

# Item 7

## AUDIT COMMITTEE

2<sup>nd</sup> JUNE 2008

### REPORT OF DIRECTOR OF RESOURCES

**Portfolio: STRATEGIC LEADERSHIP**

**Subject: INTERNAL AUDIT SERVICE – ANNUAL REPORT 2007-08**

#### **1. SUMMARY**

- 1.1 The requirement for an Internal Audit function derives from local government legislation, including section 151 of the Local Government Act 1972 which requires authorities to “make arrangements for the proper administration of their financial affairs”. Proper administration includes Internal Audit. More specific requirements are detailed in the Accounts and Audit Regulations 2006, in that a relevant body must “maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control”.
- 1.2 The Internal Audit Plan for 2007-08 year was considered and approved by the Audit Committee on 23<sup>rd</sup> April 2007 (Minute ref: AC.32/06). A half-yearly report on the work undertaken was considered by the Audit Committee on 5<sup>th</sup> November 2007 (Minute ref: AC.15/07). This report provides performance information for the full year, with details of specific areas of work undertaken in the second half of the year. The report has been prepared in accordance with standards defined in the CIPFA Code of Practice for Internal Audit in Local Government 2006.

#### **2. RECOMMENDATIONS**

It is recommended that:

- 2.1 Audit Committee notes the contents of the Internal Audit Service Annual Report 2007-08.

#### **3. AUDIT ACTIVITY APRIL 2007 TO MARCH 2008**

##### **3.1 Background**

- 3.1.1 Senior managers within each department are responsible for the system of internal control and should set in place policies and procedures to help ensure that the system is functioning correctly. Internal Audit review, appraise and report on the effectiveness of the system of internal control. The Audit Committee is responsible for obtaining assurance in respect of the control environment, part of which comes from the work and opinion of Internal Audit.

### **3.2 Annual Audit Plan**

- 3.2.1 The Internal Audit Section produces an Annual Audit Plan based on an assessment of risks in relation to audit areas and allocates its resources accordingly. The approved Audit Plan for 2007-08 scheduled a total of **911** days for the full year. Actual audit work carried out during the year totalled **805** days, resulting in a shortfall of 106 days less than planned.
- 3.2.2 The reason for the shortfall in audit days is that the Internal Audit Section has been operating with staffing vacancies during the year. As a consequence, audit work was prioritised during the year with greater emphasis given to areas of higher risk to ensure that Internal Audit was able to complete work in these areas and provide a sufficient opinion on the adequacy of the control environment.
- 3.2.3 The programme of regularity audit for 2007-08, which forms the core of the Audit Plan, has been substantially completed. Those areas not reviewed during the year included some aspects of services primarily within Housing, Leisure and Neighbourhood Services Departments.
- 3.2.4 There were **59** formal audit reports issued during the period with **25** confirming that there were satisfactory arrangements in place.
- 3.2.5 Within the **34** reports issued where recommendations had been made there were a total of **43** classified as being of '**high**' importance, and **19** of '**medium**' importance.
- 3.2.6 All recommendations were made following detailed discussions and with the agreement of the appropriate service managers.

### **3.3 Audit Opinion**

- 3.3.1 **Appendix A** provides a brief summary of actual audit work carried out and of matters identified as part of the work undertaken by the Internal Audit Section. These items are intended to give a flavour of the wide range of activities covered by the Audit team and the matters that may arise from the work performed. Members will note that the appendix shows that positive progress has been made in the resolution of the matters highlighted.
- 3.3.2 Based on the work undertaken during the year and the implementation by management of audit recommendations, Internal Audit can provide **reasonable assurance** that the Council's systems of internal control were operating adequately and effectively during 2007-08. There are **no** qualifications to this opinion.
- 3.3.3 The above opinion is derived from audit work undertaken, both planned and unplanned, which is detailed in **Appendix A**. Other sources of information, such as Audit Commission reports have also been taken into consideration where appropriate. Specifically, the level of assurance takes into account:

- All audit work completed in 2007-08;
- Follow up actions from previous years' audits;
- Management responses to findings and recommendations;
- Effects of significant changes in Council systems;
- Whether or not limitations have been placed on the scope of Internal Audit;
- Extent of resources available to deliver the audit plan;
- Quality of Internal Audit Service performance.

3.3.4 There are no issues identified of such significance as to require disclosure in the Council's Annual Governance Statement for 2007-08.

