

**AGENDA ITEM: 10**

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Meeting	Audit Committee
Date	21 June 2010
<b>Subject</b>	<b>Review of the Effectiveness of Internal Audit</b>
Report of	Interim Assistant Director Audit and Risk Management
Summary	To consider the report from the External Auditors on the above review of Internal Audit

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Officer Contributors	Richard King, Interim Assistant Director Audit and Risk Management and Hem Savla, Audit Manager
Status (public or exempt)	Public
Wards affected	Not applicable
Enclosures	Appendix A - Report on Review of Effectiveness of Internal Audit
For decision by	Audit Committee
Function of	Council
Reason for urgency / exemption from call-in (if appropriate)	Not Applicable

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## **1. RECOMMENDATIONS**

**1.1 That the report of the External Auditors is noted and that the Action Plan is approved.**

**1.2 That the Interim Assistant Director, Audit and Risk Management report back to future meetings of this Committee on progress against the actions.**

## **2. RELEVANT PREVIOUS DECISIONS**

2.1 None

## **3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS**

3.1 An effective Internal Audit service is a prerequisite for a well run local authority to achieve its objectives. Internal Audit provides a key assessment of how the Council's risk management processes identify, evaluate, monitor and report that controls are operating effectively. Thus, Internal Audit supports the achievement of all of the Council's priorities and objectives.

## **4. RISK MANAGEMENT ISSUES**

4.1 If the External Auditor does not regard the Internal Audit Service of the Council as effective, it will be impossible to achieve the highest score of 4 for internal control in the their Use of Resources judgement.

4.2 In addition, if the External Auditor does not feel confident about Internal Audit's work and output, this may well lead to additional costs to the Council as they will perform extra work to compensate for any identified deficiencies.

4.3 An ineffective Internal Audit Service will not be able to provide the level and types of assurance that members and directors need for the effective achievement of their responsibilities. Thus, there is a risk that the Council may not achieve all its aims and objectives.

## **5. EQUALITIES AND DIVERSITY ISSUES**

5.1 It is an overriding principle that services provided to the whole community represent value for money in terms of quality, efficiency and effectiveness. This supports the Council's obligations in meeting public duties under equalities legislation.

## **6. USE OF RESOURCES IMPLICATIONS (Finance, Procurement, Performance & Value for Money, Staffing, IT, Property, Sustainability)**

6.1 None at present as the implementation of the action plan will be carried out as part of the reorganisation of the Section's working methods and processes.

## **7. LEGAL ISSUES**

7.1 None in the context of this report.

## **8. CONSTITUTIONAL POWERS**

8.1 Section 3 of the Constitution covers the statutory obligation for the Council to have an adequate and effective internal audit. This obligation flows from the Accounts and Audit Regulations 2006 (as amended) which states in the explanatory notes that proper practice for internal audit is contained in the CIPFA Code.

## **9. BACKGROUND INFORMATION**

9.1 Attached to this report at Appendix A is the report from Grant Thornton.

9.2 Representatives from the External Auditors, Paul Dossett and Hanisha Solanki, will attend the meeting to introduce the report and answer any members' questions.

## **10. LIST OF BACKGROUND PAPERS**

10.1 None.

Legal: SS  
Finance: AT

## London Borough of Barnet

### Review of the Effectiveness of Internal Audit

22 April 2010

Draft Issued	15/2/2010
Draft Discussed	11/3/2010
Revised draft	01/4/2010
Management comments	13/4/2010
Final Issued	22/4/2010
Presented to Audit Committee	21/6/2010

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# 1 Executive Summary

## Introduction

- 1.1 During 2009/10 the Council has been considering the provision of its internal audit services, this has included an Interim Chief Internal Auditor being in place since November 2009. The Chief Executive has also been instrumental in lifting the profile of internal audit through the process of making reference to the post of Head of Internal Audit within his management restructure. The basis of our review was to consider the current arrangements to ensure that the Council has an internal audit service that responds effectively and in a timely manner to the current high risk environment that the Council is pursuing through its Future Shape agenda.
- 1.2 In our Annual Audit Report to those Charged with Governance (ISA 260) and our Use of Resources Report for 2008/09, we raised concerns about the coverage and other areas that implied a lack of effectiveness of the Council's in-house Internal Audit service. This resulted in a risk being identified in our 2009/10 audit plan, which was included within our indicative fee letter in May 2009 and approved by the Audit Committee in March 2010.
- 1.3 As the Council's External Auditors, we have to consider the effectiveness of the organisation's Internal Audit service in two key respects:
  - **Financial Statements Audit** - the work of Internal Audit provides us with an assessment of the Council's key financial controls in place during the year, which helps provide assurance that the figures presented in the Financial Statements are fairly stated. This determines the amount of substantive audit work we are required to undertake in order to support our audit opinion. Generally, we seek to rely on the work of internal audit as much as possible in order to minimise the duplication of work and reduce the level of year end accounts testing where systems are considered appropriate.
  - **Use of Resources Assessment** - consideration of the Council's Internal Control arrangements form a key part of our Use of Resources Assessment. This incorporates both the significant findings from the work of Internal Audit in the year, and an assessment of the effectiveness of Internal Audit itself. In addition to the UoR assessment, this work supports the VFM conclusion in our audit report.

