INTERNAL AUDIT SERVICE:
TERMS OF REFERENCE & INTERNAL AUDIT STRATEGY
(Report by the Audit & Risk Manager)

1.   Introduction

1.1   The terms of reference and strategy documents for Internal Audit were last approved by the Panel in March 2007. The strategy covered the period to March 2010. It has been reviewed and amended where necessary and is attached for approval.

1.2   Whilst reviewing the strategy a review of the Terms of Reference for internal audit has also been undertaken. The CIPFA Code of Practice for Internal Audit 2006 (Code) requires that the Terms of Reference are formally approved by the Panel.

1.3   CIPFA have prepared, and are currently consulting on a document entitled "Statement on the Role of the Head of Internal Audit in Public Sector Organisations". A copy of the consultation paper has been obtained and considered during the review of both documents. The Statement sets out what CIPFA considers to be best practice for the delivery of an internal audit service. Unlike the Code, it is guidance only and does not have 'proper practice' status.

2.   Changes Proposed

2.1   The main changes made to the terms of reference and audit strategy are listed below for ease of reference.

Terms of Reference

- Replacement of the requirement to **annually** review whether the Internal Audit Service is compliant with the Code of Practice with a requirement that the Director of Commerce & Technology ensure that periodic reviews are undertaken and report these findings to the Corporate Governance Panel. This includes an external review every 5 years.
  (Panel agreed in March 2009 that due to introduction of the assurance framework, an annual review of the Internal Audit Service was not required).

- Addition of a requirement to consider the significant risks and opportunities facing the service.

Internal Audit Strategy

- Strategic audit planning shall take account of the areas of assurance identified by the Panel at its March 2009 meeting and the associated framework of assurance.

- Acknowledgement that the annual audit plan shall run from August to July to coincide with the governance reporting timetable.

- Amending the timescale for the presentation of the annual audit report, to coincide with the review and adoption of the annual governance statement.

- The Audit & Risk Managers involvement in considering the effectiveness of the Council's system of internal audit and annual governance statement.

- Similar to the Terms of Reference, the requirement for an annual review of the internal audit service has been omitted. To meet the requirements of the "Statement", a 5 yearly external review of the service, commencing March 2011, has been included.

3.   Compliance with the Code

3.1   It is a requirement of the Code that any element of non-compliance is highlighted and reported to the Panel, together with any safeguards or measures that have been introduced to mitigate this. There is one area in which this applies.

3.2   The code expects the Audit & Risk Manager to be directly line-managed by a member of the Corporate Management Team. In the Director of Commerce & Technology's opinion, it is an advantage to the Internal Audit service to have the benefit of the added level of management and expertise accorded by it reporting to the Head of Financial Services. To mitigate any disadvantage that this might create the independence of the Audit & Risk Manager is assured by him having the right of access to the Director of Commerce & Technology whenever he considers it appropriate. This is reflected in the Audit Strategy.

4.   Recommendation

4.1   It is recommended that the Panel approve the Internal Audit terms of reference and strategy.

ACCESS TO INFORMATION ACT 1985
CIPFA Code of Audit Practice 2006
Accounts & Audit Regulations 2003 (as amended)
Consultation draft May 2010 – The Role of the Head of Internal Audit

Contact Officer: David Harwood, Audit & Risk Manager ☎ **01480 388115**

Internal Audit Service

Terms of Reference

INTERNAL AUDIT SERVICE
TERMS OF REFERENCE

Statutory Requirements
The Accounts & Audit Regulations 2003[1] require the Council to "maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with proper practices".

"Proper practice" is contained in the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom 2006 (the Code of Practice).

Director of Commerce & Technology
The Director of Commerce & Technology (the Director) is the officer responsible for maintaining an internal audit service.

Effective reporting and managerial arrangements will be established between the Director and the Audit & Risk Manager.

The Director will ensure that periodic reviews of whether the service meets the requirements of the Code of Practice are undertaken and report these findings to the Corporate Governance Panel. These will include an external review at least every 5 years.

