

Review of internal audit

Lancashire County Council

July 2012



Contents

- Key messages 3**
 - Overall conclusion 3
- Detailed findings 4**
 - Background..... 4
 - Scope and objectives..... 4
 - CIPFA standards for Internal Audit 5
 - Areas for improvement 9
- Appendix 1 – Action plan 12**

Key messages

This report summarises the findings from our assessment of how the Council's Internal Audit function meets the CIPFA standards for Internal Audit and CIPFA best practice.

Overall conclusion

- 1** We have concluded that the Council's Internal Audit function meets each of the eleven standards for Internal Audit set out in the CIPFA Code of Practice for Internal Audit in Local Government.
- 2** Our review has also concluded that the Internal Audit function demonstrates many of the characteristics of best practice as set out in the CIPFA Statement on the role of the Head of Internal Audit and The Excellent Internal Auditor. In particular, the Internal Audit work programme includes proactive fraud awareness work, thematic and corporate reviews to promote good governance across the organisation, and the annual plan is based on a comprehensive risk assessment process.

Recommendations

- 3** We have identified a small number of areas where there is scope for improvement and these are summarised in table 2. Our recommendations are made within the context of the good service provided by Internal Audit and have been prioritised accordingly within the action plan attached to this report.
- 4** The main area for improvement relates to progress reporting to the Audit Committee. Whilst the current progress reports are informative and useful, they need to more clearly sign-post at the beginning the key issues to aid the Audit Committee in undertaking its role. They would also benefit from greater consistency in being clear about which audit areas have been given limited assurance, and for those areas, why a limited assurance rating has been given, and the consequences and resultant risks for the Council taking into account other relevant controls and the wider context of the services affected.

Detailed findings

We have concluded that the Council's Internal Audit function meets each of the eleven standards for Internal Audit set out in the CIPFA Code of Practice for Internal Audit in Local Government. Our review has also concluded that the Internal Audit function demonstrates many of the characteristics of best practice.

Background

5 Internal Audit is 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 resourcesⁱ.

6 The Council is responsible for establishing and maintaining appropriate risk management processes, control systems, accounting records and governance arrangements. Internal Audit plays a vital part in advising the Council that these arrangements are in place and operating properly. The Accounts and Audit Regulations 2011 require the Council to make provision for internal audit in accordance with proper practice, which is generally accepted to constitute the CIPFA Code of Practice for Internal Audit (2006).

Scope and objectives

7 At the request of the Council we have undertaken a detailed review to assess how the Council's Internal Audit function meets each of the eleven standards for Internal Audit set out in the CIPFA Code of Practice for Internal Audit in Local Government. Our review has also considered whether the Internal Audit function demonstrates the characteristics of best practice as set out in the CIPFA Statement on the role of the Head of Internal Audit and The excellent internal auditor.

8 The objective of this work is to provide the Council with an independent view on the extent to which the Internal Audit function meets the CIPFA standards and best practice. Our conclusions are based on evidence provided by the Head of Internal Audit in her detailed self assessment, review of documentary evidence, discussions with a number of Internal Audit staff, and review of a sample of Internal Audit assignment files.

ⁱ CIPFA definition of Internal Audit, Code of Practice for Internal Audit in Local Government (2006)

CIPFA standards for Internal Audit

9 We have concluded that the Council's Internal Audit function meets each of the eleven standards for Internal Audit set out in the CIPFA Code of Practice for Internal Audit in Local Government. Our review has also concluded that the Internal Audit function demonstrates many of the characteristics of best practice. Our findings in respect of each of the eleven standards for Internal Audit are summarised in the following table.

