

Audit Committee – 29th June 2009

Report of the Interim Director of Finance

Annual Review of Internal Audit

Purpose of the Report

1. This report deals with the annual review of the effectiveness of the system of internal audit [see Appendix 1] that will form part of the Annual Governance Statement for the financial year 2008/2009.

Background

2. As a result of the Accounts & Audit Regulations 2006, every local authority is now required to carry out a review of the effectiveness of the system of internal audit. This builds on the requirement in previous years for each local authority to carry out a review of the effectiveness of the system of internal control. This has now been superseded by CIPFA requiring each local authority to carry out a review of corporate governance arrangements.
3. The legislation is non-specific as to who should actually carry out the review but guidance from CIPFA does suggest that the review should include input from Senior Offices and Members. The review has been carried out by the Head of Audit Services and has been reviewed by the Corporate Governance Group who are tasked with :-
 - a. Collating and reviewing reports from external inspection agencies in terms of impact on control and governance
 - b. Collating and reviewing information on any significant control weaknesses, including details of remedial action
 - c. Reviewing the Code of Corporate Governance.
4. The review considers various aspects of the effectiveness of internal audit and, in conjunction with the Annual Planning Report, also considers the efficiency and economy of internal audit. The review has considered a number of documents and sources i.e :-

Review Sources	Target	Achieved
Compliance with the CIPFA Code of Practice for Internal Audit	100%	95%
Performance against plan and targets	100%	99%
Benchmarking of costs using CIPFA Benchmarking Club	Achieve median placing on costs i.e. around £50,903 average per auditor	£42,400 per auditor
Customer satisfaction survey	100% satisfactory or better	100%

Audit Commission review on Audit Services	High level of compliance with CIPFA Code of Practice as certified by Audit Commission	Achieved
Audit Commission reliance on Audit Services	Yes	Yes
Audit Committee operations in line with CIPFA guidelines	Yes	Yes

The review also considers other matters, including :-

- a. Quality Control
- b. Audit Partnerships
- c. Audit Services Annual Planning Reports 2008/09 and 2009/10
- d. Audit Committee Annual Reports on Directorates

5. In my opinion, the Review set out at Appendix 1 presents a reasonable and balanced view about the effectiveness of the Council's Internal Audit function.

Finance

6. This report has no direct financial effect.

Law

7. The Account and Audit Regulations 2006 require that the relevant body shall conduct a review at least once a year of the effectiveness of its system of internal audit and the findings of the review shall be considered by a committee of the relevant body.

Equality Impact

8. This report does not raise any equal opportunities issues.
9. Whilst children and young people are not directly consulted on, or involved with the development of the review, it will help ensure their interests are protected.

Recommendations

10. The review of the effectiveness of the system of internal audit included at Appendix 1 to this report is considered and accepted.



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Bill Baker

Interim Director of Finance

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REPORT ON THE REVIEW OF THE EFFECTIVENESS OF THE SYSTEM OF INTERNAL AUDIT

INTRODUCTION

1. The Accounts & Audit Regulations 2006 introduced a requirement for the Council to carry out a review of the effectiveness of the system of internal audit once a year and for the findings of the review to be considered by the Audit Committee or Council as part of the consideration of the governance arrangements.
2. This report identifies background information and the results of a self assessment carried out by the Head of Audit Services, which has been reviewed by the Corporate Governance and the Director of Finance.

BACKGROUND

3. CIPFA's Finance Advisory Network has noted that limited guidance has been issued on the methodology for the review but offers some ideas :-
 - a. The system of internal audit is deemed to be the total internal audit provision be it an in house or outsourced service or a mix of the two.
 - b. The review of the effectiveness of the system of internal audit should include a review of the effectiveness of the Audit Committee.
 - c. The Audit Committee should receive and consider the results of the review of the effectiveness of the system of internal audit.
 - d. The review will not be carried out by external audit as part of its annual work.
 - e. As with the Annual Governance Statement the review will usually be carried out by a group of officers and/or members. Whilst there will usually be input from the Head of Audit Services they cannot be allowed to influence the direction or extent of the review. The Head of Audit Services could carry out a self assessment which would then be suitably reviewed.
 - f. The effectiveness of internal audit should not solely be judged by the extent of compliance with the Code of Practice for Internal Audit. The review is primarily about effectiveness not process or value for money. The focus of the review should be on the delivery of the internal audit service to the required standard set by the Authority and that it adds value to the Authority.
 - g. The review should also consider the level of reliance placed on internal audit by the external auditor.

