

<b>AUDIT COMMITTEE</b>	AGENDA ITEM No. 6
<b>27 JUNE 2011</b>	PUBLIC REPORT

Cabinet Member responsible:	Councillor Seaton, Resources Portfolio Holder	
Committee Member responsible:	Councillor Lamb, Chair of Audit Committee	
Contact Officer(s):	Steve Crabtree, Chief Internal Auditor	☎ 384 557

## **ANNUAL REVIEW OF THE EFFECTIVENESS OF INTERNAL AUDIT – 2010 / 2011**

<b>R E C O M M E N D A T I O N S</b>	
<b>FROM</b> : John Harrison, Executive Director (Strategic Resources)	<b>Deadline date</b> : N/a
Committee is asked to:	
1. Consider and comment on the Annual Review of the effectiveness of Internal Audit 2010 / 2011.	

### **1. ORIGIN OF REPORT**

This report is submitted as part of the annual Audit Committee work programme for 2011 / 2012.

### **2. PURPOSE AND REASON FOR REPORT**

In accordance with the requirements of the Accounts and Audit Regulations 2011 the Council conducts an annual review of the system of internal audit to be considered as part of its governance assurance processes, including the production of the Annual Governance Statement.

### **3 ANNUAL REVIEW OF INTERNAL AUDIT 2010/11**

3.1 Communities and Local Government (CLG) have now published the Accounts and Audit Regulations 2011. The main amendments contained within the final regulations now require a review of the effectiveness of internal audit, rather than a review of the effectiveness of the system of internal audit. Such a review has historically been provided as a fundamental part of the Annual Head of Internal Audit Opinion presented to this committee. This will remain the same.

3.2 Internal Audit is defined as the means by which the Council addresses its governance and assurance requirements, ensuring that an effective internal control system is in place. Outcomes from the current governance processes are evaluated and reported in the Annual Governance Statement.

3.3 To address the Accounts and Audit Regulations requirement an assessment of Internal Audit has been carried out which is presented for consideration by those tasked with completion of the Annual Governance Statement and by Audit Committee. It contains an opinion on the effectiveness of the Internal Audit Service including a self-assessment against the "Code of Practice for Internal Audit in Local Government in the UK" (CIPFA). Additional evaluation has been made against the CIPFA publication "Statement on the Role

*of Head of Internal Audit*". Furthermore, separate analysis of key performance indicators for 2010 / 2011 have also been utilised and these are reported in the Head of Internal Audit Annual Opinion which is also on this agenda.

- 3.4 The review was undertaken by the Head of Internal Audit and the report is presented for Members' consideration and comment.

#### **4 CURRENT ARRANGEMENTS FOR INTERNAL AUDIT**

4.1 A dedicated Internal Audit Section forms part of the system of internal audit in the Council. The Section is part of the Strategic Resources Department. It is led by the Chief Internal Auditor. It works closely with others in the Council tasked with assurance, governance and risk management but the Section retains a separate identity in relation to the performance of Internal Audit and investigation functions for the Council.

4.2 The Chief Internal Auditor reports directly to the Head of Corporate Finance and the Director of Strategic Resources but also has direct access, if required to the Chief Executive, Solicitor to the Council, Council Leader and Executive Members and the Chair of the Audit Committee.

4.3 At the start of 2010 / 2011 the in-house team comprised 8.10 FTE approved posts including the Chief Internal Auditor. This has reduced by 0.83 FTE by year end following the creation of the shared resource with Cambridge City Council (Chief Internal Auditor reduction 0.5 FTE) and one officer reducing their hours (0.33 FTE). Included in the current posts is one vacant post.

4.4 Due to the size of the section, it is not structured around client / service based teams nor the Council's directorates. This approach has allowed the opportunity for auditors to develop a depth of knowledge and relationships with customers in relation to the work of a number of services rather than specific areas. However, a number of officers do have specific technical attributes that provide the organisation with a "first point of contact". As a result, this provides some continuity to the customer who can regularly deal with the same auditor over a period of time.

4.5 The Section's strategy for the delivery of Internal Audit is set out in the Annual Audit Plan. The Internal Audit Service Terms of Reference (TOR) outline the status of the Section and define the principles of how it operates within the Council. It provides appropriate arrangements to ensure that the Internal Audit Section is sufficiently independent and objective and that there is access to all information and people required to discharge its responsibilities. This has been agreed with the Audit Committee. Arrangements for investigation work are defined in the Council's policies and procedures for Anti-Fraud and Whistleblowing and these are reported on in the Investigation Team Annual Report 2010 / 2011 which is submitted to the Audit Committee in June 2011.

4.6 Internal Audit undertakes its work in accordance with the CIPFA Code of Practice for Internal Audit in Local Government (2006). This is best practice guidance for the discharge of an internal audit function covering expectations and the standards required. External Audit carries out its review of the internal audit function against these standards.

