

APPENDIX A

REVIEW OF THE EFFECTIVENESS OF THE SYSTEM OF INTERNAL AUDIT

1 Introduction and 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 one of the means by which the Council assesses the adequacy and effectiveness of its governance and risk management arrangements, ensuring that an effective internal control system is in place. It is a key source of independent assurance to management and Members and its work, including the Chief Internal Auditors Annual Opinion helps inform the Annual Governance Statement.
- 1.4 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.
- 1.5 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.
- 1.6 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.
- 1.7 The Accounts and Audit Regulations 2018 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 and demonstrate conformance”*.

1.8 For 2019/20 the review of effectiveness of internal audit has been informed by a review of progress against the Internal Audit service improvement plan; ongoing monitoring of the performance of the internal audit activities; and a self-assessment against the QAIP and independent assessment against the PSIAS.

1.9 In examining the effectiveness of internal audit I have focused on the following areas:

Internal Audit service improvement plan:

- Structure, staffing and skills
- Improvement action plan

Performance monitoring:

- Planning, delivery and performance
- Implementation of Internal Audit recommendations

Compliance with Professional Standards:

- Public Sector Internal Audit Standards (PSIAS)
- Quality Assurance Improvement Programme
- CIPFA Financial Management Code

Role of the Audit Committee

2 Internal Audit Service Improvement Plan

Structure, staffing and skills

2.1 Local government and the environment in which we operate is changing and internal audit must ensure that its activities not only provide assurance but also create business value, delivering insights into the business, which may be leverage to improve the systems and processes or gain a competitive advantage.

2.2 The Council's internal audit service is provided in-house and incorporates Assurance, Counter Fraud and Investigations functions. The team was restructured early 2019 following which the Chief Internal Auditor and Deputy Chief Internal Auditor roles were formally established replacing the interim operating arrangements that were in place. The current Chief Internal Auditor joined the Council in July 2019, and continues to report administratively (i.e. day-to-day operations) to the Director of Finance (Section 151 officer) and has unfettered access to the members of the Corporate Leadership Board (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 throughout the year.

2.4 The team comprises 24.5 FTE posts and are supplemented by up to 60 days per annum of specialist external ICT audit support. The team principally deliver work for the Council, but also have a small level of external income from the Council's subsidiary companies. The FTE available for audit work in the service for 2019/20 is estimated to be 17.5 and the impact of staff absences and 7

vacancies are balanced in part during the year with the 1 fixed term appointment and 4 FTE experienced auditors secured via agency.

- 2.5 This shortfall in resources has proved challenging and delivery of annual audit plan remains the function's key priority. Supported by some flexibility in the timing and scoping of work and with the ability to source some external specialist resource, where required, the level of resources and skills available for delivery of the annual audit plan and wider service objectives is considered to be sufficient.
- 2.6 The audit team has an appropriate mix of experience and qualifications to support the previously agreed 2019/20 activity in year and where appropriate specialist resources are bought in for some work in line with resourcing plans and budgets. The team has extensive experience in undertaking audits and the professional skill mix includes five qualified accountants, one qualified chartered internal auditor and six members who are qualified in investigation techniques. Staff have undertaken e-learning and continue to develop a range of professional skills as part of the service learning and development plan and requirement for continued professional development.
- 2.7 In developing the 2020/21 plan we have recognised the changing nature of the council's business, in financial, social, economic, environmental and technological aspects as well as acknowledging the need to adopt a more robust risk based approach and changing the business perception of Internal Audit from one primarily of a provision of compliance / assurance feedback to one with the capability and skills to provide insight into efficiency and effectiveness. This will require the capacity and skills to be strengthened and change in culture with a revised management engagement model. Plans are in place to address this as outlined in the Quality Assurance and Improvement Programme, individual development plans and consideration is currently being given to how reach back capacity can be provided for workflow peaks. Given the track record of what the Internal Audit Function have achieved over recent years I remain confident that the transition can be achieved for 2020.

