

INSURANCE INSIGHTS

News for Insurance Internal Auditors

Welcome to the November 2017 edition of Insurance Insights, a regular round-up from PKF Littlejohn's Financial Services team of the main developments affecting the insurance market.

In this edition, we consider the implications of the recent changes to the Chartered Institute of Internal Auditors' 'Guidance on Effective Internal Audit in the Financial Services Sector'.

Overview of changes to the Code

The Chartered Institute of Internal Auditors' 'Guidance on Effective Internal Audit in the Financial Services Sector' (the Code) was originally published in July 2013 to 'raise the bar' of Internal Audit functions in financial services organisations and to promote good practice. Following the recent consultation process and review by an independent committee, a new version of the Code was published on 1 September 2017.

Although the changes to the Code are described as 'modest amendments' to either clarify or emphasise certain points, we recommend that the implications of the changes, on a practical level, are carefully considered by Internal Audit functions. This is particularly important at this time of year when many Internal Audit functions are preparing and presenting their annual reports for 2017 and Internal Audit plans for 2018 to their Audit Committees.

The changes to the Code are shown in the table below (highlighted in **bold**). The full text of the new Code can be found [here](#).

Para	Old Code (July 2013)	New Code (September 2017)
4	<p>In setting its scope, Internal Audit should take into account business strategy and should form an independent view of whether the key risks to the organisation have been identified, including emerging and systemic risks, and assess how effectively these risks are being managed. Internal audit's independent view should be informed, but not determined, by the views of management or the Risk function. In setting its priorities and deciding where to carry out more detailed work, Internal Audit should focus on the areas where it considers risk to be higher.</p> <p>Internal Audit should make a risk-based decision as to which areas within its scope should be included in the audit plan – it does not necessarily have to cover all of the potential scope areas every year.</p>	<p>In setting its scope, Internal Audit should form its own judgement on how best to segment the audit universe given the structure and risk profile of the organisation. It should take into account business strategy and should form an independent view of whether the key risks to the organisation have been identified, including emerging and systemic risks, and assess how effectively these risks are being managed. Internal Audit's independent view should be informed, but not determined, by the views of Management or the Risk function. In setting out its priorities and deciding where to carry out more detailed work, Internal Audit should focus on the areas where it considers risks to be higher.</p> <p>Internal Audit should make a risk-based decision as to which areas within its scope should be included in the audit plan – it does not necessarily have to cover all of the scope areas every year. Its judgement on which areas should be covered in the audit plan, and on the frequency and method of audit cycle coverage, should be subject to approval by the Audit Committee.</p>
6		<p>The scope of Internal Audit's work should be regularly reviewed to take account of new and emerging risks. Where relevant, Internal Audit should assess not only the process followed by the organisation's first and second lines of defence, but also the quality of their work.</p>
6c	<p>Internal Audit is not responsible for setting the risk appetite but should assess whether the risk appetite has been established and reviewed through the active involvement of the Board and Executive Management. It should assess whether risk appetite is embedded within the activities, limits and reporting of the organisation.</p>	<p>Internal Audit is not responsible for setting the risk appetite but should assess whether the risk appetite has been established and reviewed through the active involvement of the Board and Executive Management. It should assess whether risk appetite is embedded within the activities, limits and reporting of the organisation; and it should report annually to the</p>

Audit Committee its conclusions on whether the organisation's risk appetite framework is being adhered to.

