



HM TREASURY

# Internal Audit Strategic Improvement Plan:

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**Consultation**

**January 2010**





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# Foreword

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This paper has been produced as a product of the Internal Audit Transformation Project. It is undergoing consultation through to the 15<sup>th</sup> February 2010. For information on the consultation process please contact Steve Barnes, Lead Audit Policy Adviser<sup>1</sup>.

I am grateful to all those who have contributed to the document through interviews, discussions and other work.

Chris Wobschall

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# Executive summary

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Our proposals are based on one of the largest internal audit (IA) stakeholder surveys and reviews of leading IA practices ever undertaken in the public sector. We conclude that the current strategy, people and resourcing model and structure of internal audit are not well aligned to deliver cost effective assurance to Accounting Officers, Audit Committee Chairs and other senior stakeholders. Risks to public service delivery are becoming increasingly complex and interdependent and the current fiscal climate gives rise to new challenges for organisations; IA must recognise these developments and respond with efficient, high value assurance and trusted advice. This must be matched by management taking full responsibility for its risk management and assurance needs.

We propose:

- An internal audit **strategy** that is driven by strategic objectives, both within and across organisations, and delivers greater integration of assurance providers;
- A **people** and resourcing model that is designed to stimulate innovation and renewal and provide development and career opportunities;
- A **group structure** that enables the strategy and people and resourcing model to operate more effectively; and
- More **effective engagement with key stakeholders** on risk management and assurance to enable internal audit to operate with optimal effect, making a positive and tangible contribution to an organisation's success and delivery imperatives.

The Head of the Government Internal Audit Profession (HIAP) should support the implementation of our proposals, which are designed to spread best practice, drive up standards, promote consistency and deliver substantial improvements in internal audit's capability, efficiency and effectiveness.

The benefits to central government will be stronger governance and decision-making arrangements and implementation processes to mitigate risks and support more cost effective delivery of its objectives, all within a significantly improved risk management and assurance framework for Accounting Officers.



# 1

## Overview of consultation

This Plan sets out the case for change for the central government Internal Audit Service (IAS) and proposes *a clear and consistent strategy, a new people and resourcing model and a new structure for internal audit*. It recognises the need for significant improvements in governance (including decision making arrangements), risk management and the system of internal control, so that the work of internal audit is driven by the risks and exposures that matter most to Principal and other Accounting Officers.

### Purpose of this consultation

The purpose of this consultation is to seek the views of Accounting Officers, Audit Committee Chairs, other senior stakeholders and the internal audit profession in central government on the benefits of our proposals. **The deadline for comments is 15 February 2010.** Please return your comments to Steve Barnes, Lead Audit Policy Adviser: [steve.barnes@hmtreasury.gsi.gov.uk](mailto:steve.barnes@hmtreasury.gsi.gov.uk). We would welcome your views on all the proposals in this Plan. We have identified the following specific areas on which your views are sought:

1. Please comment on the proposal that an Internal Audit strategy aligned to departmental, cross cutting and other relevant strategic objectives, will maximise the impact of Internal Audit and enable a more efficient and effective assurance to be delivered to Accounting Officers and other senior stakeholders? Please state any alternative approaches that you would suggest.

2. Please comment on the need for better Accounting Officer, Audit Committee Chair and other senior stakeholder engagement in the mapping of strategic objectives, risks and sources of assurance to improve the cost-effectiveness of overall assurance arrangements and enhance the role of internal audit.

3. The fundamental proposal in the Strategic Improvement Plan is that a Group Internal Audit Service will enable Internal Audit resources to be used more efficiently and effectively? Do you agree and, if not, please state your reasons and any alternatives that you would suggest.

4. Please comment on the proposal that the larger critical masses of internal auditors provided by Group Internal Audit Services will enable resources, including the use of co-sourcing, to be used more flexibly and improve skills and career development opportunities, including identifying and developing the leaders of the future? Please state any alternatives that you would suggest to achieve the intended improvements in quality, impact and cost effectiveness, including possible outsourcing arrangements.

5. Please comment on the role we propose for the Head of the Government Internal Audit Profession and whether you agree that it will improve the quality and consistency of internal audit services and attract high calibre entrants to the IA service. If you do not agree, please state your reasons and any alternative approaches that you would suggest.



