

## **Audit and Governance Committee**

29 April 2010

Report of the Assistant Director of Customer & Business Support Services  
(Customer Service & Governance)

### **Review of the Effectiveness of the System of Internal Audit 2009/10**

#### **Summary**

1. To advise members of the process and the outcomes of the 2009/10 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 2009/10 draft 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 and what the system of internal audit is. Until 1 October 2007, in York it consisted solely of the internally provided Internal Audit and Counter Fraud service, from this point authority was given by members to operate an informal shared service with North Yorkshire County Council. This was formalised on 1 April 2009 when the service was transferred to Veritau Ltd. This change is fully reflected in this review.

6. The principal functions of an internal audit function 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 will review elements of the internal audit provider'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. The results of the recent Audit Commission review, undertaken in the last couple of months is attached as an earlier item on this committee's agenda.
  
11. The review of internal audit under the Use of Resources assessment in itself will also not fully satisfy the requirements of the regulations, as this is a wider review of which internal audit forms only a small part, (it does however look at the effectiveness of the council's governance arrangements). The analysis for the 2009/10 Use of Resources assessment will rely heavily on the detailed work carried out for the review outlined in paragraph 10 above.
  
12. This review has been undertaken jointly with North Yorkshire County Council by the Shared Service Contract Board (SSCB) and in consultation with the Audit Committee Chairs of both councils, in accordance with the agreed recommendations brought to this committee in December 2009.

## **Scope of the Review**

13. 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 for 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.
14. 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 (to follow at the June 2010 Committee);
  - (c) Internal Audit Strategy and Annual Plan (reported to this meeting);
  - (d) regular reports on the implementation of Internal Audit recommendations.

## **2009/10 Review of the Effectiveness of the System of Internal Audit**

15. For the purposes of this review, the following work has been completed:
  - (a) The Code of Practice self assessment checklist used last year has been refreshed so as to identify any significant changes in the degree of compliance against the Code.
  - (b) An overview of customer survey results have been considered as part of this review.
  - (c) Consideration of Audit Commission views expressed in any of their reports published during 2009/10.
16. In 2008/09 the review included the results of the latest benchmarking data available from CIPFA to provide some indication of how cost-effective the service was, compared to internal audit provision within other unitary councils. Given that the service is now a shared service provided by an external body, albeit owned by the two councils involved, no suitable benchmarking data has been identified for the purpose of the 2009/10 assessment. The Head of Internal Audit will endeavour to benchmark costs against similar service providers in 2010/11.

## Up-date of Code of Practice Self Assessment Checklist

- 17 The self assessment checklist has been updated for 2009/10. Carrying on from the previous year, considerable work has continued in integrating working practices and systems across the shared service and to select best practice from both partners' organisations. The Assistant Director's view is that whilst there have been some changes in operational arrangements, adherence with the professional standards set out in the Code has been maintained or enhanced. This is fully supported by the Audit Commission's recent assessment of compliance against the Code (see earlier agenda item). The 'effectiveness' part of the review is attached as Annex A to this report.
- 18 There were a small number of areas for development which were identified as part of last year's review.
- (a) The Internal Audit Terms of Reference and the council's Constitution needed 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 – **reported and agreed by this Committee in December 2009.**
  - (b) A full skills audit of all Veritau staff to be undertaken in 2009/10 – **completed.**
  - (c) This was to inform the development of a training plan linked to the service's business plan - **completed.**
- 19 The main areas for development in 2010/11 are:
- (a) Identify opportunities for cost and quality benchmarking with similar UK based organisations.
  - (b) Staff to be rotated on regular/annually audited areas. Given the organisation of the audit teams (with responsibility for service directorates allocated to specific audit teams) it may difficult to ensure regular rotation of audits as recommended. However, the service is to determine whether a greater degree of rotation can be achieved in order to improve the skills, knowledge and adaptability of the individual auditors concerned.
  - (c) To develop a protocol for defining future working relationships with the client and other managers in each Council.
  - (d) Individual auditors to maintain a record of their professional training and development.
  - (e) To improve flow of information in place at both councils to ensure that risk registers are updated for issues identified through the audit process.
20. In addition the Head of Internal Audit is committed to providing training on the role of internal and external audit to the Audit & Governance Committee which is a requirement of the CIPFA Standards, but is very much the responsibility of the council's Officer Governance Group.

### Customer Satisfaction Surveys

21. As per the CIPFA Standards, the service carries out a customer survey of each audit review undertaken. Overall customer satisfaction levels are currently at 100% at City of York Council (CYC), and more analysis will be available as part of the Annual Internal Report which will be reported to this committee in June 2010.

### Audit Commission Opinions expressed during 2009/10

22.
  - (a) Apart from the recent Review of Internal Audit (see (c) below), any reference to internal audit and related anti-fraud activity is contained in reports published in September 2009 and December 2009, but essentially relate to the financial year 2008/09. Extracts are contained in Annex B to this report
  - (b) The council achieved a score of '3 – performing well' on KLOE 2.4 (Risk Management & Internal Control) in its Use of Resources assessment for 2008/09 which included the arrangements for providing internal audit. This was reported to this committee in September 2009 (see also Annex B).
  - (c) Members are referred to the Audit Commission's Review of Internal Audit as per this committee's agenda which raises no matters of concern.

### **Conclusion**

23. 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 reviewing the draft Annual Governance Statement for 2009/10.

### **Consultation**

24. This review has been conducted by the SSCB in consultation with the Chair of the Audit & Governance Committee as recommended and agreed by this Committee in December 2009.
25. The Chair has responded with one comment relating to the 'characteristic of effectiveness' in Annex A which suggests that internal audit should 'Be involved in service improvements and projects as they develop, working across internal and external boundaries to understand shared goals and individual obligations.' The Chair expressed concern about internal audit being able to do this and stay independent.
26. Assurance has been given that the CIPFA Code of Practice for Internal Audit covers this specifically, it is also covered in the CYC Terms of Reference for internal audit and Veritau's Code of Ethics for its staff.

There are merits and benefits to the organisation of the internal audit function keeping a watching brief or to act as a 'critical friend' on major projects and developments, but it will not take responsibility for decision making, 'signing-off' or approving projects.

### **Options**

27. Not relevant for the purpose of the report.

### **Analysis**

28. Not relevant for the purpose of the report.

### **Corporate Priorities**

29. 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**

30. 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**

31. 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

32. 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.*

## Contact Details

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Report Approved



Date 15.4.10

## 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
- Audit Commission's Review of Internal Audit 2009/10 (April 2010)
- Audit Commission's Use of Resources Report 2008/09 (September 2009)

## Annexes

Annex A – Effectiveness Checklist for Internal Audit

Annex B - Extracts from Audit Commission reports published in 2009