## The Context of this Review

- 1.4 During 2008/09, the Council made progress towards enhancing Internal Audit effectiveness through reorganisation of the service. The Council has recently appointed an Interim Chief Internal Auditor, who is a former Chair of the CIPFA Audit Panel. This appointment reflects recognition from the Council that Internal Audit requires a significant overhaul in its strategic and operational management and performance. The initial outline plan for the reorganisation was presented to the Council's December Audit Committee.
- 1.5 The Interim Chief Internal Auditor is in the process of implementing a series of significant changes, which started with a detailed self assessment against the CIPFA Code of Practice for Internal Audit in Local Government.

- 1.6 In undertaking this review we sought to satisfy ourselves that the organisation is aware of the development needs of Internal Audit, and that these issues are being addressed. In doing so we will contribute to the process of development by providing the Council with our assessment of the effectiveness of Internal Audit. We designed this review to complement the work already underway and to avoid unnecessary duplication of effort.

### **The Purpose of this Review**

- 1.7 The purpose of this review is two fold:
- ***To support the 2009/10 audit process*** - enhancing our understanding of the effectiveness and capability of Internal Audit in 2009/10, in order to support our use of resources assessment. The review will also help inform the level of reliance we place on the work of internal audit in forming our audit opinion.
  - ***To help the Council to improve its Internal Audit service*** - comparing the current Internal Audit arrangements, and the outline plan for re-organisation, to our assessment of effectiveness and to best practice to identify recommendations for improvement which will contribute to the enhanced effectiveness of the service.

### **Overall View**

- 1.8 In our view, Internal Audit, in its current form, provides an adequate level of assurance to those charged with governance that significant business risks are being appropriately managed. However there are a number of opportunities to improve the effectiveness of internal audit which the Council is already in the process of implementing. A focus on improvement is essential to ensure that the Internal Audit function keeps up with the pace of change that the Council is currently experiencing.
- 1.9 We have considered the steps that the Interim Chief Internal Auditor is implementing to improve current arrangements and we wish to express our support for this process.
- 1.10 We have made a number of recommendations which are intended to support and complement the work already underway at the Council. These are set out in Section 2 of this report, and summarised in Appendix B.

## Key Findings

- 1.11 Our review focused on eleven key questions that address fundamental aspects of an effective Internal Audit service. The detailed results of our review are set out in Section 2 of this report. The basis of the review was to assess the current provision, which had elements of looking backwards on the service provided to date, however we sought to balance our view with improvements the Council is already undertaking. Our summarised findings are as follows:

	Key Question	Our View
1	Is the annual audit strategy appropriately focused on the organisation's key risks?	No
2	Is the in-house service granted sufficient independence within the organisation?	Yes
3	Does the service have sufficient stature, in terms of corporate sponsorship and powers of access, within the organisation?	Yes, improvement needs
4	Does the service have sufficient resources to deliver the level of audit coverage required?	Inconclusive
5	Does the audit strategy provide assurance to management that key business risks are being effectively managed in year?	Partially
6	Does the audit strategy provide adequate assurance to management that business critical systems are operating effectively in year?	Partially
7	Does detailed audit work achieve the correct balance between assessing management arrangements and testing compliance?	Yes
8	Does the service achieve appropriate levels of co-operation and buy in from departmental management, to support its conclusions and recommendations?	No
9	Are risks identified by audit appropriately measured and prioritised in terms of organisational risk?	Inconclusive
10	Is the interface between internal audit and the Audit Committee effective in communicating critical risk management issues to those charged with governance?	No, for 2008/09



	Key Question	Our View
11	Is internal audit effective in following up and driving improvement in regard to identified key weaknesses?	Yes, improvement needs

### **Use of this Report**

- 1.12 This report has been prepared for use by the Council, no responsibility is assumed by us to any other person.
- 1.13 This report includes only those matters that have come to our attention as a result of performing this review. Our review is not designed to identify all matters that may be relevant to Those Charged With Governance. Accordingly the review does not ordinarily identify all such matters.

### **Acknowledgements**

- 1.14 We would like to record our appreciation for the co-operation and assistance provided to us by management and officers during the course of our review.