# 2

## The case for change

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Internal Audit is an independent, objective assurance and consulting activity, designed to add value and improve an organisation's performance. In central government, its main purpose is to provide assurance to accounting officers and boards that the controls used by management are adequate and operating effectively. This includes the systems of governance and risk management, as well as financial and wider controls. Reviews by Internal Audit do not in any way relieve management of its absolute responsibility to ensure that the controls on which it relies are robust.

Internal Audit in central government has evolved over many years into a large and wide ranging service. There are now around 2,000 auditors in over 300 organisations, with an estimated annual cost of around £200 million.

Risks within the public sector are becoming increasingly complex and interdependent, placing particularly challenging demands on Principal Accounting Officers (PAOs) in delivering core and cross cutting services. The tight fiscal environment is giving rise to new risks, as departments are challenged to improve their service delivery, but with fewer resources. These developments require ever more effective assurance arrangements. An increased focus by the National Audit Office on the accuracy and usefulness of the Statement on Internal Control means that the systems on which the Statement is reporting have to be robust – management and internal audit will have to rise to this challenge.

The IAS must play a full and strategic part in identifying where assurance is most needed and in delivering high value from its finite resources. It must also respond itself to the need for efficiency gains.

HM Treasury has undertaken one of the largest reviews ever of public sector internal audit. This has included: over 150 interviews with Accounting Officers (AOs), Audit Committee Chairs, Senior Operational and Finance Directors and Heads of Internal Audit; interviews with large private sector organisations; reviews of best practice research; and an on-line survey of Heads of Internal Audit. We have found a number of examples of emerging good practice that are consistent with the proposals we are making later in this Plan. However, the general story is that within organisations there are multiple sources of assurance that are not well harnessed by senior stakeholders, nor cost effectively aligned to key strategic risks. These misalignments include the role of internal audit. Assurances should be better arranged to provide improved value for money in meeting the assurance needs of Accounting Officers (AOs) and other senior stakeholders.

The way the IAS currently works across departments and their arm's length bodies differs greatly in terms of planning, delivery and reporting. We have identified disparity in the views of HIAs and key stakeholders, both on their expectations and understanding of the role of internal audit and on the quality of the service being delivered. It is not clear that stakeholders understand what they should expect from the IAS. There is no coherent people development programme in place across the IAS. This compromises the ability of the IAS to attract, develop and retain the high calibre people it needs to interact credibly with top management.

In parallel, the Treasury is undertaking a review of corporate governance in central government. This review is addressing issues that are complementary to those identified in this Plan, including the need to improve the performance of boards and to clarify the governance relationship between departments and their arm's length bodies.

Our overall conclusion is that the current delivery model for Internal Audit is not well placed to meet the significant challenges faced by central government. The key risks across delivery chains and the wide range of assurances being provided make it difficult for AOs and other stakeholders to know if there is adequate assurance over governance, risk management and internal control. Stakeholders are not currently deriving maximum benefit from the IAS.

The objective of this Plan is to drive transformation in the IAS, so that it makes a positive and tangible contribution to an organisation's success and delivery imperatives. It should be recognised at senior levels in organisations as a strategic partner, with people positioned and equipped to give high quality and strongly valued assurance in a cost effective and professional way. This requires an improved understanding by stakeholders of the IAS, with raised expectations and levels of engagement, and with the IAS mandate aligned to the real assurance needs of PAOs, AOs and other key stakeholders.

# 3

## The goal: a high performing Internal Audit service

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A high performing IAS will work collaboratively with AOs, boards, audit committees, non executive board members and senior management, will be perceived as a trusted adviser and make a big difference in the effective delivery of public services. It will provide proportionate, high quality, timely, objective and, where necessary, up-front assurance to top management on the effectiveness of governance, risk management and internal controls across departments and arm's length bodies, and on wider cross cutting activities. A high performing IAS should exemplify strong governance and leadership, with effective stakeholder engagement, coherent and integrated audit strategies, and people with the right knowledge, skills and understanding to make a real contribution to strategic issues. It will use highly skilled people in flexible ways to deliver new insights and innovation in order to improve organisational effectiveness and efficiency.

An IAS will not be able to perform at this level without strong backing and a clear mandate from PAOs, AOs, audit committees and boards. A pre-requisite is that these stakeholders must understand all major risks and their related assurance needs, and actively support an integrated assurance process to increase focus, reduce duplication and eliminate unnecessary over assurance. This requires a comprehensive understanding and awareness of all assurance needs in order to avoid creating potentially damaging gaps or overlaps in the level of assurance.

