

Meeting: AUDIT COMMITTEE

Agenda Item:

Date: 10 June 2008

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**REVIEW OF THE EFFECTIVENESS OF THE SYSTEM OF INTERNAL AUDIT
2007/08**

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1 PURPOSE

To review the effectiveness of the system of internal audit.

2 RECOMMENDATIONS

- 2.1 That Members consider the results of the review of the effectiveness of the system of internal audit.
- 2.2 That Members confirm that the system of internal audit undertaken by the Council is effective.
- 2.3 That Members confirm that the effectiveness of internal audit can be included in the Annual Governance Statement.

3 BACKGROUND

- 3.1 The Accounts and Audit (Amendment) (England) Regulations 2006 came into force from 1 April 2006. Paragraph 6 (3) states that:-

“the relevant body shall, at least once in each year, conduct a review of the effectiveness of its system of internal audit”.
- 3.2 The Regulations go on to state that the findings of this review be considered by a Committee of the relevant body. In this Council, the relevant Committee is the Audit Committee.
- 3.3 The regulations also state that the findings of the review of the effectiveness of its system of internal audit will be considered as part of the review of the Annual Governance Statement. That report is also on this Committee’s agenda. From 2007/08, the Annual Governance Statement has replaced the Statement on Internal

Control.

- 3.4 In 2006, the Department of Communities and Local Government (DCLG) issued guidance on this effectiveness review. This guidance cites the CIPFA Code of Practice for Internal Audit in Local Government which was published in December 2006.
- 3.5 The Chief Internal Auditor's Annual Internal Audit Report for 2007/08 is on the agenda. This report reviews the work undertaken by Internal Audit and contains the Chief Internal Auditor's opinion. Because of the requirement to review the effectiveness of its system of Internal Audit consideration of the compliance with the Code of Practice is included in this report. This meets the requirements of the Regulations.
- 3.6 The review should not only cover the work of the Internal Audit Section. The effectiveness of the system of internal audit should include the effectiveness of the relevant Member Committee as well as the performance of the internal audit provider. The starting point for the review is an assessment against the relevant internal audit standards. Details are included in the self assessment checklist included in Appendix 2.
- 3.7 The 2006 Accounts and Audit Regulations require the results of the review to be reported to the appropriate Committee. The task of carrying out the review could be undertaken by any of the following:-
- self assessment
 - peer review
 - external auditors
 - internal panel
 - any other suitably qualified person
 - combination of some or all of above.

The vast majority of authorities have opted for a self assessment based upon the CIPFA checklist.

- 3.8 The DCLG guidance refers to 'proper practices' set out in the Accounts and Audit Regulations. With regard to proper practices in relation to internal audit, the DCLG guidance identifies the CIPFA Code of Practice for Internal Audit. This Code includes a checklist which is an essential tool for assessing the effectiveness of internal audit. The standards covered in the checklist are set out in Appendix 2.
- 3.9 In summary, the review of the effectiveness of the system of internal audit should cover:-
- compliance with CIPFA Code of Practice
 - effectiveness of relevant Member Committee
 - reliance on Internal Audit
 - client and management opinion
 - extent to which Internal Audit adds value and helps delivery of corporate objectives

- any other relevant information.

3.10 Some of the evidence which has been included in the effectiveness review is as follows:-

- Annual Audit Report and opinion of the Chief Internal Auditor (as substitute Interim Head of Finance) – presented to Audit Committee 10 June 2008
- internal audit progress update as presented to the Audit Committee 16 January 2008
- periodic reports of the Partnership Audit Manager presented to the Audit Committees of the Council and Stevenage Homes Ltd – details listed in Appendix 1
- key performance indicators
- summaries of client satisfaction surveys and questionnaires
- surveys of key stakeholders
- Audit Commission – report on the Review of Internal Audit Management Arrangements which was presented to the Audit Committee on 17 March 2008
- Audit Commission – Annual Governance Report presented to the Audit Committee on 27 September 2007 and subsequent progress reports against the Action Plan
- Audit Commission – Use of Resources Assessment presented to the Audit Committee on 17 March 2008.
- Audit Commission – Post Statement Report
- Self-assessment against professional standards.

