



NEW STRATEGIES AND BEST
PRACTICES IN INTERNAL AUDIT

An emerging model for building organisational value
focusing on risk

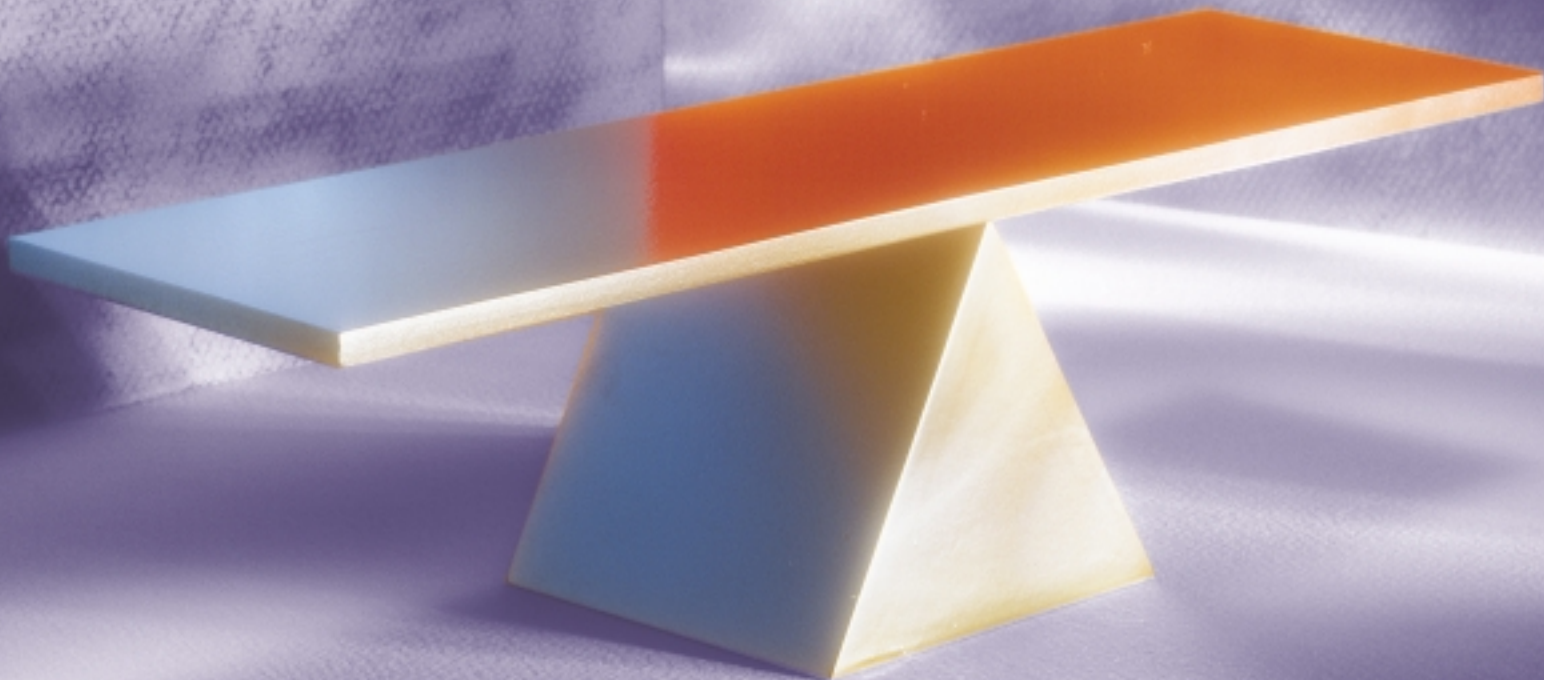




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Internal audit has long been a function of many of the world's most progressive organisations. Originally developed as a way to assist organisations with safeguarding corporate assets and enforcing corporate policies, internal audit has traditionally occupied a secure spot in modern corporations, with one of its primary focuses on monitoring compliance with policies and controls. This mode of operation has resulted in a function and a profession that have historically been viewed as stable, traditional, and beneficial but not necessarily essential for the organisation.

Recent business conditions are forcing many changes in operations:

- ▲ Technology has erased global barriers and made communications instantaneous;
- ▲ Interlocking global economies require constant monitoring of international events that can affect local business conditions;
- ▲ Customer sophistication has increased the simultaneous demand for both *higher* levels of services and *lower* prices.

These conditions are creating many new risks and are forcing business leaders to look at their organisations through a strategic lens—namely, that of the business risks they are encountering. The ability to manage these risks is often the key differentiator between the company that survives and indeed thrives, and the one that flounders or, at worst, fails.

