Internal Auditing: A New Direction in the Wake of the Financial Crisis

Essay Topic

What lessons should internal auditors learn from the current financial crisis? What opportunities for improvement exist for the internal audit (IA) profession in the risk management and governance arenas? What corrections should be made moving forward to:

a) Better prevent such a global crisis from occurring in the future

b) Enhance IA’s value to stakeholders and senior management?

Submitted by

Richard Millichip
Birmingham City University, UK
1st March 2010
Table of Contents

About the Author .................................................. Page 3
Acknowledgements ............................................. Page 3
Introduction ......................................................... Page 4
Part I – The Current Financial Crisis ...................... Page 5
Part II - Lessons for Internal Auditors ..................... Page 7
Part III - Opportunities for the Internal Audit Profession Page 10
Part IV – Corrections to Prevent Re-Occurrence ........ Page 13
Part V – Enhancing Internal Audit’s Value to Stakeholders Page 16
Conclusion ............................................................... Page 18
References ............................................................. Page 19
ABOUT THE AUTHOR

Richard Millichip is a part-time postgraduate student currently studying the first year of an MSc in Audit Management & Consultancy at Birmingham City University in the UK.

He has been working full time in the internal audit department of a financial services institution for eighteen months, following a ten year career in customer services with the same company.

ACKNOWLEDGEMENTS

The author would like to thank Steve Shackleford at Birmingham City University for kindly taking the time to read the essay and provide invaluable feedback.

Many thanks are also extended to Darren Johnson for his help, feedback and encouragement in the early stages of composition.
INTRODUCTION

The intended approach is to start with a brief consideration of the current financial crisis, as this contextualisation is deemed vital in order to fully address the essay topic in an informed manner.

Thereafter, the essay will follow the order of the set topic, by deriving seven key lessons for internal auditors to learn from the current financial crisis, before moving on to consider the opportunities for internal auditors in the areas of corporate governance and risk management.

Finally, the essay will discuss the changes necessary to mitigate the risk of such a crisis re-occurring and explore how internal auditors can enhance their value to internal and external stakeholders.

NOTE – Unless specifically referenced otherwise, all summaries, ideas, opinions, conclusions, lessons derived and opportunities suggested are my own.
PART I – THE CURRENT FINANCIAL CRISIS

In order for internal auditors to discern any meaningful lessons from the current financial crisis, it is first necessary to identify the root cause(s) of the crisis. Quite simply, we need to find out what went wrong before we can hope to start putting things right.

The precipitating events of the current financial crisis can appear numerous and complex. Years of low interest rates and cheap borrowing in the aftermath of 9/11 fuelled rapid expansion for some organisations (through growth and acquisition) and individuals (through the housing market). As their relative empires grew, organisations and individuals became hungry for more. This kick-started what can only be described as a “greed cycle”, whereby greed begat further growth, which begat further borrowing, which begat further lending, which begat further greed, and so on. As this cycle seemed to work to the mutual benefit of all participants, it became self-perpetuating.

The era of cheap debt oiled this well-run machine, but once the oil dried up the inevitable rust started to set in. The cost of borrowing increased as interest rates started to rise; banks made changes to the source of their funds for wholesale lending; the re-packaging and selling of wholesale debt became increasingly difficult; subprime mortgage lending in the US went into meltdown and the housing bubble finally burst. The greed cycle stagnated as organisations and individuals struggled with the ongoing affordability of their expanded empires. The ascendency of growth ended; replaced by a downward spiral of debt default, foreclosures, repossessions, insolvency, individual bankruptcies and corporate liquidations.

