Grant Thornton

The developing internal audit agenda

Summary findings from our survey of public sector heads of internal audit

May 2012

CIPFA The Chartered Institute of Public Finance & Accountancy

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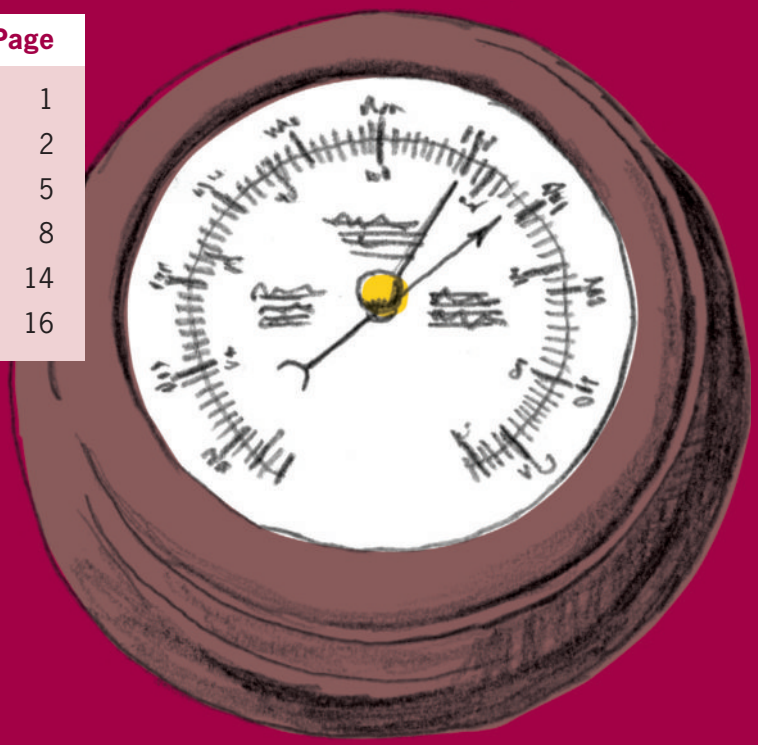


Introduction

Context

No public sector internal audit function can be immune to the issues presently facing the sector. The increased pressure on budgets, the constant demand to deliver more for less, the evolution of service delivery models and an increasing focus on good governance and risk management has meant that internal auditors need to keep pace with the changes, focus effort where it most needed and be highly professional in their delivery. This professionalism is strongly supported by CIPFA and the IIA, who are pressing for the consistent adoption of key professional standards and principles.

Meanwhile, the external audit landscape is also facing radical changes, with the disbanding of the Audit Commission, the councils' prospects of being able to appoint their own auditors and the concept of Independent Audit Appointment Panels (IAAPs). Almost a third of our respondents believe the advent of IAAPs will mean that the audit committee becomes more important. The same number think that the existing audit committee will transform into an IAAP body, although 73% still see the appointment of independent members as the most significant stumbling block to their establishment.

So, how are internal auditors responding to the pressures? Do they have the resources to deliver what is needed? Are they having to compromise their standards or their coverage, or are better and more efficient solutions being identified? Do internal auditors have the support and sponsorship they need from within their organisations, with the necessary board-level relationships, to be effective?

In conjunction with CIPFA, we undertook a survey of UK heads of internal audit at local authorities, police, fire and NHS bodies, to address these questions. The survey focused on the year 2011/12 as its base, with forward-looking questions covering 2012/13 and 2013/14. The results are based on 97 responses.

Highlights

Provision, skills and professionalisation

- 52% of respondents had a fully in-house team, with an additional 27% co-sourcing selected skills. A significant proportion of respondents (33%) anticipated that the structure would change in the next two years.
- A recognition of the need to address skills gaps and increase the professional qualification of team members indicates an acceptance that modern internal audit is widening in scope and starting to respond to the challenge of a more competitive market environment.

The head of internal audit

- While 98% of heads of internal audit had a role that was clearly officially recognised, the key challenges in meeting CIPFA's statement on the role were due to resourcing issues and the support of the chief executive.

Service delivery

- Our respondents anticipated a net increase in the breadth of internal audit coverage, which emphasises the issues of limited resources and skills gap.
- While 82% believe there will be no impact in delivering their annual opinion in the short-term and actions are being taken to mitigate the reductions in resource, it is apparent that there will be a compromise on standards and a limit to the depth of service as the breadth of audit increases.
- Measurement of output will become key in ensuring that the value of internal audit is recognised.

Internal audit provision, skills and professionalisation

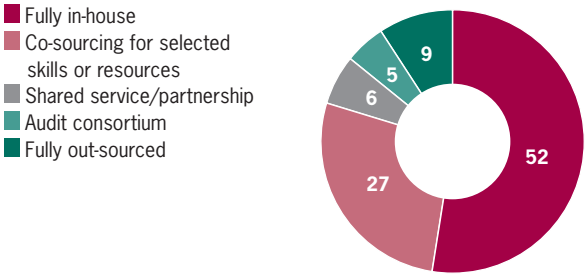
52% of respondents had a fully in-house team, with an additional 27% co-sourcing selected skills. A significant proportion of respondents (33%) anticipated that the structure would change in the next two years. However, a recognition of the need to address skills gaps and increase the professional qualification of team members indicates an acceptance that modern internal audit is widening in scope and starting to respond to the challenge of a more competitive market environment.

In-house versus out-sourced provision

Over half of internal audit functions are delivered wholly by an in-house team and over a quarter have an in-house team with a co-sourcing arrangement in place for selected skills or resources. One third of respondents believe this mix will change in the next two years. Of these, 56% anticipate a significant growth in shared service or partnership provision and 28% an increase in co-sourcing arrangements. However, very few (3%) saw wholesale outsourcing as their likely business model going forward.

For those commissioning internal audit services cost and value for money will inevitably be factors. As one respondent from an audit consortium noted: "Most of the NHS periodically tenders internal audit services. The process quite often focuses on cost, so proposals are driven predominantly by the need to be competitive rather than audit needs." However, to ensure value for money, commissioners will also need to identify and understand their needs for audit and assurance if they are to be an 'intelligent client' and procure effectively.

