

GOVERNMENT INTERNAL AUDIT STANDARDS

GOOD PRACTICE GUIDE

AUDIT STRATEGY



HM TREASURY

**HM Treasury
Audit Policy & Advice
May 2002**

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FOREWORD

This guide offers good practice guidance on the development of a comprehensive internal audit strategy which will be capable of delivering an opinion to the Accounting Officer on the whole of an organisation's risk management, control and governance.

It is important to note that in practice the scope of the audit opinion may be constrained by factors such as the scope of audit access or availability of resources to deliver audit work. Nevertheless, strategic planning should start from the premise of aiming to deliver the optimum audit product and only be constrained when the circumstances mean that the Head of Internal Audit encounters circumstances that prevent them from delivering it.

This document sets out guidance aimed at helping Heads of Internal Audit to deliver the optimum audit product and also offers some direction in the key potential circumstances in which it may not be achievable (such as a management risk analysis which is not adequate for the approach set out here or inadequate resources to deliver the optimum audit product).

It should also be noted at the outset that the provision of an audit opinion does not necessarily deliver assurance in the colloquial sense of that word; it may deliver a lack of assurance, or discomfiture, if the state of risk, control and governance merits it. Nevertheless, such an opinion should be based on sufficient reliable and relevant evidence to allow it to be positively stated within the boundaries of reasonableness.

By careful consideration of this guidance in developing their audit strategy any Head of Internal Audit should be able to demonstrate that they have done the best possible to add value to the risk, control and governance of their organisation even if the audit product is less than the optimum because of given circumstances.

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I. Introduction

1.1 The definition of Internal Audit in the “Government Internal Audit Standards” (GIAS) specifies that Internal Audit “provides an independent and objective opinion to the Accounting Officer on risk management, control and governance”. This opinion will normally take the form of a narrative summarising relevant strengths and weaknesses and their implications. Standard 1 (Scope), sets out the need for that opinion to be of a “nature specified by the Accounting Officer” (1.1.1h) and to include “all its operations, resources, services and responsibility for other bodies” (1.1.1g) in the scope of consideration of specific audit work which needs to be done to deliver that opinion. Standard 6, at 6.1.1, notes that the “Head of Internal Audit’s opinions are a key element of the framework of assurance the Accounting Officer needs to inform their completion of the annual Statement of Internal Control”.

1.2 An Accounting Officer needs to be adequately informed of the effectiveness of their internal control system¹ in order to prepare the Statement of Internal Control (although they do not have to disclose that effectiveness in the Statement). In terms of accountability to Parliament, which is the primary line of accountability of the Accounting Officer, it is clear that the Committee of Public Accounts does not accept lack of knowledge of weaknesses in control as an adequate defence for the realisation of risk which could have been controlled or for risk taking which has not been well managed. The Accounting Officer therefore needs a reliable and evidenced opinion on risk, control and governance; this has to be positively expressed, in the sense of being evidenced, (even though the opinion may be adverse in the sense of advising that risk, control and governance is not efficient, effective or economical). It can, however, only be reasonable in the sense that no opinion or assurance can ever be absolute and is by definition an extrapolation of the evidence available. The audit opinion is by definition a cornerstone of the assurance available to the Accounting Officer on risk, control and governance. Annex 1 provides a more detailed definition of an optimum audit opinion.

1.3 It is important to note that the Internal Audit opinion does not supersede the Accounting Officer’s personal responsibility for risk, control and governance and as long as internal audit work is demonstrably conducted in accordance with the Standard on Due Professional Care there can be no question of internal auditors being responsible for control failures. This is a feature of the role of internal audit which some Heads of Internal Audit may wish to make explicit in the elements of their strategy which they present to the Audit Committee and Accounting Officer for approval.

¹ Note that “internal control system” in relation to the Statement of Internal Control should be taken to include all responses to risk, including control which is exercised by transferring risk to an outside partner (such as through insurance) and “soft” controls such as ethical standards as well as “hard” controls exercised by specific actions within the organisation.

1.4 This guide aims to highlight the range of specific considerations which have to be made in developing the audit strategy. It does not set out a “model strategy”; because each organisation is unique, its risk management, control and governance is unique and the internal audit strategy is unique. However, the use of this guide should allow a Head of Internal Audit to ensure that they give attention to all the key elements of an effective audit strategy.

