The case for an independent reporting line

Internal audit is a key element of good governance, providing assurance, insightful challenge and transparent information. Independence is the USP that facilitates the 'internal' element of internal audit. Audit leaders may, for whatever reason, find themselves without an independent reporting line. Should this be accepted?

We take a practical look at the importance of the reporting line for chief audit executives. For some, these may be discussion topics to generate change, and, for others, a reminder not to take the status quo for granted.

Are you independent within your organisation?

Why does independence matter?

There have been many high-profile failings in recent years: Carillion, Patisserie Valerie, Grenfell Tower and the Post Office. All very different scenarios yet with a common thread of poor governance.

An organisational culture that values governance and oversight will ensure that its internal audit function has uncompromising independence and authority to perform its work and report its results.

Yet, internal audit's role requires careful balance.

Being internal to the organisation enables auditors to gain understanding, knowledge and insight, to build

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relationships and observe what is really going on. But it also risks being institutionalised and too closely aligned to the organisation.

Independence is the difference between internal audit and all other business functions. For the board, internal audit without independence is like driving a car on worn out tyres. Getting from A to B without issue when conditions are good but dangerous when it rains or you need to do an emergency stop.

Independence must be present at all levels: in the thought process of individual auditors, setting the scope of engagements, running the function and its reporting line.

The importance of a reporting line

There are many elements to independence and arguably, none more so than the reporting line of the chief audit executive (CAE).

Reporting outside of the organisation’s executive structure:

- makes possible internal audit’s position within the three lines of defence
- distances internal audit from the organisation
- facilitates a constructive audit plan
- separates internal audit from the organisations performance framework
- builds powerful partnerships with governance leaders.

An independent reporting line for a CAE should be to an independent board member – aka the chair of the audit committee or the chair of trustees.

In organisations, like councils and some public sector bodies, where there are no independent members on the board, this makes true independence more complex. In such instances the highest level of authority would be recommended such as an accounting officer or CEO. The audit charter is of paramount importance to CAEs in any organisation but particularly the public sector.

On a practical level, CAEs may also have a functional reporting line to an operational board member, such as the CEO or CFO. This should only ever be used to simplify administration and endorse authority not to turn the formal reporting line into a figurative one.

A dual-reporting line, whilst commonplace, requires all parties to be clear on their accountabilities, lines can be easily overstepped and independence lost even when it appears to be in place on paper.

Professional Practice

The Global Standards state essential conditions for Standard 7.1 including

- the board *establish a direct reporting relationship with the CAE*
- senior management enables [IA] to perform its services and responsibilities without interference

Organisations that value the professionalism of internal audit must ensure an independent reporting line in order to conform to the Standards.

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What is the risk to the organisation?

An organisation without independent members for the CAE to report to faces the same risks as one where a non-executive makes excuses for not taking accountability for its internal audit function.

There are risks associated with a lack of internal audit independence:

- Sanitised audit reports due to interference from senior management results in the audit committee/board receiving false assurance
- Information is withheld from internal audit due to lack of respect for function resulting in poor quality assurance to the audit committee/board
- Difficult messages are managed by senior management leading to misinformation at audit committee/board level
- CAE is coerced into an audit plan by senior management resulting in an assurance gap over risks such as strategy, governance and culture
- CAE does not attend key meetings at the request of senior management making it difficult to provide comprehensive assurance
- CAE is assigned operational responsibility (business continuity, whistleblowing, health & safety) due to organisational need leading to a conflict of interest, inability to provide assurance in that area and a distraction from core duties
- Internal audit operate controls due to organisational design (validating reports, checking exceptions, ongoing monitoring) compromising the provision of assurance.

Audit leaders often talk about partnerships with management and governance leaders. Such partnerships without an independent reporting line are high risk for a CAE. There is a fine line between partnership to achieve defined goals and objectives where there is mutual benefit and collaboration that is coercive and manipulative. Perception is everything where reputation is concerned for a CAE.

Steps to take

If you are a CAE without an independent reporting line assess your situation.

Which of the risks resonated with you?

Are there activities you do that compromise assurance?

Do you find assurance gaps are accepted to accommodate consultancy to support management?

Perhaps the consequences are subtle.

Find ways to raise the subject with the chair of the audit committee or the person that you believe you should report to.

Focus on three key elements, rehearse them, repeat them and rephrase them.

Purpose. Articulate your objective clearly. Be specific. Be very clear on what you want to achieve. Avoid overloading the conversation with too many points, focus on key points, always explain the relevance to your objective and never assume understanding.

Perspective. Consider what matters to your governance leaders. Why is the situation as it is? Put yourself in their shoes, what knowledge do they have, what experiences to draw on, what challenges do they

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perceive? Take time to listen to what matters to them, find a ‘hook’ to make your proposal a solution to one of their issues.

Personality. Be prepared to be invest time in creating the environment for your proposal. Think about the ideal approach. Does your target like ad-hoc conversations or the formality of meetings? Will you need to prepare a business case or presentation? Consider the style of your stakeholders and how to adapt your own to negotiate a win-win scenario.

Closing Thoughts

Independence is fundamental to internal auditors: independence of thought and independence within the organisation. Governance leaders might not see the importance as clearly as auditors. Audit leaders should take every opportunity to build understanding as to why an independent reporting line matters and how it can be achieved. And remember… if at first you don’t succeed, try and try again.

"Feware made for independence. It is the privilege of the strong."

Friedrich Nietzsche, philosopher

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