

## **AUDIT COMMITTEE**

28<sup>th</sup> June 2012



### **Review of the Effectiveness of Internal Audit**

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## **Report of Don McLure, Corporate Director of Resources**

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### **Purpose of the Report**

1. The purpose of this report is to advise Members of the outcome of the annual review of the effectiveness of Internal Audit.

### **Background**

2. The Authority has a requirement under the Accounts and Audit (England) Regulations 2011 to review the effectiveness of Internal Audit each year. Internal Audit is an important element of the system of internal control and consideration of its effectiveness contributes to the annual review of the Authority's corporate governance arrangements, and is required to inform the Annual Governance Statement (AGS). If Internal Audit is not considered effective, the reliability of the annual internal audit opinion is in question.
3. The outcomes of the last review carried out by the Corporate Director Resources, and considered by the Audit Committee in June 2011, were informed by work undertaken during the year, an assessment of compliance with the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom 2006 and an assessment of compliance with CIPFA's Statement on the role of the Head of Internal Audit (HIA) in public sector organisations. The review concluded that the service is effective but noted that some improvements had been identified for the service to be fully compliant with the requirements of the Code and the Statement.

### **Improvements made during the year**

4. The main areas where improvements were identified from the last exercise related to:
  - Embedding a risk based audit approach
  - Improving relationships with other regulatory and inspection agencies
  - Improving assurance on programme and project risks

5. In response, the Internal Audit Charter, which defines the detailed terms of reference and audit strategy, was reviewed during the year to reflect an improved risk based auditing approach. This revised approach is summarised as follows:
- To work in consultation with senior management teams and other providers of assurance to prepare strategic and annual audit plans
  - To carry out planned assurance reviews of the effectiveness of the management of operational risks in all key service activities/systems over a rolling 5 year programme (Strategic Plan)
  - To carry out assurance reviews of the management of strategic risks where the effective management of the risk is heavily dependent on identified controls
  - To carry out annual reviews of key risks where a high level of assurance is required to demonstrate the continued effectiveness of internal controls, for example those associated with key financial systems
  - To use a Control Risk Assessment (CRA) methodology to focus audit resources on providing assurance on key controls where there is little or no other assurance on their adequacy or effectiveness
6. The use of a CRA methodology provides a much more focused and consistent approach to the development of the scope of audit assurance reviews. Reviews are informed by an assessment of key risks and other sources of assurance agreed with the key contact as part of the planning and preparation process of each assignment.
7. Audit processes have also been revised during the year to reflect this risk based approach. These include:
- A revised Terms of Reference format informed by the agreed CRA.
  - A revised audit report format to help focus executive summaries on key findings i.e. those that will increase the impact or the likelihood of key risks occurring if not addressed. The CRA is updated at the end of the process and issued with final reports to reflect actual controls in place and provides a mechanism for on-going self-assessment.
  - A revised methodology for categorising the importance of audit findings, resultant recommendations and audit assurance opinions.
  - The introduction of a Post Audit Evaluation (PAE). This is carried out by the lead auditor in conjunction with the relevant audit manager on

the completion of each audit. In addition to providing a mechanism for reflecting on what went well during the audit and identifying any areas for improvement, the PAE also consists of an audit need risk assessment which is used to inform the strategic audit plan and future audit coverage.

8. Work was begun during the year to develop a corporate assurance framework to help identify key assurance providers and the assurance they provide on the management of risks and / or the effectiveness of internal controls. As a result, a corporate assurance framework was approved by full Council in December. This provides a high level illustration of the Council's assurance framework but further work is needed in the current year to understand the nature of assurance provided and to develop a more co-ordinated and coherent approach to assurance provision.
9. More resources were allocated in 2011/12 to improve assurance on programme and projects. However, some work scheduled in this area has not progressed, at the request of management, due to concerns about duplication with other assurance providers and the demands placed on service managers. Whilst the CRA approach seeks to ensure that reliance would be placed on the work of other assurance providers wherever possible, these concerns have emphasised the need for clarity over roles and responsibilities of the various internal providers of assurance and on which risks they provide assurance. Work has therefore begun to clarify the roles and responsibilities of other assurance providers, whether internal or external, and the nature and limitation of what assurance they provide as part of development of the corporate assurance framework. This will however take time to develop and require the investment of not only internal audit resources but also that of senior management.
10. Briefing sessions have been provided to the Improvement Planning Group (IPG) and Tier 4 managers to improve understanding of the role and work of internal audit and how the service can help support managers through the added value of independent and objective assurance.
11. In recognition that the in house risk and audit service may not have all the necessary skills and experience to provide reliable assurance in the specialist area of the Pension Fund, an internal audit partner was appointed to develop a strategic risk register and assurance map in consultation with management and the Pension Fund Committee. The partner was also commissioned to deliver pension fund audit in 2011/12. This partnership arrangement has allowed the opportunity of skills transfer and the sharing of best practice with the in house team which has contributed to further improvements to audit processes and procedures introduced during the year. The appointment of an external partner has also enabled the "call off" of additional audit resources when required and the contract has therefore been extended on this basis for another year. Audit coverage of the pension fund for 2012/13 is to be considered in consultation with management and the Pension Fund Committee following review of performance in 2011/12.

