

Audit and Governance Committee

29 June 2009

Report of the Assistant Director of Resources (Customer Service & Governance)

Review of the Effectiveness of the System of Internal Audit 2008/09

Summary

1. To advise members of the process and the outcomes of the 2008/09 review of the effectiveness of the council's system of Internal Audit, as part of the review of the overall system of internal control required for the 2008/09 Annual Governance Statement (AGS).

Background

Legislative Requirements

2. The Accounts and Audit Regulations 2003, as amended, require each local authority to conduct an annual review of the effectiveness of its system of internal audit, and to report the findings of this review to an appropriate committee. The changes came into effect from 1 April 2006 onwards. The process is intended to form part of the wider review of the effectiveness of the system of internal control which is necessary to prepare the Annual Governance Statement (which is a later item on this agenda).
3. All local authorities have a statutory requirement to make provision for internal audit in accordance with proper standards of professional practice, as set out in the CIPFA Code of Practice for Internal Audit in Local Government. Internal Audit is defined as an assurance function that provides an independent and objective opinion to the organisation on the effectiveness of the control environment. As such Internal Audit forms an essential part of the council's corporate governance arrangements.

Defining the System of Internal Audit

4. The Regulations require, as a primary matter, that the body shall maintain an adequate and effective system of internal audit, of its accounting records and of its system of internal control in accordance with proper internal audit practices.
5. Before considering the process of reviewing the effectiveness of the system of internal audit it is therefore necessary for the body to define what effectiveness means (see paragraph 12 below) and what the system of internal audit is. Until 1 October 2007, it consisted solely of

the internally provided Internal Audit and Counter Fraud service provided, from this point authority was given by members to operate an informal shared service with North Yorkshire County Council. This was formalised on 1st of April 2009 when the service was transferred to Veritau Ltd. This change will be reflected in the 2009/10 effectiveness review.

6. The principal functions of Internal Audit are to:
 - (a) provide assurance to members, chief officers, other key stakeholders and the wider community on the effectiveness of the governance arrangements and internal controls at the council;
 - (b) provide advice and make recommendations to improve controls and/or address the poor or inappropriate use of the council's resources;
 - (c) examine and evaluate the probity, legality and value for money of the council's activities;
 - (d) act as a visible deterrent against all fraudulent activity, corruption and other wrong doing;
 - (e) respond to and investigate any instances of suspected fraud or corruption.

7. The best practice guidance states that the effectiveness of the system of internal audit should include the effectiveness of the Audit Committee itself (to the extent that its work relates to Internal Audit) as well as the performance of the audit provider.

8. The CIPFA Code of Practice for Internal Audit in Local government sets out eleven standards (or principles) for the establishment of a professional service. Each principle is supported by detailed guidance. The principles cover the following areas:
 - (a) Scope of Internal Audit (Terms of Reference)
 - (b) Independence
 - (c) Ethics for Internal Auditors
 - (d) Audit Committees (including Internal Audit's relationship with the Audit Committee)
 - (e) Relationships (with management, elected Members and other auditors)
 - (f) Staffing, Training and Continuing Professional Development
 - (g) Audit Strategy and Planning
 - (h) Undertaking Audit Work
 - (i) Due Professional Care
 - (j) Reporting
 - (k) Performance, Quality and Effectiveness.

Who Should Undertake the Review?

9. The Regulations require either the Council itself or a committee of the Council to review the system of internal audit. The main reasons why, in York's case, the Audit & Governance Committee is considered as "an appropriate means through which to carry out the review of Internal Audit" are:
 - (a) It is already a core responsibility of the Committee to approve Internal Audit plans and monitor its work;
 - (b) The Committee is independent of the management of the council;
 - (c) The annual report and the opinion of the Head of Internal Audit is considered by the Committee;
 - (d) The external auditor reports to the Committee and is therefore readily available to give a view on the report on Internal Audit;
 - (e) The review of the effectiveness of the system of internal audit feeds into the AGS review which is already being considered by the Committee.
10. A key point is that it is the responsibility of the council to conduct the annual review; it is not a review that is carried out by the external auditor as part of the annual audit. The Audit Commission review elements of Internal Audit's work to assess what reliance can be placed upon it for other purposes and the audit of the accounts. However, this review will not cover all the elements of the system of internal audit and, therefore, in the Audit Commission's view, cannot be relied upon to fulfil the requirements of the Regulations. Nor will the review of Internal Audit under the Use of Resources assessment in itself satisfy the requirements of the regulations, as this is a wider review of which internal audit forms only a small part.
11. There are no hard and fast rules as to who performs the review but the Audit and Governance Committee's own expectations on this need to be considered as members will need to be satisfied that the review has been completed correctly. Given the timing of the review in line with the review of the whole system of internal control by the Officer Governance Group (OGG), the review therefore has been carried out by the OGG based on a self-assessment completed by the Assistant Director of Resources (Customer Service & Governance) who was responsible for the provision of Internal Audit & Fraud Services during 2008/09. This is wholly in line with CIPFA guidance on the recommended process.

