



HM TREASURY

Good Practice Guidance: **the consultancy role of internal audit**

July 2010



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1

Introduction

1.1 The definition of Internal Audit in the “Government Internal Audit Standards” effective from April 2009 states that:

“Internal Auditing 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 There is not an absolute distinction between assurance work and consultancy work. Assurance work may lead to the identification of a need for consultancy work as well as having an in-built consultancy element in the form of the making of recommendations. Consultancy work similarly enriches and makes a contribution to the overall assurance that can be delivered (see Section 2).

1.3 The concept of Internal Audit offering consultancy advice is not completely new. Traditionally, internal auditors have offered advice, in the form of audit recommendations, on possible actions to be taken in response to control weaknesses identified in the course of assurance work. Such recommendations can be regarded as a form of consultancy because management are free to accept or reject them. Further, Internal Audit has traditionally undertaken system development audits on significant systems developments to help ensure that effective control is built into new systems at the time of their development. Such audits can be regarded as another form of consultancy, although normally delivered at the instigation of Internal Audit.

1.4 What may now be new is the provision of consultancy as part of a programme of work planned to primarily meet management need rather than purely assurance needs. As managers continue to recognise the value of internal auditor’s systematic, disciplined and independent approach to areas of governance, risk and control, the profession will increasingly be called upon by management to engage in consultancy activities. Managers do not want internal auditors to come along and criticise after they have either conducted an analysis and evaluation of risks or developed or redesigned a control system or process, and then report on what could have been done better or on alternative approaches that might have been helpful. Similarly management may want internal audit advice in “emergency situations”, for example, following a major fraud or identification of a major risk exposure. It is important that Internal Audit should plan to make appropriate resources available to deliver the intended consultancy service.

1.5 Internal auditors are trained² to have particular skills in the understanding of risk and the development of appropriate control to constrain these risks. Making these skills available to management at their request helps the organisation as a whole to be economic, efficient and effective in its approach to risk and control and offers a route to maximising the value added by the Internal Audit function and enriches the overall assurance which can be delivered.

¹ GIAS 2009 – Definition as approved by The Institute of Internal Auditor’s Global Board of Directors 1999

² The requirement for every internal auditor functioning in government under that title to hold the “Government Internal Audit Certificate” provides a guarantee to management that all internal auditors have indeed achieved a minimum level of relevant skills.

1.6 This Good Practice Guide offers support in the planning and delivery of a consultancy service in parallel with the assurance work plan. It is in four sections that explore:

- Linking consultancy work to the delivery of audit assurance.
- The nature of this consultancy service.
- Planning for delivery of consultancy services.
- Professional conduct of consultancy assignments and issues of independence/objectivity.

2

The Relationship between Consultancy Work and Audit Assurance

2.1 The primary purpose of Internal Audit¹ is to provide “independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations...”. This is primarily achieved by the planned programme of assurance assignments. Consultancy work driven by risk based planning may typically be on those areas of the organisation’s business where risk and control are not in existence or not well established. This could relate to new systems or areas undergoing significant change where there is no system of risk management or control framework to assure.

2.2 Consultancy or advisory work can also be carried out at management request. Where this happens it will be necessary to contextualise the findings of consultancy assignments so that their incorporation into the overall opinion does not lead to inappropriate distortion of the materiality of findings against risk and control priorities. This is because the criteria that are used for prioritising acceptance of consultancy assignments may well not be the same as those used for identification of assurance assignments (see paragraph 4.4). Putting findings into context should be done at the time of the conclusion of a consultancy assignment; the internal auditor should interpret the assignment report into assurance terms with due regard to the materiality of the consultancy conclusions in relation to organisational risk and control priorities.

2.3 Interim reports to the Audit Committee and the Accounting Officer should take account of the evidence being acquired from consultancy assignments and should report on progress against the planned consultancy workload as well as against the planned assurance programme.

2.4 It may arise that management want Internal Audit to undertake a consultancy assignment but seek some form of assurance that any findings will not be reported upwards or included in Internal Audit’s overall assurances. In such cases the assignment should be declined; the circumstances may cause Internal Audit, in its assurance role, to want to investigate the reasons behind such a request in case it is an indicator of a not yet revealed material issue.

