

**Financial Scrutiny and Audit
Committee**

9 July 2013

Agenda Item No 10

Review of the Effectiveness of Internal Audit

Report by Head of Internal Audit

Summary:

This report sets out the results of an annual review of the effectiveness of Internal Audit, undertaken to satisfy criteria in the Accounts and Audit Regulations 2011.

Internal Audit's performance and quality assurance framework has been examined to enable the Financial Scrutiny and Audit Committee to confirm whether Internal Audit Services are effective, and that the assurances provided in the Internal Audit Annual Report and Opinion can be relied upon, and used to inform the Authority's Annual Governance Statement for 2012/13. The outcomes of the review are attached at Appendix 1.

Recommendation: That the Committee is requested to note the findings of the review, and the evidence gathered in support of the effectiveness of the Internal Audit Service, and takes these into consideration when receiving the Head of Internal Audit's Annual Report and Opinion, and the Authority's Annual Governance Statement.

1 Introduction / Background

- 1.1 CIPFA's Statement on the Role of the Head of Internal Audit in Local Government states that "the Head of Internal Audit occupies a critical position in a local authority, helping it to achieve its objectives by giving assurance on its internal control arrangements and playing a key part on promoting good corporate governance."
- 1.2 The Accounts and Audit Regulations 2011 further require that an organisation the size of the Broads Authority must undertake an annual review of the effectiveness of its internal audit function, and that this review be undertaken by the same body that reviews the effectiveness of the system of internal control. To assist this process, Internal Audit working practices are required to comply with CIPFA's Code of Practice for Internal Audit in Local Government in the United Kingdom (2006), although these arrangements are set to change from 2013/14 when new consolidated Public Sector Internal Audit Standards (PSIAS) will replace CIPFA's Code of Practice. However, for the purposes of this effectiveness review, the Code of Practice remains applicable and an assessment has been undertaken to verify the level of compliance achieved

during 2012/13, but it should also be appreciated that steps are currently underway to migrate to the new Standards in the new financial year.

- 1.3 The existing performance and quality assurance framework developed by the Head of Internal Audit to ensure adherence to CIPFA's Code of Practice predominantly meets much of the newly introduced PSIAS requirements, although there is also an obligation to arrange for an external assessment of the effectiveness of internal audit at least once every five years. The way in which external assessments should be conducted is covered in PSIAS No. 1312 and summarised at Appendix 2 to this report, to give members early oversight regarding provisions that will need to be developed in the future.
- 1.4 With reference to the 2012/13 review of the service's effectiveness however members can be satisfied that the relevant assurances provided are reliable and based upon a firm foundation, and that the service itself is operating effectively.
- 1.5 A summary of review outcomes are attached at Appendix 1, and essentially benchmark the service against a range of eight measures, whilst additional supporting information generated in the course of the review has been supplied to the Authority's Section 17 Officer and the Head of Finance to afford independent verification of the detailed processes followed by the Head of Internal Audit.

Background papers: None

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Date of Report: 21 June 2013

Broads Plan Objectives: None

Appendices: APPENDIX 1 - Annual Review of the Effectiveness of Internal Audit
APPENDIX 2 - Externally assessing Internal Audit

Annual Review of the Effectiveness of Internal Audit

The Scope of this Review

This review is primarily about effectiveness, not process. In essence, the need for the review is to ensure that the opinions expressed by the Head of Internal Audit in the Annual Report may be relied upon as key sources of evidence in the Annual Governance Statement.

In order for the Broads Authority to be able to place reliance on the opinions contained within the Annual Report and Opinion, the Internal Audit Consortium Manager (as the Authority's Head of Internal Audit) has in place a performance and quality assurance framework to demonstrate that the Internal Audit Service is:

- Meeting its aims and objectives.
- Being compliant with the CIPFA Code of Practice for Internal Audit in Local Government.
- Being compliant with the CIPFA Statement on the Role of the Head of Internal Audit in Public Service Organisations.
- Meeting internal quality standards, confirmed through performance indicators and post audit feedback received.
- Putting forward practical audit recommendations that are agreed with senior management and lead to ongoing improvements to the internal control environment at the Council, as evidenced by the subsequent implementation of agreed actions.
- Continually seeking to improve service delivery whilst also adding value and assisting the Council in meeting its objectives.
- Producing work which the External Auditor is able to place reliance upon.
- Supporting an effective Audit Committee.

Delivering the Aims and Objectives of Internal Audit

The aims and objectives of the Internal Audit Service are established in Internal Audit's Terms of Reference, Internal Audit's Strategy, Annual Audit Needs Assessment and Strategic and Annual Audit Plans, which are updated each year and submitted to the Audit Committee for formal approval.