So what does this tell us – that greed caused the financial crisis? Well no, not really. Greed was more a symptom than a cause of the current financial crisis (although excessive greed may well have exacerbated the problem). To a certain extent, greed is healthy for successful enterprise and the strategic exploitation of growth opportunities demonstrates an awareness of upside risk management within organisations. The danger occurs where greed inhibits a counterbalanced focus on downside risk management. This certainly seems to be the case here, with organisations, individuals and regulators all failing to adequately evaluate the risk of default. However, it is not that straightforward. There is a basis for ignoring downside risk here, as there is less likelihood of default during times of boom and the losses from any actual default could be offset against the rising market, thereby reducing the risk impact.\(^1\)

Financial institutions, senior corporate executives, economic experts, governments, and indeed the general public will no doubt be debating the causes of the current financial crisis for many years to come, and laying blame in varying proportions at the respective doors of greedy borrowers, reckless lenders, financially overstretched homeowners, ineffectual corporate

\(^1\) Although this approach ultimately perpetuates the whole “boom and bust” economic cycle that Gordon Brown wants to eliminate.
directors, inadequate regulators, ignorant governments and oblivious auditors. But who is really to blame?²

An in-depth assessment of all these various financial, economic and societal factors is beyond the remit of this assignment; however, it is perhaps fair to say that none of these factors in isolation can be held solely to blame. Different combinations of these (and perhaps other) factors have resulted in varying degrees of fiscal meltdown and economic ruin for some financial institutions, but – crucially - not for all. Where Northern Rock and HBOS floundered, HSBC and Barclays survived³. Logic therefore dictates that external factors alone cannot have caused the current financial crisis; else failure would have been unanimous. This opinion is echoed by Sir David Walker, in his review of corporate governance in UK banks and other financial institutions:

“It is not the purpose of this Review to assess the relative significance of the many different elements in the build-up to the recent crisis phase. But the fact that different banks operating in the same geography, in the same financial and market environment and under the same regulatory arrangements generated such massively different outcomes can only be fully explained in terms of differences in the way they were run. Within the regulatory framework that is set, how banks are run is a matter for their boards, that is, of corporate governance.” (Walker Review, 2009, p.6)

Walker quickly sidesteps the external elements of the current financial crisis to focus on the internal elements. Taking this approach, it is easy to see that many of the potential causes of the current financial crisis already described can be further deconstructed to reveal a more common underlying root cause: governance failures within organisations. Corporate governance is defined as “the system by which companies are directed and controlled” (Cadbury Report, 1992)⁴ so there are two aspects to consider here. The governance failures that precipitated the current financial crisis could have resulted from a failure of direction, in terms of wrong strategic models and risk appetite, or a failure of control, in terms of operational oversight and internal systems. Either way, it is here - within the heart of organisations - that the real potential lies for internal auditors to derive lessons from the current financial crisis.

---

²Neil Hodge’s “Scupper Club” article (Financial Management (UK), April 2009) considers this very question and concludes that every agency has some culpability. However, most discussions tend to overlook internal audit for blame, perhaps because they perceive that internal auditors focus on operations rather than strategy.

³ But they were not immune – the share performance of all UK banks was affected during these times and indeed there were other major failures, such as Bradford & Bingley (which was nationalised) and Alliance & Leicester (which was rescued by Santander).

⁴ Quoted in John Chesshire, Corporate Governance & Risk Management, 2009, p.2,
PART II – LESSONS FOR INTERNAL AUDITORS

It is all too easy to blame external financial and economic factors for the current financial crisis, as these are the public face of the crisis on the news and in the print media. However, these external factors are merely the visible manifestations of internal governance failures. Herein lies the first important lesson for internal auditors to learn from the current financial crisis: the majority of failed organisations sowed the seeds of their own destruction by not operating robust corporate governance, risk management and internal control processes.

But no organisation sets out to deliberately fail. Therefore, the corporate failures experienced as part of the current financial crisis must be unintended consequences for those organisations. Herein lies the second important lesson for internal auditors: governance failures are usually an unintended consequence of some other activity. But what activity can be so appealing to organisations that it has the power to detract them from maintaining adequate corporate governance? In general terms, there can be only one answer to this: an over-zealous focus on exploiting upside risk opportunities for growth and profit during the times of boom. Herein lies the third important lesson for internal auditors: governance failures often follow where an organisation has focused too heavily on exploiting upside risk opportunities.