A New Role Emerges for Internal Audit

New ways of assessing and managing business risk are causing internal audit leaders and their customers (top business executives and their boards) to revisit the purpose, scope, and operations of the internal audit function. Driven by revolutionary developments and ever-accelerating change in markets, industries, and technology, a new internal audit model is necessary and is now emerging. This model is that of a future-focused “risk authority,” which can help enable insightful corporate leaders to manage business risks as well as protect and enhance shareholder value. Aligned with corporate strategy and

focused on the specific risks that will make the difference between organisational success and failure, it is the internal audit model corporate leaders increasingly need and want.²

This document makes the business case for this new internal audit model—a model that embodies the vision and encompasses the skills enabling it to operate at a strategic, risk-focused level in a 21st century organisation. To implement the new model, corporate leaders must first understand how their organisations can benefit from such a strategic approach to internal audit as well as determine the strengths and weaknesses of their existing internal audit function. They must then sponsor an effort to identify and understand their specific strategic business risks, define the levels of those risks that they are willing to accept, and develop an internal audit function that encompasses the skills needed to effectively identify, monitor, measure, and manage those risks. Finally, having set new standards for internal audit, they must ensure that the department has the personnel and the support it needs to succeed. Nothing less than future organisational competitiveness and profitability are at stake.

The new internal audit model is that of a future-focused “risk authority,” which can help enable insightful corporate leaders manage business risks as well as protect and enhance shareholder value.

Figure 1: Segmentation of Existing Internal Audit Departments

Internal Audit Skill Sets	Key Focus	Key Deliverables	Benefit To Entity	Personnel/Skills Required
Internal Policy Compliance	Review of compliance with management's policies and procedures	Focus on exceptions to policies and recommend preventive measures; review of internal controls related to policies	Monitor compliance; create comparability across business unit	Auditors
Regulatory Policy Compliance	Review of compliance with external regulatory requirements	Focus on regulatory compliance; recommend ways to increase compliance with existing requirements and monitor new requirements; review of related internal controls	Help control business risk posed by non-compliance; may help manage regulatory relationships	Auditors; regulatory experts
Training and Development	Combines review of business issues with need to acquaint personnel with corporate operations, culture, and issues	Focus on business analytics; key deliverable is quality of training received by personnel	Steady stream of talent that knows the corporation and can move into management; problem-solving team to assist internal management	Varies by company, but typically MBAs
Process Improvement	Evaluate internal controls and monitor efficiency and effectiveness of operations	Report on how to improve operations and value for customers	Comprehensive look at operations with focus on either improving cost competitiveness or revenues	Auditors; engineers; former consultants; others identified by the company

As depicted above, Internal Audit departments traditionally encompass capabilities including internal policy compliance, regulatory policy compliance, training and development, process improvement. These four skill sets are central to this discussion of the evolving Internal Audit Model.



he internal audit function historically has encompassed certain capabilities or segments, including internal policy compliance, regulatory policy compliance, training and development, and process improvement (see *Figure 1* at left).

Organisations typically tend to focus on or be strong in one of these areas more than the others, with considerable overlap. Driven in part by corporate culture and the desires of the audit committee, these segments tend to define the direction of an organisation’s internal audit model, as described below.

Internal Policy Compliance

Establishing and monitoring internal policies and controls is one of the functions that historically tends to be most closely associated with internal audit. This function channels the efforts of the internal auditors toward measurement of compliance against predetermined standards, providing a level of comfort to the business executive:

“Adherence to standards established by senior management [remains] important to the consistency and integrity of operations throughout the organisation. It is important for senior management to be able to review and compare the results of the disparate business units of the organisation on an ‘apples-to-apples’ basis in order to make strategic and tactical decisions.

The keys to such a business-oriented approach are integration with the overall business system, proactivity, a focus on potential, and a broad business perspective.” [Internal Auditor]³

Regulatory Policy Compliance

Internal auditors have a strategic role to play in regulatory compliance, whether they serve their organisations by assisting corporate compliance officers, help develop and monitor newly

mandated regulatory compliance programs, or use technology to ensure accurate implementation of rules and regulations.

Organisations typically tend to be strong in one of these areas more than others, with considerable overlap.

Financial service providers, government contractors, health care providers, and other highly regulated industries have faced an increasing need for strict compliance programs in recent years.

The role of the internal auditor in helping to control regulatory risk is a key one for many organisations.

Training & Development

Using the internal audit department as a training ground for the organisation's future finance and corporate leaders is a strategy employed successfully by a variety of leading-edge companies.

This approach moves internal audit away from the role of detective and closer to a partnership with management—one devoted to real-world problem-solving focused on determining the strategic direction of the business.

Process Improvement

Organisations with a process improvement focus link internal audit disciplines with the organisation's critical business processes; they tend to audit whole units versus discrete activities. Such an orientation means that internal audit may, for example, when auditing for controls, view the entire purchasing or payables cycle, rather than separate transactions or activities.