Table 1: **Compliance with CIPFA standards for Internal Audit**

CIPFA Standard for Internal Audit	Conclusions
1) Scope of Internal Audit	<p>Internal Audit has terms of reference which cover the CIPFA minimum requirements and makes clear reference to Management's responsibilities and the role of Internal Audit. The Terms of Reference have been periodically reviewed and updated as deemed necessary by the Head of Internal Audit.</p> <p>The planning process is clearly risk based and focuses on issues arising from Service, Director and Internal Audit risk assessments. Internal Audit involvement in other work is primarily on a consultative basis as a 'critical friend' for the implementation of new processes and systems.</p>
2) Independence	<p>Terms of reference and the day to day functioning of Internal Audit demonstrate independence from the services subject to audit. Internal Audit involvement in system or process implementation is limited to a consultative or review role.</p> <p>Internal Audit has no operational responsibilities with the exception of risk management and investigations. Whilst these roles go beyond the work needed for Internal Audit to meet its assurance responsibilities, they do not have any implications for the independence of Internal Audit.</p> <p>The Head of Internal Audit has appropriate status and direct access to members and senior officers. The budget for Internal Audit is managed directly by the Head of Internal Audit who remains satisfied that the service has sufficient resources to undertake an adequate work programme at present.</p>
3) Ethics for Internal Auditors	<p>All staff are required to make an annual declaration of interest, including nil returns, to demonstrate compliance with ethical standards. The annual request for declarations includes guidance and reminders about professional responsibilities. The declaration process could be improved if staff were required to provide positive declarations in respect of adherence to professional standards.</p>

Working to client portfolios enables staff to maintain competence in the service areas subject to audit, and training and development opportunities are provided to enable staff to update their knowledge and understanding of service areas as required. Work on 'thematic' or 'cross-cutting' reviews allows staff to gain exposure to other service areas outside of their normal client portfolio.

4) Audit Committees

The Council has an Audit Committee which is politically balanced and independent of executive and scrutiny functions. Its terms of reference are included within the Council's constitution. The Audit Committee monitors progress against the Internal Audit Plan and the results of Internal Audit work are reported to the Audit Committee in quarterly progress reports and the annual Head of Internal Audit report.

Internal Audit Progress reports include information on work completed against the plan, and a narrative summary of matters arising in the last quarter. We have made some recommendations in relation to how these reports could be improved to better support the Audit Committee in undertaking its role. (See table 2)

5) Relationships

The Terms of Reference and Strategy, annual planning process and Terms of Reference for each audit assignment ensure the objectives and responsibilities of Internal Audit and Management are clearly defined and understood.

Relationships with Management are established and maintained via the annual planning process and regular liaison meetings with senior client staff in each directorate. Discussions with staff indicate constructive and professional relationships with clients, and this is supported by the results of Client Satisfaction Questionnaires completed in 2010, 2011 and the recently available results from the 2012 survey.

The Terms of Reference define relationships with elected members and specifically the Audit Committee. The Head of Internal Audit attends all meetings of the Audit Committee and holds a briefing session with members in advance of each Audit Committee meeting. The progress report provided to each Audit Committee includes summaries of matters arising from Internal Audit work completed.

6) Staffing, training and continuing professional development

The Internal Audit team has a defined establishment and structure. Whilst the team currently has a number of vacancies, both the Head of Internal Audit and Principal Auditors remain satisfied that the team has sufficient resources to deliver an adequate work programme at present.

In recent years the size of the Internal Audit function has been reduced as part of the council's wider actions to reduce costs. New ways of working have been developed to provide the necessary levels of assurance across the Council accommodating this reduction whilst also responding to the changing and increasing risks arising from the significant structural changes which have been made across the Council.

Further changes across the Council and within the Internal Audit team are planned in the future. It will be important that the impact of further change is clearly considered in the context of:

- the impact on risks and controls across the council;
- the level of assurance needed from internal audit work;
- different options for achieving the required level of assurance; and
- the adequacy of internal audit resources to provide that level of assurance.

These are issues which Internal Audit, the Treasurer and the wider Council management team will be likely to consider in the normal course of events. It will be important that the Audit Committee keep this under review.

The Head of Internal Audit is a qualified Chartered Accountant, with previous audit experience from the private sector, and is also a member of CIPFA's Technical Audit Panel. Job descriptions are in place for each role in the audit team, including roles and responsibilities and a person specification, and a core competency framework exists for the team as a whole. These job descriptions and the competency framework are used as the basis for annual performance and development reviews, and six monthly interim reviews for all staff.

Training and development needs are identified through the performance and development review process. The Head of Internal Audit encourages staff to attend events hosted by CIPFA and other training or seminars where these are relevant to an individual's specific client service areas. Various recent examples were identified through discussions with Internal Audit staff who have found these useful.

