

# Effective Internal Audit in the Financial Services Sector

Recommendations from the Committee on  
Internal Audit Guidance for Financial Services:  
How They Relate to the Global Institute  
of Internal Auditors' (The IIA) International  
Standards for the Professional Practice  
of Internal Auditing (*Standards*)

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The recommendations mapped to the Standards

*September 2013*

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# Introduction

▶ In July, 2013, the Chartered Institute of Internal Auditors (the Chartered Institute), the UK and Ireland affiliate of The IIA, published "Effective Internal Audit in the Financial Services Sector". The publication offers recommendations on how to enhance internal audit in the UK financial services sector as "an additional benchmark against which firms can measure their internal audit function". It aims to build on the IIA International *Standards*.

The recommendations were made directly to the Chartered Institute by an Independent Committee comprised of noted board directors, internal audit professionals, and academicians, and included observers from the UK financial services regulators (the Financial Conduct Authority and the Prudential Regulation Authority) and corporate governance regulator (Financial Reporting Council).

The recommendations are based on the mandatory elements of the IIA's International Professional Practices Framework (IPPF), which comprise the:

- Definition of Internal Auditing,
- Code of Ethics, and
- International Standards for the Professional Practice of Internal Auditing (*Standards*)

While the *Standards* outline what internal auditors must do, and are mandatory for all internal auditors who are members of The IIA, the recommendations of the Independent Committee are intended to provide additional guidance to all financial services internal auditors, as well as their companies' boards and executive managements. The recommendations supplement the *Standards*, but are neither mandatory nor "strongly recommended guidance" of the IPPF. The IIA supports and appreciates the work of the Independent Committee and believes the Committee has provided thoughtful recommendations for financial services internal audit functions operating in the UK to consider. The applicability of these recommendations should be viewed in that context.

In order to illustrate the relationship between the *Standards* and the recommendations of the Independent Committee, the Chartered Institute and The IIA have jointly prepared documents demonstrating how relevant components of the *Standards* relate to the individual recommendations. In this version it maps the individual recommendations to the *Standards*. A companion document has also been produced presenting how the relevant *Standards* map to the recommendations.

# How the Financial Services Committee Recommendations Relate to Global IIA Standards

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

## IIA STANDARDS

### [A] Role and Mandate of Internal Audit

1. The primary role of Internal Audit should be to help the Board and Executive Management to protect the assets, reputation and sustainability of the organisation.

It does this by assessing whether all significant risks are identified and appropriately reported by management and the Risk function to the Board and Executive Management; assessing whether they are adequately controlled; and by challenging Executive Management to improve the effectiveness of governance, risk management and internal controls. The role of Internal Audit should be articulated in an Internal Audit Charter, which should be publicly available.

**Definition of Internal Auditing** – Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

#### 1000 – Purpose, Authority, and Responsibility

The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and the Standards. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.

#### **Interpretation:**

*The internal audit charter is a formal document that defines the internal audit activity’s purpose, authority, and responsibility. The internal audit charter establishes the internal audit activity’s position within the organization, including the nature of the chief audit executive’s functional reporting relationship with the board; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. Final approval of the internal audit charter resides with the board.*

2. The Board, its Committees and Executive Management should set the right “tone at the top” to ensure support for, and acceptance of, Internal Audit at all levels of the organisation.

Does not relate directly to an IIA Standard

## [B] Scope and Priorities of Internal Audit

### 3. Internal Audit's scope should be unrestricted.

There should be no aspect of the organisation which Internal Audit should be restricted from looking at as it delivers on its mandate. Whilst it is not the role of Internal Audit to second guess the decisions made by the Board, its scope should include information presented to the Board as discussed further below.

### 1110 – Organizational Independence

The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfil its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

#### Interpretation:

*Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:*

- Approving the internal audit charter;
- Approving the risk based internal audit plan;
- Approving the internal audit budget and resource plan;
- Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters;
- Approving decisions regarding the appointment and removal of the chief audit executive;
- Approving the remuneration of the chief audit executive; and
- Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.

### 4. Risk assessments and prioritisation of Internal Audit work

In setting its scope, Internal Audit should take into account business strategy and should form an independent view of whether the key risks to the organisation have been identified, including emerging and systemic risks, and assess how effectively these risks are being managed. Internal audit's independent view should be informed, but not ►

### 2010 – Planning

The chief audit executive must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organization's goals.