1.5 This guide focuses on strategy for delivering assurance. It covers the consultancy role of internal audit only to the extent that this contributes to delivering assurance, and does not encompass other specialist roles which internal audit may have such as fraud investigation (although these areas of work may well provide knowledge and produce findings which are of value in preparing the overall assurance on risk, control and governance). These are the subjects of other good practice guidance which should be used in conjunction with this guide.

2. Overview of the Audit Strategy

2.1 The purpose of the audit strategy is to put in place a strategic approach which will allow the Head of Internal Audit to manage the audit unit in a way which will facilitate:

- The provision to the Accounting Officer of an overall opinion each year on the organisation's risk management, control and governance, to support the preparation of the Statement of Internal Control
- Audit of the organisation's risk management, control and governance through periodic audit plans in a way which affords suitable priority to the organisations objectives and risks
- Improvement of the organisation's risk management, control and governance by providing line management with recommendations arising from audit work
- The identification of audit resources required to deliver an audit service which meets the Government Internal Audit Standards, particularly in respect of the scope of audit work defined in Standard 1
- Effective co-operation with external auditors and other review bodies functioning in the organisation
- Provision of both assurance and consultancy services by internal audit

2.2 The documented audit strategy should set out, at any point in time,

- The extent to which internal audit is able to rely on management's risk analysis² (OR the ways in which internal audit is assisting management to develop their risk analysis)
- The elements of the risk analysis which are regarded as essential for annual review in order to provide a positive, reasonable assurance to underpin the Statement of Internal Control
- The further coverage of the risk analysis which is necessary to provide a positive reasonable assurance and to meet the specified assurance requirements of the Accounting Officer and the Audit Committee
- The areas of change in the organisation which are being subjected to systems development audit
- How and to what extent, internal audit will seek to rely on other assurance work to develop the audit opinion
- The range of approaches which internal audit plans to deploy

² In this document the term risk analysis is taken to mean the process in which management have identified, evaluated and prioritised the risks facing the organisation.

- The key ways in which internal audit will communicate the results of its work
- The assessment of resources required to deliver the audit assurance, including identification of specialist skills which may be required
- The way in which internal audit and specialist resources will be procured
- The approach to recruiting / training / continuing professional development of internal audit staff to ensure that they are suitably skilled to deliver the internal audit service
- How the internal audit service will measure its performance, Quality Assure itself, and seek continuous improvement
- Risks which the audit unit itself faces in delivering the strategy and plans for controlling these risks.

2.3 The format of the audit strategy should be determined by the Head of Internal Audit. Options include the production of a single strategy document which is kept under regular review, the setting out of the strategy in an Audit Manual or a series of Audit Policy papers which can be separately reviewed and amended as necessary. Whatever format is chosen, all elements of the strategy should be promulgated to all members of the audit unit, and (at least) the elements which relate to the issues on which the Accounting Officer should seek the Audit Committee's advice (see Standard 3.2) should be provided to the Audit Committee. (It may be necessary for details of some aspects of staffing/procurement to be restricted to audit management).

3. Pre-requisites for developing the Audit Strategy

3.1 There are a number of knowledge based pre-requisites for developing the audit strategy:

- A thorough understanding of the organisation's objectives and performance targets
- A thorough understanding of the organisations risk analysis procedures, including the risk priorities of the organisation and the allocation of ownership of key risks
- A thorough understanding of the processes by which the Accounting Officer gains his overall assurance about risk management, control and governance (for example, the way in which stewardship reporting processes are structured or the role and remit of designated risk managers)
- A thorough understanding of the current responses to risks (the control system) which is in place [hopefully for a new IAS there will be info from previous service]
- A thorough understanding of the senior management structures and roles and the consequent organisational structures
- A thorough understanding of the priorities of the Management Board (if possible, the Head of Internal Audit should regularly have sight of Board minutes and changes to key documents such as the Departmental Investment Strategy (DIS)).

Gaining this knowledge will be an important issue for external providers of internal audit services when a new contract is let; it will also be important for all internal audit services to have a mechanism to ensure that their knowledge remains current and comprehensive.

