

ITEM

ITEM

Audit Committee – 07 April 2009

INTERNAL AUDIT STRATEGY 2009/10

Report of Strategic Director (Resources)

Statutory Powers: Section 111 Local Government Act 1972; and
Accounts and Audit Regulations 2003.

Financial Implications: None: within existing budgets.

Purpose

The purpose of this report is to allow the Audit Committee to review the Internal Audit Strategy 2009/10, and seek their approval for the documents as required by the CIPFA 'Code of Practice for Internal Audit in Local Government' (2006).

Recommendations

That the Audit Committee review and approve the Internal Audit Strategy 2009/10.

Background

1. The Accounts and Audit Regulations, 2003 (Regulation 6) state that:

"A relevant body shall maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with the proper practices."
2. For the purposes of the Regulations, proper practice is that contained in the CIPFA 'Code of Practice for Internal Audit in Local Government' (2006). A copy of this document has been made available to the members of the Audit Committee.
3. The Internal Audit Manager maintains an Audit Manual which sets out the standards and procedures expected of the team and has been updated to reflect the requirements of the 2006 Code of Practice. It is not intended to present the latest version, Audit Manual 2009, to the Audit Committee because of the detailed nature of the document.
4. However both the Code of Practice and Audit Manual 2009 require that the Audit Strategy is presented to the Audit Committee for review and approval.

Audit Strategy 2009/10 (Appendix A)

5. Standard 7 of the Code of Practice requires the Internal Audit Manager to produce an audit strategy, and this is also reflected in the Council's Internal Audit Manual 2009.

6. The Strategy is a high-level statement of how the internal audit service will be delivered and developed in accordance with the Terms of Reference and how it links to the organisational objectives and priorities.
7. It should be kept up to date with the organisation and its changing priorities and communicate the contribution that Internal Audit makes to the organisation and including:
 - (a) Internal Audit objectives and outcomes;
 - (b) How the Internal Audit Manager will form and evidence his or her opinion on the control environment to support the annual Statement on Internal Control;
 - (c) How Internal Audit's work will identify and address significant local and national issues and risks;
 - (d) How the service will be provided, i.e. internally, externally, or a mix of the two; and
 - (e) The resources and skills required to deliver the strategy.
8. The Strategy should be approved, but not directed, by the Audit Committee.
9. The 2009/10 Audit Strategy (**Appendix A**) has been updated compared with the 2008/09 version (minute ref: A21/07) and is presented to members with the Internal Audit Plan for 2009/10 (separate report).
10. The Strategy reflects the required change from the Statement of Internal Control to the Annual Governance Statement, additional performance measures for the audit team and the known impact on the service of the shared service agenda.

Risk Assessment

Opportunity	Issues / Obstacles	Benefits
<p>An adequate and effective system of internal audit operating in accordance with the proper practices contributes to the overall control environment (system of internal control) and the Annual Governance Statement.</p>	<p>Audit's objectives and responsibilities do not reflect the Accounts and Audit Regulations 2003 requirements of providing an adequate and effective system of internal audit in accordance with the proper practices.</p>	<p>An Audit Manual documenting the audit processes is maintained and reflects the CIPFA 'Code of Practice for Internal Audit in Local Government' which sets out the standards that internal audit are expected to achieve.</p> <p>A self assessment of the effectiveness of Internal audit, carried out annually, confirms that the proper practices set out in the Code of Practice are in place and operating.</p> <p>The external auditor reviews the audit approach and work undertaken to enable him/her to place reliance upon the work of internal audit.</p>

Risk Assessment (Continued)

