

The Role of the Auditor in the Proactive Dissemination of Information

DISSEMINATION OF INFORMATION

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Introduction

- On first seeing the proposed topic, I certainly found it intriguing - if somewhat pretentious! - but I was not at all certain that I could craft a speech on it. My first thoughts were that the audit role tends to be diagnostic - serving either management or a key stakeholder - rather than being a proactive role on its own. Usually it is important that the auditor has a clear sense of the mandate that they are working under.

However, on reflection, I realised that the Audit Office does have quite a strong role in the dissemination of information - not just within organisations we audit, but also to wider publics. We are not simply diagnosticians, but also interpreters and informers.

In my experience, the need to be proactive can be even stronger for internal audit - at least within the organisation itself.

- I will start by considering the various roles of an auditor. First external audit in general, then the Audit Office itself, and finally internal audit. I will then go on to consider the purpose of audit interventions, and discuss the implication that each purpose has for the auditor, in the "proactive dissemination of information". I will look at the roles in terms of assurance, diagnosis, design and implementation.
- I will then go on to:
 - examine some of the risks of involvement in proactive dissemination of information;
 - identify some implications for the auditor; and
 - come to some conclusions.

The Auditor's Role

1. Role of External Auditors in General

- I have no doubt that the core role of external auditors is **assurance**.
- Recent trends towards providing "added value" or the "**improver role**" have limits.

For instance:

- they create independence risks;
- the assumption of wider responsibility seems to conflict with moves towards limiting liability; and
- the market drive to add value runs counter to the recent moves, in the UK in particular, to a more regulatory role.

2. Role of the Audit Office

- In the Audit Office our primary role is giving assurance to Parliament and other key stakeholders about government activities. We see our business as the maintenance of the financial integrity of the parliamentary system of government. We achieve our aims by providing assurance through reporting on the state of the sector and on what improvements are needed.
- Obviously then, the Audit Office has a much **wider role** than simply attesting to financial statements. You may remember that I spent much of my speech to you last year explaining this wider role. I noted that our concerns were not just with accountability, but also with authority, performance, waste, and probity.
- The Audit Office obviously has a role in the public arena. I have both the requirement and the power to **report publicly** on such matters as I think fit. There is no doubt that the Audit Office, probably more than the external audit profession in general, has a role in information dissemination outside the organisations we audit. Mainstream external auditing tends to be confined to internal information dissemination - usually going no further than the main shareholders.

3. Role of Internal Audit

- I also noted in last year's speech the increasing overlap in our roles with your internal audit roles. I surmised that there might be some ideas for internal auditors in our legislative audit model.
- From the Audit Office's perspective, internal audit is an internal executive tool whose primary function is the **reduction of business and operating** risks. A secondary role may be to **increase the operational payoff** in any and all operations. Specific objectives and strategies, and particular tasks and methods, will vary between entities - as will the degree of freedom from the executive.
- If I'm right in asserting that reduction in risk is the primary role for internal audit, it is somewhat unclear whether the internal auditor has a role in the proactive dissemination of information. However, as we go into more detail, the fact that **there is a role, but it has severe limitations**, will hopefully become clearer.

Possible Purposes of the Audit Role

- As a first step in my analysis, I broke down the audit role into its possible purposes, and looked at the information components, and the dissemination components of each purpose.
 - I identified four possible key purposes in any audit intervention:
- to provide **assurance** to some audience on the state of the entity;
- to provide **diagnostic information** to some audience;
- to provide **advice on the design of new systems**; and
- to provide **advice on the implementation of existing or new systems**.
- Let's look at each possible purpose in more detail.

Assurance

- **Assurance** is the core of the external auditor's role. It has a very high comfort component, as opposed to an information component. For example, the first outcome statement for the Audit Office - as published in our 1996/97 Departmental Forecast Report - identifies the following desired outcome:

" Parliament and the public will be confident that public sector organisations:

- Are delivering what they have been asked to;
- Have operated lawfully and honestly, and have not been wasteful;
- Have fairly reported their performance in their statements of account; and
- Know that, if this is not the case, we will tell them."

- Note the key word "confident" and the statement that 'we will let them know if there is a problem'. The extent to which there is a true information component depends on how far the stakeholders we are reassuring trust us!
- To achieve assurance, auditors need to perform some **detection work**. The basic underpinning of an audit is the testing of whether information is appropriately supported. Of course, the auditor's presence acts to **prevent** as well. The very fact that the auditors are on the premises, or they are known to be coming, has some sort of prevention effect - although no one has ever been able to quantify it. This mix of assurance based on prevention and detection is hard to assess, and in my view is often undervalued by stakeholders.
- As a general rule, auditors support their assurance with **diagnostic information**. They describe their audit process and its results to the relevant stakeholders, and provide details of any exceptions they've noted. In this way auditors provide at least the first step towards a solution for any issues that they've raised.
- This purpose - assurance - is met by a wide range of reporting in the Audit Office. Not just audit opinions, but also reporting on the state of

individual sectors, reporting on the state of functions across sectors of similar management regimes, and so on.

