



Chartered Institute of  
Internal Auditors

# **Parliamentary briefing: An introduction to internal audit**

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## **What is internal audit and why should it matter to parliamentarians?**

As a parliamentarian, it is helpful for you to understand the role and value of internal audit in promoting greater accountability, transparency, effective risk management and good corporate governance across the public, private and third sectors.

Everyone will have heard of auditors, and for many this will mean what is technically known as external audit. External auditors analyse and test financial accounts to ensure the financial statements give a true and fair view of the financial situation of an organisation. As the name suggests, these auditors must be external to the organisation whose accounts are being audited.

Internal audit is there to provide independent assurance that an organisation's risk management, governance and internal control processes are operating effectively. Often, although not always, internal auditors are employed directly by the organisation. When they are not, they are usually referred to as outsourced or co-sourced internal audit.

The risks that an internal auditor looks at are not just financial risks, but also non-financial risks like cybersecurity, supply chains and ESG-related risks including climate change and even assessing the corporate culture or diversity and inclusion initiatives.

Internal audit are independent from the operations they evaluate and they report to the highest level in an organisation: senior managers and the board (or governing body). This is why typically, internal audit reports to the audit committee.

Read on to learn more about how internal audit plays a key role in protecting jobs, investments, and growth across all sectors of our economy.

### **What do internal auditors do: Assessing the management of risk**

Internal auditors independently evaluate and assess an organisation's management of risk. All organisations face risks, for example, risks to the organisation's reputation if it treats customers or employees incorrectly, health and safety risks, risks of supplier failure, risks associated with market failure, cybersecurity, and financial risks to name some key areas.

To evaluate how well risks are being identified, managed, and mitigated the internal auditor will assess the quality of risk management processes, systems of internal control and corporate governance processes, across all parts of an organisation and report this directly and independently to the most senior level of executive management and to the board's audit committee.

### **What do internal auditors do: Assisting management in improving internal controls**

An internal auditor's knowledge of the management of risk also enables them to act as a consultant providing advice and acting as a catalyst for improvement in an organisation's practices. So, for example, if a line manager is concerned about a particular area of responsibility, working with the internal auditor could help to identify improvements. Or perhaps a major new project is being undertaken – the internal auditor can help to ensure that project risks are clearly identified and assessed with action taken to manage them.

### **Where does internal audit add value?**

Internal audit carries out independent risk assessments and provides independent assurance that the controls and measures put in place to manage and mitigate these risks are effective.

Here are some of the ways internal audit supports organisations:

Risks	How does internal audit add value?
<b>Fraud</b>	Internal audit conducts risk assessments, recommends fraud detection procedures, and helps ensure compliance with anti-fraud policies. These measures help internal audit identify vulnerabilities, detect fraudulent activities, and recommend improvements to reduce the likeliness and impact of fraud.
<b>Cybersecurity &amp; data security</b>	Internal audit plays a crucial role in supporting the organisation to mitigate cybersecurity and data security risks. By conducting systematic assessments, internal audit can identify weaknesses in cybersecurity controls and measures and recommend improvements.
<b>Legal and regulatory compliance</b>	Internal audit plays a vital role in monitoring compliance with laws and regulations. By supporting adherence with legal and regulatory requirements, internal auditors assist organisations in mitigating legal and reputational risks.
<b>Climate change and ESG (Environmental, Social and Governance)</b>	Internal audit can support the management and mitigation of climate change and ESG risks by conducting independent assessments of the organisation's sustainability practices, carbon footprint, climate transition and ESG compliance. Internal audit can recommend adopting environmentally friendly practices, promoting ethical conduct and responsible corporate behaviour.
<b>Human capital, diversity and talent management</b>	Internal audit can evaluate the effectiveness of recruitment, retention and employee development strategies. By identifying gaps and recommending improvements, internal audit helps the organisation optimise its human capital potential, assessing diversity, equality and inclusion, and reducing risks associated with talent acquisition and workforce retention.
<b>Geopolitical &amp; macroeconomic</b>	Internal audit can play a role in independently evaluating and assessing the organisation's preparedness for geopolitical and macroeconomic events and the associated risks. By analysing and evaluating geopolitical and macroeconomic risks, internal auditors can provide advice and recommend risk mitigation strategies.