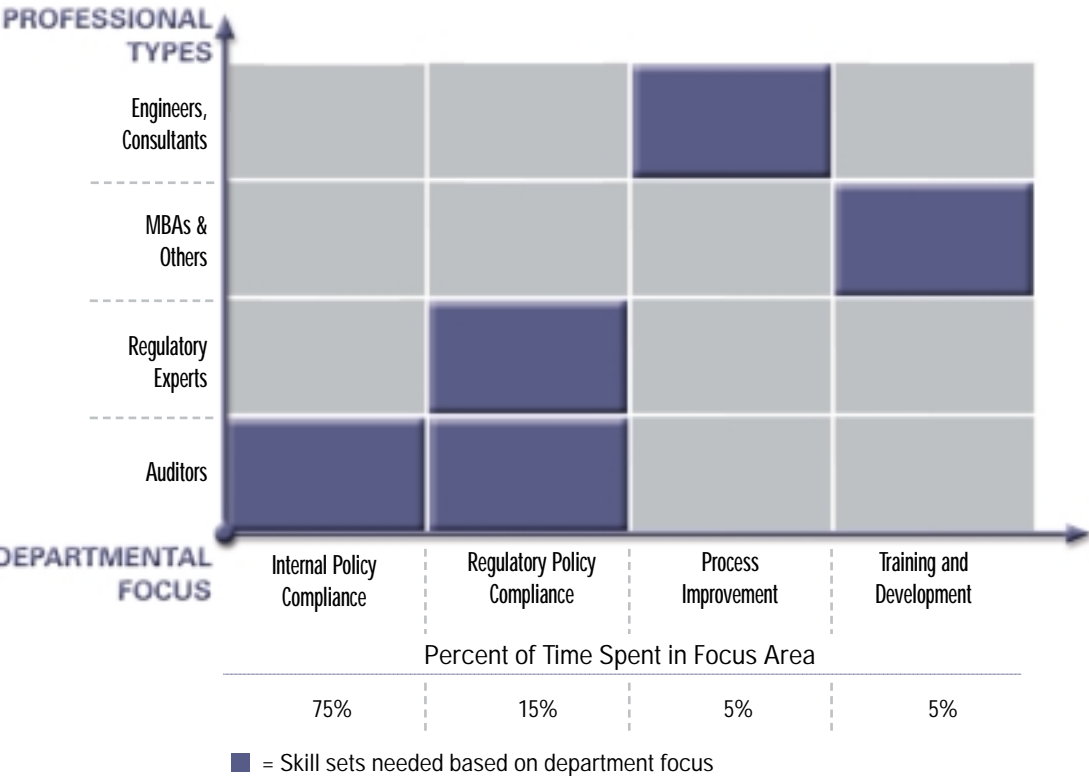
Understanding the Focus of an Internal Audit Department

Senior management must take steps to understand the focus of its internal audit department, for several reasons. This focus:

- ▲ Indicates the particular exposures and business risks the internal audit department is helping to mitigate;
- ▲ Drives the skill sets and type of personnel needed to staff the internal audit function; and
- ▲ Helps to set performance expectations for the department.

One technique for understanding the focus of an internal audit department is to graph the time and effort it spends. As shown below in *Figure 2*, one can attain a quick snapshot of the area of focus and the related skill sets needed to execute that focus by comparing the percentage of time spent in each area with the skills required.

Figure 2: The Internal Audit Department Focus Determines Required Skill Sets



As discussed in *Figure 1*, internal audit departments tend to fall into segments that focus on different areas and require particular types of professionals. By identifying the percentage of time that a department spends in a particular area, one can predict the staffing needs for that department.

In this example, over 75% of the staff in the department would be expected to be auditors, because that is the skill set needed in a department primarily focused on compliance with internal and regulatory policies.

BRIDGING THE “EXPECTATION GAP” : A NEW VISION



As previously described, the existing internal audit models have important strengths. They also have limitations, however, and, increasingly, leaders are recognising that focus in the existing models may result in lack of attention to changing business conditions, emerging business risks, and related issues that influence organisational results and performance.

While the focus of the existing models may have served businesses well in the past, research and experience show that their focus is no longer sufficient. An “expectation gap” has emerged between the capabilities the existing models embody and what

corporate leaders now need them to provide.⁴ This gap may exist in part because most traditional internal audit functions focus on what *is* or what *was*—not on what *will be*.

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for internal audit.*

The new business environment requires an equally new vision for internal audit. This new vision calls for management to elevate internal audit’s focus to those critical business risks and exposures

that determine an organisation’s success or failure. It requires internal audit to understand those key business risks and how they enable or impede the organisation in building shareholder value. This new vision requires internal audit to assess the risk-responses that mitigate the key exposures as well as determine if those responses are sufficient or relevant. By shifting its focus from last month’s results to the future’s key issues, internal audit (in concert with like-minded external auditors) can help the organisation achieve its goals.

A risk-based focus on building shareholder value presents no conflict to internal auditor independence; rather, such a focus is in keeping with internal audit's core responsibility to management and the audit committee:

“As long as the recommendations being made by the auditor are aligned with the interests of the shareholders, there should be no conflict of interest on the part of the auditor.... In fact, the audit committee should be acutely aware of major recommendations being made by the auditors and be able to tout their effectiveness to the shareholders and others. This elevates the impact of corporate audit and the audit committee from merely protecting the interests of the shareholders to enhancing the interests of the shareholders.” [emphasis added; Internal Auditor]⁵

A Focus on Shareholder Value

This new focus on risk requires internal audit to add or develop the specific skills and other multidisciplinary resources needed to help the organisation build shareholder value. With top management's support and guidance, internal audit must take a leadership role in assessing and managing risk, applying continuous quality initiatives, benchmarking and migrating best practices, and identifying opportunities. It must focus on value, by managing business and operational risks and identifying profit opportunities. Identifying lost revenue recovery opportunities, using specific risk-responses to reduce the potential for undesired and unanticipated costs, pinpointing programs that fail to accomplish their objectives, and identifying problems associated with inadequate information are among the ways internal audit will evolve to support the future needs of management, according to Michael Fabrizio, past international chairman of the Institute of Internal Auditors.⁶

A risk-based focus on building shareholder value presents no conflict to internal auditor independence.

