



HM TREASURY

Internal Audit Strategic Improvement Plan:

Research summary

January 2010



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Introduction

This document contains summaries of the work supporting the Internal Audit Transformation Project.

The key work undertaken in support of the project was:

- Structured interviews with central government stakeholders;
- Survey of central government Heads of Internal Audit;
- Interviews with private sector Heads of Internal Audit;
- Desk based research.

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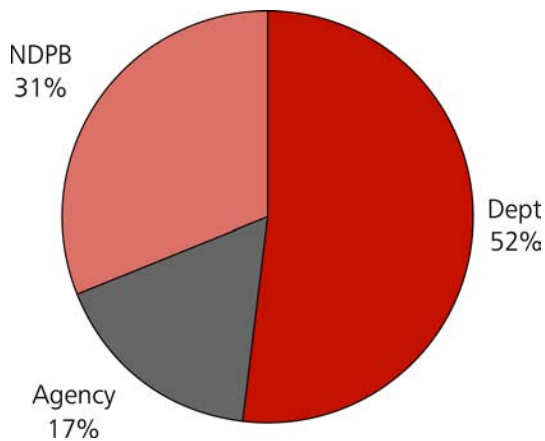
Public sector interviews

Public sector interviews

Structured interviews

The interviews covered different types of central government departments, agencies and Non Departmental Public Bodies (NDPBs) and a range of senior stakeholders, with over 150 individual interviews. The breakdown of interviews is show below:

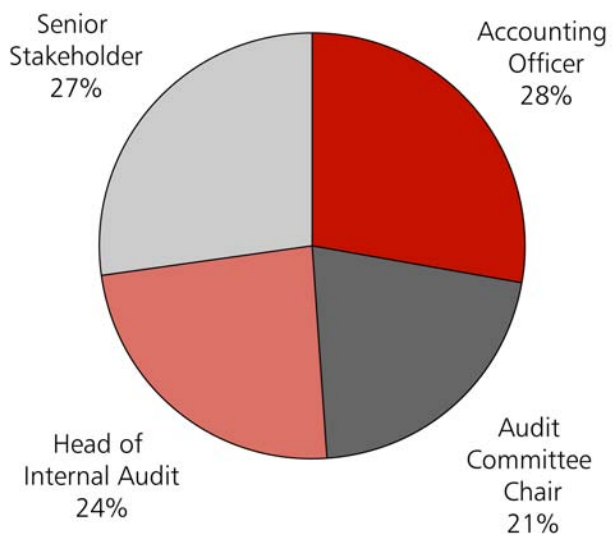
Chart 2.A: Interviews by organisation type chart



Approximately half of the interviews were undertaken with central departments reflecting their size and contribution to total government expenditure. The project has also recognised that some very large and high spending NDPBs exist, hence the significant proportion of interviews with these bodies.

Chart 2.B: Interviews by stakeholder

A good balance of interviews with Heads of Internal Audit, Accounting Officers and Audit Committee Chairs was achieved. Other senior stakeholders were also interviewed such as Finance Directors and Operational Directors.



The interviews were analysed by the following themes:

Engagement of stakeholders

A majority of all stakeholders did not consider 'engagement' to be an issue. Heads of Internal Audit had a more positive view of this than other stakeholders.

Audit scope and planning

Most stakeholders did not consider audit scope and planning to be an issue, although roughly a third raised some form of concern. Heads of Internal Audit had a more positive view of this than other stakeholders.

Internal Audit people – knowledge skill and experience

Approximately half of all Heads of Internal Audit and their stakeholders raised concerns in relation to people. Audit Committee Chairs consistently raised more concerns than any other stakeholder.

Quality of audit work

Roughly a third of stakeholders considered there to be issues in relation to the quality of audit work. Heads of internal audit had a marginally more positive view of this to other stakeholders.

HIA grade and status

The majority of interviewees did not see the grade and status of the HIA as an issue, although just under a third did. Amongst NDPB interviewees there was support for a dedicated, clearly identified HIA. The status and calibre of the HIA was seen as important as part of international comparisons.

HIA leadership and quality

Almost a third of interviewees thought that current leadership issues affected the performance of internal audit, although the majority did not. In particular, for NDPBs the interviewees were generally satisfied with their existing internal audit arrangements.

Role of HM Treasury/centre

The vast majority of interviewees thought the role of the centre needed to be clarified and used more effectively. The role of the Head of Profession should be strengthened, particularly in respect of propagating best practice and engagement with senior stakeholders.

Cross cutting (shared PSAs, shared services)

The vast majority of interviewees thought there was a need to address the challenges of obtaining assurance on delivery objectives and services shared by more than one organisation.