FINDINGS

CIPFA CODE OF PRACTICE FOR INTERNAL AUDIT

4. CIPFA published a revised Code of Practice for Internal Audit in December 2006 and the Code included for the first time self assessment checklists covering both audit standards and the characteristics of effectiveness. Details are set out at Appendices A and B. Our self assessment on all aspects of compliance with the Code of Practice suggests 95% compliance, which is consistent with our assessment in 2009.

AUDIT PERFORMANCE

5. The Annual Report covers this topic in detail and reports that our performance was up on last year at 99% of plan which, represents an excellent level of performance.
6. New targets were introduced in 2007/08 to look at how long the process from start of audit work to issue of draft audit report takes with a target of a maximum of eight weeks which would be a significant improvement on previous years. We achieved this target in 97% of the audits we carried out in 2008/09. The results for previous years were 92% in 2007/08 and 54% in 2006/07. We have hardened the target for 2009/10 by reducing the time from eight weeks to seven.
7. We operate Audit Process protocols with all Directors which set out our targets and also asked them to co-operate in finalising draft audit reports within six weeks of the report being issued. We achieved this in 70% of reports in 2008/09, which was a small improvement on the figure of 68% reported for 2007/08. Further monitoring of responses and discussion with management will take place to improve performance.
8. We have also developed our input to value for money studies and this resulted in us delivering approximately £80,000 in cashable savings arising out of a study into invoices processed by the authority. We are committing some of these funds towards additional resources to strengthen and expand the range of work we carry out to seek further efficiencies and savings.

BENCHMARKING

9. We are members of the CIPFA Benchmarking Club for Internal Audit and supply details to enable comparison of costs with other Authorities. The results of the 2008 exercise produced the following estimates for the financial year 2008/09 :-

	<u>Dudley</u>	<u>Similar</u>	<u>Rest of</u>
	<u>[£]</u>	<u>Boroughs</u>	<u>Black Country</u>
		<u>[£]</u>	<u>[£]</u>
Cost per auditor	41,400	48,428	57,055
Cost per £1m turnover	765	903	1,032
Cost per audit day	225	283	354

We are pleased to note that our costs are the lowest in the Black Country.

CUSTOMER FOCUS

10. In 2008 in conjunction with the Directorate, we achieved re-accreditation of the Charter Mark standard for excellent customer service.
11. Our main system for identifying customer views is in a Post Audit Questionnaire which goes out after the final audit report is issued. The Annual Planning Report covers the results in depth and concludes that satisfaction levels are good.

12. We continue to organise meetings of the Nominated Officer Group which includes representatives from all Directorates and is tasked with :-
 - a. Discussion forum to consider best practices within the Directorates, concerning Audit Reports, implementation of Audit Recommendations & monitoring of Management Action Plans.
 - b. Act as client consultation group to consider ways in which the Audit Service can be developed.
 - c. Forum to consider how the control environments can be improved within the Directorates.

The meetings are well attended and Directorates are developing increasingly sophisticated tools to ensure Audit Reports are actioned in line with timescales given.

AUDIT COMMISSION

13. The Audit Commission confirmed that they continue to rely on us for audits on the major financial systems.
14. The Audit Commission are required to carry out an annual "Use of Resources" assessment as part of the Comprehensive Performance Assessment process. This covers a wide range of finance related activities, including the internal control environment and risk management. The last review resulted in an overall rating of 3 (out of a maximum of 4), with risk management and fraud assessed as 3 [good], with internal control rated as 2 [satisfactory] largely due to the control failures on the Leaps & Bounds project.
15. The Audit Commission carried out their triennial review of Audit and reported that "Audit Services continue to demonstrate a high level of compliance with the standards outlined in the Code" [i.e. CIPFA Code of Practice for Internal Audit]. They identified four minor non compliance areas which were :-
 - a. Operate a declaration of interest scheme to ensure that staff do not get allocated to audits they have previously been operationally involved in. However we did not specify the length of time that rule should apply for. This has now been rectified.
 - b. We only have an informal system in place to capture any potential conflicts of interest in respect of contractors delivering internal audit work. This has been rectified for the 2009/10 plan.
 - c. The audit plan does not prioritise individual audits to enable re-assessment of quarterly plans in the vent of slippage. This has been rectified.
 - d. The audit plan does not balance available resources to those required to deliver the plan. This was done in practice but has been formalised.