Some progressive organisations have begun to move in this new direction. For example, it was the internal auditors' business-oriented approach to due diligence and transition planning that helped drive the success of the 1997 merger of NationsBank (now Bank of America) with Boatmen's Bank. In partnership with management, internal audit helped the bank avoid consulting fees and unnecessary expenditures; developed goodwill among Boatmen's auditors; established programs to enhance customer retention; identified back-office inefficiencies and mitigated risks; helped management make sure that computer systems conversions would be seamless for customers, and facilitated the maintenance of normal operations during the merger.

“Eventually, NationsBank’s internal audit department found its role shifting from a traditional one of assessing the adequacy of existing controls to that of a management adviser charged with developing new process flows and controls in the redesigned operation as well as gathering and reporting key performance information and monitoring operations stability during the transition.” [Journal of Accountancy]⁷

Other organisations have finely tuned their training and development functions within internal audit. Companies that use this approach include Ameritech,⁸ Digital Equipment,⁹ and, most notably, General Electric:

“General Electric is probably the best-known and most successful organisation in this regard. Individuals who begin their careers in the audit department spend two to four years there, simultaneously going through a developmental training program to prepare them for other positions within the company. As a result, audit has a reputation for being a great place to develop professionally. For honing analytical and facilitation skills, building an extensive base of company knowledge and learning to implement change, there’s no better laboratory than an internal-audit department with an activist orientation.” [Financial Executive]¹⁰

Process improvement also thrives at key organisations that focus on that aspect of the traditional internal audit model. “We used to analyze the transactions; now we analyze the processes,” says Robert Brewer, director of audits at Praxair, a \$4 billion supplier of industrial gases.¹¹ Both Mobil and G.E. have moved in this direction,¹² as has telecommunications giant Ameritech. To support its process improvement efforts, Ameritech’s internal audit department developed “Coach,” an interactive technology tool that aids in internal auditor training as well as in business process improvement.¹³ Coach uses videos, simulated conversations, and problem-solving techniques to teach auditors about Ameritech’s audit process as well as the organisation’s business processes:

“For each Ameritech business process, a model is stored in Coach memory that lists all of the activities in the process, segregated into auditable units or audit topics. Each audit topic has a different business objective that contributes to the overall purpose of the business process...”

[B]usiness process knowledge in Coach helps [internal audit] concentrate on improving efficiency and effectiveness of operations, rather than financial integrity or compliance with laws or regulations. Audits are performed across departmental, functional, and organisational boundaries and focus on what the process delivers to Ameritech’s cash-paying customers. Such audits allow [the department] to be more proactive identifying high-risk areas and improvement opportunities throughout a business process...

This focus aligns internal audit with the business units’ objectives and helps [it] develop improvement opportunities that are of value to the clients.” [Internal Auditor]¹⁴

