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Development Paper
Internal Audit and the Trustee Board: Evolutionary Governance in the UK Charity Sector

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I. Introduction

This research paper further develops earlier work examining charity governance at a conceptual level, a summary of which is found in part IV, 'The Role of Trustees in Charity Governance: a conceptual framework for best practice'. A case study drawing on empirical data collected in 2013 is used to illustrate current practices and consider their origins, purpose and effectiveness from a theoretical viewpoint. The author considers the data collected and uses notional tools to help understand and predict human behaviours in complex social settings.

The overall focus of this mixed methods research study is one of collaboration with practitioners and professional bodies to produce findings and recommendations that contribute toward the continued advancement of the internal audit profession and sound governance in the UK charity sector. Strong and effective trustee relationships are essential for internal auditors in the provision of strategic level assurance. Internal audit must raise its profile and re-evaluate its traditional skill set in order to make a significant contribution at the highest level (Chambers, A, 2008: Cowley, 2009).

II. Aim and objectives of the study

Aim:
To analyse and evaluate internal audit's relationship with the Board of Trustees and consider its contribution to effective governance in the UK charity sector.

Objectives:
a) To analyse and evaluate internal audit relationships with charity trustee board members and consider the contribution of those relationships to the theory and practice of governance.

b) To identify and consider governance structures and strategies employed by charitable bodies in response to the evolutionary growth of an organisation with a view to evaluating their impact upon the roles and relationships of internal audit and trustee board members.

c) To explore the inter-relation between the performance of the Trustee Board and that of the internal audit function.

d) To present an idealised model of governance structure and behaviour for future practices within the UK charity sector with particular reference to the relationship between internal audit and Trustee Boards.

III. Research Design and Methodology

a) Approach
The methodological approach applied involved a combination of both qualitative and quantitative techniques. This study includes complexities associated with human interaction in social settings, and as such, lends itself to a phenomenologist approach, which traditionally targets qualitative data. However, the researcher believes that value will be added from the quantitative analysis of some of the empirical data generated, and that this will provide statistical insight alongside the narrative.

b) Surveys and interviews to collect primary data
Survey questionnaires were used to collect empirical evidence on the views of both trustees and internal auditors working within the charity sector. The electronic survey application allowed for both qualitative and quantitative analysis of the responses, with the option to include weightings for answers available and text boxes for additional narratives.

Questions were based on auditing standards taken from the International Professional Practices Framework published by the Institute of Internal Auditors. They asked internal auditors about reporting lines, contact and relationships with trustees and the executive board. They enquired regarding governance structures and strategies and the provision of strategic level assurance. An opinion was sought over the level of understanding that executive and trustee board members had of their governance role. Trustees were asked a corresponding and complimentary set of questions to

identify where correlations and differences lay. They were also asked about the nature of their role in governance including relations with donors, beneficiaries and external networks ("boundary spanning": Provan, 1980; Leocovich, 2005).

c) Collaboration
The study collaborated with the Charities Internal Audit Network (CIAN) and took its sample from the largest 200 UK based charities, many of which were members of CIAN. As only larger charitable organisations have internal audit functions, the sample for this study is taken from organisations with a turnover in excess of £35 million. This was identified as the (inflated) income level required by a similar study conducted by KPMG on behalf of CIAN in 2006. Although this was not an academic research study it provided an additional point of reference for contextual information.

d) Triangulation
Triangulation of these results was achieved via the comparison of survey data from both internal auditors and trustees. Survey findings were supplemented with unstructured interviews in cases where the participants were willing to engage further with the study. Interviews were unstructured to allow interviewees to present their own agenda and facilitate an exploratory and inductive element to the research.

e) Case Studies
Where a quorum of participants was achieved within the same organization small case studies were used to illustrate relevant findings and form conclusions for the overall study. Further contextual input was sought from key regulatory and professional bodies including the Charity Commission and the National Council for Voluntary Organisations. Empirical results will be collated and disseminated to academics, expert authors and practitioners in the field to facilitate the discussion and validation of the findings and conclusions. Their feedback will substantiate the development of practical recommendations for subsequent changes to professional policy and best practice that may originate from the empirical research findings.

f) Use of epistemological reflexivity
Epistemology is the study of knowledge and justified belief. It is concerned with what it means to "know" something as opposed to simply having an opinion and is described by Bryman and Bell (2003) as "what can be considered acceptable knowledge". The questioning of preconceptions and consideration of prior knowledge is important for individuals conducting a research study. Consideration of the epistemological stance in this study has influenced the research methods adopted. An introspective or "reflexive"

approach has been applied to question the validity of preconceived elements within research assumptions. The researcher holds opinions generated from experience as an internal audit professional in a non-profit environment and so has identified preconceptions to be explored. This study aimed to test these preconceptions, derived through general observation, in line with a deductive approach.