Management must fulfil its own risk management and assurance responsibilities, so that the IAS can use its skills and resources to optimum effect to provide independent assurance that the system of internal control is robust, adequate and complete and in line with the relevant organisation's risk appetite.



# 4

## What are the benefits to public service delivery?

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### **Increasing organisational effectiveness and efficiency:**

*Stronger Delivery Mechanisms* – PAOs and AOs will receive better assurances on the management of risks across their delivery group, with an early warning of issues likely to impact on public service delivery.

*Stronger Implementation Mechanisms* – All central government bodies, whether departments, executive agencies or NDPBs, will be more certain that, in implementing new projects and programmes, the delivery risks have been properly assessed and mitigated and that leadership, resourcing and capabilities have been adequately considered. Internal Audit will leverage its knowledge from across its delivery group to provide practical advice to developers of policy.

*Stronger Governance* – Assurance mapping and scrutiny of the interfaces across and between delivery groups will clarify and strengthen governance arrangements.

*Better Value for Money* - An integrated approach to risk management and assurance, driven by strategic objectives, will provide improved information and analysis and deliver better overall value for money.

*A stronger Central Government Control Environment* – This will be achieved through aligning assurance more clearly to strategic objectives, and through a greater sharing of best practice.

### **Increasing efficiency and effectiveness of Internal Audit and other assurance providers:**

*Cost effective assurance* – A comprehensive understanding and reshaping of all assurance activities will reduce audit activity, provide a more transparent and aligned approach to annual assurance opinions, and allow the IAS to focus its efforts on assurance gaps and avoiding duplication.

*Efficient and flexible use of IA resources* – By directing its people and specialist skills to where assurance is most needed, by improving value for money in procuring and using private sector resources and specialisms, and through larger critical masses, the IAS will deliver improved economies of scale and value for money.

*Greater confidence in the quality of Internal Audit work* – The deployment of IA resources across delivery groups, with strong leadership and collaboration from all HIAs and staff, working flexibly and understanding the need for proportionate and risk based assurance, will deliver better engagement, trust and respect, making a positive and tangible contribution to an organisation's success and delivery imperatives.

## **The benefits to the Internal Audit service**

The IAS will be an attractive place in which to work and develop. It will be an acknowledged springboard for launching successful careers in other areas of government, as well as offering careers itself for top talent. The IAS will be highly valued by AOs and senior management, thereby increasing its morale and enabling it to become a natural first choice for high potential staff to begin or develop their careers.

# 5

## How will this goal for Internal Audit be delivered?

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Successful delivery will require strong leadership, a common purpose, greater consistency in achieving best practice, economies of scale and a clearer role for the Head of the Government Internal Audit Profession (HIAP).

To realise this goal we propose:

- A clear and consistent internal audit strategy;
- A new people and resourcing model;
- A new internal audit structure.

### A clear and consistent Internal Audit strategy

Integrated audit planning will operate across organisational boundaries, including at department level for cross cutting activities, with a full sharing of audit strategies and objectives and collaborative working to meet the assurance needs of PAOs and other AOs.

Internal audit will work with departmental and other boards and audit committees to review their risk management processes and to help them establish appropriate management assurance frameworks. Leveraging assurance mapping, HIAs will ensure strong alignment between the strategic objectives and priorities of the organisation and the focus and thrust of their internal audit work. This will include an assessment of the reliance they can place on management and other assurances.

The HIAP will work more widely with AOs and Audit Committee Chairs to raise awareness of how Internal Audit can assist in improving the effectiveness of risk management arrangements.

The HIAP will also ensure that lessons are learnt, best practice is shared and appropriate benchmarking is developed.

### A new people and resourcing model

Internal audit is a demanding role. It calls for well-developed technical and analytical skills, as well as highly developed leadership, communications and behavioural capabilities to foster trust and provide constructive challenge. Inadequate people skills can damage relationships with stakeholders. There is evidence that gaps in capability are affecting the quality of internal audit's outputs and outcomes. Added to this, the 'churn' of people in the IAS is low, which does not fuel innovation, refreshment and new ideas.

The size of the IAS in central government provides opportunities to attract and develop new talent and make effective use of co-sourcing. However, its fragmented nature has meant that opportunities to improve have not been exploited systematically, unlike some other professions in government.