We can see that there are no new lessons to learn here; just the same old lessons as before. History keeps repeating itself, albeit with slightly different external outcomes each time. Various corporate scandals in the UK (Guinness, Polly Peck, Maxwell, Barings, Northern Rock), the US (Enron, WorldCom, Xerox) and Europe (Parmalat, Societe Generale) demonstrate a widespread and recurrent theme of poor corporate governance over the past 20 years. In contrast to the current financial crisis, many of these historic scandals were perpetrated by fraudulent activity; however, the fact that such corruption was initially possible, and was not detected in a timely manner, is itself indicative of internal governance failures within these organisations. Quite simply, had there been adequate corporate governance arrangements in place, these fraudsters would not have been able to succeed. Thus the current financial crisis can be seen as an extension to this legacy of corporate scandal; the latest chapter in a sorry history of weak governance. Herein lies the fourth important lesson for internal auditors: organisations do not always learn from each other’s mistakes.

There is a familiar pattern at work here. Following the exposure of each new scandal comes a broadly similar cycle of activity: confession and contrition offered by the failed organisation; investigation and inspection undertaken by the watchdogs; new rules and regulations enacted by the legislators; all leading to improved corporate governance designed to prevent re-occurrence. And, for a short time, things often improve, with a concerted effort to maintain better corporate governance. However, even the most robust corporate governance and risk management processes can only ever provide reasonable assurance, never absolute assurance.

---

5 Equally, an over-focus on the control of downside risk can also be seen as a governance failure.
Eventually (some might say inevitably) complacency sets in⁶, followed by greed, followed by a failure of governance, which leads to another scandal, thereby kick-starting the cycle all over again. Herein lies the fifth important lesson for internal auditors: governance failures are inevitable. This is not to say that the failures will necessarily occur within our own organisations, or always be large enough to result in media exposure and public disgrace, but the history of corporate scandals does evidence a certain inevitability of governance failure.

A further consideration is that organisations are only ever a collection of individuals, so there is always a dichotomy at work between the best interests of the organisation and the best interests of the individual. It is naive to expect individuals to always act with unaltering altruism towards the best needs of the organisation. Again, this is not to say that all organisations will eventually fail, but rather that there is potential within any organisation for unscrupulous individuals to pursue their own agenda and thereby undermine the organisation’s agenda.⁷ In addition, even without being unscrupulous, people can become agents of risk because organisations often encourage individuals to take greater risks in times of boom. This is because the impact and likelihood of risks is reduced by the rising market, which shoulders the consequences of the risk materialising. Herein lies the sixth important lesson for internal auditors; governance failures are more likely to stem from the shortcomings of people rather than from defective processes.⁸

The seventh and final important lesson for internal auditors to learn from the current financial crisis, and from historic corporate scandals, is that organisations tend to be reactive rather than proactive when it comes to addressing governance failures. There is always a tendency to mitigate against the specific failings that led to the most recent scandal, even though the likelihood of an identical failure reoccurring is actually quite slim. Instead, organisations should try to anticipate where the next failure could occur and proactively mitigate against it.

In summary then, we have identified seven key lessons for internal auditors to learn from the current financial crisis: But identifying these lessons is only part of the battle; internal auditors must actually learn from these lessons to help prevent their own organisations from making the same mistakes. Table 1 below suggests some appropriate actions that internal auditors can take to ensure they learn from the lessons identified:

---

⁶ There is some tendency to treat governance as a one and done process, rather than as an ongoing activity.
⁷ Humankind has the capacity for extreme selflessness or extreme selfishness, and the risk of the latter must be recognised and adequately mitigated against.
⁸ Although, one could argue that the process is ultimately at fault if it allows people to predicate governance failures in the first place. There is a vicious circle at work here – which failed first, the people or the processes? I prefer to think it is the people.
Table 1 – Lessons to Learn and Suggested Actions