WHICH OF THE FOLLOWING BEST DESCRIBES THE WAY IN WHICH YOUR CURRENT INTERNAL AUDIT SERVICES ARE DELIVERED? (%)



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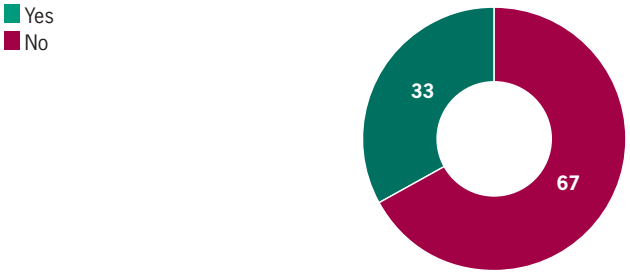
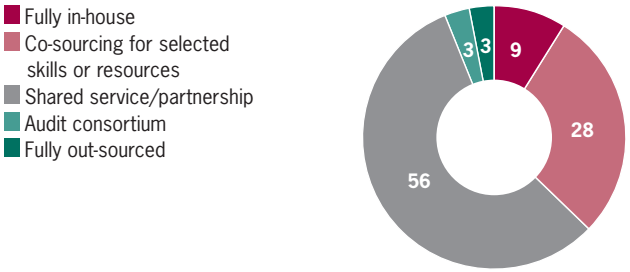
DO YOU SEE THE WAY YOUR INTERNAL AUDIT SERVICE IS PROVIDED CHANGING IN THE NEXT 2 YEARS? (%)



IF 'YES', WHERE YOU THINK THERE WILL BE A CHANGE TO THE WAY THE SERVICE IS PROVIDED, HOW DO YOU THINK YOUR SERVICE WILL BE PROVIDED IN 2 YEARS TIME? (%)



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The development of a shared service arrangement is seen by some as an opportunity to consolidate valued audit skills and experience and a way to tackle resourcing issues.

"I believe that many of the challenges that face internal audit today, which this survey covers, can only be addressed by local authorities joining their audit resources together. My partnership now has the breadth and depth of resources to weather the current difficulties and provide a constant, high quality internal audit service to our partners. It's difficult to see how quality and delivery can be maintained by individual internal audit teams working alone."
Survey respondent

For the 33% of organisations making changes to their internal audit provision there will be a number of challenges for both internal auditors and their clients and this will increase the importance of building good relationships.

Skills gaps and preparing to compete

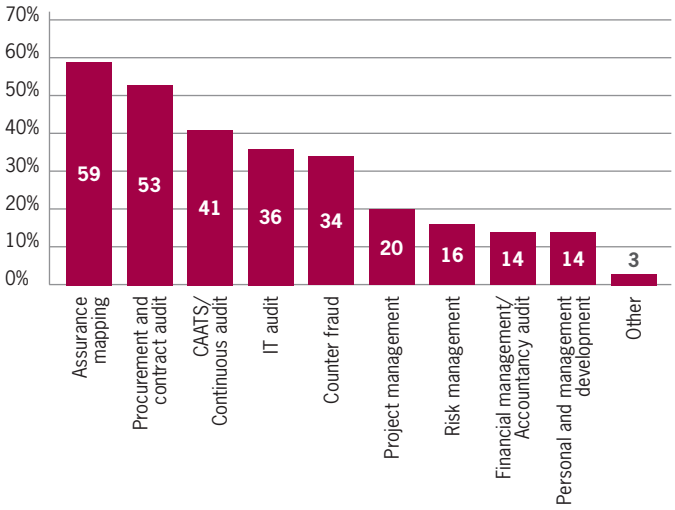
Over the next two to three years, heads of internal audit (HIAs) recognised skills gaps in the following areas:

- assurance mapping (59%)
- procurement and contract audit (53%)
- use of IT tools (41%) and IT auditing (36%)
- counter fraud knowledge (34%)

This indicates evolution in three areas of internal audit:

1. **Internal audit plans** – which now focus on business areas which drive good value (better procurement and contract management, stamping out fraud) and respond to greater automation and use of technology to deliver local services (IT auditing).
2. **Assurance focused approach** – the particular focus on increasing assurance mapping skills indicates that limited audit resources are being focused on key areas to provide the greatest assurance possible. This is particularly required as an internal auditor can no longer rely on a standard programme of work, rather the focus and level of assurance must continually evolve, with the auditor in a unique position to advise on whether coverage is sufficient.
3. **Future internal audit market** – the focus on this skill set could indicate that HIAs are considering the future landscape and preparing for the inherent threat and/or opportunity in the market.

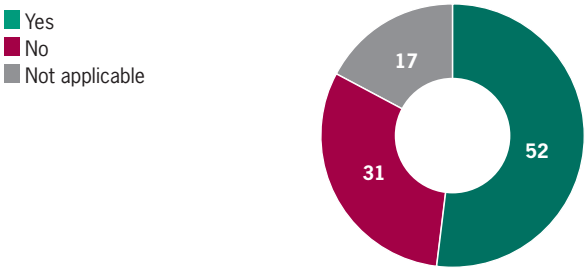
WHICH ARE THE THREE KEY AREAS OR SKILLS WHICH WILL NEED TO BE DEVELOPED WITHIN THE NEXT 2-3 YEARS?



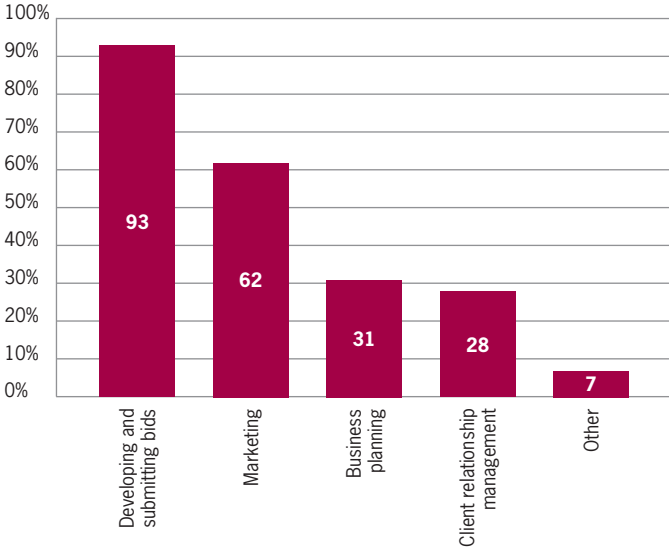
When asked, 52% of respondents were confident of their ability to compete against private firms for additional work (perhaps by forming a consortium themselves or acting as a shared service centre for internal auditing in their region). Nearly a third, however, disagreed. For those with doubts, the key skills believed to be missing were commercial skills around developing and submitting bids, and marketing and business planning, rather than the technical skills of audit delivery.

Internal audit teams are being challenged not only in their ability to deliver good audit work, but are also starting to recognise the wider market place threat and competition to their very existence, and are quickly identifying how they need to change.