4.7 To examine the system of internal audit, this review considered several key elements and assessed their contribution to enabling the section to fulfil its responsibilities. These were:

- The structure and resourcing level, including qualifications and experience of the audit team;
- The extent of compliance with the CIPFA Code of Practice in producing quality work;
- Comparison with the Statement on the Role of the Head of Internal Audit;
- Ensuring that the Section successfully audits the most appropriate areas on a prioritised (risk) basis; and

- The performance of the audit team (full details of which are reported in the Head of Internal Audit Opinion report).

## **5 BASIS FOR OPINION**

### **5.1 Staff Resources**

5.1.1 During 2010 / 2011 there was a minor reduction in staffing changes as a result of the shared arrangement for the Chief Internal Auditor post with Cambridge City Council (0.5 FTE reduction from January 2011), and reduction in working hours by a Senior Auditor. The reduced staffing position during the year did not severely impact on the ability to deliver some aspects of planned work within proposed timescales, despite a number of investigation referrals received and in-year requests for support from directorates. However a number of actions were taken which helped to ensure that overall delivery was achieved. A revised plan was brought before the Audit Committee in November 2010 that detailed various changes made following additional works requested and other activities being delayed or deleted. There were some audits carried forward from 2010 / 2011 to be completed in Quarter 1. Various options are being explored to fill the vacant post to increase available resources.

### **5.2 Training and Experience**

5.2.1 Training and development plans are in place to encourage development through both the career progression and continuing professional development. The following information about qualifications and experience of staff available for audit work demonstrates the significant experience and rich qualification mix in the Section.

Audit experience:

- Peterborough City Council service ranges from a minimum of 3 years service within Internal Audit to over 20 years; and
- Previous work experience is with banks, accountancy firms, other local authorities and other public sector organisations.

Qualifications:

- Qualified Accountants (CIPFA x1);
- Institute of Internal Auditors – Fellow / Member (CFIIA x2);
- Institute of Internal Auditors – Practitioner Level (PIIA x1);
- Institute of Internal Auditors – Certificate Level (CIA x1);
- Association of Accounting Technicians (MAAT x3).

5.2.2 The level of experience of audit staff remained static during the year, benefiting initially from stability within the audit team and increased time spent on audit work. There was some rotation of staff to enable a breadth of experience and for continuing professional development and this will continue based on operational need and the priority and timing of work. This approach provides increased flexibility to meet audit and investigation needs, particularly in time specific and statutory audits.

### **5.3 Compliance with the Code of Practice for Internal Audit in Local Government**

5.3.1 While an action plan has been reported to Members of this Committee in recent years, a fresh assessment was undertaken to ensure that no previous strengths had slipped. No slippages were identified. For 2010 / 2011 this demonstrated that the Section was meeting 188 out of 192 applicable Code requirements. There is still work to do on 4 areas and these are detailed in the attached Appendix 1.

### **5.4 External Audit Opinion**

5.4.1 PricewaterhouseCoopers comment in the Annual Audit Letter on the adequacy, or otherwise of Internal Audit as well as other governance arrangements. The latest report,

taken to Audit Committee in February 2011 concluded that they could place reliance on the work of Internal Audit. As a result the auditors have confirmed that they will be able to take assurance over the quality and extent of audit work done in 2010 / 2011 including assurance over the core financial systems activity.

5.4.2 Liaison with the external auditor continues to be productive and offers the opportunity to co-ordinate audit plans and to share information and to inform risk assessments. The Section agreed the scope and approach to auditing the core financial systems enabling Internal Audit to deliver work of increased value to the Council whilst ensuring that the needs of the external auditor are addressed.

#### 5.5 Comparison with Statement on Role of Head of Internal Audit

5.5.1 CIPFA published its Statement on the role of the Head of Internal Audit in public service organisations in December 2010 following widespread consultation. The statement sets out best practice for HIAs to aspire to and for Audit Committees and others to measure internal audit against. The original document was brought to Audit Committee in September 2010.

5.5.2 The statement sets out an overarching principles-based framework which is intended to apply to all HIAs in the UK. The Statement draws on the best practice and regulatory requirements in public services, as well as the requirements of CIPFA, other professional accountancy bodies' and the Institute of Internal Auditors' codes of ethics and professional standards. As well as articulating the core responsibilities of the HIA, the statement also identifies the personal and professional skills needed.

5.5.3 The Statement sets out the five principles that define the core activities and behaviours that belong to the role of the HIA in public service organisations and the organisational arrangements needed to support them. For each principle the Statement sets out the governance arrangements required within an organisation to ensure that HIAs are able to operate effectively and perform their core duties. The Statement also sets out the core responsibilities of the HIA.