#### Interpretation:

*The chief audit executive is responsible for developing a risk-based plan. The chief audit executive takes into account the organization's risk management ►*

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

determined by the views of management or the Risk function. In setting its priorities and deciding where to carry out more detailed work, Internal Audit should focus on the areas where it considers risk to be higher.

Internal Audit should make a risk-based decision as to which areas within its scope should be included in the audit plan – it does not necessarily have to cover all of the potential scope areas every year.

### 5. Internal Audit planning

Internal Audit plans, and material changes to Internal Audit plans, should be approved by the Audit Committee. They should have the flexibility to deal with unplanned events to allow Internal Audit to prioritise emerging risks. Changes to the audit plan should be considered in light of Internal Audit's ongoing assessment of risk.

### 6. Scope of Internal Audit

Internal Audit should include within its scope the following areas:

#### a. Internal governance

Internal Audit should include within its scope the design and ►

## IIA STANDARDS

*framework, including using risk appetite levels set by management for the different activities or parts of the organization. If a framework does not exist, the chief audit executive uses his/her own judgment of risks after consideration of input from senior management and the board. The chief audit executive must review and adjust the plan, as necessary, in response to changes in the organization's business, risks, operations, programs, systems, and controls.*

### 2020 – Communication and Approval

The chief audit executive must communicate the internal audit activity's plans and resource requirements, including significant interim changes, to senior management and the board for review and approval. The chief audit executive must also communicate the impact of resource limitations.

### 2060 – Reporting to Senior Management and the Board

The chief audit executive must report periodically to senior management and the board on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan. Reporting must also include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the board.

### 2110 – Governance

The internal audit activity must assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:

- Promoting appropriate ethics and values within the organization; ►

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

operating effectiveness of the internal governance structures and processes of the organisation.

- b. The information presented to the Board and Executive Management for strategic and operational decision making

Internal Audit should include within its scope the processes and controls supporting strategic and operational decision making. It should assess whether the information presented to the Board and Executive Management fairly represents the benefits, risks and assumptions associated with the strategy and corresponding business model.

- c. The setting of, and adherence to, risk appetite

Internal Audit is not responsible for setting the risk appetite but should assess whether the risk appetite has been established and reviewed through the active involvement of the Board and Executive Management. It should assess whether risk appetite is embedded within the activities, limits and reporting of the organisation.

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- Ensuring effective organizational performance management and accountability;
- Communicating risk and control information to appropriate areas of the organization; and
- Coordinating the activities of and communicating information among the board, external and internal auditors, and management.

### 2120 – Risk Management

The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes.

#### **Interpretation:**

*Determining whether risk management processes are effective is a judgment resulting from the internal auditor's assessment that:*

- *Organizational objectives support and align with the organization's mission;*
- *Significant risks are identified and assessed;*
- *Appropriate risk responses are selected that align risks with the organization's risk appetite; and*
- *Relevant risk information is captured and communicated in a timely manner across the organization, enabling staff, management, and the board to carry out their responsibilities.*

*The internal audit activity may gather the information to support this assessment during multiple engagements. The results of these engagements, when viewed together, provide an understanding of the organization's risk management processes and their effectiveness.*

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### d. The risk and control culture of the organisation

Internal Audit should include within its scope the risk and control culture of the organisation. This should include assessing whether the processes (e.g. appraisal and remuneration), actions (e.g. decision making) and “tone at the top” are in line with the values, ethics, risk appetite and policies of the organisation.

Internal Audit should consider the attitude and assess the approach taken by all levels of management to risk management and internal control. This should include Management’s actions in addressing known control deficiencies as well as Management’s regular assessment of controls.

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### 2110 – Governance

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*The internal audit activity may gather the information to support this assessment during multiple engagements. The results of these engagements, when viewed together, provide an understanding of the organization’s risk management processes and their effectiveness.*



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- e. Risks of poor customer treatment, giving rise to conduct or reputational risk

Internal Audit should evaluate whether the organisation is acting with integrity in its dealings with customers and in its interaction with relevant markets. Internal Audit should evaluate whether Business and Risk Management are adequately designing and controlling products, services and supporting processes in line with customer interests and conduct regulation.