MANY IA TEAMS CONTRACT WITH OTHER ORGANISATIONS TO PROVIDE AUDIT SERVICES. DO YOU CONSIDER THAT YOUR IA TEAM HAS THE NECESSARY BUSINESS SKILLS TO COMPETE IN THE MARKET? (%)

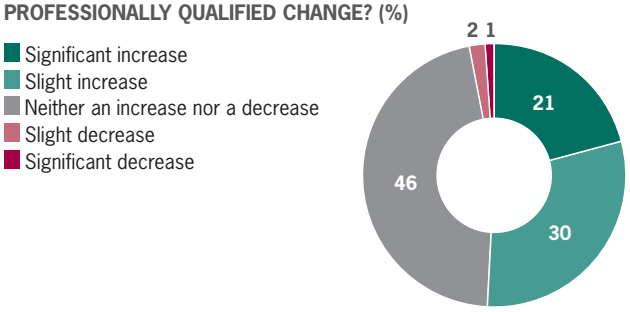


IF 'NO', WHICH OF THE FOLLOWING AREAS OF SKILLS REQUIRE FURTHER DEVELOPMENT? (%)



Professionalisation of the internal audit function

HOW WILL THE NEED FOR INTERNAL AUDITORS TO BE PROFESSIONALLY QUALIFIED CHANGE? (%)



At present there is no formal requirement for internal audit team members to hold a professional qualification. However, 51% of our respondents anticipated that over the next two years there would be an increase in the need for internal auditors to be professionally qualified. Two main reasons were given for this. Firstly, that the organisations' responses to external drivers were creating an environment that required a broader and deeper internal audit skill set. Secondly, that clients' expectations of professional status were also increasing, with comparison with private sector competition acting as a catalyst. Unsurprisingly, reduced training budgets were identified as a barrier to supporting professional training.

"Client expectations will increasingly be for assurance about quality delivery – for which demonstrated professional competence will be critical."
Survey respondent

"Internal audit is a specialist discipline and needs to have appropriately qualified and experienced staff to carry out the reviews in the complex environment that we now face."
Survey respondent

CIPFA's view is that professional training for internal audit staff not only offers development, career choices and motivation to the team member, but that it enhances the overall effectiveness of the audit team. Professional training alone does not ensure optimum performance and effectiveness from the team but it does provide a core platform of competence on which additional skills, experience and personal effectiveness can be developed. As audit teams continue to demonstrate their value and effectiveness to their clients, professional development will be a core strand of that offering.

The head of internal audit

While 98% of heads of internal audit had a role that was clearly officially recognised, the key challenges in meeting CIPFA's statement on the role were due to resourcing issues and the support of the chief executive.

CIPFA statement on the role of the head of internal audit in public service organisations

The head of internal audit in a public service organisation plays a critical role in delivering the organisation's strategic objectives by:

1 championing best practice in governance, objectively assessing the adequacy of governance and management of existing risks, commenting on responses to emerging risks and proposed developments; and
2 giving an objective and evidence based opinion on all aspects of governance, risk management and internal control.

To perform this role the head of internal audit:

3 must be a senior manager with regular and open engagement across the organisation, particularly with the Leadership Team and with the Audit Committee;
4 must lead and direct an internal audit service that is resourced to be fit for purpose; and
5 must be professionally qualified and suitably experienced.

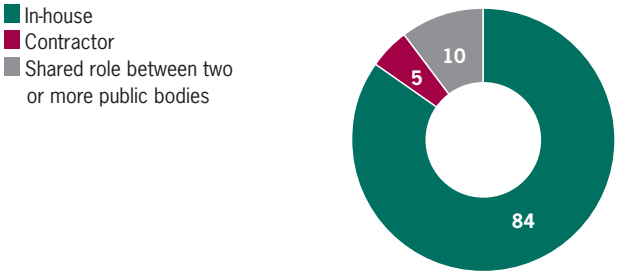
The role of the head of internal audit, CIPFA, Dec 2010

The HIA is an important and challenging role, requiring a wide range of technical and managerial skills to be effective. It also includes building relationships with other senior staff and influencing governance and control matters.

As HIAs themselves, 98% of our respondents work for organisations where the role of head of internal audit is 'clearly nominated'. Although there is a variety of internal audit delivery models, in 84% of responses the role of the HIA is undertaken by an in-house employee and for a further 10% the HIA role is fulfilled by someone who acts on behalf of more than one body.

IS THE HEAD OF INTERNAL AUDIT A CLEARLY NOMINATED ROLE? (%)

IS THE ROLE OCCUPIED IN-HOUSE, BY A CONTRACTOR OR SHARED BETWEEN TWO OR MORE PUBLIC BODIES? (%)



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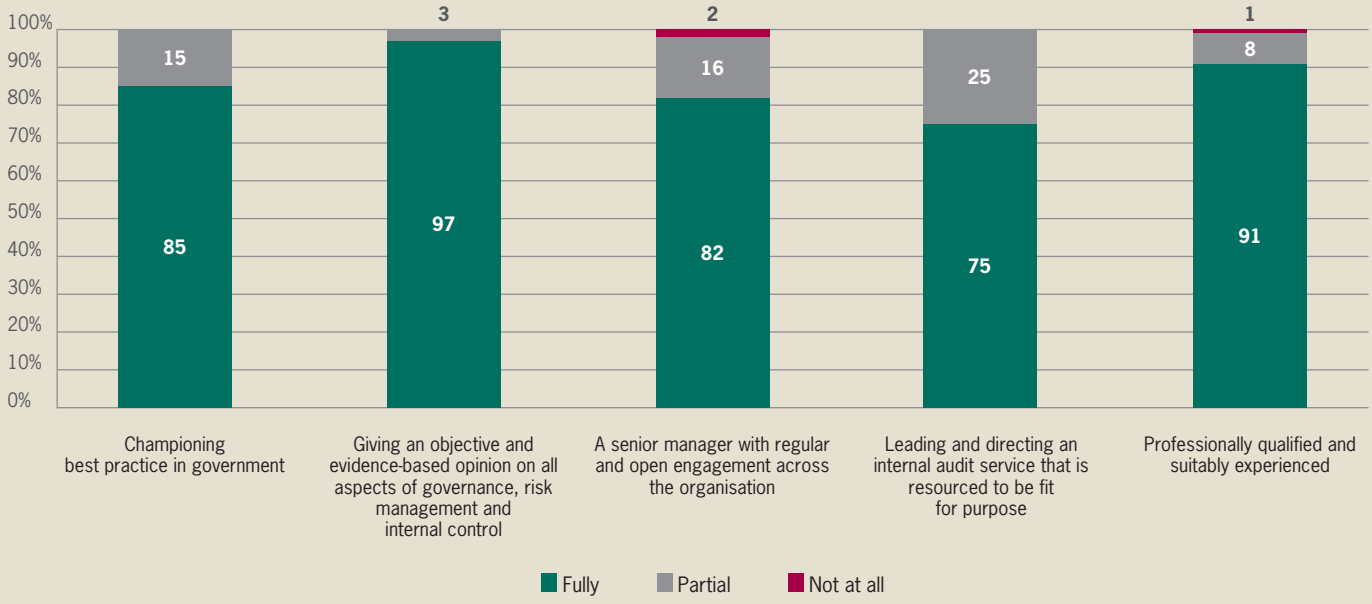
Professionalism of the HIA