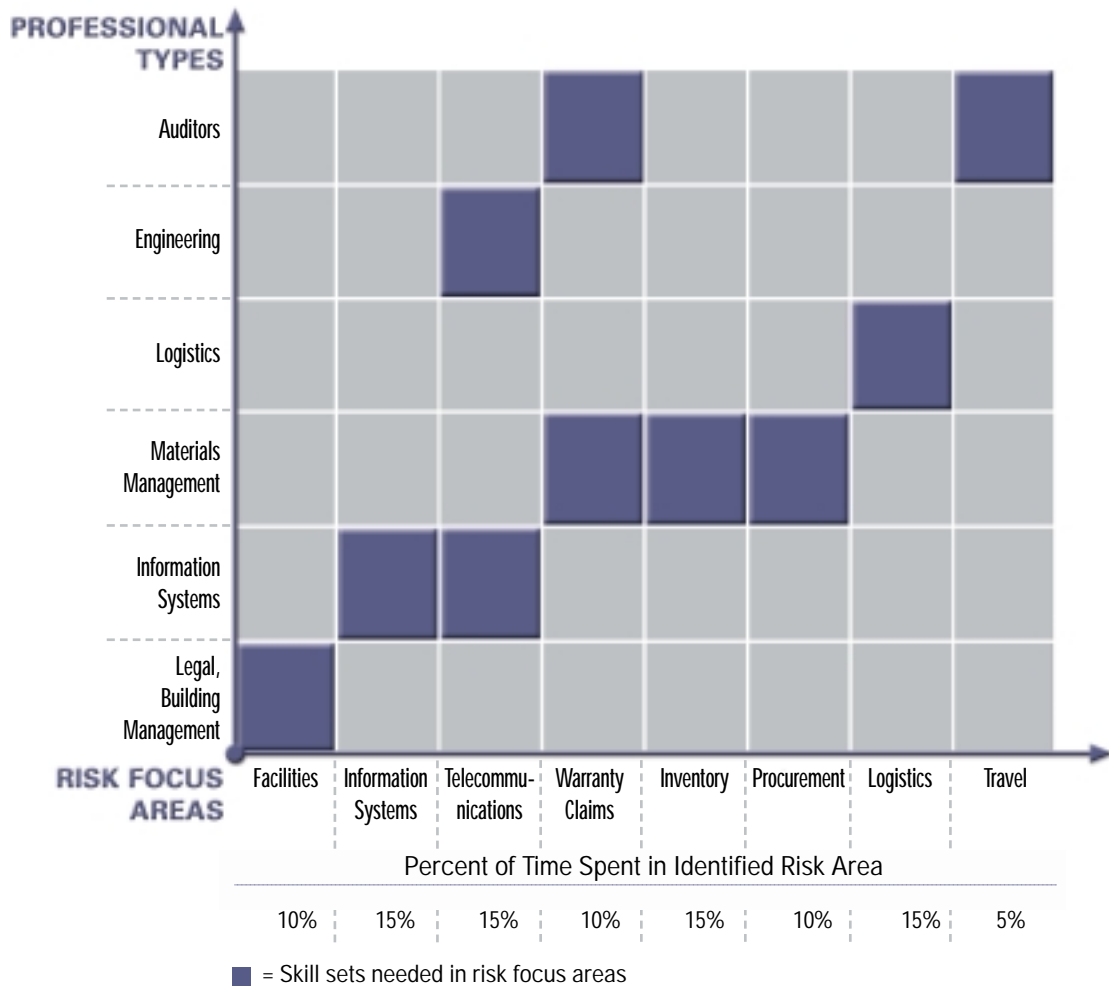
An Evolving Risk Focus

While leading-edge organisations are changing, traditional organisations do not yet focus sufficiently on risk or on the future to meet the evolving needs of their organisations. To begin to make the needed changes, however, internal audit departments require specific business skills as well as industry- or technology-based expertise and resources not embodied in many existing internal audit models. To bridge the expectation gap between what leaders want and internal audit can provide, the model must include a new element—one that focuses on the external risks and threats posed by globalisation, new competition, changing technology, and mergers and acquisitions activity. That new element can infuse a powerful new risk focus into each of the historic segments, creating a new model for internal audit.

To bridge the expectation gap, the model must include a new element—one that focuses on external risks and threats.

As shown in *Figure 3* on page 12, when this new element is applied, it changes both the axes along which internal audit effort must be plotted and the skill sets required for the proper execution of their programs. *Figure 3* depicts a situation in which internal auditors with specific skills spend their time focusing on identified risks in keeping with priorities established with management. In this way, internal audit time and capabilities are better aligned with business risks.

Figure 3: A Risk Focus Changes Internal Audit Department Staffing



When the focus of an internal audit department is changed from "focus areas" (as in *Figure 2*) to "identified risks," the allocation of resources must change as well. In the example above, the risk areas have been identified and the decisions made on how to allocate time to each of them. By comparing this information to the skills sets needed to address each of the risks, one can readily see that a wide range of professionals with specific skills are needed to enable the department to meet its goals.

B

y looking at what corporate leaders

want—focused capabilities, risk management, and strategic guidance—organisations can begin to instill a risk-based focus into their existing activities (internal and regulatory policy compliance, training and development, and process improvement). “For most auditors, the shift will be subtle. Instead of identifying and testing controls, the auditor will identify risks and test the ways management mitigates those risks.... [T]he auditor will test ‘how well are these risks being managed?’ rather than ‘are the controls over this risk adequate and effective?’” *[Internal Auditor]*⁵

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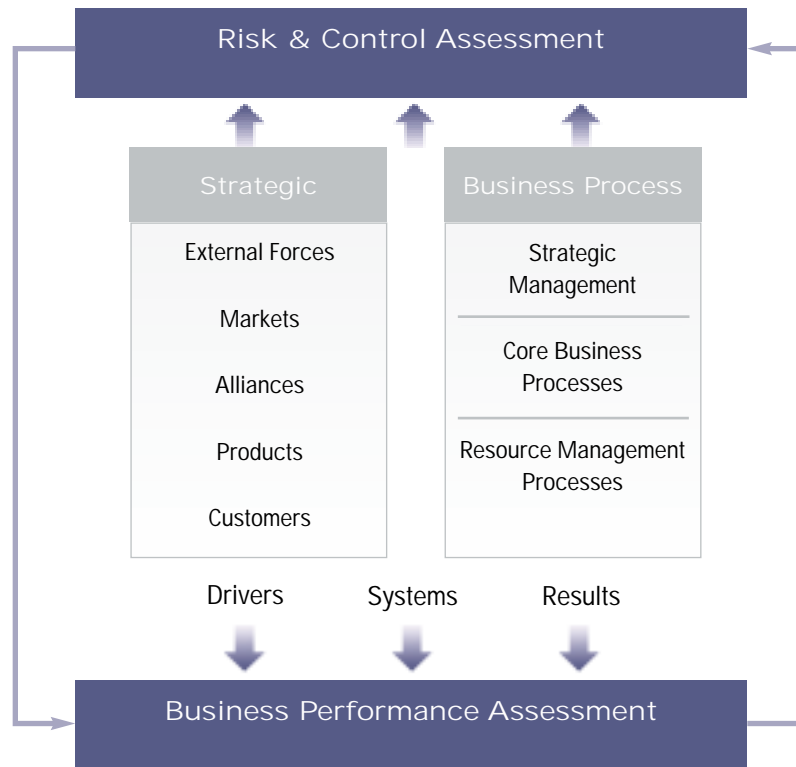
To develop such a model, organisational leaders must first perceive a need as well as the benefits they can expect to derive from it. They must then identify and understand their specific operational and financial risks, define the levels of those risks that they are willing to accept, and then seek to develop an internal audit function that encompasses the broad range of expertise needed to effectively monitor, measure, and manage those risks. This new model infuses a risk focus into every aspect of the internal audit function. The work itself may not change, but its high-risk focus will be new, and the specialised skills required to do the work will likely require new expertise or personnel.