<p>6d Internal Audit should include within its scope the risk and control culture of the organisation. This should include assessing whether the processes (e.g. appraisal and remuneration), actions (e.g. decision making) and "tone at the top" are in line with the values, ethics, risk appetite and policies of the organisation.</p> <p>Internal Audit should consider the attitude and assess the approach taken by all levels of management to risk management and internal control. This should include Management's actions in addressing known control deficiencies as well as Management's regular assessment of controls.</p>	<p>Internal Audit should include within its scope the risk and control culture of the organisation. This should include assessing whether the processes (e.g. appraisal and remuneration), actions (e.g. decision making), 'tone at the top' and observed behaviours across the organisation are in line with the espoused values, ethics, risk appetite and policies of the organisation.</p> <p>Internal Audit should consider the attitude and assess the approach taken by all levels of Management to risk management and internal control. This should include Management's actions in addressing known control deficiencies as well as Management's regular assessment of controls.</p>
<p>6h Internal Audit should evaluate the design and operating effectiveness of the organisation's policies and processes. As part of this evaluation, Internal Audit should consider whether the outcomes achieved by the implementation of these policies and processes are in line with the objectives, risk appetite and values of the organisation.</p>	<p>Internal Audit should evaluate the design and operating effectiveness of the organisation's policies and processes. In doing so, it should not adopt a 'tick box' approach based purely on the design of processes and controls, and should always consider the actual outcomes which result from their application, assessed against the espoused values, ethics, risk appetite and policies of the organisation.</p>
<p>8 Internal Audit's reporting to the Board Audit and Risk Committees should include:</p> <ul style="list-style-type: none">• a focus on significant control weaknesses and breakdowns together with a robust root-cause analysis;• any thematic issues identified across the organisation;• an independent view of Management's reporting on the risk management of the organisation, including a view on Management's remediation plans (which might include restricting further business until improvements have been implemented) highlighting areas where there are significant delays; and• at least annually, an assessment of the overall effectiveness of the governance and risk and control framework of the organisation, together with an analysis of themes and trends emerging from Internal Audit work and their impact on the organisation's risk profile.	<p>Internal Audit's reporting to the Board Audit and/or Risk Committees should include:</p> <ul style="list-style-type: none">• a focus on significant control weaknesses and breakdowns together with a robust root-cause analysis. Internal Audit's reports should identify owners, accountabilities and timescales for each management action;• any thematic issues identified across the organisation;• an independent view of Management's reporting on the risk management of the organisation, including a view on Management's remediation plans (which might include restricting further business until improvements have been implemented), highlighting areas where there are significant delays;• a review of any post-mortem and 'lessons learned' analysis if a significant adverse event has occurred at an organisation (for example, a regulatory breach). Any such review should assess both the role of the first and second lines of defence and Internal Audit's own role; and• at least annually, an assessment of the overall effectiveness of the governance, and risk and control framework of the organisation, and its conclusions on whether the organisation's risk appetite framework is being adhered to, together with an analysis of themes and trends emerging from Internal Audit work and their impact on the organisation's risk profile.
<p>11 Internal Audit should exercise informed judgement as to when to place reliance on the work of Risk Management, Compliance or Finance. To the extent that Internal Audit places reliance on the work of Risk Management, Compliance or Finance, that should only be after a thorough evaluation of the effectiveness of that function in relation to the area under review.</p>	<p>Internal Audit should exercise informed judgement as to what extent it is appropriate to take account of relevant work undertaken by others, such as Risk Management, Compliance or Finance in either its risk assessment or determination of the level of audit testing of the activities under review. Any judgement which results in less intense Internal Audit scrutiny should only be made after an evaluation of the effectiveness of that function in relation to the area under review.</p>

<p>17 The Chairman of the Audit Committee should be accountable for setting the objectives of the Chief Internal Auditor and appraising his/her performance. It would be expected that the objectives and appraisal would take into account the views of the Chief Executive. This appraisal should consider the independence, objectivity and tenure of the Chief Internal Auditor.</p>	<p>The Chair of the Audit Committee should be accountable for setting the objectives of the Chief Internal Auditor and appraising his/her performance at least annually. It would be expected that the objectives and appraisal would take into account the views of the Chief Executive. This appraisal should consider the independence, objectivity and tenure of the Chief Internal Auditor. Where the tenure of the Chief Internal Auditor exceeds seven years, the Audit Committee should explicitly discuss annually the Chair's assessment of the Chief Internal Auditor's independence and objectivity.</p>
<p>28 In addition, the Audit Committee should obtain an independent and objective external assessment at appropriate intervals. This could take the form of periodic reviews of elements of the function, or a single review of the overall function. The conformity of Internal Audit with the recommendations included in this guidance should be explicitly included in this evaluation. The Chairman of the Audit Committee should oversee and approve the appointment process for the independent assessor.</p>	<p>In addition, the Audit Committee should obtain an independent and objective external assessment at appropriate intervals, irrespective of the size of the organisation. This could take the form of periodic reviews of elements of the function, or a single review of the overall function. In any event, the Internal Audit function as a whole should as a minimum be subject to a review at least every five years, as set out in the International Professional Practice Framework for Internal Audit. The conformity of Internal Audit with this guidance should be explicitly included in this evaluation. The Chair of the Audit Committee should oversee and approve the appointment process for the independent assessor.</p>

Practical implications for Internal Audit functions

The changes to the Code require consideration by Internal Audit functions as to their practical implications, particularly in the following areas:

1. Annual report on adherence to risk appetite framework

The new Code introduces a requirement for Internal Audit functions to report annually to the Audit Committee on whether the organisation's risk appetite is being adhered to. This indicates that Internal Auditors will perhaps need to look more closely at the activities of the Risk function than they have in the past. This is alluded to elsewhere within the changes to the Code, which emphasise that Internal Audit should assess not only the process followed by the Risk function but also the quality of its work.

