HM TREASURY

Public Bodies Reform:

a guide for Internal Auditors

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1 Introduction

1.1 On 14 October 2010 the Government announced proposals to abolish, merge or substantially reform 481 public bodies. The changes will take place over the next few years with a target saving of £600 million. For organisations concerned, it can be a time of massive change in terms of corporate culture and strategy. It will be important to handle the change with minimal disruption to the public, ensuring that an adequate level of service is maintained throughout, whilst ensuring that the savings are realised. Internal audit has a rich organisational experience and a good knowledge of best practice in governance, risk and control so is well placed to provide assurance or play a key advisory role.

1.2 It will vary as to whether departments manage the projects centrally or whether this will be a matter for individual Arms Length Bodies (ALBs). Whatever the arrangements, the departmental Accounting Officer (AO) and board, as well as individual AOs and boards, will want assurances that adequate processes are in place to reduce the risk of programmes and projects failing to be delivered successfully, that controls continue to operate effectively throughout the change process so that services to customers continue to be provided effectively during the change period and that assets are protected against damage or theft.

1.3 Cabinet Office has produced a comprehensive checklist[1] for departments covering many of the issues that need to be addressed in implementing reforms. This checklist is also a valuable reference document for internal auditors in considering how comprehensively and proficiently the change is being managed.

1.4 Internal audit has no executive role in the merger or closure process, but can add significant value to the process through proactive assurance or advice. This could be at key stages or through more routine arrangements. The Head of Internal Audit (HIA) will need to ensure that they have the necessary resources and skills in the team. Organisational change is also a key time to consider the appropriate structure and arrangements for the internal audit service.

[1] http://www.cabinetoffice.gov.uk/resource-library/public-bodies-reform-proposals-change

2 Planning and scoping internal audit work

2.1 As with any major change, there are risks associated with the management of the change itself, as well as the associated delivery arrangements. Internal audit's Involvement at an early stage can help to ensure that the programme and project objectives are clearly understood, the cultural and strategic implications have been considered, plans are being established to deliver the change and that there is good communication across the parties concerned.

2.2 Early work could include:

- Identifying the organisations likely to be affected by the changes and the changes that are likely to occur (e.g. abolish, merge, reform);
- Clarifying who provides internal audit cover for the organisations affected by the changes and establishing an effective communication and collaboration process for all the audit groups involved;
- Agreeing the assurance needs of the AOs, Boards and Audit Committees in the bodies affected by the changes;
- Identifying and engaging with any steering groups, programme, project or assurance boards involved in planning and managing the transition ensuring that internal audit receives appropriate information/communication;
- Considering the likely impact on audit plans, resources and the respective risks/priorities.

2.3 An assurance framework may be in place that identifies the risks and sources of assurance. This could help to clarify the respective sources of assurance for each key risk area, eliminating potential duplication of effort and identifying assurance gaps. Where there are multiple audit arrangements across the organisations affected, the respective HIAs may need to meet to discuss what role each will play, who will do what and how they will communicate this to management and each other throughout the change process.

2.4 Organisational reforms involve significant cultural and strategic change. There is an opportunity for internal audit to be involved at the strategy stage of any programme or project, to see that the objectives and anticipated benefits are clearly identified together with an objective analysis of constraints and barriers to the successful achievement of objectives. Early involvement will allow internal audit to assess the extent to which major control issues and known deficiencies have been identified and addressed as part of the project considerations.

2.5 The lines of accountability and the nature of change will be key determinants of what assurances will be required, by whom and at what stage. Internal audit will need to be mindful of the concerns and potential assurance requirements of the respective parties. For example:

- Departmental AOs, Boards and Audit Committees may be concerned that programmes will be completed on time and within cost, will deliver their intended objectives and realise their intended benefits (both for transferring and for ceasing functions).

- AOs, Boards and Audit Committees in the organisations undergoing change are likely to have similar concerns, with particular emphasis on their organisation's continued ability to deliver services up to the point that the new arrangement come into force or the provision of the service ends.
- Where two or more organisations are merging, there may be several AOs, Boards and Audit Committees that need assurances at different points in time.
- Where one department or agency takes over the work of an abolished ALB (s), concerns may centre on the ability of the department to handle the extra work effectively and on the accuracy of the assets, liabilities and information transferred.

2.6 Where internal audit arrangements exist in each of the bodies affected by the changes, they will need to support the AO of a closing body with assurance up to the date of closure and handover to the AO of the body taking on the new responsibilities. This may involve the termination of a contract with an outsourced internal audit service or cancellation of a service level agreement with a government provider. There will be 'auditing risks' to the retention of good calibre staff through to the closing date. The internal auditors in the recipient organisations may wish to review the termination process to see how this is being managed, and consider any associated contingency arrangements warranted.

2.7 The work is likely to have an impact on the internal audit annual plan, and may call for a round of discussions with directors and senior managers involved to ensure that efforts are best directed to important areas. Any re-planning should identify associated risks and any potential mitigation in relation to resources. Significant changes to the audit plan will have to be agreed with the AOs and Audit Committees in the bodies affected.

