

Mr PATTISON

*B/F Party*

*Something is on its way from Tsg*

*MAP 1/4*

INTERNAL AUDIT

1. I refer to Mr Whitmore's letter of 20 March to Mr Wiggins saying inter alia that the Prime Minister would like to be informed of the main elements in the programme of reform referred to by the Chancellor in his minute of 11 March, preferably before officials appeared before the PAC in April.
  
2. I understand that central department officials give evidence on Monday 6 April. I think it important that the PM should have an opportunity to comment and I suggest that if nothing has been heard by Thursday morning 2 April the Treasury should be prodded firmly.
  
3. You might like to have for your file a copy of the Bancroft/Wass letter of 20 March as issued to Permanent Secretaries and of the record of discussion by a few of them under Sir Douglas Wass's chairmanship on 24 March in SY.

*CP*

C PRIESTLEY  
31 March 1981

Encs: As indicated



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Sir Douglas Wass GCB  
Permanent Secretary

Sir Derek Rayner  
Cabinet Office  
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LONDON  
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20 March 1981

*Mr. Patten*  
*Please add to pp.*  
*and return to me.*

*Mr Priestley*

*25.iii.81*

See Flag on file.

*ME*  
*25/iii/81*

Dear Derek,

INTERNAL AUDIT

Thank you for your letter of 17 March.

I enclose a copy of the letter to Permanent Secretaries which Ian Bancroft and I have just sent out. It was amended to reflect a number of the comments which you, Ken Sharp and Clive Priestley made on the previous draft. In particular, referring to your own letter, it makes clear in paragraph 9 and elsewhere that the Treasury is in the lead, although there are matters on which the CSD will in the normal course be consulted.

*Good*

We have not made amendments to reflect the comments in paragraph 6 of your letter to me, since we shall have to work up the more precise documents we agree will be needed in consultation with the departments concerned. Geoffrey Littler proposes to hold an early meeting of Principal Finance Officers, and to develop with them and with the AFA Division a programme of work and priorities and arrangements for keeping track of progress.

*Good*

On the remaining points you make, we did not feel that we should go so far as to give instructions to our Permanent Secretary colleagues to set up Committees and select fast-stream principals. Those will not in all cases be the sensible answers, and I think we must leave some freedom to Permanent Secretaries to choose their own best methods of management.

*See PR suggested "advising" Com. Sec. to set up Audit Committees*

I am copying this letter to Ian Bancroft and Ken Sharp.

*Yours ever,*

*Douglas Wass*  
DOUGLAS WASS

*that the centre "would expect" Dept. to place of fast stream principals in newly developing internal audit areas.*

HM TREASURY  
Parliament Street  
LONDON  
SW1

CIVIL SERVICE DEPARTMENT  
Whitehall  
LONDON  
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20 March 1981

*Dear Brian,*

INTERNAL AUDIT

We are writing jointly to you, after consultation with the Head of the Government Accountancy Service, about the general problem of the quality of internal audit service-wide, in the light of three recent indications of the need for fresh attention and action in this field.

2. Of particular importance is the Memorandum submitted by the C & AG to the Public Accounts Committee, analysing a recent survey by the Exchequer and Audit Department of internal audit in departments. It is subject to Parliamentary privilege until the PAC publishes it, but we enclose a copy, with Douglas Henley's agreement, on a confidential basis. The Memorandum is highly critical. Its message is that the general standard of internal audit units is too low and is particularly inadequate in relation to the audit of computer-based systems. These faults are attributed to insufficient involvement at senior levels in departments, a lack of professional skills and management within the audit units, personnel policies which result in staff being engaged in internal audit for too short a period, and inadequate direction from the centre.

3. The two other pieces of evidence are the results of surveys commissioned by the CSD last year on aspects of computer audit. Copies of these are also enclosed. They also report serious deficiencies.

4. These criticisms do not apply with equal force to all departments. We have already seen some comments from those who feel that they are not wholly fair. There will be opportunity later, when the report is published, to deal with its contents in more detail. But we believe that the need is demonstrated to bring the performance of internal audit up to an acceptable standard.

5. This is not just a matter of defence against criticism. Effective internal audit is an essential service for departmental management. The investigations of the Exchequer and Audit Department are no substitute for an efficient internal audit. They fulfil a different purpose; the C & AG reports to Parliament, whereas internal audit serves departmental management.

6. The range and purpose of internal audit are set out in paragraphs C 21-24 of Government Accounting. This makes clear the

Sir Brian Hayes KCB  
Ministry of Agriculture, Fisheries and Food  
Whitehall Place  
SW1

importance of an effective system to the department, particularly to the Permanent Secretary and his senior management. It is the business of internal audit to report not only on propriety, security, completeness and accuracy of departmental activities and transactions, but also on the reliability and efficacy of financial control systems. In short, internal audit is a potent weapon to help us control our businesses, look after our assets, and secure value for money. The Head of Internal Audit should have direct access to the Principal Finance Officer, and where necessary to the Head of the Department; and get real and visible backing from them.