'Family group' assurance

The majority of interviewees said that the relationship between the department and other entities in a 'family' group in respect of risk and assurance needed to be addressed (this was not a concern for most NDPBs in isolation). We identified a diverse range of service delivery models in place. This ranged from units working in isolation of related organisations through to coordinated family approaches and shared services. Some NDPB interviewees saw the benefits of having an extended internal audit resource capability, but did not think a group internal audit approach was the only way to achieve this; some also felt that there were already mechanisms for providing management assurances to the parent department and were concerned about the impact of ceding control to the parent department.

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HIA Survey

Background

This survey was sent to 137 HIAs in Departments, Agencies and Executive NDPBs. 46 responses were received. 20 respondents were HIA in more than one entity. The total number of HIA-entity relationships covered by these responses is estimated to be 84.

Summary of Findings of the HIA Survey

Planning
Overall Planning – in aggregate, 70% of IA plans were for Business As Usual assurance, 20% were around change initiatives, and 10% other.
95% felt their plan was effectively aligned to risks.
79% thought that the IA plan was well aligned to the strategic objectives.
42% of HIAs consider that managements' RM arrangements are effective in identifying and prioritising risks to the objectives.
59% of HIAs believe risks to strategic objectives have been getting greater and 54% believe they will continue to do so in future.
56% thought they did not have a lot of visibility of risks and sources of assurance across their family group.
Joined Up Audits – ranged from 'not an issue in NDPBs', 'we don't do this', to 'working together with our parent/OGDs'.
Engagement
31% said their main reporting line was to the Accounting Officer.
49% said their was a need for their AO to be more actively engaged with IA.
15% said they 'never' or 'rarely' had one to one meetings with the Audit Committee Chair
85% said that senior management were expected to actively engage with and act on IA advice and recommendations 'for the most part' or 'always'.
87% said that IA was respected in their organisations
74% said that senior mgt seek IA advice on some key decisions frequently or on an ongoing basis.
People
Overall HIAs rated the capabilities of their teams (people - collectively) highly. Areas for improvement were in project management and in strategic awareness.
62% of HIAs estimated the average length of service of team members in their teams to be 3 years or more.
37% of HIAs used secondments to augment their resources. 83% used private sector providers.
Competencies rated high for core 'operational auditing' and compliance with GIAS. Gaps – Enterprise Risk Management, accounting and financial reporting, programme management, legal/regulatory compliance, environment health and safety and IT.
69% thought their competency development processes were effective.

Quality
92% thought IA was effective in meeting AO/ACC expectations.
Completion of plan, auditee surveys, timeliness of reports and recommendations accepted were the most common measures of effectiveness quoted.
46% said that value added by IA was not measured.
67% said the quality of IA work had improved in the past 12 months.
65% have had an external quality assessment in the past 3 years, 9% had not had one in the past 5 years.
90% thought audit reports were effective in content and timeliness.
95% said that their reports were found to be helpful to stakeholders.

Role of HOP/HMT
HOP/HMT – only 60% of HIAs saw HMT as a standard setter.
More HOP/HMT support was strongly supported in respect of: Best practice guidance, knowledge sharing, and identifying specialists, developing innovative methodologies, support and ad hoc advice. ; Should ‘bang the drum’ of IA and develop the Intelligent Customer for IA.
HIAs strongly disagreed with HM/HOP involvement in HIA appointments, sourcing of external providers, providing a top down view of risk across family groups or promoting cross-resourcing between teams.

Selected Narrative Responses

Survey Question	Response
What do you believe to be the greatest strengths of IA?	USP of IA is its ability to provide an organisation-wide view.
What changes would you like to see or where would you like to see improvement to internal audit arrangements?	Greater working across departments would be welcomed. Being recognised as a proper profession, high profile leadership from Cabinet Office/HMT. Best quality entrants; use of secondments.
How does your organisation articulate the alignment of assurance providers (including IA) to risks?	(Assurance mapping) is a work in progress; it doesn't happen; Only by IA.
How effectively is IA meeting the expectations of Accounting Officer, CEO, Audit Committee and Board?	This is easier in an NDPB, AO is far more accessible; stakeholders have not articulated their expectations; AOs ‘policy background’ means they have very little exposure throughout their careers.
Describe how well IAs role and responsibilities align with executive management's strategic objectives and initiatives?	The IA strategy links the objectives to (organisational) planning – but it's a moving target!
How often does the AO and management seek advice from IA?	No real contact with the AO. Communication is very much one-way – from us to management. This is improving as we develop intelligent customers.
How is IA perceived within the organisation?	Not sure it is. Some pockets are familiar with our work. Continuing challenge to keep the reputation ‘up there’. Pockets less engaged than they should be.
Is there a need for the AO to be more actively engaged?	Regular contact (without reporting line). Formally every other month. Monthly meetings. We are not his first port of call for assurance. Yes. If the guy at the top... is not interested... can't find the time... Why should anyone else? Our AO is very ‘outward looking’.