Does not relate directly to an IIA Standard

- f. Capital and liquidity risks

Internal Audit should include within its scope the management of the organisation's capital and liquidity risks.

Does not relate directly to an IIA Standard

- g. Key corporate events

Examples of key corporate events could include significant business process changes, introduction of new products and services, outsourcing decisions and acquisitions/divestments. Internal Audit should decide if these events are sufficiently high risk to warrant involvement on a real time basis. In doing so, Internal Audit will evaluate whether the key risks are being adequately addressed (including by other forms of assurance, e.g. third party due diligence) and reported. Internal Audit should also assess whether the information being used in such key decision making is fair, balanced and reasonable, and whether the related procedures and controls have been followed.

Does not relate directly to an IIA Standard

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

### h. Outcomes of processes

Internal Audit should evaluate the design and operating effectiveness of the organisation's policies and processes. As part of this evaluation, Internal Audit should consider whether the outcomes achieved by the implementation of these policies and processes are in line with the objectives, risk appetite and values of the organisation.)

## IIA STANDARDS

### 2120 – Risk Management

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#### **Interpretation:**

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- *Organizational objectives support and align with the organization's mission;*
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- *Appropriate risk responses are selected that align risks with the organization's risk appetite; and*
- *Relevant risk information is captured and communicated in a timely manner across the organization, enabling staff, management, and the board to carry out their responsibilities.*

*The internal audit activity may gather the information to support this assessment during multiple engagements. The results of these engagements, when viewed together, provide an understanding of the organization's risk management processes and their effectiveness.*

### 2130 – Control

The internal audit activity must assist the organization in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement.

## [C] Reporting Results

7. Internal Audit should be present at, and issue reports to the appropriate governing bodies, including the Board Audit Committee, the Board Risk Committee and any other Board Committees as appropriate. The nature of the reports will depend on the remits of the respective governing bodies.

### 1111 – Direct Interaction with the Board

The chief audit executive must communicate and interact directly with the board. ▶

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

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### 2060 – Reporting to Senior Management and the Board

The chief audit executive must report periodically to senior management and the board on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan. Reporting must also include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the board.

### 2400 – Communicating Results

Internal auditors must communicate the results of engagements.

### 2440 – Disseminating Results

The chief audit executive must communicate results to the appropriate parties.

#### Interpretation:

*The chief audit executive is responsible for reviewing and approving the final engagement communication before issuance and for deciding to whom and how it will be disseminated. When the chief audit executive delegates these duties, he or she retains overall responsibility.*

#### 8. Internal Audit's reporting to the Board Audit and Risk Committees should include:

- a focus on significant control weaknesses and breakdowns together with a robust root-cause analysis;
- any thematic issues identified across the organisation;
- an independent view of Management's reporting on the risk management of the organisation, including a view on Management's remediation plans (which might include restricting further business until improvements have been ►

### 2060 – Reporting to Senior Management and the Board

The chief audit executive must report periodically to senior management and the board on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan. Reporting must also include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the board.

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

- implemented) highlighting areas where there are significant delays; and
- at least annually, an assessment of the overall effectiveness of the governance, and risk and control framework of the organisation, together with an analysis of themes and trends emerging from Internal Audit work and their impact on the organisation's risk profile.

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### [D] Interaction with Risk Management, Compliance and Finance

9. Effective Risk Management, Compliance and Finance functions are an essential part of an organisation's corporate governance structure. Internal Audit should be independent of these functions and be neither responsible for, nor part of, them.

#### 1110 – Organizational Independence

The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfil its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

##### **Interpretation:**

*Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:*

- Approving the internal audit charter;
- Approving the risk based internal audit plan;
- Approving the internal audit budget and resource plan;
- Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters;
- Approving decisions regarding the appointment and removal of the chief audit executive;
- Approving the remuneration of the chief audit executive; and
- Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations. ►

### 1130 – Impairment to Independence or Objectivity

If independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment.

**Interpretation:**

*Impairment to organizational independence and individual objectivity may include, but is not limited to, personal conflict of interest, scope limitations, restrictions on access to records, personnel, and properties, and resource limitations, such as funding. The determination of appropriate parties to which the details of an impairment to independence or objectivity must be disclosed is dependent upon the expectations of the internal audit activity's and the chief audit executive's responsibilities to senior management and the board as described in the internal audit charter, as well as the nature of the impairment.*

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### 2120 – Risk Management

The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes.

