

MANAGEMENT BOARD

Development of Internal Audit service

Paper from the Director of Internal Audit

Purpose

1. This paper addresses concerns raised at the November 2011 Management Board, originally on the level of implementation of Internal Audit recommendations, but then about improving the effectiveness of Internal Audit (see extract in Annex B). It suggests ways that management and internal audit can develop their relationship and work more effectively together.
 - 1.1 *The role of Internal Audit is to provide independent and objective assurance to the Chief Executive (in his role as Accountable Officer) {and the Management Board / Audit Committees}, that the House is being appropriately governed, is managing its risks effectively and has the necessary controls in place and in operation to keep it so.*

(Internal Audit Charter – approved January 2011)

Action for the Board

2. The Board is invited to discuss the proposed way ahead and confirm next steps, in particular to agree that :
 - the overall approach is the desired one,
 - the proposed way forward for Internal Audit is appropriate, including the specific actions in section 6:
 - approach to the Internal Audit Programme for 2012/13
 - introduction of quarterly reporting to the Management Board and senior management teams
 - the specific points for Directors / Director Generals and Line Managers in section 7 will be supported and implemented, including the main developments :
 - review of all “live” agreed actions, as at 31 December 2011, by mid-February, and commitment to implement all those then deemed necessary
 - commitment to supporting the detailed planning and completion of audit assignments.
3. Board Members are asked to respond to the Director of Internal Audit, with any comments or questions on detail, ahead of the Management Board meeting.

Consultation

4. The Director of Internal Audit has met with all members of the Management Board and received a range of feedback. He has carried out a second self-assessment of the service against HM Treasury's Internal Audit Quality Assurance Framework to identify any professional gaps. The Head of the Office of the Chief Executive has been consulted on this paper.
5. A paper on the development of the Internal Audit Programme for 2012/13 will have been discussed at the Audit Committees' meeting on the evening previous to the Management Board meeting. A copy of that paper is attached as a Annex B to this paper. It incorporates a number of the points made below. Any feedback from the Audit Committees will be reported to the Management Board.

Main proposals for Internal Audit

6. The developments that I propose that Internal Audit take are :

6.1 Annual Planning / Reporting

6.1.1 Reduce the number of audits in the annual plan to increase time on individual audits, and to allow more flexibility/additional audits later in the year, but still have sufficient coverage (see Annex A) to provide a meaningful Annual Report and Opinion.

6.1.2 Include in the plan the ability to carry out short "high level" visits to areas that might not result in an audit, or a report, but rather feedback to the Director/Director General and a collective feedback to the Management Board. These could be at the invitation of the Director/Director General or the Management Board, or as part of an ongoing plan for internal audit to build its business knowledge.

6.1.3 Introduce quarterly reporting to the Management Board on findings from audits and common learning points that can be shared with senior management.

6.2 Audit Assignments

6.2.1 Greater commitment of time to the planning of audit assignments, including time spent in departments/areas due to be reviewed, shadowing roles, gathering more background information before any audit testing plan is suggested.

6.2.2 Sharing more detailed planning approach and documentation with line managers to increase their understanding of our approach and the consequences of our work (for instance the Risk and Control Matrices in our working papers, the proposed testing programme, etc.). This might also allow a greater understanding of the amount of work that is undertaken but not, necessarily, seen (e.g. testing of samples, evaluation of systems, etc.).

6.2.3 Explain, in advance, what benchmarks or standards Internal Audit will be assessing the area against (risks and controls, good practice models, benchmarks, etc.). Internal Audit have access to a range of good and best practice frameworks, as well as generic approaches to auditing areas.

6.2.4 Exit meeting (booked in advance) for Internal Audit to talk through factual findings with management and discuss initial implications.

6.2.5 Look to write shorter reports - balancing the needs of the range of stakeholders who will read them, but continuing to making clear that they are “exception” based and thus will inevitably focus on areas of non-compliance or for improvement.