Opportunity	Issues / Obstacles	Benefits
<p>An internal audit plan considering all areas of risk to the Council contributes to the overall control environment (system of internal control) and the Annual Governance Statement.</p>	<p>Audit plans may not include all areas of potential coverage by the Internal Audit team.</p>	<p>Identifying the 'Audit Universe' for the risk assessment involves reviewing Council, Executive, Scrutiny and SMT minutes, the budget book, risk registers, internal policies that require an audit input, and external influences such as the Use of Resources self assessment checklist (KLOE) and liaison with the external auditor.</p>
<p>An internal audit plan directing resources to the areas of highest risk to the Council contributes to the overall control environment (system of internal control) and the Annual Governance Statement.</p>	<p>Audit plans do not direct audit resources to the areas most beneficial to the Council and so scarce audit resources are kept away from areas of high risk.</p>	<p>An assessment of risk is applied to the 'Audit Universe', based on a statistical methodology that takes account of the:</p> <ul style="list-style-type: none"> • Value of transactions; • Complexity of the system; • Inherent risk (vulnerability to fraud or error); • Political sensitivity; • Time since last audit; and • Impact on other systems.
<p>Completion of the work identified in the internal audit plan contributes to the overall control environment (system of internal control) and the Annual Governance Statement.</p>	<p>The audit plan and its coverage may not contribute to the Council's system of internal control, as required by the related guidance, to allow the Internal Audit Manager to provide members with an opinion on internal control.</p>	<p>Identification of the Audit Universe and subsequent assessment of risk.</p> <p>The audit plan is presented for review and comment to senior managers (including the s.151 Officer), Audit Committee and the external auditor.</p> <p>Monitoring takes place of performance against the plan and reported, and action on significant issues identified.</p> <p>The audit plan is linked to the Council's aims, priorities and commitments.</p>
<p>Amending the internal audit plan during the audit year to reflect emerging risks contributes to the overall control environment (system of internal control) and the Annual Governance Statement.</p>	<p>New systems or issues, both local and national, may come into place that are more important than some of those areas already included in the audit plan.</p>	<p>The audit plan is reassessed through the year to compare emerging risks with the original risk assessment. Any emerging risk that is considered to require audit coverage during the year is included at the expense of the lowest priority areas. The revision is reported to senior managers including the s.151 Officer and the Audit Committee.</p>

Risk Assessment (Continued)

Opportunity	Issues / Obstacles	Benefits
<p>An internal audit plan directing resources to the areas of highest risk to the Council, but with some contingency time for unforeseen events, contributes to the overall control environment (system of internal control) and the Annual Governance Statement.</p>	<p>Due to circumstances beyond the audit manager's control, staff absences may have an impact on the delivery of the audit plan by the relatively small internal audit team.</p> <p>A fraud or other irregularity is identified and audit resources are required to be directed away from planned audit work.</p>	<p>Audit work in the plan is prioritised. The most important has a rating number of 1 and is of a high internal risk plus external influences such as the External Auditor or Use of Resources assessments.</p> <p>If audit resources are not available to complete this work, consideration will be given by the Internal Audit Manager with the s.151 Officer on how the highest priority work can be completed. Skills shortages are identified through the Council's appraisal system.</p> <p>A contingency is built into the audit plan to guard against any unexpected pieces of work including investigation of alleged fraud.</p>

Conclusion

The standards for proper practice for internal audit are contained in the CIPFA 'Code of Practice for Internal Audit in Local Government' (2006).

The Internal Audit Manager maintains an Audit Manual which sets out the standards and procedures expected of the Council's Internal Audit team and this has been updated to reflect the standards required by the Code of Practice.

Both the Code of Practice and Audit Manual require that the Audit Strategy is presented to the Audit Committee for review and approval. The document is attached at Appendix A.

Allan Goodman
Internal Audit Manager

Audit Committee
 07 April 2009

John Foxworthy
Head of Financial Services

Mark Seymour
Strategic Director (Resources)

Background Documents:

SHDC Internal Audit Terms of Reference (Minute ref: A21/07)

CIPFA 'Code of Practice for Internal Audit in Local Government' (2006)

Reference(T:\.\\doc)



Internal Audit

Audit Strategy 2009/10

South Hams District Council

Internal Audit Strategy

Introduction

The Accounts and Audit Regulations, 2003 (Regulation 6) state that:

"A relevant body shall maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with the proper practices."

For the purposes of the Regulations, proper practice is that contained in the CIPFA 'Code of Practice for Internal Audit in Local Government' (2006).

Standard 7 of this Code requires the Internal Audit Manager to produce an audit strategy, and this is reflected in the Council's Internal Audit Manual 2009, which states that the Strategy:

- Is a high-level statement of how the internal audit service will be delivered and developed in accordance with the Terms of Reference and how it links to the organisational objectives and priorities. The strategy can be presented as a document in its own right or integrated into an existing document, such as the business or service plan. It sets the context within which more detailed plans can be developed. The strategy should be kept up to date with the organisation and its changing priorities;
- Will communicate the contribution that Internal Audit makes to the organisation and should include:
 - (a) Internal Audit objectives and outcomes;
 - (b) how the Internal Audit Manager will form and evidence his or her opinion on the control environment to support the Annual Governance Statement;
 - (c) how Internal Audit's work will identify and address significant local and national issues and risks;
 - (d) how the service will be provided, i.e. internally, externally, or a mix of the two; and
 - (e) the resources and skills required to deliver the strategy.
- Should be approved, but not directed, by the Audit Committee.