Evaluating Organisational Strategy

Perhaps the greatest difference between the existing and the emerging models is in the strategic analysis and business process assessment that precedes the actual work (see *Figure 4* on page 14). In an ideal business cycle, internal audit must first perform a strategic analysis of the organisation’s industry, its business objectives and strategies, and its associated risk-responses. What are the organisation’s objectives and strategies in the context of the industry and market environment in which it operates? What future changes might be forced by regulators or others who influence core processes? What fundamental risks affect the business strategy, and how does the control environment complement those risks? Controls will always be important, but the organisation’s critical business risks and exposures should be internal audit’s top focus. As Fannie

Mae president Larry Small points out, “Without question, the quality of the french fries, the speed of delivery, and the cleanliness of the restaurant are far more important to the success of a McDonald’s franchise than an \$87 deficit in some cash register last month.”¹⁶

Figure 4: Internal Audit Methodology



Next, internal audit would use the strategic analysis to determine the strategic relevance, inherent risk, and control environment of each key business process, in the context of the organisation’s objectives, strategy, and significant business risks. Using these conclusions, the internal auditor would analyze the key business processes in detail, focusing on those aspects of the operations that incur business risk and those where additional opportunities are likely to arise. The organisation must identify which business processes are most significant, given the results of the strategic analysis, and then assure that efficient and effective risk-responses are aligned with those processes.

Assessment of exposures and related risk-responses calls for evaluating the significance of the risks on the economic value of the business, considering whether the key business processes have

been analysed sufficiently to allow understanding of the relevant business risks. Fewer areas will need to be audited because the focus is on those that pose the most risk to the organisation. The auditor determines whether the risk-responses are adequate to mitigate the key exposures and to what extent extra test work is required.

Finally, because the marketplace expects that internal auditors identify performance improvements, a business performance assessment provides a formal means of ensuring that such improvements are continuously identified and addressed. No longer merely the organisational traffic cop, internal audit's business performance assessment assures that key business risks and exposures are being identified and mitigated. The department must also assure that quality measures are in place to guard against customer dissatisfaction.

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truly risk-focused model for internal

audit requires both auditors and management to change their perceptions of internal audit's role and influence in the organisation. Fannie Mae president Larry Small is blunt about the need for change: "In a perfect world, top management and the board would make the modernisation of the audit function a top priority. They would insist that internal auditing be at the epicenter of risk definition, quantification, and monitoring; and they would not feel comfortable without the chief auditor playing a key role in the institution's senior management."¹⁷

No change is possible, however, without forward-looking leaders assessing the value they currently derive from internal audit and determining to what extent an improved risk-focus and a broader base of skills would improve its capabilities and its impact on shareholder value. The board of directors and management must support a new role for

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internal audit, and reporting relationships must validate that support. In some cases, a risk management committee or comparable organisation may be an appropriate addition to the governance apparatus (see *Appendix II* on page 22).

Specialised expertise will almost certainly be needed to adequately assess and mitigate newly identified risks. Leading educators are beginning to change their programs to meet

business's evolving needs in internal audit, emphasising multidisciplinary business and technology skills over finance and accounting. "Auditors are going to have to become better business people. In fact, they're going to need to be good business people first and good auditors second," says Glenn Summers, DBA, of Louisiana State University,¹⁸ whose ground-breaking internal audit master's program had just two accounting majors among its 45 post-graduate candidates in 1998 (see *Appendix I* on page 20).

Co-sourcing and Outsourcing

Organisations may also seek to deploy internal audit co-sourcing and outsourcing arrangements with public accounting or boutique firms as a means of gaining access to the specific expertise a risk focus requires. Properly managed, these arrangements can quickly ameliorate inadequacies in personnel, technical support, information technology, and business risk analysis, all of which can be costly and slow to develop internally. Under either arrangement, the organisation maintains ownership and responsibility for internal controls, and management determines the scope, extent, and frequency of internal audit activities. The organisation must designate a senior individual to provide day-to-day oversight of the co-sourced or outsourced internal audit function; and management is responsible for evaluating the findings and recommendations resulting from its activities. The Institute of Internal Auditors acknowledges that outsourcing can be an effective solution, with proper oversight and management.