Definition and Role of Internal Audit
Internal Audit is an assurance service with the primary aim of providing an independent and objective opinion to the Council on the overall adequacy of the Council's control environment. It will objectively examine, evaluate and report on the effectiveness of the control environment to ensure the correct balance between propriety and cost effectiveness in achieving the Council's objectives.

The Code of Financial Management shall contain a statement explaining Internal Audit's responsibilities.

Responsibility for the management of services rests fully with Directors and their managers[3]. This includes ensuring value for money, minimising the risk of services not being delivered and reducing the opportunities for theft, fraud and corruption by ensuring that appropriate and adequate risk and control arrangements exist. Internal Audit compliments this by providing an expert and independent appraisal function to help managers determine the adequacy of their internal control, risk management and governance processes.

Internal Audit Responsibility
In order to fulfil its role the Internal Audit Service shall:
- Prepare a strategy document explaining how the service will be delivered which will include an explanation of the assessment of resources required.
- Undertake reviews that focus on the areas of greatest risk to the Council.
- Have the authority and right of access to all relevant records, assets, personnel and premises, including those of partner organisations, that it considers necessary to fulfil its responsibilities.
- Report to the Corporate Governance Panel on the matters referred to in the Code of Practice.

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[1] Including the Accounts & Audit (Amendment)(Regulations) 2006
[3] Code of Financial Management: paragraph 1.11

- Provide clear reports that provide management with an opinion on the soundness, adequacy and application of internal controls.
- Enhance efficient and effective risk and control management by recommending cost effective controls which aim to improve service delivery whilst avoiding or minimising operational losses.
- Provide an annual opinion to the Chief Officers' Management Team, timed to coincide with the preparation of the Annual Statement of Assurance on Corporate Governance, on the soundness of the systems of internal control and the internal control environment.
- Provide advice and training on the management of risk and on issues surrounding the design, implementation and operation of systems of internal control.
- Contribute to the general management and conduct of business through provision of expertise on appropriate working groups and participation in ad-hoc exercises, including value for money, best value or consultancy studies.
- Have in place arrangements that ensure that it is notified of all suspected or detected instances of fraud, corruption or impropriety. Investigate and report upon all (non-benefit related) frauds and irregularities in accordance with documented procedures. (The Head of Revenue Services is responsible for investigating benefit related fraud).

Independence
The Audit & Risk Manager is responsible for the delivery of the Internal Audit, Insurance and Risk Management services. All three areas have a key part to play in mitigating the risks facing the Council. Responsibility for these operational areas is recognised by the Director of Commerce & Technology and the Corporate Governance Panel, together with the possibility that occasionally these responsibilities could, unless specifically addressed, compromise the operational independence of the Internal Audit Service.

Therefore, clear separation and divisions of duty will be established by the Audit & Risk Manager to ensure that the Internal Audit staff who have been involved in dealing with risk management operational matters do not undertake audit reviews within this area.

Apart from the areas of risk management and insurance, the Internal Audit Service shall not be responsible for the operation of any systems which could compromise its independence. It will however proactively offer advice and guidance on risk and internal control implications arising from planned or proposed changes to, or development of, systems or services.

The Audit & Risk Manager be responsible for the content of the annual audit plan and shall have direct access to, and freedom to report in his own name and without fear or favour to, all Officers and Members.

Audit Management
The Council shall appoint an Audit & Risk Manager who will be required to determine the priorities of, deliver, and manage the Internal Audit Service for the Council. In discharging these duties the Audit & Risk Manager will:
- Ensure that he has a comprehensive understanding of the Council's systems, structures and operations so allowing for, after consulting with senior management, the preparation of a strategic risk based audit plan

- Update the plan regularly to reflect changes in Council priorities and risk registers
- Translate the strategic plan into annual plans for formal agreement with the Director of Commerce & Technology
- Ensure that an audit brief is prepared for each individual audit assignment undertaken, setting out the scope and objectives of the work, timescales and reporting arrangements
- Ensure that all audit work is completed to high standards and in accordance with appropriate professional standards
- Maintain an internal audit manual that describes the standards, practices and procedures that are required to be met by internal audit staff and contractors
- Undertake an annual review of the development and training needs of internal audit staff and arrange for appropriate training to be provided
- Establish effective relationships with managers at all levels
- Proactively work with the External Auditor to ensure that audit resources are used in the most effective and efficient manner
- Monitor the effectiveness of the service delivered and compliance with professional and ethical standards.