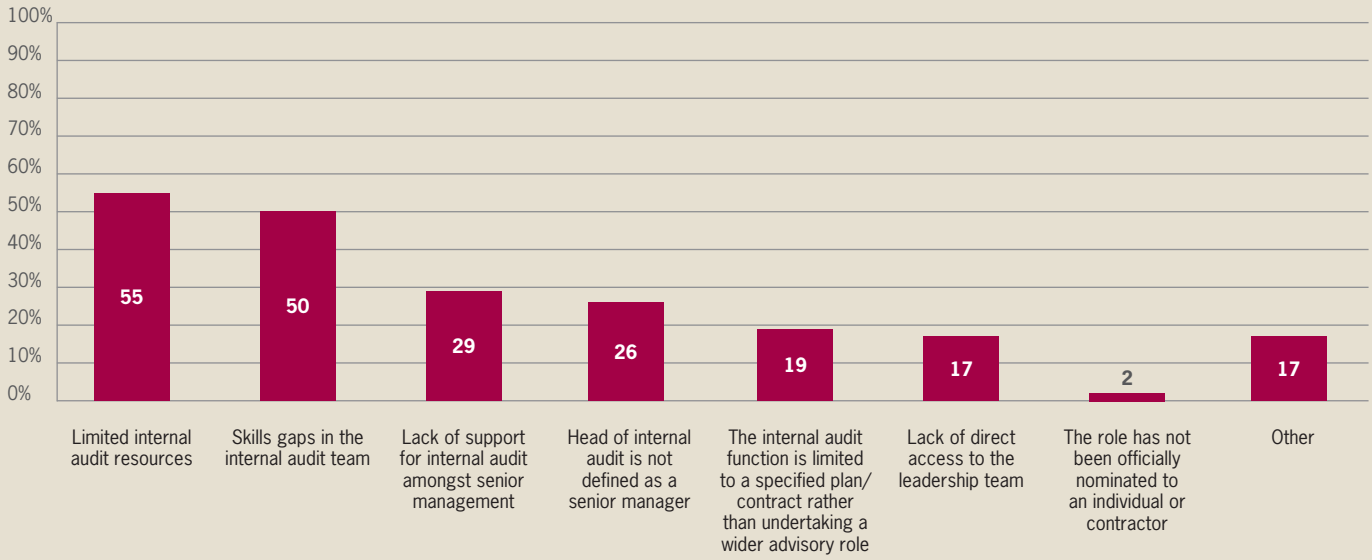
HIAs consider that they fully comply with the principles of the CIPFA statement, in particular in giving an objective opinion on all aspects of governance, risk management and internal control (97%), being professionally qualified and suitably experienced (91%) and in terms of championing best practice (85%).

The least level of compliance with the CIPFA statement was in terms of 'leading and directing an internal audit service that is resourced to be fit for purpose', with only 75% agreeing and 25% partially agreeing. Combined with the leading reasons for not complying with the five principles – 'limited internal audit resources' (55%) and 'skills gaps in the internal audit team' (50%) – it is clear that resourcing is a major challenge.

TO WHAT EXTENT DOES YOUR HEAD OF INTERNAL AUDIT COMPLY WITH THE PRINCIPLES OF THE STATEMENT?



WHERE YOU DO NOT COMPLY WITH ONE OR MORE OF THE FIVE PRINCIPLES, WHAT ARE THE THREE MAIN REASONS?

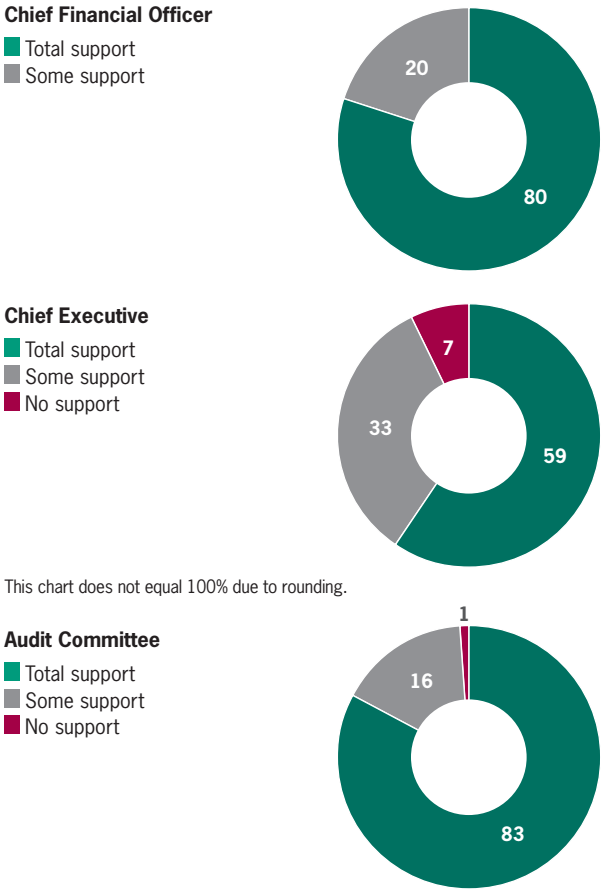


The importance of relationships

There was also less confidence from HIAs in fully complying with the requirement of being 'a senior manager with regular and open engagement across the organisation' (82%) and a small proportion indicated that this was not the case at all (2%).

Over a quarter (29%) cite 'a lack of support amongst senior management' as a reason for not complying with one of CIPFA's five principles, possibly because a similar number structurally place the HIA below the 'senior management' level. This lack of support appears to be a particular problem for unitary authorities, with 40% identifying the issue. It may be that the HIA is seen as less important in a larger organisation and therefore receives less support.

WHAT LEVEL OF SUPPORT FOR THE HIA IS RECEIVED FROM: (%)



80% of HIAs receive total support from chief financial officers and 83% receive a similar level of support from audit committees. This level of support drops to 59% from chief executives and is generally lowest among county authorities and 'other' bodies, such as police and fire. The implication is that to address the 'lack of support from senior management', HIAs need to increase the level of dialogue with chief executives, particularly as pressures inevitably increase. Building relationships and understanding of the internal audit role are critical for ensuring that the function can 'add value' at an early or critical stage of major projects or new developments. Where there is only limited recognition of the HIA role it is more likely that the contribution internal audit makes will be more constrained.