There are essentially three main objectives which drive service delivery:

Objectives	Means of delivery
To provide an independent and objective opinion to the organisation on the control environment comprising risk management, control and governance, by evaluating its effectiveness in achieving the organisation's objectives.	<p>In June / July each year, the Head of Internal Audit provides an annual opinion on the Authority's system of internal control, and its arrangements for corporate governance and risk management.</p> <p>Internal Audit's Terms of Reference (Section 5 – Internal Audit's Independence and Accountability) and Code of Ethics explain how the Council's Internal Auditors are able to provide independent and objective opinions in</p>

	relation to individual audit assignments and when developing an overarching annual opinion.
To carry out an examination of the accounting, financial and other operations of the Council.	The Internal Audit Strategy and Terms of Reference demonstrate that Internal Audit reviews the a range of activities including Financial Key Controls, Corporate Governance, Risk Management, Planning Services and elements of ICT. All planned audit coverage is determined with the aid of a risk based annual audit needs assessment.
To assist management with the prevention, detection and investigation of fraud and abuse.	<p>Through undertaking in-depth reviews of business operations, the Internal Audit Service supports management in minimising the risk of fraud and abuse.</p> <p>In the course of 2012/13, the Council has been additionally proactive in refreshing its Counter Fraud, Corruption and Bribery Policy.</p> <p>In accordance with the Broads Authority's Financial Regulations – Section 35 Irregularities <i>“All Officers and Members are responsible for giving immediate notification to the Monitoring Officer, Director of Planning and Resources or Head of Finance where there are grounds to suggest any financial impropriety or irregularity concerning income, expenditure, cash, stores, or other property of the Authority or held by the Authority.”</i></p> <p>On the basis of the above, there is then the expectation that thereafter, the Internal Audit Consortium Manager will be consulted regarding incidents of suspected or detected fraud, corruption or impropriety.</p> <p>Furthermore the Whistleblowing Policy does recognise that concerns raised can be referred to Internal Audit.</p>

In the course of the financial year, the Head of Internal Audit has had progress meetings with the Treasurer / Financial Advisor (Section 17 Officer) and the Head of Finance, some of which have also been attended by the Director of Change Management and Resources to discuss the status of audit assignments featuring in the Annual Audit Plan and the quality of service delivery generally, and to debate and agree Draft Audit Plans for the following year,

prior to their submission to Corporate Management Team and the Financial Scrutiny and Audit Committee for formal approval.

The Internal Audit Consortium Manager has similarly met with members of the Financial Scrutiny and Audit Committee, attending 3 of the 4 scheduled Committee meetings convened during the year, and has contributed to Committee agendas with reports on the outcomes of Internal Audit work carried out at the authority. The adoption of private discussions with the Committee has now also been agreed, the first of which is tabled for the 9 July 2013, prior to the Committee meeting taking place, and this will enable Internal and External Audit to discuss the delivery and outcomes of their work with members without senior management being present.

The Head of Finance and Director of Change Management and Resources have also participated in 2 meetings of the Norfolk Internal Audit Consortium held in September 2012 and January 2013 (one attending each), with the Treasurer / Financial Adviser attending both meetings. These meetings are used to bring together Consortium members to review progress in relation to Annual Plans, discuss the performance of the contractor as well as any client officer issues arising, be appraised of any new developments/changes to working practices designed to improve service delivery and consider the future arrangements for the Internal Audit Service, when the contract with Deloitte & Touche Public Sector Internal Audit Ltd expires at the end of September 2014.

Complying with CIPFA's Code of Practice for Internal Audit in Local Government

The CIPFA Code of Practice for Internal Audit in Local Government specifies the standards for Internal Audit. In 2012/13, the Code of Practice self assessment checklist, completed by the Internal Audit Consortium Manager and submitted to the Head of Finance and the Treasurer/Financial Adviser (Section 17 Officer) for independent validation, confirmed **full compliance** had been achieved in relation to the 11 key criteria stated therein.

Positive steps have been taken in year to address two instances where deviations were noted in 2011/12. The Committee has now undertaken an exercise to evaluate its own effectiveness against the CIPFA Toolkit for Local Authority Audit Committees, with action points agreed to ensure full compliance. In addition private discussions have now been tabled with Internal and External Audit without the Authority's management being present, enabling the Committee to receive feedback from its auditors, in order to be assured that they have been receiving the necessary degree of co-operation and there have not been any attempts to restrict the work of the auditors.