**Grant Thornton UK LLP**  
**April 2010**

## 2 Detailed Findings

### **The Scope of This Review**

2.1 The review of Internal Audit comprised two key stages:

#### **Stage 1**

- Documenting and reviewing the arrangements in place for the 2009/10 financial year.
- Comparing the arrangements to 'best practice' within local government and in other sectors.
- Identifying potential gaps or weaknesses in the service.

#### **Stage 2**

- Documenting and reviewing the proposed outline changes to the service for 2010/11.
- Mapping the proposed changes to the service to the service gaps or weaknesses identified in Stage 1 to ensure that these have been adequately addressed.
- Where appropriate, providing recommendations for further improvement.

### **Our Approach**

2.2 We conducted our review using the following approach:

- Interviews with Key Staff (Appendix A)
- Document Review
- Comparison to latest guidelines from the Chartered Institute of Public Finance Accountants (CIPFA) and Institute of Internal Audit (IIA).
- Assessment against recognised 'best practice' applicable to Local Authorities and from our experience in other sectors.

### **Key Findings**

2.3 Our review focused on eleven key questions that address fundamental aspects of an effective Internal Audit service. The details provided in this section support our conclusion on each of the key questions identified.

<b>Question 1</b>	<b>Is the annual audit strategy appropriately focused on the organisation's key risks?</b>
<b>Our View</b>	<b>No</b>
<b>Findings</b>	<p>Up to 2009/10, the annual Internal Audit planning process has not been entirely driven by the organisation's corporate risk register which is instead considered along with the risk registers of the various directorates and taken into account with the internal audit team's separate risk analysis. Discussions are then held with directors to agree the most appropriate areas for review during the coming year. The plan is presented with reference to directorates, processes and corporate priorities and, as a result, possibly delivers broader assurance than is necessary over a range of processes as opposed to focusing more acutely on fewer, more important risks.</p> <p>Internal Audit undertook a review of the risk management framework in 2006/07 and then a follow-up audit in 2008/09, which resulted in satisfactory assurance. However this assurance has not provided Internal Audit with sufficient confidence in the risk management framework to use it as the basis for setting its overall plan. In the view of Internal Audit, the current risk management approach is not applied consistently across the Council. Internal Audit are currently reviewing risk management arrangements to ensure reliance can be placed for the compiling of the 2010/11 Internal Audit Plan, which is due at the end of April 2010.</p> <p>The Institute of Internal Auditors (UK &amp; Ireland) says that if the organisation's own risk register is not a suitable basis for planning, then the internal audit department should use other means. However, where this is the case, it is suggested that internal audit works with the organisation in order to improve its risk maturity and the reliability of its risk management processes as a basis for planning.</p> <p>Best practice internal audit plans should be driven primarily by the organisation's own corporate risk register and focus the delivery of assurance on the effective operation of the key controls identified in the risk register. Typically, as is already the practice in Barnet, a proportion of available days will also then be made available to review the ongoing effectiveness of core systems.</p> <p>In planning for 2010/11 Internal Audit intends to draw direct links between the directorate level risks to risks identified in the corporate risk register. Arrangements have been made for the Interim Chief Internal Auditor to meet regularly with the Head of Risk Management so that they can achieve better coordination. The organisation's risk management process is going to be reviewed by Internal Audit in 2009/10 but the outcome of this will not be available in time to influence the initial 2010/11 audit plan. It is possible that the internal audit plan will change as a result of the review if it emerges that the organisation is less risk mature than the new approach assumes.</p>

<b>Recommendation</b>	<p>We support the view of the Interim Chief Internal Auditor that the starting point for the revised Internal Audit strategy should be to provide assurance on the effectiveness of controls and other mitigating actions used to manage the Council's key corporate risks. Coverage should then cascade down through the risk registers of individual directorates to ensure that significant risks are addressed in order of priority (i.e. likelihood and potential impact). This should provide a more direct means of assurance to Those Charged With Governance, that key corporate risks are being addressed appropriately. Portions of the strategy can be redirected to provide assurance on the effectiveness of core systems, special projects and other developmental tasks as the revised Strategy suggests.</p> <p>If the corporate risk register is not appropriately robust to be used in this way, Internal Audit should work with Council officers to help develop risk management arrangements.</p>
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<b>Question 2</b>	<b>Is the in-house service granted sufficient independence within the organisation?</b>
<b>Our View</b>	<b>Yes</b>
<b>Findings</b>	Internal Audit operates with a significant degree of independence and objectivity within the Council. Self assessment against the CIPFA standards recognises that regardless of how the internal audit service is designed, staff should be reminded of the need for independence, objectivity and professionalism at all times. This is Defined by Financial Regulations (section 2, paragraph 3.2) and is emphasised through reporting lines within internal audit, and considered appropriate.