Improvement action plan

- 2.8 An Improvement Plan was prepared for the Internal Audit Service in September 2017 by the (then) Interim Chief Internal Auditor. In February 2018, a Peer Review was undertaken which expressed an opinion about Internal Audit's conformance with the Standards, the Definition of Internal Audit and Code of Ethics. 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. The following were ongoing in 2019/20 and progress reported below:
- Audit Processes and approach - Automation of the audit process is currently being pursued as is the increased use of data analytics to not only inform the audit planning process, but to also enhance the audit approach and increase the audit value. Increased client engagement has also been introduced in the latter stages of the year, with very positive feedback received from management to date.

- New Audit Report formats – The new report format which became effective in November 2019 introduced a new approach to forming assurance opinions in line with Audit Committee and Internal Audit Annual Report. Initial feedback has been positive and Internal Audit will continue to monitor the new reporting arrangements ensuring they remain fit for purpose.
- Business Development – this work remains ongoing. As part of the corporate drive, the team has developed its service offer and has been able to generate additional income through schools and the group of companies.
- Culture – work is ongoing with significant investment in both the development of colleagues and system improvements as well as engagement with the senior management to ensure that there is common purpose in delivering the outcomes for the Council.
- Supporting Governance processes – completed. There is work that is currently underway to introduce new business assurance statement that will enable the organisation to fully understand its sources of assurance. This will help the organisation to understand the risks and ensure that resources are allocated to those areas of highest risk. In addition, this work is critical to informing both the Annual Governance Statement and Annual Audit Plan.
- Profile – this work is ongoing given the time that is required to embed the new processes and arrangements. The team has introduced a new client engagement model that has increased visibility at senior management forums. This engagement is seen as key in ensuring effective collaboration between Internal Audit and all their key stakeholders.
- Skills Mix review of Section - A skills mix review of the section has been undertaken and the team is aware of any gaps. Where significant gaps have been identified, arrangements are being explored to find alternative ways of enhancing the skills mix of the team. This includes upskilling through group training as well as securing external support to compliment the team.
- Training Needs- Immediate training requirements have been identified and plans are currently in place to provide team wide training in the last quarter of 2019/20. Going forward, a learning and development plan is being drafted which will identify ongoing training needs of the team.
- Working Agile – this is ongoing recognising the need to continuously leverage technology in delivering the service objectives. Appropriate training such as lean auditing and reporting as well as data analytics has been delivered.

2.9 The specific identified actions against the above improvement categories are broadly complete but as outlined in section 4.5 there is more to do if we are to achieve the changes required for 2020 and therefore those outlined as ongoing will be recalibrated and continue to be monitored in a new plan.

3 Performance monitoring

Planning, delivery and performance

3.1 The work of internal audit for 2019/20 was set out in an audit strategy and annual plan discussed with senior managers, and then approved by Audit Committee in March 2019. The approach taken was to provide a range of audit work with different scope risks and coverage comprising:

- Audit Opinion Reviews (around 42% of plan)
- Audit embedded Assurance Reviews (around 5% of plan)
- Advice, Guidance and Support (around 6% of plan)
- Counter Fraud, Probity and Investigations (around 47% of plan)

3.2 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.

3.3 Delivery and the outcomes of audit work is reported to Executive Directorate Management Teams (EDMs), CLB, Statutory Policy Board and Audit Committee throughout the year. Audit plans are reassessed as part of regular delivery progress reviews and discussed with Audit Committee. A request to cancel or defer audits would only be where the risk or system had fundamentally changed and/or where alternative assurance could be obtained (internal or external SME) or where timing made the work impractical. The amendments requested to plans were supported by the Audit Committee during the year.

3.4 Whilst performance and impact cannot be assessed solely on the numbers of reports issued, in 2019/20 it is anticipated that the majority of the amended audit plan will be delivered or substantially underway by the end of March 2020.

3.5 Delivery in year is monitored as part of regular review by the audit management team and regular progress reviews are undertaken to support the direct supervision of audit work. Issues for delay on progressing audit work are discussed with escalation where required to seek resolution and resources reassessed as needed to balance work load and skills.

