

Dear Councillor

CORPORATE GOVERNANCE PANEL - WEDNESDAY, 14 MAY 2014

I am now able to enclose for consideration at the above meeting the following reports that were unavailable when the agenda was printed.

**Agenda Item
No.**

6. REVIEW OF THE INTERNAL AUDIT SERVICE (Pages 1 - 10)

To receive a report by the Internal Audit and Risk Manager outlining the findings of the Peer Review of the effectiveness of the Internal Audit Service – to follow.

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Public
Key Decision - No

HUNTINGDONSHIRE DISTRICT COUNCIL

Title:	Peer review of the Internal Audit Service
Meeting/Date:	Corporate Governance Panel – 14 May 2014
Executive Portfolio:	Resources: Councillor J A Gray
Report by:	Internal Audit & Risk Manager
Ward(s) affected:	All Wards

Executive Summary

The Public Sector Internal Audit Standards (PSIAS) require that an internal or external review of the Internal Audit Service is conducted annually.

The 2013 review was undertaken by the Internal Audit Manager in the form of a self-assessment. The action plan arising from that review, and approved by Panel in May 2013, included provision for the 2014 review to be undertaken by an external assessor. The Internal Audit Manager (Mr Richard Gaughran) of the Welland Internal Audit Consortium was approached to undertake the review. Mr Gaughran has considerable experience of leading and managing internal audit services within local government. He is a member of the Institute of Internal Audit and the Chartered Institute of Public Finance and Accounting.

Conduct of the Review

The attached report 'Review of Effectiveness of Internal Audit' has been prepared by Mr Gaughran. Evidence to support its conclusions were obtained from:

- The results of a survey issued to Members of the Panel, the Cabinet and senior managers.
- Discussions with the Managing Director and former Assistant Director (Finance & Resources).
- Discussions with the Vice-Chairman of the Panel; and
- Discussions with internal audit staff.

A wide variety of evidence to support working practices was also provided to Mr Gaughran.

Outcome of the Review

The report concludes that internal audit is effective in delivering

- Credible assurance to stakeholders;
- Improved management of risks;
- Improved corporate governance arrangements; and
- Support in the achievement of corporate objectives.

Opportunities to further enhance the effectiveness of the internal audit service have also been identified.

- The exercise of the Panel's right to hold to account Officers who fail to implement, fully and on a timely basis, agreed audit recommendations; and
- Making arrangements that allow the Panel – or the Chairman exercising delegated authority – to approve or disapprove proposed changes to the approved Internal Audit Plan.

In addition, reference has also been made to the need to continue with the updating of the internal audit manual.

The report does not contain any comment or make any recommendation that warrant inclusion in the annual governance statement.

Financial and Legal implications

There are no direct financial or legal implications arising from the report.

Recommendations:

It is recommended that the Panel:

1. Note the outcome of the review process and the findings of the report prepared by Mr Gaughran;
2. Note that Internal Audit is delivering an effective internal audit service to the Council; and
3. Endorse the following actions:
 - i. Heads of Service who fail to implement agreed audit actions on time shall attend and explain to the Panel the reasons for their non-introduction; and
 - ii. The Internal Audit & Risk Manager shall liaise with the Chairman of the Panel regarding changes to the internal audit plan.

Background Papers

Review of effectiveness of Internal Audit.

Contact Officer

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Huntingdonshire District Council

Review of Effectiveness of Internal Audit

Reviewer: Richard Gaughran

May 2014

Evaluation

The Review found sufficient evidence to support a conclusion that the internal audit function for Huntingdonshire District Council is **effective** in delivering:

- Credible assurance to stakeholders;
- Improved management of risks;
- Improved corporate governance arrangements; and
- Support in the achievement of corporate objectives.

The Review identified scope for some enhancements to effectiveness or for closer conformance to the Standards by:

- The exercise of the Panel's right to hold to account Officers who fail to implement, fully and on a timely basis, agreed audit recommendations
- Making arrangements that allow the Panel – or the Chairman exercising delegated authority – to approve or disapprove proposed changes to the approved Internal Audit Plan;
- The Updating of the Internal Audit Manual.

Support for these conclusions was obtained through the evidenced responses to the series of strategic questions set out in the body of the report.

Review of Internal Audit Effectiveness

1. Introduction

The introduction of the Public Sector Internal Audit Standards (the Standards) in 2013 codified the established good practice requirement for periodic external reviews of the internal audit function. In anticipation of the introduction of the Standards, the Council's Internal Audit Manager was party to discussions within the Midlands District Chief Auditors Group about cost-effective ways of procuring reviews that would conform to the Standards. This led to an agreement that the Head of Welland Internal Audit would develop a review model and that the model would be piloted – on a no charge basis – at the Council.

2. Basis for the Evaluation

CIPFA produced the Local Government Application Note as detailed guidance as to what a local authority's internal audit function must do to conform to the Standards: the guidance was supplemented by a checklist of over 200 questions allowing conformance to every element of every Standard to be confirmed. In developing the model for evaluation, a guiding principle was that a checklist approach was not the best way to evaluate performance and instead the Standards have been analysed to determine the key drivers to effective performance. This led to the identification of seven questions focussed on drivers, and an eighth on the impact of internal audit's work.

