

Adaptive Internal Audit

Traditionally, internal audit has focused on compliance with procedures. Internal auditors spend time looking at whether managers have complied with procedures, so that reports comment on past processes. Whilst there may be valuable lessons to learn from the past, there is even more to be gained from looking at current activity and helping managers to manage risk and uncertainty in current projects. Internal audit should be helping organisations to achieve their objectives. This is a positive role and internal auditors need to have a good understanding of the organisation's strategy and how managers plan to implement it. Internal auditors then need to help managers to increase the probability of success in implementing that strategy.

Audit planning

Typically, internal auditors have spent most of their time on financial procedures and internal controls. They would draw up long-term and short-term audit plans that would ensure that every area was covered by an audit over a three- or five-year audit cycle. The plans were also drawn up according to the relative size of the activity measured by financial parameters. In charities, financial parameters may not be adequate to describe the importance of an activity, for example in a situation where a charity uses large numbers of volunteers. More recently, internal audit grasped risk assessment as an excellent basis for planning audits and giving greater emphasis to the areas of high risk. This could influence the frequency with which an area would be audited, for example. However, this has not fundamentally changed the nature of internal audit for many. Frequently, it is still backward-looking and assessing whether managers have complied with procedures.

Using risk management

Internal audit has also been captivated by risk assessment. It is a very useful tool and it is certainly an activity that managers should spend time on, preferably more than once a year. However, some internal audit functions have become *captured* by risk assessment. They spend all their time chasing up risk assessment documentation, analysing the results and refining the organisation's view of its risks. Hence, the internal auditors become the organisation's risk managers – this was not meant to happen! Risk management should be an integral part of management. Internal audit's remit should be to ensure that risks are being managed effectively. It will never be possible to identify every single risk. How many charities had foot and mouth disease on their risk register? And yet it had a significant impact on a very large number of charities for a range of reasons. It is more important that organisations increase their capacity to manage risk generally, and to deal with unforeseen risks.

Reputational risk

Every charity considers reputational risk to be the highest ranked risk. Even an apparently trivial incident can seriously damage an organisation's standing and therefore its supporter base and funding. At **Help the Aged**, the importance of increasing your reputational "capital" has been recognised as a strategy in the management of this key risk. The management of reputational risk is no longer seen as only managing negative events of bad publicity, but also building up a positive image of the organisation in the eyes of stakeholders. It was also recognised that reputational risk could not be assigned only to the PR people – it is an all-pervading risk and every individual needs to be aware of it. The components of reputational risk had to be identified and the particular contribution of different departments and individuals mapped onto an overview map of reputational risk management. So at Help the Aged, reputational risk is no longer one big risk area, but is many identifiable activities and areas which individuals can relate to in their day to day work.

Strategic plans

Internal audit needs to start from the strategic plan for the organisation. As a starting point this helps to ensure that internal audit is focusing on how the charity will achieve its objectives and helps internal auditors to be more forward-looking. To prepare plans of audit activity, internal auditors should discuss the strategic plan and how it will be implemented with senior managers. This should highlight new activity and new projects, which are likely to be the higher risk areas and should therefore be selected for internal audit.

YWCA adopted a completely new strategy, moving from the provision of registered social housing for young women to concentrate on the other area of their work – providing support, information and the opportunity to learn for disadvantaged young women in a number of projects across England & Wales. To support this strategy, they needed to develop new funding and specifically a new donor base of individuals supporting their work. There were a number of components to this part of the strategy, including a new database, new ways of raising funds, a new PR strategy – and lots of new risks. Trustees and managers were aware of the risks and so built in contingency plans and risk management tactics into the plans. The internal auditors had to understand the whole strategy and the objectives so that they could contribute positively to the management discussions about managing risk. The internal audit is on-going and forward-looking – helping managers to identify possible ways of improving their chances of success with the whole strategy and individual components of the project.

By gaining a deep understanding of the strategic plan and how this is to be implemented, the internal auditor will be able to identify key aspects of the plan that are crucial to its successful implementation. Managers may have identified key milestones and the internal auditor can use this as a basis for the assessment. Strategic plans are actually a series of hypotheses. For example, a strategic plan may set out the objective of increasing regular giving by donors, with an action to achieve this identified as sending more direct mail shots to warm contacts. There is an inherent hypothesis here that direct mail to warm contacts will increase the number of regular donors. It is this sort of hypothesis that carries risk – the extent of the take-up and the return on investment can vary enormously. Internal audit can help managers to examine such plans in more detail, to draw out the hypotheses and uncertainty inherent in them, and then to test them. Gathering evidence to support or negate a hypothesis will help managers to manage the risks, increasing the probability of success. For example, the result should be a plan that has been refined to take account of additional information gathered from pilots and tests, and has a much better chance of good outcomes.

Management information

In practice, this means that internal auditors should also be spending time looking at management information systems more generally. In order to implement strategies, managers need to assess continuously whether the information and feedback suggests that they have the right strategy, or whether it needs to be tweaked. Frequently, organisations spend a great deal of time formulating strategy, but then give little thought to how they will monitor its implementation. This is not simply a matter of having scores of key performance indicators – it is about having the right feedback loop and allowing managers to adapt plans. Internal auditors should be checking that action is taken as part of the whole process of managing risk and receiving feedback on how plans are working in practice.

Reassurance on compliance

Internal audit does not have to abandon all compliance work, but it is worth considering how this should be undertaken in order to get best value from your internal audit function. Internal auditors can assist in the development of self-assessment tools such as checklists and questionnaires. These can be used by managers to help them check that procedures and good practice are in place.

In addition, it may be helpful to provide trustee boards with an overview of compliance with laws and regulations. Whilst compliance in these areas is necessary and important, it is not necessarily worth significant amounts of internal audit effort. The reassurance needed is that managers are undertaking the appropriate actions and checks. It is relatively straightforward to construct a full list of all the areas where the charity needs to comply with laws and regulations, and then to annotate this with the people responsible and ways that managers ensure compliance. Typical entries on the list might include data protection, health and safety, employment law as well as areas specific to the activity, such as criminal bureau checks for staff and volunteers working with children. Internal audit can help to set up such a system and oversee it, but it should not consume too much of this valuable resource.

Conclusion

In order for internal audit to add value in today's environment it needs to be focussed on strategy and where the charity is going, not looking back critically at past activity. Internal auditors need to focus on the uncertainty and risk inherent in any strategic plan and help the organisation to manage risk, with a positive emphasis. Internal auditors should be helping to increase the chances of success, not simply focussing on problems and risks.

Example of a compliance checklist

Area	Manager responsible	Action to ensure compliance	Date of last action
Company secretarial	JM	Annual return – due September 25 every year. Check accounts filed and registers up to date at same time	24/09/05
Charity Commission	JM	Annual return due in by 31 January including Part C SIR. Accounts to be filed by 31 January each year	24/09/05
Data protection	FB	Registration checked annually January	26/01/05
Health and safety	TW	Six-monthly self-assessments undertaken at each location and submitted to HR for checking and filing	Rolling
Employment law	TW	HR procedures and contracts of employment checked and updated after seeking advice from specialist lawyer annually	3/02/05
Child protection	TW	CRB checks and two written references obtained for all new staff and volunteers	rolling