3.2 Risk analysis belongs to management, and in particular to the Accounting Officer; they, not internal audit, are accountable for the economy, efficiency and effectiveness of risk management control and governance. It is therefore essential that the audit strategy is based on management's risk priorities, not on a separate audit analysis of risk (but see below for actions when an adequate management risk assessment is not in place).

3.3 Where a complete management analysis of risk is in place, internal audit should undertake certain preliminary work to inform the audit strategy:

- The risk analysis should be audited on a systematic basis. This serves two purposes
 - It provides the Accounting Officer with an opinion about the organisations own strategic approach to the analysis of risk
 - It provides internal audit with assurance that the risk analysis is a sound basis for planning audit work

- This audit should seek evidence of
 - the completeness of the risk identification process
 - the identification of appropriate criteria for the evaluation of risk in respect of both impact and likelihood
 - the appropriate application of these criteria to the identified risks
 - appropriate consequent prioritisation of risks and identification of key risks
 - appropriate relationship between organisational objectives and prioritised risks
 - assignment of ownership of risks at an appropriate level which has authority to assign resources in responding to the risks
 - the regular review / revision of the risk analysis

3.4 If internal audit is not satisfied with any of the above, the issues identified should be discussed with the Accounting Officer (or Audit Committee or Risk Committee or other body assigned responsibility by the Accounting Officer for preparing the risk analysis) to try to resolve the issues.

3.5 If, after such discussion, internal audit considers there are material deficiencies in the risk analysis (and potential consequent deficiencies in the organisation's risk management, control and governance process), the perceived deficiencies should be reported to the Accounting Officer with the request that they record their acceptance of the risk analysis as it stands if they do not wish to have it revised.

3.6 When a complete management analysis of risk is not in place, internal audit should first consider what help management needs to develop an appropriate analysis and how this would help the audit process. Without an adequate risk analysis internal audit cannot proceed with its strategy. Where it is appropriate for internal audit to provide consultancy advice and this can be done without prejudicing objectivity and independence, internal audit should emphasise that:

- They need to work in partnership with management to develop the risk analysis
- The risk analysis will be owned by management, not internal audit
- Internal audit's role in the development of the risk analysis does not
 - Prevent consequent revision of audit opinion on the adequacy of the analysis
 - Guarantee freedom from error in the analysis.

3.7 If management declines to accept such an offer and takes no other action to develop a risk analysis internal audit should formally advise the Accounting Officer that there is a material and fundamental deficiency in the organisation's risk management, control and governance process which will directly impact on the Accounting Officer's ability to make a Statement of Internal Control in accordance with Treasury requirements.

3.8 In such circumstances it will then be necessary for internal audit to develop their own analysis of risk to facilitate the preparation of an audit strategy.

3.9 The background research undertaken, and the relationship between management's risk analysis and the audit strategy should be summarised in the strategy.

4. Identifying audit coverage necessary

4.1 The next stage in developing the audit strategy is consideration of the coverage of the risk management, control and governance which is required in order to provide the Accounting Officer with an opinion.

4.2 Consideration of the coverage necessary has to be premised on Standard 1 - Scope of Internal Audit Work. It will not be necessary to audit every aspect of risk, control and governance every year, but certain factors will be relevant to considerations at this stage:

- The organisation's risk analysis should be reviewed every year to gain assurance that it continues to be appropriate
- Within the risk, control and governance there may be certain high risk systems or processes which will need to be reviewed annually to deliver the assurance required
 - There is a consequent consideration of whether such systems and processes need to be fully and systematically audited every year or whether techniques such as key control testing or compliance testing in some years will be adequate
- The overall coverage will need to encompass the whole range of risks which the organisation has identified as "key" to the achievement of its objectives
- An adequate range of non-key risks needs to be included in any year's coverage to give credibility to the comprehensiveness of the opinion
 - Risks not defined as key still need to be given attention to gain assurance that material adverse impacts are not arising
- Current knowledge of the organisation's risk management, control and governance (including past Internal Audit Opinions and external audit management letters) will inform assessment of the likelihood of there being (material) deficiencies which will mitigate for greater audit coverage
- The audit coverage should also take account of significant centrally driven developments to which organisations are required to respond. These may include issues such as (for example) Freedom of Information, E-government / Modernising Government, BS7799, Health and Safety, Resource Accounting and Resource Budgeting.