Internal Audit Objectives and Outcomes

The primary objective of the Internal Audit team is to provide an independent and objective opinion to the Council on the control environment by evaluating its effectiveness in achieving the organisation's objectives through examining, evaluating and reporting on the adequacy of the control environment as a contribution to the proper, economic, efficient use of resources.

To achieve this primary objective, the Council's Internal Audit Manager aims to fulfill the statutory responsibilities for Internal Audit by:

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- Identifying all of the systems, both financial and non financial, that form the Council's control environment and contribute to it meeting its obligations and objectives – the 'Audit Universe';
- Creating an audit plan that will enable Internal Audit to carry out reviews covering all of the Audit Universe over a period of 3-years, prioritised through a risk assessment;
- Translating the 3-year audit plan into an annual plan by reassessing the risk for each audit area against emerging risks and the Council's Risk Registers;
- Undertaking individual audit reviews, to the standards set by CIPFA's Code of Practice for Internal Audit, to independently evaluate the effectiveness of internal control;
- Providing managers with an opinion on and recommendations to improve the effectiveness of risk management, control and governance processes as to:
 - the extent to which the Council's assets and interests are accounted for and safeguarded from losses of all kinds;
 - the completeness, suitability, reliability and integrity of financial and other management information developed within Council (Data Quality);
 - the systems established to ensure compliance with policies, plans, procedures, laws and regulations, i.e. rules established by management of the Council or externally. These include in particular the Council's Financial Rules;
 - whether operations are being carried out as planned and objectives and goals are being met.
- Providing managers with advice and consultancy on risk management, control and governance processes;
- Liaising with the Council's external auditors to ensure efficient use of scarce audit resources through the avoidance of duplication, and to enable them to place reliance upon the work of Internal Audit; and
- Providing the Council through the Audit Committee with an opinion on internal control as a contribution to the System of Internal Control and Annual Governance Statement.

Opinion on Internal Control

As stated above one of the key objectives of Internal Audit is to communicate to management within the Council information that provides an independent and objective opinion on their control environment and risk exposure, and to prompt management to implement agreed actions.

Significant issues and risks are to be brought to the attention of the Section 151 Officer and Deputy as and when they arise. For routine work a written monthly report summarising the main issues from all audit reports and the performance of the Internal Audit team is to be provided by the Internal Audit Manager copied to these officers. A formal monthly meeting must also be held to discuss issues arising and other matters.

The Internal Audit Manager must report progress against the annual audit plan and any emerging issues and risks to the Audit Committee quarterly in a format agreed between the parties.

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The Internal Audit Manager must also provide a written annual report to the Audit Committee timed to support their recommendation to approve the Annual Governance Statement to the Council.

The Internal Audit Manager's annual report to the Audit Committee must:

- (a) Include an opinion on the overall adequacy and effectiveness of the Council's control environment;
- (b) Disclose any qualifications to that opinion, together with the reasons for the qualification;
- (c) Present a summary of the audit work from which the opinion is derived, including reliance placed on work by other assurance bodies;
- (d) Draw attention to any issues the Internal Audit Manager judges particularly relevant to the preparation of the Annual Governance Statement;
- (e) Compare the work actually undertaken with the work that was planned and summarise the performance of the internal audit function against its performance measures and targets; and
- (f) Comment on compliance with these standards and communicate the results of the internal audit quality assurance programme.

Local and National Issues and Risks

The audit planning process is subject to a risk assessment at all stages of the process: the 3-year plan; annual plan and individual audit reviews.

Prioritising the 3-year plan is completed using a risk assessment scoring methodology that takes account of: the £k value; inherent risk (definition below); political sensitivity; last audited; and impact on other systems.

Updating the original risk assessment above to create an annual audit plan includes taking account of emerging risks, both local and national, through consideration of the:

- Council's Risk Registers (which are updated with emerging risks from the Council's service planning process, that also forms part of the Council's System of Internal Control);
- Minutes of the Council, Executive, Scrutiny and Strategic Management Team;
- issues arising from the previous year's audit reviews, including those covering the Risk Management and Corporate Governance frameworks;
- National issues highlighted by professional bodies such as CIPFA's Finance Advisory Network (FAN) or the Council's external auditor; and
- Liaison with other Internal Audit teams on a formal and informal basis.

