

# audit viewpoint

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## Driving leadership, performance and quality management in internal audit in Scottish local government

By Philip Atkinson, Dave Reynolds & Janine Wilson

### Introduction

In Scotland there are 32 local authorities and all differ in how they transact business. Because of the uniqueness of Scotland in terms of a few high population urban areas centred around Edinburgh, Glasgow and Aberdeen, the differing island communities and the

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variation in geographic and administrative spread in countryside areas, it makes it almost impossible to develop a 'one size fits all' approach to managing internal audit. However, it was possible to achieve how to focus on best practice and then suggest how these 'best practices' could be tailored to each.

Scottish Local Authorities Chief Internal Auditors' Group (SLACIAG) is the professional networking group for local authority heads of internal audit (HIAs). The purpose of the group is to develop and improve the practice of internal audit in Scottish local authorities, police, fire and public transport bodies. It achieves this by meeting to discuss issues of common concern, commissioning work to develop ideas, sharing good practice, working in partnership with other professions/governing bodies and promoting SLACIAG as the representative body for internal audit in public authorities.

## **Readiness for change in the public sector**

The serious financial pressures facing local government are proving to be a driver for change and, as change is often difficult, chief internal auditors in Scottish local authorities had recognised that there was a need to act to support each other through what was set to be a difficult and unsettling period.

A leadership, quality and performance change programme was identified as a development need to provide the tools and a platform for continuous improvement and a bespoke programme was commissioned from the Chartered Institute of Internal Auditors (IIA) to underpin this.

The reception of this development programme initiated by SLACIAG was greeted with an optimistic and enthusiastic response by their members. Expectations from participants were high but so were their spirits for the idea of changing and improving performance.

Philip Atkinson, Director of Learning Strategies Ltd and Dave Reynolds, Vice President of the IIA, devised the process underpinning the development programme and workshops, working closely with SLACIAG's executive committee. They also delivered the workshops, finding that the intellectual stretch and participation of attendees matched any they had experienced in the private sector.

## **Bespoke approach**

It is impossible to create a template that could be adapted and all local authorities could emulate in providing an internal audit service, but Dave drew on his experience as former director of internal audit with a FTSE 100 global company and director of MorganFranklin Ltd<sup>1</sup>, and provided much appreciated case material of how change can be implemented quickly if the 'will to change' is strong. Philip complemented this with appropriate leadership methods and strategies allowing the design and delivery of a comprehensive training workshop to provide personal development opportunities for SLACIAG members to support them in making the transition to that more strategic role and to meet the challenging times ahead. The workshops provided them with the impetus and input to achieve just that.

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1. MorganFranklin Ltd is a subsidiary of the MorganFranklin Corporation – a finance, management and technology consultancy based on the east coast of the United States.

## SLACIAG's expectations

The executive committee were acutely aware of the importance of the exercise they were about to undertake. They had been conscious for some time that the landscape of local government internal audit was changing and HIAs, as leaders of their teams, needed to be sure that they had the tools and the skills to steer their functions through the challenging times ahead. When the initial brief for the workshops was developed, local government knew it was facing substantial financial pressures in the way of direct budget cuts, but did not have clear knowledge of the extent. What was evident was that internal audit would not be spared their share and that the HIAs needed to look to becoming more efficient in all that they did.

At the same time CIPFA had been consulting on their *Statement on the Role of the Head of Internal Audit* and it was obvious that this would represent a substantial change to the way HIAs delivered their service, necessitating a move to the strategic and more forward-looking advisory function. SLACIAG as a group had a strong role to play in supporting their members through this, but the executive committee needed a better sense from the members of the most beneficial way they could progress.

## Internal audit pressures

The impacts of the financial pressures with the requirements to generate efficiencies and hard savings are likely to see audit resources reduced over the next few years, at a time when other constant changes in their organisations mean fast changing risk profiles. Even more, internal audit will be required to deliver a quality product meeting both internal client expectations, the assurance needs of members and the requirements of external audit who place significant reliance on their work in delivering their opinion on the councils' annual accounts. In addition, performance management arrangements within internal audit were inconsistent and it was important that internal audit, where possible, developed some common performance management, measurement and monitoring systems that would allow benchmarking.