2.5 Consultancy work further adds to Internal Audit’s knowledge base about risk, control and governance and therefore makes a contribution to the overall internal audit opinion.

¹ GIAS 2009 – Definition as approved by The Institute of Internal Auditor’s Global Board of Directors 1999

3

The Nature of the Consultancy Service

3.1 The scope of the consultancy service that internal auditors can offer is bounded by their skills set and Audit Charter. This puts the focus clearly on risk, control and governance arrangements. The consultancy service should not aim to deliver advice on topics or in areas in which internal auditors do not have appropriate training and experience.

3.2 Whereas assurance work tends to appraise the adequacy and effectiveness of established systems of risk management, control and governance, consultancy work is likely to be on areas where the control framework yet to be fully put in place. The “advice” offered by Internal Audit in its consultancy role may include analysis of situations, risk analysis and evaluation, developing potential solutions to problems, providing controls assurance on either a systems or a substantive basis, and validation exercises. Consultancy services from Internal Audit offer management the added benefit of being delivered by people with a good understanding of the overall risk, control and governance concerns and priorities of the organisation.

3.3 Individual internal auditors may have knowledge, experience and skills other than their internal audit skills which management would like to exploit. For instance, internal auditors may also have particular training, experience or qualification in IT, accountancy or legal issues. If a consultancy assignment is to be delivered in which these skills will be of particular benefit it will, of course, make sense to deploy those internal auditors who have these skills on the assignment. However it will be necessary to make clear in the agreed Terms of Reference for the assignment that the Head of Internal Audit can only be accountable for ensuring due professional care is taken in developing advice offered on risk and control issues. If management choose to place reliance on specialist advice drawing on skills beyond the internal audit skills set this will be at their own risk in respect of due professional care and it should be made clear that the work is carried out outside of the core internal audit remit. All acceptances by management of advice given to them, of course, involves acceptance by management of accountability for the consequences of implementing the advice; it may be beneficial to note this in the agreed Terms of Reference for the assignment.

3.4 It is important that consultancy services are offered to support management in their work, not to be a substitute for management’s own efforts to address the issue in question. The consultancy role should offer management participative advice and support in their activities.

3.5 There are a number of ways in which internal auditors can undertake their consultancy role:

- 1 They may facilitate management activity. For example, if management want to hold a workshop to brainstorm risks and controls around a particular issue they will be well served to have at facilitator. Internal auditors can be well placed to undertake this role as their skills will help them to inspire and provoke management into effective identification and analysis of risks and controls and to organise the results of their brainstorm into a structured view of what they are working with (specific training in facilitation skills is beneficial for internal auditors who will undertake this sort of work). It is important that this role does not lead to the facilitator telling management what their risks, controls, and planned actions are or should be as this would undermine management responsibility for their own activities. This

facilitation of management activity may also include advice in “emergency situations” as referred to in paragraph 1.4

- 2 They may undertake an educational role. Internal auditors may be asked to support management by imparting appropriate risk and control skills and techniques so that managers are better equipped to undertake their own role effectively. This provides long-term added value by improving skills in risk and control issues.
- 3 They may offer specific advice on particular risk and control issues (including development of new systems or redevelopment of existing systems). This may be at any level of the organisation, ranging from the corporate risk register and strategic governance system to detailed control of particular and low level risks relating to specific individual activities. In this role it is important that the internal auditor offers advice to management and does not undertake the task on behalf of, or as a substitute for, management. Acceptance by management of the advice offered by the internal auditor does not transfer or reduce management’s accountability for their own areas of responsibility. Conversely, management’s retention of accountability does not allow the internal auditor to be any less diligent in exercising due professional care in developing the advice that they will offer.

3.6 Specific consultancy assignments may incorporate a number of roles. For example, facilitating a workshop can also have an educational effect, as can the delivery of specific advice on particular issues. Delivering specific advice may involve a facilitation role in discussions around the issue being addressed.

