Appendix 2

Newcastle City Council

DURHAM COUNTY COUNCIL

PEER REVIEW OF INTERNAL AUDIT AGAINST THE UK PUBLIC SECTOR INTERNAL AUDIT STANDARDS

CARRIED OUT BY:
NEWCASTLE CITY COUNCIL

REPORT DATE: JULY 2016

CONFIDENTIAL

1. Introduction

1.1 In April 2013, the Public Sector Internal Audit Standards (PSIAS) became effective. These standards apply to Internal Audit in all parts of the public sector in the UK and are mandatory. The standards are intended to reflect that "a professional, independent and objective internal audit service is one of the key elements of good governance".

1.2 The PSIAS introduced a requirement for an external assessment of an organisation's internal audit function, which must be conducted at least once every five years by a qualified, independent reviewer from outside of the organisation.

1.3 Durham County Council, Newcastle City Council, South Tyneside Council and North Tyneside Council have established a 'peer-review' process that is managed and operated by the constituent authorities. This process addresses the requirement of external assessment by 'self-assessment with independent external validation' and this report presents the summary findings of the review carried out on behalf of Durham County Council.

1.4 The assessment was carried out April and May 2016.

2. Purpose

2.1 The purpose of the external assessment is to help improve delivery of the Internal Audit Service and establish whether governance requirements relating to provision of the Service are embedded. The assessment should be a supportive process that identifies opportunities for development and enhances the value of the audit service to the authority.

3. Approach/Methodology

3.1 Review of Self-Assessment

The Chief Audit Executive (Chief Internal Auditor and Corporate Fraud Manager) had completed a self-assessment of Durham County Council's Internal Audit Service, and its compliance with the Standards. The self-assessment was used as the basis for the external assessment, which was then evidenced with reference to a range of internal and published documentation.

3.2 Further Evidence Gathering and Testing

Operational practices were discussed with the Chief Internal Auditor and Corporate Fraud Manager and the Audit and Fraud Managers.

A meeting was held with the Corporate Director, Resources to explore the key expectations of the Internal Audit Service.

To support and further inform the assessment, a sample of internal audit files was randomly selected and compared against the requirements of the Standards and the related Local Government Application Note. The files selected for review were:

- Agency Staff
- Licensing
- Internet Security
- Budgetary Control (Durham Constabulary)

4. Opinion of External Assessment

4.1 This external assessment concludes that Durham County Council's Internal Audit Service **conforms** to the requirements of the Public Sector Internal Audit Standards. There are some areas which require action but these do not significantly impact on the overall opinion.

5. Executive Summary

5.1 It was evident from the self-assessment, review of supporting evidence and on site interview with the Corporate Director, Resources that the Service is valued and is seen as making a positive contribution to the continuous improvement of governance, risk management and internal control.

5.2 The Service is viewed as independent, operating to ethical standards and operates with a high level of professionalism and integrity. This is achieved through the planned programme of audit work but also the engagement and involvement of the Service in system development and working groups looking at changing ways of working. This is further enhanced by the Corporate Fraud Team sitting directly under the management of the Chief Internal Auditor and Corporate Fraud Manager.

5.3 The Corporate Director, Resources expressed his opinion that the leadership style of the Chief Internal Auditor and Corporate Fraud Manager has made a significant impact in improving both the profile and perceived value of the Service since his appointment. This is supported by the Service winning external business in the recent past.

6. Findings

6.1 The Public Sector Internal Audit Standards include a specific definition of Internal Auditing (expected to be used whenever the function of internal audit is explained, for example in the Audit Charter); a Code of Ethics and eleven specific standards. The standards are divided into attribute standards and performance standards as follows:

Attribute Standards

- Purpose, authority and responsibility
- Independence and objectivity
- Proficiency and due professional care

- Quality assurance and improvement programme

Performance Standards

- Managing the internal audit activity
- Nature of work
- Engagement planning
- Performing the engagement
- Communicating results
- Monitoring progress
- Communicating the acceptance of risks

6.2 The evidence examined as part of the assessment demonstrated that the Internal Audit Service was compliant with the majority of the Standards. A summary of this is detailed below.

