

**Financial Scrutiny and Audit
Committee**

10 July 2012

Agenda Item No. 6

Review of the Annual Effectiveness of Internal Audit for 2011/12

Report by Head of Internal Audit

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| <p>Summary:</p> | <p>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 Head of Internal Audit's Annual Report and Opinion can be relied upon, and used to inform the Authority's Annual Governance Statement for 2011/12. The outcomes of the review are attached at Appendix 1.</p> |
| <p>Recommendation:</p> | <p>That the Committee is requested to receive and note the findings of the review, and the evidence gathered in support of the effectiveness of the Internal Audit Service, and take these into consideration when receiving the Head of Internal Audit's Annual Report and Opinion, and the Authority's Annual Governance Statement.</p> |

1 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 role in promoting good corporate governance". The same can be said to apply to an organisation such as the Broads Authority.
- 1.2 The Accounts and Audit Regulations 2011 additionally 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.
- 1.3 Through undertaking this review, 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.
- 1.4 The review is attached at Appendix 1, and essentially benchmarks the service against a range of eight measures.

2 Conclusion

2.1 The report demonstrates that due processes have been followed in relation to conducting an annual review of the effectiveness of Internal Audit, whilst the outcomes of the exercise provide appropriate confirmation that Internal Audit:

- is delivering against its aims and objectives;.
- Is substantially complying with recognised good practice as specified in the CIPFA Code of Practice for Internal Audit in Local Government and the CIPFA Statement on the Role of the Head of Internal Audit in Public Service Organisations;
- is meeting its internal quality standards;
- is supporting management in the monitoring and further development of the Authority's internal control environment, making practical audit recommendations and overseeing implementation of agreed actions;
- is continually looking at ways of improving service delivery, adding value wherever possible;
- is working closely with its External Audit colleagues to ensure they can place reliance on its work; and
- is supporting an effective Audit Committee.

2.2 On the basis of the above, there is justification for placing reliance on the opinions expressed by the Head of Internal Audit in the Annual Report, and to ensure that the information thus given in this Report is then used to inform the Authority's Annual Governance Statement.

Background papers None

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Date of Report: 29 June 2012

Broads Plan Objectives: None

Appendices: APPENDIX 1 – Annual Review of the Effectiveness of 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 opinion expressed by the Head of Internal Audit in the Annual Report may be relied upon as a key source 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 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 Authority, as evidenced by the subsequent implementation of agreed actions.
- continually seeking to improve service delivery whilst also adding value and assisting the Authority in meeting its objectives.
- producing work which the External Auditor is able to place reliance upon.
- supporting an effective Audit Committee.

Delivering the 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 Plan, which are updated each year and submitted to the Financial Scrutiny and 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 organisation's Internal Auditors are able to provide independent and objective opinions in relation to individual audit assignments and when developing an overarching annual opinion.</p> |
| To carry out an examination of the accounting, financial and other operations of the Authority. | The Internal Audit Strategy and Terms of Reference demonstrate that Internal Audit reviews 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 and a 3-yearly computer audit needs assessment. |
| To assist management with the prevention, detection and investigation of fraud and abuse. | Through undertaking in-depth reviews of business operations, the Internal Audit Service supports management in minimising the risk of fraud and abuse. |

Throughout the year, the Head of Internal Audit has had five meetings with the Director of Change Management and Resources, some of which have also involved interaction with the Treasurer/Financial Adviser (Section 17 Officer) and the Corporate Management Team to discuss such topics as delivery of the Annual Audit Plan, the service generally and development of new Strategic/Annual Audit Plans. Meetings of the Financial Scrutiny and Audit Committee have additionally been attended by the Deputy Audit Manager on 12 July 2011 and the Head of Internal Audit on 14 February 2012. In the course of these meetings of

the Committee, members received the Annual Audit Report and Opinion for 2010/11, and Audit Plans for 2012/13 with updated Terms of Reference, Code of Ethics, and the Audit Strategy.