The new people and resourcing model will create a more dynamic service and profession, capable of meeting the assurance needs of its stakeholders by:

- offering varied and challenging roles to those with high potential, spanning multiple organisations in order to develop them into well-rounded and strongly

performing professionals, whose next career moves will not usually be in internal audit;

- increasing the movement in, out and between internal audit services to foster new understandings, gain greater insights, promote innovation and promulgate a greater awareness of governance, risk and control across government as a whole;
- maximising the efficient allocation of internal audit resources, including those drawn from the private sector;
- raising the profile of HIAs to ensure they are equipped fully to engage with senior stakeholders and give more effective and upfront delivery of assurance;
- developing future leaders; and
- developing the role of the HIAP to be a more effective facilitator across government.

The HIAP will work with human resources specialists and HIAs, building on lessons learned from other professions across government, to deliver this people and resourcing model.

## **A new internal audit group structure**

The current structure of Internal Audit is a barrier to transformation. Larger internal audit groupings would facilitate better alignment of assurances to strategic objectives, with improved people development, including career opportunities through secondments between organisations, greater knowledge management and increased economy and efficiency. Fewer units in total would also help to achieve a more consistent application of best practice. Although there are already some good examples of integrated approaches to internal audit across departmental families, the diversity in approach creates barriers to the transfer of knowledge and is not efficient or economic. Also, it may not be sufficiently effective.

How the IAS is organised will depend on the commonality of public service delivery objectives and the related risk environment. For example, it may reflect a departmental led group, where risks and assurances can be mapped across the group (department, executive agencies and NDPBs). Alternatively, it could reflect groups of entities performing similar or related functions or cross cutting activities, or those which do not have sufficient critical mass as individual bodies to maximise the efficient and effective delivery of the internal audit service.

The assurance requirements of individual bodies will have to be reconciled with those of the group, for example how an NDPB Accounting Officer obtains sufficient assurance across the NDPB risks when these are set in the context of the group risks. Different groupings and risk considerations will apply to arm's length bodies depending on their actual and perceived autonomy in the context of central government delivery, but the aim should be to deliver effective assurance across central government.

It follows that for these arrangements to work effectively, there must be an aligned management assurance framework, which also is organised appropriately around cross cutting activities. The Group HIA will therefore need to operate at senior levels in the organisation and be seen as a key strategic partner in the successful delivery of central government services. Where there is an aligned management assurance framework, most internal audit groups will be able to achieve efficiency gains through a top down assessment of risks.

There are other possible ways within existing structures of delivering improvements in audit assurances across central government, including through a more flexible use of co-sourcing arrangements and better talent management. This Plan has not explored these incremental approaches in any great detail, as we do not believe that, in themselves, they would lead to a sufficiently radical improvement in governance, risk management, control and assurance across

central government. However, these alternative ideas are complementary to our proposals and could be used as an integral part; for example, co-sourcing to fill specialist skill gaps.

There are risks attached to the proposals in this Plan, but we believe that they are worthwhile as they will drive substantial improvements in performance, value for money and internal control. Mitigations will include management rising to the challenge to take full responsibility for gaps in management assurances, internal audit acquiring the skills to operate effectively at a strategic level, and a continued independent assurance by internal audit on lower level risks, where this is essential to the overall system of internal control.



# 6

## What this will mean in practice

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Management has the primary responsibility for assurance. Governance, risk management and the internal control system should be well understood and embedded by management, so that controls operate effectively, within strong operational and financial frameworks. AOs and boards will continue to take overall responsibility and, on a continuing basis, should ensure that control requirements are being met. The annual Statement on Internal Control will continue to report on the effectiveness of the system of internal control, but with substantially increased scrutiny by the NAO. Internal audit is not responsible for putting in place these control arrangements, but it is responsible for providing assurance to accounting officers that the arrangements are operating efficiently and effectively.

To fulfil its role, internal audit needs to test the adequacy and completeness of management assurances, from whatever source. It should therefore ensure management's mapping of assurances is complete, map them itself where the mapping is insufficient, and test their effectiveness against the risk profile of the organisation, reporting to management for it to take any corrective action where the assurance is insufficient.

It follows that:

- 1 the system of internal control must be understood at board level;
- 2 internal audit must provide independent assurance on the system of internal control. This assurance should be given at a sufficiently high level and have sponsorship from the top, including a direct relationship with the PAOs and other AOs, as the primary recipients of the independent assurance. The HIA must understand the quality and extent of management assurances and be strong enough to report to, and effect change from, the top to fill the assurance and internal control gaps;
- 3 internal audit's prime focus should be on the key strategic risks to delivery and control, including across cohesive delivery groups;
- 4 internal audit must have the necessary leadership and skills to be credible and sought after at Board level;
- 5 there will need to be a significant cultural change in many parts of central government in the way management assurances operate and internal audit services are delivered.