Survey Question	Response
In which areas could your IA function benefit from central direction and support?	Getting out there and 'beating the drum' for IA in government. Doing VFM Reports (a la NAO) across departments to raise IA profile. Assisting in creating an intelligent customer.
What are your views on the capabilities of the people in your IA function?	GIAC creates a barrier to entry. Need to have free movement in and out. People get trapped in IA.
How well does the internal audit plan align to the risks within your organisation?	We balance the programme – key business risks and assurance in core areas that may not readily feature on a high-level risk register. Significant 'policy' risks have controls that are hard to audit – liaison and influencing in policy making.
Describe how you approach auditing joint organisational objectives (e.g. PSAs) or governance arrangements, which cut across several organisations?	We work with our parent department. We don't; our governance branch leads this. Not yet been an issue (in an NDPB). Really need a cross government approach to this area, including talking to PMDU about how we can support their PSA Review work or place reliance on it.
How has the quality of IA changed over the past year	Department is on a 3 year improvement programme – standardising practices, use of IT, training and coaching.

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Private sector interviews

Background and approach

The organisations were selected on the basis of differing internal audit team sizes, corporate structures, geographic spread and corporate philosophies on centralised versus decentralised management. The sample selected included:

	Sector	Size of IA function (FTE)
Company A	UK focused utility provider	25 + moderate co-sourcing
Company B	Multinational conglomerate	34 + limited co-sourcing
Company C	Multinational consumer products business	85 + limited co-sourcing
Company D	Multinational food & drink business	40 (estimated by HIA) (including co-sourced/contract resource)
Company E	European focused business services	2.5 + moderate co-sourcing
Company F	Multinational consumer product business	22 + very limited co-sourcing/contracted resources

The sample was designed to identify a variety of approaches to Internal Audit.

The interviewees were asked open questions covering the structure of IA, their audit approach and the people strategy. The results were grouped into three areas for consideration: Family Group approach, assurance mapping and people management.

Summary of results

The results showed that IA in the private sector adopted a variety of structures and approaches, as we found in the public sector interviews.

Stakeholder engagement was not considered a major issue by those interviewed, but they struggled to articulate exactly why it was not an issue. The majority felt that their role was well defined and understood by senior management and their line manager acted as a strong advocate. In turn, this strong sponsorship was felt to empower them and the “front-line” auditors in dealing with the business. Group HIA’s were part of the senior management team and attended executive meetings. Some were invited to Board meetings, but usually for a specific agenda item. The majority were heavily involved in the Risk Committee(s) (or similar bodies).

Family group approach – centralised v decentralised

The degree of centralisation was mixed, but there was a trend towards centralisation. Four of the companies were “centralised”, with one decentralised approach and another approach which had a high degree of local autonomy but with a central direction set by the Group HIA.

The key aspects of the centralised approach were:

- Establishing a top down audit plan, based on the risks to the group. The audit plan then mapped entities to these risks based on their activities. Generally, there was a limited assessment of “local” assurance needs. One company did allow for limited “local consultancy time” within the audit plan to address any local needs. Another had allowed the development of local compliance functions but these were deemed to be local management activities rather than internal audit.

- Shared resource pools at a corporate or geographic area level were in place, with senior audit managers assigned to specific groups of divisions/product lines/geographic areas depending on the corporate structure. However, some geographic areas had “resource pools” of one or two auditors due to the limited operations and risks in that area.
- Common methodologies and reporting had typically been established within the Group. There was also a high level of oversight from the Group HIA who would direct high profile reviews and would typically receive and review draft audit reports.

Assurance mapping

The concept of assurance mapping was seen as valuable by four of the companies interviewed. However:

- Only one company had fully implemented assurance mapping which was embedded into the group risk management process.
- Two companies were in the process of implementing assurance mapping within the risk management processes.
- One company was intending to document other assurance providers to help inform their next annual audit plan.

The remaining 2 companies were not currently considering assurance mapping. Company D’s decentralised nature made it difficult to implement consistent approaches and Company C informally considered corporate assurance providers as part of their top down audit plan.

People Management

Career Paths – Interviewees felt that IA should not be a long term career for their auditors and had structured their people management strategy to achieve this. However, there were a few long serving staff who did not desire a career outside IA or the company. This was only deemed a problem if their performance did not meet expectations. Generally a term of 2-4 years was seen as an appropriate length of time with the intention that the auditor would then secure a role in the business. This was explained to auditors as part of the interview process. Indeed one company went as far as insisting that candidates identified an area of the business they would like to work after IA (an interview with someone from that business area being part of the recruitment process).

Skills Mix – The change from financial reporting risks to operational and strategic risk had resulted in changing skills needs, although two companies were still very focused on financial reporting risks. These skills had been met through co-sourcing, recruitment of non-financial resources but also through leveraging business skills. However, only two functions felt that they had been successful in embedding short-term business secondments. Others were reliant on negotiations with other parts of the business for available resources.