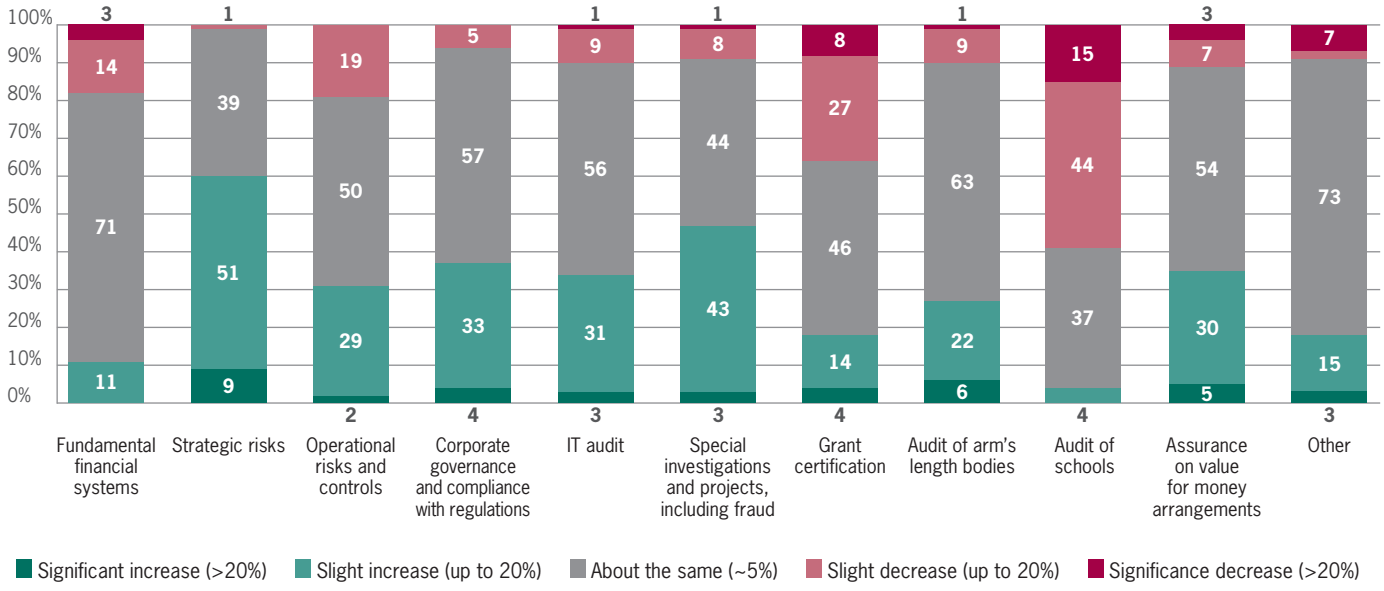
"The concept of the head of internal audit being involved in advising on impact of proposed policy initiatives, programmes, projects and emerging risks is not always accepted or agreed in the organisation."
Survey respondent

Service delivery

Our respondents anticipated a net increase in the breadth of internal audit coverage, which emphasises the issues of limited resources and skills gap. While 82% believe there will be no impact in delivering their annual opinion in the short-term and actions are being taken to mitigate the reductions in resource, it is apparent that there will be a compromise on standards and a limit to the depth of service as the breadth of audit increases. Measurement of output will become key in ensuring that the value of internal audit is recognised.

Coverage of internal audit work

LOOKING FORWARD TO THE NEXT TWO YEARS (2012/13 AND 2013/14), AND FOR EACH OF THE FOLLOWING AREAS OF IA WORK, PLEASE IDENTIFY HOW MUCH THE AMOUNT OF WORK IN EACH AREA IS LIKELY TO CHANGE



Looking forward over the next two years, there are some trends in the nature and coverage of internal audit work. The majority see most types of internal audit work staying the same with about 30% of respondents seeing a potential for increase in work in operational risks and controls, IT audit and value for money arrangements. The clear exceptions to this are:

- **Strategic risks** – where 60% of respondents expect an increase in work.
- **Special investigations and projects including fraud** – where 46% of respondents expect to see an increase.
- **Fundamental financial systems** – where 71% of respondents anticipate that this work will remain broadly the same and if not, then more likely to decrease.
- **Grant certification** – with 35% of respondents anticipating this area of work will decrease.
- **Audit of schools** – with the majority (59%) of respondents anticipating a decrease.

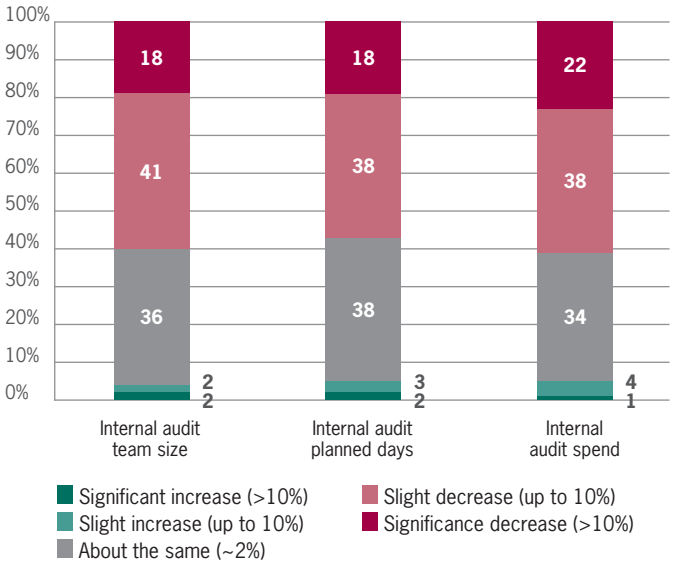
The growth of work in the area of strategic risks reflects the increasing expectation that internal audit plans will be produced with reference to the key priorities of the organisation and provide higher level assurances to management. The anticipated increase in fraud related work is perhaps expected given the well-recognised increase in fraud perpetrated against the public sector in difficult economic times.

Three key themes emerge. Firstly, this overall net increase in workload indicates that, like local public sector finance functions, there is an increasingly resource-restrained position. 59% of respondents also anticipated that the size of their audit team would reduce in the next two years.

Secondly, an expectation of a gradual shift into more traditionally 'added value' areas, reflects the requirement for additional training to meet skills gaps.

Thirdly, as internal auditors cover not only the basic financial control areas, but also audit more strategic and operational matters, the need for professional qualifications may become a greater requirement than the respondents of the survey originally anticipated.

GIVEN THE CURRENT FINANCIAL ENVIRONMENT, HOW DO YOU EXPECT THE FOLLOWING ASPECTS OF INTERNAL AUDIT PROVISION WILL CHANGE OVER THE NEXT TWO YEARS, 2012/13 AND 2013/14, COMPARED TO THE CURRENT YEAR?



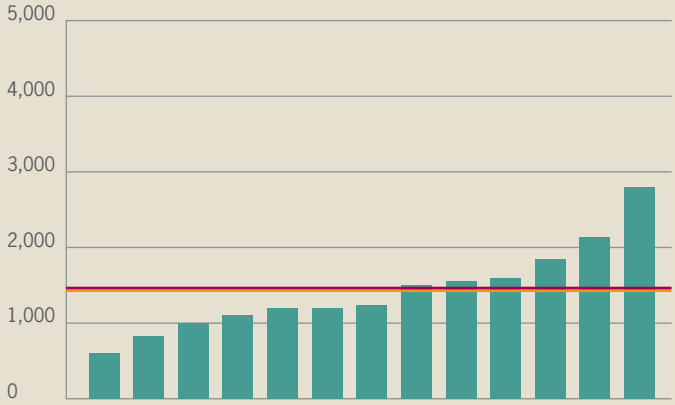
Feeling the pinch

HOW MANY AUDIT DAYS ARE IN YOUR INTERNAL AUDIT PLAN FOR THE YEAR 2011/12?