The shared services agenda is an area that has already been considered in some internal audit sections with some pressures on HIAs to adopt joint working with neighbouring authorities. There is no doubt this is an area that will continue to be explored, along with other alternative delivery models. SLACIAG can now contemplate influencing such developments rather than simply implementing them.

Given the pressures, and the increasing challenges and expectations from stakeholders, it is important that HIAs position themselves and their function in a manner that allows them to prove their need and their worth in an environment where clients are less likely to wish to spend the resource on audit and less likely to be happy to agree to recommendations if they come at a cost. Internal audit in Scottish local authorities is not a statutory function, but is there as a function of best practice to support the s95 officer<sup>2</sup> in the discharge of that statutory role. It is therefore important that internal audit plays a critical role within authorities overall governance frameworks.

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2. The officer responsible for the administration of a council's financial affairs under the Local Government (Scotland) Act 1973.

## Role of the Head of Internal Audit

CIPFA's *Statement on the Role of the Head of Internal Audit in Public Service Organisations* was issued in December 2010. This document will become part of the best practice against which HIAs and their internal audit sections will be assessed by external audit and provided the driver behind Dave and Philip's input.

The Statement highlighted the importance of HIAs changing their role and skill set away from 'tactical reporting' to 'strategic intervention' and partnership with their top teams. It effectively means HIAs

occupying a vital role supporting the design, delivery, assessment and provision of key strategic projects in the public sector. It will require them to be skilled in management and coaching, to set quality assurance and improvement programmes and to ensure performance standards are determined and met.

Central to CIPFA's Statement was the importance of **leadership** in driving change, in **performance management** and **quality management**. Philip and Dave presented their approach to how they would design the process and the resultant workshops. Fundamental to this was the need to design a bespoke process based on the needs and perceptions of HIAs in local authorities in Scotland.

The requirements of this document, together with the known pressures already discussed, provided the basis for the training brief, posing a number of questions around leadership, quality and performance which needed to be addressed within the workshops to give both SLACIAG as a group and its members a way forward to meet their challenges.

### Workshop delivery

The workshops have been delivered to 36 senior staff in Scotland. The first workshop was hosted by Edinburgh City Council, the second by Glasgow City Council and the third by Scott Moncrieff.

The programme was designed specifically for HIAs, was based on action learning and focused on the completion of two group projects in each session. As the sessions progressed, there were inputs on strategic leadership, transformational change management, leadership and team development and the implementation of a rigorous performance management process supported on the foundation of quality management.

Dave recalled and expanded on his experience of performance and quality management as a director of internal audit and outlined how these areas could be integrated into the culture of internal audit, using the IIA's standards as a



foundation. Philip discussed the essence of change leadership, the management of differences, strategies to influence etc based on his work with blue chip companies over the last 20 years. The three strands of leadership, quality and performance covered in the workshops provided the delegates with a strong foundation to progress the strategic directions of themselves, their teams and SLACIAG as a group.

Each of the workshops ended with presentations by the delegates, which were recorded for future use should SLACIAG need to disseminate the messages further through internal audit in Scottish public sector organisations. Much of the material generated was used in SLACIAG's June 2011 conference in Stirling. Post reviews of the programme were extremely positive with a 96% rating by participants.

## **Programme benefits**

Feedback at the end of the three workshops from participants was extremely positive and the messages from Dave and Philip to the executive committee brought out a number of areas where SLACIAG needed to be proactive as a group in supporting the road ahead for members.

Collectively, one of the main benefits was a confirmation from participants that SLACIAG needs to drive change across local government internal audit in Scotland, with most of the workshop participants looking for SLACIAG to have a strategic role. Within this there was an identified need for SLACIAG to sharpen its focus and refresh its role and purpose. SLACIAG needs to consider its own vision, strategic objectives and values and develop an action plan around the strategic issues the group needs to take forward.

