

## APPENDIX A

# REVIEW OF THE EFFECTIVENESS OF THE SYSTEM OF INTERNAL AUDIT

### 1. Background:

- 1.1 The mandatory requirement for an internal audit function for local authorities is within section 151 of the Local Government Act 1972 and, for the Council, authority is delegated to the Director: Finance to fulfil this function.
- 1.2 The definition of Internal Audit, as per the Public Sector Internal Audit Standards (PSIAS) is as follows:

*“Internal Audit is an independent, objective assurance and consulting function that is designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluating, reporting on and recommending improvements where necessary to secure effective risk management, control and governance processes.”*
- 1.3 Internal Audit is a key source of independent assurance to management and Members and outcomes from the work of Internal Audit are collated into an annual opinion, which in turn is reported within the Council's Annual Governance Statement.
- 1.4 The Accounts and Audit Regulations 2015 require that *“A relevant authority must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, and taking into account public sector internal auditing standards or guidance. “*
- 1.5 To address the Accounts and Audit Regulations requirement, an assessment of Internal Audit has been carried out and is presented for consideration by those charged with governance.
- 1.6 In examining the effectiveness of internal audit, I have asked “does Internal Audit provide the assurance needed to have confidence in the ability of the organisation's people, processes, and systems to lead the council to success; and where there are opportunities to improve, do they provide actionable information that enables the appropriate changes to be made?”

This review considers the above by assessing the contribution of the key elements below:

- Structure and resourcing level.
- The extent of conformance with the PSIAS in producing quality work.
- Delivering audit work in the most appropriate areas on a prioritised (risk) basis.
- The overall performance of the Internal Audit team.
- Audit Committee reporting.
- Implementation of Internal Audit recommendations.

## **2. Current Arrangements for Internal Audit**

- 2.1 The Council's internal audit service is provided in-house and the service is part of the Resources Directorate. It is led by the Chief Internal Auditor and incorporates Assurance, Counter Fraud and Investigations functions.
- 2.2 The Chief Internal Auditor is line managed by the Director: Finance (s151 Officer) who monitors the performance of the Chief Internal Auditor and the audit function. The Director: Finance is a Corporate Leadership Board (CLB) member. These management arrangements meet the CIPFA expectation that the Chief Internal Auditor should be line managed by a member of the CLB/ senior management team. The Chief Internal Auditor has unfettered access to the members of the CLB and direct access to the Audit Committee Chair.
- 2.3 The Chief Internal Auditor reports functionally to the Audit Committee in terms of approving the Internal Audit Charter and risk based plan; reviewing Internal Audit's performance and effectiveness and receiving the Chief Internal Auditor's Annual Report and other reports.
- 2.4 At the start of 2018/19, the team comprised of 19.58 (fte) approved posts supplemented by specialist external ICT audit support and interim capacity, which included an Interim Chief Internal Auditor. The restructure of the service in 2018/19 has proposed an enhanced structure across the Assurance and Counter Fraud and Investigations functions. At the time of compiling this report, the full implementation of the restructure is in part dependent upon clarifying funding for activities outside the council's general fund. This team principally deliver work for the Council, but also have several external clients.
- 2.5 The Objectives and Mission of the Internal Audit service is described in the Internal Audit Charter, which also outlines the position of the service in the context of the Council's organisation.
- 2.6 The Charter defines the purpose, authority, scope and responsibility of the Internal Audit service and is consistent with the mandatory requirements of the Public Sector Internal Audit Standards (PSIAS) and the supporting Local Authority Guidance Note (LGAN) produced by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Chartered Institute of Internal Auditors (IIA). It also meets the PSIAS requirement for Internal Audit's risk-based plan to incorporate or link to a strategic or high-level statement.
- 2.7 The Charter and its operation provides appropriate arrangements to ensure that the service is sufficiently independent and objective and that there is access to all information and people required to discharge its responsibilities. The requirements of the PSIAS are reflected in the Internal Audit Charter.
- 2.8 The internal and external quality assurance mechanisms for the Internal Audit service are specified in the service's Quality Assurance and Improvement Programme (QAIP). This is designed to provide reasonable assurance to the various stakeholders of the service that Internal Audit:
  - Performs its work in accordance with its Charter, which is consistent with the Public Sector Internal Audit Standards (PSIAS).
  - Operates in an effective and efficient manner.
  - Is perceived by stakeholders as adding value and continually improving its operations.