4 FINDINGS OF THE REVIEW OF THE EFFECTIVENESS OF THE SYSTEM OF INTERNAL AUDIT

4.1 Details from reviewing some of the major evidence listed in paragraph 3.10 is shown below.

4.2 The CIPFA Code of Practice for Internal Audit checklist is attached as Appendix 2. In the temporary absence of the Chief Internal Auditor, this was completed by the former Interim Head of Finance as a self-assessment. It has been discussed with the Deputy Audit Manager and the new Chief Internal Auditor. The checklist has been completed largely reflecting “Yes” or “Partial” compliance with the Code. Where the few responses of “No” are given, they generally contain caveats explaining the relevant circumstances or reflect areas that are not considered to materially detract from the effectiveness of the system of Internal Audit in the Council and can, in most instances, be easily addressed, if applicable. Not all areas have to be ticked as “yes” to be rated as compliant with the Code.

4.3 2007/08 has been a year of significant change for Internal Audit. The initial Partnership Manager left during Spring 2007 and Uttlesford District Council withdraw from the Audit Partnership in April 2007. There were other staff changes before a pilot Partnership arrangement with North Herts DC was set up from June 2007. As reported to the Audit Committee on 16 January 2008, for various reasons, this was not as successful as anticipated and it has been terminated with effect from 31 March 2008. The Council has recruited its own Chief Internal Auditor who has been in post from May 2008.

- 4.4 The staff/partnership changes plus others factors such as a high level of special audit investigations and a very significant under-estimate of the SHL audit workload has resulted in slippage of several audits into 2008/09. However with the recruitment of a full time dedicated Chief Internal Auditor and some temporary additional resources to clear the backlog, audit work should be completed to plan in 2008/09. Progress against the 2008/09 plan will be closely monitored by the Chief Internal Auditor and regular updates will be provided to the Audit Committee.
- 4.5 After allowing for the points included in the two previous paragraphs, the review of the checklist gives assurance that the Internal Audit Section has the appropriate building blocks in place (Policies, Procedures, Structures) that will provide an adequate base from which an effective Service can be delivered to the required standard. In addition a summary has been produced at Appendix 3, to support the reviewed degree of compliance with each of the elements of the Code.
- 4.6 As previously stated, the Chief Internal Auditor's Annual Internal Audit Report 2007/08 is the subject of a separate report on this agenda. It is the Chief Internal Auditor's opinion that risks within the Council as identified by Internal Audit are "largely adequately controlled". This reflects a substantial to full level of assurance on the overall adequacy and effectiveness of the internal control environment at the Council. That report details the audit coverage during 2007/08 and details of the areas of audit activity conducted during the financial year. Despite the audit plan slippage mentioned above, the Council's Chief Financial Officer (Strategic Director – Resources) shares this opinion. Contributing to this adequate control is the work undertaken by the Internal Audit Section which during 2007/08 is assessed to have still been undertaken in an effective manner resulting in effective outcomes as reflected in the respective Internal Audit Reports and associated Management Action Plans issued throughout the year. 13 areas of the Council's services were the subject of Internal Audit reviews during 2007/08 resulting in over 140 individual recommendations to managers. Of these recommendations the vast majority were assessed as being medium to low risk.
- 4.7 Processes are in place to seek to enhance the overall effectiveness of Internal Audit throughout the year with regular meetings between the Chief Internal Auditor and Strategic Director (Resources) and Head of Finance as Chief Financial Officer and Deputy Chief Financial Officer respectively to review progress to date and audit issues arising.
- 4.8 It is considered that the overall effectiveness of the internal audit system is very much enhanced by having an Audit Committee. This Committee has in itself had a successful year taking on and addressing its various Terms of Reference, which specifically in relation to internal audit have included the review of the Internal Audit Plan and progress reports against the Plan, Annual Internal Audit Report and reviews of specific audit reports. It is these reviews of the specific service audit reports that has added an additional dimension to the consideration and potential effectiveness of these reports.
- 4.9 The Audit Commission's report on the Review of Internal Audit Management Arrangements has the following main conclusions:-
- Internal Audit's corporate arrangements broadly meet the required CIPFA Code standards. It notes areas where further improvements can be made.

These mainly relate to improving the way in which Internal Audit engages with and reports to the Audit Committee

- A revised resourcing table indicated insufficient resources to deliver the 2007/08 plan with consequent slippage in delivering the planned audits.
- With the termination of the Audit Partnership arrangement and the recruitment of a new Chief Internal Auditor, the Council needs to closely monitor the effectiveness of the internal audit service to ensure timely delivery of the audits as per the agreed internal audit plan.

