Effective relations between Internal and External audit

Presentation by Richard Maggs to
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Scope of presentation

- A reflection on cooperation between internal and external audit
- Benefits and of cooperation
- Building effective cooperation
- Where to cooperation
- When to cooperate
- Key success factors
- What can go wrong

Benefits of cooperation

- More effective total audit of the entity based on a clear understanding of respective roles – maximising audit coverage
- Reduced burden of audit on the client
- Better coordinated internal and external audit activity based on joint planning and communication of needs – reducing overlaps and duplication of audit work
- Increased scope for use by both internal and external audit of each other's work
- Exchange of ideas and knowledge
- Wider access to skills

Potential risks

- A compromise of confidentiality, independence, and objectivity;
- Possible conflicts of interest;
- Dilution of responsibilities;
- Use of different professional standards relating to independence or audit;
- Misinterpretation of conclusions when using each other’s work;
- Possible difference of conclusions or opinions on the subject matter;
- Premature communication to an external party
- Not considering constraints or restrictions placed on the other auditor in determining the extent of coordination and cooperation.

Key enabling factors

- Senior management support and encouragement
- An organisational entity to help promote cooperation (e.g. an audit committee)
- A common planning timeframe
- A culture and behaviours that promote cooperation
- Both sets of auditors seek out opportunities to cooperate

Building effective cooperation

- Commitment
  - The roles of the internal and external auditor often overlap so effective cooperation demands a willingness to cooperate
- Consultation and common understanding
  - Regular consultation between Internal and External Audit is the basis for identifying ways to cooperate effectively
- Communication
  - There should be both formal and informal communication
- Confidence
  - There needs to be mutual confidence between both groups based on recognition of professional standards

Where to cooperate

- Some examples include:
  - Reviews of the effectiveness of internal control
  - Audit of Financial statements
  - Compliance with laws and regulations
  - Fraud and corruption
  - Reviews of performance data
  - Developing systems and major initiatives
  - Audit of widely dispersed geographical units

When to cooperate

- Coordination and cooperation can happen during the entire audit process
  - Before the audit *(e.g. shared understanding of the audit entity and extent of potential reliance)*
  - At the planning stage *(e.g. sharing of risk assessments)* ;
  - Performing further audit procedures *(e.g. when additional work is needed in an area of additional risk)*;
  - Concluding, finalisation, and reporting stage *(e.g. where the conclusions of Internal Audit work can be taken into account by the external auditor)*; and
  - Follow up of audit findings and recommendations *(e.g. where Internal audit take responsibility for follow up of all audit recommendations – internal and external)*

Key success factors

- Mutual understanding of respective roles
  - Internal Audit is a service to management
  - External Audit has wider reporting lines (e.g. to Parliament) or specific legal requirements (e.g. court decisions).
- Agreement on procedures to underpin cooperation
  - Programme of regular meetings
  - Sharing of planning information
  - Procedures to share audit findings
  - Procedures of share information
- Agreement on external audit reliance on internal audit work
- Management support for cooperation

What can go wrong

- If there are all these benefits why does cooperation fail. Some common reasons:
  - Professional jealousy - auditors cannot agree a reasonable share of work
  - Mistrust based on lack of understanding of roles and/or poor communication
  - External Audit assumes a dominant role based on their wider responsibilities
  - Lack of mutual respect
  - Poor quality of staff in either internal or external audit
  - Lack of senior management support in either organisation

Conclusions

- Cooperation is not a one way street.
  - One of the myths is that cooperation benefits external audit more than internal audit. This is incorrect. Both have much to gain from effective cooperation
- The barriers to cooperation are as much behavioural as structural
  - It is the way that the individual auditors behave that has the most impact on the success of cooperation
  - And top down support is a key factor
- But formal structures do provide a basis for establishing the relationships needed to make cooperation a success