

cc. to Mr. Wolfson

SUBJECT

JS

cc CSD
CO
Mr. Wolfson



10 DOWNING STREET

From the Private Secretary

7 May 1981

INTERNAL AUDIT AND FINANCIAL CONTROL

The Prime Minister held a meeting at 1700 hours on Tuesday 5 May with Sir Douglas Wass, Sir Ian Bancroft, Sir Derek Rayner and Mr. David Wolfson. The purpose of the meeting was to review the programme for improving the quality of internal audit within the Civil Service described in the letter of 20 March from Sir Douglas Wass and Sir Ian Bancroft to Sir Brian Hayes and other Heads of Departments. This programme had been prompted by a memorandum from the Comptroller and Auditor General reviewing Departments' internal audit systems, completed in February 1981.

The Prime Minister expressed her concern at the apparently tentative nature of the proposed programme. She recalled that Mr. Whitmore had written to Mr. Wiggins on 20 March emphasising the need for all Departments to review their audit systems. She was therefore concerned at the apparent lack of urgency in the deadlines set out in the letter to Heads of Departments for reviewing the objectives of their internal audit sections, for deciding the job descriptions of the heads of these sections, for agreeing the composition of these sections, and for reviewing computer audit systems. To make progress quickly outside consultants should be retained to scrutinise internal audit systems within Departments, and perhaps to look as well at the wider question of financial control systems as a whole. It was not enough for Departments to concentrate on simple accountancy and the detection of abuse: there was a clear need for greater efficiency in the use of resources. This suggested that there was perhaps a need to review not just audit systems but also investment appraisal techniques, and for giving finance staff within Departments a stronger voice in decisions on investment control.

Sir Douglas Wass and Sir Ian Bancroft explained that the system of Cabinet Government delegated considerable responsibility to Ministers and Departments, and this limited the freedom of the Treasury and the CSD to require Departments to take action. But they had impressed on Heads of Departments the urgent need for action on internal audit and they believed that their words had been heeded. Moreover, the fact that there were deficiencies in internal audit systems did not necessarily mean that control

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systems generally were inadequate. The criticisms of the Comptroller and Auditor General had been confined solely to departmental internal audit systems. There was a group within the Treasury headed by Mr. Littler studying resource and financial management. There was also the Accountancy, Finance, and Audit Division of the Treasury, which could provide Departments with a management consultancy service. The deadlines set for the review programme on internal audit might appear long, but Departments were large and the task was considerable.

Sir Douglas Wass said that political and other considerations sometimes meant that decisions on investment issues were not based strictly on financial factors. It was the duty of departmental Finance Officers and the Treasury, to ensure that Ministers were aware of the financial consequences of their decisions. It was not necessarily the case that investment appraisal systems were inadequate or that finance staff did not have sufficient expertise.

Sir Derek Rayner said that in his experience it was not possible to rely on line management, even in large companies, to introduce internal audit systems. Outside advice on systems and instruction on how best to use them were needed. Such training was required at all levels, but it was particularly important for senior management to recognise the value of internal audit. The Civil Service was lagging behind the best practices outside. The necessary training and advice could perhaps be best provided by a group of outside consultants retained by the Treasury for one or two years. They would help build up the small central unit that would be needed to give Departments the leadership they would require when introducing and keeping up to date the best internal audit practices.

As regards investment appraisal, the assumptions used were often over-optimistic. On other occasions, Principal Finance Officers were over-ruled for political reasons. There might be a case for giving Principal Finance Officers the option of reporting to the Treasury when decisions were taken by their Departments against their advice.

The Prime Minister, summing up the discussion, said that it would be helpful if Sir Douglas Wass, in conjunction with Sir Derek Rayner, could arrange for case studies to be carried out of internal audit systems as they operated now in one or two Departments. The agreement of the Ministers and Permanent Secretaries concerned would need to be sought. The help of outside management consultants should be used. Mr. Wolfson would consult Sir Arnold Weinstock to see whether he could suggest suitable consultants.

I am copying this letter to Jeremy Colman in Sir Ian Bancroft's office and to Clive Priestley in Sir Derek Rayner's unit.

(SGD) W. RICKETT

J.M.G. Taylor, Esq.,
HM Treasury.

cc Mr Wolfson A type

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7/5

DRAFT LETTER TO PRIVATE SECRETARY TO SIR DOUGLAS WASS

Internal Audit and Financial Control

The Prime Minister held a meeting at 1700 hours ^{on Tuesday 5 March} yesterday with Sir Douglas Wass, Sir Ian Bancroft, Sir Derek Rayner, and Mr. David Wolfson. The purpose of the meeting was to review the programme for improving the quality of internal audit within the Civil Service described in the letter of 20 March from Sir Douglas Wass and Sir Ian Bancroft to Sir Brian Hayes and other Heads of Departments. This programme had been prompted by a memorandum from the ^{Comptroller} ~~Controller~~ and Auditor General reviewing Departments' internal audit systems, completed in February 1981.

The Prime Minister expressed her concern at the apparently tentative nature of the proposed programme. She recalled that Mr. Whitmore had written to Mr. Wiggins on 20 March emphasising the need for all Departments to review their audit systems. She was therefore concerned at the apparent lack of urgency in the deadlines set out in the letter to Heads of Departments for reviewing the objectives of their internal audit sections, for deciding the job descriptions of the heads of these sections, for agreeing the composition of the sections, and for reviewing computer audit systems. ^{To make progress quickly} ~~She said that in her view this demonstrated that there was a need for outside consultants to~~ be retained to scrutinise internal audit systems within Departments, and perhaps to look ^{as well} at the wider question of financial control ^{a whole} systems as ~~well~~. It was not enough for Departments to concentrate on simple accountancy, and the detection of abuse; there was

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a clear need for ~~a~~ greater efficiency in the use of resources. This suggested that there was perhaps a need to review not just audit systems, but also investment appraisal techniques, and for giving finance staff within Departments a stronger need ~~will~~ ⁱⁿ for decisions on investment control.