Complying with CIPFA's Statement on the Role of the Head of Internal Audit in Local Government

This Statement sets out the 5 principles that define the core activities and behaviours that apply to the role of the Head of Internal Audit, and the organisational arrangements to support them. The Head of Internal Audit needs to:

- Champion best practice in governance, objectively assessing the adequacy of governance and management of risks, commenting on responses to emerging risks and proposed developments;
- Give an objective and evidence based opinion on all aspects of governance, risk management and internal control;
- Undertake regular and open engagement across the authority, particularly with the Leadership Team and with the Audit Committee;
- Lead and direct an Internal Audit Service that is resourced to be fit for purpose;

- Be professionally qualified and suitably experienced.

Each principle has associated requirements (59 in total) to demonstrate how they should be employed in practice. **The Internal Audit Service has been benchmarked against these criteria and been found to satisfy all relevant elements.**

Positive steps have also been taken in year to address the one aspect of partial compliance recorded in 2011/12; the Authority has recently refreshed its Counter Fraud, Corruption and Bribery and Strategy and this has ensured that the Internal Audit Consortium Manager as the authority's Head of Internal Audit now has overall responsibility for the progression of fraud investigations and will be notified of any suspicions/instances of fraud at the earliest opportunity.

N.B. The detailed assessment of the Internal Audit Consortium Manager's compliance with the key governance requirements and core responsibilities as specified in the CIPFA Statement has been forwarded to the Head of Finance and the Treasurer / Financial Advisor (Section 17 Officer), for independent scrutiny and verification.

Quality Standards applying to the Internal Audit Service

The Internal Audit Service is benchmarked against a number of performance indicators as agreed by the Financial Scrutiny and Audit Committee within the Terms of Reference for Internal Audit. Actual performance against these targets is outlined within the table below and overleaf:

Indicator	Target	2012/13 Performance	2011/12 Performance	Comment
% of audit recommendations accepted	90%	100%	100%	This continues to exceed target.
% of high priority recommendations implemented	100%	Not applicable	100%	No high priority recommendations were raised during 2012/13.

Indicator	Target	2012/13 Performance	2011/12 Performance	Comment
Days between issue of audit brief and fieldwork commencing	More than 10 days (average) 100%	16 100%	28.5 75%	Audit briefs are issued ahead of fieldwork being undertaken, and a 2 week lead in time has been adhered to for both audits undertaken.
Number of days between expected fieldwork completion and actual	0 days 100%	0 100%	0.2 80%	Fieldwork has been completed as expected.
Number of days between completion of audit fieldwork and draft report issue	10 days or less (average) 100%	9 50%	9.2 60%	Performance continues to meet target, however there was one audit where delays were experienced.
Number of days between issue of draft and final reports	15 days or less (average) 100%	3 100%	10.8 60%	Performance has improved greatly within this area.

Number of days between completion of fieldwork and final report issue	25 days or less (average) 100%	12 100%	20 60%	Again performance has improved greatly within this area.
Average score given to audit feedback	Adequate (4 out of 6)	Adequate (4.88)	Good (5.06)	Client satisfaction has deteriorated slightly, although we are still receiving positive feedback within target.

All performance targets have been met or exceeded the target during 2012/13.

The only slight exception is in relation to the timeframe between fieldwork completion and turn around of draft report, this was in relation to one audit and was as a result of the audit being selected to go through Deloitte's extended quality review process.

Strengthening the Council's Systems of Internal Control

Our work has confirmed that assurance levels for individual audits carried out in 2012/13 were both positive, with an adequate and a good assurance level being awarded.

It is pleasing to report that for the second year Corporate Governance arrangements and systems of Risk Management have been awarded a good assurance level in 2012/13. The organisation's provisions in these two areas effectively mirror best practice.

Standards of internal control have remained satisfactory during 2012/13, with an adequate (positive) opinion being awarded.

Our year end review of audit recommendations has indicated that there continues to be a good level of audit recommendations being progressed, with 83.3% of audit recommendations being recorded as implemented. The Annual Report and Opinion examines this in more detail.

In conclusion, it is acknowledged that Internal Audit work seeks to enhance the Council's internal control environment and management are responsive to accepting audit recommendations put forward.

Improving Service Delivery and Adding Value

We constantly strive to improve the Internal Audit Service, with reference to the way we operate and the quality of our outputs.

Other areas where we have sought to improve service delivery in year have concerned the redevelopment of our audit brief and reporting templates, to enhance the approach taken to the scoping of projects and communication of audit findings, together with submitting greater justification for audit opinions given.

The continuing production of Audit Newsletters over the course of the year and our ongoing membership of the Norfolk Chief Auditors Group – an excellent forum where we are able to network with our peers, discuss developments within the sphere of auditing and share best practice, represent additional ways in which we seek to add value for our clients.