3.6 Any complaints made against the service are addressed as part of the Council's corporate complaints process and or whistleblowing policy. Any whistleblowing allegations against senior officers in the service are brought to the attention of the Director of Finance to consider whether it should be referred outside the service for investigation. No formal complaint has been received to date for this year.

Implementation of Internal Audit recommendations

3.7 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 for Members to challenge progress and outcomes.

- 3.8 The performance of the organisation in the consistent and full implementation of Internal Audit recommendations continues to be an area in need of improvement. Increased engagement has taken place including quarterly updates to all Directorate EDM's and it's is hoped that we will see some improvements. Further process enhancements have been proposed in term of provider greater clarity via the revision to the audit opinions categories and system improvements are being explored for the follow up process and system automation.
- 3.9 With the role out of the revised management engagement model it is expected that we will increase the understanding and consideration of appropriate interventions and that will be impactful in improving the weakness identified.
- 3.10 Both management and the Audit Committee need to monitor this consistently with acceleration and appropriate action for noncompliance to have greater assurance that agreed improvements to internal control are fully implemented within reasonable timescales.

4 Compliance with Professional Standard

Public Sector Internal Audit Standards (PSIAS)

- 4.1 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.
- 4.2 The Council's internal audit system must be in compliance with the material provisions of the PSIAS and within the PSIAS there is a requirement for an independent external review of the internal audit function once every five years.
- 4.3 A 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. The Peer Review identified 28 recommendations to further increase the level of conformity with the PSIAS (of the 342 standards, 84% fully conformed and 98% fully / partially conformed) and enhance the service. As reported to the Audit Committee November 2019 any recommendations that had not been fully implemented were included in the new action plan for continuous improvement.

Quality Assurance Improvement Programme

- 4.4 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.

4.5 Internal Audit's QAIP covers all aspects of Internal Audit activity in accordance with the PSIAS Standard 1300 (Quality Assurance and Improvement Programme) and the QAIP is reviewed at least on an annual basis. The 2019/20 review has identified the following actions needed to enhance the quality assurance and improvement programme:

- Skills review should be undertaken by the Chief Internal Auditor.
- A Training Strategy should be developed for the team.
- Roll out training on Computer assisted audit techniques (CAAT).
- Progress assurance mapping for the Council.
- Documented processes in the form of an audit manual and/or use of and electronic management system.
- Consistent completion of evidence based working papers to support audit conclusions and aid quality assurance

CIPFA Financial Management Code

4.6 The Chartered Institute of Public Finance & Accountancy (CIPFA) has issued (October 2019) the new Financial Management Code (CIPFA FM Code) which is designed to support good practice in financial management and governance and to assist local authorities in demonstrating their financial sustainability. The CIPFA FM Code will set the standards of financial management for local authorities and places a greater emphasis in the role of the Audit Committee in ensuring compliance.

4.7 The first full year of compliance will be 2021/22, in recognition that organisations of the scale of the Council will need time to reflect on the contents of the code we will use 2020/21 to demonstrate how we are working towards compliance and further guidance in relation to the code will be provided in 2020/21.

5 Role of the Audit Committee

5.1 Audit Committee discharged its role in considering findings and issues arising from audit reports thereby supporting an effective system of internal audit. The Audit Committee are scheduled to meet 6 times in the year and to date have considered reports from the audit service and the responses from management as part of an assessment of progress and assurance. In 2019/20 this resulted in a number of specific reports being presented to Audit Committee from management and Directors on key areas of risk including ICT, Asbestos and Procurement.

6 Conclusion

6.1 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.

6.2 The internal audit service, while recognising the need for continuous improvements and specific areas which are still to be addressed, 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 and can be relied upon when considering the Annual Governance Statement for 2019/20.

7 Recommendations

That Members:

(i) note the findings and conclusion of the annual review of the effectiveness of internal audit for 2019-20; and

(ii) note that Internal Audit generally conforms to the Public Sector Internal Audit Standards, is operating effectively and can be relied upon when considering the Annual Governance Statement for 2019-20.