

## Role of Internal Audit

### Traditional internal audit

Internal audit has a pretty tarnished image that is hard to shake off, even if it is now out of date. Internal auditors have famously been described as the ones who “come onto the battlefield after the battle and bayonet the wounded”. This refers to the low-value compliance audit work that was

#### Internal audit in the past

- Low value work
- Focus on financial controls
- Compliance with procedures
- Looking backwards
- Irrelevant to managers

commonly undertaken by internal audit departments. Internal auditors used to be looking backwards – reviewing activities after they had taken place. They would focus on financial controls and compliance with procedures, and admonish managers for not following them.

Managers felt that internal audit reports were irrelevant, and just ignored them or signed up to actions they would never actually undertake. Boards would receive some assurance from the internal audit work, but were possibly lulled into a false sense of security.

### Risk-based internal audit

Internal audit has moved on. It begins from the risk profile of the organisation – which areas of activity pose significant threats? What are the risks that will prevent the charity from achieving its objectives? These risks are unlikely to be immediately concerned with the financial controls. Risk management needs to encompass all activities of the organisation and internal audit does too. Internal audit now focuses on the risks faced by the organisation and the controls in place to manage those risks. Internal audit ensures that the controls are effective, recommends improved controls and monitors the completion of actions to close control gaps.

Internal audit will not necessarily look at every area of activity over the audit cycle – it may look at the high-risk areas every year. It all depends on the risk profile and the emphasis is on managing the major risks the charity faces.

#### Internal audit today

- Risk-based work
- Wider framework
- Controls to manage assessed risk
- Focus on highly-ranked risks

### Looking forward

Commonly, the highest ranked risk in charities is reputation. It is also the most valuable asset for most charities. Reputation is the basis for everything. People fund or donate to your charity on the basis of your reputation. They give their time to your charity, want to work for it, support campaigns and so on – all on the basis of your charity’s reputation. Charities need to consider how they manage intangible assets such as reputation and brand values more effectively. Internal audit can contribute effectively as it works across the whole organisation. It should also pick up on the positive side of risk management – charities should be building up their reputation, not just developing contingency plans.

The other major areas for internal audit attention will be any areas where there is major change – new projects, new areas of investment, new strategic direction. Internal audit can review current

activity, rather than look back over the organisation's shoulder. It can assist managers to ensure that the process for introducing the change is well-managed, suggesting improvements. This means that internal auditors have a different objective – their work increases the chances of success of new projects and change. True, in order to deliver this objective, internal auditors may need to have more skills and experience.

#### Internal audit looking forward

- Focus on important areas such as reputation
- Consider upside risk and positive side as well
- Using role to cover whole charity
- Contributing to the success of projects and change
- Internal auditors more skilled and experienced

#### Role of internal audit

Internal audit does not have to abandon all compliance work, but it is worth considering how this should be undertaken in order to get best value from your internal audit function. Internal auditors can assist in the development of self-assessment tools such as checklists and questionnaires. These can be used by managers to help them check that procedures and good practice are in place.

In addition, it may be helpful to provide trustee boards with an overview of compliance with laws and regulations. Whilst compliance in these areas is necessary and important, it is not necessarily worth significant amounts of internal audit effort. The reassurance needed is that managers are undertaking the appropriate actions and checks. It is relatively straightforward to construct a full list of all the areas where the charity needs to comply with laws and regulations, and then to annotate this with the people responsible and ways that managers ensure compliance. Typical entries on the list might include data protection, health and safety, employment law as well as areas specific to the activity, such as criminal bureau checks for staff and volunteers working with children. Internal audit can help to set up such a system and oversee it, but it should not consume too much of this valuable resource.

#### Role of the audit committee

The audit committee should oversee the charity's risk assessment process, and ensure that the charity is managing its risk. This does not mean creating a culture that is totally risk averse. On the contrary – it should mean that the charity consciously takes risks in the areas it considers appropriate. For example, a grant-maker may *wish* to take some risks in making grant awards, but would not wish to jeopardise its income stream from investments.

The audit committee needs to gather evidence from various sources that the charity is managing its risks adequately. This includes evidence from management, internal audit and external audit. One audit committee chairman asks each senior manager to appear from the audit committee in turn, asking them to explain the risks they face, how they manage them and how effective they consider their controls to be. Perhaps it is worth remembering that the origin of the word "audit" is the Latin for "to hear". Listening is an important skill for audit committees.

#### Conclusion

Internal audit is changing. It is no longer simply focused on financial controls, but covers a much wider range of risk areas. For many charities, the major risks are connected to reputation and their brand – internal audit should embrace these areas too. Internal audit can be more forward-looking and concentrate its efforts on current activity and enhancing the chances of success. Audit committees too need to focus on the future more than the past. They need to understand the key risk areas, how managers view risk, and manage it.

Kate Sayer [kate@sayervincent.co.uk](mailto:kate@sayervincent.co.uk)