<b>Question 3</b>	<b>Does the service have sufficient stature, in terms of corporate sponsorship and powers of access, within the organisation?</b>
<b>Our View</b>	<b>Yes, with improvement needs</b>
<b>Findings</b>	<p>The stature and corporate sponsorship of the service is defined in the organisation's Financial Regulations (section 2, paragraph 3.2). Since the Head of Internal Audit post was left vacant, the audit manager acting as Head of Internal audit has provided and delivered an audit plan. However, the strategic direction of Internal Audit has been less clear given the lack of direct links with the corporate risk register, and there is scope to improve the quality of reporting to the Audit Committee as noted in question 10.</p> <p>Due to this focus on lower level details of processes, the service has not been able to achieve the 'buy-in' of service managers, exacerbated by the perceived lack of focus in the audit work. This view has been supported from informal discussions external audit have had with officers over the past few years. This in turn has led to an erosion of confidence in the service from both senior management and External Audit.</p> <p>However, the current powers of access including the Audit Committee Chairman, Chief Executive and Directors should ensure that the appropriate direction of travel is achieved.</p> <p>With the Interim Chief Internal Auditor in place and reporting to the Corporate Governance Director (and recently the Deputy Chief Executive), who is part of the statutory officers' group, this has provided a more robust platform, and a stronger voice with a particular focus on strategic issues, for Internal Audit within the Council. However we are aware that the Interim Chief Internal Auditor's contract may expire in the short term.</p>
<b>Recommendation</b>	It is imperative that the Council fills the substantive post of Head of Internal Audit on a permanent basis, as soon as possible, to ensure that the Internal Audit service is taken forward appropriately, and that the momentum for improvement is not lost.

<b>Question 4</b>	<b>Does the service have sufficient resources to deliver the level of audit coverage required?</b>
<b>Our View</b>	<b>Inconclusive</b>
<b>Findings</b>	<p>It is not possible to conclude whether or not the internal audit department has adequate resources. This would require the Council to undertake a formal audit needs assessment including consideration of the resources required to provide adequate assurance to Those Charged With Governance that key corporate risks are being appropriately managed.</p> <p>Currently, the level of available Internal Audit resource within the Council dictates the amount of work which is delivered. Following best practice, Internal Audit resources should be determined by management and reviewed by the Audit Committee on an annual basis. This should include due consideration of the minimum level of assurance required for key corporate risks, additional assurance that may be desirable and the number of audit days that can be delivered in the year within existing budgetary constraints. This requires a thorough understanding of the Council's priorities in regard to risk and a degree of flexibility in regard to the budget available for audit resources.</p> <p>Furthermore, the Council makes use of additional resource supplied by Deloitte and Enpeyz. It is understood that Deloitte have been used in the past to provide specialist skills which are not present in the Internal Audit team such as IT audits, and also to provide additional resource to the team.</p> <p>The Council has recognised a need to continue to develop the competence and skill base of the existing Internal Audit staff resource. The CIPFA Audit Skills Framework, which is similar to the IIA competency framework, is to be introduced in the department in 2010/11. This will allow the training needs of the team to be better assessed and identified and their performance managed.</p> <p>We understand that the Interim Chief Internal Auditor is undertaking a full assessment of the training needs of Internal Audit Staff in order to make sure that the team is equipped with the necessary competencies and skills to take forward the revised Internal Audit Strategy.</p>
<b>Recommendation</b>	<p>A formal audit needs assessment should be undertaken to identify the minimum level of assurance required to assess the mitigation of key corporate risks and to support the preparation of the Annual Governance Statement. Once this has been established, the Council should review the available financial resources and consider the impact on the audit strategy, including consideration of how best to deploy additional resource (e.g. from Deloitte).</p>

<b>Question 5</b>	<b>Does the audit strategy for 2009/10 provide assurance to management that key business risks are being effectively managed in year?</b>
<b>Our View</b>	<b>Partially</b>
<b>Findings</b>	<p>Up to 2009/10 the audit strategy has evolved to provide assurance to service directors on key business processes, which have been identified through a combination of dialogue with these managers and historical precedent. This is done on the assumption that these key processes contribute to the achievement of the directorate's strategic objectives, on the basis that the failure of a process presents a 'risk' that the strategic objective is not met.</p> <p>These key financial processes are reviewed on a cyclical basis (e.g. every three years) but are not prioritised in terms of corporate risks, however each system is reviewed in the planning process in terms of risk factors such as staff changes, system changes etc. The Council's corporate risk register does have some influence on audit planning and many key corporate risks receive at least some coverage, by virtue of being driven by risks identified at directorate level.</p> <p>However, because there is no direct link between Internal Audit's work and corporate key risks, the appropriate coverage of all risks is not certain and can not easily be ascertained by Those Charged with Governance.</p> <p>The approach is, therefore, directorate risk based, in that for the key processes reviewed relevant directorate level risks are identified in discussion with service directors. These risks broadly correspond to those identified on the directorate risk registers, which feed into the corporate risk register. However, it is important to note that the prioritisation and coverage of the work is driven by service level risk concerns, rather than corporate risk concerns. This means that corporate level risks which do not fit into one of the identified key processes, do not necessarily receive direct audit coverage. Furthermore, the prioritisation and timing of audit review tends to be determined by the established audit cycle, rather than the organisation's immediate need to manage its exposure to corporate level risks.</p> <p>We understand that senior management within Internal Audit have, to date, not had sufficient confidence that the risk management process has been applied consistently across the organisation, and therefore the corporate risks register has not been used as a starting point for the audit strategy.</p> <p>We recognise that responsibility for risk management does not rest with Internal Audit, but there has been a lack of engagement, and understanding of the relationship, between the managers responsible for the design and maintenance of the corporate risk management processes and Internal Audit. This has been identified as a result of the Internal</p>