Programme benefits were also realised in relation to frameworks for quality and performance management where it was identified that there is little common ground between internal audit sections. The workshops provided participants with the characteristics and key elements of good quality and performance systems along with measures and strategies for implementation. These were based on IIA principles and guidance and development of these areas would put HIAs in a strong position to exercise control over the quality of their teams' performance and outputs as well as monitor the overall performance of the internal audit function.

On an individual basis, the workshops gave participants a solid platform to identify and develop their own leadership styles, measure themselves against 'the best' and identify any development needs. The leadership training also provided tools to identify the styles of others who they are seeking to influence, thus allowing HIAs to demonstrate influential leadership to their teams and their stakeholders and facilitate the development of their roles as ambassadors of governance and assurance.

## **Moving forward**

HIAs now have a wealth of information, tools and guidance to develop their individual action plans to move themselves and their teams forward in terms of leadership, quality and performance.

To fully realise the programme benefits, the executive committee agreed that the June 2011 SLACIAG conference would have a strong development focus. A substantial portion of conference time needed to be allocated to establishing the

new strategic direction by identifying purpose, objectives and values of SLACIAG as a group. Some initial pre-conference work was undertaken by the executive committee, facilitated by a questionnaire developed by Philip to identify some basic objectives, values and behaviours together with strengths and weaknesses of SLACIAG as a group. The consolidated results of the questionnaire were circulated as a pre-conference pack to delegates to inform the three sessions designed to move this forward.

## **SLACIAG conference outcomes**

The conference was attended by 31 delegates comprising HIAs and their direct reports. Held over two days, over half of the conference was devoted to establishing the group's new strategic direction.

Janine Wilson, Chair of SLACIAG, led the first session on vision, values and objectives. This built on the pre-conference work by the committee, with the outcomes including a group vision, set of values and four strategic objectives for SLACIAG.

The second session, led by Jill Stacey of Scottish Borders Council and facilitated by both Philip and Dave, saw the conference delegates split into teams to conduct a stakeholder analysis. This involved a five-stage process of identification, prioritisation, identifying strategies, mapping and action planning. Feedback by the three groups highlighted a common view of core stakeholders with whom relationships could be strengthened.

The third development session was led by Kenneth Ribbons of West Lothian Council. This identified where SLACIAG is now, where it wants to be and how it bridges the gap. This session gave a direct lead and link into the action planning session on day two, which took place around each of the agreed objectives. Useful feedback was presented from each of the groups providing a basis for the executive committee to develop a detailed action plan to identify the steps SLACIAG need to take to become the influential voice of internal audit in Scottish local government.

One final session led by Andi Priestman of Inverclyde Council looked at performance management for internal audit. This had been recognised as a gap with a need for more consistency and structure. Andi outlined the various possible approaches, recommending a format utilising the balanced scorecard which would link well into the vision and values the group had agreed.

## **The action plan**

The outputs of the various sessions of the conference were consolidated by the committee into an initial action plan which will be considered at the next group meeting. In the meantime momentum continues with development of performance management and initial contact planned with some of the primary stakeholders. The group has recognised the imperative of developing stronger linkages with stakeholders which include our chief executives and directors of finance, along with our teams, audit committee members and our professional bodies. Prioritising developed relationships with these stakeholders is one of the main areas of focus within the group's action plan.

## The future

There is no doubt that the leadership, quality and performance workshops and the conference were successful and delivered on members' expectations, giving HIAs the tools they need to take on their new strategic role, to lead their teams better and deliver stakeholder benefits. The workshop and conference outcomes also provided a strong forward sense for SLACIAG as a group and are being further developed within the action plan. This work has provided SLACIAG with the foundation to move forward, both individually and collectively, to meet the challenges ahead and work toward recognition of SLACIAG as the voice of internal audit across Scottish local authorities, championing best practice in respect of local authority internal audit, governance and operations.

