



HM Treasury

Internal audit customer handbook

July 2013



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Contents

		Page
Chapter 1	Introduction	3
Chapter 2	Internal audit – the basics	5
Chapter 3	Driving high performance	9
Annex A	Related guidance	13

1

Introduction

Purpose and intended audience

1.1 This handbook is designed for all customers of internal audit within central government, to help ensure the effective delivery of internal audit services. Key customers within central government (including departments, agencies, NDPBs and other arm's length bodies) are typically:

- Accounting Officers;
- boards (including Non Executive Directors);
- Audit and Risk Assurance Committees (ARACs); and
- other senior management directly involved in the areas subject to internal audit review, and any recommendations thereon.

Focus on high performance

1.2 The focus of this handbook is on the customer's role in recognising and developing internal audit into a high performing service which adds value to the organisation. The handbook first establishes the basics of an internal audit service and then describes how to identify and drive high performance.

1.3 A strong understanding and management of internal audit can help provide both an effective and efficient service which:

- meets quality standards and performance targets and seeks continuous improvement in its services;
- focuses on the areas of greatest importance to the organisation;
- minimises duplication with other sources of assurance and makes the best use of resources available; and
- can act as both a trusted advisor and a critical friend, helping improve public service delivery.

2

Internal audit – the basics

What does internal audit do and why?

2.1 Public Sector Internal Audit Standards define Internal Auditing as “an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes”.¹

2.2 The internal audit profession in central government is focused on evaluating the management of key risks to and the continuous improvement to the delivery of effective public services and is a key source of independent insight and assurance for Accounting Officers, ARACs and boards.

2.3 The work undertaken by internal audit culminates in the provision of “an **annual internal audit opinion** based on an objective assessment of the framework of governance, risk management and control”² and the results of internal audit’s work should help improve management’s ability to achieve the organisation’s public service delivery objectives, by improving the effectiveness of risk management, control and governance.

2.4 The annual internal audit opinion and report should also be used by the organisation to inform its governance statement. The **annual report** must incorporate:

- the annual internal audit opinion;
- a summary of the work that supports the opinion;
- a statement on conformance with the UK Public Sector Internal Audit Standards (PSIAS); and
- the results of the quality assurance and improvement programme.

2.5 The purpose, authority and responsibility of the internal audit service should be defined formally in an **internal audit charter** and should be supported by clear service levels and performance targets. The charter should be periodically reviewed and presented to Accounting Officers, ARACs and boards for approval.

The internal audit function – composition and reporting lines

2.6 Where internal audit is provided by a group or shared service, the overall delivery of the service is the responsibility of the Group Chief Internal Auditor (GCIA), who may be supported by one or more designated Heads of Internal Audit (HIA). The GCIA may also be the designated HIA to certain organisations. In other organisations there may simply be a HIA who leads the service.

¹ Public Sector Internal Audit Standards – Definition of Internal Auditing – p.9

(https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207064/public_sector_internal_audit_standards_december2012.pdf)

² Public Sector Internal Audit Standards – p.5

(https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207064/public_sector_internal_audit_standards_december2012.pdf)

2.7 The HIA must report functionally to the board (which can be represented by the ARAC) and should be accountable to Accounting Officers, ARACs and boards for the delivery of the agreed internal audit plan (see below). The HIA should periodically be invited to attend board meetings, particularly where discussion relates to governance, risk management or control and the Accounting Officer should undertake, countersign, contribute to or review the HIA's performance appraisal.³

2.8 Each organisation receiving an internal audit service should appoint an Internal Audit sponsor, who should usually be the Accounting Officer and/or a designated Senior Civil Servant (or equivalent), with whom the GCIA and or designated HIA should engage regularly. Regular meetings should include: a discussion of progress against the agreed internal audit plan and other service level issues; any emerging assurance needs; and any significant issues either raised during or affecting the work of the service.

2.9 Each internal auditor should be qualified as either an internal auditor or accountant from a recognised chartered body (each of whom should have their own ethical standards), or be training towards such a qualification. Exceptions to this may include secondees or certain subject matter experts, who may bring an alternative set of skills and experience.

The annual internal audit plan

2.10 The internal audit service should be delivered in accordance with a risk-based **internal audit plan** which has been agreed with Accounting Officers, ARACs, boards and relevant senior management. The plan should determine the priorities of the internal audit service, consistent with the organisation's goals. It should therefore demonstrate the extent of its alignment with the organisation's strategic and other key risk assessments and risk register and set out the engagements to be conducted and the planned timescales, and should differentiate between assurance, consulting and if undertaken any other non-audit work.