Scope of the Review

12. The review is primarily about effectiveness, not process. In essence the need for the review is to ensure that the opinion contained in the Annual Report provided by the Head of Internal Audit may be relied upon as a key source of evidence in the AGS statement. The focus of the review should concentrate on the delivery of the internal audit function to the required standard in order to produce the required

outcome i.e. a reliable assurance on internal control and the management of risks in the council, rather than an assessment of value for money.

13. Other sources of assurance that the Committee receives, from which it can take a view on the effectiveness of the service include:
 - (a) regular outturn reports on Internal Audit & Counter Fraud work and related performance measures;
 - (b) Internal Audit Annual Report;
 - (c) Internal Audit Strategy and Annual Plan;
 - (d) The outcomes of the Use of Resources assessment.

2008/09 Review of the Effectiveness of the System of Internal Audit

14. For the purposes of this review, the following work has been completed:
 - (a) A further review has been undertaken to assess the progress which has been made to address the recommendations for improvement arising from the 2007 Audit Commission report;
 - (b) Consideration of Audit Commission views expressed in any of their reports published during 2008/09;
 - (c) The Code of Practice self assessment checklist has been refreshed so as to identify any significant changes in the degree of compliance against the Code, and this has informed the effectiveness assessment shown in Annex A;
 - (d) Customer survey results have been considered as part of this review;
 - (e) The results of the latest benchmarking data available from CIPFA, have been reviewed, so to establish how cost effective the service is compared to other unitary councils.

Audit Commission Review of Internal Audit – Progress

15. To comply with International Auditing Standards, the external auditors are required to periodically review the internal audit function. The Audit Commission last reviewed the work of Internal Audit and assessed compliance with the standards set out in the Code of Practice, in Spring 2007. They concluded that the service met the requirements of all eleven standards and that it could continue to rely on the work carried out by Internal Audit. A small number of areas were identified where there was scope to enhance the existing working arrangements. Four recommendations for improvement were made.
16. The actions taken to address the four recommendations for improvement made by the Audit Commission are detailed below:

Agreed Recommendation	Action Taken to Date
Incorporate formal reminders of auditors' ethical responsibilities into performance appraisals as planned.	Auditors have been reminded of their ethical responsibilities at team meetings during the year, and as part of the going performance appraisals.
Deliver plans to require all auditors to sign confidentiality agreements.	A statement of standards and values was prepared and discussed with staff. The statement incorporates a commitment to safeguard confidential information. Some revisions to this statement are however being made to reflect the move to the shared service.
Ensure that the working protocols are kept up to date.	The protocols with external agencies were reviewed and updated. A new protocol is however being developed with North Yorkshire Police to reflect the move to the shared service.
Enhance the existing strategy by including narrative information to set out Internal Audit's strategic purpose, direction and approach.	Work is ongoing to review and update the Internal Audit Strategy, so that it includes the required information. This work will be complete by 30 September 2009.

Audit Commission Opinions expressed during 2008/09

17. (a) There were no matters of concern raised regarding Internal Audit in the Annual Governance Report 2007/08 reported to this Committee in September 2008.
- (b) The council retained its score of '3 – performing well' on KLOE 4.2 (the council has arrangements in place to maintain a sound system of internal control) in its Use of Resources assessment for 2007/08 which included the arrangements for providing internal audit. This was reported to this Committee in January 2009.

- (c) There were no matters raised regarding internal audit arrangements in the Annual Audit Letter 2007/08 which was reported to this Committee in March 2009.

