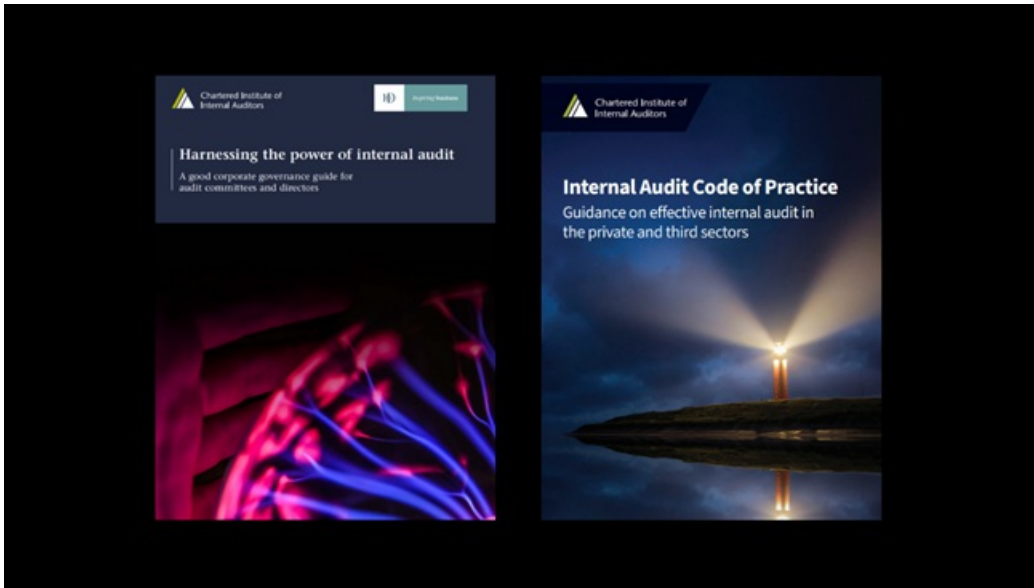




## Harnessing the power of the internal audit code of practice



**There has potentially never been a more important time for audit leaders; a time for objectivity, integrity and insight in a world that has turned on its axis. We look at two of the most important professional publications of recent times and how audit leaders can use them to best effect with their key stakeholders.**

- The Internal Audit Code of Practice (the Code): Launched in January 2020. Applies to all to organisations in the private and third sectors (separate **codes and standards** exist for the Public Sector and Financial Services).
- Harnessing the Power of Internal Audit (HtP): Published in February 2019. Serves as a good corporate governance guide for audit committees, directors and audit leaders.

During the launch of the Code, Brendan Nelson, Chair of the audit committee at BP, and Chair of the steering committee that developed the code said that “too often after crises we hear people say ‘if only I’d understood this better’, the point of the Code is to help internal audit highlight the critical issues that executives need to be aware of before they reach crisis point.”

Fast forward a matter of weeks and the entire planet is in the depths of the **COVID-19** pandemic crisis. There will be time for reflection and learning. Good governance alone cannot prevent failure, organisations, governments and global systems are complex.

There is however a real opportunity for audit leaders, as assurance providers and trusted advisors, to raise the bar on their professional offering and their own personal courage. These documents provide significant support with delivering tough messages, appraising difficult decisions, demonstrating strong leadership and

advocating good governance.

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## A 30 second summary

It is vital to understand that these documents were designed to be shared, read and referred to; they can only reach their audience with your help.

### Harnessing the Power of Internal Audit

HtP makes a compelling case for the role of internal audit. In a post COVID-19 era, many organisations will be evaluating overheads; audit leaders need to embed the answers to the eight powerful questions discussed in this report in their own discussions and strategic planning. It is your responsibility to ensure that the audit committee and the board understand and appreciate the value of internal audit; don't wait for them to ask.

These questions are as follows:

- What is internal audit's role and mandate?
- What is its scope? How should it be resourced?
- What is the relationship between the audit committee and internal audit?
- Are all risks being managed?
- How should internal audit's recommendations be monitored?
- How should internal and external auditors work together?
- How should the quality of internal audit's work be assessed?

### The Internal Audit Code of Practice

The Code is an easy, ten-minute read for stakeholders and practitioners alike, it has nine sections with a total of 38 recommendations. It is complementary to the IPPF which contains all the details for actually doing the job.

Use it to perform an honest appraisal of your function and share your thoughts with the audit committee chair. Recognise where you need to raise the bar and how it will be achieved.

- Role and mandate - scope and priorities - reporting results
- Interaction with risk management, compliance and finance
- Independence and authority - resources - QAIP
- Relationship with regulators - relationship with external audit

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## Your audit mantra

The common theme crossing between the two publications is that internal audit is a powerful tool – a cutting edge internal audit function can help organisations deal with a wide variety of issues to prepare for the challenges ahead.

As audit leaders you should be familiar with the messages from the Code and HtP. Meaning you should be able to talk about them at any time, and understand the concepts detailed in both documents and how they add value to your organisation.

## Role and mandate

The primary role of internal audit, defined in a charter, should be to help the board and executive management to protect the assets, reputation and sustainability of the organisation.

Fundamentally, internal audit's role is to assess the identification, reporting and management of significant risks by working with stakeholders to improve the effectiveness of governance, risk management and internal controls.

- Is your audit charter fit for purpose?
- Has it been recently reviewed and approved by the audit committee?
- Is it a living document or nodded through as an agenda item?

## Scope and priorities

Internal audit must be unrestricted in its work to cover the full portfolio of risks that an organisation faces – strategic, cultural, governance, operational, regulatory, compliance, financial – whether formal assurance or in an advisory capacity.