5.5.4 The Statement supports CIPFA's work to strengthen governance, risk management and internal audit across public services. It is intended to allow the "Leadership Team" of a public service organisation to benchmark its existing arrangements against a defined framework. CIPFA recommends that organisations should report publicly on compliance to demonstrate their commitment to good practice.

*The statement recognises that the Head of Internal Audit will play a critical role in delivering the organisation's strategic objectives by:*

- *Championing best practice in governance and management, objectively assessing the adequacy of governance and management of existing risks, commenting on responses to emerging risks and proposed developments; and*
- *Giving an objective and evidence based opinion on all aspects of governance, risk management and internal control.*

*To perform this role the Head of Internal Audit:*

- *Must be a senior manager with regular and open engagement across the organisation, particularly with the Leadership Team and with the Audit Committee;*
- *Must lead and direct an internal audit service that is resourced to be fit for purpose; and*
- *Must be professionally qualified and suitably experienced.*

5.5.5 There are a series of attributes and personal qualities which sit below these principles, some subjective. However, an initial assessment would indicate that the role of the Head of

Internal Audit at Peterborough City Council already meets the underlying aims of the five principles set out above.

## 5.6 Integrated Audit Work With Risk Management and Governance Arrangements

5.6.1 Prioritisation of the work of the Audit Section is achieved by the development and delivery of an annual risk based Audit Plan. This describes the assurance plans for the Section and includes some capacity for flexibility to adjust to changing circumstances and for demand led and urgent work if appropriate. The plan is based on a mix of different types of audit and risk based work to ensure that assurance over the Council's systems of governance, risk management and internal control is obtained from a number of different directions and sources as illustrated below.

5.6.2 The Section's methodology for establishing audit priorities is aligned with the Council's governance and risk management systems. Audit plans are developed through an assessment of risk and assurance needs to support the Council's overall objectives. The Section reviews corporate and departmental risk registers, business plans and discusses Council objectives and priorities with Directors and Heads of Service to assess assurance needs. The Audit Plan is discussed and approved by Audit Committee in March each year.

5.6.3 It is considered that the 2010 / 2011 Audit Plan represented a reasonable view of critical areas for audit review and assurance needs when it was constructed and agreed with senior management and Audit Committee. Some changes were reported in mid-year following additional requests from senior managers; nevertheless, the plan was largely delivered as planned.

5.6.4 During the year some audit work was deferred or cancelled due to the timing of the audits and the changes to organisation objectives. The impact of budget cuts and organisational change was reflected in the reassessment of the work and alternative means of gaining assurance where appropriate.

5.6.5 For 2011 / 2012, the agreed Audit Plan now show links to the corporate aims / objectives in order to clearly demonstrate how audit work relates to the achievement of Council objectives.

## 5.7 Performance Measures

5.7.1 Internal Audit has a number of performance indicators that it monitors throughout the year. To avoid duplication, these are reported separately within the Head of Internal Audit Opinion. However the key issues are:

### *Better than target*

- Positive feedback on Post Audit Questionnaires (PAQ);
- Good levels of ongoing training / development provided;
- 100% of critical and high recommendations made were agreed;
- Fieldwork completion to draft report above target;
- Compliments exceed expectations.

### *On Target*

- No complaints in year.

### *Areas for improvement*

- Implementation of recommendations by management;
- Continue to reduce sickness levels.

## 5.8 Audit Committee

5.8.1 The system of Internal Audit includes the role of the "Audit Committee" and in particular its role in the receipt and evaluation of audit reports, both in terms of assurance opinions and

in ensuring that appropriate arrangements are in place for the delivery of an effective service. The arrangements for Committee remained the same during 2010 / 2011 with continuity of membership assisting in maintaining an effective committee. Membership has altered for 2011 / 2012 with 4 new Members. During 2010 / 2011 regular briefings took place with the Chair of the Audit Committee. This covered the future agenda items together with discussions around the works undertaken by Internal Audit.

5.8.2 As part of the audit protocol, all finalised audit reports are issued to the appropriate officers within the Council as well as the Executive Member and Chair of Audit Committee. These reports are discussed at the above briefings.

5.8.3 It is proposed that ongoing development and training for the Committee will continue in 2011 / 2012 with a programme of refresher and new Member training to be agreed. As part of this programme it is also proposed that the Terms of Reference for the Committee be reviewed and re-approved. In addition, a separate handbook will be regularly reviewed on the roles and responsibilities for an effective audit committee.

## **6 CONCLUSION**

Consideration of a range of views on the effectiveness of Internal Audit operating within the Council during 2010 / 2011 indicates that this has been both appropriate and effective. The report demonstrates that the Council has an effective system of internal audit including a policy framework, internal audit function, audit committee and effective management engagement.

