



National Audit Office

**FINANCIAL
MANAGEMENT
AND REPORTING**

A Good Practice guide to the Statement on Internal Control



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National Audit Office

Contents

Introduction **3**

A clear, evidence-based picture of the effectiveness of internal controls across the organisation **4**

Appropriate support for Audit Committees **5**

Governance arrangements and processes supporting the production of the SIC **6**

Disclosure of risks and controls within the SIC **7**

Stability in risk management, internal control and SIC production **8**

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In the current climate of fiscal restraint and declining availability of resources, it is important that central government bodies can demonstrate the resources that they are responsible for are appropriately managed and controlled.

Introduction

Statements on Internal Control (SICs) are an important public accountability document, but they often fail to provide a transparent and accountable report of the control issues and risks faced by central government organisations.

To promote greater accountability and transparency we reviewed a wide range of central government bodies to determine the following:

- the assurances supporting the Accounting Officer's assessment of the effectiveness of internal controls; and
- the processes and governance arrangements underlying the production of SICs.

Our work concluded that a number of barriers to effective accountability exist:

- Organisations often do not have a clear, evidence-based picture of the effectiveness of internal controls across the piece.
- Audit Committees do not receive adequate information to support them in their challenge function.
- Governance arrangements and processes supporting the production of the SIC lack strength.
- Long narrative and process-based descriptions in the SIC obscure disclosures on risks and controls.
- Machinery of Government changes and organisation-led overhauls frequently disrupt risk management, internal controls and SIC production processes.

This good practice guide identifies ways that central government organisations have overcome these barriers and will be of interest to both executives and non-executives. Not all of the good practice will be appropriate to all organisations, but the principles should be considered in the context and circumstances of the organisation.

This guide complements our earlier report *The Statement on Internal Control: A Guide for Audit Committees* and I hope you will find it useful and informative.

Andrew Baigent
Director General, Financial Audit

A clear, evidence-based picture of the effectiveness of internal controls across the organisation

Our work considered Director-General¹ level assurance statements and tried to establish the quality of the assurances they received and passed on. The results highlighted that some organisations could not substantiate the assurances provided to the Accounting Officer by Directors-General.

A significant number of organisations did not take the further step of pulling the Director-General level returns together to provide senior management and non-executives with an overview of the effectiveness of controls related to key processes across the organisation. The benefit of such an overview is clear highlighting of areas for targeted investigation or for department-wide action to tackle systemic risk and control issues.

Good practice relating to provision of a clear, evidence-based picture of the effectiveness of internal controls across the organisation

Assurances are evidence-based

The Accounting Officer is provided with sufficient evidence to make informed assessments on the effectiveness of internal controls. The evidence should support and complement any Director-General level assurance statements.

Senior executives and Audit Committee members have an overview of the effectiveness of key processes across the organisation

Combining Director-General level assurances into a matrix or summary document gives senior management and non-executives a clear picture of where day-to-day processes are working effectively across the organisation, and highlights emerging systemic risk and control issues for early action.

¹ Throughout this document we have used the term 'Director-General' to indicate the level of senior staff who sit directly below the Accounting Officer. Organisations should consider how this term might be applied to them.

Appropriate support for Audit Committees

Audit Committees play a valuable challenge and oversight role in the production of the SIC. In the absence of earlier senior executive engagement, they also provide the only forum for debate and discussion.

The quality of the information provided to Audit Committee members on the SIC varied across government and demonstrated a lack of appropriate corporate support in some cases.

Good practice relating to appropriate support for Audit Committees

The Audit Committee is provided with information on all the assurances underlying the production of the SIC

Audit Committees can challenge the disclosure of control issues more effectively if they are provided with a summary of the assurance statements underlying the SIC, and have access to the underlying evidence supporting the statements.

The Audit Committee is aware of the recommendations made in external reports and of progress against these

Knowledge of external report recommendations (e.g. NAO value for money studies or select committee reports) and progress against these enables Audit Committees to challenge the SIC more effectively. Expanding Audit Committees' recommendation trackers to include substantial recommendations in all external reports is an easy way of communicating this information.

Governance arrangements and processes supporting the production of the SIC

Ideally, the SIC should be a by-product of day-to-day risk management arrangements; the effectiveness of internal controls is under constant review and this information flows up and down the organisation to allow appropriate action. For most central government organisations, risk management is not sufficiently embedded to permit this approach and a separate process to produce the SIC is needed. The quality of these arrangements varied widely.

Our work also found the governance arrangements overseeing the production of SICs to be weak in several areas.

Good practice relating to governance arrangements and processes supporting the production of the SIC

Assurances are subject to challenge, corroboration and review

Challenge meetings take place at all stages in the process. They involve the senior management and the team responsible for producing the SIC who ensure consistency and can identify common internal control issues. The involvement of Internal Audit and the Audit Committee Chair in the later stages can introduce additional and valuable challenge to the process.

Senior executive engagement with the SIC before it goes to the Audit Committee

Early senior executive engagement improves the quality of the SIC. Where senior executives did not engage with the SIC prior to Audit Committee review, the first draft was often boilerplate with little additional disclosure on risk and control issues. In these cases, the Audit Committees then requested significant redrafting before they recommended the SIC to the Accounting Officer.

The assurance process is not just a year-end exercise

An annual assurance process provides a snapshot in one point in time only. An ongoing process helps risk management and control to be more effective. More frequent assurance reports allow senior management and non-executives to have additional information on risks and the effectiveness of controls during the year.

Annual assurance processes often result in little opportunity for the Audit Committee to consider and comment on the draft SIC before the Accounting Officer is required to sign.

Disclosure of risks and controls within the SIC

Our work found that SICs were most transparent when describing the processes in place over the 'capacity to handle risk' and the 'risk and control framework'.

Disclosures relating to significant internal control issues were the least transparent area of reporting.

Good practice relating to information on risks and controls

Information on risks and control is the focus of the SIC

Most SICs contain long, process-based descriptions. Better SICs are short and punchier, shifting the reader's focus to the risk and control issues.

More open reporting of risk and control issues

SICs commonly disclose only the most serious control issues, for example those that have led to a qualified audit opinion. More transparent reporting of other significant risks and how they are controlled enhances public accountability.

External report findings are reflected in the SIC

Accounting Officers should reflect the findings of external reports, for example NAO value for money studies and capability reviews, in their assessment of the effectiveness of internal controls.

Stability in risk management, internal control and SIC production

Four departments have been subject to Machinery of Government (MoG) changes in the last two years. The new departments struggled to bring together legacy systems to ensure effective risk management, internal controls and robust SIC production. MoG changes are an inevitable part of public administration and the organisations affected can do little to prepare for their impact.

Our review also found that four departments had significantly revised their risk management framework or SIC production processes in the last two years without any external impetus.

Lack of stability in these areas, whether externally or internally driven, creates a significant resource burden and is a barrier to organisational effectiveness.

Good practice relating to stability in risk management, internal control and SIC production

Appropriate risk management processes and internal controls are in place

Better risk management and internal control systems remain stable over time. Constant redesign prevents these systems from embedding in an organisation's day-to-day operations.

Staff receive on-going training on risk management

Periodic refresher training is a common feature in central government organisations with embedded risk management processes.

Appropriate SIC production processes are in place

SIC production processes should ensure the Accounting Officer receives appropriate assurances, deliver adequate governance and remain stable. Application of the good practice points in this guide will help achieve these objectives.

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