2.9 Internal Audit's QAIP covers all aspects of Internal Audit activity in accordance with the PSIAS Standard 1300 (Quality Assurance and Improvement Programme), including:

- Monitoring the Internal Audit activity to ensure it operates in an effective and efficient manner (1300).
- Ensuring compliance with the PSIAS' Definition of Internal Auditing and Code of Ethics (1300).
- Helping the Internal Audit activity add value and improve organisational operations (1300).
- Undertaking both periodic and on-going internal assessments (1311).
- Commissioning an external assessment to the Audit Committee at least once every five years, the results of which are communicated to the Audit Committee (1312 & 1320).

### **3. Assessment of Effectiveness**

#### **a) Resourcing:**

3.1 Audit work is actively managed within the resource available and progress toward delivery of the Audit Plan is reviewed regularly. Focus is maintained on scoping and coverage for planned assurance activity; timing of work and availability of stakeholders; and control over the allocation of resources for investigation referrals and in-year requests for support.

3.2 The delivery of the Audit Plan is monitored via the Chief Internal Auditor and management team, the Director: Finance and via regular reports to the Audit Committee. Where there are resourcing considerations for effective delivery of the Audit Plan, there is close and regular discussions between the Director: Finance and the Chief Internal Auditor.

3.3 Training and development within the Directorate encourages development through professional qualification, for example the Institute of Internal Auditors (IIA), the Association of Accounting Technicians (AAT) and Counter Fraud qualifications. The Training Strategy and maximising delivery towards these aspirations is a key aspect of service development for 2019/20.

#### **b) Structure:**

3.4 A review of the staffing and skills needs has been undertaken in 2018 and the section is in the process of implementing a restructure, which increases capacity to facilitate the delivery of core and strategic objectives and includes the recharging of some services where additional external funding is available or a continued yield of savings for the Council can be realised. Existing ICT audit capacity is currently supplemented with an effective agreement with another Local Authority and planning for this key area of delivery is kept under regular review. Subject to the ability to fill these posts, this level of resources for Internal Audit and Counter Fraud is considered to provide an effective internal audit service.

3.5 Audit work is undertaken by experienced and qualified staff, whether permanent or on an interim basis but the challenges in recent recruitment exercises have highlighted that reviewing the structure and the skill needs of the section to meet the Council's assurance needs should be kept under permanent review.

### c) Compliance with Professional Standards:

- 3.6 In April 2013, a new set of Public Sector Internal Audit Standards (PSIAS) became effective. These standards apply to the internal audit functions in all parts of the public sector in the UK and are mandatory. The objectives of the PSIAS are to:
- Define the nature of Internal Auditing within the Public Sector.
  - Set basic principles for carrying out Internal Audit.
  - Establish a framework for provision of Internal Audit.
- 3.7 CIPFA (Chartered institute of Public Finance and Accountancy) have produced a local government application note in the United Kingdom for the PSIAS. The Accounts and Audit Regulations deem this as a “proper practice.” Consequently a Council’s internal audit system must be in compliance with the material provisions of the PSIAS.
- 3.8 Within the PSIAS there is a requirement for an independent external review of the internal audit function once every five years. A Peer Review was completed in February 2018, the purpose of which was to establish compliance with the PSIAS, ensure that governance is embedded within the service and identify areas where further improvement was required, thereby ensuring that the service is fit for purpose and free from any influencing factors which may impact on its independence.
- 3.9 The Peer Review was undertaken by the Chief Internal Auditor from Sheffield City Council. The outcome of the Review was reported in full to the Audit Committee in March 2018 and concluded that “*BCC’s Internal Audit Service **Generally Conforms with the requirements of the Public Sector Internal Audit Standards.***” The Internal Audit Service was assessed against 342 Standards, of which the reported outcome was:
- 84% Fully Conformed.
  - 98% Fully / Partially Conformed.
- 3.10 The Peer Review identified 28 recommendations to further increase the level of conformity with the PSIAS and enhance the service and the Audit Committee were provided with an update on progress with the full implementation of 43% of the recommendations and partial implementation of a further 46% as at September 2018.
- 3.11 It is, therefore, concluded that in all material aspects, the Internal Audit service complies with the requirements of the PSIAS.