Overview of an individual internal audit engagement

Planning

2.11 Each engagement should be specifically planned in order that the auditors obtain an adequate understanding of the audit area and can determine an appropriate scope and approach for the engagement. The output of this exercise should be a **formal terms of reference** agreed with the appointed audit engagement sponsor which should include the engagement's objectives, scope, timing and resource allocations.

2.12 Where the approach to risk management is relatively mature, internal audit should use the risks and controls identified as the basis (but not sole focus) for the detailed audit work undertaken. Where the approach to risk management is immature or there is deemed to be some degree of deficiency in the approach, then internal audit should seek to understand and identify the key risks and controls pertaining to the audit area as part of the audit planning and fieldwork.

Fieldwork

2.13 The audit work should comprise assessment and testing of key controls in place to manage the identified risks (e.g. the risks within programmes to deliver objectives such as new services and facilities and fiscal consolidation), or within core systems. This would typically be undertaken

³ Public Sector Internal Audit Standards – p.14
(https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207064/public_sector_internal_audit_standards_december2012.pdf)

through discussion with key staff responsible for the relevant processes; review of documentation; and testing of controls (which may be on a sample basis) to confirm that they are both designed and operating effectively. Such controls may be financial, operational or compliance in nature and might range from the segregation of incompatible duties, to the analysis of business cases before strategic plans are implemented, to embedding appropriate cultural attitudes.

Reporting

2.14 Each internal audit engagement should culminate in a conclusion/opinion on the adequacy and effectiveness of the framework of risk management control and governance. These conclusions, and corresponding recommendations for potential improvements in processes and controls, should be documented in a specific internal audit report. This report, which should include the actions agreed with management to address the internal audit findings, should be agreed with the local management contacts for the area being reviewed, before being finalised with the audit engagement sponsor.

Follow-up of internal audit actions

2.15 Following the identification of actions to improve the organisation's framework of governance, risk management and control, internal audit also has a role to play in helping ensure such actions are taken. "The chief audit executive must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action."⁴

⁴ Public Sector Internal Audit Standards – page 30
(https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207064/public_sector_internal_audit_standards_december2012.pdf)

3

Driving high performance

Meets quality standards and performance targets and seeks continuous improvement

A high performing internal audit service...

- conforms to the UK Public Sector Internal Audit Standards (PSIAS);
- has a clear methodology for its work which supports PSIAS;
- collects performance measurement data for use in:
 - improving its efficiency;
 - measuring its impact on the organisation; and
 - benchmarking itself against other internal audit services;
- has a quality assurance and improvement programme in place that covers all aspects of the internal audit activity; and
- receives an external quality review of the service (in accordance with the Internal Audit Quality Assessment Framework (IAQAF), developed by HM Treasury) at least every five years, the scope of which must be agreed by and results communicated to an appropriate senior management sponsor and the board and/or ARAC.

Key challenges

- how effective is internal audit's methodology? Does it lead to robust evidence based conclusions, and promotion of good practice in the business?
- how does the internal audit service perform against the standard Performance Measures set out by HM Treasury and any other measures agreed with the Accounting Officer and or the board/ARAC? Where targets are not met, or other services perform better, are actions in place to improve performance and implementation monitored?
- how does internal audit ensure quality and continuous improvement is built into all of its work?
- what are the results of the most recent Quality Assurance and Improvement Programme (both internal and external) and how are internal audit responding to the findings?
- how comfortable is external audit in relying on the work of internal audit? Do external audit have concerns about the quality of internal audit's work?

Focus on the areas of greatest importance

A high performing internal audit service...

- focuses their work on where assurance is most needed, but ensuring sufficient assurance to support the governance statement; and
- applies a risk-based approach to setting their internal audit plan, but also ensures sufficient coverage is provided of core systems and there is flexibility to meet key emerging issues.

Key challenges

- have key stakeholders been involved in the creation of the annual internal audit plan to ensure it meets their needs?
- to what extent is the internal audit plan risk-based and how has it taken account of the risk maturity of the organisation?
- does the plan also include sufficient coverage of core systems?
- overall, how effectively will the plan enable an annual opinion on the framework of governance, risk management and control to be provided, which supports the governance statement?