Code of Practice Self Assessment Checklist

- 18 The self assessment checklist has been updated for 2008/09. Considerable work was undertaken to integrate working practices and systems across the shared service and to select best practice from both partners' organisations. In the Assistant Director of Resources' view there has therefore been some changes in operational arrangements, but adherence with the professional standards set out in the Code has been maintained or enhanced. There are a small number of areas for development which the Chief Internal Auditor will build into work plans for the current financial year as follows:
- (a) The Internal Audit Terms of Reference and the council's Constitution need updating to reflect the change to Veritau Ltd and the transfer of the Head of Internal Audit role from the Assistant Director of Resources to the Chief Internal Auditor at Veritau Ltd;
 - (b) A full skills audit of all Veritau staff is to be undertaken in 2009/10;
 - (c) This will inform the development of a training plan linked to the service's business plan.

Customer Satisfaction Surveys

19. After each audit review, the audit clients are asked to give their opinion of the quality of the work undertaken by Internal Audit. The feedback covers:
- (a) The scope of audit work undertaken
 - (b) The objectivity and professionalism of the audit staff
 - (c) The conduct of the audit itself
 - (d) The audit report
 - (e) Customer service.

The recipients of the surveys are asked to answer 12 questions in total, ranking each 1 to 5 (where 5 is very good and 1 is poor). There is also an opportunity for service managers to raise any other issues about the audit process and to identify possible specific service improvements.

20. The results of the surveys are summarised in Annex B. 13 surveys were returned during the year. The overall weighted average score for 2008/09 was 77.3% (2007/08 – 80%). Where issues were identified then these were followed up with the relevant Service Manager. The Audit and Fraud Manager has built improvement areas from previous surveys into Service Plans, and in preparation work for the launch of Veritau Ltd. A similar detailed survey to the one sent to chief officers and senior managers last year will be undertaken shortly. This will

enable account to be taken of the views of chief officers about overall service delivery and to enable trends in performance to be assessed.

Benchmarking

21. The latest benchmarking data available from CIPFA relates to the exercise undertaken in May 2007. This exercise included a comparison between unitary authorities of the 2007/08 budget estimates for internal audit. A summary of the results is given in Annex C. This shows that compared to other unitary councils, the internal audit function at York remains cost effective.

Conclusion

22. Based on the results of this review, the council's system of internal audit is considered to be operating in accordance with accepted professional best practice, and it remains effective. The council can therefore continue to place reliance on its internal audit arrangements when preparing the Annual Governance Statement. For the 2009/10, the opinion will take into account a planned in-depth review of the service to be carried out in Autumn 2009 by the Audit Commission.

Consultation

22. Not relevant for the purpose of the report.

Options

23. Not relevant for the purpose of the report.

Analysis

24. Not relevant for the purpose of the report.

Corporate Priorities

25. This report contributes to the council's overall aims and priorities by helping to ensure probity, integrity and honesty in everything it does. It also contributes to the improving Effective Organisation corporate priority.

Implications

26. The implications are;
 - **Financial** – there are no financial implications to this report.
 - **Human Resources (HR)** – there are no HR implications to this report.
 - **Equalities** - there are no equalities implications to this report.
 - **Legal** - there are no legal implications to this report

- **Crime and Disorder** – there are no crime and disorder implications to this report.
- **Information Technology (IT)** - there are no IT implications to this report.
- **Property** - there are no property implications to this report.

Risk Management Assessment

27. The council will fail to comply with the Accounts and Audit Regulations if it does not undertake an annual review of the effectiveness of internal audit, as part of the wider review of the effectiveness of the system of internal control. The council could be criticised by the external auditor, and this in turn would adversely impact on the council's CAA score for the Use of Resources.

Recommendation

28. Members are asked to note the results of the review of the effectiveness of the council's system of internal audit.

Reason

To enable members to consider the adequacy and effectiveness of the council's control environment.

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Report Approved



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Specialist Implications Officers

Not applicable

Wards Affected: Not applicable

All



For further information please contact the author of the report

Background Papers

- Accounts and Audit Regulations 2003
- Accounts and Audit (Amendments) (England) Regulations 2006
- Department of Communities and Local Government (DCLG) – Guidance on the accounts and audit regulations

- CIPFA Rough Guide to the Review of Effectiveness of the System of Internal Control
- CIPFA Code of Practice For Internal Audit in Local Government in United Kingdom 2006

Annexes

Annex A – Effectiveness Checklist for Internal Audit

Annex B – Client survey feedback results

Annex C - CIPFA Benchmarking Results – 2008/09