

RAISING THE GAME: THE AC-INTERNAL AUDIT RELATIONSHIP

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Clearly, audit committees (ACs) are shouldering heavier responsibilities than ever before, all while juggling the disparate expectations of shareholders, regulators and other stakeholders.

In this context, ACs need to maximise the value they get from existing and limited resources. The internal audit function is one such resource and here, especially, stakeholders' expectations of efficiency and effective delivery are high.

Indeed, many internal audit functions, properly implemented, provide value across a spectrum of delivery approaches which include being an assurance provider, problem solver, insight generator and, ultimately, a trusted adviser.

The problem is this: recent research by PwC suggests that internal

audit's credibility as the organisation's watchdog is generally declining. Only half of AC members and about one third of management rate internal audit's performance as strong. While AC members see more value in internal audit than management, many AC members do not consider their internal audit function to be strong enough in critical performance areas such as promoting quality improvements and innovation, use of technology and acquiring the right talent.

So how should ACs oversee, monitor and, more importantly, promote the effectiveness of internal audit?

BUILDING A TRUST-BASED RELATIONSHIP

It helps to realise that several elements underpin the relationship between the AC and the internal audit function. Together, they form a strategic partnership that is not only critical to ensuring that accurate information is delivered in a transparent manner to the AC, but also provides valuable insight into how effectively the company is managing its business and financial reporting risks.

It follows that the AC and the internal audit function cannot work in separate silos. In overseeing internal audit, ACs must demonstrate visible support. Specifically, they must communicate the value of internal audit to the entire organisation including the board. Sometimes this can mean having the courage to raise sensitive matters.

When such support is extended to the internal audit function, empowerment is likely to follow. Specifically, proposed recommendations by internal audit are more likely to be given serious consideration, gain acceptance and be implemented, instead of getting pushed back or watered down.

Creating such trust may require action on several fronts. Regular one-on-one meetings between the head of internal audit and the

chairman of the AC would be a good start. Inviting department heads whose departments have received a poor internal audit rating to an AC meeting, so that they may provide explanations and suggestions as to how the situation can be remediated, will also send the signal that the findings of the internal auditor matter. Similarly, the AC should review significant internal audit recommendations that have not been implemented in a timely manner and ensure that there is follow-through by management.

CLARIFYING ROLES

It is also important that management and the AC define the role internal audit should play. An internal audit function may be performing a wide spectrum of work but not all of its efforts may be channelled to the right places. Sometimes, this is the result of poor communication. Sometimes, it arises from different perceptions between the different hierarchical levels within the organisation.

The roles, priorities and responsibilities of internal audit should be clearly understood by all personnel including management and the internal audit team. The board, as well as management, should agree on where internal audit efforts should be channelled. Only then can expectations be communicated effectively and resources directed efficiently.

ESTABLISHING CLEAR REPORTING LINES

The internal audit head should report directly to the AC and attend AC meetings. His performance should be evaluated by the AC, with appropriate input from the chief executive officer. These measures would empower the internal audit function to report without fear or limitation.

Typically, an effective internal audit report is a succinct one. In that regard, the head of internal audit should have a thorough understanding of management's expectations so that he can exercise reasonable judgment and raise for discussion only those findings that have a significant impact on the company. In this regard, the AC may hold periodical meetings with internal audit to discuss what should be submitted to management.

Properly utilised, internal audit is the AC's most dependable and powerful ally. After all, as a key player in "the third line of defence", internal audit by virtue of its functional reporting is at the AC's full disposal.

For many companies, achieving the desired level of unity with internal audit is not the easiest of tasks, but both the AC and management need to recognise that creating a good internal audit foundation will help all parties expand and develop new strengths in problem solving, generate insights, and provide sound advice. In the end, this allows the internal audit function to generate the most value for the company, and this can be something that the board and management will agree is a laudable objective. ■