We also find ourselves in the role of interpreting Annual reports and Estimates information for Select Committees and Parliament. Unfortunately, sometimes this means we have to substitute for management in providing high level overview information. So, while the purpose of what we do is assurance, There is often quite a high information content involved.

- The **target audience** for this assurance is clearly the **primary stakeholders** - and this holds true for both internal and external audit. For the Audit Office, the primary stakeholder is either Parliament or individual local authorities. However, as I have previously mentioned, we reserve the power to report to wider audiences. And I guess the extent of media interest sometimes ensures that we reach those audiences!
- I believe that assurance is at the core of the internal audit role as well - although perhaps it is less fundamental. If your business is the reduction of risk, then conveying assurance of well-managed risk to the Board and/or senior management is a central part of your purpose. The information component of this role would tend to be illustrative, as it is for external auditors.
- To summarise then - the auditor's role in proactively disseminating information for assurance purposes tends to be confined to the provision of illustrations. These illustrations are more to emphasise the level of assurance obtained on the state of a system or entity, than to help make decisions.

Diagnosis

- The assurance role is, of course, supported by a high level of system or information diagnosis. However, what I'm turning to now is diagnosis for its own sake. I define this as analysing and reporting on the state of systems or information for the purpose of achieving change rather than assurance.
- For example, in the Audit Office, and no doubt in most internal audit functions, specific audit projects such as performance audits and operational audits are all at least partially of this diagnostic nature. Some audits are designed to diagnose because it is known that there are issues or risks; and the first step towards finding a solution is diagnosis. Other audits come from a more neutral basis, with a balance of assurance and diagnostic purposes. Often audits evolve and change as they proceed - as a problem is identified more effort is put into diagnosis.
- Our second Outcome statement is:

"Parliament and the executive branch of government will effect improvements in public sector performance and accountability in areas where we have advised potential for such improvements to be made."

- Diagnostic audits have a very high **information component**, and focus primarily on detecting the state of the system. The auditor compares the operation of the system with some sort of benchmark, and then produces a finding and a conclusion.
- To the extent that a system is fundamentally flawed or not running well, there may be a policy decision for owners. However, most of the diagnostic information auditors provide is **information for managers' decision making**.
- **Diagnosis for the purpose of improvement or change seems to me to be at the heart of internal audit - whereas assurance or comfort is at the heart of external audit.**

Design of New Systems

- When we get beyond assurance and diagnosis, we are starting to move into delicate territory. Since we as auditors should be expert in systems analysis, surely we have a significant contribution to make to systems design? This of course is one of the major ongoing debates in the external audit profession, and probably amongst internal auditors as well. Can you, having been involved in the design of systems, retain your objectivity when reviewing them?
- The short answer is that your **objectivity will always be compromised**. However, providing the risks are managed properly, there can be significant benefits in being involved in designing systems.
- At the Audit Office, we are often involved in systems design on a government-wide basis as well as at an entity level. One advantage of being the auditor of an entire sector is the ability to apply lessons learned across the sector. We are proactive in such diverse areas as:
 - the financial management component of new legislation; and
 - the design and improvement of reporting strategies, such as Statements of Service Performance and environmental reporting.
 In working government-wide we can deal with principles, and be at the input end of design rather than being responsible for the final outputs. Our role tends to be advisory rather than taking a lead.
 - Our field auditors also give advice on systems design at an entity level, but there are strict independence rules governing the nature and extent of the advice they can give.
 - We see ourselves in a prevention role here - ensuring that system design includes key elements of risk management and minimisation. However, we have to be aware that the more we are involved in detailed systems design, the greater is the risk of compromise of our objectivity and the acceptance of our subsequent audit work.
 - No doubt you will be subject to the same risks when as internal auditors you are involved in the design of new systems.

- As far as the implications of these risks for information dissemination are concerned, again we are dealing with a very specific target audience. If we are involved in systems design, the managers responsible for design and implementation must be our audience.

Implementation of Systems

- As far as the implementation of systems is concerned - especially new systems - I hope we are all of a mind that the auditor should **stay as far away from this activity as possible**. It is here that the greatest compromise to the auditor's independence and objectivity can occur.
- Of course, There is a role for the auditor in post implementation review - but this is more of a diagnostic activity than an involvement in implementation itself.