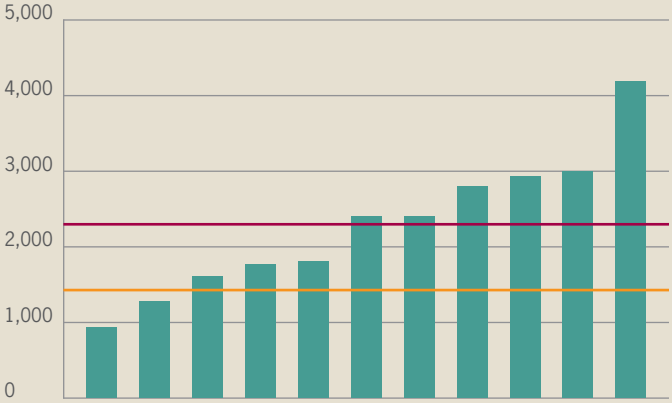
These charts show the typical spread of the number of days in the current audit plan, split according to authority type. There is a range, with significant outliers in each authority type. The mean average number of audit days is 1,400 for a unitary authority, 2,300 for a county and 560 for a district.

56% also anticipate that the number of days in their plan will reduce and that the amount spent on internal audit will similarly fall (60%).

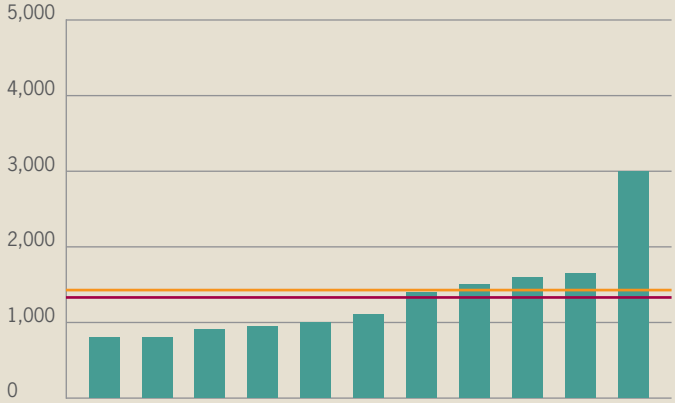
Audit days – unitary authorities (England)



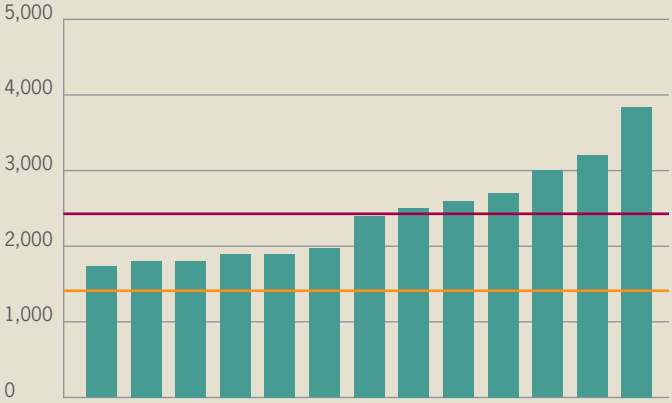
Audit days – English counties



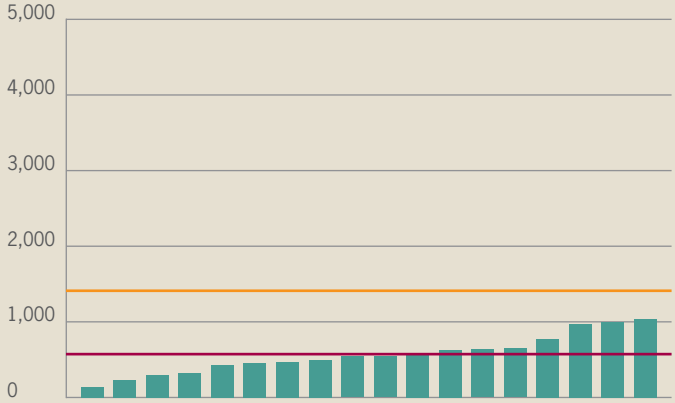
Audit days – London



Audit days – metropolitan authorities



Audit days – non-metropolitan districts (England)



Individual authorities | Local authority average | Authority type average

Reflecting on the impact of resource reductions, 74% of respondents have already reduced the coverage of the control environment, implying that while breadth of the audit has increased, the depth has been reduced. While 63% of respondents believe that in this situation they have maintained existing levels of internal audit professional standards, 36% recognised that "some compromises [will need to be made] in certain areas".

Yet only 35% have raised their concerns about internal audit resources with the audit committee, chief financial officer or chief executive. Is this simply accepting the inevitable, agreeing to budget cuts just like every other department? Or is it symptomatic of the nature and level of the relationship the HIA has with senior management?

Actions being undertaken by HIAs to mitigate the reduction in resource include improving staff performance (76%), improving audit planning (66%), making greater use of technology in delivering audit work (51%) and restructuring teams to make better use of the days available (40%). In the main, HIAs think this response will be enough for now, with 82% saying there will be no impact of their ability to deliver their annual opinion. The long-term however, is less certain.

"I would now argue that the internal audit function is at the minimum level possible. I have managed to get support from the s151 officer, management team, external audit and the audit committee to maintain staffing levels as they currently stand. However, the function is now two thirds the size it was three years ago."

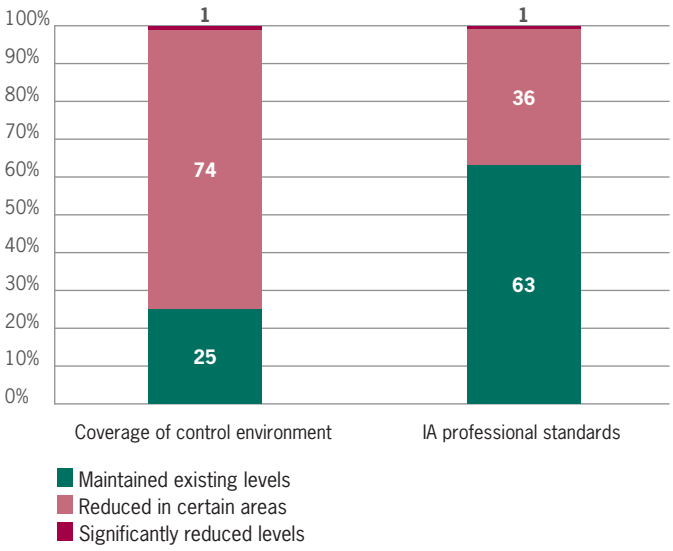
Survey respondent

From a professional point of view, the CIPFA Code of Practice requires the HIA to advise their organisations if the level of resource prejudices the ability of internal audit to deliver a service consistent with the definition of internal audit. NHS standards also require a similar safeguard. This will clearly be a challenge for many HIAs going forward.