Minimises duplication and makes best use of resources

A high performing internal audit service...

- avoids duplication of effort with other assurance providers; and
- ensures the best value is received from the resources available.

Key challenges

- have the ARAC/board determined and articulated their Assurance Framework, which identifies the various sources of assurance received by the organisation?
- how has the internal audit plan taken into account the assurance provided by other sources, for example, the Cabinet Office's Major Project Authority or Gateway Reviews; or other providers (e.g. information assurance; health and safety etc) to avoid duplication?¹ NB – Whilst the scope of National Audit Office (NAO) financial audit work or value for money reviews may also be relevant, the NAO are external to the organisation with a statutory responsibility to report to Parliament rather than the organisation.
- does the internal audit plan set out the engagements to be conducted; their respective priorities and timescales; the estimated resources needed and how the requirements have been assessed?
- has the capability of the existing resources been appraised to ensure the correct skills and experience are available to deliver the internal audit plan?

¹ HM Treasury Guidance on Assurance Frameworks (http://webarchive.nationalarchives.gov.uk/20130410173120/http://www.hm-treasury.gov.uk/d/psr_governance_risk_assurance_frameworks_191212.pdf)

- how well does the internal audit service develop their people to attract and nurture talent to maximise their effectiveness and the value they can add?
- where external resources are used, has the provision been sufficiently appraised to ensure they are only used to provide specific needs that cannot be provided from within the central government internal audit service as a whole?

Acts as a trusted advisor and a critical friend, improving public service delivery

A high performing internal audit service...

- understands and keeps abreast of the increasing complexity of the relevant area of public service delivery;
- is respected, taken seriously and has strong relationships with key stakeholders within the business, built on credibility, strong communication skills and relevant experience;
- provides advice and recommendations at all stages of the business cycle, driving and influencing decision making, not just providing retrospective assurance;
- ensures its independence and has procedures in place to manage any potential conflicts of interest;
- provides relevant, effective, evidence-based and pragmatic advice and recommendations and robust conclusions, drawing on experience of best practice to help improve public service delivery; and
- ensures that recommendations, which address their findings, are implemented in line with agreed timescales.

Key challenges

- how visible and valuable is the service provided by internal audit and how is this assessed? Are there specific areas for improvement identified by key customers? If so, are these being addressed to improve the value of the service provided?
- do senior management trust, respect and actively seek the counsel of internal audit?
- are there appropriate mechanisms in place for internal audit to keep abreast of the organisation's strategic objectives and performance thereon, in order to effectively contextualise their findings?
- are internal audit involved in and able to contribute to, challenge and influence senior management strategic decision-making from a governance, risk and control point of view?
- is internal audit's work focused on more than simply retrospective assurance? For example, are internal audit engaged in reviews that provide assurance/advice as significant projects/programmes progress, or on emerging risks/issues, rather than solely ex-post?
- are the internal audit team able to challenge the current practice sufficiently and draw on experience of best practice to communicate the results of their work

effectively and credibly and improve the framework of governance, risk management and control?

- is the GCIA/HIA able to promote the work of internal audit effectively?
- how does internal audit ensure its independence and manage any potential conflicts of interest?
- how timely, clear and useful are internal audit's reports? Do they provide relevant, effective, evidence-based and pragmatic advice and recommendations?
- how effectively does internal audit ensure recommendations are implemented in line with agreed timescales?

A

Related guidance

Overall responsibilities for governance, risk management and internal control

- Managing Public Money
- Corporate governance in central government departments: Code of good practice 2011
- Audit and Risk Assurance Committee Handbook, published by HM Treasury 2013

Standards and guidance for, and assessment of, internal audit performance

- Public Sector Internal Audit Standards, issued by The Chartered Institute of Internal Auditors and The Chartered Institute of Public Finance and Accountancy
- Internal Audit Quality Assessment Framework, developed by HM Treasury 2013
- Internal Audit Performance Measures, published by HM Treasury 2013
- Service Level Agreement template (where internal audit is not provided in-house) 2013
- Good Practice Guide: audit strategy, published by HM Treasury – July 2010

Risk management and assurance frameworks

- The Orange Book – Management of Risk – Principles and Concepts, published by HM Treasury
- Guidance on Assurance Frameworks, published by HM Treasury

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This document can be downloaded from
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