Soft skills – These were viewed as critical by the interviewees. Rather than providing soft skills training it was felt that recruiting resources with the right soft skills was a more effective approach.

Use of third parties – Transformational partnerships had been used by one company who believed that it had been beneficial in rapidly increasing the profile of IA and also visibly setting the expectations for the in-house team. Traditional co-sourcing or contracting was used by all the companies to varying extents, primarily to increase their geographic reach, bring foreign language skills or specific skills not available in-house. Full outsourcing had not been recently used by any of the functions.

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Desk based research

Desk based research

Approach

We undertook a desk-based review of Internal Audit (IA) leading practice. The review began with the Government Internal Audit Standards (GIAS) and good practice guidance. This was supplemented by a review of international internal audit developments in the public sector and best practice publications, for example:

- Professional services firms research and analysis papers;
- The Institute of Internal Auditors' papers and guidance;
- Accountancy Boards' papers and articles;
- Academic research articles.

Findings

Headline findings from the research work are set out below:

- Operational independence of internal audit is a priority and needs to be enshrined in clear reporting lines to an appropriate officer. In the future, organisations may wish to consider IA reporting to an independent Chair of the Board, although this does not apply directly to the governance arrangements in central government.
- Internal audit can derive better results where there is a well-embedded enterprise risk management system. This allows IA to piggyback off the existing risk management control framework and demonstrate clearly why and where it is delivering assurance.
- In many organisations, numerous assurance activities commonly exist but are often un-coordinated risking duplication, fragmentation, misalignment and fatigue on the business. In addition, Audit Committees miss a valuable opportunity to question why, where and how assurance is being provided across the organisation.
- The maturity of risk management is often over estimated by NEDs and managers. The implication of this finding is that IA should not rely solely on managers' assessment of risks and need to supplement this with IA's own view of risks when completing the IA plan.
- The capability, skills and experiences of professional auditors are critical in delivering an effective and valued assurance service. There are opportunities to raise the bar significantly on capability. This needs to cover: setting minimum standards, ensuring that standards are met, soft skills development to facilitate better engagement, improvements to the leadership qualities of Heads of Internal Audit and more effective career development.

- Internationally, internal audit arrangements in the public sector are structured differently. In Australia and the United States, for example, there are internal audit units at all levels: in departments, agencies and arms length bodies (and in federal entities in the United States). Internal audit units in the Netherlands are installed at the departmental level, and some independent administrative agencies also have internal audit units. In Canada, departments and agencies (top 50 by spend and headcount) usually have their own internal audit function but shared internal audit arrangements are provided to smaller bodies from a central pooled resource under the 'Comptroller General' Treasury arrangements. They have also created an aggregated call off contract to provide cost effective support to audit work avoiding a multiplicity of contract arrangements. Most countries operate with a high status leading internal auditor reporting direct to the Chief Executive of the organisation.

Documents reviewed as part of the project are listed on the next page.

Documents reviewed as part of the project include:

State of the Internal Audit Profession Study, 2009, Pricewaterhouse Coopers (PwC)

The Future of Risk – Protecting and Enabling Performance, 2009, Ernst and Young

Effective Internal Audit: Is the Audit Committee Expecting Enough? 2009, Deloitte

Maximising the Use of Internal Audit Resources, 2009, Deloitte

The Risk Intelligent IT Internal Auditor, 2009, Deloitte

The Audit Committee's Relationship with the Internal Audit Team, 2009, Deloitte

The Risk-Intelligent Chief Audit Executive, 2009, Deloitte

IT Internal Audit Survey, 2009, KPMG

Internal Audit Strategic Sourcing, 2009, KPMG

The Evolving Role of the Head of Risk, 2009, KPMG

A World in Economic Crisis: Key Themes for re-focusing Audit Strategy, 2009, IIA GAIN

International Financial Reporting Standards: What Internal Auditors Need to Know, 2009, IIA

Why ERM is Vital from Companies Experiences with Sarbanes Oxley Section 404 Compliance, 2009, IIA

The Board's Black Hole: Filling their Assurance Vacuum, 2009, ACCA

King 3 (Draft), 2009, Institute of Directors

Review of Risk maturity in Central Government Agencies, 2008/09, Bentley Jennison

Escalating the Role of Internal Audit (Global Survey), 2008, Ernst & Young

Internal Audit Perspective on Sustainability, 2008, PwC

Internal Audit 2012, 2007, PwC

The Evolution of Risk and Controls, 2007, KPMG

Upside of Risk, 2007, MCA/Ernst & Young

International Audit Trends in the Public Sector (comparison 6 OECD countries), 2006, Public Management Institute Belgium

Competency Framework for Internal Auditing (CFIA), 1998, IIA

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