Sir Douglas Wass and Sir Ian Bancroft explained that the system of Cabinet Government delegated considerable responsibility to Ministers and Departments, and this limited their freedom ^{of the Treasury and the CSD} to require Departments to take action. But they had impressed on Heads of Departments the urgent need for action on internal audit. Moreover, the fact that there were deficiencies in internal audit systems did not necessarily mean that control systems ~~overall~~ ^{generally} were inadequate. The criticisms of the ^{sup} Controller and Auditor General had been confined solely to departmental internal audit systems. There was a group within the Treasury headed by Mr. Littler studying resource and financial management. There was also the ^{of the Treasury} Accountancy, Finance, and Audit Division which could provide Departments with a management consultancy service. The deadlines set for the review programme on internal audit might appear long, but Departments were large and the task was considerable.

~~On the question of investment appraisal raised by the Prime Minister,~~ Sir Douglas Wass said that political and other considerations ^{sometimes} occasionally meant that decisions ^{on investment cases} were not based strictly on financial ^{factors} considerations. It was the duty of ^{departmental} finance officers, and the Treasury, to ensure that Ministers

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and they believe that their words have been heard

were aware of the financial consequences of their decisions. It was not necessarily the case that investment appraisal systems were inadequate or that finance staff did not have sufficient expertise.

Sir Derek Rayner said that in his experience it was not possible to rely on line management, to ^{introduce} implement internal audit systems. Outside advice ^{on systems} and instruction ^{how best to use them} on ~~methods of~~ systems ^{were} was needed. Such training was ^{requested} needed at all levels, but it was particularly important for senior management to recognise the value of internal audit. ^{The Civil Service was lagging behind the best practices outside.} The necessary training and advice could perhaps be best provided by a group of outside consultants retained by the Treasury for one or two years. ^{of} Mr. Wolfson agreed with Sir Derek Rayner that there must be pressure on Departments from the Treasury and the CSD, and that Departments must be encouraged to take expert advice.

When in large companies,

They would help build up the small central unit that would be needed to give Departments the necessary ^{very important} leadership ^{in their} ~~introduction~~ and ~~help~~ ^{to} ~~set~~ ^{up} ~~the~~ ^{wise} ~~audit~~ ^{audit} ~~process~~.

^{As regards} On the question of investment appraisal, ~~Sir Derek Rayner~~ said that there was often a problem of optimism in the assumptions used for appraisal. ^{were often over-optimistic} ^{On other occasions (inquiry)} As Sir Derek Wass had said, Finance Officers were occasionally overruled. There might be a case for ^{giving limited} highlighting the importance of financial considerations by allowing Finance Officers ^{the option of reporting to the Treasury when} to deny accountability ^{was taken by their departments} for decisions taken against their advice.

to be carried out) * for 14

The Prime Minister, summarizing the discussion, said that it would be helped if Sir Douglas Hogg, in conjunction with Sir Derek Rayner, could arrange. In conclusion it was agreed that outside consultants should be retained to study the financial control and internal audit departments. ^{for case studies} ~~of internal audit systems as they operated now in one or two~~ ^{of} ~~departments.~~ ^{The help of} ~~management consultants should be used.~~ ^{external} ~~systems of perhaps two Departments.~~ The Controller and Auditor General's memorandum would give an indication of which Departments

should be chosen so as to give a representative sample.

*
to Mr. Wolfson

The agreement of the Ministers and Permanent Secretaries

concerned would need to be sought. ~~But as the first step~~

Mr. Wolfson would ^{consult} talk to Sir Arnold Weinstock ^{to see whether he could suggest} on the

~~question of suitable consultants. Sir Derek Rayner also~~

~~agreed to advise on suitable candidates. Sir Douglas Wass~~

~~agreed to discuss the terms of reference of these studies~~

~~with Mr. Wolfson and Mr. Priestley.~~

Since this meeting, } the Prime Minister has also }
approached Sir Gordon Richardson and Mr. Raisman of Shell }
for advice on suitable } outside consultants. }

I am copying this ^{with} to Jeremy Colman & in Sir Ian Bancroft's
Office ^{at} to Clive Priestley in Sir Derek Rayner's unit ~~and to~~
~~David Hoffman.~~



10 DOWNING STREET

From the Private Secretary

11 May 1981

C/7 file RB
cc: As below +
Mr Wolfson
Govt Mail

At the meeting last week on internal audit and financial control, it was suggested that the help of outside management consultants should be sought.

The Prime Minister had a word with the Governor about this last week. She asked in particular if he could suggest which firms could best help with improving our computer audit arrangements. The Governor has since telephoned me and, for what it is worth, I thought I should pass on to you what he told me. He said that, on the basis of advice he had taken from within the Bank, the following firms, and in the following order of merit, could help the Government:-

Cooper and Lybrands;
Ernst and Ernst;
Deloitte's;
Peat Marwick; and
Thomson McLintock.

I am sending copies of this letter to Ian Bancroft and Derek Rayner.

T. P. LANKESTER

Sir Douglas Wass, G.C.B.,
H.M. Treasury.

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