Purpose, authority and responsibility

6.3 Internal Audit has an Audit Charter which defines its purpose, authority and responsibility. The Charter was last revised in June 2015 and approved by the Audit Committee.

Independence and Objectivity

6.4 The Chief Audit Executive was appointed by management not the Board. Whilst this is not in accordance with PSIAS it is in line with standard practice within Local Government and in our opinion is an appropriate deviation from the Standard.

6.5 The Standards expect feedback to be sought from the Chair of the Audit Committee and Chief Executive as part of the Chief Audit Executive's performance appraisal. At present, this appraisal is performed by the Corporate Director, Resources who confirmed that informal feedback is provided throughout the year and this informs the appraisal process. In our opinion this is an appropriate approach and in line with standard practice within Local Government.

6.6 All staff within the service are required to complete a Record of Personal Interests, including a statement confirming they understand PSIAS and the requirements of the Code of Ethics and the Seven Principles of Public Life, on an annual basis. However, the declarations completed early in the 2015/16 financial year could not be located at the time of the assessment. The previous declarations, completed by most staff in July / August 2013 (January 2014 for the Corporate Fraud Team), are the latest declarations held.

6.7 The roles of the Audit and Fraud managers within the Service are not periodically rotated due to their experience and knowledge of the areas they oversee although arrangements are in place to rotate staff completing audits. This should be kept under review to ensure there is no actual or perceived conflict of interest which could compromise independence and objectivity.

Proficiency and due professional care

6.8 The Chief Audit Executive is professionally qualified (CIPFA) and has over 20 years of experience working in local government. Staff within the Service have a range of financial qualifications and a number of individuals are currently studying. The Service also possess qualifications and experience in the areas of fraud and IT.

Quality assurance and improvement programme

6.9 The Chief Audit Executive has a formally documented Quality Assurance and Improvement Programme (QAIP) Framework which was agreed in October 2015. This comprises 2 elements:

- Internal Review
  Incorporating quality assurance checks on samples of completed audits and performance reporting of internal audit activity. The outcomes of these were reported to Audit Committee in June 2015 as part of the Annual Review of the System of Internal Audit.

- External Review
  The Standards require an external assessment at least once every five years. This peer review assessment satisfies this requirement of the Standard.

Managing the internal audit activity

6.10 There is a robust audit planning process in place which involves consultation with key stakeholders including Service Group Management Teams, Corporate Management Team and Audit Committee. The audit plan also demonstrates clear links to the objectives within the Council's corporate plan.

6.11 The Chief Audit Executive has overseen the development of the Assurance Map for the Council and has used this to inform audit planning for 2016/17.

Nature of work

6.12 The Service's systems and processes for undertaking work are supported by the Audit Manual and the use of the Galileo audit management system which contains all information relevant to individual assignments.

6.13 The Chief Audit Executive is also responsible for the Risk Management section within the Council and this enables them to understand the arrangements in place. A Fraud Risk Register is also maintained. Independent peer reviews are undertaken by external sources where appropriate.

Engagement planning

6.14 A terms of reference is prepared and agreed for each assignment. The terms of reference identifies key officers, audit objectives, audit scope, approach, reporting arrangements and anticipated timescale for completion.

6.15 The planned dates for completion and associated resource budgets are recorded within the Galileo system to enable managers to monitor progress.

6.16 When reviewing a sample of personal interest records one auditor declared their mother worked in an area where they subsequently undertook audit work. Whilst it is clear that this did not impact upon the audit and there was no conflict this should have been highlighted as a potential conflict at the outset and risk assessed to confirm independence could not be compromised.

Performing the engagement

6.16 Detailed working papers are held on Galileo to support each engagement undertaken. These are completed by the auditor and reviewed by the responsible supervising officer assigned to the engagement.

6.17 The quality assurance and improvement programme reviews a sample of engagements. These are supported by sufficient, appropriate evidence and are completed to expected standards.