Audit Reporting

At the completion of an audit assignment a written report will be agreed with the appropriate manager. The report shall contain an opinion on the adequacy of the risk management and internal control arrangements within the area of review and, where necessary, list the actions for improvements. If the manager and auditor cannot reach consensus then the appropriate Director(s) will resolve the issue.

Copies of all final audit reports shall be sent to the Director of Commerce & Technology and, when requested, the External Auditor. Electronic copies will be made available to Members via the intranet.

The Audit & Risk Manager shall report to the Corporate Governance Panel any probity issues that arise, either directly from an audit or via an investigation into a fraud related matter, following the conclusion of his review.

Implementation of Agreed Audit Actions

The Audit & Risk Manager shall regularly review the progress made by managers in introducing the agreed actions and shall report quarterly to each Director on the actions taken. Each Director shall take appropriate action to ensure that agreed actions are implemented.

Risk Management

The Audit & Risk Manager shall regularly consider the significant risks and opportunities relating to the delivery of the Terms of Reference and Audit Strategy and shall update the risk register accordingly.

Corporate Governance Panel

The Audit & Risk Manager shall present an annual and interim report to the Panel that meets the requirements of the Code of the Practice. The annual report shall be timed to support the Council's Annual Statement of Assurance on Corporate Governance and include an opinion on the overall adequacy and effectiveness of the control environment.

The Audit & Risk Manager shall have the right to report to the Panel and attend all of its meetings.

The Audit & Risk Manager will have the right , if he feels it is necessary, to meet with the Chairman of the Corporate Governance Panel and/or the relevant Portfolio Holder to discuss any matters or concerns that have arisen from internal audit work.

Professional & Ethical Standards
The objectivity, impartiality, integrity and conduct of all Internal Audit staff must be above reproach at all times.

All Internal Audit staff shall comply with the ethical standards contained in the *Code of Practice* and those professional and ethical standards issued by the professional body to which they belong. They shall also comply with the Council's own codes and ethical standards.

Internal Audit Strategy

2010 - 2013

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Internal Audit Strategy
2010- 2013

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Introduction
This document sets out the Council's Internal Audit Strategy for the period to March 2013. It is intended to demonstrate how Internal Audit will support the overall aims and objectives of the Council and meet the requirements of its terms of reference in a way that will allow it to:

- provide an opinion on the internal control environment[4] to support the completion of the Annual Statement of Assurance on Corporate Governance which incorporates those internal control aspects required by the Accounts and Audit Regulations 2003[5];
- prepare audit plans that give suitable priority to the Council's objectives and key risks and concentrate resources on areas that have been identified as being the most vulnerable;
- agree actions with managers at the conclusion of each piece of audit work that will assist in continuous service improvement and reduce the risks being faced;
- identify the audit resources required to deliver an audit service that meets required professional standards; and
- provide regular reports to the Corporate Governance Panel.

CIPFA Code of Audit Practice
The Audit & Risk Manager shall ensure that the standards contained within the CIPFA Code of Audit Practice shall be applied to the work of the Internal Audit Service. Any standards that cannot be complied with in full shall be discussed with the Director of Commerce and Technology, as the Council's "Chief Financial Officer", and agreement reached as to the alternatives to be accepted. Substantial differences shall be reported to the Corporate Governance Panel.

Corporate Governance Panel
The Council has established the Corporate Governance Panel. The Panel will undertake the functions of an "Audit Committee", as detailed in Standard 4 of the Code of Audit Practice by receiving information on or approving the:

- terms of reference for Internal Audit
- Internal Audit strategy
- resourcing of Internal Audit
- periodic plans of Internal Audit, progress in achieving them, significant matters that may jeopardise its delivery, any material changes made including implications arising from audit report findings and opinions.
- adequacy of management response to Internal Audit advice and recommendations
- Audit & Risk Manager's annual report
- arrangements for and the results of quality assurance and performance management processes
- arrangements made for co-operation between Internal Audit, External Audit and other review bodies.

