

# **Scottish Government**

Strategic review of Internal Audit

## **SUMMARY FINAL REPORT**

December 2015

# 1. Introduction

## Introduction

The Scottish Government currently controls annual resources of around £37 billion and is a unique and complex organisation. It is also an organisation going through a period of significant change in outlook and delivery requirements. Key challenges going forward include the implementation of the Scotland Act 2012, the creation of Revenue Scotland, the further devolution of powers and responsibilities to the Scottish Government through the Smith Commission, increasing fiscal autonomy and budgetary pressures and a need to move from a spending environment to an income/expenditure landscape. The Scottish Government 2020 strategy is preparing the organisation to respond to these challenges.

This is exactly when Internal Audit should be stepping up to be more prominent and be resourced to respond confidently to these challenges.

Internal Audit is one of the cornerstones of good corporate governance and the Scottish Government needs to ensure that the Internal Audit function is fit for purpose and provides a valued and respected service to the organisation and a wider community of public bodies in Scotland.

The Interim Head of Internal Audit was requested to undertake an independent and objective strategic review of the Scottish Government's (SG) Internal Audit Directorate to help shape the future leadership requirements of the Internal Audit Division, including recommendations for service improvement and consideration of delivery structure, staffing levels, approaches to resourcing and training requirements. The review will also help determine what skill set and qualities are needed for the future leader to place Internal Audit at the forefront of best practice going forward, as well as identifying innovative and added value aspects of the service to improve the overall profile of the Scottish Government's internal audit function.

This full report will be shared with key stakeholders including the Scottish Government Executive Team, SGARC and PARC members and the Internal Audit team.

A summary version of the report will be shared with other key stakeholders including ARC members from the Public Bodies, NMDs and NDPBs serviced by IA and Audit Scotland. (See full list of clients in Appendix B).

## Scope

The scope of the review focussed on the 3 key areas of Purpose and Mandate, People and Approach and considered the following key areas. The report is structured under these key headings:

Purpose and mandate	➤ IA are aligned to the expectations of the Audit and Risk Committee(s) and management. IA are responsive to changes in the business and focused on the key areas of risk to the organisation.
People	➤ IA has appropriate leadership and influence across the organisation to respond to the changing risk profile and client requirements from IA. ➤ IA has the right level of staff with the right skills and experience to provide assurance on complex risk areas.
Approach	➤ The IA approach delivers consistently good quality work and appropriately leverages tools and technology.

*The review did not assess the level of compliance with Public Sector Internal Audit Standards (PSIAS) or the Institute of Internal Audit (IIA) Standards as this is done annually by Audit Scotland to enable them to place reliance on IA work. An independent external review of compliance with the above standards was also completed in 2013 by the Northern Ireland Civil Service Internal Audit team.*

## Approach

The review was based on:

- interviews with selected key stakeholders in Internal Audit (IA) from across SG and other bodies (see Appendix A);
- Survey results from key stakeholders and the Internal Audit team (see Appendix A);
- Review of key information relating to IA; and
- Benchmarking to assess the current state of IA against knowledge and experience of leading practice including private sector organisations.(see Appendix D).

## 2. Executive summary

### Strategic assurance to meet tomorrow's risks

The IA function and team has clearly been under considerable resource pressures over the past year delivering Internal Audit services to a complex portfolio of clients, both within the SG and the wider public bodies who receive IA services, together with the increasing workload from the European Funding Audit Authority requirements. Resources were also stretched following the Head of Internal Audit taking early severance and the Deputy Head of Internal Audit being on maternity leave.

This has been well documented at Audit and Risk Committee (ARC) meetings and by Audit Scotland and has detracted from the full delivery of the Internal Audit plans across the SG portfolio and the quality and timeliness of the work delivered. This was borne out from the interviews and surveys conducted and is recognised by the Internal Audit team.

