

## **Audit and Governance Committee**

28 June 2011

Report of the Assistant Director Financial Services

### **Review of the Effectiveness of the System of Internal Audit 2010/11**

#### **Summary**

1. To advise members of the process and the outcomes of the 2010/11 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 2010/11 draft Annual Governance Statement (AGS).

#### **Background**

##### **Legislative Requirements**

2. The Accounts and Audit Regulations 2011 require each local authority to conduct, at least once a year, a review of the effectiveness of its internal audit arrangements, and to report the findings of this review to the Council or an appropriate committee. 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 separate item on this Agenda).
3. The Regulations require that the Council:  
  
"must undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control".
4. The 2011 Regulations consolidate and update previous similar regulations, and guidance to these earlier Regulations states that, for principal local authorities, the proper internal control practices for internal audit are those contained within the CIPFA Code of Practice for Internal Audit in Local Government. It is not known whether formal guidance will be issued under the 2011 Regulations, but for 2010/11 the 2006 edition of this Code of Practice has applied, and the intention would be to continue to apply the Code, subject to any amendments, in future.
5. A review of compliance with the Code of Practice has been completed and is referred to in the next section of this report.

## Defining Internal Audit

6. In the Code of Practice, internal audit is defined as:

“an assurance function that provides an independent and objective opinion to the organisation on the control environment, by evaluating its effectiveness in achieving the organisation’s objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources.”

As such internal audit forms an essential part of the Council's corporate governance arrangements.

7. Since April 2009, internal audit has been provided under contract by Veritau Ltd, a company wholly owned by City of York Council and North Yorkshire County Council, with the service being provided under a formal “shared service” arrangement. This review takes full account of this framework of provision for the service.
8. 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
  - (f) assist the Audit Committee in the performance of its functions as set out in its Terms of Reference.
9. The best practice guidance states that the review of the effectiveness of internal audit should also include consideration of the effectiveness of the Audit and Governance Committee itself (to the extent that its work relates to internal audit) as well as the performance of the audit provider. The Audit and Governance Committee has not reviewed its own effectiveness, and this will be an action to undertake during 2011/12 (See Annex 2)
10. 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 and scope of work)
- 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, regulators and inspectors)
- 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?**

11. 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 and Governance Committee is considered as "an appropriate means through which to carry out the review of Internal Audit" are:
- (b) it is a core responsibility of the Audit and Governance Committee to approve internal audit plans and monitor the work of the service;
  - (c) the Audit and Governance Committee is independent of the management of the council;
  - (d) the annual report and the opinion of the Head of Internal Audit are considered by the Audit and Governance Committee;
  - (e) the External Auditor reports to the Audit and Governance Committee and is therefore readily available to give an opinion on the work of Internal Audit;
  - (f) the review of the effectiveness of the system of internal audit feeds into the Annual Governance Statement which is also considered by the Committee.

12. 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 their annual audit. External audit 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 work does not cover all the elements of the system of internal audit and, therefore cannot be relied upon to properly fulfil the requirements of the Regulations.
13. The review of the effectiveness of internal audit has been undertaken jointly with City of York Council by the Shared Service Contract Board (SSCB) and in consultation with the respective Audit Committee Chairs, in accordance with the process agreed by this Committee in April 2011. The SSCB comprises the respective client officers from the County Council and the City of York, and Veritau's Head of Internal Audit. Meetings of the SSCB are held approximately six times a year and performance indicators and changes in working practices are discussed.
14. Using the SSCB as the focus for this annual review ensures consistency and avoids unnecessary duplication of work by the two client officers. The opinions reflected in this report reflect the shared view of the two client officers arrived at during the review. It should be noted that the statistics in this report are solely in respect of the service provided to the City of York Council.

### **Scope of the Review**

15. 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 Annual Governance Statement. The focus of the review has, therefore, concentrated on the delivery of the internal audit function to the required professional standards 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.
16. 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 work and related performance measures;
  - (b) the Annual report of the Head of Internal Audit (which is a separate item on this Agenda);
  - (c) the Internal Audit Plan (the 2011/12 Plan was reported to the April 2011 meeting of this Committee);
  - (d) regular reports on the implementation of internal audit recommendations.

## **2010/11 Review of the Effectiveness of the System of Internal Audit**

17. For the purposes of this review, the following work has been completed:
  - (a) 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
  - (b) An overview of customer survey results has been undertaken
  - (c) The opinions of external audit and the results of other external review work received during 2010/11 have been considered.
18. In previous years, the results of the latest benchmarking data available from CIPFA have been used 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, suitable benchmarking data has been more difficult to obtain. Alternative sources of information have therefore been used to provide evidence of the continued cost effectiveness of the current arrangements.

### **Update of Code of Practice Self Assessment Checklist**

19. The self assessment checklist has been comprehensively reviewed and updated for 2010/11. This has been reviewed in the SSCB and is considered by the SSCB as a fair reflection of the priorities that need to be progressed at this time.
20. As previously reported to this Committee, considerable work has been undertaken to integrate working practices and systems across the shared service and to select best practice from both partners' organisations.
21. In respect of the delivery of the service for the council, it is the view of the Assistant Director – Financial Services (who acts as the lead client for the County Council on behalf of the S151 Officer), 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 view is based on the Audit Commission's assessment of compliance against the code, the regular discussions held with the Head of Internal Audit necessary to fulfil his role as lead client officer for the Veritau contract, and also with his involvement on the SSCB

22. Those aspects of the current internal audit arrangements that have been identified as not complying fully with the Code of Practice are listed in Annex 2. Where changes and/or improvements to working practices are considered necessary then these have been included in the Veritau Business Plan for 2011/12, and are reflected in paragraph 24 below.
23. There were a number of areas for development which were identified as part of last year's self assessment. These are listed below, with information on progress made in the year, as follows:

**(a) to identify opportunities for cost and quality benchmarking with similar UK based public sector shared service organisations**

Limited information is available on a consistent basis, bearing in mind that Veritau operates as a local authority company, and this differs from other services provided either in house or wholly within the private sector. As this is a competitive market, providers are generally reluctant to share cost and pricing information. However, during 2010/11 Veritau participated in a benchmarking exercise with a group of similar local authorities to compare salary grades for internal audit staff. The results of this confidential exercise showed that the salary grades set by Veritau are consistent with those grades offered elsewhere.

