At a glance: The revised FS Code for internal audit

The 2017 revisions to the Chartered Institute of Internal Auditors (CIIA)'s Financial Services (FS) Code are welcomed by PwC as we recognise that the amendments make good sense for the profession. Whilst the changes are not significant, they do raise the bar in certain areas - such as independence and reporting to the Board - and help to clarify certain areas of ambiguity.

Over the last year, we have seen the regulators take an increasing interest in the standards to which internal audit functions in Financial Services are held. When the CIIA first introduced the FS Code in 2013, it set a standard that was seen as aspirational. However, the regulators' expectations of internal audit in the FS sector are ever-increasing to an extent that, in the near future, the FS Code may be seen as the minimum expected standard rather than aspirational. Firms should be prepared to take action to ensure conformance with FS Code as a minimum, with a view to going beyond their requirements, in order to keep pace with peers and the expectations of regulators.

What's the FS Code?

- On 1 September 2017, the CIIA released its revised ***Guidance on Effective Internal Audit in the Financial Services Sector***, commonly known as the 'FS Code'.
- The CIIA commenced its review of the original 2013 FS Code in 2016, in order to further strengthen the standards and clarify any ambiguities experienced through the implementation of the 2013 FS Code.
- The changes are not significant, but will have a greater impact on small and mid-tier FS firms.

What's changed?

The changes seek to strengthen internal audit in two key ways:

- ***Heightened independence and standing of internal audit*** – there is an increased focus on internal audit forming its own view on risks and exercising judgment, particularly when using the work of other controls functions.
- ***Increased explicit reporting to the Audit Committee*** – reflecting the increased information and assurance needs of those charged with governance to execute their responsibilities under the Senior Managers Regime.

We have summarised the key changes over the page.

What does this mean?

- Many functions will require an increase in the depth and breadth of subject matter expertise to deliver against the requirements.
- With the increasing demands from the FS Code, internal audit budgets may come under increasing pressure.
- The enhanced reporting requirements will need to be considered during the internal audit planning cycle as functions must be able to demonstrate that sufficient work has been undertaken for the conclusions being reported.
- While remaining as guidelines, there is a market-wide expectation of compliance, with a requirement to report on conformance to those charged with governance.

What do firms need to do?

- Assess their conformance with the revised FS Code.
- Plan now for the work needed to allow them to deliver against the enhanced reporting requirements.
- Audit Committees members must familiarise themselves with the new requirements, including where responsibilities rest with Non-Executive Directors, and hold Chief Audit Executives to account.
- Firms should give consideration to their internal audit operating model in light of the revised requirements. For example, is the optimal model in-house, co-source or outsource, and should the function make use of wider expertise in the business through guest auditor programmes?
- Firms must also plan for the expertise needed to deliver the requirements, and how this will impact upon the function's budgets.

Summary of changes

Internal audit standing and independence

- Internal audit must form its own view on the audit universe, as well as undertaking its own risk assessment.
- There is emphasis that internal audit may "take account of" the work of others where the previous FS Code referred to "placing reliance". In any case, internal audit must evaluate the effectiveness of any function before taking account of its work. This now explicitly includes an assessment of the quality of the work of the first and second lines of defence.
- For Chief Audit Executives (CAE) with more than seven years' tenure, the annual assessment of his/her independence and objectivity by the Chair of the Audit Committee must be discussed (and minuted) by the Audit Committee each year. Note that this does not require the rotation of the CAE every seven years.

Reporting to those charged with governance

- Internal audit must report annually to the Audit Committee on its conclusions on whether the risk appetite framework is being adhered to.
- The methodology employed by internal audit to determine what areas of the audit universe are to be covered each year (based on the outcome of the risk assessment) must be approved by the Audit Committee annually.
- For any significant adverse event, internal audit must review and report on any post-mortem and lessons learned analysis undertaken. Internal audit will be required to report on the roles played by all lines of defence in the event.

Other changes

- Internal audit reports must identify owners and accountabilities for each management action. This will likely have no impact on most firms, for whom it is normal practice.
- The phrasing of requirements around customer outcomes has been revised to emphasise the importance of assessing the impact of controls on outcomes.
- Internal audit must review its audit universe and plan on a regular basis to ensure that new and emerging risks are adequately considered.
- In relation to the risk and control culture, internal audit must now also assess the observed behaviours across the organisation. The assessment must be against the articulated values, ethics, risk appetite and policies of the organisation.
- A form of External Quality Assessment must be undertaken in full at least every five years, irrespective of the size of the function.
- In considering resources, the technical subject matter expertise within the function must be compared against the operations and risks of the organisation.

Contacts

Banking & Capital Markets

Steve Frizzell
+44 (0)7802 659 053
steve.j.frizzell@pwc.com

Insurance

Paul Pannell
+44 (0)7725 068 227
paul.pannell@pwc.com

Asset & Wealth Management

Alison Morris
+44 (0)7714 226 313
alison.c.morris@pwc.com

FS Regions

Nick Elliott
+44 (0)7714 708 731
nick.elliott@pwc.com

Authors

Aaron Oxborough
+44 (0)7711 562 170
aaron.oxborough@pwc.com

Fiona Gray
+44 (0)7809 551 526
fiona.c.gray@pwc.com