**Interpretation:**

*Determining whether risk management processes are effective is a judgment resulting from the internal auditor's assessment that:*

- *Organizational objectives support and align with the organization's mission;*
- *Significant risks are identified and assessed;*
- *Appropriate risk responses are selected that align risks with the organization's risk appetite; and*
- *Relevant risk information is captured and communicated in a timely manner across the organization, enabling staff, management, and the board to carry out their responsibilities. ►*

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

## IIA STANDARDS

10. Internal Audit should include within its scope an assessment of the adequacy and effectiveness of the Risk Management, Compliance and Finance functions. In evaluating the effectiveness of internal controls and risk management processes, in no circumstances should Internal Audit rely exclusively on the work of Risk Management, Compliance or Finance. Internal Audit should always examine, for itself, an appropriate sample of the activities under review.

*The internal audit activity may gather the information to support this assessment during multiple engagements. The results of these engagements, when viewed together, provide an understanding of the organization's risk management processes and their effectiveness.*

### 2100 – Nature of Work

The internal audit activity must evaluate and contribute to the improvement of governance, risk management, and control processes using a systematic and disciplined approach.

### 2120 – Risk Management

The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes.

#### **Interpretation:**

*Determining whether risk management processes are effective is a judgment resulting from the internal auditor's assessment that:*

- *Organizational objectives support and align with the organization's mission;*
- *Significant risks are identified and assessed;*
- *Appropriate risk responses are selected that align risks with the organization's risk appetite; and*
- *Relevant risk information is captured and communicated in a timely manner across the organization, enabling staff, management, and the board to carry out their responsibilities.*

*The internal audit activity may gather the information to support this assessment during multiple engagements. The results of these engagements, when viewed together, provide an understanding of the organization's risk management processes and their effectiveness.*

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

## IIA STANDARDS

11. Internal Audit should exercise informed judgement as to when to place reliance on the work of Risk Management, Compliance or Finance. To the extent that Internal Audit places reliance on the work of Risk Management, Compliance or Finance, that should only be after a thorough evaluation of the effectiveness of that function in relation to the area under review.

### 2050 – Coordination

The chief audit executive should share information and coordinate activities with other internal and external providers of assurance and consulting services to ensure proper coverage and minimize duplication of efforts.

## [E] Independence and Authority of Internal Audit

12. The Chief Internal Auditor should be at a senior enough level within the organisation (normally expected to be at Executive Committee or equivalent) to give him or her the appropriate standing, access and authority to challenge the Executive. Subsidiary, branch and divisional Heads of Audit should also be of a seniority comparable to the senior management whose activities they are responsible for auditing.

### 1110 – Organizational Independence

The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfil its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

#### Interpretation:

*Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:*

- Approving the internal audit charter;
- Approving the risk based internal audit plan;
- Approving the internal audit budget and resource plan;
- Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters;
- Approving decisions regarding the appointment and removal of the chief audit executive;
- Approving the remuneration of the chief audit executive; and
- Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

13. Internal Audit should have the right to attend and observe all or part of Executive Committee meetings and any other key management decision making fora.

14. Internal Audit should have sufficient and timely access to key management information and a right of access to all of the organisation's records, necessary to discharge its responsibilities.

In organisations in which the Internal Audit function is outsourced, the Chair of the Audit Committee should identify an appropriate individual responsible for ensuring that the Chief Internal Auditor has sufficient and timely access to key management information and decisions.

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### 1100 – Independence and Objectivity

The internal audit activity must be independent, and internal auditors must be objective in performing their work.

#### **Interpretation:**

*Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the chief audit executive has direct and unrestricted access to senior management and the board. This can be achieved through a dual-reporting relationship. Threats to independence must be managed at the individual auditor, engagement, functional, and organizational levels.*

*Objectivity is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others. Threats to objectivity must be managed at the individual auditor, engagement, functional, and organizational levels.*

### 1000 – Purpose, Authority, and Responsibility

The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and the Standards. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.

