



The Internal Audit Code of Practice for Private & Third Sectors

How will it impact you?

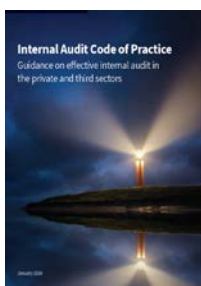
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The Chartered Institute of Internal Auditors ('CIIA') released the Internal Audit Code of Practice (['the Code'](#)) in January 2020 (following a consultation phase in 2019) which provides guidance on effective Internal Audit in the Private and Third Sectors. The Code is principles-based, and is intended as an industry benchmark, to help embed good practice Internal Audit and raise the bar across the profession.

Since the guidance on effective Internal Audit in the Financial Services Sector (['FS Code'](#)) was introduced in 2013 (and updated in 2017), the CIIA reports a significant improvement in the scope, skills and status of Internal Audit, and in the wake of recent corporate collapses, there is now an appetite to see additional guidance for the rest of the Private Sector and beyond.

The Code provides some welcome guidance for Internal Audit functions, Boards and Audit Committees, and we support the introduction of the Code. The application of the Code may present challenges for some organisations and we note the key areas Internal Audit should consider and those areas that we believe will have the biggest impact on Internal Audit.



“The aim of the guidance is to increase the effectiveness of internal audit functions in the private and third sectors”

**Brendan Nelson, Internal Audit Code of Practice
Steering Committee Chair**

Application of the Code

Like the FS Code, this Code is a voluntary, principles-based code, setting the benchmark against which Internal Audit functions should be assessed – by the Board and Audit Committee (where an Audit Committee exists), as well as by appropriate regulatory bodies.

The guidance has been drafted in the context of a reasonably sized private sector organisation based in the UK and is intended for the private and third sectors.

Internal Audit functions in public sector organisations should continue to follow the Public Sector Internal Audit Standards. Similarly, Internal Audit functions in the financial services sector should continue to follow the FS Code.

The Code is principles-based and the procedural requirements are intended to be applicable to all private and third sector organisations, including where the Internal Audit function is outsourced, but should be proportionately implemented depending on the size, risk profile, structure and the nature, scope and complexity of business operations.

The recommendations

The Code consists of a series of recommendations around the following key themes:

- Role and mandate of Internal Audit
- Scope and priorities of Internal Audit
- Reporting results
- Interaction with Risk Management, Compliance and Finance
- Independence and authority of Internal Audit
- Resources
- Quality assurance and improvement plan ('QAIP')
- Relationship with Regulators
- Relationship with External Audit.

Key areas for consideration

For the most part, the Code is self-explanatory. However, there are areas of the Code which may present a challenge for Internal Audit functions to either interpret or comply with. These areas will need to be considered by Internal Audit functions and we recommend that the approach should be agreed with the Audit Committee (where an Audit Committee exists) and/or the Board.

1. Proportionality

The Code recognises the concept of proportional implementation. However, there is limited guidance on how proportionality may work in practice or which elements of the Code should be prioritised. Whilst Application Guidance is available to supplement the FS Code, there is currently no additional IIA guidance to supplement the Code.

Internal Audit will need to carefully consider how to apply the concept of proportionality, and we recommend that the approach is agreed with the Board and/or Audit Committee.

2. Scope of Internal Audit

Internal Audit's scope should be unrestricted and include:

(i) Internal governance

Internal Audit should assess the design and operating effectiveness of the internal governance structures and processes of the organisation, including the information used for strategic and operational decision-making. This includes assessing whether the information presented to the Board and Executive Management fairly represents the benefits, risks and assumptions associated with the viability of the strategy and business model.

Internal Audit will need to consider whether there are additional meetings or forums they should attend and observe, and additional information they require.

(ii) Risk appetite

Internal Audit should assess whether the risk appetite has been established and reviewed through involvement of the Board and Executive Management. It should assess whether risk appetite is embedded within the activities, and report at least annually on whether the risk appetite is being adhered to.

In the absence of a formally defined risk appetite, Internal Audit will need to consider how it will conduct such an assessment.

Where risk appetite is defined, Internal Audit will need to determine its methodology for assessing this and whether it has appropriate skills to make this assessment.

(iii) Risk and control culture

Internal Audit should assess the risk and control culture of the organisation, including whether the processes (e.g. appraisal and remuneration), actions (e.g. decision-making), 'tone at the top' and observed attitudes and behaviours across the organisation are in line with the values, ethics, risk appetite and policies of the organisation. This includes management's regular self-assessment of controls and their actions in addressing known control deficiencies.

Internal Audit will need to determine their audit approach for assessing risk and control culture. This may include introducing 'management awareness' or 'control culture' rating in reports alongside ratings on control environments, and/or the performance of separate culture audits. Internal Audit will also need to consider whether they have the appropriate skills to make these assessments.

3. Interaction with other functions

Internal Audit should assess the adequacy and effectiveness of other functions. In cases where the Chief Internal Auditor ('CIA') has additional responsibility (a common example is a joint Head of Risk and Internal Audit), the Audit Committee should ensure that the additional responsibilities: do not undermine the ability to give appropriate attention to Internal Audit; do not impair independence from management; and are appropriately documented in the Internal Audit Charter.

Internal Audit will need to ensure any additional responsibilities for other functions are reflected in the Internal Audit Charter and that the effectiveness of those functions is performed by an independent assurance function or provider.

4. Reporting lines

The CIA's primary reporting line should be to the Audit Committee Chair, who is accountable for their annual objectives and performance appraisal. Any secondary reporting line should be to the CEO although can be to other Executive Management, if agreed with the Audit Committee Chair.

The Audit Committee (or the Board, where an Audit Committee doesn't exist) will need to consider whether the reporting lines of the CIA are appropriate. In our experience, the CFO is often currently recognised as the most practical secondary reporting line. However, the overriding principle is that the secondary reporting line should be to someone who promotes, supports and protects Internal Audit's independence.

5. Operating model

The Audit Committee should be responsible for appointing and removing the CIA from post. In organisations where the Internal Audit function is outsourced, the CIA should be employed directly by the organisation to ensure sufficient and timely access to management information and decisions.

Where Internal Audit is outsourced, the organisation will need to consider the extent to which someone is assigned CIA responsibility or a dedicated CIA is recruited. In the former, the level of authority, skillset and independence to fulfil the role effectively will need

to be considered. For the latter, the ability to recruit into this role and the likely cost impact is important.

6. Resources

The Audit Committee should be responsible for approval of the Internal Audit budget and disclose in the Annual Report if it is satisfied that Internal Audit has appropriate resources.

We would suggest a disclosure in the Annual Report as to how the Audit Committee has assessed the quantity and quality of resources within the Internal Audit function.

7. Quality Assurance

Internal Audit functions should develop a QAIP, performed by individuals independent of audit delivery and with the experience to meaningfully challenge the judgements and opinions reached, the results of which are presented to the Audit Committee at least annually.

The Audit Committee should obtain an external quality assessment at least every five years. It should report on compliance with the Code, as well as the International Professional Practices Framework and International Standards on Internal Auditing.

The CIA will need to consider whether the QAIP arrangements and Audit Committee reporting are appropriate and whether external resource is required. The Audit Committee will need to consider the timing and scope of external quality assessments.

8. Relationship with Regulators

The CIA should consider the impact of the regulatory environment and have an open, constructive and cooperative relationship with relevant Regulators.

The CIA, in conjunction with the Board and/or Audit Committee, will need to consider which, if any, Regulators to interact with and on what basis.

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