

AUDIT COMMITTEE

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REVIEW OF 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 Following the Council's decision to establish this committee, it is within the remit of this committee to take decisions regarding accounts and audit issues.

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 the Department of Communities and Local Government (DCLG) 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 the DCLG 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 Financial Rule 5 states that internal audit will also have regard to any auditing standard pronouncements issued by Cipfa. Therefore, Cipfa’s Code of Practice forms part of the guidance that the internal audit team aims to adhere to.
- 2.5 Guidance from the Audit Commission has indicated that the annual review of internal audit’s work carried out as part of the external auditor’s accounts and governance audit will not, in itself, be sufficient to meet the needs of the annual review required by the A&AR.
- 2.6 The A&ARs do not specify how the review should be conducted or define what constitutes the “internal audit system”. However, CIPFA’s Audit Panel has interpreted the “internal audit system as follows:

“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.”

3. Current Arrangements

3.1 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.

3.2 Therefore, the annual review for 2009/10 was conducted as follows: -

Topic	Assurance obtained
The process by which the control environment and key controls have been identified	<ul style="list-style-type: none"> • Risk management reports to Cabinet and overview and scrutiny committees, • internal audit of risk management, • external audit reports.
The process by which assurance has been gained over controls	<ul style="list-style-type: none"> • external audit reports, • other agency reports (reported to other committees), • outcomes of internal audit activity.

Topic	Assurance obtained
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	<ul style="list-style-type: none"> • follow up audits carried out by internal audit • items referred to other committees • directorates/departments own actions
the operation of the Audit Committee and the internal audit function to current codes and standards	<ul style="list-style-type: none"> • external audit's assessment as part of their governance reviews, • external audit's view of IA as part of their accounts and governance work • internal audit's self assessment against the Code of Practice for Internal Audit in the UK. The outcome of this assessment was reviewed by the Chief Finance Officer. • internal audit performance indicator outcomes covering service delivery information.

3.3 There is no clear Cipfa recommendation that the annual review of the effectiveness of the internal audit system should include an external review.

3.4 The key issues arising from the 2009/10 review are set out at Annex A.

4. Risk Management, Financial and legal implications

4.1 There are no risk management or financial implications arising directly from this report. There is a legal requirement for Medway Council to conduct a review of the effectiveness of the internal audit system each year and for outcome to be considered by the Audit Committee.

5. Recommendations

5.1 That this committee endorses the approach of the review of the effectiveness of the internal audit system for 2009/10 and the outcome of the review in support of the committee's consideration of the Annual Governance Statement.

Lead officer contact

Name Richard Humphrey
Job Title Audit Services Manager
Telephone: 01634 332355 email: richard.humphrey@medway.gov.uk

Background papers

Accounts and Audit Regulations.

Review of the effectiveness of the internal audit system

Where the review identified areas where improvements may be necessary, corrective action has been agreed and is being implemented.

The process by which the control environment and key controls have been identified

Key points were:-

- Corporate risks continue to be well managed,
- Potential risks had been identified in all Cabinet reports relating to projects and procurement exercises,
- Risks relating to partnerships are identified in the corporate risk register. At Local Strategic Partnership level, risks relating to partnership working are documented in a LAA risk log, but this has not been updated during 09/10,
- service business risks continues to be less well developed.

The process by which assurance has been gained over controls

The Audit Committee receives all reports from the external auditor and outcomes of internal audit activity. The external auditor's reports included the outcome of the comprehensive areas assessment including the use of resources assessment, audit of the annual accounts and grant claims. None of these reports raised any serious concerns on the effectiveness of the control framework.

Similarly, reports from other external inspections (Ofsted and the Care Quality Commission) have not raised any concerns on the effectiveness of the control framework.

Internal audit reports regularly to the Audit Committee on the outcomes of their work and also provides an annual summary report to support the governance statement. Whilst individual audits have identified control failures, the key financial systems are assessed as operating a sound control framework and the operational audits have not identified any authority wide issues.

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

Where internal audit assess the management of risks as "uncontrolled", follow up audits are carried out by internal audit and reported to the Audit Committee. Each audit report contains an agreed management action plan to rectify control issues and the purpose of the follow up audit is to ascertain that the agreed actions have been taken and that senior management is aware of the outcome.

On receipt of an internal audit report, Directorate's have their own arrangements for ensuring that corrective action is taken,

- either by meeting with the Director, the appropriate manager and internal audit to confirm the actions to be taken are understood by all, or
- quarterly return to a Director setting out the actions required.

The Audit Committee has referred items to other committees for them to monitor that agreed actions have been completed successfully.

The operation of the Audit Committee and the internal audit function to current codes and standards

External audit have not raised any issues in their reports. They have also confirmed in their reports that they can place reliance on the work of internal audit.

The outcome of the review of IA's compliance with the Code of Practice for Internal Audit in the UK was as follows;-

The Cipfa Code of Practice identifies eleven key areas as follows:-

- Scope of IA (terms of reference and scope of work)
- Independence
- Ethics for internal auditors
- Audit Committees
- Relationships (management, other auditors, members)
- Staffing, training and continuing professional development
- Audit strategy and planning
- Undertaking audit work
- Due professional care
- Reporting
- Performance, quality and effectiveness

Key Outcomes

The review identified a number of strengths and some areas where improvements can be made. The key strengths are:

- Reliance on IA work by the external auditor. For a number of years the external auditor has requested that IA carry out work on their behalf. This work, and the reliance placed upon it, has been recognised in the annual audit letter. There have been no critical comments of IA in the annual letter in recent years.
- The starting point for audit planning is the authority's own risk identification processes. This ensures that audit work is geared towards the authority's key objectives. This approach is enhanced through the use of IA's own risk assessment to identify key areas for audit activity.
- Use of private sector resources to supplement the in-house team's skills and competencies and to learn from how the private sector carries out such work.
- The level of request from directors and senior managers to carry out audit work.

- A member Audit Committee has been in existence since Medway Council's creation in 1998.
- Open reporting to members. IA has reported independently to the Audit Committee from 1998 and, wherever possible, the outcomes of internal activity are reported in open session of the Audit Committee.
- The use of audit opinions in reports from 1998.
- The assessment showed good scores in all eleven areas of the code of conduct.
- All key assurance work completed, although some audit activity was curtailed due to staff vacancy level.

The key areas for improvement are:

- Benchmarking data has consistently shown that audit resource levels are one of the lowest in the country. Whilst high risk areas are identified and audited, any loss of staff has an immediate impact on the team's ability to carry out their work. The review did confirm that IA does not carry out any non audit functions and, therefore, the total resource is used on audit activities.
- Customer feedback is positive but the level of responses from auditees is low. This is a common problem within authorities and no research has yet offered a solution. Work will continue to identify other ways of obtaining relevant feedback. The Chief Finance Officer's soundings of senior colleagues has not identified any issues.
- There were no issues arising from the examination of IA performance indicators.