Other possible roles for the Auditor

- In terms of the general provision of information, and the ongoing activities of the organisation, however, There is still a question to answer. **What is the role of the auditor** in, for example:
 - communicating information on the operating environment;
 - communicating information on benchmarking and market opportunities;
 - reinforcing management goals and strategies; and
 - commenting on other facets of day-to-day organisational operation?
- For external audit, this is a boundary we do not cross lightly. If we observe anything dysfunctional in an organisation, we simply put it into our kit of diagnostic information to provide to the appropriate level of management or stakeholder group. If we obtain key operating environment or other information, we follow the same approach. We are not in the business of substituting or interfering with management's role in disseminating operating information.
- It seems to me that it is not nearly as clear cut for internal auditors. There are some specific and some general areas where internal auditors clearly can and perhaps should play a part. A **specific area** is identification of benchmarking opportunities. Auditors are in a good position to do this directly, or to act as expert advisers to managers in benchmarking to external operations.
- A **general area** could be the broad promotion of management's goals and desired culture. Obviously, internal auditors should design their audit work in the context of management goals, and not work across or counter to them. However, one question I would like to leave you with is - how far is the active reinforcement of management goals and strategies an appropriate role for internal audit?

It is my personal view that it is risky to be involved in these activities, as it may cut across management lines and initiatives, even if done informally. To be effective, and recognised as such, the auditor should stay as removed from day-to-day operations as possible.

Risks of Proactive Information Dissemination

- I have already identified some of the key risks, and I would like to touch on them again.
- First, the risk of being unbalanced - of not being **objective**. If we are in diagnostic mode, we are trying to find out what is wrong. An inevitable issue for us is presentation of too negative a picture of a situation. We do not want to be like some of the media - reporting news for the sake of the immediate impact. We want to have a longer term, positive impact on the organisation. Bad news can create a negative environment, and often we are carriers of bad news. Balance and objectivity are key to our success in this role.
- Secondly, we are in a privileged position as auditors, and this privilege must not be abused. Our words carry weight with key decision or opinion makers, so they must be carefully chosen. Not only must they be accurate, and in an appropriate context, but they must also meet a useful purpose for the organisation - for either diagnostic or assurance purposes. Our words must have **integrity**.
- The question of **confidentiality** is related to objectivity and integrity. The auditor's watchword is discretion. We are listeners, not actors. For external auditors, the second of our ten auditing standards deals with confidentiality - especially as it relates to commercially sensitive information. Our whole culture is based on a "need to know" principle. The wrong word in the wrong place at the wrong time is inappropriate.

The message I would like to give you is not that we should not proactively disseminate information, but rather that we have to choose carefully which audiences we pass information on to.

- Another key risk for the auditor is crossing lines of authority. In being actively involved in information provision, we can interfere with the roles of line managers. Our primary audiences should almost invariably be primary stakeholders or managers. To the extent that we provide information to other groups, we must be aware of the risks of **interference**.

We should be the messenger, rather than the message. Yet even in the Audit Office we can get into an unfortunate position. As I mentioned previously, in interpreting information for Select Committees we feel sometimes that we are substituting for management.

- This brings me to the last of the major risks. The specific risk to us as auditors, rather than to the organisation as a whole - the risk to our **independence**. As auditors we should not be a primary conduit for information, but rather we should be encouraging the system to produce the appropriate information. If we are directly involved in dissemination of operational information, we've lost that independence of conduct. And independence is an essential requirement for both internal and external auditors.

To summarise

- I have no doubt that there is a role for auditors in the proactive dissemination of information. However, my statement is hedged by a number of key provisos and risks.
- First, the nature of the information we should impart is squarely based in our professional competence, and should be primarily diagnostic in nature.
- Secondly, we are not in the business of general dissemination of information. Our involvement should be limited to selected information being provided to selected audiences for selected purposes.
- Thirdly, being proactive increases rather than decreases risks. We are at risk of:
 - compromising audit standards to do with objectivity, integrity and confidentiality;
 - flouting cultural imperatives such as discretion; and
 - interfering with management in carrying out its primary role.And the flip side to this is that we are in danger of compromising our own independence.
- If there is a lesson to come out of this, it is that we should *interpret* any role we have in the proactive dissemination of information quite *conservatively*. If in doubt, be discreet!

