

REVIEW OF THE EFFECTIVENESS OF THE INTERNAL AUDIT SERVICE

(Report by the Managing Director - Resources)

1. Introduction

- 1.1 This report explains why a review of the effectiveness of the internal audit service is required, the outcomes of that review and proposes a procedure for future reviews.

2. Previous arrangements

- 2.1 Reviews of the Internal Audit Service were completed against 'proper practice' in 2007 and 2008. 'Proper practice' is acknowledged to be the 2006 Code of Practice for Internal Audit in Local Government issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). The Code contains 11 Standards (Annex A) that describe the processes that a professional internal audit service should follow and comply with. Compliance with these Standards provides assurance to the Panel that the Audit & Risk Manager's (A&RM) annual report and opinion is based upon sound audit practices and supported by sufficient, evidenced work to allow supportable conclusions and opinions to be formed on individual audit reviews. The annual report is an important source of evidence to the Panel.
- 2.2 By March 2009, the Panel had adopted both an Assurance Framework to support the production of its annual governance statement and had also defined its 'system of internal audit', a term that had been introduced by the Accounts & Audit Regulations (AAR) 2006. In accepting that the 'system of internal audit' required assurance to be obtained from a variety of sources, not just from internal audit and that the 2008 review of the effectiveness of Internal Audit showed that the service was indeed effective, Panel agreed that the next review of Internal Audit against the Cipfa Code should be undertaken in 2011.

3. Undertaking the Review against the Cipfa Code

- 3.1 The Code of Practice contains a 100 point checklist which has been used as the basis for a self-assessment review of the internal audit service by the A&RM. The review was completed in August. Four areas of non compliance have been identified.

Checklist	Response
Obtaining assurance from partnerships (1.2.3)	Discussions have taken place between the A&RM and PPP staff on a number of occasions over the past years and no significant partnerships have been identified. This will be kept under review and considered when necessary.
Internal audit free of non-audit duties (2.1.1)	As per the 2007 & 2008 reviews, the non-audit responsibilities of delivering risk management and insurance services are carried out by the Audit and Risk Management Section. There

Checklist	Response
	are no plans to change this. Audit reviews of these areas are commissioned from the computer audit partner.
A&RM managed by a member of the COMT (2.3.1)	Line management is via the Head of Financial Services. A&RM has free access to both Managing Directors.
Protocol between internal and external audit (5.6.1)	Grant Thornton did not require a formal protocol to be in place and discussions are underway with PWC as to whether they require such a protocol.

3.2 Whilst the internal audit service does not fully comply with all aspects of the Code, the areas of non compliance are not considered to be sufficiently serious, either individually or collectively to suggest that the internal audit service is not effective.

3.3 The review has identified a small number of areas where improvements could be made to current working practices. These are listed in Annex B and for completeness, include the issues raised in 3.1 above.

Audit's terms of reference, approved by the Panel in June 2010, require that an external review of the service against the Code should be undertaken every 5 years. It is proposed that such a review is commissioned and considered by the Panel in September 2012. At that time, Panel will be requested to determine the frequency of future reviews.

4. External Audit Opinion

4.1 The Council's external auditors, PriceWaterhouseCoopers, have requested sight of a number of internal audit reports on key financial systems to gain an understanding of the internal control framework. As 2010/11 is their first year of appointment, they have undertaken their own tests on key controls within the financial systems to determine the reliance they can place on the work of internal audit.

5. Recommendations

5.1 It is recommended that the Panel:

- note that the internal audit service is generally effective; and
- note the action plan that has been prepared to address the areas for improvement identified in the self assessment

ACCESS TO INFORMATION ACT 1985

CIPFA Code of Practice for Internal Audit in Local Government 2006
Internal audit self-assessment

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2006 Code of Practice for Internal Audit in Local Government: Standards

Standard

- 1 **The Scope of Internal Audit** – deals with formal terms of reference, coverage of the internal control environment and the audit's role in relation to preventing fraud and corruption.
- 2 **Independence** – deals with overall operational independence as well as auditors own independence and impartiality.
- 3 **Ethics** – sets minimum standards for the performance and conduct of all internal auditors under the four main principles of integrity, objectivity, competence and confidentiality.
- 4 **Audit Committees** – deals with the relationship between the Audit & Risk Manager and the Audit Committee (i.e. this Panel).
- 5 **Relationships** – sets out the principles of good relationships with management, other internal auditors, external auditors, other regulators and inspectors and elected members.
- 6 **Staffing, Training and Continuous Professional Development** – deals with staff resources, qualifications and training.
- 7 **Audit Strategy and Planning** – deals with the requirement to produce a strategy document and annual audit plan.
- 8 **Undertaking Audit Work** – deals with risk based auditing, the processes to be carried out in individual audit assignments, incl. planning, fieldwork and quality control.
- 9 **Due Professional Care** – deals with auditor competence and diligence, respecting and understanding confidentiality.
- 10 **Reporting** – sets out the principles of reporting on audit assignments, follow-up arrangements and providing an annual opinion on the control environment.
- 11 **Performance, Quality and Effectiveness** – sets out the need for an audit manual and establishing quality and performance measures.