The HIAP will work with each department and other central government bodies to identify coherent assurance and internal audit groups, to review and agree implementation plans and help address the barriers to achieving them. Sustainability will be achieved through continuing quality assurance of the performance of the IAS across central government.

The proposals will result in:

### **An Internal Audit service driven by risks to strategic objectives:**

- Internal audit's drive will be on the risks to delivery that matter most and in the context of groups not individual organisations.
- The focus of internal audit work will be to ensure that adequate management assurances are in place and operating effectively. The assurances will be driven from the top of the organisation and mapped across the group. As far as possible, the IAS will rely on these management assurances and not duplicate them. The IAS will aim to identify any significant and material gaps in management assurances and report accordingly.
- Lower risk areas and organisations will be monitored by internal audit through reviews of management controls and assurances. There should be no expectation of internal audit continually providing assurance on routine risks.
- The application of the fundamental components of the corporate governance framework will be scrutinised on an ongoing basis.
- There will be consistency in approach and reporting to provide clear and integrated assurance on governance, risk management and controls.

### **Strong governance and stakeholder engagement to promote effective use of Internal Audit:**

- The governance, risk and control frameworks of central government organisations will be sufficiently mature and satisfactory to enable IAS to work efficiently.
- Boards will review periodically the system of internal control, and this will include the way in which individual board members are held accountable for the systems of internal control in their areas of responsibility. Risks flowing across boundaries must be understood by all parties and responsibilities agreed with the relevant counterparties.
- HIAs will have active endorsement and sponsorship (driven top down from the PAO and other AOs within the relevant groups) and the leadership capability required to engage with senior management and influence necessary improvements in management controls and assurances and in the way that the IAS is delivered.
- The HIA will operate at a sufficiently senior level to engage fully with the AO and the board.

### **Modernised Group Internal Audit Services, offering credible and effective leadership:**

- The Group HIA, in conjunction with AOs, Audit Committee Chairs and other senior stakeholders will take the lead in establishing consistency and efficiency in the planning and delivery of the IAS across their group.
- The IAS grouping will reflect departmental and other relevant groupings, and single internal audit units will not be matched to individual organisations (including wholly outsourced arrangements). Depending on the group, staff other than the Group HIA may fulfil the role of HIA for individual organisations.
- The Group HIA will drive continuous improvement and consistency across the internal audit group, and ensure effective collaboration with other groups, in order to allocate the right resources to the right audits and to address cross cutting risks and issues.

- HIAs will resource their audits through the group; auditors will be assigned to assurance requirements based on their skills, knowledge and development needs. All public sector audit staff will be employed in the group.

#### Group Internal Audits delivering efficient and effective assurance:

- Internal Audit will be, and be seen to be, a lean, efficient service, with the right people and the right skills to provide optimal assurance to AOs and other senior stakeholders.

#### An effective resource capability, offering development opportunities and attractive career options for auditors and others:

- IAS will facilitate a healthy churn and acceleration of people development in governance, risk management and control and other particular specialisms. This movement will equip people for wider career opportunities in government and bring innovation and refreshment to the IAS.
- Skill sets for IAS people will include core professional skills and high quality relationship, influencing, presentational and leadership skills.
- Skills will be augmented through secondments in and out of the IAS and through the strategic use of co-sourcing arrangements (including with the private sector).

#### A smaller, more effective IAS:

- With management meeting its full control and assurance responsibilities and providing internal audit with a strong and ongoing leadership mandate from the top, we would expect internal audit to operate at the level and with the strategic focus and the capabilities described in this improvement plan. As a result, we would expect the IAS as a whole to be significantly smaller, relying more fully on management assurances, which are developed as an integral part of normal operations and therefore more efficient.

#### The HIAP will help drive continuous improvement:

- The HIAP will help increase stakeholder awareness of the role of internal audit in improving governance, risk and control frameworks.
- The HIAP will facilitate the management of top internal audit talent and liaise with other professions to provide entry and exit routes into the IAS.
- The HIAP will ensure that best practice is shared, lessons are learnt and appropriate benchmarking data can be used effectively.
- The HIAP will assist with the recruitment of Group HIAs and advise on other recruitments, as necessary.
- The HIAP will ensure that arrangements are in place for the continuous quality assurance of the performance of the IAS

## HM Treasury contacts

This document can be found in full on our website at:  
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