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[4] The control environment comprises risk management, control and governance processes. Further information is available in the glossary.
[5] As amended by the Accounts & Audit (Amendment)(England) Regulations 2006

Audit Needs Assessments and Strategic Planning

An Audit Needs Assessment (ANA) shall be prepared by the Audit and Risk Manager. This shall be closely aligned to providing assurance for the eleven areas agreed by the Corporate Governance Panel in March 2009 and the associated framework of assurance that has been adopted.

All internal audit work undertaken shall follow the risk based systematic approach[6].

The ANA shall determine the relative importance of the risks identified, the frequency with which each risk should be audited, and the anticipated resources required to audit those risks.

A four year strategic plan based upon the ANA shall be prepared. The strategic plan shall initially be determined without regard to any constraints (such as the staff resources available). The number of days allocated to audit areas in the strategic plan shall be the Audit & Risk Manager's best estimate based upon the risk priorities, the scope of the audit and previous audits carried out.

If after allocating resources to audits a shortfall of resources occurs over the four year strategic plan period, then the Audit & Risk Manager shall discuss the shortfall with the Director of Commerce & Technology. The Audit & Risk Manager will report annually, to the Corporate Governance Panel the consequences of the shortfall (reduced frequency of audit coverage, the increase in risk that this may bring, and the robustness of the Audit & Risk Manager's annual internal control opinion). The Panel shall recommend to Cabinet whether or not to accept the consequences identified or request an increase in Internal Audit's resources.

The Audit & Risk Manager shall consult service managers every six months to ensure that the ANA and strategic audit plan appropriately reflects the current operational, financial and business risks facing the Council and risks arising from national initiatives or developments.

The Audit & Risk Manager shall determine, after taking into account the level of resources available, the audit coverage over the four year period. This decision will have regard to the Council's responsibilities under the Accounts and Audit Regulations 2003, and the expectations placed upon Internal Audit by the external auditors and other outside organisations.

Risk Registers & Assurance Frameworks

The Audit & Risk Manager has responsibility for the development of the Council's risk management processes, including the risk registers, and as such is able to rely on them, together with his own assessments, for compiling the ANA.

The Council continues to implement its assurance framework in support of the Annual Statement of Assurance on Corporate Governance. The framework identifies and records the risks and barriers to successful service delivery and achievement of the Council's objectives.

If at any time the Audit & Risk Manager believes that the risk register or assurance framework is not fit for purpose he shall undertake such additional work as he considers necessary to prepare the ANA.

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[6] See glossary

Annual Audit Opinion

Each year the Audit & Risk Manager will provide his opinion on the effectiveness of the internal control environment to the Chief Officers' Management Team and the Corporate Governance Panel. It will be influenced by the individual opinions provided for each piece of audit work undertaken and the progress made by managers in implementing previously agreed actions.

The opinion shall be supported by sufficient, reliable and relevant evidence.

Annual Audit Plan

The strategic audit plan shall be used to prepare annual audit plans. Annual audit plans shall prepared to align with the Council's governance reporting timetable.

After consulting with the Chief Officers' Management Team, Directorate Management Teams and the Corporate Governance Panel the Audit & Risk Manager shall prepare/amend the annual audit plan as he feels necessary. Ownership of the annual plan rests with the Audit & Risk Manager although it shall be formally agreed by the Director of Commerce & Technology. The agreed plan shall be presented to the Corporate Governance Panel for information.

The Audit & Risk Manager's decision on which areas to include in an annual audit plan shall take into account the Council's requirement to provide an annual corporate governance statement that includes reference to the internal control environment. Audits may be included in the plan where the risks are able to be audited in respect of individual systems (e.g. Council Tax) or where the identified risks apply to systems and processes across the whole Council (e.g. the recruitment process). When deciding which areas are to be included in the annual plan consideration will also be given to the work that is being undertaken by other assurance providers and the opinions they are able to provide.

Within the control environment there may be certain high risk systems or processes which will need to be reviewed annually in order to allow an opinion to be reached.