Defining the Future of Internal Audit

Internal auditors will need specific capabilities to meet the challenge of industry change, according to Steve Brazier, chief internal auditor for the New Zealand Ministry of Health. These capabilities, which easily apply to internal auditors in industries other than health care, include:

- ▲ “An intimate knowledge of their clients’ needs.”
- ▲ “The ability to use other disciplines in audit work—bean counters will soon join the dinosaurs.”
- ▲ “The ability to advise on key issues as they emerge, and, more importantly, to anticipate them.”
- ▲ “To emphasise the role of the auditor as a value-driven internal consultant.”
- ▲ “To demonstrate the benefits of internal auditing and ensure that true benefits exist.”¹⁹

C O N C L U S I O N



s technology has evolved in recent years, erasing global barriers, companies worldwide have dramatically transformed their operations. The transaction-based audit approach that evolved during the industrial age is not suited to the information age, when inventory arrives just in time, processes have value, and property is often intellectual.²⁰ Organisations have changed, and so have the risks they must balance.

While the best of the traditional internal audit shops have some valuable strengths, many tend to remain largely focused on where the organisation has been rather than on where it is going. Also, most current functions do not encompass enough of the expertise or the range of risk-based information and financial analysis that organisations require to thrive in a changing global marketplace. “[I]t is the influence of the market, in competitor behavior, or changing customer preferences, that creates the real risks to the organisation.”²¹ Those real risks are the top priority for organisational leaders. Thus, they must also be the top priority for internal audit.

A P P E N D I C E S



Q *KPMG interviewed Glenn Sumners, DBA, head of Louisiana State University's Center for Internal Auditing. A leading authority on internal audit and the value it can bring, Sumners provides his perspective on the future of internal audit and why a risk focus is good for business.²²*

A How are new market demands changing internal audit?

Future audit emphasis will focus more on operations and strategies than it has in the past. Financial analysis remains important, but increasingly, the historical side of accounting is significant to the internal auditor only as it relates to future decision-making. That's where internal audit adds value. So, internal auditors must be involved in organisational planning and strategy, especially at the operating and management level. They will determine how to identify the most significant business risks and exposures as well as identify missed opportunities.

What skills will be most important to future internal auditors? What should management expect of its IA function and the people who are part of it?

Internal auditors are going to need to be good business people first and good auditors second. They will have to focus on what's happening outside their organisations—especially with their industry, the economy, market trends, technology, best practices, benchmarking, and so forth. They will need multidisciplinary skills to do so; and, as a result, the percentage of accounting people in IA will continue to decline.

How does internal audit fit with an organisation's risk management function?

Internal audit has to be part of the risk management process. A company may have a risk manager or chief risk officer focused on insurable risk, but the auditors have to develop a risk assessment methodology, whether it's a subjective process or a highly structured model. Auditors must be well grounded in risk analysis, and, increasingly, the risk focus must be futuristic.

When companies benefit from a good internal audit function, how do they do so?

The ideal internal audit shop assists management with emerging problems. It is aligned with management's concerns, and it looks forward, focusing on potential risks. Internal audit is changing, and we will see some resistance to that on both sides, but I think management will embrace a risk-focused internal audit shop. Companies that don't change will essentially be misallocating resources.

What stands in the way?

Part of the problem is that internal audit has a stereotype like many other professions, and an education process is needed. Management will have to begin to look at internal audit as an objective consulting group and not an independent compliance group. Straight compliance will remain relevant in a lot of industries—certainly for those that are highly regulated—but for many organisations, the biggest risk is change. Auditors must be able to anticipate change, predict change, react to change, facilitate change, and prepare for it.

How have new market needs changed the focus of IA education?

We have redirected our focus away from accounting and toward information systems and MBA programs. In fact, we have just two accounting majors among the 45 people in our graduate program. Organisations want skill sets, not specific degrees. They want interpersonal and systems skills, unstructured problem-solving skills, project management ability, and analytical skills. They're looking for people who can blend a variety of disciplines. (We basically manufacture a product, and that's what the customer wants.) Our graduates will obtain primarily CIA and also CISA certifications. Most will never sit for the CPA exam—which also fits with what the market wants.

How is LSU's program changing to meet new market needs?

We intend to focus our curriculum along the lines of the Competency Framework for Internal Audit (CFIA), a research project undertaken by the Institute of Internal Auditors that will be completed later this year. It's a ground-breaking project that essentially says that auditors are going to be focused on the future, not the past, and that they are going to work more in partnership with management at the strategic levels of the organisation. It will probably de-emphasise independence in the standards and highlight objectivity as a role for auditors.

Beyond that, we will recruit international students, bilingual students, people who work well on teams and are receptive to travel because audit people will continue to go where the risks are. Also, unless auditors have fairly good systems skills, they won't be in high demand. Technology discounts experience. Many organisations want to hire people with current systems skills because of the difficulty and cost of maintaining skill sets. We also intend to enhance our intern program: we expect to sponsor 100 interns next summer.