Both the Director of Change Management and Resources, and the Treasurer/ Financial Adviser have also attended a meeting of the Norfolk Internal Audit Consortium, which was convened on 9 September 2011, affording these officers the opportunity to meet with other Heads of Financial Services/s151 Officers served by the Consortium and review internal audit progress across all partner authorities, discuss any issues arising, and be advised of new initiatives being introduced and/or under development to improve Internal Audit Services.

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 2011/12, the Code of Practice self assessment checklist, completed by the Head of Internal Audit and submitted to the Director of Change Management and Resources, and the Treasurer/ Financial Adviser, for independent validation, confirmed substantial compliance had been achieved in relation to the 11 key criteria stated therein. There were just two instances where deviations were noted and the Committee was first made aware of these items in July 2011. Essentially, the Financial Scrutiny and Audit Committee has yet to undertake a self assessment exercise to evaluate its own effectiveness and there is also a need to instigate private discussions with both Internal and External Audit.

It is recommended that the Committee consider addressing these matters at its next scheduled meeting. Completion of the checklist of best practice requirements attaching to the CIPFA Toolkit for Local Authority Audit Committees will satisfy the first of these outstanding elements, whilst the second matter can be remedied by holding private discussions with Internal and External Audit without the Authority's management being present. It is important that the Committee is able to receive feedback from its auditors, in order to be assured that the latter have been receiving the necessary degree of co-operation from management 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 professional 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 the majority of elements applicable to the current service delivery model operating at the Broads Authority. There was one aspect where partial compliance only was recorded in 2011/12. This concerned counter fraud provisions at the Authority and the 'arms length' role of the Head of Internal Audit in such matters. However, at the time of completing the Annual Review of the Effectiveness of Internal Audit, the Director of Change Management and Resources was redrafting the Authority's Counter Fraud, Corruption and Bribery Strategy and making the part played by the Head of internal Audit more proactive when fraud was suspected, in terms of notification/consultation, leading investigations as appropriate, maintaining a corporate overview of incidents arising and providing reports to management, the Financial Scrutiny and Audit Committee and External Audit, regarding internal audit work subsequently carried out in this area.

Having worked through the CIPFA Statement, the Head of Internal Audit is also keen to pursue the following in the interests of continuous service improvement:

- It is the aim of the Audit Management Team in 2012/13 to gain an even greater insight into the Authority's Assurance Framework and examine more fully the wide ranging ways in which the organisation is monitoring the quality of its governance, e.g. internal management reviews, work commissioned from management consultants, inspection and other review agencies and service delivery partners.
- It is further suggested that development of Audit Pages on the Authority's Intranet be explored. This would raise staff awareness in relation to the Internal Audit function and further support the organisation's counter fraud framework.

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. Performance against these targets for the year is outlined within the table below:

| Indicator | Target | 2011/12 Performance | 2010/11 Performance | Comment |
|---|-----------------------------|----------------------------|----------------------------|--|
| % of audit recommendations accepted | 90% | 100% | 100% | The target set has been exceeded. |
| % of high priority recommendations implemented | 100% | 100% | 100% | Full compliance with targeted performance duly achieved. The level of performance demonstrates a strong commitment by management to address significant internal control issues in accordance with deadlines agreed for delivery of high priority recommendations. |
| Days between issue of audit brief and fieldwork commencing | More than 10 days (average) | 28.5 | 4.7 | Substantially exceeding targeted expectations. The Internal Audit Service is averaging 5+ weeks between agreeing the scope of forthcoming reviews (as confirmed through the formal issue of audit briefs) and starting audit fieldwork. |
| Number of days between expected fieldwork completion and actual | 0 days | 0.2 | 0 | Target is being satisfactorily met. |
| Number of days between completion of audit fieldwork and draft report | 10 days or less (average) | 9.2 | 15 | A much improved performance compared with the previous year, to the point of exceeding targeted expectations. |

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| issue | | | | |
| Number of days between issue of draft and final reports | 15 days or less (average) | 10.8 | 12.3 | Internal Audit has been continuing to meet targeted requirements. |
| Number of days between completion of fieldwork and draft report issue | 25 days or less (average) | 20 | 27.3 | Timeframes have improved over the last 12 months, so much so that final reports are issued within a shorter timescale than the 5 week target set. |
| Average score given to audit feedback | Adequate (4 out of 6) | Good (5.06) | Good (5.13) | Consistently good post audit feedback scores have been received. |

There have been no deviations from quality standards set.