AUDIT COMMITTEE

16. The roles and responsibilities of the Audit Committee are a key part of the system of internal audit. Dudley has an established Audit Committee and its Terms of Reference are in line with guidance issued by CIPFA.
17. CIPFA guidance on this review of the effectiveness of the system of internal audit suggested that the effectiveness of the Audit Committee should also be assessed. In October 2007, the Audit Committee completed a self assessment using a toolkit issued by CIPFA's Better Governance Forum. This exercise concluded that the work of the Audit Committee was effective.

QUALITY CONTROL

18. Each piece of audit work is governed by the standards set out in the Code of Practice for Internal Audit and our own Audit Manual. All audits are subject to ongoing supervisory input before and during the audit. Once the audit work has been completed the file is subject to review by Audit Managers who ensure that the work is to acceptable standards.
19. In line with the Code of Practice for Internal Audit the Head of Audit Services carries out a series of file overviews to ensure that standards have been achieved in the work, reviews and reports of all staff. These reviews assist in ensuring that the two teams operate to the same working practices.
20. We also operate a Methods Group to ensure all audit working practices are current and consistent across the Division. The work has included ensuring audit programmes utilise modern approaches to audit and, sampling policies are benchmarked against other Local Authority Audit Departments to ensure best practice is employed.

PARTNERSHIPS

21. Audit Services operates in partnership with Deloitte's and another company for the provision of more detailed computer audits. The previously agreed protocol to formalise the working and reporting arrangements that operate between Deloitte's, Audit Services and customers has been well received and is working well in practice.
22. A new four year Strategic ICT Audit Plan was prepared for 2007/11 and all audits scheduled for 2008/09 have been completed.

REPORTING

23. In line with CIPFA best practice, reports covering a range of issues are presented by Audit Services to the Audit Committee:-
 - a. Planning Report
 - b. Performance Plan
 - c. Results of work on each Directorate
 - d. Use of Resources

24. In April 2009 a new Fraud Report was presented and this will be an annual report going forward.

CONCLUSION

25. I believe that the findings identified in this report and in the Annual Planning report demonstrate that the system of internal audit is effective.

Les Bradshaw
Head of Internal Audit

APPENDIX A

CIPFA Code of Practice – Standards – 2009 Assessment

2006 Code Standard	Suggested Evidence of Achievement	Notes
<p>1. Scope of internal audit</p> <ul style="list-style-type: none"> • Terms of reference • Scope • Responsibilities in respect of other organisations • Fraud and corruption 	<p>Terms of reference reflecting current Code of Practice were approved by authority</p> <p>Scope of audit work takes into account risk management processes and wider internal control.</p> <p>Resource levels reviewed and commented on in report to Audit Committee</p> <p>The terms of reference identify responsibilities in respect of other organisations, including all key partnerships and LAAs.</p> <p>Terms of reference define audit responsibilities in relation to fraud.</p>	<p>Y</p> <p>Y</p> <p>Y</p> <p>Partial, in generic terms this is covered</p> <p>Y</p>
<p>2. Independence</p> <ul style="list-style-type: none"> • Organisational independence • Status of head of internal audit • Independence of individual internal auditors • Independence of internal audit contractors • Declaration of interest 	<p>Chief Internal Auditor has direct access to those charged with governance through the Audit Committee – see Fin Regs.</p> <p>Reports are made in own name to management and to Audit Committee.</p> <p>No conflict of interest between operational responsibilities and audit has been found.</p> <p>Rotation of audit work within the team is the norm.</p> <p>Contractor IT auditor firm does not have any other role within the authority.</p>	<p>Y</p> <p>Y</p> <p>Y</p> <p>Y</p> <p>Occasional consultancy via another team at Deloitte but this is managed</p>