## **7. CONSULTATION**

This report has been issued to the Executive Director (Strategic Resources) and Head of Corporate Finance for consideration.

## **8. ANTICIPATED OUTCOMES**

It is reasonable from all the assurances now available to the Council to conclude that a sound system of internal audit operated throughout 2010 / 2011.

## **9. REASONS FOR RECOMMENDATIONS**

To seek endorsement from members that internal audit within the authority is being delivered and provide effective challenge to the organisation.

## **10. ALTERNATIVE OPTIONS CONSIDERED**

None required at this stage.

## **11. IMPLICATIONS**

This report contains no specific financial implications.

## **12. BACKGROUND DOCUMENTS**

(Used to prepare this report, in accordance with the Local Government (Access to Information) Act 1985)

- Internal Audit Plans
- Internal Audit reports issued
- Internal Audit Terms of Reference
- Accounts and Audit Regulations 2011
- Code of Practice for Internal Audit in Local Government in the UK, CIPFA
- Statement on the Role of the Head of Internal Audit, CIPFA

**REVIEW OF SYSTEM OF INTERNAL AUDIT 2010 / 2011****Summary of Findings**

The internal self-assessment and sources of evidence provided, established the following areas which could be improved, or considered for improvement.

<b>Code Ref</b>	<b>Standard</b>	<b>Recommendations</b>
5.1.1 d	Is there a protocol that defines the working relationship for IA with other regulators and inspectors?	Establish a protocol for effective liaison with external inspectors (other than PwC).
5.5.1	Has the HoIA sought to establish a dialogue with the regulatory and inspection agencies that interact with the organisation?	As above.
6.1.2	Does the HoIA have access to appropriate resources where the necessary skills and expertise are not available within IA?	Develop an overall strategy to take forward specialist auditing areas in conjunction with Cambridge City Council (and others as appropriate).
11.3.4	Do the results of the performance management and quality assurance programme evidence that the internal audit service is adding value and assisting the organisation in achieving its objectives?	Internal Audit to issue a survey to senior management to establish the extent to which audit is adding value to their services.

**Conclusions**

Based on the assessment against 192 questions, the evidence collected demonstrates the Council operates in compliance with professional standards, and initiates change where improvements to the internal control environment is required. The review has identified a number of areas where ongoing improvements could be made (within internal audit and also corporately).

In conclusion, there are no material weaknesses which impact on the overall effectiveness of the internal control environment.

## **REVIEW OF SYSTEM OF INTERNAL AUDIT 2010 / 2011**

<b>1</b>	<b>SCOPE OF INTERNAL AUDIT</b>
1.1	Terms of Reference
1.2	Scope of Work
1.3	Other Work
1.4	Fraud and Corruption
<b>2</b>	<b>INDEPENDENCE</b>
2.1	Principles of Independence
2.2	Organisational Independence
2.3	Status of the HoIA
2.4	Independence of Internal Audit Contractors
2.5	Declaration of Interest
<b>3</b>	<b>ETHICS FOR INTERNAL AUDITORS</b>
3.1	Purpose
3.2	Integrity
3.3	Objectivity
3.4	Competence
3.5	Confidentiality
<b>4</b>	<b>AUDIT COMMITTEES</b>
4.1	Purpose of the Audit Committee
4.2	Internal Audit's Relationship with the Audit Committee
<b>5</b>	<b>RELATIONSHIPS</b>
5.1	Principles of Good Relationships
5.2	Relationships with Management
5.3	Relationships with Other Internal Auditors
5.4	Relationships with External Auditors
5.5	Relationships with Other Regulators and Inspectors
5.6	Relationships with Elected Members
<b>6</b>	<b>STAFFING TRAINING AND CONTINUAL PROFESSIONAL DEVELOPMENT</b>
6.1	Staffing Internal Audit
6.2	Training and Continuing Professional Development
<b>7</b>	<b>AUDIT STRATEGY AND PLANNING</b>
7.1	Audit Strategy
7.2	Audit Planning
<b>8</b>	<b>UNDERTAKING AUDIT WORK</b>
8.1	Planning
8.2	Approach
8.3	Recording Audit Assignments
<b>9</b>	<b>DUE PROFESSIONAL CARE</b>
9.1	Responsibilities of the Individual Auditor
9.2	Responsibilities of the HoIA
<b>10</b>	<b>REPORTING</b>
10.1	Principles of Reporting
10.2	Reporting on Audit Work
10.3	Follow-up Audits and Reporting
10.4	Annual Reporting and Presentation of Audit Opinion
<b>11</b>	<b>PERFORMANCE, QUALITY AND EFFECTIVENESS</b>
11.1	Principles of Performance, Quality and Effectiveness
11.2	Quality Assurance of Audit Work
11.3	Performance and Effectiveness of the Internal Audit Service