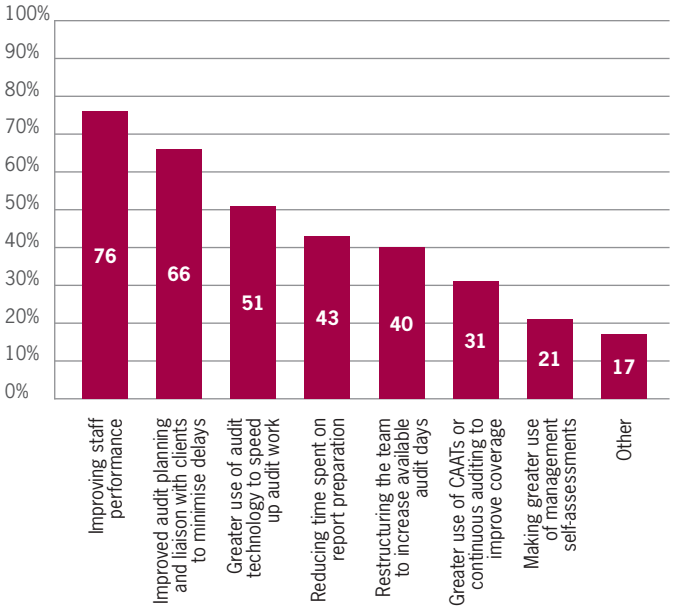
IF THERE HAS BEEN A REDUCTION IN THE OVERALL INTERNAL AUDIT RESOURCE, WHAT IMPACT HAS THIS HAD ON:

A. THE COVERAGE OF THE CONTROL ENVIRONMENT BY INTERNAL AUDIT WORK?

B. YOUR ABILITY TO MEET PROFESSIONAL STANDARDS OF INTERNAL AUDIT FOR OUR WORK?



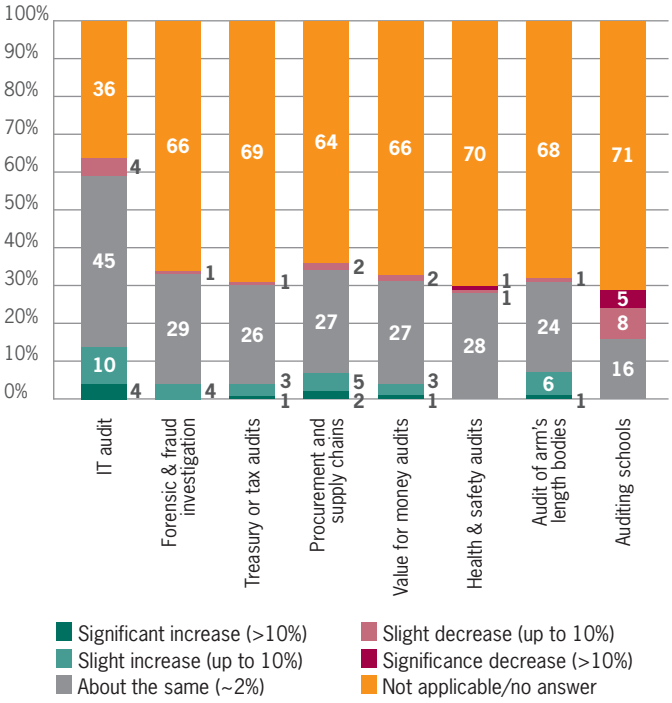
WHAT STEPS HAVE BEEN TAKEN BY INTERNAL AUDIT TO IMPROVE THE EFFICIENCY OF THE FUNCTION?

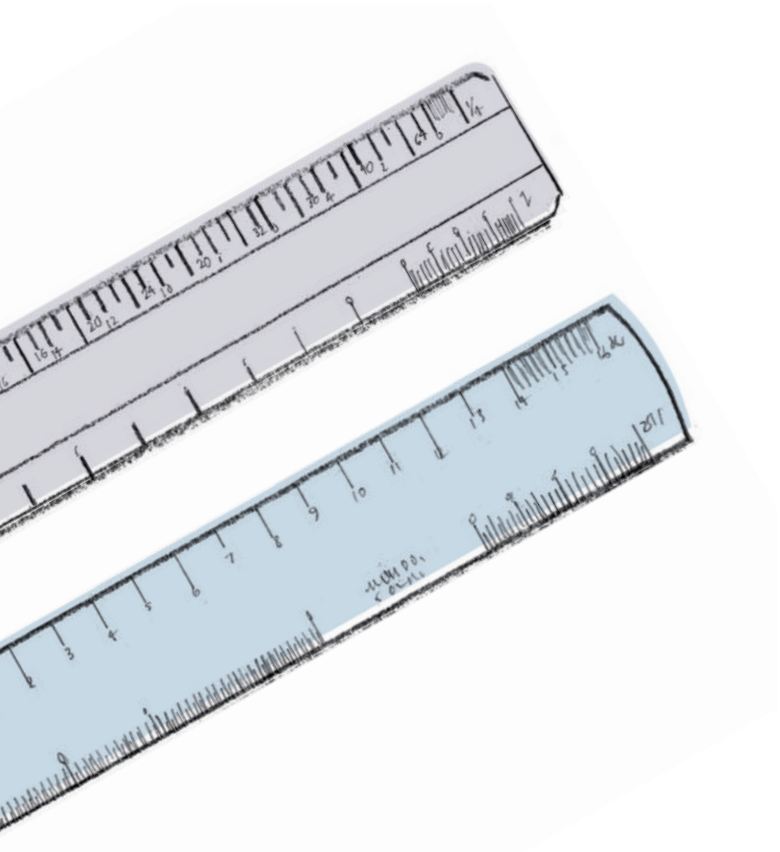


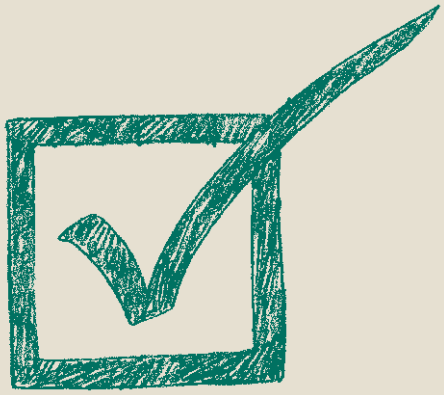
Other responses

If internal resources are under pressure, one possible response would be to buy in additional resources when needed, increasing co-sourcing arrangements. While there are slight increases in the expected purchasing of external resources for some specialist areas, there is no overall trend in this direction. We can only draw the conclusion that the main driver for co-sourcing arrangements is in the more generalist skill areas: the volume of resource needed, rather than their specialism.

FOR EACH OF THE FOLLOWING AREAS, HOW WILL THE EXTENT TO WHICH YOU BUY IN THESE SERVICES CHANGE OVER THE NEXT 12 MONTHS?







What does good look like?

