



19 February 2010

Our ref: ICAEW Rep 25/10

Your ref:

Chris Wobschall
Head of Government Internal Audit Profession
H M Treasury

Dear Chris

ICAEW response to HM Treasury's consultation on its Internal Audit Strategic Improvement Plan

The ICAEW is pleased to respond to your request for comments on your consultation on the *Internal Audit Strategic Improvement Plan*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

ICAEW's response to HM Treasury's Internal Audit Strategic Improvement Plan

Memorandum of comment submitted in February 2010 by The Institute of Chartered Accountants in England and Wales, in response to HM Treasury's consultation paper *Internal Audit Strategic Improvement Plan* published in January 2010

Contents	Paragraph
Introduction	1
Who we are	2 - 3
Major points	4 - 5
Responses to specific questions	6 - 20

INTRODUCTION

1. The ICAEW welcomes the opportunity to comment on the consultation paper *Internal Audit Strategic Improvement Plan* published by HM Treasury (HMT).

WHO WE ARE

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

MAJOR POINTS

4. We support the move by HMT to shift internal audit services throughout government to a more strategic level which will, in our view, help to raise standards and the quality of the internal audit service within government. It will also increase the value that internal audit can add to an organisation and will therefore provide more benefit to government departments generally.
5. There are, however, a number of key and fundamental changes that need to be made first before these proposals can be put into place to add real value to government:
 - The review of corporate governance and the roles of accounting officers, boards and audit committees within central government needs to be completed. The internal audit strategy could then complement and be integrated within the corporate governance framework rather than be developed on its own. The setting of the “assurance agenda” needs to remain a key part of the core strategic role of the board with internal audit concentrating on and spending time on providing assurance on operational systems and compliance.
 - This success of this initiative is dependent upon the engagement with key stakeholders (as outlined in your consultation document on page 6) and their understanding of all the major risks, their related assurance needs, and actively supporting an integrated assurance process. In our view, this position has not yet been reached and the proposals within this document may fail if management is unable to deliver the fundamentals of risk management that the initiative is based upon.
 - The skills, knowledge and expertise of internal auditors will need to be developed further to provide real benefit in some of the more complex areas of government.
 - If the group internal audit service proposal is to go ahead there would need to be clear guidelines regarding the design and operation of the service, the size and make-up of the service, the mechanisms for developing work programmes and allocating resources between members of the group. The role of the group head of internal audit would need to clearly identify the accountability lines, authority and control in relation to individual ‘subsidiaries’ boards, accounting officers and heads of internal audit.
 - The concept of pooling and combining internal audit services into larger groupings must, in theory, be useful. However, to enable this to be a success and to avoid fall out, career

development, training, and appraisal processes need to be established up front demonstrating how this will benefit the careers of internal auditors across government.

- The suitable candidate for the role of the Head of Government Internal Audit Profession will need to be of the highest calibre, qualified both professionally and by experience in audit and finance, with leadership skills significant to provide the necessary authority and influence in the role to be able to take the proposals forward.

RESPONSES TO SPECIFIC QUESTIONS

Q1. Please comment on the proposal that an Internal Audit strategy aligned to departmental, cross cutting and other relevant strategic objectives, will maximise the impact of Internal Audit and enable a more efficient and effective assurance to be delivered to Accounting Officers and other senior stakeholders? Please state any alternative approaches that you would suggest.

6. In our view, the setting of the “assurance agenda” needs to remain part of the core strategic role of the board. Internal audit needs to concentrate on and spend time on providing assurance on operational systems and compliance. The strategic objectives set by the board would lead to assurance mapping with a debate at board about the type and level of the assurances that it needs, both from management and from independent sources. The type of assurance may include internal audit and it may also include the provision of assurance by other means. It should not, however, be internal audit’s role to determine the type and level of assurance that a government department requires.
7. We agree that internal audit work needs to be aligned with the strategic priorities and risks of the relevant client/group as this will assist with efficiency and effectiveness. However, the emphasis should be on positioning internal audit work on areas of risk, which may not necessarily be the same as the department’s strategic priorities. Internal audit functions have added greatest value where their work has highlighted risks which are not necessarily evident to management and might even fall outside management’s attention. While an aligned internal audit strategy is important it must not be at the cost of providing this independent perspective on risk.
8. We would, however, urge caution about internal audit’s level of involvement in all of the areas highlighted within the document. The internal audit plans will need to be realistic in terms of the skills required to do a particular piece of work and our view is that internal auditors across government will need to develop further skills to deliver some of what is outlined in the document. Clearly they will be able to review the financial controls and governance arrangements, which are important features of internal control but we question how realistic the plan is in assuming that internal auditors will currently have the required skills and experience to add value in some of the more complex areas. For example, strategic issues at the Ministry of Defence include topics such as the Afghan War and major procurement around aircraft carriers and planes are detailed and complex areas and would require a detailed level of knowledge for internal audit to be of any real value.
9. Our view, therefore, is that this initiative should not overplay the involvement of internal auditors in complex areas where they may lack the necessary skills/knowledge required and which could result in ineffective outcomes/outputs causing damage to their reputation and raise questions about their competency. Before introducing such complexity, there would need to be retraining and re-development of internal auditors’ skills to equip them to meet these challenges.