On a practical level, Internal Auditors will need to consider:

- The extent to which they understand and have reviewed the organisations process for establishing, communicating, embedding, monitoring and reporting on the risk appetite framework;
- Whether they need any specialist skills within the Internal Audit team to effectively review and evaluate the Risk function; and
- The frequency with which they review their Risk functions going forward in order to report annually to the Audit Committee on adherence to risk appetite.

2. Post mortem and 'lessons learned' reviews

The new Code introduces a new requirement for Internal Auditors to undertake post mortem or 'lessons learned' reviews following the occurrence of significant adverse events. On a practical level, Internal Audit functions will need to:

- Consider and define what types of events may warrant this type of review. For example, this might include a legal or regulatory breach or fine, IT security breach, significant underwriting breach, internal or external fraud event, or significant broker/coverholder failure;
- Establish a process for monitoring the occurrence of significant adverse events within the organisation. For example, this may be through regular meetings with senior management, attendance at key committee meetings and review of near-miss or breach registers; and
- Incorporate a contingency or flexibility within their Internal Audit plans for allow for review of significant adverse events.

On the one hand, this new requirement will help to raise the profile of Internal Audit functions within their organisations as it will mean that senior management will need to turn to their Internal Auditors for their help in understanding what went wrong. On the other hand, this new requirement increases the accountability of Internal Audit teams as the review requires an assessment of Internal Audit's role in relation to significant adverse events. For example, this may raise questions about whether the Internal Audit function has been effective – has it been looking at the right areas of the organisation within its Internal Audit plan or has it been sufficiently challenging and robust in the work it has undertaken, for example?

3. Assessment of the effectiveness of the Internal Audit function

The new Code emphasises the requirement to obtain an independent and external assessment of the effectiveness of Internal Auditors, irrespective of the size of the organisation. This could take the form of periodic reviews of certain aspects of the function or a single review of the whole function. Either way, the function as a whole should be assessed at least every five years. In our experience, many teams have not undertaken an external assessment in recent years and the reason often given for this is that it is 'not the right time'. This may be valid in certain circumstances, however, we recommend that now is the time for all functions, irrespective of their size, to consider and articulate to their Audit Committees how they plan to address the requirements for an external assessment. This should be clearly set out and budgeted for within your Internal Audit strategy/plans to ensure that it takes place within the expected timeframe. As the Code suggests, the external assessment can take different forms and it doesn't need to be an extensive or onerous exercise.

Please talk to us if you are interested in how PKF Littlejohn can tailor and perform an external assessment to your specific circumstances and size.

Other considerations

In addition to the practical implications highlighted above, Internal Auditors will also need to:

- Inform their Audit Committee of the changes to the Code and how they are planning to address them
- Review and update their Internal Audit Charter and operating procedures manuals
- Review and update their annual reporting templates to Audit Committee

Our specialist team is here to help. If you would like advice the Code and best practice in the Internal Audit arena, please contact one of our Insurance - Internal Audit team members.

We hope you've found this issue useful. If anyone within your business would like to receive future issues, please send their details to Shannon Skeels (sskeels@pkf-littlejohn.com).

PKF Littlejohn LLP
1 Westferry Circus
Canary Wharf
London E14 4HD
Tel: +44 (0)20 7516 2200
pkf-littlejohn.com

Follow us on  [Twitter](#)
and  [LinkedIn](#)

PHILIP ALEXANDER
Partner
E: palexander@pkf-littlejohn.com
T: +44 (0)20 7516 2444

IAN SINGER
Partner
E: isinger@pkf-littlejohn.com
T: +44 (0)20 7516 2236

JESSICA WILLS
Director
E: jwills@pkf-littlejohn.com
T: +44 (0)20 7516 2229

INSURANCE

This document is prepared as a general guide. No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication can be accepted by the author or publisher.

PKF Littlejohn LLP, Chartered Accountants. A list of members' names is available at the above address. PKF Littlejohn LLP is a limited liability partnership registered in England and Wales No. 0C342572. Registered office as above. PKF Littlejohn LLP is a member firm of the PKF International Limited family of legally independent firms and does not accept any responsibility or liability for the actions or inactions of any individual member or correspondent firm or firms.

PKF International Limited administers a network of legally independent firms which carry on separate business under the PKF Name. PKF International Limited is not responsible for the acts or omissions of individual member firms of the network.