Implications of the provisos and risks

- There are two key implications of the provisos and risks I have just discussed. Both are simple in concept, but often difficult or complex to implement.
- ***The first general message is that auditors must have a very clear approach to communications. I have put this under the general term of "communications strategy".***

The following questions need to be answered:

- How proactive should the audit communication function be?
- What should we communicate to whom, when, and how?
- What is our communications role with respect to staff, to management, to primary stakeholders, and to the wider public?
 - To be effective, your communications strategy will be heavily dependent on the primary purpose you have in providing the information. You may make a different choice as to what and how you communicate depending on whether you are in an 'assurance' role or an 'improver' role.
 - For example, one possible strategy for the Audit Office is to "fearlessly and frankly" report all that it finds - asking Parliament to be the vehicle for action and change. At the other end of the spectrum we could attempt to work almost solely through the Executive, leaving anodyne

statements for Parliament - a sort of "trust me, it is all under control" approach. In practice, we steer a delicate and sometimes difficult path between these two extremes. Being fearless and frank can sometimes result in less assurance, and less stability, than not! Conversely, excluding the primary stakeholders from information about risks and solutions is also likely to be a recipe for eventual disaster.

- This approach to communication means that we are continually reconsidering our reporting and communications strategies. The fourth of our six published goals as an Office is:

"That our reporting practices ensure that we communicate effectively with those who have a key interest in the results of our work."

And we identify a number of key strategies in support of this goal.

- At an overall level for example, we are currently reassessing our relationship with Parliament in the light of MMP. It is likely that Select Committees will have more power in an MMP Parliament, and we have to adjust our reporting and relationship strategies accordingly.
- At a specific level, each project has to identify in advance the prime audiences, and the type of message that will be conveyed. Multiple reports are often provided to multiple audiences from the one project or group of projects. An example being our assurance role. A set of audits in a particular sector may provide the basis for reporting to:
 - the entity, perhaps at different levels;
 - the Board;
 - the Minister;
 - Select Committees; and
 - Parliament.

At entity level we may be providing diagnostic information; while at Parliamentary level the reporting will be more of an assurance nature.

- As internal auditors do you have a defined communications strategy? Have you clarified why you are communicating what to whom? Have you identified the risks of fearless and frank reporting? Or the risks of taking a more active role in information dissemination?
- ***The second general message should also be quite clear. Any active role in the dissemination of information carries with it a number of risks, which must be recognised and managed. Auditors must try and clarify which are the worst risks to take.***

The following observations might be helpful:

- You are at risk if you get into proactive dissemination of information at the implementation end of the spectrum - you are likely to lose independence and objectivity, both perceived and real;
- You are at risk if you interfere with or substitute for management - even if your intention is to complement and reinforce;
- You are definitely not in the business of countering information provided by management or undercutting what management is doing - even if in your view they are in error. (In this case, your role is to tell the manager or the manager's superior - not the staff.)

External Reporting for Internal Auditors

- Before I conclude, one issue that can not be ignored is the role of the internal auditor in providing information outside the organisation. External auditors have a responsibility to shareholders, who are somewhat at arm's length from the organisation. The Audit Office has a wider public reporting responsibility which I have already referred to. Is there any role, then, for internal audit in disseminating information outside the organisation?
- The short answer in my view is no. If an internal auditor reports outside the organisation it should not be as a consequence of their role as internal auditor. Rather, it would be acting either as management, or as a whistle blower. Two cases in point are:
 1. Reporting on fraud or legal breaches to regulatory authorities. As a general rule, internal audit will report these through normal channels to the Board, which will then either authorise or undertake the transmission of the information to the appropriate authorities.
 1. Where internal audit has observed something which in the public interest they believe should be exposed outside the organisation. Here we are in whistleblowing territory. Unless the entire board is in collusion, the auditor will have internal avenues for formally reporting the matter. If you believe that further action should be taken, then you cease acting as an internal auditor and become a citizen - weighing up your own personal view of social responsibility against your loyalty to the organisation. Whistleblowers are acting as concerned citizens - not as functionaries of the organisation.
- In other words, it would only be in rare circumstances that the role of the internal auditor went beyond reporting internally to the organisation. Internal audit is set up as a management service, preferably reporting independently to the Audit Committee or Board. In my view, internal audit has no real parallel with external audit or the role of the Audit Office in serving a need for wider public accountability.

Conclusion

- Yes, as auditors we do have a role in the proactive dissemination of information - but it is a circumscribed role.
- And, our information dissemination needs to be clearly targeted.

Perhaps the most important message I want to leave you with is that you should not think of yourselves as proactive disseminators of information. Rather, you should have clear and well-targeted communications and reporting strategies that:

- ***Provide the right information, to the right people, at the right time, for the right purpose.***

Thank you