	<p>Control Improvement Action Plan.</p> <p>We understand that that the risk management process is currently being reviewed by Internal Audit before the end of April 2010.</p>
<b>Recommendation</b>	<p>See recommendation for Question 1.</p>

<b>Question 6</b>	<b>Does the audit strategy provide adequate assurance to management that business critical systems are operating effectively in year?</b>
<b>Our View</b>	<b>Partially</b>
<b>Findings</b>	<p>Up to 2009/10 core financial systems audits have been viewed as work carried out solely on behalf of External Audit, in order to help avoid increases in external audit fees by performing the work that would otherwise be done by us. These reviews cover the core systems on a cyclical basis of three years.</p> <p>This view highlighted the disconnect between the Internal Audit strategy and the understanding of corporate risks, as the failure of core financial systems, such as Housing Benefit or the Financial Ledger, is likely to present a substantial financial and reputational risk to the Council.</p> <p>When a core system is reviewed, testing is performed on key controls identified within the in-scope processes. The key controls are agreed in discussion with the External Auditors. From this, Internal Audit provide different levels of assurance that the strategic objectives for the system are likely to be achieved.</p> <p>Under current development plans for Internal Audit, a more corporate risk-based approach is to be taken in planning and delivering work and a proportion of the plan will be allocated to providing ongoing or cyclical assurance that key systems continue to operate effectively. This approach broadly matches best practice in other sectors.</p> <p><b>The following improvements have been undertaken by the Council in response to these issues:</b></p> <ul style="list-style-type: none"> <li>• core financial systems are considered in the context of the associated business risks, and that Internal Audit coverage is directed to provide assurance accordingly. This should leave scope for systems which are not considered to present a significant corporate risk, to be reviewed in order to maximise efficiency in working with External Audit.</li> <li>• The Council is considering the relative merits of annual and cyclical reviews of core financial systems, in order to provide assurance on key risks and to promote efficient working with External Audit.</li> </ul>

<b>Question 7</b>	<b>Does detailed audit work achieve the correct balance between assessing management arrangements and testing compliance?</b>
<b>Our View</b>	<b>Yes</b>
<b>Findings</b>	<p>The Council currently strikes a balance between review of management arrangements and high level controls, and more detailed testing of key controls within a process.</p> <p>All reviews identify the risks that may prevent the achievement of service level strategic objectives, associated with the processes under review. The existence of management arrangements to mitigate the identified risks is then assessed and then whether there is evidence of operational compliance with these arrangements. By nature, many of these arrangements operate at high level, rather than at a detailed process level.</p> <p>The exception tends to be in regard to core financial systems work, where the review focuses more on the operation of the key controls at a detailed process level. This work is more likely to be supported by detailed compliance testing, which is appropriate to the task.</p> <p>Reports provide some commentary on the design of controls and mitigating actions, although the relative effectiveness is not always stated explicitly which we believe is necessary as an assurance measure for the Audit Committee. The reports focus on those controls and mitigating action which are not operating as intended.</p>

