

# Internal audit in financial services



Guidance for the *Effective Internal Audit in the Financial Services Sector* was published by the Committee on Internal Audit Guidance for Financial Services in July 2013. The guidance builds on International Auditing Standards and aims to improve the effectiveness and raise the profile of internal audit across the Financial Services sector.

The guidance is expected to be regarded as an industry benchmark against which firms can measure their internal audit functions. The development of recommendations of what may be considered 'good practice' is helpful in terms of clarifying expectations and requiring internal audit teams and audit committees to justify alternative approaches or gaps.

The final recommendations provide further guidance for smaller internal audit functions recognising that modifications may be needed to implement the detail whilst retaining the spirit of the principles. However, it is likely the guidance will impact medium and smaller financial services organisations more so than those with larger internal audit teams. The key recommendations within the final guidance include the following areas.

## **Role and mandate of internal audit**

The primary role of internal audit should be to help the board and executive management protect the assets, reputation and sustainability of the organisation. Internal audit are expected to assess whether all significant risks are identified and appropriately reported by management and the risk function to the board and executive management; assess the adequacy of the control over the risks; and challenge executive management to improve the effectiveness of governance, risk management and internal controls.

## **Scope and priorities of internal audit**

The scope of internal audit should be unrestricted such that internal audit functions are able to assess the management of any risk in the business. The internal audit function should take into account business strategy and form an independent view of whether key risks have been identified including emerging and systemic risks and how these are being effectively managed.

The guidance includes recommendations on the coverage of governance processes, management information presented to the board, risk appetite, risk and control culture, key corporate events, capital and liquidity risks and outcomes of processes (including conduct risks).

## **Reporting results**

Internal audit should issue reports to appropriate governing bodies including risk and audit committees. The guidance outlines some specific reporting expectations which go beyond what is typically conducted at present.

## **Interaction with risk, compliance and finance**

Internal audit should be independent of the risk, compliance and finance functions, should include in scope an assessment of their adequacy and effectiveness and should not rely exclusively on their work without such an assessment.

## **Independence and authority of internal audit**

The chief internal auditor should normally be an appointment at an executive committee level and should have a primary reporting line to the audit committee chairman and a secondary reporting line to the CEO. The audit committee chairman should be accountable for setting the chief internal auditor's objectives, their appraisal and be responsible for recommending their remuneration.

## **Resources**

The chief internal auditor should ensure the internal audit function has the skills and experience commensurate with the risks of the organisation and should provide to the audit committee a regular assessment of resources needed and budget required to provide effective challenge. The audit committee should be responsible for approving the internal audit budget and disclosing in the annual report whether it is satisfied that internal audit has appropriate resources.

## Quality assessment

The board/audit committee is responsible for the regular assessment of internal audit performance and should identify appropriate criteria for defining success. Internal audit should maintain performance and effectiveness measures. Functions of sufficient size should develop quality assurance capability and the scope of this activity should cover both adherence to the methodology and internal audit's understanding and identification of risk and control issues. Outsourced functions should be subject to the same quality assurance assessment. The audit committee should obtain independent external assessment of the function at appropriate intervals with the audit committee chairman overseeing the assessor's appointment.

## Relationships with regulators

The chief internal auditor and other senior managers within the function should have an open, constructive and co-operative relationship with the regulator.

## Next steps

The guidance will likely be regarded as a benchmark against which firms can measure their internal audit function. An immediate priority, which is already planned in some organisations, should be a gap analysis of your internal audit function against the new recommendations. Where required, plans should be developed by internal audit and the implementation of actions overseen by the audit committee to ensure compliance is achieved.

Further analysis of some of the specific challenges associated with the new guidance will be addressed in the *ACI Quarterly*.

The guidance can be accessed at:

[www.iaa.org.uk/fsguidance](http://www.iaa.org.uk/fsguidance)

## Contact us

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