12. The Head of Internal Audit now reports direct to the Corporate Director Resources rather than the Head of Finance. This change has helped raised the profile of the audit service and improved its independence. It has also provided a better platform for the work of the service to influence senior management.

**. Approach to this years annual review of effectiveness**

13. This years review of effectiveness has been informed following consideration of an approach suggested by the external auditor and consists of a series of questions considered independently by:

- The Chair of the Audit Committee
- The Corporate Director Resources
- External Audit
- The Head of Internal Audit

14. Copies of the completed questionnaires are attached as Appendices 2, 3, 4 and 5.

15. It should be noted that responses provided by the Corporate Director Resources and the Head of Internal Audit also incorporate feedback from other Corporate Directors following 1-2-1 discussions reflecting on effectiveness in 2011/12 as well as consideration of priorities for audit coverage in 2012/13.

**Conclusions**

16. The service has made good progress in implementing a risk based approach to auditing. This is particularly important given the reduction in audit resources as a result of budget efficiencies.

17. Audit Plans to develop assurance maps, linked to identified and agreed key risks, as the CRA approach is rolled out across all services, will provide an improved understanding of the risk profile of the Council and lead to a more co-ordinated and coherent approach to assurance. This in turn will improve the risk based approach to strategic audit planning.

18. It has been recognised that the skills mix of the in house team needs improving in the specialist areas of IT audit and fraud investigation and plans are already in place to address this.

19. Plans to increase IT audit resources will enhance the skills and knowledge in this specialist area, improve succession planning, enable independent forensic investigations and provide greater flexibility to respond to changing demands on the service.

20. Plans to increase fraud investigative skills will enhance the investigation of irregularities and allow planned counter fraud work to progress on a more

timely basis This will help improve the management of fraud risk within the Council and help it to respond to the requirements of “Fighting Fraud Locally” which is the National Fraud Authority’s strategy to help reduce fraud in the public sector.

21. The planned investment in IIA qualifications will not only help develop those individual members of staff undertaking the training but will also help embed the risk based approach across the whole service through the sharing of best professional practice and additional support available through the IIA. The profile of the service will also be raised by having a number of IIA qualified staff and should make the service more marketable to potential new external clients.
22. The engagement of an external partner has increased the flexibility of the service to respond to changing demands and has provided access to additional, skills, knowledge and experience to supplement the in house team when required.
23. Overall the effectiveness and performance of the service is considered adequate and continues to improve. It is particularly pleasing to note that since the introduction of the CRA methodology the percentage of customers scoring the audit service good or above (4 out of 5) has increased from 87% to 96%.
24. It is also pleasing to note that the external auditor has observed that, “the standard of audit reports has improved in recent years, including progress reports which are now much clearer.”
25. The comments made by the Chair and Vice Chair in their assessment of the service are acknowledged and a training session for the Committee will be arranged for the Head of Internal Audit to go through the risk based approach and the whole audit process in a practical session.
26. The need to improve the monitoring of managers progress in the implementation of agreed audit recommendations as highlighted in the Chair and Vice Chair’s assessment is also acknowledged. Whilst there has been good progress in implementation, performance does vary across service groupings. In future, the Head of Internal Audit will provide more detail of key findings from audit work completed each quarter, together with overdue recommendations, in progress reports, (not just the statistics) so that the Committee will be in a better position to evaluate the added value from audit work undertaken and where necessary challenge management on the lack of progress made in addressing issues raised.
27. It is recognised by the Head of Internal Audit that further improvements can be made to enhance effectiveness and improve performance in delivering agreed targets and the efficiency of some audit processes. To help achieve this, performance management processes are being reviewed and all aspects of audit work, processes and procedures will be documented in a comprehensive updated audit manual to improve the

existing quality assurance framework. There is an action in the Resources Service Plan to achieve this by 31/3/13.

### **Recommendations**

28. Members are asked to consider the responses provided in appendices 2, 3, 4 and 5 to gain assurance on the effectiveness of internal audit and to place reliance on its work.

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## **Appendix 1: Implications**

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### **Finance**

There are no direct financial implications arising for the Council as a result of this report.

### **Staffing**

None

### **Risk**

None

### **Equality and Diversity**

None

### **Accommodation**

None

### **Crime and disorder**

None

### **Human rights**

None

### **Consultation**

None

### **Procurement**

None

### **Disability**

None

### **Legal Implications**

Compliance with Accounts and Audit Regulations 2011