

Scottish Government

Review of Internal Audit 2020/21



 AUDIT SCOTLAND

Prepared by Audit Scotland

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Audit findings

Introduction

1. The Scottish Government is a large and complex organisation responsible for administering a budget of approximately £50.7 billion in 2020/21. The governance structures within the Scottish Government draw on several sources of assurance, including the work of internal audit within the Directorate of Internal Audit and Assurance. This aims to provide assurances that the framework of governance, risk management and internal control operates satisfactorily and that proper arrangements are in place for the prevention and detection of fraud and corruption. An efficient and effective internal audit function is a key element of good governance.

2. The Directorate of Internal Audit and Assurance (DIAA) was formed to provide an integrated approach to assurance and is headed by the Director of Internal Audit and Assurance. It encompasses:

- internal audit
- the Digital Assurance Office which administers the Technology Assurance Framework covering mandatory assurance for digital projects in central government
- the Portfolio, Programme and Project Assurance (PPA) Hub which manages independent assurance reviews including Gateway Reviews
- the Data Protection Officer.

3. During 2020/21, internal audit provided services to the Principal Accountable Officer (PAO) and the six Director-Generals within the Scottish Government as well as the Accountable Officers (AO) for 21 other public bodies (see [Appendix](#) for details). The Division of Internal Audit's (DIA) structure is based around portfolios of audit work broadly reflecting the wider structure of the Scottish Government.

4. Each year, as part of our appointment as external auditors, we obtain an understanding of DIA's responsibilities, its organisational status, and the activities performed, or to be performed. The DIA is required to comply with Public Sector Internal Audit Standards (PSIAS). The purpose of the PSIAS includes setting basic principles for carrying out internal audit and establishing a framework for providing internal audit services, which provide assurance and add value to the organisation, leading to improved organisational processes and operations.

5. The PSIAS are mandatory for all central government departments, agencies, and executive Non-Department Public Bodies. These standards define the role

of internal audit and its Code of Ethics and Standards. The Scottish Government is one of six Relevant Internal Audit Standard Setters including HM Treasury and the Chartered Institute of Public Finance and Accountancy.

6. PSIAS emphasise the importance of External Quality Assurance (EQA) which involves an independent review of the quality of internal audit work at least once every five years. The scope of our work assesses aspects of PSIAS compliance, but it does not equate to a full EQA review of internal audit. The last EQA was completed by the Institute of Internal Auditors (IIA) in 2018/19.

7. We also undertake a review of the Scottish Government's internal audit arrangements in accordance with International Standard on Auditing (ISA) 610 *Using the work of internal audit*. ISA 610 requires an assessment on whether the work of the internal audit function can be used for the purposes of external audit. This includes:

- the extent to which the internal audit function's organisational status grand relevant policies and procedures support the objectivity of the internal auditors
- the level of competence of the internal audit function
- whether the internal audit function applies a systematic and disciplined approach, including quality control.

8. A key purpose of our review is to determine the extent to which we can use internal audit work for the purpose of our external audit of the Scottish Government. Audit Scotland's [Code of Audit Practice](#) sets out the wider dimension of public sector audit. The Code highlights the importance of ensuring that auditors coordinate their work with internal audit to secure value for money and avoid unnecessary duplication.

9. This report summarises our audit findings for 2020/21. We reviewed internal audit's approach and planning, governance, and reporting, staffing and resources and quality assurance. We also considered our planned use of internal audit work in accordance with ISA 610.

10. Our detailed review of internal audit work was conducted during March to May 2021. As this coincided with Covid-19 pandemic restrictions, the detailed review work was completed remotely after DIA provided access to their systems (Galileo and ERDM).

11. We also share the results of our review with the external auditors of the other public bodies that use the services of internal audit.

12. The assistance provided by internal audit staff during the course of our review is gratefully acknowledged.

Key messages

13. Our work to meet the requirements of ISA 610 found that the improvements in the standard of internal audit work noted in the past two years continued during 2020/21. We did not find any areas of significant non-compliance with

the PSIAS. We did identify some areas for improvement, and these are referred to below.

14. The 2020/21 Annual Audit Plan noted that we would consider using the work of internal audit work as part of our audit. The reports considered are detailed at paragraphs 38-40.

15. During 2020/21, internal audit re-focussed their 2020/21 Internal Audit Plan to support the overall Scottish Government response to the Covid-19 pandemic. The revised plan focussed on enabling internal audit to provide targeted and timely advice and assurance on the Covid-19 response arrangements and included key areas such as corporate systems, certificates of assurance, counter fraud, and risk management.

