Elevating Impact

The Institute of **Internal Auditors**
Australia

Factsheet: Chief Audit Executive Roadblocks

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What is Internal Audit?

The definition of internal audit is:

An independent, objective assurance and advisory activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes.

This definition is contained in the 'Global Internal Audit Standards' issued by the Institute of Internal Auditors (IIA).

What is a Chief Audit Executive?

The 'Global Internal Audit Standards' define the chief audit executive as:

The leadership role responsible for effectively managing all aspects of the internal audit function and ensuring the quality performance of internal audit services in accordance with Global Internal Audit Standards. The specific job title and/or responsibilities may vary across organisations.

Where the term chief audit executive (CAE) is mentioned in this Factsheet, it relates to the generic term used in the 'Global Internal Audit Standards' to refer to the head of internal audit in an organisation.

The 3 Lines Model (The Institute of Internal Auditors, Inc., 2024) shows where the various assurance activities are positioned. The important aspect of this is that internal audit and its leader - the CAE - are positioned independent of the line management structure to preserve internal audit independence and objectivity.

3 Lines Model		
Line 1 Part of the line management structure	**Line 2** Part of the line management structure	**Line 3** Independent of the line management structure
Business operations that own and manage risk	Oversight functions that monitor risk	Assurance that risk is managed

Chief Audit Executive Positioning

The CAE needs to be independent of the management hierarchy structure. In this context, 'independence' means:

The freedom from conditions that may impair the ability of the internal audit function to carry out internal audit responsibilities in an unbiased manner.

The governing authority of an organisation is ultimately responsible for an organisation's governance. In a company, this will be the board of directors. In the public sector where there is not a board of directors, governance arrangements are implemented by the head of the organisation (sometimes called the accountable authority) such as the secretary / director general / chief executive.

While expertise may be engaged to assist in governance of an organisation, accountability remains with the governing authority. See, for example Section 190 of the 'Corporations Act 2001' and Section 15 of the 'Public Governance, Performance and Accountability Act 2013'. Part of this responsibility is to maintain an effective internal audit program: see for example, Prudential Standard CPS 510 'Governance', NSW Treasury Policy TPP 20–08 'Internal Audit and Risk Management Policy for the General Government Sector', and Recommendation 4.1 of the ASX Corporate Governance Council 'Corporate Governance Principles and Recommendations'.

To be compliant with the 'Global Internal Audit Standards', an organisation with an internal audit function must appoint an officer of sufficient status to provide strategic guidance to the internal audit function. The 'Global Internal Audit Standards' allow that the CAE need not be a specialist internal auditor but must have direct access to resources who are.

An organisation that fails to appoint a senior officer to fulfill the CAE role is not operating in conformance with the 'Global Internal Audit Standards'. Appointing an officer who is too junior will limit the ability of internal audit to perform its function effectively.

As a part of the organisation, internal audit must be independent of management (separate from Line 1 and Line 2 assurance) if it is to perform its role and provide information and advice to the audit committee and top decision-makers, independently and effectively without undue influence from management.

It is usual practice for the governing authority to establish an audit committee to exercise a number of the governing authority's responsibilities. These responsibilities usually include the oversight of internal audit. Such a committee may be

established as an advisory body to an accountable authority or a subcommittee of a board of directors.

Internal audit independence is achieved by the chief audit executive reporting:

› Functionally for internal audit operations to the audit committee through the chair.

› Administratively to the chief executive officer.

Chief Audit Executive Reach

The CAE is required to be positioned independent of management. This is so the CAE can operate independently and objectively without interference from management. This requirement is usually reinforced through inclusion in the internal audit charter endorsed by the audit committee and approved by the governing authority.

Standard 7.1 'Organisational Independence' requires the CAE to confirm to the board (audit committee), at least annually, their freedom from conditions that impair their independence. This includes communicating incidents where independence may have been impaired.

CAE 'reach' throughout their organisation will include such things as:

› All internal audit work is undertaken under authority of the governing authority exercised through the audit committee.

› Internal auditors shall have full and free access at all reasonable times to all accounts / information / documents / records / property of the organisation in order to perform proper internal audit duties in a timely manner, including reporting to the audit committee.