<table>
<thead>
<tr>
<th>Lessons for Internal Auditors</th>
<th>Actions for Internal Auditors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organisations fail because of inadequate internal governance.</td>
<td>Check that adequate processes are in place for corporate governance, risk management and internal control.</td>
</tr>
<tr>
<td>Governance failures are usually an unintended consequence of some other activity.</td>
<td>Be alert to unintended consequences as part of every audit undertaken.</td>
</tr>
<tr>
<td>Governance failures often follow an over-exploitation of upside risk opportunities.</td>
<td>Consider the flip-side to every activity – is there a counter risk that is going unnoticed?</td>
</tr>
<tr>
<td>Organisations do not always learn from each other’s mistakes.</td>
<td>Be aware of competitors - watch what they are doing and learn from them. Adopt the good points and avoid the bad.</td>
</tr>
<tr>
<td>Governance failures are inevitable.</td>
<td>Aim for reasonable assurance rather than absolute assurance.</td>
</tr>
<tr>
<td>Governance failures usually stem from people not processes.</td>
<td>Check that the relevant people in each area under review are assessed in addition to the processes.</td>
</tr>
<tr>
<td>Organisations are reactive, rather than proactive, in addressing governance failures.</td>
<td>Be alert to signs of emergent risks and focus resource on proactive mitigation.</td>
</tr>
</tbody>
</table>
PART III – OPPORTUNITIES FOR THE INTERNAL AUDIT PROFESSION

We have briefly considered the general backdrop to the current financial crisis and derived that internal governance failures are the root cause. As such, in the aftermath of the current financial crisis, organisations will be eager for assurance over their own corporate governance and risk management strategies. This presents an immediate and obvious opportunity for the internal audit profession to assist organisations in reinforcing their corporate governance and risk management processes. However, this is not necessarily just an opportunity afforded by the reaction to the current financial crisis, but rather a fundamental part of what a good internal audit department should already be undertaking. This can be seen within the Institute of Internal Auditors (IIA) own definition of the profession:

“Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.” (The IIA, 2009)

Ultimate responsibility for corporate governance, risk management and internal control rests with the board, with operational responsibility often delegated to senior management. However, that is not to say there is no opportunity for internal auditors to play a part; indeed, the IIA specifically states that internal auditors must be involved:

“The internal audit activity must evaluate and contribute to the improvement of RM, control and governance processes using a systematic and disciplined approach” (IIA Standard 2100)⁹.

The first point to make from the IIA definition is that internal auditors provide a dual role to organisations; an assurance role and a consulting role. Traditionally, it is the assurance role that is given precedence, which has lead to the stereotype of an internal auditor as a glorified work checker. However, the assurance function is much more than mere checking, as its ultimate aim is to provide assurance to the board that activities being performed within the area under review are complete, correct and compliant. In addition to any necessary sample checking of work undertaken, the assurance element of internal auditing should also include an assessment of any relevant regulatory requirements and internal corporate governance documentation, to ensure that this in itself is up-to-date and compliant.

Arguably, the fallout from the current financial crisis provides a greater opportunity for internal auditors to concentrate resource on this element of the assurance role, as opposed to endless sample checking. Organisations should recognise the greater value in allowing internal auditors

---

⁹ More specific guidance on the role of internal audit in corporate governance, risk management and internal controls can be found in IIA Standards 2110, 2120 and 2130 respectively.
to assess the adequacy of the process itself, rather than just how well the process is being performed operationally. A concentration on the former might reveal large-scale systemic issues, whereas a focus on the latter is likely to reveal only small-scale individual discrepancies. Ideally, internal auditors should strike a balance between these two extremes and seek to allocate resources to cover all elements of the assurance role.

The dual internal auditing roles of assurance and consultancy are detailed within the IIA Position Statement on Organisational Governance: Guidance for Internal Auditors (2006). The Internal Audit Governance Maturity Model suggests that the balance between the assurance and consultancy roles is dependent upon the governance maturity of the organisation. In organisations with less structured governance practices, the focus is on assurance work; whereas in more structured environments, the consultancy element is brought to the fore.

