Internal Audit Independence ~ in the real world
By James C Paterson

I was fortunate to chair a panel discussion at the IIA UK Internal Audit Leaders Conference in London on this topic. On the panel were:

- Saleem Chowdhery, Director of Internal Audit at the Co-op Group,
- Audrey Haaxman, Director of Internal Audit and Risk, British Council,
- Bill Tonks, Director of Audit, St James' Place Wealth Management.

In the audience were around 100 Heads of Internal Audit from a range of organisations in the UK & Ireland and from further afield. We also had the benefit of a some polling and questionnaire software, which enabled us to collect views and questions from those in attendance.

Here are some of the key insights from our session, with some additional reflections in parentheses.

First and foremost, this is an important topic; independence is a bedrock of what it is to be an internal auditor, and a key platform from which we can offer advice, insights and reliable assurance. Second, we should recognise that there is a degree of tension between being independent and being seen to be "a trusted advisor" and a function that delivers added value. Third, there are important psychological traps that we must be mindful of when considering our independence, particularly "self-justification" and "confirmation bias." These are pervasive human traits and can lead us to remember situations when we have pushed back, against some resistance, on certain points; but might forget, or gloss over, or explain away, when we have, for example, postponed an audit, or changed the wording of a report to keep a key stakeholder on board.

Audit Planning

Saleem Chowdhery started by observing that a good starting point was to be clear about who were the key stakeholders of internal audit – very often this would be the Non-Executive Directors and the Senior Executives. The former offer a potential balance towards independence. In addition, a risk based audit plan was fundamental to being independent.

There was an interesting challenge in relation to key functions such as: Finance, Compliance, Risk and Legal. These functions could provide useful and important inputs to the audit planning process and could play a key assurance role. However, these "friends of internal audit" could also encourage audit to delay certain audits, with comments such as "we are still working on that and need a bit longer". On the one hand, since they are "allies" of internal audit, it can be understandable to have sympathy with these views, but on the other, there is a risk that internal audit will avoid, or "pull its punches" in relation to the work of these functions.

Bill Tonks agreed that the audit plan was a crucial arena in which internal audit needed to exercise its independence, since "If you have a poor strategy, all the tactics in the world, won't recover fully what has been lost". He added that it was sometimes difficult for internal audit to have a really good understanding of exactly what some second line functions did on a day to day basis. He also observed that it was not unusual to hear Heads of Audit

questioning the role of their risk management functions ("How do they get away with doing so little?").
A key way to demonstrate independence in the audit planning process was to "triangulate" between different stakeholders and sources of information. For example, what do the Executive know, but the Non-Executives do not? What sources of information are there to validate the risk position? For example, Regulator guidance (and fines) on certain areas; or the internal incidents and issues that were arising; or the issues that external experts were raising as potential areas of concern (often called "Audit hot spots").
Audrey Haaxman highlighted that being transparent about plan coverage was a key way to demonstrate that audit was aiming for a balanced, risk based and independent view.
It was agreed that proposed changes to the audit plan during the year needed to be explained and justified.

Assignment scoping and fieldwork
Audrey explained that scoping was another key area where internal audit independence could be challenged since the scope of an assignment was often a matter of significant discretion. This highlights the importance of having a strong connection between the audit plan, and key risk coverage, and what is then included in the scope of audit assignments. Additions or deletions to the scope of an audit was therefore something to watch carefully. (Note that adding areas to the scope of an assignment can have the effect of reducing the amount of time the audit team has to look at key "exam questions", and therefore be almost as problematic as management asking for items of scope to be removed).
Bill noted that sometimes audit scopes can be used by managers to push back at what audit wants to report; which is clearly something that needs to be named and managed.

In terms of assignment delivery, a properly managed audit process, with a focus on factual evidence, and with the right quality control, should be less prone to independence threats. However, it was important there was a robust process of agreeing up front the criteria against which the facts / assignment were going to be judged.
Bill highlighted the importance of remembering that very often senior leaders do not get in contact with the reality of processes and transactions, and therefore there was a crucial role for internal audit to not lose its ability to report these crucial factual details which can shed so much light on the way an organisation works in fact.
(Using a peer review process to cross check assignment progress and proposed findings is also worth thinking about to ensure auditors do no miss anything key and there is consistency between different auditors or audit teams).

One final area to watch is the quality of interviews during assignments. Heads of Audit and/or their managers should be clear how effective auditors were in dealing with "side tracking" by "foxy" managers. This is important because if something is missed in an interview, and therefore not pursued further, it will not necessarily appear in the audit work papers (so a file review may not spot this).

Audit reports
Bill stressed that audit reports were often the "flagship product" of any internal audit team. For this reason, a late, unclear or badly written/punctuated report was likely to undermine audit's ability to offer an effective independent and insightful perspective that is noticed and

acted upon. This was also because those with a "malign intent" could exploit weaknesses in reports to undermine the message from internal audit. Heads of Audit should be mindful of "foxy" managers influencing junior audit team members to amend the audit before it reaches the Head of Audit.

Saleem advocated that the best mind-set for a report was to get it "right first time" and to try to set expectations that the report was largely a non-negotiable document. The goal was to ensure that stakeholders were "fully informed" and "never misinformed."

Minor changes to wording or grading adjustments (in borderline cases) could arise from time to time, but it was suggested that such changes should be made transparent to Senior Stakeholders (i.e. a metric on the number of such changes and the reasons for this).

