-Risk Areas)

Benefits:
- Enhanced oversight and visibility into international operations
- Greater confidence in the propriety of local business practices and compliance with corporate policies and regulations (e.g., FCPA)
- Increased consistency of policies and procedures across all locations.

One of the key drivers for technology companies in 2012 is international market expansion. Many technology companies are exploring new and expanded global opportunities for revenue generation and operational efficiencies. However, international operations come with risks that include product quality concerns, intellectual property (IP) protection, import and export compliance, anti-bribery and corruption concerns, consistency of business practices, inadequate corporate oversight, and complicated and changing legal and regulatory requirements.

Areas that Internal Audit can examine during an internal operations review include:
- Overall key process areas and control environment, including compliance with U.S. and local requirements (such as import and export regulations)
- Business practices, potential code of ethics, and anti-bribery and corruption issues of the foreign entity or partners
- Communication of the company’s risk and controls to international employees.
**Mergers, Acquisitions, and Integration**

Benefits:

- More rigorous and better-controlled acquisition programs
- Validation of deal risks and expectations before they are communicated to stakeholders
- Enhanced execution planning, delivery, and performance tracking
- An enhanced integration process across all key functions of the entity.

A need to better manage execution risk is also leading many companies to design more rigor into their merger and acquisition (M&A) programs to help ensure a fact-based and well-controlled diligence, valuation, integration planning, and execution process.

Example activities for Internal Audit to consider include:

- Perform "postmortem" reviews on prior deals to assess the effectiveness of existing processes and playbooks
- Review M&A playbooks, which document integration processes and should be customized to existing company culture, business process, and governance
- Understand communication processes among finance, internal audit, and deal teams to proactively assess control implications of executing business process change during active integrations
- Perform a project risk assessment review of the business integration process, focusing on risks associated with the process, integration success metrics, and information systems.
Managing Costs

Outsourcing, Off-Shoring, and Shared Services

Benefits:
- Consistency with industry practice and company objectives over strategies, vendor selection processes, and agreements
- Improved program governance and decision making
- Increased success rate associated with sourcing relationships and transition to new delivery models
- Improved monitoring, measuring, and reporting of performance and achievement of expected benefits.

Pressures to reduce costs by either outsourcing (e.g., engaging external service providers to assume activities traditionally performed within the company) or off-shoring (e.g., moving processes to centers outside the originating country to be managed by an internal or external service provider) are expected to continue in 2012.

Example areas where Internal Audit can assist management include:
- Assess program governance and sourcing partner selection processes, including reviewing RFP content, selection methodology and criteria, parties involved, etc.
- Assist and review transition activities, including transition plans, controls, methodologies, ongoing transition monitoring, and transition results
- Review ongoing service management key factors including service level agreements, performance metrics, and performance management processes and procedures
- Review postimplementation benefits monitoring and realization to help management determine whether estimated benefits have been achieved.
Information Security and Privacy

Benefits:

- A more comprehensive and structured information security and privacy management approach is in place to mitigate risks
- Improved compliance with regulatory and legal requirements
- Reduced reputational risk associated with denial of service attacks, privacy breaches, and other security-related weaknesses.

As companies manage through the impact of continued globalization and economic recovery, an increased sense of urgency has emerged surrounding information security and privacy. If privacy and security are not addressed actively and effectively, organizations can be exposed to a host of risks ranging from breach of personal information that may lead to identity theft and identity access management issues to availability and company reputation.

Areas that would be examined by Internal Audit during an information security and privacy review may include:

- Security monitoring and detection programs as well as controls with a focus on Secure Incident Event Monitoring (SIEM)
- Programs for data breach notification as required for regulatory and legal compliance
- Access governance, process, and controls. Determine sufficiency of governance program to help ensure inappropriate access is not permitted
- Management sponsorship of security and privacy programs and level of awareness training that is provided (e.g., password protection, information risks, and appropriate handling of confidential customer/employee information).

System Implementation and Upgrades

Benefits:

- An increased rate of project success through an objective assessment and communication of risks affecting system implementation project objectives
- A timely view into the risks and issues that allows management to correct course or implement risk mitigation strategies prior to going live
- Continued monitoring of risk mitigation plans that address critical risk areas.

The implementation or an upgrade of significant ERP system or applications can help companies realize benefits, including driving efficiencies and cost reduction through the automation of key business processes. These software applications provide complex features and functions to meet a range of business requirements across industries. This complexity, as well as the inherent difficulty in integrating these applications into a company’s existing environment, require sophisticated project management capabilities and techniques, specialized resources, and leadership from the business, creating significant challenges to achieving success.