External Audit's Reliance on Internal Audit's Work

We continue to maintain good working relationships with the Council's External Auditors, i.e. the Audit Commission and thereafter, Ernst and Young. We have always advocated close ties with our External Audit counterparts, in order to deliver effective and efficient integrated auditing provisions for the Council. As a consequence, throughout the year, we have had regular meetings and periodic email exchanges with our External Audit colleagues to discuss progress with the Annual Audit Plan, plus any key findings and issues arising from our work.

Since Ernst and Young assumed responsibility for External Audit at the Broads Authority, we have explored the feasibility of establishing an Audit Joint Working Protocol with them. We have been advised that such a Protocol cannot be finalised until their interim financial work has been completed in June 2013, after which we have been told that they will be in a position to confirm key controls they will be expecting us to test in the future as part of our review work, upon which they will then place reliance. However, for the time being, we have adopted their audit sampling requirements with reference to all 2012/13 financial audits - all samples being fully compliant with their specifications. We have also supported External Audit in drawing up a Briefing Paper to clarify how they will use our work.

At year end, we were additionally asked to provide Ernst and Young with a written response regarding our Objectivity, Competence and Due Professional Care, with evidence supplied in support of statements made. This was sought to enable them to form a view on our effectiveness. A copy of this document has been made available to the Head of Finance and the Treasurer / Financial Advisor (Section 17 Officer).

We also responded on another information request from Ernst and Young relating to the Risk of Fraud at the authority and the quality of provisions in place to safeguard the Council from fraudulent acts that could potentially be committed against it. This information has also been copied to the Head of Finance and the Treasurer / Financial Advisor (Section 17 Officer).

Supporting an Effective Audit Committee

The Audit Committee undertook a review of its own effectiveness for the first time during 2012/13, assessing itself against 66 separate elements detailed in the checklist provided in the IPF publication: 'A Toolkit for Local Authority Audit Committees'. Upon completion of the self-assessment exercise, it was agreed that 6 action points need to be addressed to ensure full compliance with the checklist. The action points were:

1. To regularly (annually) review the effectiveness of the Financial Scrutiny and Audit Committee against the self assessment checklist.
2. New member training to be provided, as and when necessary, by relevant officers, and in particular for the new member at the earliest opportunity.
3. Training is to be provided on topical issues throughout the year, as agenda items are considered.
4. That the Committee's terms of reference (paragraph 3) be amended to state – "To approve the Authority's Financial Regulations, Standing Orders relating to contracts and fraud, corruption and bribery arrangements." This review is also to consider the terms of reference as a whole for adequacy.
5. Private discussions to be held with the Committee, at least annually, the first of which will be prior to the meeting in February 2013.
6. A rolling work programme is to be developed and held as a standing agenda item.

Work is being undertaken to ensure that these action points are addressed, thus ensuring full compliance.

Additional Requirements specified by the Public Sector Internal Audit Standards (PSIAS) concerning External Assessments of the Effectiveness of Internal Audit

1. The requirement for an external assessment to be carried out at least once every 5 years may be satisfied by either arranging for a 'full' external assessment or by undertaking a self-assessment with independent validation.
2. PSIAS 1312 states that the Head of Internal Audit must discuss the format of the external assessments with the Audit Committee and therefore the Head of Internal Audit will have to consider the pros and cons for each type of external assessment before presenting the outcomes of such a deliberation to the Audit Committee.
3. If a local authority Head of Internal Audit elects to carry out a validated self-assessment, CIPFA's Local Government Application Note is recommended for externally validated self-assessments although other available checklists may be used to inform the process.
4. An independent person or team must be sourced to validate that self-assessment in order to meet the requirements set out in the PSIAS that arrangements are put in place to avoid conflict of interest and impairment to objectivity.
5. In ascertaining whether the external assessor or assessment team are appropriately qualified to carry out the full assessment or independent external validation of the self-assessment, it is key that the two areas of competence as set out in the PSIAS are met. This is particularly important where a system of peer review is set up to provide the external assessment.
6. Although it is possible that a local authority's external auditor may be appropriately independent to act as the external assessor or assessment team, the reviews that may already be carried out by the external auditor for placing reliance on the work of the internal audit activity, for example, do not automatically correspond with the requirements laid out in the PSIAS and CIPFA's Local Government Application Note.
7. The Head of Internal Audit must also set out, and discuss with senior management and the Audit Committee, the qualifications and independence of the external assessor or assessment team in accordance with both the main standard and the public sector requirement which go into detail on how an external assessor or assessment team should demonstrate their competence.
8. The public sector requirement mandates that local authorities must find an appropriate sponsor and suggests that this could be another officer within the organisation (for example the Chief Finance Officer or Chief Executive Officer). This is intended to further safeguard the independence of the external assessment process.