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**Editor's note: please see *The Excellent Internal Auditor* publication, due for release in December, which reflects the themes in this article.**

# The Fourth Line of Defence

## It's all in the culture

One of the current audit dogmas is that there are three lines of defence – controls, managerial monitoring and independent challenge and assurance, aka internal audit. I want to suggest to you that there's a fourth line of defence, which can be as powerful as any of the standard trio. It's called culture. Of course, it's quite a problematic way of protecting your organisation. It's hard to measure and harder to change. It will be difficult, therefore, to demonstrate that it exists or works effectively. And – in common with the conventional three – it can fail abysmally. But here's the thing. When it works, it gives a degree of protection that is truly embedded and entirely positive. It means that every single person in and around the organisation is protecting assets and interests.

Steven R Covey identifies it in *The 7 Habits of Highly Effective People* (Simon & Schuster Ltd, 2004) – it's what is at work when every member of an organisation takes responsibility for all aspects of that organisation. So the cleaner volunteers information to the confused visitor who can't find an office and the revenue protection manager collecting tickets on a train listens, understands and acts on a complaint about station staff behaviour (yes – it has happened and on a train operated by one of the worst of the privateer companies). And, more to the point for our purposes, the invoice clerk looks at the paperwork with intelligence switched on and queries the stuff that he does not understand – even if it has come from his own boss. You can harness this drive and responsibility, but there is a price. We'll come to that later.

If this sort of brain-on culture suffuses the organisation, it means that you have every single employee watching out for corporate interests. And that multiplies the effectiveness of control ten-fold.

This is not the suspicious and nosy voyeurism beloved of red-top papers. It is a synthesis of enlightened self-interest and integrity – good workers are jealous of the good reputation of their employer. Just about every individual has the potential to be like this, so a major question is: why do so many people appear to behave in exactly the opposite way?

## It starts at the top...

One of the formative experiences of my professional life was running a major investigation of matters that proved to be rather more mundane than they were supposed to be, but which still cost a dozen employees their jobs.

There were several different control systems that should have alerted the organisation to what was going on, but all of them failed. Basic controls were ignored, along with audit reports (this was in the days of CCT, and a manager who delivered the right bottom-line figures was sometimes above the law or, at least, above the reach of routine audit reports). HR rules were flouted, and there was considerable nepotism in the service (as I recall, thirteen employees were relatives of one senior manager). 'Equalities' was a dirty word, and probably the subject of a good few dirty jokes.

In the end, there was a particularly mischievous piece of whistle blowing, but while this misdirected the investigation for a while, it also led to finding what was really going wrong. This is relevant because we need to recognise that a good culture leads to good whistle blowing: whistleblowers may be mistaken in a strong culture, but not mischievous or malicious.

‘Where did the culture come from?’ is an excellent question. The answer is simple, but possibly disturbing – it came from the director. I must stress that he was not in any way corrupt, but he did not always do what he said he was going to do and could adopt a very autocratic management style. This, effectively, mandated a bullying culture among his managers. It was more important to be the boss than to make accurate assessments or make decisions based on objective facts. And so, it was only a short step to managers exploiting their position for personal gain – selling fleet vehicles to relatives, using junior employees as airport chauffeurs for holidays and signing off their timesheets for that day as work time and similar petty but obvious abuses. This in turn set a poor example for front-line staff and inadequate stores procedures were duly exploited.



## Remedies and reality checks

If a poor or unconsidered managerial culture can lead to severe and unintended problems, it is entirely logical that a carefully considered and purposeful approach from the top can, at the very least, enable a really sound organisational culture. It won't always be easy, but it is encouraging to note that the more one practices an open and learning culture, the easier it becomes to do it – it becomes a part of how you work.

Before moving on to the characteristics that I suggest we should encourage in top managers, we need to do a reality check on our own culture in internal audit. I'm old enough to remember the bad old days of 'set 'em up, knock 'em down' audit – I've had colleagues who were all sweetness and light during the audit, but who turned into vicious critics once they put pen to paper (it was that long ago, fortunately). That's wrong, it's unethical and it does not work.