### **3.4 Code of Practice for Internal Auditors**

3.4.1 In 2006, CIPFA issued a revised Code of Practice for Internal Audit which further emphasised the importance of internal audit to the proper management of the Council. The Code of Practice provides details of 11 professional standards - shown below - with associated checklists and criteria covering all aspects of the internal audit function:

- Standard 1 – Scope of Internal Audit
- Standard 2 – Independence
- Standard 3 – Ethics for Internal Auditors
- Standard 4 – Audit Committees
- Standard 5 – Relationships
- Standard 6 – Staffing, Training
- Standard 7 – Audit Strategy and Planning
- Standard 8 – Undertaking Audit Work
- Standard 9 – Due Professional Care
- Standard 10 – Reporting
- Standard 11 – Performance, Quality and Effectiveness

3.4.2 Internal Audit regularly reviews its service against the Code of Practice, which contains just under 200 individual criteria, to ensure continued compliance. The latest assessment undertaken in April 2008 indicates that Internal Audit continues to be effective and sufficiently compliant with the requirements of the CIPFA Code of Practice to ensure that the opinion given in this Annual Report can be relied upon for assurance purposes.

3.4.3 In order to focus on areas of development, **Appendix B** identifies those areas of partial or non-compliance with the Code, which amount to only 20 individual criteria out of a total of just under 200. These areas are not those considered to have a material impact on the effectiveness of the service.

### **3.5 Quality Assurance Programme and Performance Management**

3.5.1 Audit work is governed by standards set out in the Code of Practice for Internal Audit and the Audit Section’s own Audit Manual. All audits are subject to ongoing supervisory input throughout all stages of audit fieldwork and are subject to a two stage review; firstly, by Principal Auditors and secondly, by the Audit and Resources Manager. This quality review process ensures that work is carried out to an acceptable standard and in line with the CIPFA Code of Practice. Some of the key features of the quality review and assurance process are as follows:

- An up to date internal audit manual provides direction to all auditors in carrying out day to day audit work
- Work is carried out by auditors with appropriate experience and skills
- All audit work is supervised, monitored and quality assessed
- Key performance indicators have been devised for monitoring performance
- User feedback is requested after each planned audit assignment

3.5.2 During 2007-08 the Internal Audit Section has continued to tailor its Internal Audit Manual for use by all auditors. The Terms of Reference (or Audit Charter) has been reviewed and approved for the section by the Audit Committee. The Section has also spent time reviewing and developing its own processes.

3.5.3 A range of performance measures is maintained covering the work of the audit team. The outturn performance for a range of selected indicators is as follows:

<b>No.</b>	<b>Performance Measure</b>	<b>2007-08 Target</b>	<b>2007-08 Outturn</b>
1.	Percentage of overall audit plan completed in year	95%	88%
2.	Percentage of audit recommendations accepted by client	100%	100%
3.	Percentage of planned audit assignments on ‘core financial systems’ completed in year	100%	100%
4.	Average customer satisfaction rating received [1]	4 = Good	4 = Good
5.	Average sickness absence per employee [2]	5	0.7
6.	Maintain service costs within budget	Yes.	Yes (achieved savings of £48, 561)

Notes:

[1] Overall 95% rated the service as ‘good’ or ‘very good’

[2] Total of only 3 days lost in total to sickness absence in the Audit Section in 2007-08

### **3.6 Staffing**

- 3.6.1 The Audit plan for 2007/08 allowed for 5.5 persons to deliver the work contained in the plan.
- 3.6.1 The half-yearly report on Internal Audit activity for the six months to 30<sup>th</sup> September 2007 explained that a number of structural changes had been in the Financial Services division, which affected the Internal Audit section. This included the strengthening of the Internal Audit section by the addition of a second Principal Auditor post; with a corresponding reduction in the number of Trainee Auditor posts from 4 to 3. Line management responsibility for the Internal Audit section had been transferred to a newly designated post of Audit and Resources Manager (formerly Policy and Finance Manager) from 1<sup>st</sup> July 2007 onwards. A new post of Governance and Risk Manager has been created (and filled by the former Audit Manager) and is dedicated to driving the Council's corporate and strategic approach in these respective areas.
- 3.6.2 The Audit team is currently operating with two vacancies at the Trainee Auditor level. The staffing arrangements and resource requirements are currently being reviewed to ensure that the Internal Audit function continues to maintain the standard of service and that appropriate staffing is in place to carry out the work contained in the Audit Plan for 2008-09. Any audit work not completed in 2007-08 due to the staffing position was considered low risk but will be reviewed and considered for inclusion in the 2008-09 Plan.

