



National Audit Office

HM Treasury

The effectiveness of internal audit in central government

Detailed methodology

JUNE 2012

Detailed methodology

1 This document provides a detailed description of the methodology used for the study on the effectiveness of internal audit in central government. A summarised methodology is at Appendix One of the report.

2 The study considered the effectiveness of internal audit across central government in the United Kingdom. This included internal audit services at government departments and arm's-length bodies. The report reaches a value-for-money conclusion on the internal audit service across central government. In particular, the report aims to conclude on the efficiency and effectiveness of internal audit in central government. A key area of consideration was the relationship between internal audit and its users and stakeholders, and the effective and efficient provision of these parties' requirements.

3 The main elements of the fieldwork took place during February and March 2012. The methods we used for this study were:

- consultation with users and heads of internal audit;
- review and analysis of internal audit plans, strategies and reports;
- review of our audit teams' assessments of internal audit;
- review of documentation supporting HM Treasury's Internal Audit Transformation Programme;
- semi-structured interviews with heads of internal audit and NAO financial audit directors;
- review of good practice guidance in providing an internal audit service;
- consultation with subject matter experts; and
- case studies.

4 Further information about our approach for each method is detailed below.

Consultation with users and heads of internal audit

5 We produced an online questionnaire to capture the views of key internal audit users (such as accounting officers and audit committee members) and heads of internal audit. We received 118 responses from internal audit users and 59 from heads of internal audit. Respondents included accounting officers, audit committee chairs, finance directors and non-executives from central government departments and other public bodies.

6 The results of the consultation enabled us to gauge the opinions of users of internal audit about:

- the value added by internal audit;
- the effectiveness of internal audit;
- consulting or seeking internal audit's advice over emerging risks;
- areas for improvement;
- the level of influence of internal audit within an organisation; and
- how internal audit could provide a better service.

7 Questions for the heads of internal audit focused on the following key areas:

- the extent of engagement by senior management with internal audit;
- responses to internal audit's observations and recommendations;
- the frequency of requests for advice and assistance to internal audit;
- the alignment of the focus of internal audit with the organisation's core activities and objectives;
- the skills and capabilities within the team;
- internal audit's role in identifying efficiencies within the organisation; and
- barriers preventing the provision of a better service.

8 Of the 59 responses from heads of internal audit received, 15 were from government departments. The rest represented executive agencies, non-departmental public bodies and other public organisations.

Review and analysis of internal audit plans, strategies and reports

9 Much of our findings were informed by an analysis of internal audit outputs. In particular, we reviewed 71 internal audit plans (including 16 government departments and a range of other small, medium and large arm's-length bodies). These plans set out individual internal audit services' programmes of work. Review of these documents enabled us to gather information on:

- the rationale for the audit coverage;
- the type of internal audit service provision (for example, in-house, parent department, hybrid, contracted-out or shared service);
- the type of audit coverage;
- the level of activity (such as number of audit days and costs); and
- key performance indicators.

10 We reviewed seven internal audit annual reports for government departments and other public bodies. Our review of these reports gave us information on:

- the reporting of internal audit's annual opinion;
- recommendations made;
- actual performance against planned delivery; and
- performance review.

11 We reviewed 46 individual audit reports, from 14 government departments and four other public bodies. Our review included reports covering a range of types of review including core systems, risks and advisory work. Our review of the reports focused on:

- the quality and impact of internal audit work;
- the methods used in the work; and
- the ratings systems used to convey opinions and the strength of conclusions.

Review of our audit teams' assessments of internal audit

12 The NAO routinely assesses the work of internal audit as part of its external audit of public bodies. This is to help understand issues affecting the audited body and see whether there is any work on which reliance can be placed. According to International Standards on Auditing 610 *Using the work of internal auditors*, if the work of internal auditors is used by external auditors, 'the external auditor shall include in the audit documentation the conclusions reached regarding the evaluation of the adequacy of the work of the internal auditors'. We reviewed 52 such assessments to develop a better understanding of our auditors' considerations and their assessments of the internal audit services provided to their clients.

Review of documentation on the Treasury Internal Audit Transformation Programme

13 The Treasury provided us with a considerable amount of documentation relating to various aspects of its Internal Audit Transformation Programme, including board papers and responses to consultation. We reviewed this to obtain an understanding of how the Treasury views the current status of internal audit provision and where it thinks there are gaps and scope for further improvement.

Semi-structured interviews with heads of internal audit and NAO financial audit directors

14 We conducted semi-structured interviews with four departmental heads of internal audit services to get a better perspective on what constitutes a good service. Topics for discussion included:

- the need to provide an annual opinion and the influence this has on the focus of work;
- stakeholders' understanding of what good internal audit looks like;
- the expectations of the accounting officer and the chair of the audit committee on the focus of internal audit work;
- how internal audit is seeking to provide a better service; and
- how to evaluate the effectiveness of internal audit.

15 Our financial audit directors regularly review internal audit's work, engage with audited bodies' senior management and attend audit committees. We therefore held semi-structured interviews with our financial audit directors to obtain their views on the internal audit service provided at their client organisations. Key areas for discussion included:

- opinions of the internal audit service at the department and its delivery bodies;
- the extent to which they relied on internal audit's work;
- views on how internal audit could provide a better service;
- ways in which internal audit is seeking to improve the quality of service;
- how the effectiveness of internal audit could be evaluated; and
- examples of good practice.

Review of good practice guidance in providing an internal audit service

16 We reviewed publications outlining what constitutes an effective internal audit service, including guidance from:

- HM Treasury: *Government Internal Audit Standards and Good Practice Guide: the internal audit role in information assurance*, as well as other frameworks and sources of advice;
- the Chartered Institute of Internal Auditors;
- the Chartered Institute of Public Finance & Accountancy: *The Excellent Internal Auditor*; and
- the private sector (including evaluative frameworks produced by Deloitte, KPMG and PricewaterhouseCoopers).

17 This review provided us with a set of characteristics to evaluate internal audit across government, in particular focusing on:

- setting the right strategy;
- having the right capabilities; and
- assessing performance.

Consultation with subject matter experts

18 We consulted with a small group of subject matter experts, including the Chartered Institute of Internal Auditors, PricewaterhouseCoopers and Deloitte, to give us an insight into the characteristics of an effective internal audit service. The discussions also helped in providing further context and improving our understanding through the exploration of themes such as:

- the approach to internal audit;
- the skills and capabilities of internal audit staff and recruitment issues;
- the alignment between what the users of internal audit want and what the service provides;
- stakeholders' understanding of the role of internal audit; and
- the status of internal audit.

Case studies

19 In addition to the interviews and document review, we identified three case studies for use in the report. These covered:

- setting out an appropriate balance of internal audit coverage (Ofcom);
- reviewing and improving the capability of the Ministry of Defence internal audit; and
- the performance scorecard used by the Department for Education's internal auditors.

20 The purpose of this work was to help us to understand some key areas of internal audit practice and highlight how elements of the service can work more effectively.