The challenges presented by the COVID-19 pandemic will require boards to evaluate their risk appetite on a much more frequent basis due to the speed of changes in the external environment as the global economy adjusts and recovers over time. Assurance over the process of setting and communicating this is as

important as ensuring the organisation complies with the decisions that are made.

Important risk areas such as workplace culture, reputation, cybersecurity, political uncertainty and digitalisation are highlighted in HtP. These headline topics will always remain valid although audit leaders should ensure priorities from the Code such as risk culture, significant business change, mergers, acquisitions and governance are not pushed aside in favour of high profile audits.

- Is your internal audit plan keeping pace with the priorities of the organisation?
- How strategic is your assurance?

*“Internal audit is a vital part of the overall assurance that companies provide their investors and stakeholders, which helps to build trust in business.”*

**Sir Jon Thompson, CEO, Financial Reporting Council**

## Reporting results

The relationship between the audit committee and the chief audit executive (CAE) is of primary importance. And never more so than during a crisis. It requires open, honest lines of communication – both formal and informal.

Reporting to the relevant governance bodies is detailed in the Code. Audit leaders should ensure that the format and style is readable and relevant; messages can be all too easily lost in long documents, those that change little from quarter to quarter or get pushed for time on a busy agenda.

When management fails to adequately implement agreed actions, CAEs should report this when it results in an unacceptable level of risk being taken. It is important that the audit committee invite relevant directors to explain and resolve issues rather than always devolving responsibility to CAEs.

Interestingly, in HtP, stakeholders are reminded that there will be grey areas due to big data where internal audit provides assurance and traditional evidence is limited. This mindset is now essential in an era of remote working, social and process reengineering together with rapidly changing risks.

Please take a moment to read question 4 in HtP and think about how you can share this with your audit committee.

## Relationships with control functions

Are all the risks being managed, is one of the eight questions posed in HtP.

Given the diversity and volatility of risk, the answer reminds governance leaders about the three lines of defence **model** and the role of the 2<sup>nd</sup> line.

In many organisations the risk profile is complex; an **assurance map** helps to put structure around the topic for reporting in addition to clarifying ownership and responsibility for risk management.

Internal audit should include within its work regular assessments of the adequacy and effectiveness of the control functions. To maintain objectivity, it is advisable if internal audit is neither responsible for, nor part of, the control functions.

- Do you use an assurance map with your audit committee?
- How regularly do you evaluate the 2<sup>nd</sup> line?

## Independence and authority

It is the audit committee's role to oversee the appointment and termination of a CAE. The Code content is very clear on their role in enabling and maintaining the independence and authority of the CAE through reporting lines, objective setting and remuneration.

Ultimately though it is the actions of a CAEs that demonstrate independence and authority not words in a role profile.

- Do your actions advocate the internal audit profession?
- Are you a brave, candid and trustworthy CAE?

## Resources

Both publications call upon the audit committee to challenge both the capacity and capability of internal audit activities. Most organisations tolerate an assurance gap; it is incumbent on audit leaders to make sure that the consequences of this are understood by decision makers.

Organisational viability is a major consideration as the economic realities of the COVID-19 pandemic take effect. Audit leaders may need to do more with less, be creative with resourcing options and redefine what constitutes a principal risk to provide assurance over.

Is your internal audit activity suitably skilled and qualified?

What alternative resourcing models could be used in your sector?

*"The Institute of Directors very much welcomes the introduction of the Internal Audit Code of Practice which serves to codify the essential elements of internal controls required as the basis for any good business"*

**Jonathan Geldart, Director General of the Institute of Directors**

## Quality assurance and improvement programme

Audit leaders should be ready to answer questions on their performance and the ongoing development of the internal audit activities. Audit committees receive a clear message from both publications that they are responsible for monitoring this.

The Code details everything from annual review to the five-year external assessment. CAEs may wish to take a similar approach to that of HiP by referencing the IPPF rather than detailing it. It is very much a practitioner guide rather than the basis of discussion with stakeholders. The Code may be a better framework to report against having assessed the detail of the IPPF at an activity level.

- Could your QAIP be enhanced?
- How engaged is your audit committee in the development of the internal audit activity?

## External relationships

Following high-profile corporate failures such as Carillion and Thomas Cook, commentary in HiP reminds governance leaders that the assurance provided by external auditors is limited. The CAE and the partner responsible for external audit should ensure appropriate and regular communication together with sharing of information; effective relationships benefit the organisation and avoid duplication of assurance.

CAEs should also have an open, constructive and cooperative relationship with relevant regulators. Good practice would be to share regulatory guidance and insights with the organisation to improve risk awareness and improve compliance.

- Which regulators should you look to improve relations with during and after times of crisis?
- How do you ensure there is no assurance gap between internal and external audit over key financial controls?

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## Closing thoughts

Without question audit leaders are the best way to get these important publications under the nose of governance leaders, particularly members of the board and the audit committee. Printed copies can end up under a pile of reading material full of good intentions and an email version is great but digital files can easily be forgotten or lost in the magnitude of a hard drive.

So, what can you do?

Say it, say it again, and then repeat it.

Don't just provide it once. Embed the messages into your discussions and reports.

Make the Code important and help your organisation harness the power of internal audit.

*"It is essential that the new Internal Audit Code of Practice is a living document. It is not something to read and file in a drawer."*

**Brendan Nelson, Chair of the audit committee at BP and chair of the steering committee that developed the code.**

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## Additional information

The Chartered Institute offer a range of [External Quality Assessment options](#)