### **3.7 Corporate Governance**

- 3.7.1 The Council continues to have strong governance arrangements which are constantly under review to ensure continuing relevance. Areas such as risk management, internal control arrangements, Constitution rules and performance management are key to the Council's operations and efforts continue to be made around the Council to ensure the highest possible standards are achieved.
- 3.7.2 Revised Contract Procedure Rules have been formally adopted by the Council at its meeting in July 2007 (Minute ref: C.42/07). Compliance with the revised rules is a necessary feature of good governance arrangements and audit work will be scheduled to ensure that the Council operates within the requirements of the new Contract Procedure Rules. Internal Audit will examine compliance with these rules as part of next year's audit plan coverage.
- 3.7.3 Recent guidance has been issued by CIPFA / SOLACE regarding recommended best practice on governance in Local Government. The content of this new guidance has recently been examined and as a consequence the Council's Local Code of Corporate has been updated to reflect this. The revised Code of Corporate Governance was approved by Council at its meeting on 18<sup>th</sup> April 2008.
- 3.7.4 The Internal Audit section is also responsible for reviewing the Council's arrangements in respect of Fraud and Corruption and during the year a review of

the Council's existing arrangements were assessed against a CIPFA best practice checklist on 'Managing the Risk of Fraud'. The results of this self-assessment and associated action plan for improvement were considered by the Audit Committee at its meeting on the 5<sup>th</sup> November 2007. Further development of policies and arrangements regarding fraud and corruption are now being considered in local government reorganisation workstreams and the Audit team is involved in this process and contributing to workstream activity.

### **3.8 Risk Management**

- 3.8.1 Risks are identified in each individual audit report produced. However, no system of review can give full assurance that all risks have been minimised and all controls have been operating effectively throughout the year. The Annual Audit Report therefore provides reasonable assurance based on the work that has been carried out.
- 3.8.2 The audit planning process aims to target the work of the Section to those areas where the impact of a control failure would have the highest impact and leave the Council vulnerable to major risks. Activity is directed toward providing assurances on the control environment and thereby highlighting any risk issues capable of causing damage to the Council.
- 3.8.3 Internal Audit continued its close involvement in the development of the Council's approach to risk management. Efforts to embed risk management into the Council's processes have continued and both Strategic and Operational Risk Management Groups continue to develop a wide range of issues. Risk is also a key feature of individual audits undertaken by the Audit team which involves reviewing 'generic risk profiles' as part of audit fieldwork.
- 3.8.4 A comprehensive report on progress with risk management was considered by this Committee on 28<sup>th</sup> January 2008 and the recommendations made were subsequently accepted by Cabinet at its meeting on 28<sup>th</sup> February 2008. As mentioned in the half-yearly report on audit activity previously considered by this Committee, revised Risk Management Policy and Strategy Statements have been approved by Cabinet on 26<sup>th</sup> April 2007 (Minute ref C207/06).

## **4 RESOURCE IMPLICATIONS**

- 4.1 There are no direct implications for resources arising from the content of this report.

## **5. CONSULTATION**

- 6.1 The Audit Plan for 2007-08 had been prepared and delivered following consultation across the Council and with the Audit Commission.

## **6. OTHER MATERIAL CONSIDERATIONS:**

### **6.1 Links to Corporate Objectives / Values**

6.1.1 The Internal Audit activity effectively supports all services in the delivery of the Council's priorities, together with the re-enforcement of the need for accountability for public finances.

### **6.2 Risk Management**

6.2.1 This has been considered in Section 3.8 of this report. The full co-operation of management across the Council is essential to the maintenance of good quality governance, including risk management.

### **6.3 Equality and Diversity**

6.3.1 No material considerations have been identified.

### **6.4 Legal and Constitutional**

6.4.1 The Audit Plan activity recognizes the statutory framework associated with services, the corporate governance framework, as well as the Council's constitutional arrangements.

### **6.5 Other Material Considerations**

6.5.1 Issues associated with procurement and efficiency are addressed within a wide range of audit activities.

## **7. LIST OF APPENDICES**

7.1 Appendix A - Internal Audit Plan Summary of Work – April 2007 to March 2008

7.2 Appendix B - CIPFA Code of Practice Compliance Checklist

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<b>Wards:</b>	<b>Not ward specific</b>
<b>Key decision validation:</b>	<b>Not applicable</b>

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### **Background Papers:**

1. Audit Committee, Internal Audit Plan for 2007/08, 23<sup>rd</sup> April 2007
2. Audit Committee, Half Yearly Report 2007/08, 5<sup>th</sup> November 2007

### Examination by Statutory Officers

- |  | Yes                                 | Not Applicable           |
|--|-------------------------------------|--------------------------|
| 1. The report has been examined by the Council's Head of the Paid Service or his representative. | <input type="checkbox"/>            | <input type="checkbox"/> |
| 2. The content has been examined by the Council's S.151 Officer or his representative.           | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 3. The content has been examined by the Council's Monitoring Officer or his representative.      | <input type="checkbox"/>            | <input type="checkbox"/> |
| 4. The report has been approved by Management Team.  | <input type="checkbox"/>            | <input type="checkbox"/> |