16. Internal audit adopted a revised methodology for its work relating to the Covid-19 pandemic response. This allowed it to adopt a more agile approach but still maintain a documented audit trail over work performed as part of the Covid-19 response. We consider that the revised approach complied with the main requirements of PSIAS and was appropriate in the circumstances. There is scope for improvement to better demonstrate compliance with PSIAS in relation to documenting preliminary risk assessments, consistency of approach to documenting audit work, and evidencing of supervision and review.

17. We understand that the Internal Audit Manual is currently being reviewed, with a view to incorporating some aspects of the Covid-19 response methodology, where possible, to produce efficiencies and a more streamlined approach in the longer term. It will be important for DIA to ensure that demonstrating compliance with the PSIAS requirements is considered as part of this review.

Review of Internal Audit

18. This section sets out our review of internal audit covering its audit approach and planning, governance, and reporting, staffing and resources and quality assurance, and details our planned use of internal audit work in accordance with ISA 610.

Audit approach and planning

19. Internal audit takes a risk-based audit approach to planning. This includes consideration of key organisational risks identified in risk registers, consultation with senior staff and non-executive directors and is informed by its own understanding of key risk areas. The annual audit plans consist of thematic cross-cutting reviews, portfolio specific reviews and other work to provide assurance on the Scottish Government's core corporate systems. The Director of Internal Audit and Assurance (DIAA) together with her senior team liaise with Director-Generals, Directors, and other key stakeholders to ensure that the DIAA is aware of new systems, programmes, projects, and procedures for consideration for future work.

20. The 2020/21 Internal Audit Plan was due to be approved by the Scottish Government Audit and Assurance Committee (SGAAC) when the Covid-19 pandemic emergency arose in March 2020. In response to the pandemic, the original draft internal audit plan was re-focussed, and internal audit adjusted its approach to best support the overall Scottish Government response.

21. The DIAA's Progress Report to SGAAC in April 2020 identified the initial priorities for internal audit for the first few months of the pandemic. These were:

- to provide advice on the arrangements being put in place by the Scottish Government to maintain sound proportionate governance and effective and transparent decision making
- to test their compliance and effectiveness
- to provide direct support to specific areas
- to provide advice to key areas of risk where strong controls were critical to safeguard against exploitation at a time of potential vulnerability.

22. The 2020/21 audit plan was revised from Quarter 2 to Quarter 4 and focussed on enabling internal audit to provide targeted and timely advice and assurance on the Covid-19 response arrangements. The revised plan approved by SGAAC in September 2020 covered both assurance and advisory work and included key areas such as corporate systems, certificates of assurance, counter fraud, and risk management.

23. Reporting to SGAAC on progress against the 2020/21 audit plan has included details of progress at an individual audit level and changes to the plan were made clear. As at May 2021, internal audit reported that the substantive work associated with the 2020/21 plan is now complete with final reports due to be presented to SGAAC in June.

24. It will be important for internal audit to continue to review and revise its 2021/22 audit plan in light of the continuing Covid-19 response and ongoing budget and capacity pressures. This will help to ensure that it has the necessary coverage and its completion will be achieved in sufficient time to allow the DIA to provide her annual statement of assurance to the Permanent Secretary.

Governance and reporting

25. The Director of Internal Audit and Assurance has the right of access to the PAO (the Permanent Secretary), other Accountable Officers, the chair of SGAAC and other relevant audit committees to which DIAA provides a service. The Director of Internal Audit and Assurance reports to the Director-General Scottish Exchequer for line management purposes.

26. The PSIAS requires certain information to be reported to senior management and the board, including the audit charter, the audit plan, resource requirements and conformance with the code of ethics. This information is reported directly to SGAAC.

27. DIAA provide regular updates to SGAAC and the Director-General (DG) assurance meetings. Cross-cutting reviews are reported to SGAAC with other reports considered by the relevant DG assurance meeting. We have observed this arrangement operating in practice and consider it a reasonable approach. In 2019/20, we reported that there was scope for internal audit representatives to provide a greater contribution to DG assurance meetings over and above reports presented. This would help strengthen their role as third-line assurance providers in the Scottish Government's corporate governance model by providing challenge and support to DGs on all aspects of discussion, including key areas of risk, governance, and finance. We are pleased to see improvement in this area and look forward to the contribution becoming further developed and embedded.