A further risk assessment is required at the commencement of each individual audit review to establish the level of testing required. This considers:

- When the system was last audited, the results of that review and whether the recommendations made have been implemented;
- Any changes to the system since the last audit;

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- The results of an analytical review (comparison of the data for the year of audit with the previous year's equivalent, taking account of expected changes);
- The inherent risk: the level of risk to the Council of the system if there were no controls in place, such as the vulnerability to fraud and if there are any known incidents of fraud;
- The quality, experience and morale of officers involved in the system; and
- Impact on the control environment of service reviews by managers and the results of best value and local performance indicators.

Provision of Internal Audit

The Internal Audit service is provided on behalf of the Council by a small team of in-house auditors. Past benchmarking of the cost of Internal Audit when compared with other Councils has shown that it is a cost effective service that continues to meet the requirements of its stakeholders.

The Internal Audit Manager has established policies and procedures in an audit manual to guide staff in performing their duties and complying with the latest available CIPFA Code of Practice. The manual is regularly reviewed and updated to reflect changes in working practices and standards.

Performance Management and Quality Assurance

The CIPFA Standards and the Council's Audit Manual state that performance, quality and effectiveness should be assessed at two levels:

- (a) For each individual audit; and
- (b) For the internal audit service as a whole.

The documents also state that the Internal Audit Manager should have in place a performance management and quality assurance framework to demonstrate that the internal audit service is:

- (a) Meeting its aims and objectives;
- (b) Compliant with the CIPFA Code of Practice;
- (c) Meeting internal quality standards;
- (d) Effective, efficient, continuously improving; and
- (e) Adding value and assisting the organisation in achieving its objectives.

This performance management and quality assurance framework must include, but not be limited to:

- (a) A comprehensive set of targets to measure performance, developed in consultation with appropriate parties. Performance measures should be included in any service level agreement. The Internal Audit Manager should measure, monitor and report appropriately on the progress against these targets;
- (b) Seeking user feedback for each individual audit and periodically for the whole service;

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- (c) A periodic review of the service against the strategy and the achievement of its aims and objectives. The results of this should inform the future strategy;
- (d) Internal quality reviews to be undertaken periodically to ensure compliance with this Code and the audit manual; and
- (e) An action plan to implement improvements.

The following table shows the key performance indicators used by the service. New indicators were introduced for 2008/09 to align with other Devon audit teams, or as requested by the Audit Committee.

Once collated the indicators must be reported to the s.151 Officer and Deputy on either a monthly or annual basis in line with collection and to the Audit Committee quarterly and/or annually. Performance indicators should be presented with prior year's equivalent to aid comparison.

Table 1: Internal Audit Key Performance Indicators

	<u>Current Target, and, Frequency of Measure</u>
➤ Achievement of the annual audit plan.	90% Covalent Monthly
➤ Percentage of draft audit reports issued within 10 working days of the completion of the audit.	100% Annually
➤ Percentage of final audit reports issued within 10 working days of the discussion and agreement of the draft audit report.	100% Annually
➤ Reliance of work of IA by the external auditor	Yes/No Annually
➤ Customer Survey: Responses Received; Audit Planning - <i>Consultation; Objectives</i> Quality of Audit Report - <i>Clarity; Accuracy; Value; Presentation</i> Communication - <i>Feedback; Helpfulness; Professionalism; Timeliness.</i>	90% Annually 90% Annually 90% Annually
➤ Overall cost, with/without oncosts/recharges	£ Annually
➤ Average cost per audit day: direct costs, and with/without oncosts/recharges.	£ Annually £ Annually
➤ The percentage of audit reports where the agreed recommendations were satisfactorily actioned, or follow up indicator to align with other audit teams to be agreed later with the Chairman and reported to the Committee.	90% Annually

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Performance indicators or targets may be amended from time to time with the prior agreement of the Audit Committee.

The Internal Audit Manager needs to ensure that the performance and the effectiveness of the service improve over time, in terms of both the achievement of targets and the quality of the service provided to the user.

Collaboration with Teignbridge District Council (Shared Service)

The Shared Service Joint Steering Group considered the proposals of a business case for a shared service presented by South Hams (SHDC), Teignbridge TDC) and West Devon District/Borough Councils.