However, the primary aim of this research was to collect and analyse the views of participants and to be responsive to their opinions. Therefore, the researcher wishes to maintain the exploratory nature of a combined deductive and inductive approach so that the study may be responsive to feedback.

The unstructured interviews with auditors and trustees allow for the introduction of their own agendas and opinions and are not led by the researcher. These are used to reflect back on survey results and to facilitate a case study approach built around further qualitative data with quantitative findings used to provide contextual input. This inducted input assisted in verification of extant knowledge and the methodological stance.

IV. The Role of Trustees in Charity Governance
It is interesting to contrast the relative merits of governance mechanisms derived from conceptual frameworks and also the limitations and problems they present. In any one organisation there will be a variety of human behaviour exhibiting qualities that fit within the theoretical stereotypes we encounter in Agency, Stakeholder (Freeman, 1984), Stewardship and Resource Dependency theories: selfish, altruistic, collaborative and engaging extrovert. If we were to use these frameworks as tools to help understand and predict differing human behaviour in complex social situations, it might be considered that they do not have to be mutually exclusive. This is a view held by Oliver (1991) and Miller-Millesen (2003) with regard to Agency and Resource Dependency theories. This is further discussed in an earlier paper presented and published as part of the Tenth European Conference Internal Audit and Corporate Governance 2013, online available at http://www.iacmaster.it/iacgconference2012/wp-content/uploads/2012/04/Toothill.pdf.

The literature review evaluates extant literature and key theoretical models in the field of charity governance and internal audit (**objectives a & d**). It discusses key theoretical models including Stewardship, Agency, Stakeholder and Resource Dependency Theories and examines the inter-relationships of the trustee boards and internal audit

within these differing conceptual frameworks (Bruce & Chew, 2011: Callen *et al.*, 2009: Hyndman& Jones, 2011: Hyndman & Mc Donnell, 2009: Marvel & Marvel, 2008: Sinclair *et al.*, 2010). Perhaps a combined approach that addresses relative merits and limitations from the theories and draws on the best practice from each might appear as follows:

The Role of Trustees in Charity Governance: a conceptual framework for best practice
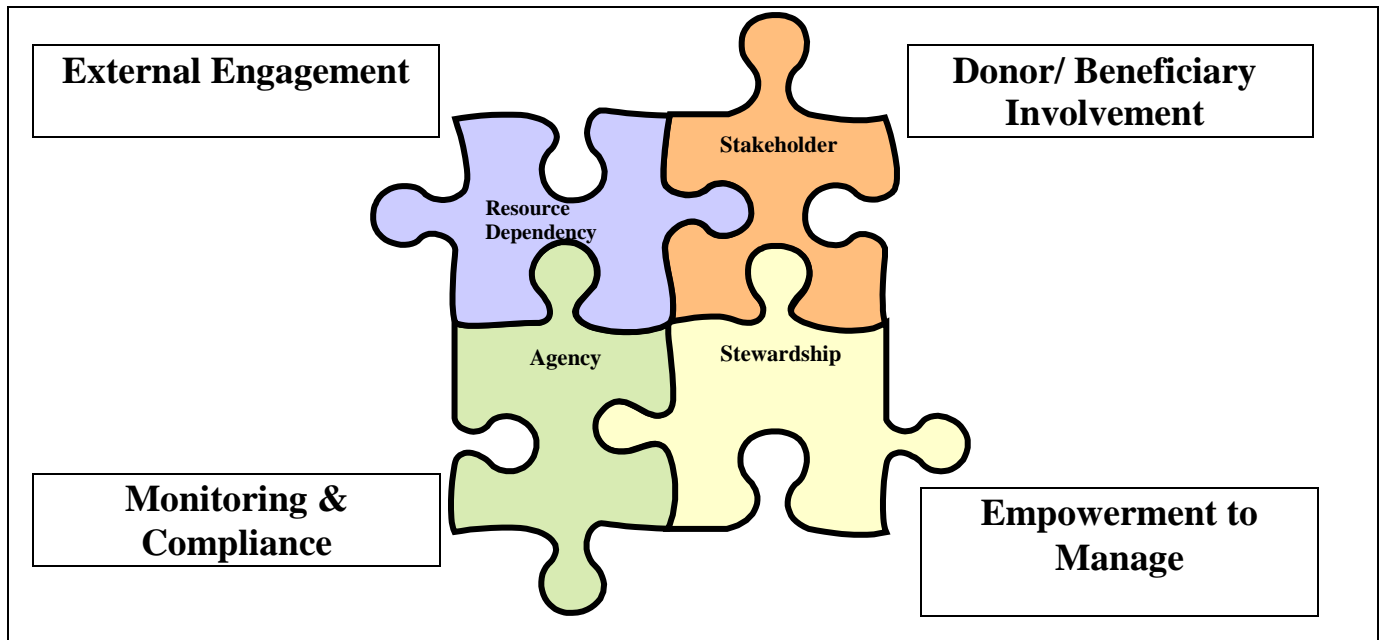
Source: Author 2011