28. Since the DIAA was formed in April 2019, it has been headed by the Director of Internal Audit and Assurance. The PSIAS require that in these circumstances, where the chief audit executive has responsibilities out with internal audit, safeguards are put in place to ensure the independence of internal audit is not impaired. In addition, the PSIAS also require the board to approve any safeguards put in place.

29. The 2019/20 DIAA Annual Report set out the safeguards in place to maintain the independence of internal audit. These were discussed with The Chartered Institute of Internal Auditors' External Quality Assessment team and SGAAC and considered appropriate. The safeguards reported were:

- the separation of internal audit resources and the retention of internal audit practices as set out in the audit manual
- the Director of Internal Audit and Assurance would not direct or control the development of the work plans for the teams out with internal audit
- the Director of Internal Audit and Assurance would in future report on activities across all three assurance areas to SGAAC, which will enable regular scrutiny of the activity
- periodic agreement would be sought from SGAAC that the structure is effective
- in 2020/21 the co-source provider would be asked to undertake a review of the other assurance teams within DIAA and assess whether there were any issues arising with regards to the independence and objectivity of the Director of Internal Audit and Assurance.

30. The 2020/21 DIAA Annual Report, including an update on the safeguards to maintain internal audit independence, is due to be presented to the June 2021 SGAAC meeting. The review which was due to be undertaken by the co-source provider has been delayed while a new approach to assessments carried out by the Digital Assurance Office is embedded.

31. We are not aware of any evidence that would suggest that these safeguards are not appropriate or not operating as designed. The DIAA has recognised that this approach needs to be monitored closely to ensure that any emerging risks are managed effectively.

Staffing and resources

32. The Scottish Parliament's financial powers have changed substantially with new responsibilities for taxes, social security and borrowing through the 2012 and 2016 Scotland Acts. Further devolved financial powers create new demands for internal audit skills particularly in new and complex areas such as tax and social security, including the audit of Social Security Scotland. The scale of change needed to implement and manage the new powers continues to be significant. In addition, there remains some uncertainty over the impact of the UK's withdrawal from the EU.

33. As noted in paragraph 20 above, the original 2020/21 internal audit plan was re-focussed in light of the Covid-19 emergency. Six internal audit staff were seconded to the Covid-19 Health Finance and the Coronavirus Legislation Co-ordination (Reporting) teams. The majority of staff were seconded between March and September 2020, with all staff returning to the division by November 2020. The redeployment of DIA staff did not significantly impact on the delivery of the re-focussed internal audit plan.

34. DIA produced a resourcing strategy and succession plan in February 2018 to be updated on a three-yearly basis, with the next update falling due in February 2021. The strategy recognised that a more structured approach needed to be taken to resourcing to ensure that internal audit had both the right

capacity and the relevant skills to meet the organisation's needs and included the introduction of a co-source partnership. The planned review and refresh of the plan was delayed due to the Covid-19 emergency response. The 2021/22 Internal Audit Strategy document presented to SGAAC in March 2021 notes that the review will now be undertaken in the first quarter of 2021/22.

Quality assurance

35. The Internal Audit Manual was significantly rewritten in August 2018 following a 'Back to Basics' project which involved reviewing internal audit's guidance and practices on working papers, documentation, quality assurance and peer review processes with the aim of ensuring best practice in these areas is embedded across DIA in line with the PSIAS.

36. Supplementary guidance was created in 2020/21 to allow a more agile approach but still maintain a documented audit trail over work performed during the Covid-19 pandemic response. This included a suite of templates covering planning, documenting, and reporting of internal audit work. Elements of the Covid-19 response methodology are being assessed for longer term adoption and, if adopted, will be incorporated into the Internal Audit Manual as appropriate during 2021/22.

37. Public Sector Internal Audit Standards emphasise the importance of External Quality Assurance (EQA) which involves an independent review of the quality of internal audit work at least once every five years, along with an internal review carried out at least once in the interim period. An EQA was completed by the Institute of Internal Auditors (IIA) in 2018/19 and the results were formally reported SGAAC in June 2019. Overall, the review concluded that DIA 'generally conforms' with the PSIAS. This was a positive outcome, reflecting the commitment made to the 'Back to Basics' project.

Planned use of internal audit work

38. As set out in our 2020/21 Annual Audit Plan, we seek to use the work of internal audit wherever possible. Our review in accordance with ISA 610 has given us assurance that, in general, the work of DIA is of a sufficient standard to consider using it to support our own audit work and conclusions.