Example areas to be examined by Internal Audit during a system implementation review may include reviews of the following:

- Project plans and planning assumptions, and assessment of project feasibility
- Key business processes, and the evaluation and testing of key application controls, user access, and segregation of duties
- Key project risks through monitoring and reporting on risk mitigation plans
- Data integrity controls related to interfaces and conversions.
**Business Continuity Management and IT Disaster Recovery**

Benefits:
- Mitigates risk due to business interruption
- Mitigates risk to employee safety and the organization’s profitability
- Improves compliance with regulatory and legal requirements.

Business Continuity Management (BCM) is gaining in prominence as the focal point in managing enterprise risks, due to recent global events (such as the 2011 Japan earthquake and tsunami) and the volatility of the economic recovery over the last few years. BCM is viewed by organizations as an effective way to instill resiliency in an organization’s people, processes and technology infrastructure, and as an effective means to help ensure the continuity of business operations in the face of a natural or man-made disaster.

Areas that could be examined by Internal Audit during a business continuity management review include:
- Assess the maturity of the business continuity program elements, including a remediation plan to mitigate the risks and a benchmark comparison against companies of similar size and industry peers
- Audit of Business Continuity Program (BC Program) Elements such as risk assessments, business impact analyses, continuity strategies, IT disaster recovery, and crisis management plans to determine if the business continuity and IT disaster recovery plans are current and will be executable in a disaster situation
- Assess the effectiveness of the training and awareness of the BC Program
- Assess related business continuity and IT disaster recovery exercises.

**Use of Cloud Services**

Benefits:
- Better managed cloud service vendor contracts
- Managed risks surrounding unique cloud-related regulatory compliance issues
- Improved cloud-specific security and privacy.

Adopting cloud has considerable impact on IT, but it doesn’t stop there. Beyond IT implications, critical business operations such as tax, regulatory compliance, vendor management, security and privacy, and a host of other areas are also affected. Corporations should extend their reviews beyond existing IT risk areas to identify new strategies to manage the variety of risks related to cloud.

Internal Audit could assist with following:
- Business case and vendor due diligence – Assist management in establishing a business case for cloud and performing due diligence for the service provider
- Legal and compliance – Work with general counsel and IT to determine if proper processes and controls are present
- Vendor management – Assess the vendor management function. Advise IT of associated risks when selecting a cloud service provider
- Security and privacy – Perform security audits around cloud services
- Availability and performance – Perform operational audits to determine if cloud services meet expected availability and performance metrics (e.g., SLAs) and if expected benefits are realized.
Foreign Corrupt Practices Act (FCPA) and Anti-Bribery and Corruption (ABC)

Benefits:
- Prevent, detect, and respond to bribery and corruption
- Effectively manage issue of noncompliance with FCPA if necessary
- Manage third-party compliance auditing
- Effectively execute due diligence, as well as variations in country-specific requirements.

Managing bribery and corruption risk continues to take center stage in corporate boardrooms. Many business leaders recognize the potential for significant reputational harm from public scandal—economic cost in the form of investigations, fines, and penalties, and individual cost including possible criminal prosecution. For many multinational companies, the enactment of the United Kingdom (UK) Bribery Act in 2010, which criminalizes private sector bribery and the failure by commercial organizations to prevent it, only raises the ante.

For others, continued high levels of enforcement activity by the United States Department of Justice (DOJ) and Securities and Exchange Commission (SEC), including imposition in 2010 of eight of the largest combined criminal and civil fines and penalties against corporations in the history of the FCPA, has led to a renewed emphasis on anti-bribery and corruption compliance activities. Given the global nature of FCPA matters, corporations and legal counsel often enlist the support of experienced professionals to respond to complex forensic and investigative challenges.

Internal Audit can help organizations, officers, and employees maintain compliance with all aspects of FCPA and resolve potential noncompliance issues by assisting with the following:
- Bribery investigations
- Forensic analysis of books and records
- Electronic evidence recovery and review of electronic data
- Pretransaction FCPA due diligence
- Global enterprise FCPA risk assessment, including field office FCPA compliance assessment
- FCPA policy and procedure development and training.

