AEROSPACE AND DEFENSE

The Value-Adding Internal Audit Function
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Internal Audit, Regulatory & Compliance Services Thought Leadership

KPMG LLP
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Nearly all larger U.S. aerospace & defense (A&D) companies spend budget dollars to maintain internal audit functions. Some of these functions are viewed only as cost centers, a necessary evil, but others are viewed by senior and business unit management as value-adding business partners. What distinguishes those functions that provide value-added service to their companies?

Executive Summary

While there are many small factors that add up to a successful internal audit (IA) function there are three major thrusts that are critical for an A&D company IA function to truly add value.

First, the IA function must take a risk-based approach to planning that is done in conjunction with business unit and corporate management. An effective risk-based approach identifies issues and creates the opportunity for resolution before the issue becomes an accounting or operating "surprise." An effective risk-based approach provides an early warning system.

Second, the internal audit function should work closely with business unit management and the company’s government oversight agencies (DCAA, DCMA, and others) to promote appropriate compliance with FAR, CAS, and other contracting requirements, and to demonstrate to the government customer the company’s commitment to being a reliable supplier that can be counted on from both from a delivery perspective and a compliance perspective. By demonstrating to the compliance arm of the government customer a commitment to exceptional governance, the value-adding audit function provides the company a competitive advantage over suppliers that require significant government oversight.

Third, the IA function should work closely with business and operations management to identify opportunities for business process improvements, cycle time reductions, and cost savings. The value-adding IA function involves subject matter specialists in the conduct of audits that can bring new perspectives and industry better practices to the areas under review.
Risk-Based Approach
An effective risk-based approach to IA is done collaboratively with business unit and corporate management. The audit function facilitates discussions which help the business look past the immediate fire drills to identify those risk areas where additional management focus can head off problems before they mushroom. This approach gets to risk issues before they manifest themselves in losses or compliance deficiencies. It provides an early warning system and it provides a method for extending management’s reach, analyzing the controls to mitigate risks at a high level and then scheduling audit projects to address risks that have been identified and can be addressed appropriately through an IA process.

Risk-based planning is done in conjunction with business management. The audit function leverages its knowledge of the business and business risks to start the process but also seeks the input of business management so that upcoming trends and initiatives are taken into consideration. Another critical element of a forward-looking risk assessment process is to understand industry, economic, and political influences that impact the company’s risk profile. It is important not only to consider internal systems, controls, and initiatives but also to understand the impact of risk areas that are connected to business partners and even to consider what risks and issues competitors are experiencing.

Compliance Proponent
The value-adding IA function assists business unit management by finding cost-effective methods for maintaining FAR and CAS compliance, by identifying noncompliance before it grows into a significant issue, and by mapping out strategies for remediation and recovery when issues do arise. The value-adding IA department establishes a teaming relationship with government representatives and maintains open lines of communication with DCAA and DCMA officials. The value-adding IA department uses these open lines of communication to demonstrate to the compliance arm of the government customer the company’s commitment to good governance.
This requires that the audit staff and managers have thorough understanding of the regulations. It also requires management and staff that understand the business and how to properly apply the regulations. Too frequently compliance concerns arise because an auditor, be it an internal or government auditor, does not thoroughly understand how the contractor is achieving compliance with a particular section of regulation. The value-adding IA staff thoroughly understands the regulations and the approach the business takes to achieve compliance so that they can explain how compliance is being achieved to those who may not understand the business as deeply or thoroughly.

**Business Process Improvement Adviser**

The IA function should work closely with business and operations management to identify opportunities for business process improvements, cycle time reductions, and cost savings.

The value-adding IA function includes subject matter specialists in the conduct of audits who can bring new perspectives and industry better practices to the areas under review. In most audit projects, the auditor takes a process view of the function that is being examined. This affords the audit team and management an opportunity to assess not only compliance and controls but also process efficiency. To do this effectively, it is important that the audit team be able to look at processes not only from a controls perspective but also from the prospective of a business owner who wants to maximize the return that the company is making in the area under review.

**Choosing the Right Partner to Help Your Audit Function Get There**

All large A&D companies invest significantly in IA and have in-house staff that can achieve some of these objectives. However, without an outside perspective to lend a hand, it’s difficult to effectively accomplish all three of these critical roles at a world-class level. The right cosource partner can help your internal function perform risk assessments that bring a fresh and independent perspective. A cosource partner can bring added government compliance knowledge and credibility. A cosource partner with a broad depth of services can provide subject matter resources across multiple finance, IT, and operations disciplines to provide the ability to bring industry better practice ideas to every audit project.
A cosource partner should be able to bring knowledge of DOD regulatory and government contracts to projects, including intimate familiarity with government procurement regulations. A strong cosource partner should have operations risk management specialists who can guide business managers in improving supply chain, operations, and product delivery processes. KPMG’s Advisory Services practice can provide subject matter resource specialists with A&D experience who can assist your IA function in achieving an even higher level of performance.

Conclusion
The value adding IA function benefits the company by focusing IA resources on coverage of high-risk and high-benefit areas, improving compliance-related processes and controls thereby enhancing credibility with government oversight customers, and deepening the business’s understanding of and insight into operational activities and offering better practice suggestions to improve processes and enhance controls.
About Us
KPMG’s Aerospace and Defense (A&D) practice is dedicated to working with you to help navigate the risks and impacts of changing industry conditions. Our A&D group’s level of direct industry experience complements KPMG LLP’s advisory capabilities and solutions to address the distinct challenges our clients face.

KPMG is a provider of end-to-end A&D solutions delivered by professionals with extensive industry experience. We are well positioned to team with A&D manufacturers, government contractors, service providers, and IT and MRO companies to provide audit, tax and advisory services. Our services include targeted capabilities in specific areas that serve the needs of the A&D customer throughout its life cycle. We are independently positioned and have a proven track record working with leading A&D companies focused on maintaining productivity and performance in an increasingly competitive marketplace.

KPMG responds to your complex business challenges with consistent methodologies and common tools developed specifically for the A&D industry sector. Our professionals team with A&D companies to help them maintain and grow business performance, integrating business functions for optimum business performance.
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