

## **AUDIT COMMITTEE**

**10 JULY 2012**

### **EFFECTIVENESS OF THE INTERNAL AUDIT SYSTEM**

Report from: Mick Hayward, Chief Finance Officer

Author: Mick Hayward, Chief Finance Officer

#### **Summary**

Members are required to review annually the effectiveness of the internal audit system, as required by the Accounts and Audit Regulations.

#### **1. Budget and Policy Framework**

- 1.1 Decisions regarding accounts and audit issues fall within the remit of this Committee.

#### **2. Background**

- 2.1 The Accounts and Audit Regulations (A&AR) were amended in 2006 to require relevant bodies to conduct an annual review of the effectiveness of the internal audit system. This process is also part of the wider annual review of governance issues, which leads to the approval by this Committee of the Annual Governance Statement and subsequent publication.
- 2.2 Guidance from Communities and Local Government (CLG) advises that where an Audit Committee exists, such a committee should consider the outcome of the annual review as the Audit Committee has a role in monitoring internal audit but is independent from it.
- 2.3 The A&AR also state that internal audit should conform to proper practices and CLG advises that proper practice for internal audit is set out in the Code of Practice for Internal Audit in Local Government in the United Kingdom, published in 2006 by the Chartered Institute of Public Finance and Accountancy (CIPFA).
- 2.4 The Financial Rules contained within the council's Constitution state that internal audit will also have regard to any auditing standard pronouncements issued by CIPFA, therefore the Code of Practice forms part of the guidance that the internal audit team aims to adhere to.

### 3. Options

- 3.1 Guidance from the Audit Commission indicated that the annual review of internal audit's work, carried out as part of the external auditor's accounts and governance audit, is not, in itself, sufficient to meet the needs of the annual review required by the A&AR.

### 4. Advice and analysis

- 4.1 The A&AR does not specify how the review should be conducted or define what constitutes the 'internal audit system'. However, CIPFA's Audit Panel has interpreted this as follows:
- 4.2 "The framework of assurance available to satisfy a local authority that the risks to its objectives, and the risks inherent in undertaking its work, have been properly identified and are being managed by controls that are adequately designed and effective in operation."
- 4.3 CIPFA guidance also states that a review of the effectiveness of the internal audit system may include:
- the process by which the control environment and key controls have been identified - the organisation's risk management system;
  - the process by which assurance has been gained over controls – its coverage of the key controls and key assurance providers;
  - the adequacy and effectiveness of the remedial action taken where there are deficits in controls, which will be led by the Audit Committee or its equivalent and implemented by management; and
  - the operation of the Audit Committee and the internal audit function to current codes and standards
- 4.4 A full and detailed review was undertaken for 2010/11 and a number of weaknesses identified. This year's review focused on confirming whether the identified weaknesses had been addressed.
- 4.5 The assurance gained from this review is complemented by a number of other assurance mechanisms:
- external audit's view of Internal Audit as part of their accounts and governance work
  - the CIPFA benchmarking exercise which compares Local Authority IA performance
- 4.6 The key issues arising from the review are set out at **Annex A**.
- 4.7 There are no diversity or sustainability implications.

### 5. Risk management

- 5.1 There are no risk management implications arising directly from this report, apart from failure to observe statutory requirements.

## **6. Financial and legal implications**

- 6.1 There are no financial implications arising directly from this report, but there is a legal requirement for local authorities to review the effectiveness of the internal audit system each year and for the outcome to be considered by the Audit Committee.

## **7. Recommendations**

- 7.1 Members are asked to endorse the approach to the review of effectiveness of the internal audit system for 2011/12 and the outcome of the review, in support of the Committee's consideration of the Annual Governance Statement.

### **Lead officer contact**

Name Alison Russell  
Job Title Audit Services Manager  
Telephone: 01634 332355  
email: [alison.russell@medway.gov.uk](mailto:alison.russell@medway.gov.uk)

### **Background papers**

Accounts and Audit Regulations (amended 2006)



**Review of effectiveness of the internal audit system**

1. This annual review, based on the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom, incorporates the following areas:
  - The process by which the control environment and key controls have been identified
  - The process by which assurance has been gained over controls
  - The adequacy and effectiveness of the remedial action taken where there are deficits in controls, which will be led by the Audit Committee or its equivalent and implemented by management
  - The operation of the Audit Committee and the internal audit function to current codes and standards

**Detail**

2. The key strengths, as outlined in the 2010/11 report of internal audit effectiveness, remain in place:
  - Position in organisation allows a degree of independence and direct access to Audit Committee;
  - Effective relationship with the Audit Committee and external auditors;
  - Risk-based annual audit planning process, taking account of the corporate risk register, with regular progress reports to Audit Committee;
  - Carrying out audit work to professional standards, with appropriate levels of supervisory review;
  - Reporting audit findings, potential risks identified and recommendations to address these clearly and concisely.

**New Arrangements in Place**

3. Since the last review of internal audit effectiveness progress has been made on a number of areas to strengthen the internal audit arrangements in place.
  - An Internal Audit Charter has been developed to formally record Internal Audit's purpose, authority and responsibility.
  - An Internal Audit Manual has been developed which sets out the audit processes and procedures.
  - An Internal Audit Strategy for 2012/13 was presented to Audit Committee in March 2012.
  - A fraud risk assessment and resilience strategy which sets out how internal audit will contribute to the assurance on the Council's fraud vulnerability was presented to Audit Committee in March 2012.
  - The 2012/13 Internal Audit plan includes a review of external assurances that will support the development of an Assurance Map for the Council. The intention is to present the first draft of the Assurance Map to the Audit Committee in March 2013 as part of the 2013/14 Internal Audit Strategy.

- The Personal Development Review process, including an annual review of training and development records and future requirements has been put in place.
  - The internal audit follow up process has been developed to incorporate a process for following up all audits, and where appropriate to revise the original audit opinion to reflect the work undertaken by management since the audit report was issued.
4. These enhancements to the procedures in place have addressed, and are addressing, the majority of the issues identified in the 2010/11 review.

#### Outstanding Issue

5. The previous audit report identified that there were no formal performance indicators in place for assessing audit performance and reporting on this to Audit Committee. Linked to this was a failure to obtain feedback from management at the conclusion of each completed audit.
6. This issue remains outstanding. The audit manual that is now in place provides a baseline for the development of performance indicators and the intention is to develop these over the coming 12 months to present to Audit Committee for approval in March 2013. Once performance indicators are agreed then monitoring mechanisms will be developed which will include obtaining management feedback on audit delivery. Actual performance against these indicators will then be reported in the Annual Audit Report to Audit Committee, beginning in March 2014.