#### **Interpretation:**

*The internal audit charter is a formal document that defines the internal audit activity's purpose, ►*



*authority, and responsibility. The internal audit charter establishes the internal audit activity's position within the organization, including the nature of the chief audit executive's functional reporting relationship with the board; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. Final approval of the internal audit charter resides with the board.*

#### 1110 – Organizational Independence

The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfil its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

##### **Interpretation:**

*Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:*

- *Approving the internal audit charter;*
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- *Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters;*
- *Approving decisions regarding the appointment and removal of the chief audit executive;*
- *Approving the remuneration of the chief audit executive; and*
- *Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations. ►*

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

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### 2070 – External Service Provider and Organizational Responsibility for Internal Auditing

When an external service provider serves as the internal audit activity, the provider must make the organization aware that the organization has the responsibility for maintaining an effective internal audit activity.

#### Interpretation

*This responsibility is demonstrated through the quality assurance and improvement program which assesses conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards.*

15. The primary reporting line for the Chief Internal Auditor should be to the Chairman of the Audit Committee. In exceptional circumstances, the Board may wish for Internal Audit to report directly to the Chairman of the Board, or delegate responsibility for the reporting line to the Chairman of the Board Risk Committee, provided the Chairman of the Board Risk Committee and all the other Committee members are independent Non-Executive Directors. The reporting line must avoid any impairment to Internal Audit's independence and objectivity.

### 1110 – Organizational Independence

The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfil its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

#### Interpretation:

*Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:*

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- Making appropriate inquiries of management and the chief audit executive ►

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

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*to determine whether there are inappropriate scope or resource limitations.*

16. The Audit Committee should be responsible for appointing the Chief Internal Auditor and removing him/her from post.

### 1110 – Organizational Independence

The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfil its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

#### Interpretation:

*Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:*

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- *Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters;*
- *Approving decisions regarding the appointment and removal of the chief audit executive;*
- *Approving the remuneration of the chief audit executive; and*
- *Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.*

17. The Chairman of the Audit Committee should be accountable for setting the objectives of the Chief Internal Auditor and appraising his/her performance. It would be expected that the objectives and appraisal would take into account the views of the Chief Executive. This appraisal should consider the independence, objectivity and tenure of the Chief Internal Auditor.

### 1110 – Organizational Independence

The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfil its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity. ►

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

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18. The Chairman of the Audit Committee should be responsible for recommending the remuneration of the Chief Internal Auditor to the Remuneration Committee. The remuneration of the Chief Internal Auditor and Internal Audit staff should be structured in a manner such that it avoids conflicts of interest, does not impair their independence and objectivity and should not be directly or exclusively linked to the short term performance of the organisation.

### Interpretation:

*Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:*

- Approving the internal audit charter;
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## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

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- *Approving decisions regarding the appointment and removal of the chief audit executive;*
- *Approving the remuneration of the chief audit executive; and*
- *Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.*

19. Subsidiary, branch and divisional Heads of Internal Audit should report primarily to the Group Chief Internal Auditor, while recognising local legislation or regulation as appropriate. This includes the responsibility for setting budgets and remuneration, conducting appraisals and reviewing the audit plan. The Group Chief Internal Auditor should consider the independence, objectivity and tenure of the subsidiary, branch or divisional Heads of Internal Audit when performing their appraisals.

Does not relate directly to an IIA Standard

20. If Internal Audit has a secondary Executive reporting line, this should be to the CEO in order to preserve independence from any particular business area or function and to establish the standing of Internal Audit alongside the Executive Committee members.

### 1110 – Organizational Independence

The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfil its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

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- *Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters; ►*

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- Approving decisions regarding the appointment and removal of the chief audit executive;
- Approving the remuneration of the chief audit executive; and
- Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.

### [F] Resources

21. The Chief Internal Auditor should ensure that the audit team has the skills and experience commensurate with the risks of the organisation. This may entail training, recruitment, secondment from other parts of the organisation or co-sourcing with external third parties.

#### 1210 – Proficiency

Internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively must possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities.

#### Interpretation:

*Knowledge, skills, and other competencies is a collective term that refers to the professional proficiency required of internal auditors to effectively carry out their professional responsibilities. Internal auditors are encouraged to demonstrate their proficiency by obtaining appropriate professional certifications and qualifications, such as the Certified Internal Auditor designation and other designations offered by The Institute of Internal Auditors and other appropriate professional organizations.*

#### 1230 – Continuing Professional Development

Internal auditors must enhance their knowledge, skills, and other competencies through continuing professional development.