Resource Dependency contribution
External engagement is a key factor in managing opportunities and threats for the organisation. Board members engage in boundary spanning activities to promote the external image of the charity and ensure a flow of local grants, talented employees and enthusiastic volunteers. A lesser focus on monitoring and compliance may reduce the influence of the Audit Committee leading to lower levels of implied authority for internal audit. They may take on more of an advisory and consultancy role and it might be difficult to ensure agreed recommendations are implemented.

Stakeholder perspective contribution
Key stakeholder involvement. Donors are kept engaged and informed through management communications. Beneficiary feedback on the appropriateness and quality of the service is channelled through service scrutiny panels. Internal audit have a wider remit for provision of assurance and governance structures reflect wider accountability.

Stewardship perspective contribution
Management are empowered to act with explicit delegated authorities and documented strategic plans agreed at board level. Operational plans, policies and procedures ensure clarity of purpose. Internal audit provide assurance against a risk based plan and in view of clearly defined objectives. Governance structures reflect the emphasis on collective and co-operative behaviour.

Agency perspective contribution
The board is independent from management and provides challenge and oversight. Their key monitoring role is supported by internal audit in providing assurance to the board, through the audit committee. Compliance and regulatory reporting takes precedence as monitoring role is primary. Internal audit may incur a compliance reporting requirement, or responsibility, toward regulator and beneficiaries.

V. Application of the theory to a Charity Case Study

The charity chosen for case study is a UK based service provider, with an annual income in the band of £100 to £200 million. It employs 5,000-10,000 staff and has a geographically dispersed UK presence, along with many international operations, some delivered through partnership arrangements. A significant proportion of its income derives from government contracts. There are between 10 and 15 registered, charity trustees. Data collected shows that internal audit has a good relationship with both executives and trustees.

The researcher believes that there is a natural alignment between the roles of independent trustees and the independence of internal audit, and that a closer alliance between the two would be of mutual benefit to both parties. The summary below analyses the focus of the trustee position and the subsequent requirements of the internal audit function. They are divided into sections that reflect on each aspect of the best practice framework.

a) **1st: Stakeholder Involvement was ranked first by the charity Trustee in order of importance to their role.**

Stakeholder Involvement
(Donors & Beneficiaries)
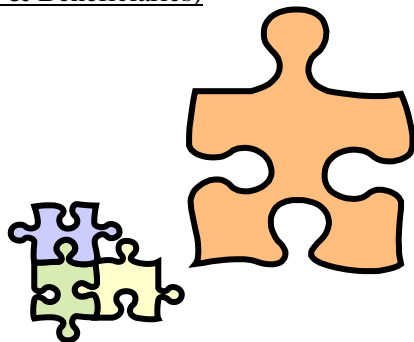
Case: Key points of interest

The Trustee focus is primarily aimed at engagement with key stakeholders (in this case the service beneficiaries).