### What types of organisations have internal audit?

In the UK and Ireland, the requirement for having an internal audit function is not universal across all types of organisations. Whether or not an organisation has an internal audit function will largely depend on its size, complexity, and risk profile. However, certain types of organisations and businesses are mandated or encouraged to have internal audit functions.

Organisations	Requirement for an internal audit function
<b>Public sector organisations</b>	Central government departments, local authorities, and other public sector bodies are often required to have internal audit functions to ensure accountability and compliance with public finance regulations.
<b>Financial services sector</b>	The Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) are the regulatory bodies responsible for overseeing financial institutions in the UK. The PRA Rulebook <sup>1</sup> and the FCA Handbook set out the regulatory requirements for financial institutions, including the expectations for risk management, governance, control, and internal audit.
<b>Publicly listed companies and public interest entities (PIEs)</b>	The decision for an internal audit function is typically left to the company's management and board of directors. The UK Corporate Governance Code <sup>2</sup> , issued by the Financial Reporting Council (FRC), sets out principles related to corporate governance for listed companies. While it does not mandate

<sup>1</sup> The Prudential Regulation Authority 'PRA Rulebook' <https://www.prarulebook.co.uk/>

<sup>2</sup> Financial Conduct Authority 'UK Corporate Governance Code' <https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf>

	internal audit, it emphasises the importance of “reviewing the effectiveness of the company's internal audit function or, where there is not one, considering annually whether there is a need for one and making a recommendation to the board”.
<b>Charities and Non-Profit organisations</b>	The Charity Commission for England and Wales <sup>3</sup> issues guidance regarding internal controls and governance for charities. The Charity Commission states “Depending on your charity’s size and complexity, you may need an internal audit function and/or audit committee. This is different to a statutory or external audit.” It goes on to say if you do not have an audit function or committee because your charity is small you should regularly review whether an internal audit function is needed and have other appropriate ways to check your internal financial controls are working.
<b>Energy sector</b>	Recently Ofgem strengthened its Financial Responsibility Principle <sup>4</sup> (FRP) meaning that energy suppliers should have an internal audit function. The FRP outlines “Where internal audit capability is not present, suppliers should provide an explanation for its absence and how independent internal assurance is achieved, as well as consider annually whether there is a need for internal audit capability, including making recommendations to the board.”

### The difference between internal and external audit

	<b>External Audit</b>	<b>Internal audit</b>
<b>Reports to</b>	Shareholders or members who are outside the organisation's governance structure.	The board and senior management who are within the organisation's governance structure.
<b>Objectives</b>	Add credibility and reliability to financial reports from the organisation to its stakeholders by giving opinions on the report.	Evaluate and improve the effectiveness of governance, risk management and control processes. This provides members of the boards/senior management with assurance that helps them fulfil their duties.
<b>Coverage</b>	Financial reports, financial reporting risks.	All categories of risk, their management, including reporting on them.
<b>Responsibility for improvement</b>	None. However, there is a duty to report problems.	Improvement is fundamental to the purpose of internal auditing. But it is done by advising, coaching and facilitating in order to not undermine the responsibility of management.

### Contact us

We hope that you find this briefing useful in understanding the role and value of internal audit. For any enquiries regarding this briefing or if you would like to set up a meeting to find out more about how we can support your work as a parliamentarian please contact:

**Gavin Hayes, Head of Policy and External Affairs at [gavin.hayes@iia.org.uk](mailto:gavin.hayes@iia.org.uk) OR 020 7498 0101.**

<sup>3</sup> Gov.UK 'The Charity Commission <https://www.gov.uk/government/publications/internal-financial-controls-for-charities-cc8/internal-financial-controls-for-charities#internal-audit-functions-and-audit-committees>

<sup>4</sup> OFGEM 'Financial Responsibility Principle' <https://www.ofgem.gov.uk/publications/decision-strengthening-financial-resilience>