Annual coverage will need to encompass a broad range of risks in order to give credibility to the comprehensiveness of the opinion.

The Annual Plan will consist of a brief description of the areas to be covered during each audit, the customer/Head of Service responsible for the audit area (including receiving and dealing with the report), appropriate issues identified from the risk register and the number of days allocated for the audit assignment.

The annual audit plan shall be posted to the Intranet for the information of Members and senior managers.

Delivering the Internal Audit Opinion

A number of different audit techniques will be used to deliver the annual audit plan and consequently, the annual audit opinion. These are:

> **Risk based system audit reviews.** The documentation, evaluation and testing of financial, operational and management information systems. These reviews, based on the standards laid down in the CIPFA Code of Practice and the Internal Audit Manual, provide much of the evidence to support the Internal Audit & Risk Manager's opinion on the adequacy and effectiveness of risk management and internal control.

ICT Audit. Specialist control evaluation of hardware, software and the ICT environment.

Fundamental financial systems tests. Reviews focusing on key controls that provide assurance to the external auditor on the completeness and adequacy of the Council's accounts.

In addition to these three main areas of work internal audit shall also provide control advice on new and developing systems and investigate potential cases of fraud and abuse.

Control advice on new and developing systems. This is a preventative activity designed to add value to the Council. Internal Audit expertise on control and best practice in systems is used to assist those responsible for developing systems and creating new systems.

Investigation of potential cases of fraud and abuse. Enquiries into cases of discovered or reported irregularity including, where required, liaison with the police and other investigatory bodies.

Audit Reporting

Internal Audit Reports
The Audit Manual shall contain the detailed reporting procedures and timescales that internal audit staff are required to follow.

All audit work completed shall be reported in writing to the appropriate Director and the Director of Commerce & Technology.

Implementation of Agreed Audit Actions
It will be the responsibility of managers to ensure that all agreed actions arising from an audit report are implemented in accordance with the timetable they have agreed.

The Audit & Risk Manager shall maintain a record of all agreed actions relating to internal and external audit reports. He shall report quarterly to each Director on the progress achieved towards their implementation. Each Director shall take appropriate action to ensure that agreed actions are implemented.

The Audit & Risk Manager shall identify to the Director of Commerce & Technology as S151 Officer, any actions that have not been introduced that have a material affect on the control environment. The Director shall take appropriate action to ensure that the agreed actions are implemented.

Reports to the Corporate Governance Panel
The Audit & Risk Manager shall submit to the Corporate Governance Panel, no later than the date at which the Council's annual governance statement is approved, his annual report and formal audit opinion. An interim progress report on the performance of the service and any emerging issues covered in the annual report shall be submitted six months later.

Annual reports should include the following information:
- The Audit & Risk Manager's opinion on the overall adequacy and effectiveness of the Council's internal control environment. This shall include any qualifications, together with the reasons for the qualification

and any issues that are particularly relevant to the preparation of the Corporate Governance statement;

- A summary of the audit work undertaken to formulate the opinion, including reliance placed on work by other assurance bodies;
- Performance for the reporting period (including a comparison of the work actually undertaken against the work planned and achievement of its performance measures);
- Details of any external quality assurance or review work undertaken on the Internal Audit Service and compliance with the CIPFA Code of Audit Practice.

The Corporate Governance Panel are responsible for:
- reviewing the effectiveness of the Council's system of internal audit[7]
- the preparation of the Annual Governance Statement.

They shall take account of the Audit & Risk Manager's Annual Opinion together with his comments and observations in carrying out these tasks. The Audit & Risk Manager will attend relevant meetings and review relevant documents prior to their presentation to the Panel.

Reporting to the Director of Commerce & Technology
The Audit & Risk Manager will meet on a monthly basis with the Head of Financial Services to discuss performance and other matters of significance who shall report this information to the Director of Commerce & Technology. The Audit & Risk Manager shall have the right to meet formally with the Director of Commerce & Technology if he feels it is appropriate to do so.