Supporting the development of the System of Internal Control

It is pleasing to report that Corporate Governance arrangements and systems of Risk Management at the Broads Authority were awarded a good assurance level in 2011/12. The organisation's provisions in these two areas have effectively mirrored best practice. Moreover, standards of internal control have remained satisfactory over the last 12 months, meriting an adequate/positive audit opinion.

Members will also recall that in February 2012, the Director of Change Management and Resources drew attention to the outcomes of a Toll Management system review in his report on the 'Implementation of Internal Audit Recommendations: Summary of Progress'. This audit generated a limited assurance, but the findings were not unexpected. Management was keen to obtain an independent assessment as to the robustness of the new Toll Management system, whilst the system was in its parallel running phase with the legacy HARPS system, three months prior to full implementation. The audit highlighted that there were a number of shortcomings attaching to the operation of the new system and the Authority has been working to address these items in recent months both prior to and since the system went live.

Another important marker as to how the Authority's internal control environment has been developing over time involves reviewing management's implementation record with regards to agreed audit recommendations. Our year end audit verification work has confirmed that although the percentage of fully completed/superseded audit recommendations for 2011/12 has fallen compared with 2010/11, there has been activity in response to 81% of recommendations due to be progressed over the 12-month period. The Head of Internal Audit's Annual Report and Opinion examines this situation in greater detail.

Improving Service Delivery and Adding Value

We constantly strive to enhance the Internal Audit Service, looking for ways to improve how we operate and the quality of the audit product. To this end, we have been liaising with Deloitte as to how we might work alongside other Internal Audit providers outside the Consortium and duly expanded Internal Audit's Terms of Reference for 2012/13 to reflect agreed Protocols to be adopted on such occasions, when linking up with other Regulatory Bodies and Internal Audit Service providers.

Moreover, we have continued to produce quarterly audit newsletters, in order to further raise officer and member awareness of latest developments.

The Head of Internal Audit is also a member of the Norfolk Chief Auditors Group and uses this forum to keep abreast of developments and share best practice. There have additionally been opportunities in year for the Head of Internal Audit to participate in some process benchmarking initiatives, and wherever possible, learn from other practitioners about different approaches to service delivery.

Finally, we have sought to support the Authority in other more specific ways during the year, i.e. the Head of Internal Audit participated in a Risk Management Workshop held on 18/10/11 and was interviewed as part of the National Parks Authority Performance Assessment exercise on 23/11/11.

External Audit's Reliance on Internal Audit's Work

We continue to work closely with the Authority's External Auditors to deliver an effective and efficient integrated audit function and as a consequence, have regular meetings and periodic email/telephone exchanges with our External Audit colleagues to discuss progress with the Annual Audit Plan, plus any key findings and issues arising from our work.

In respect of 2010/11, the External Auditor was able to confirm in the Broads Authority's Annual Governance Report, presented on 23/11/1, that when carrying out an assessment of internal controls: 'I have been able to rely on the work of internal audit and I have achieved the audit efficiencies on which my audit plan was based. No significant weaknesses in fundamental systems were identified during the audit. I have not identified any material weakness in the design or operation of an internal control that might result in a material error in your financial statements'.

Supporting an Effective Audit Committee

The Head of Internal Audit attends the Financial Scrutiny and Audit Committee, as and when required – usually twice yearly. There is always good debate and challenge at Committee meetings but it is acknowledged that at present, the Committee has not reviewed its own effectiveness, to confirm it is operating in accordance with best practice guidance. Furthermore, the Committee has yet to make arrangements to hold private discussions with Internal and External Audit. It is thus proposed that the next meeting of the Committee deals with these two outstanding matters.