What kind of person will be drawn to internal audit?

As the audit function becomes less structured, an ability to cope with ambiguity will become one of the most useful and valuable skills. Internal auditors will need to be good at working with new problems, problems with no obvious solutions, and they will need to bring a variety of skills to the problem-solving effort. The person who has, for example, an MBA with a specialisation in systems is just the kind of individual we're looking for.

It sounds like a lot of change is on the horizon.

And all of it is good for the profession, and for business.

An acknowledged pioneer in computer technology, Microsoft Corporation has also developed a reputation as an innovator in the science of risk management. Beginning in 1995, Microsoft has managed risk within Microsoft Risk Company, or MS Risk, "a virtual business consulting practice within the company," according to Scott Lange, director of risk management, who discussed the process in *CFO* magazine in 1997.²³

"Risk management should be a discipline to make sure you have an accurate picture of the risk-reward trade-off," said Lange, who came to Microsoft from Boeing Company in 1990 as its first director of risk management. "There's a broad spectrum of risk facing any organisation. But the degree of risk, the extent to which it is significant, will differ from company to company, even very similar ones."²⁴

MS Risk divides its "universe of risk" into twelve specific categories: business partners, competitive, customer, distribution, financial, operations, people, political, regulatory and legislative, reputational, strategic, and technological.²⁵ Lange and assistant treasurer Jean-François Heitz developed risk maps and risk grids to quantify these risks (determining in their initial analysis that less than 50 percent of them were properly covered). A risk manager is assigned to each of three groups (operations, sales, products) to continually monitor material opportunities, or asset devaluation.²⁶ In addition, a small committee meets quarterly to assure that internal audit, risk management, and external audit are all equally aware of the company's business and financial risks.²⁷

The establishment of MS Risk has brought changes that have extended to Microsoft's relationships with its employees and its insurers. Rather than police employees on the issue of risk management policy, the company helps managers understand what risks are inherent in any given product. Those managers then

decide whether they wish to finance that risk or transfer it elsewhere. (The company is currently phasing in a plan to allocate the costs of risk to business units, based on loss history.²⁸) As for insurers, they are used, according to Lange, "only if [their] service and infrastructure capabilities...could meet our needs." The emphasis, in any case, is on mitigating risk, rather than insuring it.

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An example of MS Risk in action illustrates how far Microsoft has advanced from the traditional model of risk management. A new keyboard for the PC was developed by the company. However, the risk analysts at MS Risk, working with internal product developers, determined that the possibility of legal liability—due to repetitive-stress injuries that might be claimed by the product's users (a hazard faced by all keyboard manufacturers)—had not been factored into total costs. This analysis showed that the product was underpriced. As a result, an additional \$2.82 per unit was added to royalty fees for licensing agreements—a measurable result of the value of risk management.²⁹

"We have to build measurement as a core competency," said Lange. "Many organisations are keyed to accounting periods, but risk may take years to play out... We want to help [each business unit] see that they are really in the business of risk management."³⁰

- ¹ Larry Small. "R.E.S.P.E.C.T. and How to Get It," *Internal Auditor*, Aug. 1998., pp. 40-45.
- ² David McNamee. "Risk-based auditing," *Internal Auditor*, Vol. 54, No. 4, Aug. 1997, pp. 22-27.
- ³ Stephen R. Thevenin. "Teaching old audit new tricks; internal auditing with business consulting dimension," *Internal Auditor*, No. 5, Vol. 54, Oct. 1997, p. 58.
- ⁴ KPMG. *Shaping the Future of World Class Internal Auditing* ("This book comprises thoughts and ideas based on the best practice sharing which took place at The First European Internal Auditing Forum, 26 and 27 Jan. 1994, at the Pendley Manor Hotel in Tring, U.K.").
- ⁵ Stephen R. Thevenin. "Teaching old audit new tricks; internal auditing with business consulting dimension," *Internal Auditor*, No. 5, Vol. 54, Oct. 1997, p. 58.
- ⁶ G. Randolph Just. "Upheaval and opportunity: challenges faced by internal auditors in health care industry," *Internal Auditor*, No. 2, Vol. 55, April 1998, p. 40.
- ⁷ John Trampe. "Thriving on change: the internal auditor's role in mergers and acquisitions," *Journal of Accountancy*, No. 4, Vol. 185, April 1998, p. 33.
- ⁸ Karen L. D'Amico; Bruce A. Adamec; Brian M. Slator. "Coach; training tool at Ameritech Internal Audit services," *Internal Auditor*, Vol. 53, No. 3, June 1996, p. 30.
- ⁹ John Pancoast. "How audit earns plaudits," *Financial Executive*, Vol. 11, No. 6, Nov. 1995, p. 30.
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KPMG Contributors

Brian Berry

Leo Epskamp

Mike Fogel

John Gibbins

Shonaid Jemmett-Page

Diane Kiffin Nardin

Jack Rose

Susan Rucker

Ted Senko

KPMG's Department of Professional Practice

KPMG's Assurance Marketing Department

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