- Active Beneficiary Forum
- Beneficiary forum representative on Trustee Board
- Beneficiary forum representative is observer at Executive Board Meetings
- Beneficiary forum representative at Finance Committee Meetings

- Donors a minor part in funding
- No donor representation in governance

Case: Implications for Governance
Key stakeholder interests, those primarily of service beneficiaries, are of optimum interest and focus. Beneficiaries have representation on the Trustee Board, so influencing governance at the highest level. A Beneficiary Forum representative is also allowed to attend Executive Board meetings as an observer. This ensures full knowledge of executive proceedings and enables this key stakeholder body to ensure that correct protocols are followed.

*Case: Implications for Internal Audit*
Internal audit are actively involved in the monitoring and review of service provision and beneficiary feedback mechanisms. As beneficiary involvement is valued as being an intrinsic part of the governance system, internal audit time and focus is allocated to ensure that the beneficiary voice is heard and responded to.

Theoretical stance: Donor/ Beneficiary Involvement
Key stakeholder involvement. Donors are kept engaged and informed through management communications. Beneficiary feedback on the appropriateness and quality of the service is channelled through service scrutiny panels. Internal audit have a wider remit for provision of assurance and governance structures reflect wider accountability.

b) **2nd: Stewardship of management was ranked second by the charity Trustee in order of importance to their role.**

Empowerment to Manage
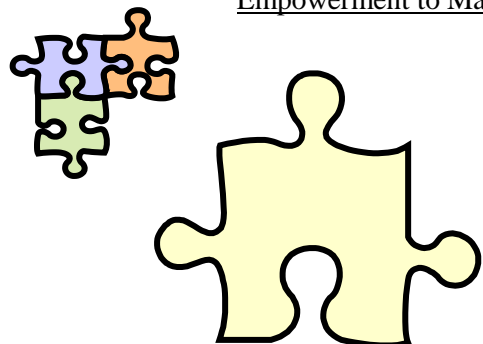
Case: Key points of interest

The charity has explicitly detailed strategies, policies and delegated authorities empowering management

but retaining Trustee and Executive Boards control and oversight.

- Trustee performance review in last three years (clear steer on strategy, explicit policies & procedures)

- Governance Structure reviewed in last three years (explicitly delegated authorities empower management)

- Governance Strategy reviewed in last three years (established focus)

- Rotation of Trustee Board Members only after greater than five years of service, however.

Case: Implications for Governance
Trustees believe that a key part of their role is enabling management to act semi-autonomously within an explicit, strategic framework of policy and delegated authorities set at board level. Emphasis is placed on the establishment of effective governance mechanisms and frameworks to empower management and facilitate a positive, motivational environment.

Case: Implications for Internal Audit
Stewardship is facilitated through a set of defined aims, objectives, strategies and structures. This provides an excellent framework against which internal audit may base its risk based plan. The internal audit function focus here is to help management "get the control framework right…" and "…provide them with assurance it's working…". Internal audit also deliver "…diagnostics and solutions if it's not working". This attitude is very much one a facilitation of good management, rather than of oversight reporting.

Theoretical stance: Empowerment to Manage
Management are empowered to act with explicit delegated authorities and documented strategic plans agreed at board level. Operational plans, policies and procedures ensure clarity of purpose. Internal audit provide assurance against a risk based plan and in view of clearly defined objectives. Governance structures reflect the emphasis on collective and co-operative behaviour.

c) **3rd: Monitoring & Compliance ranked third by Trustee in order of importance to their role.**

Monitoring & Compliance
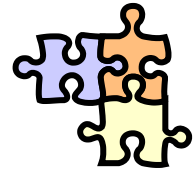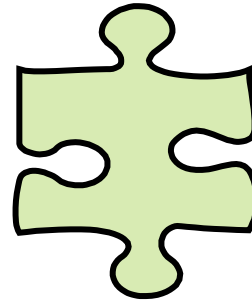
Case: Key points of interest
The monitoring and compliance role of the Trustee Board takes a lower priority as clearly defined structures allow management to concentrate on day to day operations without intrusive oversight.

- Trustee Board sees monitoring of Executives as a lower priority

- Only quarterly internal audit reports to Trustees

- No Executive Board Performance Review in the last three years

- Trustee Board satisfied with internal audit performance

- Informal contact between internal audit and Trustees

Case: Implications for Governance
The governance structure is clearly defined and requires little intervention. Oversight of management is subjugated to a lower ranking of importance due to the explicitly delegated authorities. The relaxation in 'challenge and oversight' by the Trustees is evidenced by the fact that there hasn't been an Executive Board Performance Review in the last three years.