<b>Question 8</b>	<b>Does the service achieve appropriate levels of co-operation and buy in from departmental management, to support its conclusions and recommendations?</b>
<b>Our View</b>	<b>No</b>
<b>Findings</b>	<p>When a review takes place a draft report is presented to the service manager responsible, and there is an opportunity for findings to be discussed and clarified before the report and recommendations are finalised. Once this process is complete, the service manager has provided a formal response and, by implication, has taken responsibility for addressing issues within the agreed timeframe.</p> <p>The annual audit follow-up process has identified a number of instances where directorates have failed to deliver actions in the agreed timeframe, across a number of directorates, over a number of years. From our observations and discussions with Council officers, the reasons for this may be that:</p> <ul style="list-style-type: none"> <li>• Service managers agree Internal Audit recommendations in principle, but do not regard them as a priority, as the work does not have direct relevance to the day to day operations of the directorates.</li> <li>• The significant length of time between the review taking place, and the follow-up, does not take into account changes in systems or circumstances, which make the recommendation obsolete, as recognised by Internal Audit.</li> <li>• Service managers may agree recommendations, or provide ambiguous responses in order to allow the review to be completed, but do not 'buy-in' to the process.</li> <li>• Internal Audit typically agrees the scope and subsequent findings of its reviews with service managers. We understand that some Directors are not involved in this process and often have a different view on the priorities and risks which should be addressed, although it is clear that Directors are always invited to attend by Internal Audit.</li> </ul> <p>However it should be noted that this problem is exacerbated by changes in staffing, particularly the number of interims in place across the Council that may have moved on, leading to no action being taken on the recommendations.</p> <p>During 2009/10, the Audit Committee has been addressing this issue by identifying Directors, who in turn suggested service managers, to attend the meetings to explain why recommendations have not been implemented. While this has had a dramatic effect on the profile of Internal Audit and the consequences of not delivering agreed actions, there is a risk that it does not address the underlying reasons for the lack of buy-in from service managers. This may result in further disengagement from service managers as well as consuming significant time in Audit Committees.</p> <p>This question is not entirely directed towards Internal Audit effectiveness as the culture of internal control is the responsibility of all directors, and</p>

	<p>those directorates where issues are apparent with buy-in should be working with Internal Audit to understand the reasons for this.</p>
<p><b>Recommendation</b></p>	<p>The Council should ensure that the underlying reasons for the failure to properly and promptly implement agreed actions is fully understood and addressed. The use of the appearance of service managers at audit committee should be used appropriately and efficiently as an exceptional measure.</p> <p>Directors should ensure that sufficient time is devoted to taking part in planning an internal audit review and ensuring that the results are discussed and recommendations implemented.</p>

<b>Question 9</b>	<b>Are risks identified by audit appropriately measured and prioritised in terms of organisational risk?</b>
<b>Our View</b>	<b>Inconclusive</b>
<b>Findings</b>	<p>The Internal Audit department currently provides levels of assurance, to the review of a key process as a whole, based on the balance of identified risks successfully mitigated (e.g. Full assurance, Significant Assurance, Limited Assurance and No Assurance). However, it is not clear how these statements relate to the system under review.</p> <p>Greater clarity might be provided by the use of an explicit audit conclusion, that comments on whether risk management activities and controls are, for example:</p> <ul style="list-style-type: none"> <li>• Suitably designed to address the risk management objectives required by management.</li> <li>• Operating with sufficient effectiveness to provide assurance that risk management objectives were achieved during the period.</li> </ul> <p>In this example, if both criteria are met, this may be indicative of 'Significant Assurance'. If only one of the criteria has been met, this may be indicative of 'Limited Assurance'. Neither criteria being met would indicate that 'No Assurance' could be taken.</p> <p>Two priorities for individual actions are currently included in the Internal Audit reports; Priority 1 (High) and Priority 2 (Medium). It is intended that these will be reviewed and possibly extended for 2010/11.</p> <p>Greater clarity would be provided by the use of more explicit priority gradings for internal audit findings, for example:</p> <ul style="list-style-type: none"> <li>• Fundamental - Requiring immediate resolution.</li> <li>• Significant - Requiring resolution within an agreed timeframe.</li> <li>• Best Practice - Not essential, but would reflect best practice.</li> </ul> <p>We understand that work is underway in reviewing these areas.</p>
<b>Recommendation</b>	The method used to communicate the level of assurance derived from Internal Audit reviews should be considered, and the priority of recommendations, in order to provide greater clarity to managers and Those Charged with Governance.

Question 10	Is the interface between internal audit and the Audit Committee effective in communicating critical risk management issues to Those Charged with Governance?
Our View	No, for 2008/09
Findings	<p>We consider an effective interface between internal audit and the Audit Committee is established based on the following qualities:</p> <p><b>1. concise, comprehensive and timely communication of key risks and assurances</b></p> <p>Department managers, senior managers and directors will be aware of the audit work carried out and the detailed context of the issues raised during an audit. However, the only information which members of the Audit Committee receives is contained within the annual audit report. In addition the Audit Committee only received information during 2008/09 twice - an interim and an annual audit report. This increases the risk that significant control weaknesses are not being monitored by the Audit Committee in a timely manner.</p> <p>The annual report includes the generic control issues arising and summaries of reports in which 'No assurance' was given. Without providing an appropriate context to the reviews, in terms of relevance to the risks identified in the risk register, the volume of transactions or the value of funds impacted, it is difficult for the Audit Committee to draw effective conclusions on the control environment.</p> <p>As well as simply communicating the assurance opinion and key facts arising from a review, the individual audit report creates an impression for its readers of the professionalism, competence and quality of the internal audit department. We found that there was no explanation provided of the definitions used to determine the level of assurance provided by the reports.</p> <p>We understand that the Interim Chief Internal Auditor has included definitions within current reports and the Audit Committee accepted recommendations for more concise and frequent level of reporting.</p> <p>We are pleased to note that the increase in frequency of progress reports (quarterly) has now been approved by the Audit Committee.</p> <p><b>2. an overall opinion on an annual basis</b></p> <p>The annual internal audit report for 2008/09 did not include an overall opinion on the control environment. There is therefore no overall assurance opinion to Those Charged with Governance on the adequacy of the control environment.</p> <p>The new internal audit strategy will introduce an overall opinion on the control environment in the annual report and this should require a greater</p>