	Auditors are required to declare interests and have been vetted.	Y
3. Ethics: <ul style="list-style-type: none"> • Integrity • Objectivity • Competence • Confidentiality 	Staff appraisal system considers these issues; no significant points have been identified.	Y
	Staff have been made aware of ethics requirements.	Y
	Guidance has been circulated.	Y
4. Audit Committee <ul style="list-style-type: none"> • Purpose of the Audit Committee • Internal audit's relationship with the Audit Committee 	Terms of reference have been formally approved and are regularly reviewed.	Y
	They include responsibility for the review of the SIC or governance assurance statement.	Y
	Audit committee approves and monitors audit strategy and plan.	Y
	Head of Internal Audit attends the meetings, reports on the outcome of internal audit work, identifies necessary changes to the audit plan, and presents an annual report and opinion or assurance on the internal control and risk management framework.	Y
5. Relationships with <ul style="list-style-type: none"> • Management, • Other internal auditors • External auditors • Other regulators and inspectors • Elected Members 	Managers are consulted on the audit plan and on the scope of each audit.	Y
	Responsibilities for managers and internal audit are defined in relation to internal control, risk management and fraud and corruption matters.	Y
	Good working relations established with external audit, including consultation on plan and opportunities for joint working.	Y

	<p>Sharing of information is undertaken with other internal review agencies.</p> <p>There is liaison with external regulators and inspectors.</p> <p>The responsibilities of internal audit staff and Members, particularly those of the Audit Committee are understood; training of members is carried out as necessary.</p>	<p>Y – Where appropriate</p> <p>As necessary</p> <p>Y</p>
6. Staffing, training and development	<p>The skills and competencies required of each post have been determined.</p> <p>Actual skills and competencies have been assessed and a gap analysis completed.</p> <p>Individual training and development plans have been agreed through the appraisal process and are being delivered.</p> <p>Professional staff are required to complete CPD. Training plan is linked to business plan.</p>	<p>Y</p> <p>Y</p> <p>Y</p> <p>Y</p> <p>Y</p>
7. Audit Strategy and Planning	<p>The Audit Strategy complies with the Code of Practice and has been formally approved by the Audit Committee</p> <p>It is reviewed each year.</p> <p>The risk-based Audit Plan has been prepared in accordance with the strategy. The corporate risk register has been used as the basis of the plan to the extent deemed appropriate according to the extent to which risk management has been implemented in the authority. This has been assessed by the Chief</p>	<p>Y</p> <p>Y</p> <p>Y</p>

	<p>Internal Auditor, who has also carried out his own risk assessment.</p> <p>Available resources have been compared with the resource need and a report submitted to the Audit Committee setting out proposals on dealing with the shortfall.</p> <p>The plan has been approved by the Audit Committee</p>	<p>No shortfall identified but logically we would take a report.</p> <p>Y</p>
<p>8. Undertaking Audit Work</p> <ul style="list-style-type: none"> • Planning • Approach • Recording and Assignments 	<p>An audit brief is prepared and agreed with management for each audit.</p> <p>A risk-based approach is used and an audit opinion is given.</p> <p>Issues are discussed with management as they arise.</p> <p>Standards of working papers are specified and checked as part of the file review.</p> <p>Adequate working papers supporting conclusions drawn and recommendations made are maintained and retained in accordance with defined policy.</p> <p>Reports are issued to appropriate managers in accordance with defined policy.</p>	<p>Y</p> <p>Y</p> <p>Y</p> <p>Y</p> <p>Y</p> <p>Y</p>
<p>9. Due professional care</p> <ul style="list-style-type: none"> • Responsibilities of the individual auditor • Responsibilities of the Head of Internal Audit 	<p>All internal auditors are aware of their individual responsibilities for due professional care.</p> <p>Chief Internal Auditor reviews all audit files and reports.</p> <p>Appraisal and training is in place</p>	<p>Y</p> <p>N – Files reviewed by Audit Management, but increased number of files now overviewed by HOAS</p> <p>Y</p>

