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Mr Chris Spedding
Secretary
Committee on Internal Audit Guidance for Financial Services
Chartered Institute of Internal Auditors
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London
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Dear Chris

Effective Internal Audit in the Financial Services Sector

ICAEW is pleased to respond to your request for comments on the Committee's consultation document *Effective Internal Audit in the Financial Services Sector*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

EFFECTIVE INTERNAL AUDIT IN THE FINANCIAL SERVICES SECTOR

Memorandum of comment submitted in April 2013 by ICAEW in response to the Committee on Internal Audit Guidance for Financial Services consultation document *Effective Internal Audit in the Financial Services Sector* published in February 2013.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation document *Effective Internal Audit in the Financial Services Sector* published by the Committee on Internal Audit Guidance for Financial Services in February 2013, a copy of which is available from this [link](#).

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of external auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

OVERALL POINTS

4. Overall, we strongly commend the work of the Committee, the direction taken by its draft Guidance and the recommendations therein. We believe that the Guidance will be a positive step forward for internal audit in the financial services sector.
5. Whilst some of the recommendations are specific to financial services institutions, we also believe that most of the recommendations are applicable to many non-financial services organisations. Over time, the Guidance should be carefully considered by such organisations for subsequent implementation, thereby raising good practice across all sectors. This outcome would also be applauded.
6. To ensure that the final Guidance is taken seriously by all relevant financial institutions, we strongly believe that it is important for the Committee to get formal endorsement from the relevant regulatory bodies that are the successor bodies to the FSA. This will add the necessary weight to the Guidance which we hope will also be endorsed by the Chartered Institute of Internal Auditors.

COMMENTS ON SPECIFIC SECTIONS

7. Whilst we are very supportive of the draft Guidance, there are some matters that we suggest the Committee could consider before finalising its document. Our comments follow the structure of the section headings in the consultation document.

A Role and mandate of Internal Audit

8. Although Recommendation 1 reflects many current issues, we have some concern about a couple of words used therein. We suggest that the Committee may wish to reflect upon the following points.
9. The word 'protect' can give the impression that internal audit acts as the guardian of the organisation's assets. If the relevant part of the recommendation were to be rephrased as "...help the board and management protect the resources, reputation and sustainability of the organisation....." then the Recommendation could be read more positively.
10. Our preference for use of the word 'resources' over that of 'assets' is also reflected in the above suggestion for rewording. We consider that use of the word 'resources' better covers the traditional assets as well as the softer aspects of the organisation including people, culture and information.

B Scope and priorities of Internal Audit

- 11.** With the exception of some aspects of Recommendation 3 that may need to be better explained, most areas of this Section are un-contentious. We particularly agree with Recommendation 2 that the scope of internal audit should be unrestricted.
- 12.** However, having set the expectation that internal audit's role should be unrestricted, some readers could view the eight sub-parts to Recommendation 3 as incomplete. For example, matters such as reputational or information security risks, or operational and credit risks are not included. Such risks can be as equally significant as those that are included in the eight sub-parts. We suggest that the Committee give greater emphasis to the fact that the list in Recommendation 3 is not exhaustive, perhaps even mentioning some areas that had been omitted as examples. This should help to ensure that readers do not view the list of risks mentioned in the eight sub-parts as being more important than the many other risks which are not specifically included.
- 13.** Whilst we agree with Recommendation 3(b), essentially that board members need some 'assurance' on the information they receive, in practice this may be a real challenge to internal audit. Will internal audit get enough time to review the information before it goes to the board? We suggest that it should be made clear that it is not all information that goes to the board; but perhaps selected on a risk-based approach. In practice, this may also be what information the members of the audit committee would like 'assurance' on.
- 14.** The Committee could consider making some reference in Recommendation 4 to relevant regulatory requirements/expectations that must be met in some jurisdictions. Whilst not necessarily risk-based, such requirements will be an important priority.
- 15.** We also noted that Recommendation 4 does not refer to internal audit's response to requests from senior management. We are informed that some internal audit functions have often spent a considerable amount of effort gaining credibility with senior executive management such that these executives are confident in asking internal audit to undertake work. The work of internal audit, in relation to requests from senior executive management, could be referred to in the Guidance.