#### 2030 – Resource Management

The chief audit executive must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan. ►

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

## IIA STANDARDS

22. The Chief Internal Auditor should provide the Audit Committee with a regular assessment of the skills required to conduct the work needed, and whether the Internal Audit budget is sufficient to allow the function to recruit and retain staff with the expertise and experience necessary to provide effective challenge throughout the organisation and to the Executive.

### Interpretation:

*Appropriate refers to the mix of knowledge, skills, and other competencies needed to perform the plan. Sufficient refers to the quantity of resources needed to accomplish the plan. Resources are effectively deployed when they are used in a way that optimizes the achievement of the approved plan.*

### 2020 – Communication and Approval

The chief audit executive must communicate the internal audit activity's plans and resource requirements, including significant interim changes, to senior management and the board for review and approval. The chief audit executive must also communicate the impact of resource limitations.

### 2030 – Resource Management

The chief audit executive must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan.

### Interpretation:

*Appropriate refers to the mix of knowledge, skills, and other competencies needed to perform the plan. Sufficient refers to the quantity of resources needed to accomplish the plan. Resources are effectively deployed when they are used in a way that optimizes the achievement of the approved plan.*

23. The Audit Committee should be responsible for approving the Internal Audit budget and, as part of the Board's overall governance responsibility, should disclose in the annual report whether it is satisfied that Internal Audit has the appropriate resources.

### 1110 – Organizational Independence

The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfil its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity. ►

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

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### Interpretation:

*Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:*

- Approving the internal audit charter;
- Approving the risk based internal audit plan;
- Approving the internal audit budget and resource plan;
- Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters;
- Approving decisions regarding the appointment and removal of the chief audit executive;
- Approving the remuneration of the chief audit executive; and
- Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.

## [G] Quality Assessment

24. The Board or the Audit Committee is responsible for evaluating the performance of the Internal Audit function on a regular basis. In doing so it will need to identify appropriate criteria for defining the success of Internal Audit. Delivery of the audit plan should not be the sole criterion in this evaluation.

### 1110 – Organizational Independence

The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfil its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

### Interpretation:

*Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:*

- Approving the internal audit charter;
- Approving the risk based internal audit plan;
- Approving the internal audit budget and resource plan; ►



## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

## IIA STANDARDS

25. Internal Audit should maintain an up-to-date set of policies and procedures, and performance and effectiveness measures for the Internal Audit function. Internal Audit should continuously improve these in light of industry developments.

- *Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters;*
- *Approving decisions regarding the appointment and removal of the chief audit executive;*
- *Approving the remuneration of the chief audit executive; and*
- *Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.*

### 1310 – Requirements of the Quality Assurance and Improvement Program

The quality assurance and improvement program must include both internal and external assessments.

### 1311 – Internal Assessments

Internal assessments must include:

- Ongoing monitoring of the performance of the internal audit activity; and
- Periodic self-assessments or assessments by other persons within the organization with sufficient knowledge of internal audit practices.

#### **Interpretation:**

*Ongoing monitoring is an integral part of the day-to-day supervision, review, and measurement of the internal audit activity. Ongoing monitoring is incorporated into the routine policies and practices used to manage the internal audit activity and uses processes, tools, and information considered necessary to evaluate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards.*

*Periodic assessments are conducted to evaluate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards. Sufficient ►*

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

## IIA STANDARDS

*knowledge of internal audit practices requires at least an understanding of all elements of the International Professional Practices Framework.*

### 2040 – Policies and Procedures

The chief audit executive must establish policies and procedures to guide the internal audit activity.

**Interpretation:**

*The form and content of policies and procedures are dependent upon the size and structure of the internal audit activity and the complexity of its work.*

26. Internal Audit functions of sufficient size should develop a quality assurance capability, with the work performed by individuals who are independent of the delivery of the audit. The individuals performing the assessments should have the standing and experience to meaningfully challenge Internal Audit performance and to ensure that Internal Audit judgements and opinions are adequately evidenced.

The scope of the quality assurance review should include Internal Audit's understanding and identification of risk and control issues, in addition to the adherence to audit methodology and procedures. This may require the use of resource from external parties. The quality assurance work should be risk-based to cover the higher risks of the organisation and of the audit process. The results of these assessments should be presented directly to the Audit Committee at least annually.