7. The Treasury, with the help of the CSD, has an important part to play in bringing about improvements in internal audit. The imminent transfer from the CSD to the Treasury of the Accountancy Finance Audit Division will bring together under Treasury leadership the responsibility for setting standards and procedures in Government financial control, including internal audit, and the professional capability of developing and monitoring the standards and procedures, and helping departments to make cost effective use of their own internal audit resources. Work has already begun on producing fuller audit standards and guidelines, an audit manual, and a wide range of specimen documentation. A new computer audit manual will be produced.

8. Help from the centre must extend beyond issuing written guidance. The Treasury and the CSD are reviewing the range of assistance they can provide, including help on recruitment and training.

9. Much must depend on action by individual departments themselves. Specifically we ask you, and the Permanent Secretaries of all major departments:-

- (i) To take a personal interest in reviewing and improving your internal audit arrangements and in ensuring that their importance is understood by, and recognised in relations with, Principal Finance Officers and Line Managers. You may wish to consider establishing an Audit Committee, chaired at senior level. Some departments have found this useful.
- (ii) To ensure that your Head of Internal Audit is suitably experienced, of appropriate grade, and preferably professionally qualified. We ask you to review the statement of objectives of internal audit in your department, and the job description of the Head of Internal Audit, and to submit them to the Treasury for approval by 30 September 1981. Where the description or grading of the job is to be altered you should also let us have your proposal for ensuring that the post is appropriately filled at the earliest possible date. All new appointments to the post should be cleared with the Treasury, and this will become the standard practice in future.

[Only]

- only*
- (iii) To agree with the Treasury on a provisional basis, at latest by 30 June 1982, the composition of your internal audit section. The development of these sections will have to be progressive, and it is unlikely to be completed until an appropriately qualified Head of Audit has been in post for some months and has brought his judgement to bear.
- (iv) Where the department has substantial computer operations, to agree with the Treasury by the end of this year a course of action to bring audit to an acceptable standard within three years.

You may want to consult the Treasury and the CSD on these actions, well ahead of the dates given, and we would welcome your doing so. On items (ii) and (iii) the point of contact will be Geoffrey Littler in the Treasury. On more technical audit questions and on computer audit, your people should get in touch with Edwin Walker, in AFA Division, Treasury. Where new posts above delegated levels or other matters affecting the CSD are involved, that department should be consulted in the normal way.

*ended at  
part A.*

10. We recognise that the necessary improvement in the standards of internal audit in all departments will be a very large exercise. However the C & AG concludes that the need is not necessarily for larger numbers overall, but for a greater proportion of more professional, highly graded staff. We cannot do everything at once, but it is important to set and keep up momentum.

11. There will be much to be done in developing and placing adequately qualified people to work in internal audit. We think you should ask yourself whether your personnel management arrangements will ensure that adequately qualified people are available to be posted to internal audit, receive any further training that is necessary, and are retained in the internal audit section for sufficient periods (normally not less than four years) to meet the needs of the work. The current proposals for a functional specialism are relevant, as they provide some central involvement in the management of staff trained and experienced in accounting-type work, and our hope is that it will provide a substantial impetus to the input of professional accountancy skills. We believe that the importance of internal audit justifies allocating to it a due share of really able staff, both accountants and others. Periods of duty in internal audit should swell the cadre of people from whom senior financial staff can in the future be drawn.

*ew*

12. The key posts are those of the Head of Internal Audit and the senior staff who help him to plan and supervise the work. It must be our aim to produce and train officers who can occupy these posts with full competence within the Civil Service. This however will take time. In a number of cases it may be necessary initially to use outside consultants, particularly on computer audit, though we have to recognise that there is a nationwide shortage of people with the combination of computer and audit skills. When we know the size of the demand (see paragraph 9(ii))

above), we shall consider with you what needs to be done in order to inform the unions, find appropriate candidates and settle terms and conditions.

13. Training will be a particularly important part of our efforts, and we will welcome assessments from departments of their training needs, as soon as these can be made, so that we can provide the most effective assistance. The Treasury and the CSD, in consultation with departments, will specify minimum training standards. From this specification, and the forecast of needs which departments provide, we shall be able to build up a picture of the resources needed for development and training; and as departments develop their plans further, they should keep in close touch with the College and the centre so that training resources can be developed to meet departments' needs. The Civil Service College is already planning improvements in training, including seminars for senior audit managers and on the audit of more advanced computer systems and departments will be kept informed of all further developments in the training plans of the CSD and Treasury.

14. This letter is being copied to the Permanent Secretaries of major departments on the attached list. We felt that it was right to start with these departments, but a similar letter will be issued shortly to other, smaller, departments, in a slightly different form to recognise their particular problem.