- 4.10 Detailed recommendations from the Audit Commission's report are included in an Action Plan which has been agreed with implementation dates and is attached at Appendix 4 for information. This report was presented to the Audit Committee on 17 March 2008.
- 4.11 The Audit Commission places reliance on the work of internal audit in relation to key financial controls. This is a further indicator of the effectiveness of the system of Internal Audit.
- 4.12 The Audit Commission's Use of Resources Assessment was issued in January 2008. The Council's overall score was reduced from 3 to 2. This reflected a score of only 1 in the Financial Reporting category, covering areas needing improvement in producing the annual accounts. However the Internal Control category which covers the system of internal audit maintained a score of 3. This represents work consistently above minimum requirements - performing well.
- 4.13 In addition to routine planned audit work leading to the production of internal audit reports, the Audit Section provides related advice and assistance; day to day contact monitoring; deals with fraud, corruption and theft referrals as appropriate and delivers ethics and probity training across the Council. These reflect further aspects of the overall work of Internal Audit that also contribute to its overall effectiveness.
- 4.14 Satisfaction with the Internal Audit Service following the completion of audit reviews in 2007/08 remains very high. The new Chief Internal Auditor has revised the client satisfaction questionnaire to encourage wider responses.
- 4.15 An Internal Audit Service Level Agreement (SLA) was agreed between the Council and Stevenage Homes Ltd (SHL) for 2007/08. This was largely based on audit work previously undertaken in respect of Housing Services. As previously mentioned this was significantly under-estimated and did not embrace the assurances required for a newly created multi-million pound business. There has been significant slippage. However 7 service areas of SHL were the subject of Internal Audit reviews during 2007/08. This resulted in 150 individual recommendations to managers. The majority of the recommendations were assessed as being medium to low risk. The 2008/09 audit plan has been updated to reflect this additional work and agreed with SHL's Audit Committee. Some audits are conducted jointly in respect of the Council and SHL where they cover corporate systems shared by the two organisations. The Chief Internal Auditor reports directly to SHL's Audit Committee and where necessary liaises with SHL's external auditors. These arrangements and relationships are relatively newly established and there is an ongoing review of their effectiveness as part of the annual review of the SLA.

- 4.16 The review of the effectiveness of the system of internal audit cannot be considered in isolation and it feeds into the compilation of the Annual Governance Statement. The Governance report is also on this Committee's agenda. The result of the review is therefore included in the Governance Statement and includes the opinion that the internal audit system is effective.
- 4.17 Every Council has a statutory responsibility to ensure proper and adequate arrangements are in place for the administration of financial processes and systems. The statutory S151 Chief Financial Officer has a statutory responsibility to ensure compliance. The effectiveness of the system of internal audit is evidenced in ensuring compliance and identifying any weaknesses or risks.

5 IMPLICATIONS

5.1 Financial Implications

- 5.1.1 None arising directly from this report.
- 5.1.2 Adequate and effective operation of the Internal Audit function is a key part of the Council's overall system of Internal Control and governance arrangements. As such, it contributes significantly to the proper financial management of the Council. This implication paragraph is mandatory.

5.2 Legal Implications

- 5.2.1 It is a requirement of the Council to comply with the Accounts and Audit Regulations.

BACKGROUND DOCUMENTS

The Accounts and Audit Regulations 2006

The DCLG Guidance

CIPFA Code of Practice for Internal Audit in Local Government (including effectiveness checklist)

Chief Internal Auditor's 2007/08 Annual Internal Audit Report presented to 10 June 2008 Audit Committee

The report on the Annual Governance Statement presented to the 10 June 2008 Audit Committee

Periodic progress reports during 2007/08 on the audit plan, to various meetings of the Audit Committee

Audit Commission Report on the Review of Internal Audit Management Arrangements

Audit Commission - Annual Governance report

Audit Commission - Use of Resources Assessment

APPENDICES

Appendix 1 Reports submitted to Audit Committee Meetings 2007/08

Appendix 2 Internal Audit - Checklist compliance with Code

Appendix 3 Summary compliance with the Code of Audit Practice

Appendix 4 Action Plan - Audit Commission report on the Review of Internal Audit Management Arrangements