But there's a variation, which is very easy to fall into, and my experience is that many internal audit and external audit teams do it. This is having only one language in which to report. They do not find controls 'in place' and their reports are peppered with the language of failure. The same problem reverberates through the year (think of the series of external audit reports that cover the same issues again and again, for different purposes), even though a manager agreed to address the issues, and is doing so in a methodical and sensible way, but has not yet finished.

The critical reports are utterly justified by logic – but they lack a sense of proportion and they are bereft of kindness.

## **Kindness?**

What has that got to do with internal audit? Well, this is central to dealing with culture – it amounts to being a critical friend rather than just a critic. This is the sort of person who genuinely cares about the auditee and ‘customer’ service and draws a colleague aside for a kind word of advice. Auditees will trust you and respect your integrity and they will tell you things that your critical colleagues never find out.

Is this beginning to feel uncomfortable? If so, that’s good – it gives you a good idea of how a senior manager will feel when you tell them that they need to manage differently. You don’t have to pull punches, just be fair, letting people know about problems early and seeing their point of view. And you can view this as being your contribution to organisational development. Goethe wrote that ‘when we treat a man as he is, we make him worse than he is; when we treat a man as if he were already what he potentially could be, we make him what he should be’. There aren’t many people who deliberately make a mess of control – and half of those that do are still reacting to the auditors who did them down in 1982.

There are further difficulties from our audit standpoint: trust. Our job is to check things and the idea of trusting anyone without getting evidence is professional anathema. But it pays dividends, at two levels. First, it brings dividends in the auditee relationship. With a few exceptions, when you are dealing with critical aspects of major systems, you can afford to take some things on trust. After all, you will return to do another audit and you will find out, over two or three cycles, if someone is stringing you along. The immediate return comes from the fact that trust is a great builder.

So the second benefit is that you are modelling the behaviour that you need senior managers to adopt if you are going to build the right kind of culture. What does it say about managers’ view of their staff – whatever words they say – if they are always second-guessing and controlling staff in minor ways, if they keep secrets until the last moment? How will people react? (Frankly, how would you react?)

This brings us to Covey’s idea of the emotional bank account. Every time you trust someone, every time you give them what they need, every time you value them by the way you behave, you are building credit in your emotional bank account with them. A few minutes to chat and hear how their work is going: even holding a door open is an investment. And every time you tell them to just do it, or go away and get it right, or simply fail to say thank you for doing the work, you are withdrawing from that account.

What I’m coming to is that senior management (in audit but also in the organisation as a whole) need to run their bank accounts with all their staff well in credit. That way, when things are difficult, they will trust you and do what you need.

## **Taking it to the top**

Audit is our microcosm and we have access to the macrocosm that most employees envy. How do we push what we’re doing out into the wider world and get the chief executive to behave the same way we do? Well, there is a very direct line of attack

in some audits because you can often make a recommendation that asks the boss to accept responsibility for an initiative, to lead a change, or to give a corporate mandate for a piece of work or a system.

You can also review how the annual governance statement works – in the worst case, this is all your own work. But you can very reasonably suggest that a broader process, with input from a wide range of senior managers, will be more robust (see the CIPFA Financial Advisory Network's *Rough Guide to the Annual Governance Statement*<sup>3</sup>) and this will begin to involve the people who set the organisational culture. Once there's a governance group you can even put organisational culture onto the agenda. You may be surprised how many people agree that it matters.

## **You need to care**

Looking back over what I've written, I'm aware that not all of it is about the hard deliverables that professional standards tend to address. It's about things that are harder to deliver. They require an emotional commitment to do the right thing and to make your organisation better. This is not the stuff of management seminars but it is precisely what great leaders are made of. Of course you should do things in line with professional standards and organisational rules. So should the boss (and you may need to tell him or her this in the course of an audit). But for that extra dimension, and to build the culture that will shield the organisation when the other lines of defence are down, you need to go beyond this and invest some of your personal capital in the work. It's your culture, should you choose to make it so.

**Written by John Duder who carries out interim and consultancy work in internal audit through his own company John Duder Associates Ltd.**

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3. [www.cipfanetworks.net/fan](http://www.cipfanetworks.net/fan)

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