Qualifications & Training Requirements
Internal audit staff should be appropriately qualified. They should also have suitable audit experience. Appropriate professional qualifications for internal auditors are a CCAB professional accountancy qualification, the Practitioner or Member qualification of the Institute of Internal Auditors, or full membership of the Association of Accounting Technicians. The Audit & Risk Manager shall identify and arrange for appropriate professional training to be undertaken by internal audit staff.

The Council is committed to continuing professional and personal development. Training needs for internal audit staff will be identified and reviewed as part of the Council's appraisal process. Personal development plans will be prepared for all audit staff. Training needs will be identified via staff completing a training matrix that identifies the competencies required across both technical and professional and interpersonal/organisational areas e.g. communication, management, negotiation etc.

The Audit & Risk Manager will be responsible for prioritising the training needs of all the audit staff within the section, and ensuring that resources available for training are spent in the most appropriate way.

Reviewing the Effectiveness of the Service
The Director of Commerce & Technology shall arrange for an external quality assurance review of the service to be undertaken at least every five years, commencing March 2011.   The aims of the review will be to provide assurance to the Director and the Corporate Governance Panel that the work of internal audit is of a good standard and can be relied upon.

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[7] Accounts & Audit (Amendment)(England) Regulation 2006 (6).

The results of that review shall be considered by the Director of Commerce & Technology, who shall report the findings of the review to the Corporate Governance Panel and make appropriate recommendations for any necessary action. If this includes a service improvement plan the Panel will receive six monthly updates until all actions identified have been completed.

Quality Assurance

The Audit & Risk Manager shall be responsible for introducing effective quality assurance standards and ensuring that Internal Audit work undertaken meets those standards.

A comprehensive Audit Manual shall be maintained that contains full and complete details of the working practices and procedures that have to be followed by all Internal Audit staff to ensure compliance with the CIPFA Code of Audit Practice. All audit work undertaken shall be reviewed at the following key stages by the Audit & Risk Manager:

- Preparation of the audit planning sheet
- Completion of system notes and identification of risks and controls
- Testing and the identification of the status of current risks and associated weaknesses
- Preparation of draft and final audit reports

Audit work will not continue until the Audit & Risk Manager has agreed that the work is appropriate and has met the standards defined in the Audit Manual.

Upon completion of an audit review, the Audit & Risk Manager and appropriate auditor will meet to discuss the audit and identify any issues of note regarding the conduct or delivery of the audit. Issues identified will be considered by the Audit & Risk Manager and actioned if appropriate.

The Audit & Risk Manager shall work proactively with the External Auditor to ensure that the audit resources available are used in the most effective and efficient manner (e.g. the co-ordination of audit plans, sharing of audit reports, joint working). Internal audit files will be maintained to such a standard that the External Auditor is able to place full reliance on their contents. It is expected that the annual audit letter will contain a statement that expresses the External Auditor's view as to how well the section is meeting professional standards.

The Audit & Risk Manager shall seek to ensure continuous improvement of the service by undertaking both qualitative and process benchmarking via the Cambridgeshire internal audit group and the national CIPFA benchmarking club, as resources allow.

May 2010

Control Environment

The control environment comprises the Council's policies, procedures and operations in place to:

- Establish, and monitor the achievement of, the Council's objectives
- Identify, assess and manage the risks to achieving the Council's objectives
- Facilitate policy and decision making
- Ensure the economical, effective and efficient use of resources
- Ensure compliance with established policies (including behavioural and ethical expectations), procedures, laws and regulations
- Safeguard the Council's assets and interests from losses of all kinds, including those arising from fraud, irregularity or corruption
- Ensure the integrity and reliability of information, accounts and data, including internal and external reporting and accountability processes. It encompasses elements of corporate governance and risk management.

Risk Based Systematic Approach

An audit that:

- Identifies and records objectives, risk and controls
- Establishes the extent to which the objectives of the system are consistent with higher-level corporate objectives
- Evaluates the controls in principal to decide whether or not they are appropriate and can be reasonably relied upon to achieve their purpose
- Identifies any instances of over and under control
- Determines an appropriate strategy to test the effectiveness of controls, i.e. through compliance and/or substantive testing
- Arrives at conclusions and produces a report, leading to management actions as necessary and providing an opinion on the effectiveness of the control environment