### 1300 – Quality Assurance and Improvement Program, Interpretation

The chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity.

**Interpretation:**

*A quality assurance and improvement program is designed to enable an evaluation of the internal audit activity's conformance with the Definition of Internal Auditing and the Standards and an evaluation of whether internal auditors apply the Code of Ethics. The program also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement.*

### 1310 – Requirements of the Quality Assurance and Improvement Program

The quality assurance and improvement program must include both internal and external assessments. ►

### 1311 – Internal Assessments

Internal assessments must include:

- Ongoing monitoring of the performance of the internal audit activity; and
- Periodic self-assessments or assessments by other persons within the organization with sufficient knowledge of internal audit practices.

**Interpretation:**

*Ongoing monitoring is an integral part of the day-to-day supervision, review, and measurement of the internal audit activity. Ongoing monitoring is incorporated into the routine policies and practices used to manage the internal audit activity and uses processes, tools, and information considered necessary to evaluate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards.*

*Periodic assessments are conducted to evaluate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards. Sufficient knowledge of internal audit practices requires at least an understanding of all elements of the International Professional Practices Framework.*

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### 1312 – External Assessments

External assessments must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organization. The chief audit executive must discuss with the board:

- The form and frequency of external assessment; and
- The qualifications and independence of the external assessor or assessment team, including any potential conflict of interest. ▶

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

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### **Interpretation:**

*External assessments can be in the form of a full external assessment, or a self-assessment with independent external validation.*

*A qualified assessor or assessment team demonstrates competence in two areas: the professional practice of internal auditing and the external assessment process. Competence can be demonstrated through a mixture of experience and theoretical learning. Experience gained in organizations of similar size, complexity, sector or industry, and technical issues is more valuable than less relevant experience. In the case of an assessment team, not all members of the team need to have all the competencies; it is the team as a whole that is qualified. The chief audit executive uses professional judgment when assessing whether an assessor or assessment team demonstrates sufficient competence to be qualified.*

*An independent assessor or assessment team means not having either a real or an apparent conflict of interest and not being a part of, or under the control of, the organization to which the internal audit activity belongs.*

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### **1320 – Reporting on the Quality Assurance and Improvement Program**

The chief audit executive must communicate the results of the quality assurance and improvement program to senior management and the board.

### **Interpretation:**

*The form, content, and frequency of communicating the results of the quality assurance and improvement program is established through discussions with senior management and the board and considers the responsibilities of the internal audit activity and chief audit executive as contained in the internal audit charter. To demonstrate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards, the results of external and periodic internal assessments are communicated upon completion of such ►*

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

## IIA STANDARDS

27. Where the Internal Audit function is outsourced to an external provider, Internal Audit's work should be subject to the same quality assurance work as the in-house functions. The results of this quality assurance work should be presented to the Audit Committee at least annually for review.

*assessments and the results of ongoing monitoring are communicated at least annually. The results include the assessor's or assessment team's evaluation with respect to the degree of conformance.*

### 1310 – Requirements of the Quality Assurance and Improvement Program

The quality assurance and improvement program must include both internal and external assessments.

### 1311 – Internal Assessments

Internal assessments must include:

- Ongoing monitoring of the performance of the internal audit activity; and
- Periodic self-assessments or assessments by other persons within the organization with sufficient knowledge of internal audit practices.

#### **Interpretation:**

*Ongoing monitoring is an integral part of the day-to-day supervision, review, and measurement of the internal audit activity. Ongoing monitoring is incorporated into the routine policies and practices used to manage the internal audit activity and uses processes, tools, and information considered necessary to evaluate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards.*

*Periodic assessments are conducted to evaluate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards. Sufficient knowledge of internal audit practices requires at least an understanding of all elements of the International Professional Practices Framework. ►*

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

## IIA STANDARDS

### 2070 – External Service Provider and Organizational Responsibility for Internal Auditing

When an external service provider serves as the internal audit activity, the provider must make the organization aware that the organization has the responsibility for maintaining an effective internal audit activity.