*Your ever*

*Douglas Wass*

DOUGLAS WASS

*Ian Bancroft*

IAN BANCROFT

## 3. INTERNAL AUDIT

The Committee had before them a letter of 20 March 1981 from the Permanent Secretaries of the Civil Service Department (CSD) and of the Treasury to the Permanent Secretary, Ministry of Agriculture, Fisheries and Food, and copies of a forthcoming memorandum by the Comptroller and Auditor General (C and AG) on Internal Audit in Central Government and of reports prepared by the CSD on Computer Audit Review and on Computer Audit Training in Government Departments.

SIR IAN BANCROFT said that the C and AG's report would be published shortly. The criticisms in it of Departmental internal audit arrangements were a matter of grave concern, and the Public Accounts Committee could be expected to follow them up vigorously. Although the situation varied between Departments, it was clear that major changes would be required, especially in relation to computer audit, to ensure that arrangements were brought up to a sufficiently high standard for the future. The CSD's own reviews of computer audit had pointed to the lack of relevant expertise in Departments and to the urgent need for training of existing staff and for the recruitment of appropriate specialists. For the future it would be important for Departments to assign, from within their present manpower ceilings, more able and better trained staff to internal audit. While it was extremely important to remedy the defects identified by the C and AG and by the CSD it would be a mistake to think that this could be done quickly by crash solutions rather than an evolutionary approach. It was now becoming easier to recruit outside accountants, and steps were being taken to improve the training offered by the Civil Service College; but it would probably be some years before the important defects identified in the present arrangements had been rectified.

In discussion the following were the main points made -

- a. Although the report by the C and AG had identified important defects in the present arrangements, which would need to be remedied, it did not give sufficient weight to the mechanisms within Departments, other than internal audit, for ensuring that public money was properly applied.

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No mention was made of responsibilities of line management, and there was no discussion of whether it might be better to develop management audits as well as to improving the existing arrangements for internal audits.

b. The C and AG's report, and the letter of 20 March from Sir Ian Bancroft and Sir Douglas Wass, were insufficiently clear about the precise functions and objectives of internal audit. There was an unacceptable inference in the C and AG's report that most of the routine audit work should be undertaken by Departmental internal audit sections with the Exchequer and Audit Department responsible for the rest. While the C and AG rightly pointed to matters which needed examination and improvements, his report included many generalisations which should not be allowed to pass unchallenged.

c. To achieve the necessary improvements in the present arrangements would require a sustained and carefully-planned programme of action. A major problem was the lack of skilled auditors in the Civil Service and the fact that not all of the existing trained staff were sufficiently able to become Departmental Head of Audit. The first priority was, therefore, for each Department to assess its requirements, then to see what resources were available throughout the Civil Service, and then, perhaps, to redistribute those resources. It would also be important to recruit auditors from outside the Civil Service at an appropriately senior level. This could be difficult since the levels of pay offered to auditors in the Civil Service had in the past been a barrier to the recruitment of able people, but in the present economic climate it should be possible to recruit suitable people from outside at about Principal level. Departments might also consider drawing up for the medium term an audit development plan in consultation with Central Departments. To avoid unnecessary duplication of effort some co-ordination by Central Departments would probably be necessary, especially in the case of those smaller Departments which at present had no qualified accountants on their staff and therefore had no base on which to build for the future. In allocating existing resources, priority would need to be given to particularly sensitive areas, such as Computer audit, and steps should be taken to ensure that auditors were involved in the design of computer programmes.



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SIR DOUGLAS WASS, summing up the discussion, said that a great deal of effort would be required before the present internal audit arrangements were satisfactory, and it was therefore important that Departments should embark on this task as soon as possible. The detailed arrangements discussed in the letter of 20 March to Permanent Secretaries would be the subject of further consultation with Departments. The Treasury and the CSD were due to give evidence early in April to the Public Accounts Committee. This would provide a public opportunity to describe the steps proposed to remedy the defects identified by C and AG and perhaps to refer to some of the defects ~~of that~~ identified in discussion; and before giving evidence the Treasury and the CSD would discuss this further with PFOs. ||

The Committee -

Took note, with approval, of the Chairman's summing up of their discussion.

Cabinet Office

26 March 1981

CONFIDENTIAL

*JMA* you Mack

[Blind copy:  
- Mr Pattison]



CABINET OFFICE

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25 March 1981

Sir Douglas Wass GCB

*Sir Douglas,*

INTERNAL AUDIT

Many thanks (in Derek Rayner's absence in Canada) for your letter and enclosure of 20 March. He will see it (together with the letters sent to the Chancellor on behalf of the Prime Minister on internal audit and Accounting Officers) on his return at the end of next week.

I am copying this to Ian Bancroft and Ken Sharp.

*Yours ever,*  
*Clive Priestley*  
C PRIESTLEY