2. Please comment on the need for better Accounting Officer, Audit Committee Chair and other senior stakeholder engagement in the mapping of strategic objectives, risks and sources of assurance to improve the cost-effectiveness of overall assurance arrangements and enhance the role of internal audit.

10. In principle, we agree that there is a need for better engagement by key stakeholders, but the fundamental issue will be how to implement this and therefore make the key stakeholders 'intelligent' users of internal audit. It will therefore be important to build the reputation of the internal audit service within government to get this level of engagement
11. One way of doing this might be to produce strategic internal audit plans that can align with departmental strategies and risks but also enable the impact of risks and skills of internal audit to be factored into the final work plan. This could be something that the HMT central team could develop and roll out. Focussing on sources of assurance in governance is critical. There appears to be an inference that internal audit should seek to rely on management assurances rather than seek to test these for effectiveness. In our view, management assurance processes are the bedrock of a board's assurance framework. It is then internal audit's role to check these assurances for ongoing design and operating effectiveness. Removing internal audit testing on the effectiveness of these assurance processes could remove a core element of the internal audit role.
12. There may need to be further explanation/guidance to aid management's understanding of what 'assurance' arrangements are available and who is able to provide the types of assurance to ensure that there is no expectation gap between what the board and management are expecting and what internal auditors and other assurance providers are able to provide.

3. The fundamental proposal in the Strategic Improvement Plan is that a Group Internal Audit Service will enable Internal Audit resources to be used more efficiently and effectively? Do you agree and, if not, please state your reasons and any alternatives that you would suggest.

13. We support the thrust to organising internal audit activity on a departmental group basis as this is likely to mean a better balance of work in priority/risk areas. However, this in itself introduces complexity and challenge as each accounting officer and board of entities in the group will still want assurance from their own internal auditors. In our view, this could result in a minimum amount of work for each body regardless of the group arrangement. This could only be avoided by removing the accounting officer accountability at the "subsidiary" level.
14. In principle, a group internal audit service makes sense if it is established within clear departmental groups. However, one size will not fit all and there will need to be clear guidelines regarding the design and operation of the service: the size and make-up of the service, the mechanisms for developing work programmes and allocating resources between members of the group. A group internal audit team will need to have a large enough resource pool to draw upon with the full range of skills and competencies to meet the needs of the organisation. There is also the question of in-house, outsourced or mixed market which also needs to be carefully managed. The role of the group head of internal audit will be fundamental to provide the necessary leadership and enable plans to be flexibly resources.
15. One further aspect that will need to be considered is the degree of control and oversight that the group head of internal audit will have over the 'subsidiary' heads of internal audit and how this will align with the governance and assurance arrangements of accounting officers. Is there a potential for there to be conflicts over independence (and confidentiality)?
16. Finally, whilst the paper talks about identifying leaders of the future, does HMT envisage that the current heads of internal audit will automatically be appropriate for these new roles?

4. Please comment on the proposal that the larger critical masses of internal auditors provided by Group Internal Audit Services will enable resources, including the use of co-sourcing, to be used more flexibly and improve skills and career development opportunities, including identifying and developing the leaders of the future? Please state any alternatives that you would suggest to achieve the intended improvements in quality, impact and cost effectiveness, including possible outsourcing arrangements.

17. Critical mass for any resource pool is helpful and the concept of pooling and combining internal audit services into larger groupings must, in theory, be useful. The statistics included within the document position the whole of internal audit across government comparably to the top six audit practices in the country. Harnessing the experience and skills of such a pool therefore does have potential.

18. To enable this to be a success and to avoid fall out, career development, training, and appraisal processes need to be established up front demonstrating how this will benefit internal auditors across government. The initiative should not be seen as a means of controlling resources from the centre and potentially reducing heads. The best internal audit services in the corporate world have a core of more permanent and professional trained/qualified auditors supplemented by temporary highly skilled managers/finance people who spend 1-2 years in internal audit as part of their wider career progression. Internal audit could be seen as a real opportunity if there was a clear career path. Internal auditors would benefit as they would learn more about the business and its internal control environment, gain access to senior level management and be ultimately able to enhance their overall business insight.

5. Please comment on the role we propose for the Head of the Government Internal Audit Profession and whether you agree that it will improve the quality and consistency of internal audit services and attract high calibre entrants to the internal audit service. If you do not agree, please state your reasons and any alternative approaches that you would suggest.

19. In principle, we agree with this proposal. Coupled with the group service proposal, it could be an important lever for improving quality and consistency of the internal audit service across government. However, if this role is to champion a serious repositioning of internal audit across government, the suitable candidate would need to be of the highest calibre, qualified both professionally and by experience in audit and finance. Leadership will be crucial in this role.

20. There will also need to be clarity around the authority and influence this role will have with both accounting officers and over group heads of internal audit.

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