Veritau was also recently involved in a tendering exercise for the Humberside Fire Authority Service. Whilst not successful in winning that business, the day rates that were submitted by the company were higher than those that apply to the core service provided to the County Council and the City of York Council, and took account of the relatively significant additional travel costs and lost times that would have been involved in servicing that contract. The current day rate charged to the County Council is less than the successful tender, and in particular is significantly less than the rates tendered by the large majority of the private firms bidding for this work. Whilst difficult to assess in isolation, this does suggest that the cost of the service provided by Veritau continues to be competitive.

**(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 be 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**

Work has been done on this, but as identified in **Annex 2** this remains an area for further development. Veritau are seeking to manage similar audits across the County Council and the City of

York, both as a way of achieving efficiency and effectiveness in the audits, but also to assist in the best practice of rotating responsibilities. Examples include the social services personalisation, information governance and disciplinary procedures audits.

**(c) to develop a protocol for defining future working relationships with the client and other managers in each council**

A protocol has now been developed and is considered to be working well. The customer satisfaction survey indicates good working relationships within both Councils.

**(d) individual auditors to maintain a record of their professional training and development**

This has been implemented as part of the improvements put in place in preparation for an IIP assessment. The external assessor, who is recommending IIP accreditation, has now completed the assessment. Any available update on the assessment will be provided at the meeting.

**(e) to improve the flow of information in place at both councils to ensure that risk registers are updated for issues identified through the audit process**

Good progress has been made and information is now shared regularly between the internal audit and risk management functions.

24. Following completion of the self assessment, the main areas identified for further development in 2011/12 are:

- continued rotation of internal audit staff between teams and across sites to minimise the number of occasions where systems or services are subject to audit by the same member of staff
- Audit and Governance Committee to conduct a review of it's own effectiveness
- development of a formal protocol to support joint working with other internal auditors
- development of a clearer methodology for determining the overall opinion of the Head of Internal Audit

### **Customer Satisfaction Surveys**

25. In accordance with the CIPFA Code, Veritau carries out customer survey reviews.

26. At the close of each audit, the responsible Manager of the area being audited is asked for feedback on that audit. In response to the question "Considering the audit overall, would you say that you were more satisfied than dissatisfied with the service received?" 100% assessed the audit as being satisfactory.
27. In addition, in February 2011, an overall customer satisfaction survey was sent to senior managers within the council asking a wider range of questions about the service provided. 15 responses were received.
28. Of those who responded, 74% overall considered that the elements of the internal audit work was either good or excellent, with 87% rating the overall audit as either good or excellent. All the remaining 13% believed that the service was satisfactory, therefore, no respondents assessed the service overall as being poor.
29. All of the comments made by respondents have been considered by Veritau, and will be addressed through the appropriate improvement action.
30. In respect of Counter Fraud work, 64% considered that the elements of that work were good or excellent with 100% of those responding giving an overall rating of good for such work.

**31. External Audit Opinions expressed during 2010/11**

- (a) no matters of concern have been raised with the S151 Officer or the Audit and Governance Committee by the External Auditor regarding internal audit matters during 2010/11
- (b) there were no matters raised regarding internal audit arrangements in the External Auditor's Annual Audit Letter 2009/10 which was reported to this Committee in December 2010
- (c) The Audit Commission carried out no external reviews of the Veritau service in 2010/11, although Members may recall that during 2009/10, the Audit Commission reviewed compliance by Veritau against the CIPFA Code. Two separate reviews were completed in that year, firstly in respect of the City of York Council and secondly in respect of the North Yorkshire Fire and Rescue Authority. Both reviews concluded that Internal Audit continues to meet its professional and statutory duties. No areas of concern were identified.
- (d) The External Auditor takes account of internal audit work where appropriate. On the basis of their risk assessment of areas that require testing, it would be the normal approach to check with the Internal Audit team whether previous work had been done that provided the relevant assurance to meet that assessed risk. If that is the case, then External Audit have been happy to rely on the work previously carried out by Internal Audit. The Audit



Commission have also provided written confirmation their assessment of Internal Audit and this is attached as Annex 1.

### **38 CONCLUSION**

Based on the results of this review, the council's internal audit arrangements are considered to be operating in accordance with accepted professional best practice, and remain effective. The Committee can therefore continue to place reliance on the internal audit arrangements operating within the council when considering the draft Annual Governance Statement for 2010/11.

### **39 CONSULTATION**

This review has been conducted by the SSCB in consultation with the Chairs of the Audit Committees as recommended and agreed by this Committee in April 2011.

### **40 OPTIONS**

Not relevant for the purpose of the report.

### **41 CORPORATE PRIORITIES**

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.

### **42 IMPLICATIONS**

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

43. 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.

## Recommendation

44. 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

### Author:

Keith Best  
Assistant Director Financial Services  
Tel: 1745

### Chief Officer Responsible for the report:

Ian Floyd  
Director of Customer & Business Support Services

Report Approved



Date 17.6.11

## 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 2011
- 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)
- Review of effectiveness of internal Audit report (April 2011)

## **Annexes**

Annex 1 – Letter of assurance from the Audit Commission

Annex 2 – Effectiveness Checklist for Internal Audit