



GLOBAL ADVOCACY

AUDITOR INDEPENDENCE IN TIMES OF CRISIS

COVID-19's impact on internal audit's roles and responsibilities

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About the experts

Massimo Proietti, CIA, CCSA

Massimo Proietti is the Chief Audit Executive/Anti-Corruption and Transparency Officer and the Supervisory Board Member at the “Poligrafico e Zecca dello Stato” Spa (State Mint and Government Printing Office), with more than 15 years’ experience in internal audit, risk management, compliance, anti-corruption, and transparency.

He holds an MA in Economics from La Sapienza University, Italy, the CIA (Certified Internal Auditor) Certification/Institute of Internal Auditors, and the Certification in Control Self-Assessment (CCSA)/Institute of Internal Auditors.

Mr. Proietti is a member of the Italian Association of Internal Auditors (AIIA), the Institute of Internal Auditors (IIA), as well as the AIIA Public Sector Committee coordinator and the ECIIA Public Sector Committee member (ECIIA – European Confederation of Institutes of Internal Auditing). He is also a founder of the “Italian Anti-Corruption and Transparency Association” (AITRA).

He began his career in 1999 with “Birra Peroni” SpA (subsidiary of SABMiller plc group) as an internal auditor and later as a corporate governance manager. From 1999 to 2012 he worked for “Poste Italiane” Spa as an internal audit manager.

He has been teaching at the Italian Association of Internal Auditors since 2006 (in particular the course: “Integrated evaluation methodology of the Internal Control System”).

Francis Nicholson, CIA, QIAL, CRMA

Francis Nicholson is the Managing Director of Global Advocacy at The Institute of Internal Auditors (IIA) in Florida, USA. In this capacity he is responsible for promoting the value of the profession of internal auditing globally to stakeholders in an attempt to change thinking and provoke constructive actions that will foster an environment in which internal auditors can maximize the contribution they make to their organization’s success. He also works to support The IIA’s over 200,000 members and 110 global affiliates in being effective advocates on a local, national, and regional basis.

Mr. Nicholson joined the Chartered Institute of Internal Auditors in London, an affiliate of the global body, in 2007 as the Director of Education. He has over 25 years’ experience in vocational and academic training, education, and professional development as an instructor, curriculum designer, faculty head, assistant principal, and consultant. He moved to Florida in 2013 and has held a number of roles for The IIA in training, certifications, and advocacy.

From September 2018 Mr. Nicholson was the staff liaison to the working group of The IIA that led the review and update of the Three Lines of Defense, to be launched as the new Three Lines Model in July 2020.

INTRODUCTION

Independence: Shield or barrier?

As organizations grapple with the impacts of COVID-19, everyone is expected to play their part. Many chief audit executives (CAEs) and their teams are being asked to offer more “hands on” help to support management. When the boat is sinking, everyone from captain to galley crew is expected to be on bail-out duty. However, this has caused CAEs and the audit committees to which they report to ask about independence. Is it possible for internal audit to remain independent while undertaking these new tasks?

More significantly, do auditors and audit committees need to view independence in a time of crisis as being of secondary importance compared with providing maximum value? Is there a choice to be made between helping management in any way possible — all hands on deck — or steadfastly maintaining independence by stepping aside?

THE THREE ROLES OF GOVERNANCE

Finding the balance between independence and urgency

Independence through the governance prism

To better understand audit independence, it is useful to consider it in the context of governance. Governance requires three types of roles to be effective:

- **Accountability to stakeholders for organizational oversight.** This role is played by the governing body and is dependent on transparency, integrity, and leadership.
- **Actions undertaken to achieve goals effectively, efficiently, ethically, and sustainably.** This role is delegated by the governing body to management, together with the necessary resources, and includes actions taken to manage risk. Specialist roles for managing aspects of risk may be established.
- **Objective assurance and advice on all matters.** This role is largely filled by an internal audit function independent from the responsibilities and decisions of management. Often described as the “eyes and ears” of the governing body, internal audit enables the governing body to exercise oversight and ensure adequate and effective governance and risk management. Other closely related functions, such as oversight, evaluations, investigations, inspections, and remediation, are sometimes created. External audit provides further assurance on the accuracy of financial reporting.

Objectivity

The success of internal audit is driven by both its independence and objectivity. Its objectivity is founded to a large degree on its independence from management through virtue of being accountable to the governing body, either directly or via an audit committee. Its mandate should allow it unfettered access to the people, data, and resources needed to complete its work unimpeded. Objectivity is a function of:

- Organizational independence of the internal audit activity.
- Adherence to professional standards.
- The application of disciplined and systematic procedures.
- An unyielding commitment to a code of ethics.
- Possession of a specific set of competencies.

Through rigorous investigation and insightful communication, internal audit is able to promote continuous change and improvement. This is greatly enhanced by familiarity with the organization, knowledge of the industry in which the organization operates, and a clear understanding of the organization’s goals and strategies, all of which add further to internal audit’s credibility.

UNDERSTANDING ADVISORY SERVICES

Consulting a well-established practice

Insights, advice enhance internal audit's value

COVID-19 has put pressure on independence as internal auditors strive to offer the most assistance to management as possible. It should be remembered that advisory services form part of the definition of internal auditing and the value it can bring to an organization's success. Internal audit's unique position and expertise make it ideally placed to provide insightful advice to foster continuous improvement. Internal audit should always be responsive to circumstances and be flexible in order to provide maximum benefit. Offering advice, even developing solutions, does not amount to taking management decisions and ownership of risk.