Code Ref.	Requirement	Non compliance & no change proposed	Areas for Improvement	Date
1.1.1	Do terms of reference (ToR) define the role of Internal Audit in any fraud-related or consultancy work		The ToR do not refer to consultancy work although reference is included in the audit manual, para 2.8. Whilst current audit resources are such that 'true' consultancy is unlikely to be provided, as against 'systems advice', changes will be made to the ToR.	March 2012
1.3.2	Do the terms of reference define Internal Audit's role in fraud and corruption and consultancy work?			
1.2.3	Where services are provided in partnership has the Head of Internal Audit identified how assurance will be sought and agreed access rights where appropriate?	Discussions have taken place between the A&RM and PPP staff on a number of occasions and no partnerships with significant financial implications have been identified. This requirement will be kept under review.		
1.4.2	Has the Head of Internal Audit made arrangements, within the organisation's anti-fraud and anti-corruption policies, to be notified of all suspected or detected fraud, corruption or impropriety?		Clear arrangements in Whistleblowing. Proposal that changes are made to the Employees Code of Conduct and the Code of Financial Management to make explicit the notification requirement.	December 2011
2.1.1	Is Internal Audit independent of the activities it audits and free from any non-audit (operational) duties?	The A&RM responsibility for insurance and risk management is specifically highlighted in the ToR. No changes are planned so no further action required.		
2.2.1	Does the status of Internal Audit allow it to demonstrate independence?	The A&RM is able to render impartial and unbiased judgements on the work performed. This is borne out by individual audit report opinions and the varying overall annual assurance opinions reported by the A&RM, in his own name, to CGP.	It is proposed that the A&RM confirms to the Panel annually, the no constraints have been placed upon the work of internal audit.	September 2011, in annual report and onwards.

Code Ref.	Requirement	Non compliance & no change proposed	Areas for Improvement	Date
2.3.1	Is the Head of Internal Audit managed by a member of the corporate management team?	Day to day management is via the Head of Financial Services. He reports to Managing Director (Resources). This arrangement is widely known across the Council. The A&RM has access to COMT. No changes are planned and the A&RM considers that no further action is required.		
3.3.2	Are internal auditors perceived as being objective and free from conflicts of interest?		The A&RM is unaware of any manager being of the opinion that internal auditors are not objective or conflicts of interest has arisen. The end of audit survey will be amended for a 12 month period to see if there is a problem.	October 2011
5.1.2	Is there a protocol that defines the working relationship for Internal Audit with management; other internal auditors ; external auditors; other regulators and inspectors and elected members?	Chapter 4 of the Audit Manual deals with relationships between internal audit and management, other auditors and review bodies. ToR and Strategy refer to elected members. No specific protocols with external audit.		
5.6.1	Does the Head of Internal Audit maintain good working relationships with members?		To be discussed further with Members of the Panel.	March 2012
6.2.1	Has the Head of Internal Audit defined the skills and competencies for each level of auditor?		A competency framework is in use but needs to be updated to reflect the Cipfa document : 'Excellent Internal Auditor'.	April 2012
10.3.1	Has the Head of Internal Audit defined the need for and the form of any follow-up action?		With the introduction of the SharePoint audit actions system in June 2011, there is the need to amend the follow-up action process within the audit manual, although clarification of the process to be followed has already been issued.	January 2012

Code Ref.	Requirement	Non compliance & no change proposed	Areas for Improvement	Date
10.3.2	Has the Head of Internal Audit established appropriate escalation procedures for internal audit recommendations not implemented by the agreed date?		A&RM informs COMT of performance monthly. Quarterly performance is also reported to COMT by HoS. CGP have also referred to this matter on a number of occasions. A&RM will include more detail in annual and interim reports to CGP.	September 2011
11.1.1	Is there an audit manual?		Electronic version. It needs to be reviewed and updated to take account of current procedures and recent initiatives.	March 2012
11.3.5	Does the Head of Internal Audit provide evidence from his or her review of the performance and quality of the internal audit service to the organisation for consideration as part of the annual review of the effectiveness of the system of internal audit?	Yes – this report deals with this requirement. However in March 2009 CGP agreed that the next review of the effectiveness of the internal audit service should be completed in 2011 when the next review of the effectiveness of the CGP itself was planned. Internal Audit ToR require that an external quality assurance review of the internal audit service be undertaken at least every five years, commencing March 2011. Due to the reduction in internal audit staff resources in 2010 and the introduction of lean and continuous auditing this review was deferred to allow the new approaches to settle down.	It is proposed that the external quality assurance review be undertaken so that its results can be considered by the Panel in their consideration of the 2012 Corp Gov Statement.	August 2012