### d) Improvements and Service Developments:

- 3.12 In addition to addressing recommendations from the Peer Review, the Internal Audit Service has a rolling Improvement Plan. In the last 18 months, this has included:
- Reviewing the Strategy.
  - Reviewing and refreshing performance metrics.
- 3.13 An Improvement Plan was prepared for the Internal Audit Service in September 2017 by the (then) Interim Chief Internal Auditor. The Peer Review identified several similar themes to those incorporated within the Improvement Plan and the latter focused upon improvement activities in the following areas from September 2017 and through 2018/19:

- (Contributing towards improving) Audit Committee Effectiveness (complete).
- Audit Processes and approach (part complete and ongoing).
- New Audit Report formats (part complete and ongoing).
- Business Development (part complete and ongoing).
- Counter Fraud (complete).
- Coverage (complete).
- Culture (ongoing).
- Follow-Up Process (complete).
- Supporting Governance processes (part complete and ongoing).
- Performance Monitoring (complete).
- Profile (part complete and ongoing).
- Quality (complete).
- Risk Management (complete/ superseded).
- Skills Mix review of Section (part complete and ongoing).
- Training Needs (part complete and ongoing).
- Working Agile (not complete)

3.14 Actions against the above improvement categories are monitored and re-prioritised where appropriate. Thus, for example, it is intended to review the approach to audit opinions in 2019.

**e) Quality of Reporting:**

3.15 Audit reports are shared with relevant managers (agreed in scoping the TOR for the Audit) and copies are shared with respective Directors. Reporting styles have been and will continue to be reviewed and refreshed. The Director: Finance regularly meets with Internal Audit to discuss their work, which gives a clear insight into the professional competence of the Internal Audit team.

3.16 Improvements are evident in the format and content of the reports, however as referred to above, the quality standards of reporting and reporting styles is an area we would retain under constant review.

**f) Service Delivery and KPI's:**

3.17 Performance and progress are assessed against the Business Objectives and Key Performance Indicators for the service. These are monitored on a regular basis and reported to the Audit Committee at least on a bi-annual basis, with progress last reported at the meeting in November 2018.

3.18 The key performance measures for the service as set out in Table 1 are:

Table 1: Internal Audit KPI's 2018/19

KPI No.	Ref	Measure	Target 2018/19
1	SR1	Deliver Internal Audit Plan - Completion to at least draft stage	90%
2	SR1	Level of Compliance with Public Sector Internal Audit Standards	95%
3	SR1	Delivery of 2017/18 Audit Opinion to management and Audit Committee in time to inform the AGS	By May 2018
4	SR2	Delivery of Agreed Counter Fraud Awareness Training Plan	90%
5	SR2	No. of Tenancies Recovered	30
6	SR3	Level of Recommendation Implementation (Fully / Partially)	90%
7	SR4	Client Satisfaction Survey (for individual audits) - % with score of good or above	85%
8	SR4	Annual Management Perception Survey - % of positive responses in respect of perceived benefits and value of Internal Audit service	90%
9	SR4	Review of the Skills Mix of the function	Completion and Implementation by Oct 2018
10	SR4	Delivery of Actions from Development Plan and from recommendations in Peer Review	95% of actions from the Peer Review to be addressed by November 2018.
11	SR5	Level of external income / services recharged internally	To achieve a year on year increase in external / recharged income (subject to the proviso that such use of resource should be proportionate and not to the detriment of the delivery of core BCC priorities)
12	SR6	AGS delivered in line with statutory deadlines	By 31.05.18

- 3.19 Performance Management of the service and for individual auditors is focused on deployment of auditor time to best effect. This has three main elements related to how much time is spent auditing, completion of audits within set timescales and effectiveness of time deployed. The key deliverable for the Section is the completion of the Internal Audit Plan within the year.
- 3.20 There continues to be positive responses to customer satisfaction (see paragraph 3.25) returns and positive feedback on a number of specific assignments. Equally, constructive feedback is received, which assists the section in becoming more effective.
- 3.21 No concerns have been raised in relation to the application of professional standards for audit work and there have been no formal complaints.