In a crisis situation, the CAE should anticipate where senior management and the governing body would gain most from advisory services. Through such activity internal auditors will be able to help the organization learn valuable lessons for the future. In other words, they should continue to think and act like auditors, even when undertaking advisory tasks.

For example, auditors can help senior management develop appropriate mitigation strategies to ensure business objectives will continue to be met. They can identify and prioritize emerging risks related to the pandemic that threaten the organization's top strategies. Key risks to be assessed during this pandemic period include impact to revenues, employee health and safety, supply chain, and cybersecurity. Updating the risk assessment is particularly useful as this process can highlight the impact of similar risks if the pandemic dissipates before a second wave returns in the next months.

At the same time, taking on advisory roles should not jeopardize routine assurance work. Internal audit must continue to follow a risk-based approach to its audit planning and implementation. As the risk landscape changes so too will the plan need to change but the approach does not. Ensuring relevance requires alignment with organizational needs and priorities and depends on continuous stakeholder engagement, including close liaison with external auditors.

GOING BEYOND ASSURANCE, ADVICE

Stepping out of the comfort zone

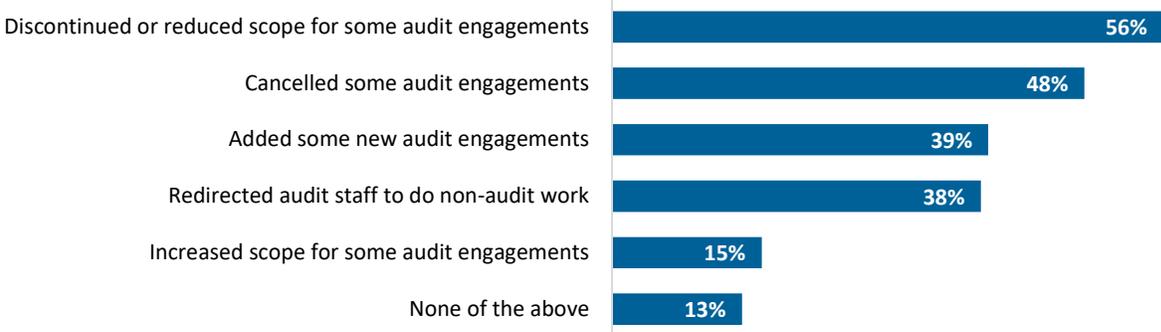
Pandemic thrusts internal audit into unfamiliar roles

While advisory services are clearly within any modern internal audit function’s scope of work, the pandemic has pressed some practitioners into roles beyond that comfortable purview.

Some internal audit functions have stepped into new roles as their risk and control knowledge allow them to be very impactful, even if their independence may be a future concern. For example, because of their risk and control knowledge, some internal auditors have moved temporarily into first- and second-line roles. Some internal audit departments are analyzing the processes that are most affected by COVID-19 and identifying the necessary changes in the key controls to minimize the risk to financial reporting, transaction processing, technology operations, and, last but not least, compliance.

A recent survey by The IIA’s Audit Executive Center (AEC¹) confirms adjustments to audit plan as well as the expanding role of internal audit due to COVID-19. Nearly 40% of survey respondents added new engagements because of COVID-19, and a similar percentage redirected staff to do non-audit work.

Exhibit 1: Internal Audit Adjusting Audit Plan Due to COVID-19



Note: Q2: How has your audit plan changed as a result of COVID-19? Choose all that apply. Survey responses collected April 9-13, 2020, from CAEs and directors in North America associated with The IIA. n = 397. Source: Audit Executive Center Knowledge Brief: COVID-19 Impact on Internal Audit: Survey, Exhibit 12 pg. 11 (The Institute of Internal Auditors, April 2020).

1. The IIA’s Audit Executive Center (AEC) is the essential resource to empower CAEs to be more successful. The Center’s suite of information, products, and services enables CAEs to respond to the unique challenges and emerging risks of the profession. For more information on the Center, visit www.theiia.org/AEC.

CONCLUSION

Reasonable safeguards

Independence is not directly valuable for its own sake but as a means to securing objectivity, authority, and credibility. It is always important to apply appropriate safeguards when independence is under threat through close association and involvement. Auditors can maintain their independence by remaining accountable to the governing body and refraining from assuming managerial responsibilities. In all such cases, the CAE should ensure the governing body is fully informed of any additional tasks they are taking on in response to management requests. If these measures are insufficient to reduce the threat to independence to an acceptable level, then the CAE should recommend use of a qualified third party to provide assurance over the activity in question.

Accordingly, CAEs should feel confident to engage with the pressing needs of management as long as reasonable safeguards are taken. Senior management and governing bodies should be encouraged to utilize internal audit services this way. Internal audit is essential for organizational success, now more than ever.

Is there a necessary trade-off for internal auditors between being independent and being valuable, especially in time of crisis? The answer is an emphatic no. With the right mindset, safeguards, and oversight by the board or audit committee, internal audit is positioned to provide its unique value of well-informed, independent, and objective insight, assurance, and advice.

About The IIA

The Institute of Internal Auditors (IIA) is the internal audit profession's most widely recognized advocate, educator, and provider of standards, guidance, and certifications. Established in 1941, The IIA today serves more than 200,000 members from more than 170 countries and territories. The association's global headquarters is in Lake Mary, Fla., USA. For more information, visit www.globaliia.org.

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Global

Global Headquarters

The Institute of Internal Auditors
1035 Greenwood Blvd., Suite 149
Lake Mary, FL 32746, USA
Phone: +1-407-937-1111
Fax: +1-407-937-1101
www.globaliia.org