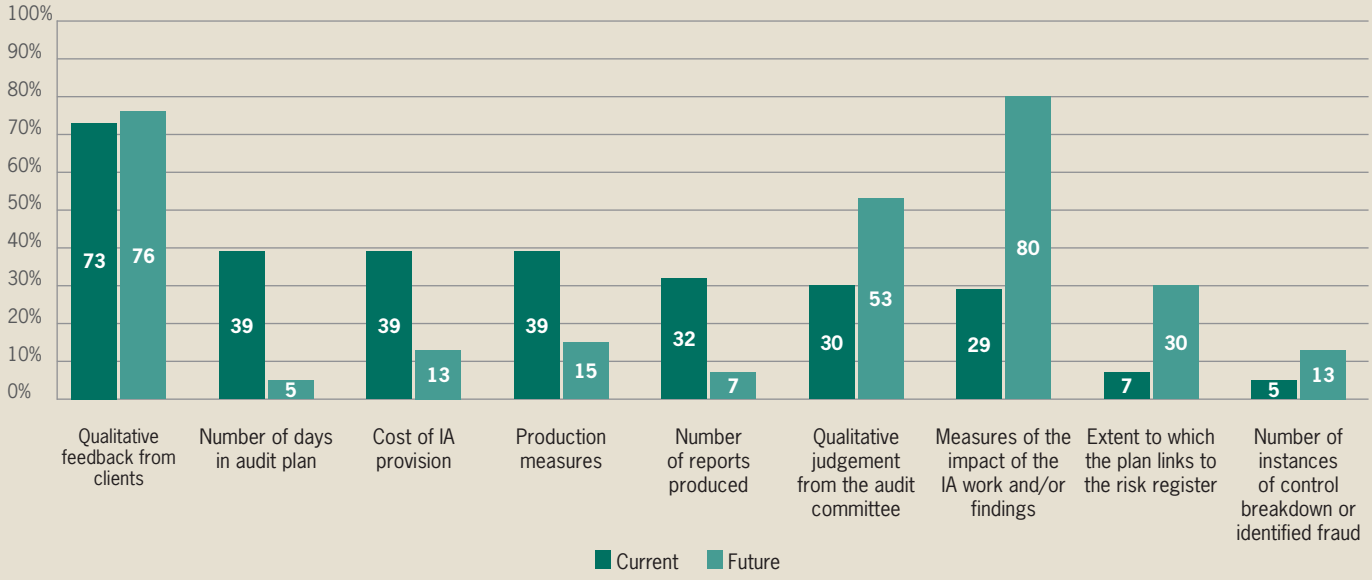
Internal auditors are always asked to 'add value', but it is notoriously difficult to measure. Current measures of internal audit performance today contrast significantly to how internal auditors wish to be measured. The strong majority (73%) do obtain qualitative feedback from clients already, but many of the other current measures of performance are about inputs. These include the number of days in the plan, cost and production measures, such as the number of reports. Currently, only 30% of respondents measure the impact of findings and just 7% the linkage to business risks through the risk register.

Preferred measures were around impacts, with 80% citing this as a desired key performance measure, along with more qualitative feedback from clients and from the audit committee. Only 13% wanted to continue to use measures of cost or production efficiency, and just 5% wanted measures around the number of days in the plan.

It appears, therefore, that there is a risk of a perception gap between internal auditors themselves and senior management, to the extent that key performance indicators do not focus on outcomes and impact. This is the fundamental challenge for HIAs themselves, and for the profession as a whole.

"The big challenge for audit is to incontrovertibly prove its worth as it can be perceived as a back office service and thus ripe for further cuts. It's still a great job to do and some great people who add real value – we need to get better at telling people about this."
Survey respondent

INTERNAL AUDITORS MUST ALWAYS ADD VALUE, BUT THIS IS OFTEN MEASURED IN DIFFERENT WAYS
A. PLEASE INDICATE THE THREE KEY WAYS IN WHICH THE EFFECTIVENESS OF THE IA FUNCTION IS CURRENTLY EVALUATED
B. PLEASE INDICATE THE THREE KEY WAYS THAT YOU WOULD WANT IA TO BE MEASURED IN THE FUTURE



Conclusions

The survey highlights some of the challenges that heads of internal audit are facing in public sector organisations. There is the ambition to meet professional standards fully and fulfil the role set out by CIPFA in the role of the head of internal audit. This may mean further development and investment in audit teams, key relationships across the organisation and involvement in the full range of audit and assurance provision. There is no doubt that internal audit teams are feeling the economic pressures like other departments. They are moving quickly to respond by improving their own efficiencies, but at the same time the expectations of what they should deliver are increasing rapidly.

Heads of internal audit will need to demonstrate effectively how they add value and the impact of their assurance work, as they prepare for the competition that is increasing in the market place.

About us

About Grant Thornton

Grant Thornton UK LLP is a leading business and financial adviser with client-facing offices in 24 locations nationwide. We are the leading provider of audit services in the local public audit market and have a longstanding reputation for our work with local authorities, public health bodies and other public organisations, including housing associations, further education colleges, universities and central government departments and related agencies.

Drawing on significant experience of working with local government and the wider public sector, Grant Thornton has the expertise and commitment to deliver tangible results for local authorities as they look at options for financing the future, adopting new delivery models in a landscape of greater partnerships and collaborations, and ensuring effective governance and risk management.

We understand and respect regional differences and are able to respond to local needs of local authorities. Our depth of experience ensures that our solutions are grounded in reality and draw on best practice, as we work to deliver proactive, client-centric relationships, and the required services in a distinctive and personal way.

About CIPFA

CIPFA is the world's only professional accountancy body to specialise in public services. That means our knowledge of the sector and the challenges that lie ahead is unrivalled. Our members work across the public sector, often at the highest levels and bring their very relevant expertise to the roles they occupy.

Setting the standards

As the standard setter for local authority accounting, we work with central government to help shape the new public finance landscape and ensure that taxpayer's money is spent wisely and accounted for as efficiently as possible.

Tackling the issues of the day

In response to the scale of the challenges faced by leaders in public finance, we're developing products and services to support all parts of the public sector as they tackle the issues of the day.

Helping at home and overseas

Our work covers England, Scotland, Wales and Northern Ireland, and our regional presence is essential in the delivery of services for the benefit of local communities. Internationally, we work with donors, partner governments, accountancy bodies and others to advance public finance and governance to support better public services.

For more information about our products and services visit www.cipfa.org.uk, or the Better Governance Forum website, at www.cipfanetworks.net/governance/

Appendix: methodology

We surveyed 702 organisations by email during February and March 2012, and asked Heads of Internal Audit around the United Kingdom a range of questions relating to internal audit. The poll focused on the year 2011/12 as its base, with forward-looking questions covering 2012/13 and 2013/14.

97 responses were received representing 21% of the local authority bodies (including police and fire) polled and 4% of health and other bodies. Owing to the small number of responses received from the health sector we have not separated out the findings.

The responses were collated and analysed by CIPFA Information Services.

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