› Employees shall render their assistance to internal auditors carrying out their duties by supplying requested information and explanations deemed necessary for internal audit to form an opinion with respect to the adequacy of systems and controls.

This gives internal audit access to everything in the organisation. For internal audit to operate effectively without 'fear or favour', independence and objectivity should never be restrained or diluted. Limitations on access to persons, facilities or information may constitute impairments to independence which hamper the internal audit role and must be reported to the audit committee.

Standard 9.4 'Internal Audit Plan' also requires the CAE to report any 'limitations on scope or restrictions on access to information'.

Chief Audit Executive Roadblocks

It is also important to protect avenues for effective CAE working relationships. Any roadblocks need to be managed swiftly but also constructively. A primary CAE objective should be to educate management on the role of internal audit and work effectively with business areas while maintaining independence and objectivity. There needs to be due care exercised crafting this message as the CAE cannot be 'pliable' for the sake of protecting a working relationship.

Additional independence safeguards may be necessary to overcome CAE roadblocks and potential recurrence. This includes being fair and balanced on a roadblock response that is commensurate with the roadblock circumstances.

Some roadblocks experienced by CAEs may be:

Internal Audit Roadblock Situations	Possible Causes

Management interferes with internal audit activities by:
› Not cooperating with internal audit
› Denying access to:
  › Information / documents / systems
  › Downstream management and staff (business operations)
  › Upstream management and staff (board / audit committee / top management)
  › Subsidiaries / controlled entities
  › Statutory bodies operating under the umbrella of a larger organisation
› Refusing or delaying internal audit meeting requests
› Filtering messages to the audit committee
› Changing the internal audit plan
› Changing internal audit reports
› Taking lengthy time to provide management responses to recommendations contained in internal audit reports
	› Management misunderstanding of how internal audit works
	› CAE positioning and reporting creates an environment where there can be management interference
	› CAE may not have direct access to the audit committee chair / chief executive officer
	› 'Tone at the top' may not be supportive of internal audit
	› Pliable CAE (easily influenced, persuaded or shaped by others)
	› Insecure or overbearing management
	› Unethical or corrupt management
	› CAE intent on working relationships at the expense of independence and objectivity
	› Distrust due to breakdown of working relationships
	› Audit fatigue from internal audit and other assurance providers

Some possible solutions may be:

› Ensure the CAE and internal audit function does not report through a layered hierarchical organisation management structure that can lead to the real risk of internal audit loss of independence.

› Develop an internal audit stakeholder engagement plan.

› Consider activities to raise awareness of internal audit including provision of advisory services.

› Enhance internal audit information on the organisation's Intranet.

› Active internal audit involvement in the organisation, such as:

  › Inductions include information on internal audit for relevant employees and contractors.

  › Steering committees for high-risk projects and business initiatives include internal audit as a non-voting assurance adviser.

  › Annual presentation of internal audit annual report to the audit committee and executive management including focus on audit action implementation.

  › An 'assurance forum' comprising all organisational assurance providers to coordinate the range of assurance activities across the organisation.

  › Integrated assurance approach comprising assurance providers across the organisation – may include development of an assurance map / assurance strategy.

› Obtain continual stakeholder feedback:

  › Post-engagement feedback surveys.

  › Audit committee annual feedback survey.

  › Corporate executive annual feedback survey.

  › Internal audit independent external assessment every 5 years.

  › Report results in an internal audit annual report.

› Try collaborative and agile techniques to solve problems such as difficulty obtaining management responses to recommendations contained in internal audit reports.

An escalation process should be documented in the internal audit charter for situations where there may be disagreement with management or where internal audit is denied access to what it needs to effectively perform its Line 3 independent oversight role. Significant disagreement between management and internal audit which cannot be resolved should be arbitrated by the audit committee.

Conclusion

Chief audit executives should be aware of potential roadblocks that impact their independence and effectiveness of their internal audit function. Organisations that take internal audit seriously will ensure the CAE and internal audit function is positioned independently of management and that adequate safeguards are in place to minimise the risk of management interference. Strong 'tone at the top' by the governing authority will also help to reinforce internal audit independence.

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