To codereview@frc.org.uk

Consultation Document: Proposed Revisions to the UK Corporate Governance Code (April 2014)

Dear Sir/Madam

In its response to the FRC consultation on the risk management, internal control and going concern basis of accounting (November 2013), the Chartered Institute of Internal Auditors argued that the importance of an independent and objective source of advice and assurance, separate from the management of a company, was so fundamental to board effectiveness that it needed to be expressed explicitly in the Code. It was vital for Boards to reassure stakeholders not only that they had assessed the principal risks, but that their views had been informed and supported by advice that was independent of the executive.

We suggested that, when outlining the role of the audit committee in respect to internal audit, the Code should establish the principle that the committee should monitor the independence and objectivity of the internal audit function in order to enable it to provide the support needed by the board. We also suggested that the audit committee should concern itself with the quality of the function, judging its performance against the International Standards for the Professional Practice of Internal Auditing, the recognised professional standards for internal audit.

We are disappointed that these points have not been taken on board by the FRC. We note that the Code establishes these principles for external audit. We also note that recent public reports on failures of governance increasingly focus on the need for internal audit to be properly positioned and resourced to carry out its governance, risk and internal control functions, and that this requires independence from the executive on a quality-assured basis. The nature of this independence may be different from that required for external audit. But it is no less important if boards are to be properly supported in their governance role.

We believe that the role of the Code is to establish principles, while that of the guidance to audit committees is to suggest how those principles should be put into practice. We therefore urge the FRC to recognise in the Code that independence, objectivity and the adherence to professional standards are vital principles for internal audit as well as external audit, and we hope that, when preparing the guidance for audit committees that will follow, the FRC will adopt the suggestions of the Chartered Institute in its previous consultation response.

We suggest a simple amendment to C.3.2 of the amended Code proposed in “Consultation Document: Proposed Revisions to the UK Corporate Governance Code (April 2014)”. This introduces equivalent language for internal audit to that for external audit thus:
“C.3.2. The main role and responsibilities of the audit committee should be set out in written terms of reference and should include:

- to monitor the integrity of the financial statements of the company and any formal announcements relating to the company’s financial performance, reviewing significant financial reporting judgements contained in them;

- to review the company’s internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company’s internal control and risk management systems;

- to monitor and review the effectiveness of the company’s internal audit function; to review and monitor the Internal audit function’s independence and objectivity and the effectiveness of the internal audit process, taking into consideration relevant professional standards;

- to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;

- to review and monitor the external auditor’s independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;

- to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken; and

- to report to the board on how it has discharged its responsibilities.”

The Chartered Institute stands ready to engage with the FRC on the question of more detailed guidance for audit committees on their role and responsibility in engaging with the internal audit function.

Yours faithfully

Dr Ian Peters
Chief Executive
About the Chartered Institute of Internal Auditors

- Established in the UK and Ireland in 1948, the Chartered Institute of Internal Auditors (IIA) has over 8,000 members. It is the only professional body dedicated exclusively to training, supporting and representing internal auditors in the UK and Ireland. We are part of a global network of 185,000 members in 190 countries.
- Members of the IIA work in all sectors of the economy: private business (including most FTSE 100 organisations), government departments, utilities, voluntary sector organisations, local authorities, and public service organisations such as the National Health Service. All members work to the same global International Standards and Code of Ethics, which are part of a globally agreed International Professional Practices Framework.
- The IIA offers a postgraduate level professional qualification in two stages, leading to the designation "CMIIA" (Chartered Internal Auditor), with an ongoing requirement for professional development and adherence to professional standards.

What is internal audit?

- All organisations face risks in everything they do. It is the role of senior management and the board to put in place frameworks and processes to manage all types of risks and to monitor how successful they are at managing them. Internal audit provides assurance to the board on the effectiveness of these frameworks and processes.
- To perform their role effectively, internal auditors must build strong relationships with line managers, audit committee chairs and members, chief executives and board chairmen. These relationships enable the internal auditor to champion effective risk management, challenge those responsible for it on its success and use their knowledge of the business and the management of risk to act as a catalyst for improvement in an organisation's risk management practices.
- Internal audit is a function that belongs to the organisation and sits within the governance structure; but it must be independent of the areas it evaluates and internal auditors must be free from undue influence from management, or indeed, anyone else, so that their judgments can be as objective as possible. To help safeguard their objectivity and independence, the head of internal audit should report directly to the audit committee.
- Internal audit is essential to the long term success of an organisation. This is because, alongside non-executive directors, executive management and external audit, internal audit is one of the four cornerstones of good corporate governance. Without it, the board would lack information and insight into how well the people within the organisation are managing their risks.

For follow up discussion, please contact:
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