The accepted proposal was for an extension of the collaboration between SHDC and TDC with exchange of audit resources, skills, training and key documents.

Details are available in the related report to the Audit Committee (minute reference: A14/08). At this meeting members also accepted in principle the mutual assurance of the high priority of both Councils' audit plan in times of crisis, subject to the specific approval of the Chairman. TDC Audit Committee made the same commitment.

Resources and Skills

Resources

The CIPFA Standards and the Council's Audit Manual states that:

- Internal Audit must be appropriately staffed in terms of numbers, grades, qualifications and experience, having regard to its responsibilities and objectives, or have access to the appropriate resources;
- The Internal Audit service shall be managed by an appropriately qualified professional with wide experience of internal audit and of its management;
- The Internal Audit Manager should be of the calibre reflecting the responsibilities arising from the need to liaise with members, senior management and other professionals.

The approved Internal Audit establishment for the Council consists of 2 whole time posts, the Internal Audit Manager and Senior Auditor, and an auditor, a shared post with European Grants. With a target of completion of 90% of the annual audit plan, this level of staffing has proved to be adequate to date.

The shared service collaboration arrangement with Teignbridge District Council will provide benefits in allowing the appropriately skilled staff to be directed towards the same audits at both Councils, reducing the time demands for research before an individual review begins. This will also assist the services in allowing independent comparison of the way they are delivered and promote the sharing of good practice. The audit managers will meet after completion of draft annual audit plans to establish in detail where the sharing of resources will prove beneficial and highlight these in the plan presented to the Audit Committee.

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The main threat to completing the targeted % of the annual audit plan is the requirement for Internal Audit to investigate fraud. A contingency budget is built into the audit plan to provide cover for such eventualities, as well as other unexpected tasks such as advice to managers on control or internal financial regulations, contributions to the setting up of new systems or unexpected additional work on planned audits.

In extreme cases the contingency budget may prove insufficient for large scale investigations. In the circumstances where this occurs and where there is likely to be an impact on the remainder of the annual audit, the Internal Audit Manager must discuss the situation with the s.151 Officer to enable a decision to be made to seek additional temporary resources if appropriate. The same comment applies to other staffing shortages brought about by long term sickness absence, vacant posts etc.

As discussed above under the title 'Provision of Internal Audit', the Audit Committee has accepted (as has TDC's Audit Committee) that the teams will mutually assure the high priority work of each others plan in the time of crisis, with the specific approval of the Chairmen.

In practical terms, such work will reduce the available resources for low priority audit work for the team providing assistance. However, the outcome may be the delivery of plans to an acceptable level at both Councils, without the additional cost of external resources. It is the responsibility of the audit managers of SHDC and TDC, in association with the s.151 Officer and the Chairman of the Audit Committee, to ensure that making additional resources available to the other team does not result in a shortfall in audit coverage that may undermine the System of Internal Control.

Skills

The Internal Audit Manager's duty is to recruit staff with the appropriate professional background, personal qualities and potential. He or she is responsible for ensuring that up-to-date job descriptions exist that reflect roles and responsibilities and that person specifications define the required qualifications, competencies, skills, experience and personal attributes.

Internal Audit staff must also be properly trained to fulfill all their responsibilities. The Internal Audit Manager will periodically assess individual auditors against these predetermined skills and competencies using the Council's formal appraisal system.

Any training or development needs identified will be included in an appropriate ongoing development programme that is recorded and regularly reviewed and monitored both within and outside of the appraisal process. A copy of the appraisal training programme will be sent to personnel as the appraisal system requires.

Time will be allowed within the annual audit plan to allow internal audit staff to receive the relevant training.

In addition, the Internal Audit Manager will allocate work to reflect the skills and experience required for the specific task, although it is essential that a balance is struck between knowledge and client relationships built through continuity and the need for audit staff to develop by auditing areas that they have not previously covered.

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In some circumstances, there may be a skill shortage within the Internal Audit team as a whole e.g. specialist audit areas such as technical computer audit. Where this applies the advice of specialists should be sought from within the Council, from colleagues at Teignbridge District Council or other neighbouring Councils or the external auditor.

In extreme situations, the services of a consultant may need to be bought in but the Internal Audit Manager will only do this with the consent of the s.151 Officer. The Audit Committee will be informed in such cases.