4.3 It should be kept in mind that the most effective audit coverage is gained by a combination of strategic audits (is risk, control and governance well **planned** and **directed**?) and operational audits (is risk management, control and governance well **executed**?). The audit coverage should aim to address both the question of how well control is planned and how well it operates in practice.

4.4 In addition to consideration of existing risk, control and governance, consideration should be given to the extent of change taking place or planned to take place in the organisation. Any planned projects or developments impacting on risk, control and governance should be encompassed in the strategy:

- Changing processes can be inherently more risky than established and known processes
- Identification of weaknesses in developing areas is more economical to correct during development rather than after the process has been put in place

4.5 As well as the considerations above, internal audit should discuss the assurance required with the Accounting Officer and the Audit Committee to help gauge the coverage which will be required. In particular the extent of assurance which they require in respect of non-key risks will be important. If the assurance required is specified as less than the definition of “positive and reasonable” (see Annex 1) the implications of this should be discussed and recorded. Conversely if it is likely that internal audit will be unable for some reason to deliver such assurance this should also be discussed and the implications agreed.

4.6 These considerations set against the organisation’s risk analysis will allow a broad template for the audit work to be done in any year to be developed, thus leading to the development of periodic audit plans

4.7 For each element of internal audit work identified, an estimate of the number of staff days which will be required to conduct the work should be made. It is important to allow adequate time for work to be done professionally and for proper acquisition and evaluation of evidence. The best resource for making these estimates is historic experience of how long audit work takes to do.

4.8 The coverage and resources envisaged should be summarised in the internal audit strategy.

5. Looking for opportunity to rely on the work of others

5.1 It is not always necessary for internal audit to directly audit processes in order to gain assurance about them. Where well developed assurance processes are in place:

- review of these processes by internal audit will often deliver a significant contribution to audit opinion.
- The Accounting Officer can be advised on the reliability of the assurance they gain from these assurance processes.

5.2 In developing the audit strategy, internal audit should therefore consider:

- What other assurance processes are in place (eg – Stewardship Reporting processes, documented CRSA reviews, the work of other review or inspection teams)
- The relationship between the coverage of these processes and the risk priorities of the organisation
- The way in which these processes can themselves be reviewed and quality assured, in order that Internal Audit can consider how the work of these assurance processes can contribute to the audit assurance (without conduct of audit work which repeats actions already taken). This may involve:
 - Specific quality assurance reviews of other assurance processes
 - Auditing on a sample basis the specific work of assurance functions to gauge reliability of findings
 - Joint working with other review teams

Plans to rely on the work of others should be summarised in the internal audit strategy.

5.3 Particular effort should be made to identify ways in which there can be co-operation with external audit. Sharing of information between internal and external auditors can avoid duplication of effort and enhance knowledge of the whole of risk management, control and governance for both parties. Detailed guidance on this is set out in “Internal – External Audit Co-operation – A good practice guide”. The practical processes put in place for effective co-operation should be summarised in the internal audit strategy.

5.4 In departments which sponsor Agencies or NDPBs with their own internal audit function, review of internal audit in the subsidiary bodies by departmental internal audit may be material to the assurance given to the departmental Accounting Officer and may underpin the departmental Statement of Internal Control. When this is the case, reference should be made to this review in the departmental internal audit strategy.

6. The audit toolbox

6.1 From the guidance given above, it can be seen that the effective internal audit service will require a range of techniques at its disposal. The audit strategy should aim to set out which techniques will be used in which circumstances.

6.2 The range of audit techniques will include:

- Systematic audit : A “full” audit in which every aspect and stage of the audited subject is considered. It includes review of both the design and operation of controls
- Compliance audits : Where there is pre-existing confidence that controls are well designed, but effective operation of the controls is a material issue, audits which test only for effective operation of controls can be appropriate
- Key control testing : A variation on compliance audits, but clearly focussed on a small number of material or key controls
- Quality Assurance Review : Reviewing the approach and competency of other reviewers rather than reviewing risks and controls. Designed to form an opinion of the reliance which can be placed on the work of others
- CRSA : A technique in which the people who run a system or process review their own risks and controls, usually with a facilitator who ensures a structured approach. Facilitating CRSA workshops serves both as an assurance technique and a consultancy technique for internal audit
- Systems Development Audit : Phased review of developing plans and designs for new systems and processes aimed at identifying potential weaknesses in control if the plans and designs go ahead as they are.