Trade and Customs Compliance

Benefits:
- Increased duty savings opportunities
- Reduced reputational risk associated with selling to restricted countries
- Enhanced controls and global trade compliance processes
- Reduced risk of noncompliance with import and export laws and regulations
- Improved operational efficiencies and effectiveness.

Cross-border trade of hardware, software, or technology can present a host of challenges for companies. Management must keep costs down to maintain their companies’ strategic advantage. Companies are also responsible for ensuring compliance with local laws and federal regulations associated with cross-border trade.

Areas Internal Audit could examine during a global trade compliance assessment include:
- Review documented policies and procedures for import and export compliance
- Review import and export transactions and global trade automation system
- Identify duty savings opportunities
- Review controls to safeguard export-controlled technology.

Intellectual Property Protection

Benefits:
- Protection of IP assets from loss or overuse
- Exploitation of IP to maximize revenue
- Ensuring IP management processes are in line with internal and external compliance requirements.

Every day, businesses lose countless dollars without even realizing it. The reason? In many cases, revenue can vanish because vendors, distributors, and licensees unintentionally fail to meet all their contractual obligations. Today, intellectual property (IP) is at the core of, and a key enabler of, many business relationships. As business increasingly takes place...
through a network of separate entities—joint ventures, alliances, and less-structured arrangements—IP makes it possible to share intangible assets in an effective ecosystem that spans the globe. Many organizations license their valuable intellectual property—trade secrets, designs, patents, and trademarks—or share them with other third parties (e.g., vendors for use in contract manufacture or channel partners for co-marketing efforts).

IP-related risk can stem from highly complex contracts that do not identify key requirements or responsibilities clearly, or from changed circumstances, mistakes, or deliberate misstatements, but managing IP means much more than enforcement. IP can be used as a separable asset to be sold or licensed for revenue, to support tax-efficient structures, or as collateral for borrowing. Whatever the situation, the need to manage risks related to third-party IP relationships is critical to delivering significant bottom-line benefits.

Internal Audit can support these efforts by reviewing and monitoring the compliance of third-party IP contracts (both internally and externally) to help protect the bottom line and nonfinancial impacts (e.g., unlicensed transfer of IP to restricted countries).

**Talent Management, Retention, and Succession Planning**

Benefits:

- Increased awareness and adherence to policies and procedures around recruiting, on-boarding, and off-boarding
- Adoption of leading practices around recruitment and retention programs and learning and development programs, leading to increased employee morale and productivity
- Reduced risk of losing top talent or being unprepared for the loss of top talent
- Better alignment between employee and company goals.

The battle for talent in the technology sector remains fierce. Executives, engineers, and others continue to jump from one technology company to the next, or leave to start their own. Technology companies face the challenge of meeting ever-changing workforce expectations and ensuring the right talent is hired, retained, motivated, and developed to help the company achieve its business objectives and strategies.

Internal Audit can assist management with these challenges by assessing the following:

- The on-boarding process for employees, contractors, and temps, focusing on areas such as security and background checks, employee agreements, buddy assignments, and education of health and safety, emergency management, code of conduct, and other key policies and procedures (e.g., security, computer use, approvals and delegations, leave, travel, and expense claims)
- Training and development programs, including processes for ensuring programs are adequately targeted to meet management’s and staff’s learning and development needs and tied to wider business objectives, and processes for identifying and developing managers, leaders, and high performers across the organization
- Recruitment and retention processes, including need identification and requisition, position descriptions and requirements, selection and interview, use of recruitment suppliers, recruitment incentives, offers and acceptance, delegated authority, and employee retention programs
- Performance and career management framework and processes, including identification of high-impact employees, goal development, linkage of individual goals to company goals, and processes for monitoring, evaluating, and reporting performance
- Succession planning process for key executive positions and high-impact employees, including critical role vulnerability analysis, and internal vs. external recruitment to fill critical roles
- Compensation strategy and structure, and benefits and reward programs, including market positioning and competitor benchmarking, signing bonus and referral payouts, relocation allowance payouts, and rewards
- Off-boarding and exiting processes, including resignations and acceptance, exit interviews (reason analysis), department clearance, and full and final settlement.
About the Authors

Tom Lamoureux is KPMG’s global advisory sector leader for the Technology Industry. He and his practice assist clients in creating leading processes to improve risk management and business process improvement. Tom’s clients include many of the world’s leading technology companies where he and his global team provide services including Software License Reviews, IT Risk Assessments, Contract Compliance Reviews, Internal Audit Sourcing, S-O 404 Advisory, and a variety of other risk-based services.

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