Case: Implications for Internal Audit
The clearly defined governance structure is also evidenced in the reporting cycle of internal audit, which is only quarterly. The formality of the internal audit role is moderated due to their reduced monitoring and compliance reporting requirement. This allows for a closer, more informal relationship to exist between the Trustees and the Head of Audit (HIA). The formal, quarterly reporting cycle is supplemented with direct, informal contact between the Trustees and the HIA, which facilitates a 'real time' flow of information between the two parties, unrestricted by the typical boardroom constraints.

Theoretical stance: Monitoring & Compliance
The board is independent from management and provides challenge and oversight. Their key monitoring role is supported by internal audit in providing assurance to the board, through the audit committee. Compliance and regulatory reporting takes precedence as monitoring role is primary. Internal audit may incur compliance reporting requirement, or responsibility, toward regulator and beneficiaries.

d) 4th: External engagement ranked fourth by the Trustee in order of importance to their role.

External Engagement
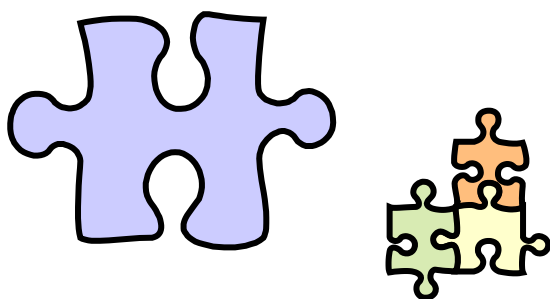
Case: Key points of interest

Although seen by the Trustee as a lower priority than other areas of responsibility, the Trustee was still heavily involved in boundary scanning activities (Provan 1980; Iecovich, 2005) on behalf of their charity as below:

- Volunteer recruitment
- Networking to attract funding
- Lobbying for social/ political change
- Bidding for public contracts
- Fundraising campaigns
- Public promotion of charity

Case: Implications for Governance
Clearly, the Trustee sees their role as having a wide remit of responsibilities. The large number of trustee board members allows for significant levels of networking to engage with the external environment and bring in essential resources such as contracted income and volunteers. Hyndman and McDonnell (2009) warn that this size of board may become "unwieldy" and difficult to manage.
Volunteers are used by the charity at a local level only and so they represent a very small element of the workforce. The 'marketization' effect (Bruce & Chew,

2011) of the government initiative, The Big Society 2010, has led to a formalization of employment in charities. Keutzen & Jager (2011) suggest that this kind of environment stifles volunteer enthusiasm as the bureaucracy of larger institutions takes over (Wellens & Jegers, 2013).

Case: Implications for Internal Audit
The willingness to engage with the external environment is also prevalent within the internal audit function, where members regularly attend forums and professional networking groups. Although external engagement is perceived to be of lower priority than other governance elements, there is a positive, outward looking approach within the organisation and this extends to the internal audit function. Risk management includes horizon scanning for changes in the external environment and this feeds through to the risk based internal audit plan.

Theoretical stance: External Engagement

External engagement is a key factor in managing opportunities and threats for the organisation. Board members engage in boundary spanning activities to promote the external image of the charity and ensure a flow of local grants, talented employees and enthusiastic volunteers. A lesser focus on monitoring and compliance may reduce the influence of the Audit Committee leading to lower levels of implied authority for internal audit. They may take on more of an advisory and consultancy role and it might be difficult to ensure agreed recommendations are implemented.

VI. Conclusion

The interim conclusion of this research study is that internal audit are not defined by a prescriptive set of rules that dictate 'what we do', rather, we are defined by a set of ideals that govern 'what we stand for'.
If we see our position as intrinsically linked to that of the independent oversight role (Trustees, Non-executive Directors, Councillors and Governors) then our requirements will flex and change as theirs do too.

Alternate elements of Trustee best practice take precedence, as an organisation grows and evolves, in order to circumnavigate particular crises. Each of these phases brings new challenges and an adaptation of practice for internal audit.
Taking these concepts further, the next phase of this study will be to collate empirical data from several case studies to populate a model of charity governance evolution.

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