7. Identifying and procuring skills and resources necessary

7.1 The considerations given to the audit coverage will also reveal any need for specialist resources in addition to staff who hold the Government Internal Audit Certificate³. These additional skills may include accountants, lawyers, technical or scientific specialists and specialist IT skills.

7.2 For these specialist resources it may not be good value to appoint full time in-house staff. It may be necessary to consider how to procure these skills to the extent to which they are required to deliver the audit strategy. If necessary, appropriate call-off contracts should be set up or arrangements made for joint working with specialists within the organisation.

7.3 As well as planning for specialist skills, the strategy should plan for the ongoing core audit skills which the internal audit service requires. There should be a “succession plan” to help ensure that vacancies are promptly filled by appropriately qualified staff and a training plan to ensure that new staff are equipped with requisite skills as early and as effectively as possible. It is also important to consider how the “core” audit staff will maintain their skills. In particular all core audit staff should be well trained in risk management issues and have a good knowledge of current governance requirements. Detailed guidance on staffing, training and development is provided in Standard 5.

7.4 The long term view of the work which needs to be done informs the assessment of the number of audit staff required to deliver the internal audit coverage required by the Accounting Officer⁴. Interpreting the estimate of staff days required to deliver an effective audit service⁵ into a staffing plan also needs to take account of:

- Supervision time – all audit work must, in the first instance be subjected to appropriate quality management through review and supervision
- Contingency time – allow an element of time to deal with unforeseen issues (for example – the emergence of a new risk)
- Training time – adequate time for training to ensure that staff are competent in their work must be allowed
- Follow-up time – adequate time must be allowed to review management response to audit reports, and in particular in addressing material weaknesses
- Management and administrative time – allow sufficient time for both strategic management, including support to the Audit committee, and for the efficient administration of the internal audit function.

³ GIAC requirements are set out in the “Internal Audit and Training Development Handbook”; it succeeds the former “Basic Audit Training Standard” (1988) and “Government Internal Audit Standard” (1996) and is based on a combination of professional qualification, internal audit experience and knowledge of the Government environment.

⁴ Any limitation on assurance caused by lack of resources should be advised to the Accounting Officer- see Standard 1.2.3

⁵ In the preliminary comments to this guide it was noted that consultancy work and other specialist functions such as fraud investigation are covered in separate guidance. Do not forget to include these functions in the total resource estimates!

8. Reporting

8.1 Reporting is the subject of Standard 9 and of separate good practice guidance. However it should be noted here that the audit strategy should include reference to the “cornerstones” of the reporting processes.

8.2 In particular the strategy should set out:

- The timing objectives for the issue of draft and final assignment reports
- The frequency of reports to the Audit Committee and Accounting Officer
- The format of reports to the Audit Committee and Accounting Officer
- The timetable for the provision of the annual audit opinion
- The procedures which will be followed when (material) weaknesses identified through audit work have not been actioned. This may include specified escalation procedures.

9. Quality Assurance

9.1 Quality Assurance is the subject of Standard 10 and of separate good practice guidance. However, in order that the Accounting Officer, Audit Committee and line managers can have confidence in the internal audit service, the strategy should set out the cornerstones of the quality assurance processes deployed by internal audit.

9.2 In particular the strategy should set out:

- The way in which the internal audit service governs and controls itself
 - By reference to the Government Internal Audit Standards
 - By reference to local structures such as an Audit Manual
 - By reporting to the Audit Committee
- The key elements of supervision, for example
 - How junior staff are supervised
 - How work is reviewed
- The timetable planned for
 - Internal Quality Assurance Reviews
 - External Quality Assurance Reviews
- Work planned to improve the quality of internal audit services, for example
 - Major training initiatives
 - Acquisition of new IT tools
 - Action plans to follow up issues identified in previous quality assurance reviews.

ANNEX I

CRITERIA TO DEFINE THE OPTIMUM AUDIT OPINION

This guidance can apply both at assignment and at summary HIA opinion level.