C Reporting results

- 16.** The fourth bullet of Recommendation 8 refers, inter alia, to an assessment of overall effectiveness of the governance, and risk and control framework of the organisation. This is a very challenging area for internal audit and the practical implications issues, particularly for insufficiently well-resourced internal audit functions in smaller organisations, needs to be carefully considered by the Committee.
- 17.** The development of board Risk Committees is an issue we refer to in Section I.

D Interaction with Risk Management, Compliance and Finance

- 18.** Recognising that many banks and insurance companies operate a 'three lines of defence' model, with management, risk management and internal audit functions each given distinct roles and responsibilities; we agree that internal audit should be separate from the risk management, compliance or finance functions. We also agree that internal audit should exercise informed judgement as to when to place reliance on the work of these other functions.
- 19.** As the internal audit and risk management functions have distinct mandates and roles, in practice it is important to ensure that co-ordination of the respective roles leads to the avoidance of the duplication of work. This point might be brought out in the Committee's final guidance.

E Independence and authority of Internal Audit

- 20.** We suggest that consideration be given to the enhancement of Recommendation 14 by giving Internal Audit unrestricted access to locations as well as to records.
- 21.** Recommendation 15, the reporting line to the Board Chairman, attracted a lot of comment. Whilst in principle we agree that the main reporting line of internal audit, both for the results of its work and organisationally, is with the organisation's non-executive directors, we suggest that the Committee should further think through these complex and practical issues which can often depend more on the characters of the people involved rather than formal roles and structures.
- 22.** The experience of some Heads of Internal Audit (HIAs) suggests that the Board Chairman may have little involvement in the internal workings of an organisation and that if the HIA is looking for support when dealing with difficult senior management, the support of the Chief Executive is likely to be far more effective than that of the Chairman.
- 23.** There are also issues related to whether or not the Board Chairman:
 - attends meetings of the Audit Committee; and
 - was independent or not (within the meaning of the UK Corporate Governance Code) upon his/her appointment.
- 24.** Whilst we suggest that the HIA should, at a minimum, primarily report to a non-executive director, there could also be some leeway for a dual reporting line to the CEO.
- 25.** In practice, the more likely reporting outcome for internal audit will be to the Chairman of the Audit Committee rather than the Board Chairman. Interaction and support for the HIA is more clearly part of the role of the Audit Committee Chairman and he/she should have the greatest interest in making sure that the internal audit function works effectively and is properly resourced.

F Resources

- 26.** We fully support this section. The availability of sufficient resources is fundamental to the effective implementation of the Guidance within organisations.
- 27.** In practical terms there may have to be some changes in the mind-set of boards, audit committees, executive management as well as HIAs. HIAs will have to plan their resources carefully to do the work now required by the Guidance and there will probably be a need for flexible resourcing from year to year.
- 28.** Because it is an important driver for this Section, we suggest that the Committee gives consideration to moving Recommendation 25 to be the first recommendation in this Section.

G Quality assessment

- 29.** We have no comments on this Section other than to note that Recommendation 28 may be more challenging for smaller internal audit departments.

H Relationships with Regulators

- 30.** We have no comments on this Section.

I Wider considerations

- 31.** The increasing relevance of Risk Committees to the work of internal audit is now rightly and more widely recognised. This not only reflects the wide scope of the work of internal audit but also, in part, because audit committees are being overloaded with financial reporting and external audit matters.

- 32.** Whilst Audit Committees have a generally well established organisational structure, membership and remit, much of which is outlined in national corporate governance codes, regulation or law as well as in European Directives, the same cannot be said of Risk Committees. This is an area of developing but varying practice not only in so far as their membership (often comprised of executives and non-executives) is concerned but also in their remit and responsibilities as well in their interaction with internal audit.
- 33.** We therefore believe that the Financial Reporting Council should carefully consider Recommendation 33.

Other matter

- 34.** Finally, whilst we appreciate that there are different interpretations of the word 'assurance', we note that, other than a passing reference to 'other forms of assurance' in Recommendation 3(g), there is no reference to it in the draft Guidance. For many in the internal audit profession the 'provision of assurance' is the product delivered by their departments/functions. We suggest that the Committee may care to add some words to the Preamble (or elsewhere) on this matter to explain its non-inclusion.

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