3.7 The consultancy service offered by internal audit is inextricably linked to the assurance role (see section 2). Consultancy activities may arise from assurance assignments when the conclusion of the assurance assignment is that there are significant risk and control issues to be resolved (i.e. – solutions need to be developed to problems identified by the assurance assignment). Conversely, consultancy activities that arise at management request promote internal audit’s knowledge and understanding of the whole of risk, control and governance in the organisation and consequently make a contribution to the overall assurance that is delivered by the Head of Internal Audit. It is important that this inter-relationship between the assurance and consultancy roles is made known to management when undertaking assignments as it:

- 1 Offers management confidence that appropriate support will be available if an assurance assignment identifies that significant work needs to be done to improve risk and control issues, and consequently will help management to be more open with the auditors and receptive to constructive criticism.
- 2 Clarifies the position that particular risk and control problems which are judged to be significant cannot be kept “hidden”, and they affect the overall risk, control and governance of the organisation (though this does not justify a “telling tales” or “blaming” approach where management are willing to work to resolve the problems). This inter-relationship offers an opportunity to promote an understanding that all elements of risk and control have an effect on the whole, and also that the organisation as a whole has an interest in constructively supporting managers in resolving particular risk and control problems that they may have.

4

Planning for Delivery of the Consultancy Service

4.1 It is self evident that the consultancy service delivered by Internal Audit will require resources, which by definition are “scarce”. It is therefore necessary to plan how much resource will be made available for consultancy work and how potential consultancy activities will be prioritised in order to determine which can be undertaken and how much resource will be assigned to each.

4.2 In establishing the formal consultancy role and in the strategic planning of the Internal Audit function it will be appropriate to assess the need for consultancy services. Elements of this assessment may include:

- 1 Consideration of past annual audit opinions; the more that general improvement is required in the organisation’s risk, control and governance the higher the need for consultancy activity is likely to be.
- 2 Consideration of the rate at which the organisation and its risk, control and governance is changing. The higher this is, the more need there is likely to be for consultancy services.
- 3 How much of consultancy being bought in could be satisfactorily and more economically delivered with the Internal Audit skills-set and how much is reliant on different specialist and technical skills.
- 4 An assessment of management demand. To what extent would management like to request consultancy services from Internal Audit?
- 5 The capacity of Internal Audit to deliver consultancy services. The consultancy role must not undermine the devotion of resources to assurance work and in the short term Internal Audit may have very limited resources for consultancy work. If it is intended to increase Internal Audit’s capacity to deliver consultancy services there will be a lead-time associated with the recruitment of appropriately qualified staff.

4.3 There is no “standard formula” for interpreting the results of assessing the need or demand for consultancy services into a resourcing or staffing plan. The extent to which Internal Audit will meet the prospective demand should be decided by consultation with the Audit Committee and the Accounting Officer, against a background of consideration of the extent to which value will be obtained by assigning additional funding to the Internal Audit function.

4.4 When Internal Audit intends to offer consultancy services to meet demands indicated by line managers, a process will need to be designed to prioritise these demands, to decide which ones can be fulfilled, and how much resource will be assigned to particular assignments. As it is unlikely that it will be possible to meet every demand made, there will be a need to create a prioritisation process.

This might include:

- 1 Relating the particular demands to the risk and control priorities of the organisation – which demands are most significant in that respect?

- 2 Which demands appear to present the opportunity for Internal Audit to add maximum value?
- 3 Which demands emanate from parts of the organisation least equipped to resolve the issues from within their own resources and/or skills? (Conversely, is the demand a request to undertake work that could equally well be undertaken by management itself?)
- 4 Which demands emanate from areas where assurance work is already planned? (If assurance work is already planned an element of consultancy will be delivered by definition through the recommendations of the assurance report, or it may be possible to combine the consultancy demand with the planned assurance work into a single assignment.)
- 5 Which demands appear to offer the opportunity for transferable “lessons to be learnt” to be generated which will benefit other parts of the organisation?

4.5 In planning for the delivery of consultancy services for any particular period, it should be borne in mind that new demands may emerge. For instance, an assurance assignment may indicate a high priority need to provide further support to management through consultancy, or a change that could not be anticipated in the objectives or activities of the organisation may need to be responded to. Plans for the delivery of consultancy services should aim to retain an appropriate level of contingency, and should be capable of being rearranged if appropriate.