	<p>level of context to be provided on the issues raised.</p> <p><b>3. set performance measures that can be monitored by the Audit Committee that give an indication of effectiveness, efficiency and quality of the internal audit service</b></p> <p>The performance indicators previously reported to the Audit Committee were the:</p> <ul style="list-style-type: none"> <li>• percentage of audit plan completed</li> <li>• percentage of audit reports followed up within 12 months</li> </ul> <p>In addition the Audit Committee had requested in 2007 that the customer evaluation questionnaires be reinstated and the 2008/09 report included the average scores for 2006/07, 2007/08 and 2008/09.</p> <p>These performance indicators are limited in their use and provide no information on the efficiency or effectiveness of the internal audit department.</p> <p>Furthermore, the analysis of performance management within the internal audit annual report for 2008/09 does not provide any comment on the low response rate to the customer evaluation questionnaires, analysis of the results or any actions which are being taken as a result of feedback received.</p> <p>The Audit Committee (March 2010) agreed a set of performance indicators for 2010/11 that will address efficiency, effectiveness, quality and workforce that will enable monitoring of performance.</p>
<b>Recommendation</b>	An overall internal audit opinion should be given on an annual basis.



<b>Question 11.</b>	<b>Is internal audit effective in following up and driving improvement in regard to identified key weaknesses?</b>
<b>Our View</b>	<b>Yes, improvement needs</b>
<b>Findings</b>	<p>Most Internal Audit reviews of key financial systems are conducted on a three year cyclical basis following the format of a full review, follow-up review, and no review. However, annual risk assessment is undertaken during the audit planning process to assess if planned cyclical review of any key financial system needs to be brought forward. Core financial systems are subject to 'follow-up' of agreed actions within 12 months. Whilst this processes ensures that weaknesses are addressed it also poses a number of problems:</p> <ul style="list-style-type: none"> <li>• Internal Audit may expend resources following up recommendations which are no longer applicable to the system as it currently operates;</li> <li>• The follow up of audit recommendations, some of which relate to significant matters, is done on an annual timetable. This means that Those Charged with Governance have to wait for a whole year for assurance that key risks have been addressed; and</li> <li>• It reduces the level of reliance that External Audit can place on the work of internal audit in the years following a core financial system review.</li> </ul> <p>Overall, we question whether the responsibility for the follow-up should rest with internal audit or within the directorate. Clearly once a recommendation is agreed the officer responsible should obtain assurance from their staff that those control weaknesses have been addressed within those timescales that had been agreed with internal audit. Ideally a database of audit recommendations should be held by or available to the Audit Committee and they should receive reports from directorates based on the priority rating given to each recommendation, for example high risk recommendations could be implemented by next quarterly Audit Committee, medium risk within 6 months and low risks within a year. There may be opportunities for the Audit Committee to commission Internal Audit, through their annual plan, to conduct spot checks that these recommendations are indeed implemented.</p> <p>A shift in the perceived responsibility of following up recommendations from internal audit to officers could reduce the need for a follow-up review with full reviews undertaken based entirely on corporate risks identified within the year. This process will ensure that the internal audit approach is properly risk based and will also mean that a cyclical audit approach is no longer required.</p>
<b>Recommendation</b>	There should be an agreed process for assurances on, and collation of, the implementation of internal audit recommendations. The responsibility for these assurances should rest with officers, with compliance testing carried

	<p>out by Internal Audit as appropriate. Internal audit may assist the Audit Committee in keeping a log of recommendations and obtaining updates from directorates.</p> <p>Follow-up audits should only be undertaken at the request of a director if assurance is not considered robust, particularly where there is significant risk to the Council if these recommendations are not implemented.</p>
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## A Appendix: Interviews with Key Staff

<b>Name</b>	<b>Role</b>
Richard King	Interim Head of Internal Audit & Ethical Governance
Hem Savla	Acting Head of Internal Audit & Ethical Governance
Jeremy Davies	Chair of the Audit Committee
Jeff Lustig	Director of Corporate Governance