The answers to the questions set out below were derived from questionnaires directed to Members and Senior Officers; interviews conducted with the Vice Chairman of the Corporate Governance Panel, Senior Officers and the internal audit team; a review of reports received by the Corporate Governance Panel; a review of the Internal Audit Manual, the Audit Charter and other documents defining the role and responsibility of internal audit; and an examination of a sample of internal audits undertaken in 2013/14.

Q1 *Is there a clear understanding of what is expected of the internal audit function; is that understanding shared by all key stakeholders?*

YES – BUT THERE IS A LESS CLEAR UNDERSTANDING OF THE PROPER ROLE OF MANAGERS

The Council responded promptly and effectively to meet the requirements of the Standards. The Corporate Governance Panel received a report in March 2013 setting out the changes required to allow the Council to conform to the Standards which clarified some of the formal issues relating to roles and responsibilities. The Panel has acknowledged that the Internal Audit Manager is responsible for specific non-audit activities (Insurance and Risk Management) which give rise to conflict of interest as defined by the Standards and accepted the opinion of the Council's Section 151 Officer that there are worthwhile synergies arising from this instance of

managed non-conformance. The Panel also approved an Internal Audit Charter defining internal audit's role and responsibilities in conformance with the Standards.

The Council's Code of Financial Management, as revised in March 2013 restates the role of internal audit as a provider of independent assurance and sets out the responsibilities of Budget Managers: to determine and manage their service risks; for effective financial and resource management; and for the prevention of fraud or corruption within their services.

However, questionnaires completed by Members and Officers identified expectations that internal audit should be directly engaged in the maintenance of the Council's control framework. When those responses were linked to comments made in the Annual Audit Letter about the "culture of compliance"; by Officers about a "culture of disobedience"; and by Auditors about clients' lack of commitment to the implementation of agreed recommendations; there are grounds for concern about the extent to which Budget Managers understand and accept the respective roles and responsibilities of internal auditor and client. While it may not be the direct responsibility of either the Internal Audit Manager or the Panel to educate managers in the proper discharge of their duties, the Panel might consider calling to account managers who fail to implement agreed recommendations fully and within agreed timescales.

Q2 *Is the internal audit function empowered to deliver what is expected; does it have the authority and status required?*

YES

The Internal Audit Charter and the relevant provisions of the Code of Financial Management provide internal audit with free, full and unrestricted access to information and anything else required for the conduct of audit work, and require all employees to cooperate with Auditors. Formal reporting lines are appropriate and consistent with the Standards.

The Internal Audit Manager is recognised by Members and Officers as an effective and influential manager. Analysis of questionnaires and interviews undertaken confirm that both Senior Officers and Members give proper weight to his advice on matters relating to risk, governance and control and regard him as having the capacity to promote the delivery of significant improvements in control and governance arrangements. There is also evidence that the competence and experience of individual Auditors is acknowledged and respected by individual clients and Senior Officers.

Q3 *Is the internal audit function appropriately resourced to meet current expectations; and does it have the capacity to access additional resources if these are required?*

YES

The Internal Audit Manager's strategic planning process involves the identification of available internal audit resources and planning is undertaken within that constraint: this approach is consistent with normal practice in local government. As part of the response to the Standards there is provision for the Panel to report to Cabinet any concerns about the adequacy of resources available.

Resources available consist of the Internal Audit Manager; three Auditors (1.5 fte); and specialist ICT Audit support from Mazzars LLP. The three Auditors are professionally qualified and have extensive experience of internal audit. All have been trained in the use of the audit software package IDEA allowing for effective analysis of financial information and other evidence held on the Council's systems. The corporate Performance Development Review process is used to review and develop the Auditors' performance and there is a training budget adequate to meet any foreseeable training needs. Crude benchmarking would suggest that the internal audit head count is relatively low but it is considered more significant that levels of skill, qualification, experience and access to specialist support are high.

Q4 *Does the internal audit function focus on the key issues?*

YES

The Internal Audit Manager maintains a four-year strategic audit plan within which is captured all risks and system areas considered likely to affect the Council's control environment. In developing the annual Internal Audit Plan the views of senior managers and the Panel to ensure that current strategic risks are captured. When seeking the Panel's formal approval of the Plan, proposed audit assignments are prioritised on the basis of risk, materiality and prior audit findings. The draft Plan considered by the Panel showed inherent and residual risk associated with each proposed assignment. The Internal Audit Manager has introduced a revised approach to audit planning (the 3+9 model) for the specific purpose of ensuring that the Plan has the capacity to reflect changes to the Council's assurance requirements. The approach adopted is consistent with best professional practice and is not yet widely adopted in local government.

The process for planning individual assignments requires the Auditor to identify the risks about which clients require assurance. The process involves reference to the Internal Audit Plan; formal engagement with the clients; and review by the Internal Audit Manager.

Questionnaires and interviews provided evidence that the Internal Audit Plan focuses on key strategic risk and that individual assignments focus on the risks about which clients require assurance.