7) Audit strategy and planning

The Internal Audit function has an audit strategy which is combined with the terms of reference. The strategy has been periodically reviewed and updated.

Audit planning is based on a comprehensive risk assessment process and consultation with services and other relevant stakeholders. The Audit plan is prepared on an annual basis and a summary version is presented to the Audit Committee for approval. The plan is based on a prioritisation process undertaken by the Principal Auditors and Head of Internal Audit. Changes made during the year to the plan are explained and highlighted to the Audit Committee.

The annual internal audit plan presented to the Audit Committee includes a good narrative summary explaining how the plan has been developed and the key factors affecting the current year's plan. We have recommended a change to the presentation of the plan to the Audit Committee which we believe will help the Audit Committee to better understand the resultant schedule of work and the prioritisation which has led to the final plan (See table 2).

8) Undertaking audit work

Internal Audit assignments are planned in advance of fieldwork being undertaken, with terms of reference agreed with the relevant service. The Internal Audit approach is risk based, using the Risk and Control Evaluation (RACE) framework as the core basis for audit testing, and terms of reference identify the risks that the work is intended to address.

Work done is clearly identified on testing schedules with supporting documentation and referencing sufficient to enable re-performance if necessary. Findings and conclusion are mapped to recommendations in the draft report enabling the reviewer to see how the work done supports the conclusions and recommendations.

9) Due professional care

The Head of Internal Audit reminds staff of their professional responsibilities as part of the annual collation of declarations of interest. The annual request for declarations includes guidance and reminders about professional responsibilities, although the declaration process could be improved if staff were required to provide positive declarations in respect of adherence to professional standards.

The audit manual quality review checklist specifies the monitoring and review requirements for each audit assignment. A review of a sample of files has confirmed that this checklist is used and there is clear evidence of appropriate and timely review of work done in all cases.

10) Reporting

The Head of Internal Audit provides progress reports for each Audit Committee. She also prepares an Annual Report to those charged with governance which is reported to the June Audit Committee and is timed to support the Annual Governance Statement. The annual report includes an opinion on the overall adequacy of the control environment and summarises all of the work undertaken and matters arising during the course of the year.

Internal Audit progress reports include a summary of the assurance level for each piece of Internal Audit work completed to date, and a narrative summary of matters arising in the last quarter. As previously referred to, we have made some recommendations to improve the presentation of these reports. (See table 2).

All detailed Internal Audit reports need to meet the minimum requirements set out in the Internal Audit Manual but the format of Internal Audit reporting is not fixed to allow reports to be tailored to the nature of the audit assignment and the client service. The team has continued to review and refine the detailed reports to ensure that only key messages are summarised in the reports, making reports shorter and more accessible to the reader. We have made a recommendation to ensure it is clear which officer has overall responsibility for ensuring the delivery of agreed actions within the internal audit reports. (See table 2).

11) Performance, quality and effectiveness

An Audit Manual is in place which includes guidance and templates for the completion of day to day work. The Risk and Control Evaluation (RACE) framework provides a clear structure and basis for all audit assignments. The audit methodology includes a detailed quality checklist for the completion and review of audit assignments.

The annual audit planning process includes a resource plan which is determined by the three Principal Auditors in consultation with the Head of Internal Audit. The resource allocation is based on skills and experience but does also allow opportunity for staff to gain exposure to new areas of work.

Performance measures for the service are agreed between the Head of Internal Audit and the County Treasurer, monitored during the year and reported in the Annual report. Arrangements are in place to obtain feedback and assess the effectiveness of individual staff members via assignment review forms, and to assess the service as a whole via client satisfaction questionnaires.

Areas for improvement

10 We have concluded that the Council's Internal Audit function meets each of the eleven standards for Internal Audit and the function demonstrates many of the characteristics of best practice. This review has identified a small number of areas where there is scope for improvement and these are summarised in the following table.