But perhaps the greatest opportunity arising from the current financial crisis for the internal audit profession is an increased tolerance within organisations for internal auditors to perform a consulting role. This allows the expertise of the internal audit department to be maximised by having input into areas of management responsibility and board strategy such as setting the policies for the corporate governance and risk management processes. Although this element of the internal auditing role has some potential risk – there is a danger that internal auditors may inadvertently assume management responsibility for these processes, which would compromise the internal audit department’s objectivity and independence – if this pitfall can be avoided, then the potential value-add here is significant and mutually beneficial to all parties. Management can exploit the knowledge and advice of the internal audit department and gain their valuable input to help shape policy rather than just police it, while the internal auditors themselves can get their views heard and gain valuable exposure within the company to help enhance their standing both as individuals and as a business function (which we will come back to discuss in more detail later). Overall, the organisation will benefit from having a rigorous process in place for robust corporate governance and sound risk management, that is owned by the board, delegated to senior management, operated by line management, and inspired, influenced and informed by the involvement of the internal audit department.

While the benefits here are obvious, the IIA does stress the importance of internal auditors not overstepping the mark when performing their consultancy role:

“When assisting management in establishing or improving risk management processes, internal auditors must refrain from assuming any management responsibility by actually managing risks.” (IIA Standard 2120.C3)

In a fully risk mature organisation, risk management should be embedded within the culture so that all employees, at all levels, have a shared responsibility for ensuring effective risk management. In the aftermath of the current financial crisis, with organisations at their most receptive towards enhancing their internal governance and risk management processes, there are opportunities for internal auditors to help enhance the risk maturity of their organisation by championing Enterprise Risk Management, which focuses on the high level, cross-enterprise
risks that are most likely to damage the organisation if not adequately managed (i.e. risks at the strategic level).

Although Enterprise Risk Management affords many advantages to organisations, it does, ironically, raise a risk of its own. If risk management is so well embedded across an organisation that risk management activities are being undertaken by a variety of different people, at all levels, then there is a danger of overlaps or gaps occurring unless the process is well monitored and managed. There is also a potential danger that shared ownership of risk management could actually lead to a shared lack of reaction, whereby staff fail to take responsibility for reporting emergent risks because they think someone else will. This deferral of responsibility from the individual to the collective could ultimately result in risks going unidentified, which demonstrates the ever-present potential for unintended consequences.

A final opportunity afforded to internal auditors from the current financial crisis is an open forum for genuine discussion and feedback on any inadequacies in the current governance and risk management systems. Such negative findings may have found little favour or audience during the boom times but, in the aftermath of the current financial crisis, management is far more likely to be attentive, receptive and grateful for this kind of constructive criticism.
PART IV – CORRECTIONS TO PREVENT RE-OCCURRENCE

We have already determined that the underlying cause of the current financial crisis was a failure in corporate governance. Therefore, it is reasonable that any corrective actions must be focused on improving corporate governance in some way. However, what has not yet been derived is the reason why corporate governance failed. This further analysis is vital to determine what corrections should be made to best prevent a global financial crisis re-occurring in the future.

There are three main reasons as to why corporate governance may have failed in the UK. It may be that the existing guidance is inadequate, so even if organisations did implement and adhere to the guidance, it would still not be enough to ensure sufficient corporate governance to protect against the kind of failures that led to the current financial crisis. This is a failure of adequacy.

Alternatively, it may be that the existing guidance is adequate, but the organisation’s compliance with the guidance is at fault. This could be for a number of possible reasons; lack of resource, lack of time, lack of board support, cost-cutting, box-ticking, general apathy around corporate governance, not understanding the value of good corporate governance, an unbalanced focus on upside risk opportunities or deliberate non-compliance to perpetrate fraud. This is a failure of compliance.

Finally, it may be that the existing guidance is adequate, but its method of enforcement has caused compliance failures within organisations. The UK guidance around corporate governance is largely voluntary, as opposed to mandatory10; relying instead on the principle of “comply or explain”. It could be that this method of enforcement is not strong enough to ensure that organisations are adhering to the guidance sufficiently to prevent governance failures like those that predicated the current financial crisis11. This is a failure of enforcement.

So we have three potential causes for governance failures (or a fourth option, which is a combination of all three). If we agree there is a failure of adequacy, then the necessary corrective action must be to strengthen the existing guidance to ensure it is adequate going forward. If however, we believe there is a failure of compliance, then corrective actions must be rooted in individual organisations, to ensure that corporate governance guidance is complied with going forward. Alternatively, if we think there has been a failure of enforcement, then corrective actions must be directed at the “comply or explain” nature of the current Combined Code, with the possible need for a greater reliance on mandatory rules, as opposed to voluntary best practice. Or perhaps corrective actions should be taken in all three of these areas?