The key areas for improvement which will require strategic investment in people, knowledge, technology and methodology are summarised below:

- The **appointment of a Director level Head of Internal Audit (HoIA)** is critical to enable the step change required in IA. The HoIA needs to demonstrate gravitas, impact and influence across the organisation and the leadership required to reposition internal audit from a compliance function to a trusted and valued business advisor.
- The **structure and resourcing** options for the team need to be addressed given the resource pressures of European Funding audit work and the changing risk profile and therefore the skills required within IA. Suggested options include a **separate, ringfenced team to deliver the European Funding audit work** and the use of a **co-sourced arrangement** with an external provider to access specialist resources. This would include access to specialist skills such as IT, cyber, digital, project management and change management and provide additional resource to cover any resource shortfalls and ensure the IA team is kept up to date with developments in internal audit, risk management and governance in both the public and private sectors and help develop the capacity and capability of the IA team.
- **Professionalising IA** by refreshing the IA approach, methodology and quality assurance processes to consistently perform quality audits. There are clear opportunities to improve the effectiveness and efficiency of internal audit by using the Lean methodology and data analytic tools. The key areas to be considered should include: developing engagement and communication protocols with stakeholders; defining the roles and responsibilities of the IA management and team; clarifying the levels of assurance and escalation protocols; and developing an IT strategy to include data analytics.

However, to provide balance, there were also a number of positive attributes noted which demonstrate that there is a solid platform to build from:

- Stakeholders support the vision for IA changing with the recruitment of the new Director level Head of IA.
- Stakeholders recognise the priority and demands of the European Funding audit work and the challenges faced by IA.
- The IA team are self aware and fully supportive of the need to change, develop and professionalise IA.
- Audit Scotland place reliance on IA work.
- IA have “kept the show on the road” and “get the basics right” despite resource challenges.
- IA are appropriately independent and objective.
- The new managers appointed in 2014/15 are already making a positive impact and have generally improved communication and co-ordination with stakeholders including ARCs.
- IA plans are generally aligned to current key risk areas across business areas.
- The IA team demonstrate flexibility in planning and approach to accommodate client requests.
- IA have acted as a trusted “critical friend” on some key projects.
- The underlying quality of IA work is well respected by stakeholders.
- Regular liaison with the risk management team
- External peer assessment regularly performed (latest in 2013 by Northern Ireland Civil Service).
- IA have engaged in recent developments to improve shared services across the Scottish Government.

## 2. Executive summary (continued)

### **Benefits to the Scottish Government of a transformed Internal Audit service**

- IA viewed by stakeholders as a valued business advisor, improving the Scottish Government's overall performance and achievement of 2020 vision.
- Timely and insightful IA engagement and communications with key stakeholders increasing confidence to meet changing stakeholder needs.
- IA proactively anticipating and addressing risks faced by the organisation during a period of significant change.
- Enhanced governance and assurance on European Funds work.
- Audit effort focused upon level of risk, leveraging technology and implementing innovative techniques to drive effectiveness and efficiencies.
- IA providing a balance of assurance on compliance activities and strategic risk areas and delivering business insights.
- Strong foundation for IA to continue to develop its approach and team enabling them to be agile and flexible to adapt to SG's changing needs and increase the value delivered.

# 3. Summary of key findings and recommendations

A summary of the key findings and recommendations and the value to the SG is set out below. The priority of the key recommendations has been assessed taking into account the level of effort required to implement. Recommendations in italics represent those actions currently being addressed and which the deputy HoIA will complete following her return from maternity leave in November. The detailed findings and recommendations for each area are set out in section 4 of this report.