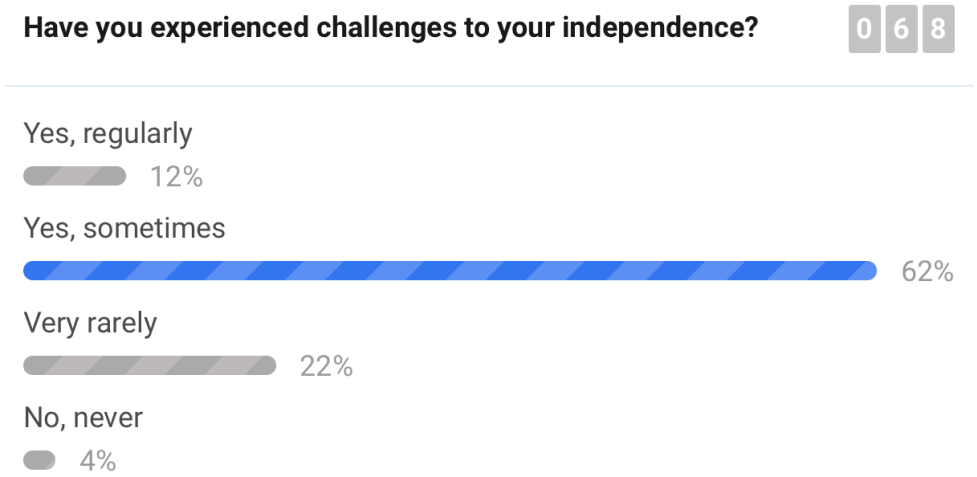
It was noted that some regulators were entitled to access audit work-papers and draft audit reports, so Heads of Internal Audit should not assume that these changes would always take place "below the radar."

Closure of Actions / The follow-up process

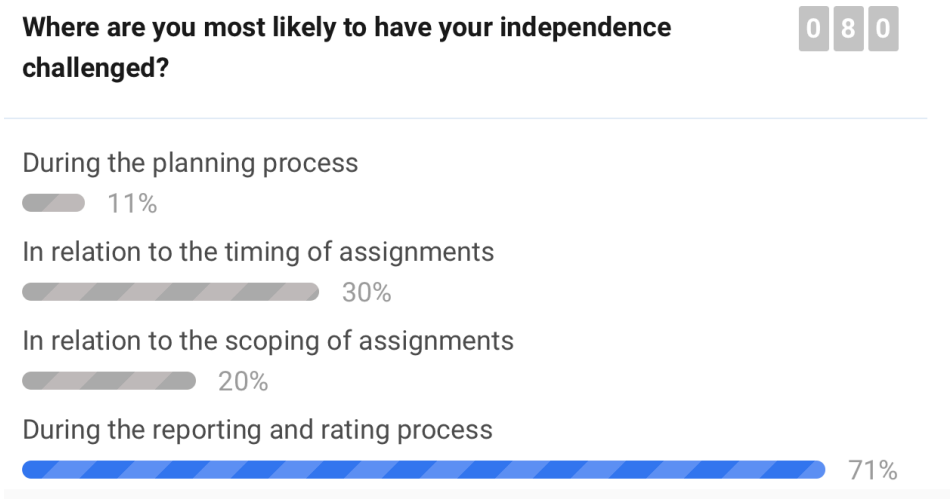
It was agreed that a robust follow-up process, where there was real rigour in checking that things were being fixed properly, on a long-term sustainable basis, was important to ensure that the audit function was taken seriously.

Survey results

During the course of the discussion, we polled the audience of Heads of Internal Audit on two key questions. Firstly:



This result is not particularly surprising and emphasises why this is such an important topic. Secondly:



There are two interesting points from this poll: i) participants were able to agree with up to two questions (hence the total % adds up to over 100%) and ii) it is somewhat surprising that the planning process scores so low, but perhaps the audience felt they had this risk under control.

Key questions posed by the audience

At the end of the discussion, we had a few brief moments to respond to some questions. These were "up-voted" so the most popular were highlighted.

Q: Can changing a single word in a report mean that IA's independence is challenged?
A: It depends on the word! (lots of laughter from the audience).

Q: Would it be OK to accept a piece of work as an advisory assignment and therefore not rate an area?
A: As a general principle, advisory work needs to be managed in terms of the time it takes, the nature of the work to be done, and the way any results are reported. It was argued that even without ratings, audit could easily communicate to stakeholders any key areas of concern.

In conclusion

I think there is no doubt that we covered an important topic and there were a number of specific, practical, bits of advice that could be used to mitigate the worst instances of internal audit losing its independence.

That said, it is clearly a fact that threats to audit independence are real, and not likely to go away. The threats can be external, from "foxy" managers, but also internally as auditors try to "add value", or as auditors think about their future career development, or even because it is decided to "shade down" a border-line rating maintain goodwill in an area. Raising the question of whether independence is something that needs to be judged issue by issue, or can be judged overall.

In any event, vigilance is clearly key.

At AstraZeneca I looked for examples of "visible challenge" from auditors, which was not unhelpful in terms of setting expectations, but I can see that the idea of having more safeguards and measures is something HIAs should think seriously about – ranging from:

- Changes to key risk coverage,
- Assignments being postponed,
- Scopes being amended,
- Report wording and grading's being changed
- Challenge (or lack of it) to the time given to remediate actions

I hope this article has given readers some food for thought and would be interested to hear from others with their ideas and good practices as well as dilemmas and war stories (that the real world is very good at throwing at internal audit!)

James C Paterson