1. The scope encompasses the whole of the organisation's risk, control and governance:
 - Sufficient work has been done across the whole of the organisation to facilitate an overall opinion on the range of risk and control which has to be encompassed in the Accounting Officer's Statement on Internal Control
 - The scope covers a sufficient range to meet the Accounting Officer's need for assurance on risk in respect of
 - Range of risks and of risk priorities
 - Range of the organisation's activities in which the risks arise
 - Range of the organisation's locations in which activities giving rise to the risks are undertaken.
2. The opinion is positively stated:
 - It is supported by sufficient reliable and relevant evidence to facilitate a confident assertion of the state of the organisation's risk, control and governance
 - It states what is considered to be the condition of the organisation's risk, control and governance, encompassing commentary on both strengths and weaknesses
 - It does not rely on stating that the auditors have failed to see evidence of weaknesses.
3. The opinion is reasonable:

In the sense of the likelihood of events taking place beyond the intended effects of the control system

- It advises that the assurance is not absolute
 - It advises that the opinion is based on the likelihood of control to constrain risk to management's risk appetite
 - In the sense of interpretation of the evidence
- Another suitably trained person would arrive at a similar conclusion based on the persuasiveness of the evidence collected.

ANNEX 2

DEVELOPING A STRATEGIC APPROACH TO AUDIT COVERAGE

The principles of

- *audit scope encompassing the whole of risk control and governance, and*
- *the audit opinion being premised on review of sufficient elements of the risk, control and governance processes to express opinion on the whole scope?*
- *being accepted, there is a need to dissect the organisation into elements which facilitate the conduct of manageable audit assignments. This annex provides guidance on how this may be achieved.*

1. A “manageable audit assignment” needs to be defined. Such definition will generally rely on factors such as audit staff days required and elapsed time for delivery of the audit. Indicatively it can be suggested that assignments of more than 100 staff days or three months elapsed time may be better broken down into separate assignments.

2. Identification of assignments may be premised on audit of

- identified risk through the systems and processes in which the risk arises, or
- strategic or framework systems and processes which set the framework within which operations take place and relating the findings back to the organisational analysis of risk, or
- operational systems and processes and relating the findings back to the organisational analysis of risk, or
- a combination of the above.

3. It is an intrinsic feature of a well developed risk register that it will indicate the hierarchy and priority of identified risks and the ways in which they are encountered in the operation of the organisation. Where the risk register is well developed, Internal Audit should be able to use it to directly identify the audit assignments which should be conducted to deliver an opinion which provides appropriate assurance about the whole of risk, control and governance.

4. Factors to be used in this identification may include

- ***What “level” of the risk register to audit?***

- The risk register should present a hierarchy of risk analysis with the highest level strategic risks diagnosed into more detailed analysis. What level of the risk register gives access to audit assignments which meet the “manageable” criteria? (unlikely to be the highest level of the register except for audits of strategic or framework systems)

- ***Audit of risks or audit of activities?***

- Will it be more practicable to audit risks through the various ways in which they arise or to audit systems or processes which are key to the delivery of objectives and relate the findings back to the risk register?
- Are there key risks for the organisation which pervade a multiplicity of systems and processes (in which case auditing the risk may be preferable) or are the risks sufficiently diverse that a clearer differentiation of priorities is obtained by consideration of the systems and processes which deliver the objectives?

- ***What steer is there from existing knowledge?***

- To what extent does existing knowledge of the control environment suggest that audit of “strategic” or “framework” processes (such as business planning or financial reporting) will deliver assurance about “operational” systems? [ie – does prior knowledge indicate a good record of compliance with strategic controls?]
- To what extent does existing knowledge of the control environment or prior audit activity suggest that particular risks or systems and processes are well controlled compared with risks or systems and processes where the efficiency and effectiveness of control are uncertain?

- ***How can existing work be utilised?***

- Are there areas or risk, or systems or processes, in which the activity of other review functions can be relied upon to deliver assurance? In particular, if a Stewardship Reporting process exists, to what extent will audit of that process deliver assurance on the risks or systems and processes which it encompasses?

- ***Who needs assurances?***

- To what extent is there co-incidence between the need to deliver assurance to defined owners of risks and to the owners of systems or processes? The priority of the need for “working level” assurance may help define the approach to deriving the overall opinion.