**Interpretation:**

*This responsibility is demonstrated through the quality assurance and improvement program which assesses conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards.*

28. In addition, the Audit Committee should obtain an independent and objective external assessment at appropriate intervals. This could take the form of periodic reviews of elements of the function, or a single review of the overall function. The conformity of Internal Audit with the recommendations included in this guidance should be explicitly included in this evaluation. The Chairman of the Audit Committee should oversee and approve the appointment process for the independent assessor.

### 1312 – External Assessments

External assessments must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organization. The chief audit executive must discuss with the board:

- The form and frequency of external assessment; and
- The qualifications and independence of the external assessor or assessment team, including any potential conflict of interest.

**Interpretation:**

*External assessments can be in the form of a full external assessment, or a self-assessment with independent external validation.*

*A qualified assessor or assessment team demonstrates competence in two areas: the professional practice of internal auditing and the external assessment process. Competence can be demonstrated through a mixture of experience and theoretical learning. Experience gained in organizations of similar size, complexity, sector or industry, and technical issues is more valuable than less relevant experience. In the case of an assessment team, not all members of the team need to have all the competencies; it ►*

## RECOMMENDATIONS OF THE INDEPENDENT COMMITTEE

## IIA STANDARDS

*is the team as a whole that is qualified. The chief audit executive uses professional judgment when assessing whether an assessor or assessment team demonstrates sufficient competence to be qualified.*

*An independent assessor or assessment team means not having either a real or an apparent conflict of interest and not being a part of, or under the control of, the organization to which the internal audit activity belongs.*

### [H] Relationship with Regulators

#### 29. Nature and purpose of the relationship

The Chief Internal Auditor, and other senior managers within Internal Audit, should have an open, constructive and co-operative relationship with regulators which supports sharing of information relevant to carrying out their respective responsibilities.

Does not relate directly to an IIA Standard

### Wider Considerations

30. The Chartered Institute of Internal Auditors should consider developing additional guidance on the application and implementation of the recommendations detailed in this guidance. In particular, less well established areas for Internal Audit activity, such as auditing culture and outcomes would benefit from additional guidance.

31. This Committee recommends that the Chartered Institute of Internal Auditors should review this guidance after a period of two to three years, and consider amending or updating the guidance as required.

## About the Chartered Institute of Internal Auditors

The Chartered Institute is the only body focused exclusively on internal auditing in the UK and Ireland. We are passionate about supporting, promoting and training the professionals who work in it and have been leading the profession of internal auditing for over 65 years. We are committed to enhancing the recognition and professionalism of internal audit in the UK and Ireland, through:

- Dynamic leadership of the profession which maximises our members' reputation and influence individually and collectively.
- Technical excellence through The IIA's International Standards and Code of Ethics.
- Representing 8,000 members from all sectors in the UK and Ireland.
- High quality support to our members throughout their careers, which enables them to continually develop their professional knowledge, skills and experience and provides other services of value to members in their roles.

These things, enacted through our staff, members and volunteers and with the support of our suppliers and partners, make a significant and unique contribution to the success of all organizations in our region.

To learn more visit the Chartered Institute of Internal Auditors website, [www.iaa.org.uk](http://www.iaa.org.uk)

## About The Institute of Internal Auditors (IIA Global)

Established in 1941, The Institute of Internal Auditors (The IIA) is the international professional association serving the Internal Audit profession globally. With global headquarters in Altamonte Springs, Florida, USA, The IIA is the internal audit profession's global voice, recognized authority, acknowledged leader, chief advocate, and principal educator. The IIA's International Standards and Code of Ethics unite a global community of over 180, 000 internal auditors in 190 countries working in myriad areas including internal auditing, risk management, governance, internal control, information technology audit, education, and security.

Our mission is to provide dynamic leadership for the global profession of internal auditing. Activities in support of this mission include, but are not limited to:

- Advocating and promoting the value internal audit professionals add to their organizations.
- Providing comprehensive professional educational and development opportunities, standards and other professional practice guidance, and certification programs.
- Researching, disseminating, and promoting knowledge concerning internal auditing and its appropriate role in control, risk management, and governance to practitioners and stakeholders.
- Educating practitioners and other relevant audiences on best practices in internal auditing.
- Bringing together internal auditors from all countries to share information and experiences.

To learn more, visit The IIA's global website, [www.globaliaa.org](http://www.globaliaa.org)

[www.iaa.org.uk](http://www.iaa.org.uk)

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