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Parliamentary briefing:

Building with confidence: the case for mandating internal audit for major construction companies

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Strengthening internal audit and governance for construction companies

The recent collapse of ISG, a major government contractor responsible for building schools and prisons, with contracts reportedly worth £1 billion, highlights ongoing concerns about the governance and independent oversight of construction companies responsible for delivering taxpayer-funded infrastructure projects.

ISG's case is not an isolated incident. Almost seven years on from the high-profile collapse of Carillion, the risks associated with inadequate governance in major government contractors persist, with the potential to destabilise public projects, waste taxpayer money, and harm confidence in the delivery of essential public infrastructure.

This briefing outlines the need for stronger governance frameworks across the construction sector and makes the case for appropriately positioned and resourced internal audit functions to provide boards and senior management with additional support in managing their major risks and help safeguard the delivery of tax-payer funded projects.

We urge Parliamentarians to act on these governance gaps by supporting stronger internal audit and independent oversight for major contractors managing taxpayer-funded construction projects.

Evidence of wider audit & governance weaknesses in the construction industry

Our findings suggest that ISG's failure may reflect a broader governance weakness across the construction industry. Based on its latest Annual Report, ISG may not have had a proper independent internal audit function at the time of its collapse, and the absence of an Audit Committee indicates a governance weakness. This gap may have left the board and senior management without critical independent oversight in managing systemic risks related to operational and financial resilience.

Audit Committees with members who are Non-Executive Directors play a crucial role in overseeing the integrity of financial reporting, as well as the effectiveness of internal controls and risk management systems. Their independent oversight helps to ensure that internal audit functions are robust, and their work is aligned with business strategy, thereby enhancing governance and accountability. Yet not all large construction firms have this.

Unfortunately, ISG's case is not isolated. To understand how well internal audit is embedded across the sector, we researched the UK's top thirty construction firms. Our findings reveal that at least nine companies involved in building public infrastructure projects—such as schools, hospitals, utilities, and transport hubs—may lack internal audit functions.

For example, according to their latest Annual Report construction firms like Willmott Dixon and Laing O'Rourke appear to lack an internal audit function, both of which have been awarded major government contracts. Even for those construction firms with internal audit functions, these may not be appropriately positioned or adequately resourced to address the risks their businesses face.

In addition, the corporate collapses of BHS, Bulb, FTX, Greensill Capital, and Patisserie Valerie highlight a common theme: none of these companies had an internal audit function either, reflecting a broader governance weakness across major companies.

The risks of weak internal audit in public construction contractors

The absence of robust, independent internal audit functions in construction firms responsible for major taxpayer-funded projects means that the boards and senior management of these companies may not be getting sufficient independent and objective assurance on their business-critical risks. Over time this could pose a threat to the long-term sustainability and viability of these organisations. Yet these companies are entrusted with billions of pounds of public money to deliver critical projects such as schools, hospitals, roads, utilities, fire stations, transport hubs, council buildings and leisure centres. So, it is vital they have safeguards like internal audit in place to support them in managing their risks and making sure they have the right controls in place.

Without effective internal audit oversight, these firms are less equipped to identify, manage and mitigate material and systemic risks such as financial liquidity, bribery and fraud, legal and compliance, health and safety, operational resilience and macro-economic uncertainty.

A properly resourced internal audit function provides independent and objective assurance and recommendations to boards and senior management. It helps organisations evaluate and improve the effectiveness of their risk management, governance, and internal controls, supporting their ability to manage risks effectively.

Without internal audit, organisations are more vulnerable to governance failures, inadequate risk management, and control weaknesses. For construction companies delivering taxpayer-funded infrastructure projects, the absence of the independent and objective assurance provided by an internal audit function increases the likelihood of unmanaged risks. All businesses must take risks to grow, but those risks must be managed appropriately and mitigated where possible in line with the business strategy and its appetite for risk.

When contractors delivering public infrastructure fail because they have not managed their risks effectively, the consequences are far-reaching, affecting not only the companies involved but also the wider economy and society. These impacts include:

- **Economic disruption:** Collapses lead to job losses, supply chain disruptions, and uncertainty for smaller businesses reliant on these contractors, causing economic instability.
- **Project delays and cost overruns:** Weak governance and mismanagement delay critical infrastructure projects, increasing public sector costs and limiting access to essential services.
- **Loss of public trust:** Failures in governance erode confidence in public institutions' ability to manage taxpayer money and deliver value for large-scale infrastructure projects.
- **Vulnerability to fraud and mismanagement:** Without independent internal audit functions, companies are less able to detect fraud, conflicts of interest, or mismanagement, jeopardising the integrity of public investments.

Legislation

To ensure our governance laws are in shape for the future, we support the Audit Reform and Corporate Governance Bill announced in the King's Speech. This legislation is needed to put the audit regulator on a statutory footing with the legal powers it needs to do its job effectively. This includes new powers to increase the accountability of company directors, such as the power to sanction all company directors and not just those who are Chartered Accountants. The collapse of ISG also highlights the importance of the secondary legislation that the previous Government laid in Parliament but unexpectedly withdrew. The legislation would have amended the Companies Act 2006 to require very large private and public companies, with 750 employees and a turnover of £750 million, to publish an Audit and Assurance Policy and a Resilience Statement.

These policies would have required companies to report on their internal auditing and other assurance capabilities and how they planned to strengthen these over a three-year period. Had the legislation been enacted, it would likely have encouraged large construction firms, such as ISG and others, to establish internal audit functions or strengthen their existing function if one is present, providing greater independent and objective assurance on risks faced by companies delivering taxpayer-funded infrastructure projects.

Next Steps for Parliamentarians

Strengthening the internal audit and governance requirements of construction firms with major public infrastructure contracts will help to safeguard taxpayer funds, provide assurance on risk management, internal controls and governance processes, and help maintain public confidence in the delivery of projects.

We urge all Parliamentarians to consider the following actions:

- **Advocate for independent internal audit for major government contractors:** Support extending internal audit requirements to all contractors delivering major taxpayer-funded projects. Just as internal audit is mandatory in the public sector to help ensure strong governance and risk management across Government, the same standard should apply to contractors responsible for building public infrastructure.
- **Support an inquiry into ISG's collapse and lessons that can be learnt:** We urge Parliament to examine ISG's governance structures and internal audit capabilities as part of an inquiry into this collapse. This could help identify lessons and inform stronger governance practices across other construction firms.
- **Support reintroduction of corporate governance and assurance legislation:** Encourage reintroducing previously proposed amendments to the Companies Act, requiring large private companies to publish an Audit and Assurance Policy and Resilience Statement. This would promote transparency and support the establishment or strengthening of internal audit functions in large construction firms managing public infrastructure projects.

Contact Us

We hope this briefing has highlighted the importance of strengthening internal audit requirements for construction firms. For any enquiries regarding this briefing or if you would like to arrange a meeting to discuss how we can further support your work as a parliamentarian, please contact Gavin Hayes, Head of Policy and Public Affairs at gavin.hayes@charterediia.org.