Q5 *Can the internal audit function consistently deliver work to appropriate standards that satisfy the expectations of stakeholders?*

YES

The Internal Audit Manager has acknowledged that the Internal Audit Manual needs to be updated but the current version sets out principles of good practice and promotes a consistent model for the conduct of assignments; evidencing audit findings; and reporting those findings to clients. All assignments are subject to review by the Manager before a final report is issued.

The Internal Audit Manager has also acted to modify the internal audit “product” to better satisfy clients’ needs for assurance. Specifically, the development of the continuous audit approach for key financial systems has proved suitable for the clients’ needs.

The Internal Audit Manager makes use of audit survey forms at the end of each assignment to capture clients’ views as to the value of the work delivered. The Manager has set a performance target that 85% of clients should judge the value of assignments as “good” or better: the latest performance report shows that all respondents considered assignments received to be good value or better. That statistic is consistent with the results of questionnaires and interviews upon which the review is based.

Q6 *Does the internal audit report to its stakeholders on a timely basis; are reporting formats appropriate?*

YES

The Internal Audit Manager has set four specific Service Delivery Targets to promote timely reporting following the completion of assignments: those targets are designed to be challenging and the most recent Progress Report to the Panel shows that performance is below target by between 10% and 33% - for reasons that are understood by the Manager and were reported to the Panel. What the Progress Reports shows is that, for most assignments, field work is completed on time; draft reports are prepared, reviewed and issued within three weeks of completion of fieldwork; and final reports are issued within a week of the client’s final response to the draft report. Those turnaround times compare well with other local authorities.

The internal audit reports reviewed were formatted to provide clear and appropriate information. Reports providing assurance set out clearly:

- the risks about which assurance is provided;
- residual risks and their ratings;
- the overall assurance rating for the assignment;
- agreed actions to be taken and timescale for delivery; and,
- a summary of the key issues arising about which the client needs to be aware.

Reports in other formats (e.g. Memo Report, Licensing and Public Safety) set out clearly the key issues addressed and record clear actions agreed to address those issues. The review also identified examples of the use of PowerPoint presentations as a more effective and direct means of communicating sensitive and important issues to clients.

Reports to the Panel on the performance of internal audit and on the assurance arising from that work are delivered in line with the agreed work programme for the Panel and provide sufficient information to allow Members to discharge their responsibilities as the Council's Audit Committee.

Q7 ***Is there effective engagement between the internal audit function and the Corporate Governance Panel?***

YES

A review of the reports received by the Panel demonstrated that Members were receiving clear and timely reports on issues impacting on the effectiveness of the Council's internal audit function. The constitutional and organisational changes demanded by the new Standards were clearly explained to the Panel and necessary actions identified and delivered. The Panel receives reports on performance that allow it to discharge the proper duties of an "Audit Committee" and included:

- evidence of appropriate challenge by Members to issues of performance
- dialogue between Members and Officers to promote a better understanding of risk;
- the cost of controlling risk; and,
- risk appetite.

Interviews with the Panel's Vice Chairman and with Officers provided further evidence that the Internal Audit Manager was providing effective support to the Panel allowing it to discharge its role in the way that senior Members deemed appropriate. That support has extended to the identification of appropriate training opportunities. It was noted that the Manager's responsibility to assess and report on the Panel's own effectiveness required the Panel to accord him an enhanced degree of authority which allowed for more effective engagement on specific internal audit issues.

However:

- 1) The Panel has expressed concern about slow and incomplete implementation of audit recommendations. It is recognised as good practice for Audit Committees to support the internal audit function by calling to account managers who fail to implement agreed recommendations within agreed timescales and such practice is consistent with the Standards.
- 2) Performance reports received by the Panel identify and explain changes made to the Internal Audit Plan and the Internal Audit Charter gives the Internal Audit Manager the authority to review and adjust the Plan as necessary. Other local authorities, looking to develop arrangements consistent with the Standards that recognise the role of the Audit Committee in determining the Council's assurance requirement, have made provision for Member approval of changes to the Plan: emerging good practice is for the Chairman of the Audit Committee to be given delegated authority to approve or disapprove proposed changes.

Q8 *Can the internal audit function demonstrate that its work has had a positive and material impact on standards of risk management and corporate governance and/or on the achievement of corporate objectives?*

YES

In 2013/14 the Council made significant changes to its Code of Procurement and approved a revision to the Employees Code of Conduct. It was established by interview and review of relevant reports that the internal audit function played a major part in identifying and designing remedies for fundamental weaknesses in arrangements to manage procurement. It is an indication of the significance of this contribution to improved governance that the Council's external auditors made direct reference to internal audit's recommendations in the Annual Audit Letter.

A review of audit assignments undertaken during 2013/14 identified the audit of Licensing and Community Safety as an example of the internal audit function making effective use of its influence to improve effectiveness of service delivery. In this example the internal audit function went beyond simple reporting, to, in effect, mediate between two services to promote better joint working.

Questionnaires and interviews established that internal audit's clients consider that the work of internal audit has led to major improvements in risk management, corporate governance and has supported the delivery of the Council's corporate objectives.