Communicating results

6.18 There are established mechanisms in place for discussing and agreeing audit reports. The final reports contain the internal auditor's opinion, an action plan which prioritises recommendations and management responses to the recommendations made. There is no indication that management unduly influence the outcomes of the audit.

6.19 The Chief Audit Executive produces an annual internal audit opinion which concludes on the overall adequacy and effectiveness of the County Council's framework of governance, risk management and control. This includes all expected elements. However, it does not explicitly state that there are no qualifications to the opinion.

Monitoring progress

6.20 All recommendations made are recorded within the Galileo audit management system and there are formal follow up processes in place. Recommendations follow up forms part of quarterly monitoring reports to Audit Committee and senior management are provided information in advance of these meetings.

Communicating the acceptance of risks

6.21 There are no examples of management accepting a level of risk which is unacceptable to the Council. However, should this be the case the formal

reporting mechanisms to Audit Committee provide an appropriate route to raise such concerns.

7 Impact of non-conformance and steps to be taken to ensure conformance.

7.1 Any non-conformance with the standards and the impact must be disclosed to senior management and the Audit Committee. The Chief Internal Auditor has agreed that an action plan will be drafted to respond to the areas of non-conformance for consideration by the Audit Committee. (Appendix 1)

8 Conduct of the External Assessment

8.1 This external assessment of Durham County Council's Internal Audit Service has been conducted in accordance with Standard 1312 (External Assessments) of the Public Sector Internal Audit Standards and the related CIPFA Local Government Application Note.

8.2 Such external assessments must be conducted at least once in every five years by a qualified, independent assessor / assessment team from outside the organisation.

8.3 The qualified assessor / assessment team must demonstrate competence in two areas – the professional practice of internal auditing, and the external assessment process.

8.4 Regarding competence, the Standards state that experience gained in organisations of similar size, complexity, sector or industry and technical issues is more valuable than less relevant experience.

8.5 Regarding independence, the independent assessor must not have either a real or an apparent conflict of interest and must not be a part of, or under the control of, the organisation to which the internal audit activity belongs.

8.6 I certify that as the external assessor as defined in the PSIAS, I am a qualified Accountant (ACCA Affiliate) and have 18 years of audit experience. For the last 10 years my experience has been gained in a comparable sector (local government). I have no conflict of interest in performing this assessment in respect of Durham County Council's Internal Audit Service – I am not a part of, or under the control of, Durham County Council.

Ian Pattison
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Observation	Recommendation	Management response
The Record of Personal Interests completed for the 2015/16 audit year could not be located.	All staff should complete an up to date Record of Personal Interests and these should be retained by the Chief Internal Auditor and Corporate Fraud Manager.	These had been completed but due to an office move have been destroyed in error. There exercise is completed annually and going forward have been made electronic so this cannot happen again in the future.
The roles of the Audit and Fraud managers are not periodically rotated due to their experience and knowledge of the areas they oversee.	The Chief Internal Auditor and Corporate Fraud Manager should consider rotation of the Audit and Fraud managers. If this is not feasible he should keep the situation under review to ensure there is no actual or perceived conflict of interest which could compromise independence and objectivity.	The situation will be kept under review and with the current reorganisation across the Council responsibilities are likely to change as a result.
When reviewing a sample of personal interest records one auditor declared their mother worked in an area where they subsequently undertook audit work. Whilst it is clear that this did not impact upon the audit and there was no conflict this should have been formally considered when planning the audit.	Where there is any potential conflict of interest a note should be retained on the audit file which confirms this has been risk assessed and management are satisfied independence could not be compromised.	Agreed that whilst this potential conflict had been reviewed it was not documented on the electronic file held within the Audit System (Galileo). A reminder to employees will be sent to document when reviews of this nature have been assessed.
The Internal Audit Annual Opinion does not explicitly state there are no qualifications to the opinion.	The Chief Internal Auditor and Corporate Fraud Manager should include a statement in his annual opinion which explicitly states there are no qualifications to his opinion.	Agreed. This has been included in the 2015/16 Internal Audit Annual Opinion to be presented to the Audit Committee on 30 June 2016.