39. We reviewed the 2020/21 Internal Audit Plan for the Scottish Government and considered using their review of Corporate Systems as part of our financial statements audit. Following the re-focussing of the original draft internal audit plan in response to the pandemic, the scope of the planned Corporate Systems work was reduced to focus on the Covid response. Consequently, we are unable to use this work to support our audit work in assessing the Government's main corporate systems.

40. We have also considered the crosscutting Governance and Risk Management Reviews as part of our wider scope audit.

41. The completed 2020/21 Internal Audit Plan includes eight assurance and five advisory assignments; this compares to fifteen assurance and four advisory assignments in the previous year. The re-focussing of the core Corporate

Systems audit work resulted in more advisory and less assurance work than previously planned. We recognise that responding to the pandemic was the main priority however, when preparing the 2020/21 annual opinion, it will be necessary to consider whether adequate assurance around the internal controls framework has been obtained.

Detailed review of internal audit work

42. As part of our 2020/21 audit work, we undertook a detailed examination of the work underpinning a sample of internal audit reports to assess compliance with PSIAS, and whether the improvements previously identified have been maintained.

43. We selected a sample of five audits completed as part of the re-focused 2020/21 Internal Audit Plan, covering three Scottish Government core and two other public bodies. The core audits selected (Covid-19 Governance, Risk Management and Finance Accountability Framework) were performed using the Covid-19 response methodology and the two non-core audits (Social Security Scotland Carer's Allowance and Transport Scotland Road Safety) were performed under the usual methodology, as set out in the Internal Audit Manual.

44. There were some key differences between the Covid-19 response methodology and the usual methodology, as set out in the Internal Audit Manual. These included:

- planning meetings did not require to be minuted and no formal risk assessment document was required, although the Terms of Reference template in the Covid response internal audit methodology includes a section on Risks
- audit work was mainly documented on ERDM instead of the Galileo system. Risk and control matrices were not required although an optional working paper template including risks and controls was available
- audit working papers did not require to be reviewed, although key documents such as terms of reference and draft reports were subject to review by senior staff.

45. Our reviews assessed whether the selected audits complied with the Internal Audit Manual or with the Covid-19 response methodology, as appropriate. We also assessed compliance with the main requirements of PSIAS in each case, assessing whether:

- the work was properly planned, performed, supervised, reviewed, and documented
- sufficient, appropriate evidence was obtained to enable the auditor to draw reasonable conclusions
- conclusions reached were appropriate and the reports prepared were consistent with the work performed.

46. We did not find any areas of significant concern and are pleased to record that the improvements in the standard of internal audit work noted in the past two years continued during 2020/21. We noted that the Covid response methodology generally conforms to the main requirements of PSIAS.

47. We identified some areas for improvement, primarily around ensuring that all reviews are documented consistently in line with the requirements of the manual or the revised methodology and the details have been shared with DIA.

48. While the revised approach was appropriate in the circumstances, there is scope for improvement to better demonstrate compliance with PSIAS in relation to documenting preliminary risk assessments, consistency of approach to documenting audit work, and evidencing of supervision and review. In addition, we noted that the working paper template developed as part of the Covid-response methodology was not used for any of the three audits that we reviewed. We were advised that the use of this template was optional however, in our view, use of the template would provide a consistent approach to documenting the audit work performed. Any action taken will help to improve the consistency and clarity of the work performed and further strengthen compliance with PSIAS.

49. We understand that the Internal Audit Manual is currently being reviewed, with a view to incorporating some aspects of the Covid-19 response methodology, where possible, to produce efficiencies and a more streamlined approach in the longer term. It is essential for DIA to ensure that demonstrating compliance with the PSIAS requirements is considered as part of this review.

Appendix

Public bodies using DIA services in 2020/21

Public bodies

Accountant in Bankruptcy

Community Justice Scotland

Crown Office and Procurator Fiscal Service

Disclosure Scotland

Education Scotland

Food Standards Scotland

Forestry and Land Scotland

National Records for Scotland

Office of the Scottish Charity Regulator

Registers of Scotland

Revenue Scotland

Risk Management Authority

Student Awards Agency for Scotland

Scottish Courts and Tribunals Service

Scottish Criminal Cases Review Commission

Scottish Fiscal Commission

Scottish Forestry

Scottish Housing Regulator

Scottish Public Pensions Agency

Social Security Scotland

Transport Scotland

Scottish Government

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