3 Audit and advice during transition

Approach

3.1 An important consideration for Internal Audit is how they will engage with transition programme boards and project teams, what their level of involvement will be (e.g. key project stages) and how they will report, agreeing this with senior stakeholders. The scope and approach will have been determined by the decisions made at the planning and scoping stage and will be specific to the associated risk profile. Coverage could range from centring on management of the change itself, to covering any or all of the types of issues identified in the Cabinet Office Checklist. Equally, or alternatively, the following areas are highlighted for consideration.

Due diligence

3.2 Where the work of an ALB is to be taken over by a department or another body, internal audit may assist by reviewing the effectiveness of any due diligence type work carried out. Such a review is designed to provide senior management in the body taking over the work with vital information about the financial position of the organisation being taken over, any internal control weaknesses, its customer base, assets and liabilities. Where the organisation being taken over has its own internal audit arrangements, their assessments and opinions will be valuable in informing this work. Scope for the due diligence review could include:

- A high level review of key control areas (e.g. inventory management, procurement, information systems, operational delivery processes and financial procedures (including month/year end reporting and budgeting processes etc), internal audit arrangements and how these might be integrated); and
- A summary report to the parent department including key control weaknesses and prioritised actions for improvement.

3.3 Reviews usually require a brief on site visit to hold interviews with management and carry out a limited degree of testing. Typically reviews are carried out as part of management review and assurance, but internal audit may be well placed to advise on key aspects or to proactively input on key areas. Internal audit could help to ensure that any weaknesses identified by the review are appropriately logged and acted upon.

Business as usual

3.4 It is important not to lose sight of the ‘business as usual’ risks. Internal audit may need to ensure that management has effective plans in place to ensure that business continues to function effectively throughout the change process and that controls continue to operate as staff reduce. The Public Body should continue to provide the service it was established to provide during the period of transition to merger or closure.

3.5 It is also important that organisations continue to be controlled, managed and directed effectively. The AO of an organisation subject to change is still accountable to Parliament for the stewardship of resources and must be satisfied that resources continue to be used efficiently, economically and effectively, that assets continue to be protected and that objectives continue to be met. Internal audit can assist by providing the AO with regular assurances that governance arrangements continue to function effectively.

The change itself

3.6 For every programme, project and workstream, clear and measurable objectives, risks and mitigations for the change should be identified by management. Internal audit may be involved in this process in an advisory capacity.

3.7 Where bodies are being wound up, internal auditors might wish to ensure that this is being done in accordance with due process (e.g. where a body was set up under statute, legislation will be required to dissolve it; where a body is registered at Companies House, its dissolution should comply with Part 31 of the Companies Act 2006).

3.8 Where the transfer of assets, liabilities and information are involved, internal auditors might wish to ensure that:

- Treasury and NAO are consulted regarding the treatment of transferred assets;
- Treasury approval is being given for the transfer of assets;
- Assets and liabilities are transferring at their "fair value";
- Information transferring, especially financial information, is complete and accurate.

In year transfer

3.9 Where responsibilities are to be transferred to successor bodies, and the transfer does not take place at year end, internal audit may wish to ensure that management has addressed the following risks:

- Inadequate or limited assurance to support the full year Governance Statement of the successor body (one solution might be a Governance Statement at the date of transfer supported by assurance statements and HIA opinions);
- Possible losses of accounting information.

End year transfer

3.10 It is important that responsibility for the production of the final report and accounts for bodies that are going to be closed or merged have been assigned to named individuals. Internal auditors could check that:

- There are sufficient finance and other staff to complete the process;
- Provision is made for any costs incurred after the changes have been made;
- There is an AO who can sign off the final report and accounts. Where the AO has changed, the new AO may want assurances on the operation of controls from the departing AO and on the accuracy of the accounts;
- Projected timescales take into account end of year processes such as the Governance Statement which extend beyond the financial year and require supporting stewardship reports, the HIA opinion and the oversight of the Audit Committee.

Closure risks

3.11 As organisations wind down new risks may arise (e.g. assets and information not adequately protected, staff not clear about their responsibilities, failure to re-allocate risk or accept responsibility, staff not motivated, contracts not managed effectively, internal and external fraud risk, internal controls might break down if there are insufficient resources to operate them or de-motivated staff lose interest). Internal audit can help ensure that such risks are identified and managed and that good governance continues to operate in bodies being wound down and established in new bodies.

Proposed control arrangements

3.12 Internal audit can advise on planned future processes and governance, risk and control arrangements to ensure that they are well designed, documented and sufficiently robust.

4 Auditing new arrangements

4.1 When projects to transfer functions or establish new organisations have been completed and new arrangements have been established, internal auditors might wish to:

- Ensure that the revised internal audit arrangements have been established to best meet the assurance requirements of the merged or integrated functions and/or organisations;
- Review new governance arrangements to ensure that adequate processes are in place to manage key risks and to deliver objectives effectively;
- Check that key issues identified at previous stages in the process have been resolved;
- Audit and review policies, procedures and controls in the new or merged organisation;
- Review whether achievement of the objectives for the change have been demonstrated, assessed and the savings properly realised and assessed;
- Review, or contribute to, the lessons learnt document for the change process.

4.2 Internal audit, as an objective party, is well placed to play an advisory role acting as a 'bridge builder' for the new functions in a merged organisation. Communications will be an important part of any merged organisation. Internal audit can help to see if systems of communication are providing good clear consistent messages, especially in the turbulent integration period.

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This document can be found in full on our website: http://www.hm-treasury.gov.uk

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