	A whistle-blowing procedure is maintained	Y
	Work is assigned so as to avoid potential conflicts of interest.	Y
10. Reporting • Reporting on audit work • Annual reporting	Audit reports give an opinion on risks and controls, using approved methodology	Y
	Scope of audit is set out in Report	Y
	Recommendations are prioritised according to risk	Y
	Draft reports are discussed with management and action plans agreed in response to recommendations made	Y
	Reports are issued to appropriate managers	Y
	Where necessary, issues are referred to risk manager	Y
	Assurances are sought from managers on delivery of agreed actions	Y
	An escalation procedure has been defined and is used as appropriate	Y
	Where necessary, the opinion is revised in the light of the delivery of agreed actions.	Y – Although this is rare
	An annual report to support the Annual Governance Statement is presented to the Audit Committee	Y
	The report includes the opinion on the control environment and any qualifications to that opinion	Y
	The work on which the opinion is based is set out	Y

	<p>in the report.</p> <p>The report highlights significant issues.</p> <p>Interim reports are submitted to the Audit Committee advising of how the opinion is developing</p>	<p>Y</p> <p>N – Not deemed necessary albeit Corporate Control Group meet twice a year</p>
<p>11. Performance, quality and effectiveness</p> <ul style="list-style-type: none"> • Principles of performance, quality and effectiveness • Quality assurance of audit work • Performance and effectiveness of the internal audit service 	<p>Policies and procedures are defined in an audit manual</p> <p>Audits are assigned according to the skills mix required and so that there is adequate supervision</p> <p>Performance measures are defined and results reported to Audit Committee in the annual report.</p> <p>Internal quality reviews are undertaken by the Head of Internal Audit for all audit work</p> <p>Client satisfaction surveys are issued with each final report and are summarised in annual report .</p> <p>An annual assessment of the work of internal audit is undertaken by the external auditor.</p>	<p>Y</p> <p>Y</p> <p>Y</p> <p>N – HOAS carries out large number of overviews.</p> <p>Y</p> <p>Y – Managed Audits</p>

APPENDIX B

CIPFA Code of Practice - Characteristics of Effectiveness – 2009 Assessment

Characteristic of 'effectiveness'	Evidence of Achievement	Notes
Understand its position in respect to the organisation's other sources of assurance and plan its work accordingly.	Internal audit identifies other sources of assurance and takes this into account when preparing the internal audit plan.	Y
Understand the whole organisation, its needs and objectives.	The audit plan demonstrates how audit work will provide assurance in relation to the authority's objectives. Individual audit assignments identify risks to the achievement of those objectives.	Y Y
Be seen as a catalyst for change at the heart of the organisation.	Supportive role of audit for corporate developments such as corporate governance review, risk management and ethics. Individual assignments may be catalyst for change.	Y Y
Add value and assist the organisation in achieving its objectives.	Demonstrated through individual audit assignments and also corporate work.	Y
Be involved in service improvements and projects as they develop, working across internal and external boundaries to understand shared goals and individual obligations.	Internal audit provides help and advice on request and supports specific projects identified in plan and on <i>ad hoc</i> basis.	Y
Be forward looking – knowing where the organisation wishes to be and aware of the national agenda and its impact.	When identifying risks and in formulating the plan changes on the national agenda are considered. The audit section maintains awareness of new developments in the	Y

	services it audits, risk management and corporate governance and disseminates this knowledge to other parts of the local authority.	Y
Be innovative and challenging shaping the values and standards of the organisation; providing internal inspection and validation and encouraging service managers to take ownership of processes, systems and policy.	Internal audit has taken an innovative approach to its reporting arrangements by focusing on risks and encouraging managers to develop their own responses to the risks, rather than audit recommendations. The aim of this is to encourage greater ownership of the control environment amongst managers.	Y – We always allow Management the opportunity to come up with alternative solutions
Ensure the right resources are available – the skills mix, capacity, specialism and qualifications / experience requirements all change constantly.	This was explicitly addressed by a paper on resources to the Audit Committee on [date]. Arrangements are in place to obtain specialist input on IT audit.	Y Y