5

Professional Conduct of Consultancy Services

5.1 The standard of work that is delivered in consultancy services should be the same as that in assurance work. The mandatory requirements of the Government Internal Audit Standards (GIASs) relate to standard of performance in both assurance and consultancy activities. Due professional care, particularly in respect of objectivity and the obtaining of sufficient reliable evidence to support conclusions, must be maintained. This is important because the standard of work does not just potentially affect credibility in respect of the particular assignment but may impact upon the reputation of Internal Audit both in the organisation as a whole and as a profession.

5.2 All of the GIASs should be applied in an appropriate manner to consultancy assignments. There are a number of areas in which particular issues of their application arise.

5.3 A particular issue arises with independence. Internal audit is not a management decision-making function; management are free to accept or reject recommendations made as a result of internal audit work. Therefore issues related to consultancy activities should not impair the auditor's independence or objectivity. The standards state that it is acceptable for internal auditors to provide consulting services relating to operations for which they had previous responsibilities (GIAS1130.C1). However, where such consultancy work is important for the annual assurance opinion, it remains important to preserve objectivity and internal audit management will need to apply similar objectivity arrangements as for assurance work. Staff within internal audit who have recent detailed experience of the business area to be reviewed should not be assigned lead responsibility for the assignment, but their knowledge and experience may be beneficial and could be utilised in an appropriate way for the benefit of the assignment. If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure must be made to the engagement client prior to accepting the engagement.

5.4 Particular attention should be paid to GIAS1120 which states "Internal auditors must have an impartial, unbiased attitude and avoid any conflicts of interest". GIAS interprets this as:

"Conflicts of interest may arise where an audit contractor provides services other than internal audit to the organisation. Steps must be taken to avoid or manage transparently and openly such conflicts of interest so that there is no real or perceived threat or impairment to independence in performing the audit role."

5.5 Relationships with management, other auditors and other review bodies are especially important in consultancy work. Consultancy work relies on working in partnership with management and internal auditors engaged on consultancy assignments should pay particular attention to building effective relationships with managers. The scope and objectives, timing, and reporting arrangements should be agreed for consultancy assignments in the same way as for assurance assignments. The objectives should make it clear that the internal auditor's involvement is a consultancy role. The Head of Internal Audit will reserve the right to audit any risk management, control and governance process developed with Internal Audit acting in its consultancy role.

This means that for a consultancy assignment:

- 1 There should be a detailed plan setting out the scope of what is to be reviewed.
- 2 The objectives should be defined at least in output terms, and ideally in outcome terms.
- 3 The exact role of the internal auditor (eg – facilitator or member of a multi-disciplinary working group) should be defined. [It should always be made clear that internal audit is not part of any sign off decision mechanism.]
- 4 Reporting formats should be defined (eg - will there be a specific audit report or will the internal auditor's work contribute to a report generated by a multi-disciplinary working group. [see also below])
- 5 Timing issues should be defined in detail, including the amount of staff days allocated and targets in terms of elapsed time.

5.6 When a consultancy assignment does not lead to a specific audit report (perhaps because the internal auditor's work has contributed to a working group report), an ancillary reporting requirement will arise. This will need to record and communicate as appropriate the extent to which other relevant reports, generated in relation to the work which has been done, fairly reflect the internal auditor's views on risk, control and governance issues, and the elements of assurance which are available to contribute to Internal Audit's overall audit opinion (see also Para 2.2).

5.7 It is important that the work of the internal auditor is appropriately documented and recorded and that same standards of evidence are applied to consultancy work as are applied to assurance work. Evidence should be sufficient, relevant and reliable to sustain the conclusions reached. In this respect one valuable role that the internal auditor can often undertake when working in partnership with others is to challenge conclusions that do not appear to be evidenced appropriately or where adequate documentary trails to support the work being done do not exist.

5.8 Both internal and external quality reviews should encompass an appropriate proportion of consultancy assignments in their review samples.

5.9 Customer or sponsor feedback is always useful for all audit assignments. It can be particularly useful for consultancy work as it is important to evaluate the extent to which line management's needs are being met. Mechanisms to gain direct feedback from customers or assignment sponsors on internal audit consultancy work should be put in place.

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