6.2.6 Seek to develop “agreed actions” with management at an early stage, rather than producing generic recommendations.

6.3 Implementation of agreed actions

6.3.1 A Sharepoint site has been developed where all agreed actions will be kept and managers can update the status of the actions. Internal Audit will provide support to managers on use of the site. Sponsors and line managers will have access to all actions within their area of responsibility and copies of reports.

6.4 More generally, I believe that we need to promote more widely the skills and experience that the team possess. The combined team (all in-house staff and key members of Deloitte) already has a range of knowledge in areas across the organisation (although we can always learn more), as well as experience outside the House and the ability to access best practice. More particularly we have skills and competencies in objectively evaluating systems and processes, analysing data and evidence, and in risk mitigation, that we ought to promote more widely.

Main proposals for management

7. From management's side (not just for Directors / Directors General as Sponsors, but more generically) I would suggest that effective Internal Audit will benefit from support and commitment in these areas :

7.1 Annual Planning / Reporting

7.1.1 More focused involvement in, and hence ownership of, the setting of the annual Internal Audit Programme and setting the scope of audit work.

7.1.2 Agreement to sharing the results of audits with other members of the Management Board (for instance through the introduction of a quarterly report from internal audit, mentioned above) and willingness to be open about areas of weakness and sharing of lessons learned.

7.2 Audit Assignments

7.2.1 Support effective planning by Internal Audit by assisting in ensuring that Internal Audit meet the right people and that knowledge of the business is transferred to them.

7.2.2 Pro-actively input into agreeing the Terms of Reference and understanding the implications of the work and potential findings.

7.2.3 Be open with Internal Audit where you think/expect problems to be, and consider if they are isolated or that there is a deeper root cause. In a similar vein don't try and hide issues or problems.

7.2.4 Turn around documents (terms of reference, draft reports) on a timely basis and avoid putting them off as, in our experience, the quicker an issue is dealt with the easier it is and less time is needed.

7.2.5 Work with internal audit to develop "agreed actions" rather than "management responses to recommendations". This is increasingly existing practice, but not universal, and is accepted practice in the wider public sector. Besides, we think that this approach helps ensure that Internal Audit is more part of the solution (not just seen as "bayoneting the wounded") and uses our skills more effectively.

7.3 Implementation of Agreed Actions

7.3.1 In the short term, Directors / Director Generals and Managers should review all "live" and outstanding Agreed Actions that Internal Audit has now placed on a Sharepoint site and either amend or re-confirm their commitment to them, including timescales and responsibilities.

7.3.2 In the medium to long-term we will then report against this list of Agreed Actions, both to the Management Board (see proposed quarterly report above) and Audit Committees.

8. The most difficult issue that we face is in the reporting of audit assignments. This takes a significant time on both sides (both in the total time spent and time elapsed) and meets most resistance (or defensiveness) from managers. We continue to look at ways that Internal Audit can improve on style and drafting, including the use of third party examples, however the particular issues that we have are :
 - Internal Audit tend to report by exception (i.e. findings that highlight risks or poor controls), but managers can be very defensive to any perceived criticism or challenge. Often they want us to give context and provide a “full” picture with all the positives, extending the length of the report.
 - Our audit reports can be for a wide range of stakeholders – from line managers to (potentially) MP members of the Audit Committees - so drafting them for such a diverse audience seldom meets everyone’s needs, all the time. It is also the most “public product” of our work and often more gets read into it than we intend.
 - In our view, management are often overly concerned with the overall level of assurance, at the expense of the wider findings of the audit, when this is a judgemental issue and indicative only rather than an exact science.
9. Whilst we are professionally required to make recommendations or suggest possible management actions in the light of our findings, the main principle is that it is for Management to decide what Actions they are going to take. Their decision may be that they accept the risk of doing nothing or continuing current practice, or that they make changes. Any recommendations that we make should be a contribution to this, but should not detract from management’s primary responsibility to manage the area.
10. I have mentioned before that Internal Audit, as a profession, has changed significantly in the last ten years, both in the private and public sector, and its Institute is now Chartered. I have a professional standard that requires me to consider quality assurance and continuous improvement, and I believe that the proposals above are part of this consideration.