---

10 For example, the Sarbanes-Oxley Act in the USA around corporate governance is almost exclusively mandatory.

11 However, this cannot be the only reason, as failures were also witnessed in the US, which has mandatory enforcement of corporate governance. Clearly there are weaknesses with both methods of enforcement.
In short, we may never know the true reason for the governance failures in the lead up to the current financial crisis, but it is highly unlikely that failures on such a grand scale would ever be derivable to a single root cause. Therefore, all three of the possible reasons outlined above have probably contributed to some degree, so corrective actions should ideally be taken to improve in all three areas. That being said, it is likely that the greatest impact came from inadequacies around the internal application and operation of corporate governance within organisations, rather than any fundamental problem with the existing guidance itself.

The Walker Review, commissioned in response to the failure of Northern Rock and other banks in the UK, makes a number of recommendations aimed at minimising the risk of a re-occurrence. Walker appears broadly happy with the “comply or explain” nature of the current enforcement as, although he admits more regulation is required, he strives to avoid the mandatory legislation route: “Despite the need for hard rules in some areas, this will not be assured by overly-specific prescription that generates box-ticking conformity.” (Walker Review, page 7). Although Walker concedes that some of his recommendations are “relatively prescriptive” he goes on to state that “most set parameters within which there is need for judgement and appropriate flexibility.” (Walker Review, page 7).

Walker also recognises the impossibility of providing absolute assurance against re-occurrence:

“For its part, better corporate governance of banks cannot guarantee that there will be no repetition of the recent highly negative experience for the economy and society as a whole. But it will make a re-run of these events materially less likely.” (Walker Review, page 10).

Finally, Walker identifies that “improvement in corporate governance will require behavioural change” (Walker Review, Page 9). This is crucial - as Walker goes on to explain:

“Behavioural improvement is more likely to be achieved through clearer identification of best practice and more effective but, in most areas, non-statutory routes to implementation so that boards and their major owners feel “ownership” of good corporate governance” (Walker review, pages 9-10).

This behavioural change is perhaps the most critical - and most challenging - correction that needs to be made going forward. Until organisations, and their key individuals, respect the need for good corporate governance, and conduct it because they want to, rather than because they have to, it will never become truly embedded. In March 2009 Hector Sants, then CEO of the UK Financial Services Authority, was quoted as saying: “A principles based approach does not work with participants who have no principles”. Thus the greatest barrier to embedded corporate governance in the UK is not the guidance or the enforcement, but the behaviours

and principles of the key individuals that are responsible for corporate governance within organisations.

In terms of corrections moving forward, this will largely be enacted in the UK via the implementation of the Walker Review recommendations and the publication of an updated Combined Code in 2010. Walker’s recommendations are far-ranging and cover areas such as board size, composition and qualification; the functioning of the board and evaluation of performance; communication and engagement with institutional shareholders; governance of risk and remuneration.

Corrections should also be made within individual organisations alongside these more general corrections. A good starting point for potential areas of correction is the seven lessons and corresponding actions for internal auditors detailed in Part II above.
PART V – ENHANCING INTERNAL AUDIT’S VALUE TO STAKEHOLDERS

There are a number of ways in which internal auditors can enhance their value to stakeholders and senior management. A common objective shared by all stakeholders and management is the success of the organisation, so anything that internal auditors can do to contribute to the organisation’s success, or augment the organisation’s reputation, will help the internal audit department to enhance their own reputation for adding value.

Therefore, one of the easiest ways for internal auditors to enhance their value is to ensure that they are compliant with the various IIA performance standards (referenced in previous sections) which are designed to:

1. Delineate basic principles that represent the practice of internal auditing.
2. Provide a framework for performing and promoting a broad range of value-added internal auditing.
3. Establish the basis for the evaluation of internal audit performance.
4. Foster improved organisational processes and operations.