## B Appendix: Action Plan

Q No	Recommendation	Management Response	Officer Responsible	Action Date
1	<p>We support the view of the Interim Head of Internal Audit that the starting point for the revised Internal Audit strategy should be to provide assurance on the effectiveness of controls and other mitigating actions used to manage the Council's key corporate risks. Coverage should then cascade down through the risk registers of individual directorates to ensure that significant risks are addressed in order of priority (i.e. likelihood and potential impact). This should provide a more direct means of assurance to Those Charged With Governance, that key corporate risks are being addressed appropriately. Portions of the strategy can be redirected to provide assurance on the effectiveness of core systems, special projects and other developmental tasks.</p> <p>If the corporate risk register is not appropriately robust to be used in this way, Internal Audit should work with Council officers to help develop its risk management arrangements</p>	<p>The outcome of the internal audit of corporate risk management arrangements will be used to drive further improvements to which Internal Audit will contribute.</p>	<p>Interim HoIA</p>	<p>31<sup>st</sup> July 2010 and ongoing</p>

Q No	Recommendation	Management Response	Officer Responsible	Action Date
3	It is imperative that the Council fills the substantive post of Head of Internal Audit on a permanent basis, as soon as possible, to ensure that the Internal Audit service is taken forward appropriately, and that the momentum for improvement is not lost.	Appoint Assistant Director Audit and Risk Management. The appointment process is currently underway with the recruitment consultant.	Deputy Chief Executive and Statutory 151 Finance Officer	1 <sup>st</sup> September 2010
4	A formal audit needs assessment should be undertaken to identify the minimum level of assurance required to assess the mitigation of key corporate risks and to support the preparation of the SIC. Once this has been established, the Council should review the available financial resources and consider the impact on the audit strategy, including consideration of how best to deploy additional resource (e.g. from Deloitte).	Formal needs assessment will be considered along with a review of the structure of Internal Audit once the level of assurance required by the new post election Audit Committee has been confirmed.	Interim HoIA	30 <sup>th</sup> June 2010
4	The Head of Internal Audit should carry out a full assessment of the training needs of Internal Audit Staff in order to make sure that the team is equipped with the necessary competencies and skills. Where the required skills are not in place, the Council should consider options for providing this resource (e.g. using the arrangement with Deloitte).	Staff self assessment against Excellent Auditor competencies currently underway to identify training and development needs, which will be taken up during staff appraisals in May 2010.  Training and Development Plan will be developed following the staff appraisals.	Interim HoIA  Interim HoIA	15 <sup>th</sup> May 2010  30 <sup>th</sup> June 2010

Q No	Recommendation	Management Response	Officer Responsible	Action Date
8	The Council should ensure that the underlying reasons for the failure to properly and promptly implement agreed actions is fully understood and addressed. The use of the appearance of service managers at audit committee should be used appropriately and efficiently as an exceptional measure.	Interim HoIA to attend directorate management meetings and discuss issues that need addressing. Interim HoIA to remind service managers of their responsibility for implementing agreed actions and hence their contribution to improve risk management.	Interim HoIA	30 <sup>th</sup> June 2010
8	Directors should ensure that sufficient time is devoted to taking part in planning an internal audit review and ensuring that the results are discussed and recommendations implemented.	As above		
9	The method used to communicate the level of assurance derived from Internal Audit reviews should be considered, along with the priority of recommendations, in order to provide greater clarity to managers and Those Charged with Governance.	Definitions have already been redrafted and will be issued as part of all future Internal Audit reports.	Interim HoIA	1 <sup>st</sup> April 2010

Q No	Recommendation	Management Response	Officer Responsible	Action Date
10	An overall internal audit assurance opinion should be given on an annual basis.	An overall Internal Audit assurance opinion will be included in the Annual Internal Audit Report for 2009-10. The plan for 2010/11 is based around giving an annual opinion.	Interim HoIA	30 <sup>th</sup> April 2010
11	<p>There should be an agreed process for assurances on, and collation of, the implementation of internal audit recommendations. The responsibility for these assurances should rest with officers, with compliance testing carried out by Internal Audit as appropriate. Internal audit may assist the Audit Committee in keeping a log of recommendations and obtaining updates from directorates.</p> <p>Follow-up audits should only be undertaken at the request of a director if assurance is not considered robust, particularly where there is significant risk to the Council if these recommendations are not implemented.</p>	<p>Positive confirmation will be sought from Directors that management actions have been implemented by agreed time scales. Use of a 'recommendations' log will be considered.</p> <p>Follow-up audits will be undertaken only where deemed necessary.</p>	<p>Interim HoIA</p> <p>Interim HoIA</p>	<p>30<sup>th</sup> April 2010</p> <p>1<sup>st</sup> April 2010</p>