Focus area	Key findings	Key recommendations		Value derived
		Quick Wins (0-3 months)	High effort (3-12 months)	
<b>Purpose and mandate</b>	<p>Shareholders are looking to value strategically and to be aligned to their needs.</p> <p>Whilst IA delivery of compliance /assurance reviews is valued, stakeholders are looking for IA to drive improvement in performance.</p>	<ol style="list-style-type: none"> <li><i>HolA and IA leadership team should engage at senior level with key stakeholders and demonstrate appropriate leadership and impact and ensure IA are focused on current and emerging risks.</i></li> <li><i>Develop engagement protocols with stakeholders to capture and meet the needs of the stakeholders' assurance requirements.</i></li> <li><i>Develop IA's brand and reputation to ensure stakeholders understand and recognise the value IA can contribute. For example, attendance at relevant business forums to share insights on emerging risks and hot topics to improve the reputation of IA.</i></li> <li><i>The IA reporting line to DG Finance with an escalation route to the Permanent Secretary and the Chair of SGARC should be formally considered and approved.</i></li> </ol>	<ol style="list-style-type: none"> <li><i>Consider merging IA and Risk functions with appropriate seniority to ensure senior engagement and improve alignment of risk and IA.</i></li> <li><i>Measure and report on stakeholder satisfaction formally through annual Assessment of Service Quality process to be conducted independently (ASQ).</i></li> <li><i>The requirements for the assurance mapping exercise should be clarified together with the timelines and responsibilities to enable the exercise to be completed to understand the levels of assurance provided across different assurance functions, identifying areas of duplication and gaps.</i></li> </ol>	<p>IA engaging at right level and delivering stakeholder needs.</p> <p>Value adding assurance with business and commercial insights to drive improvements in performance.</p>
<b>People model</b>	<p>Stakeholders view the director level appointment of the new HoIA as critical to enable the step change required in IA. Given the resource challenges, the structure of the team needs to be addressed.</p>	<ol style="list-style-type: none"> <li><i>Appoint Director level HoIA to achieve the step change in performance and reputation required.</i></li> <li><i>Restructure IA team with "ringfenced" European Funds (EF) audit team and resources to deliver to deliver EF work and pull in additional resources as required. See appendix B for proposed team structure.</i></li> </ol>	<ol style="list-style-type: none"> <li><i>Consider the current skills of IA and EF resources to ensure sufficient experience to meet changing SG needs.</i></li> <li><i>Develop a resourcing model for IA including utilising subject matter specialists from other parts of SG to input into specific audits, co-source arrangements, secondments and graduate recruitment.</i></li> <li><i>Develop appropriate training programmes for IA and EF team to provide career development and succession planning.</i></li> </ol>	<p>Credible, relevant team who share knowledge and insight from experience across SG and wider client base with appropriate stakeholder engagement.</p> <p>Increased quality of assurance on European Funds</p>
<b>Approach</b>	<p>The quality and value of IA could be enhanced by the consistent application of a refreshed IA methodology which leverages tools and technology more effectively.</p>	<ol style="list-style-type: none"> <li><i>Develop IA and EF engagement and reporting protocols to ensure appropriate engagement and sponsorship from senior management.</i></li> <li><i>Proactive scheduling and "lockdown" of IA and EF reviews to meet stakeholder expectations and minimise delays to the delivery of the annual plan.</i></li> <li><i>IA year to be aligned to accounting year to avoid future confusion for annual assurance statements for stakeholders and Audit Scotland.</i></li> <li><i>IA operational procedures need to be strengthened including formal project management and resource planning procedures to enable more efficient and effective operations and tracking.</i></li> </ol>	<ol style="list-style-type: none"> <li><i>Refresh the audit methodology for both IA and EF to drive consistency in quality of work performed, follow up on agreed actions, and documentation produced enhancing the value derived from individual audits and meet requirements from Audit Scotland and European Commission.</i></li> <li><i>Provide training to the IA and EF teams on the revisions.</i></li> <li><i>Review integrated assurance reporting to ARCs to enable more streamlined reporting process.</i></li> <li><i>Develop a strategy for the use of data analytics to be embedded in the audit methodology going forward to improve efficiency and effectiveness.</i></li> <li><i>IA recharging mechanisms to be revisited Including potential to recharge all clients for advisory work) and standardised via Shared Services Working Group to help self funding of IA going forward.</i></li> </ol>	<p>Consistent quality and approach to delivering effective assurance for both IA and European Funds.</p>