(IIA, Introduction to Standards)

We have already discussed in Part III above how a greater emphasis on a consultancy role can add value for the organisation and bring about an enhanced reputation for the internal audit department. Indeed all of the opportunities discussed in Part III are also methods by which internal auditors can enhance their value to internal and external stakeholders, as they all contribute towards the organisation’s success and standing. All of these opportunities also link into the various IIA performance standards, so these activities provide additional stakeholder assurance that the internal audit department is acting professionally and is thereby adding value to the organisation.

Another way in which internal auditors can enhance their value is to improve their own processes and mitigate against the risk of their own activities failing to assure. This can be achieved by ensuring that adequate resources are maintained, skilled auditors are employed, audit plans and objectives are clearly communicated, work quality and quantity is sufficient, advice is timely and accurate, independence is maintained, good relationships are developed with audit clients and all recommendations are followed through to implementation.

Finally, there is perhaps an untapped opportunity for internal auditors to enhance their value in the area of strategy oversight. At present, internal auditors can bring about improvements and add value either through operational assurance or strategic consultancy activities. However, there is perhaps an unfulfilled need within organisations for independent oversight and assurance around the strategic direction of the organisation. This would provide a third tier to the internal auditors remit; that of strategic assurance. This could feasibly cover all board-level
direction-setting activities, such as strategic planning, strategic decision-making, setting and monitoring strategic objectives and establishing the risk appetite.

The potential benefits and value-add for all parties is significant; the organisation will benefit from independent assurance on their strategic direction, which would either validate their decisions or provide feedback on possible amendments and the reasons why, whilst the internal audit department will have oversight from the very top of the organisation, which will increase their overall awareness and provide the best possible exposure to identify any strategic level emergent risks that may otherwise have gone unidentified until much later. Of course a knock-on effect of internal auditors successfully performing such a high-profile role within the organisation will be increased visibility to all stakeholders and a value-enhanced reputation for the internal audit department as a whole.

This type of strategic oversight capacity is not already captured in Sarbanes-Oxley legislation or the Combined Code guidance. In the UK, strategic oversight is currently only discussed in terms of the role of non-executive directors, who are supposed to be providing this kind of independent assurance. However, the capacity for non-executive directors to adequately perform this part of their role is extremely limited by their lack of specific knowledge and experience of the organisation and, critically, the time they have available. This is partly why non-executive directors have been deeply criticised within the Walker Review and are the focus of a number of its recommendations. As such, now may be the ideal time to advocate a collaborative working partnership arrangement between non-executive directors and the internal audit department in developing a new process for strategic oversight and assurance. On top of the benefits already outlined, this would bring further benefits to the non-executive directors themselves, by providing the skills, internal knowledge and time resource that they currently lack to operate adequate strategy oversight on their own. A working relationship with internal auditors may also serve to integrate non-executive directors into the organisation more closely than has previously been possible, which will further their learning and development about the organisation and increase their effectiveness in other aspects of their role.

There appears to be a genuine opportunity here, so it is recommended that the IIA issue a Practice Advisory on Internal Audit guidance in the area of Oversight of Strategy, for internal auditors working more effectively with non-executive directors. Arguably, had this kind of strategy oversight already been in place, internal auditors would have been able to avert (or at least significantly mitigate) the governance failures that led to the current financial crisis.
CONCLUSION

The scale and impact of the current financial crisis has been devastating to many individuals and organisations. Rather worryingly, internal governance failures have been shown to be the underlying cause, suggesting that organisations have failed to learn the lessons from the legacy of corporate scandals over recent years. These lessons are not difficult, yet they continue to be overlooked.

However, the aftermath of the current financial crisis affords internal auditors many opportunities to help organisations to address these issues of corporate governance and risk management and make the necessary corrective changes going forward to prevent such a crisis from re-occurring. In addition, there are opportunities for internal auditors to enhance their own value to internal and external stakeholders by taking a more central and prominent role in governance activities.

Internal auditors should therefore capitalize on all these opportunities to bring mutual benefits to both themselves and their organisations.
REFERENCES

Chesshire, John. Corporate Governance & Risk Management, (2009), The IIA UK & Ireland

Combined Code on Corporate Governance, (June 2008), Financial Reporting Council