Paul Dillon-Robinson
Director of Internal Audit
4th January 2012

Annex A

Audit Committees

Internal Audit Programme for 2012/13

Internal Audit, Office of the Chief Executive

1 Purpose

- 1.1 This paper presents an outline of the broad principles that I propose should be used to influence how the 2012/13 Internal Audit Programme will be developed, in order for a final draft to be presented to the next meeting of the Audit Committees.

2 Conclusions and Decisions

- 2.1 The Audit Committees are asked to ***note*** the proposed approach and offer any suggestions or issues for consideration to the Director of Internal Audit.

3 Proposed Approach

- 3.1 Following a round of discussions with members of the Management Board in November and December, as well as discussions with the Clerk as Accounting Officer, it is suggested that the following broad principles should be used to help guide the development of the programme :

- The number of audits should be reduced, with an emphasis on greater depth, but with better targeting and engagement from senior management in scoping.
- Use of Deloitte should be targeted on deeper technical reviews, rather than wider ranging work, to gain advantage from the technical expertise that is not available in-house. This will also be accompanied by more detailed planning and direction of Deloitte's work.
- Where possible, the evolving risk management system should be used both to target audits (through their risk assessments) and in the individual planning (testing of the risk mitigations). This will depend on the relative maturity of the system of risk management in each area.
- A higher proportion of IA time should be spent in planning and gaining in-depth awareness of the business area, including through more shadowing. This will, in itself, provide assurance, but will also allow us to target the detailed audit work into areas of most significance, and should therefore improve the usefulness and appropriateness of agreed actions.

- Build on the joint working arrangements with the House of Lords internal audit team and the National Audit Office to optimise audit resource. This will also link in to further developments in integrating and reporting assurance.
- 3.2 It is proposed that, broadly, the Internal Audit Programme is divided into four quarters :
- Assurance on the effectiveness of Corporate systems (e.g. Financial Management, Business Planning, Risk Management, Procurement, etc.) that provide an overview of the system of internal control
 - Assurance on compliance of key controls/mitigations (e.g. where there is a risk that is assessed as “red” at inherent level and “green” at residual, so that there is a high desire for independent assurance that the key controls that are relied upon are operating effectively – Payroll, ICT, etc.)
 - Reviews of High Risk areas (e.g. where the risk assessment is “red/red” and there is value in internal audit reviewing the area and assisting in improvements/value added or assuring that monitoring of the risk is effective)
 - Watching briefs/Contingency. It is proposed that we build in a more significant contingency into the plan, to react to developments, but also have a plan to pair members of the team with Directorates and Departments that they will monitor and shadow over the year, looking into both general and specific topics. This would allow a greater level of coverage, to balance more in-depth audits in the other three quarters. This would particularly cover an ongoing review of the major capital projects (M&E, Fire Safety, Cast Iron Roofs)
- 3.3 The plan would also continue to include specific work in conjunction with the NAO that they can place reliance upon (for instance in Payroll and Accounts Payable) and a 3-5 year rotational plan of coverage for technical assurance in PICT, as well as Follow Up of implementation of agreed actions.
- 3.4 We will specifically discuss what work in the area of the Members Estimate it might be appropriate for us to cover, that complements any NAO work.

Paul Dillon-Robinson
Director of Internal Audit
3rd January 2012

Annex B

Extract from Minutes of the Management Board meeting held on Friday 11 November 2011

3.3 Alex Jablonowski reported that the Audit Committees had recently held a very good meeting to review their effectiveness. The members were working very well together. He planned to have a separate meeting with Angela Eagle, the newest member, as she had unfortunately been unable to attend. The Committees were pressing for a tougher line on implementation of Internal Audit recommendations.