Table 2: **Areas for improvement**

Findings	Recommendations for improvement
<p>Internal Audit progress reports to the Audit Committee include a summary of the assurance level for each piece of Internal Audit work completed to date, and a narrative summary of matters arising in the last quarter. Given the nature and level of work completed each quarter the progress reports are quite lengthy covering a wide range of services, systems and cross cutting themes. They give a useful picture of the controls operating across the breadth of the Council's activities.</p> <p>In this context a brief summary at the outset setting out the key issues arising would be helpful to focus the committee's attention.</p> <p>The narrative summaries for each piece of work are not consistently clear about what assurance level has been given or why a report is limited assurance. Where limited assurance is given, the reports are not consistently clear about the specific risks arising taking into account other Council wide controls and the wider context of the service.</p>	<p>The Internal Audit progress reporting should clearly sign post which audit areas have been given limited assurance, and for those areas, ensure there is always a clear explanation of why a limited assurance rating has been given and what the consequences and resultant risks are for the Council.</p> <p>This would aid the Audit Committee in undertaking its role, making it easier to:</p> <ul style="list-style-type: none"> ■ focus on significant matters arising from Internal Audit work; and ■ make judgements about whether formal action by the Audit Committee is necessary to ensure control weaknesses are addressed appropriately.
<p>We reviewed a sample of audit files and detailed audit reports as part of this review. This highlighted:</p> <ul style="list-style-type: none"> ■ a range of reporting styles but with a move towards reports where only key messages are summarised in the reports, making reports shorter and more accessible to the reader; and ■ whilst the action plans included in the detailed reports identify who is responsible for the delivery of agreed actions, the report doesn't identify the client sponsor. 	<p>Internal Audit reports should clearly name the client sponsor for the service area subject to audit so that overall responsibility for action is clear. This would aid the Audit Committee in fulfilling its role should it, for example, wish to speak to the service about the issues raised in an Internal Audit report.</p>

Findings

The annual internal audit plan includes each individual audit assignment identified, the resources required, who is planned to complete the work and the type of work to be undertaken. The plan is based on a prioritisation process undertaken by the Principal Auditors and Head of Internal Audit. The resultant plan presented to the Audit Committee includes a good narrative summary explaining how the plan has been developed and the key factors affecting the current year's plan.

It can be difficult to link the key factors affecting the development of the plan to the detailed plan as presented or to understand the basis for the decisions made to include specific items in the plan.

In our view, the inclusion of a brief explanation of why each item has been included within the plan would make this clearer. This should help the Audit Committee to consider the relative importance of individual assignments within the plan. This would be particularly important if other needs are identified during the year or resourcing issues arise which would require a re-prioritisation of the plan.

All staff are required to make an annual declaration of interests, including nil returns, to demonstrate compliance with ethical standards. The annual request for declarations includes guidance and reminders about professional responsibilities, but there is no requirement for a positive declaration regarding understanding and compliance with professional standards.

Recommendations for improvement

The annual Internal Audit plan presented to the Audit Committee should briefly explain why each audit assignment has been included. For example identifying those assignments that relate to fundamental financial systems which are reviewed every year, or assignments that have been included on a cyclical basis or to address a current risk.

The annual declarations process could be improved by asking staff to provide positive assurances that they understand and seek to comply with their professional responsibilities.

Appendix 1 – Action plan

Recommendations

Progress Reporting

Internal Audit progress reporting should clearly sign post which audit areas have been given limited assurance, and for those areas, ensure there is always a clear explanation of why a limited assurance rating has been given and what the consequences and resultant risks are for the Council.

Responsibility	Head of internal audit and principal auditors
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Priority	Most important
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Date	Immediate
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Detailed Reports

Internal Audit reports should clearly name the client sponsor for the service area subject to audit so that overall responsibility for action is clear

Responsibility	Head of internal audit and principal auditors
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Priority	Medium
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Date	Immediate
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Audit assignment priorities

The annual Internal Audit plan presented to the Audit Committee should briefly explain why each audit assignment has been included. For example identifying those assignments that relate to fundamental financial systems which are reviewed every year, or assignments that have been included on a cyclical basis or to address a current risk.

Responsibility	Head of internal audit
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Priority	Medium
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Date	March 2013
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Recommendations

Annual Declarations

The annual declarations process could be improved by asking staff to provide positive assurances that they understand and seek to comply with their professional responsibilities.

Responsibility	Head of Internal audit
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Priority	Least important
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Date	March 2013
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