**g) Ensuring the effective prioritisation of Internal Audit Resource:**

- 3.22 Prioritisation of the work of the Service is achieved by the development and delivery of an annual risk based audit plan. This describes the assurance plans for the Service and includes capacity for flexibility to adjust to changing organisational priorities, risks and for demand led and urgent work if appropriate. The plan is based on a mix of different types of audit and counter fraud work to ensure that assurance over the Council's systems of governance, risk management and internal control is obtained from a number of different directions and sources. The service's methodology for establishing audit priorities is aligned with the Council's governance and risk management systems. Audit plans are developed through an assessment of risk and assurance needs to support the Council's overall objectives. The approach is set out in the Internal Audit Plan presented and agreed by the Audit Committee.
- 3.23 It is considered that the 2018/19 Internal Audit Plan represented a reasonable view of critical areas for audit review and assurance needs when it was constructed and agreed with Senior Management and the Audit Committee. It was based on reasonable estimates of available resources and with management requests and fraud investigations and referrals and any resource limitations or significant deviation from the approved plan during the course of the year has been reported to the Corporate Leadership Board and the Audit Committee.

**h) Auditee and Stakeholder Views:**

- 3.24 After the completion of each individual audit assignment, the Audit Manager issues a post audit questionnaire to each auditee along with the final audit report. The purpose of the questionnaire is to obtain information from auditees about a range of issues including:-
- Conduct of the Auditor.
  - Effectiveness of the Audit.
  - Timeliness of Reporting.
- 3.25 In November 2018, it was reported that 82% of responses responded with scores of good or above for the first half 2018/19.
- 3.26 Annual Satisfaction Surveys to key stakeholders are undertaken which includes seeking views on effectiveness, added value and professionalism with the results of which being incorporated into the Annual Internal Audit report and the feedback received is incorporated into the continuous efforts to improve the service.

**i) Audit Committee:**

- 3.27 An effective system of internal audit includes the role of the Audit Committee and in particular its role in the receipt and evaluation of audit reports, both in terms of assurance opinions and in the ensuring that appropriate arrangements are in place for the delivery of an effective service. The arrangements for the Audit Committee cover such roles by the receiving and analysing of regular reports prepared by the Internal Audit service, for example:

- Internal Audit Charter.
- Internal Audit Plan and amendments to the Plan.
- Internal Audit Activity and Performance Reports.
- Internal Audit Peer Review.
- Internal Audit Quality Assurance and Improvement Programme.

3.28 The number of members serving on the Audit Committee is 9 of which 2 are independent members which assist the Audit Committee in the discharge of its functions. In September 2018, a Value and Ethics Sub-Committee met for the first time, which will review the Member's Code of Conduct and the procedures for dealing with allegations of breach including hearing allegations of any such breaches of the Code of Conduct referred by the Monitoring Officer.

#### **j) Implementation of Internal Audit Recommendations:**

3.29 The process for monitoring implementation of recommendations includes the regular reporting on implementation status to senior managers and CLB and to the Audit Committee. This provides the opportunity to members to challenge progress and outcomes.

3.30 Despite increased engagement by the Internal Audit service in this area, including quarterly updates to all Directorate EDM's, over the last 12 months and while understanding the challenges involved for managers, the performance of the organisation in the consistent and full implementation of Internal Audit recommendations continues to be an area in need of improvement. Both management and the Audit Committee need to monitor this consistently with acceleration and appropriate action to have greater assurance that agreed improvements to internal control are actually fully implemented within reasonable timescales.

### **4. Conclusion**

4.1 There is no one source of assurance that can demonstrate the effectiveness of the system of Internal Audit. As a result, various sources of assurance have been presented in this report which it is considered, when taking all of the above factors into account, it is considered that the Council has an effective system of internal audit.

4.2 The service, while recognising ongoing improvements it needs to make continues to build on its strengths and enhance its reputation. Service delivery remains a key priority in support of the Council's priorities and to help identify and address any risks to the delivery of corporate objectives. The service is considered to have a sound base for carrying out its audit activities and meeting its objectives to provide audit assurance and advisory support to the Council.

### **5. Recommendation**

Members are asked to note the findings and conclusions of the review of the effectiveness of the system of Internal Audit contained within this report.