

# Review of Internal Audit

Ribble Valley Borough Council

Audit 2008/09

Date **June 2009**

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# Contents

<b>Introduction</b>	<b>3</b>
<b>Background</b>	<b>4</b>
<b>Audit approach</b>	<b>5</b>
<b>Main conclusions</b>	<b>6</b>
<b>Detailed report</b>	<b>7</b>
<b>The Way Forward</b>	<b>13</b>
<b>Appendix 1 – Action Plan</b>	<b>14</b>

DRAFT

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors/members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

# Introduction

- 1 This report summarises our review of Ribble Valley Borough Council's Internal Audit section. As external auditors, we are required by International Standards of Auditing (ISA+ 610) to consider and understand the activities of Internal Audit, to assist us in planning the audit and developing an effective audit approach. This is reinforced by the Audit Commission's "managed audit" principles, which encourages effective working relationships between internal and external auditors.
- 2 The Audit Commission's Code of Audit Practice requires us to review and report on:
  - the Council's financial statements and its annual governance statement; and
  - whether the Council has made proper arrangements for securing economy, efficiency and effectiveness.
- 3 Internal Audit has a key role to play in relation to both these areas. It is a function of the Council's management arrangements which is intended to confirm that the Council's systems of internal financial control are adequate and effective.
- 4 We therefore make an assessment of the effectiveness of Internal Audit as a management control by checking its compliance with professional requirements.

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# Background

- 5 Each year when planning our work we assess Internal Audit and, in every third year, we undertake a more detailed review against professional standards to:
  - confirm that the section complies with the requirements of the CIPFA ‘Code of Practice for Internal Audit in Local Government in the UK’; and
  - consider whether Internal Audit is effective as a support to management.
- 6 We agreed with the Council’s officers to undertake the detailed review this year, our first year as external auditors.
- 7 A key element of our review is an evaluation of the extent to which Internal Audit meets professional and statutory requirements contained in the CIPFA Code. The CIPFA Code sets out standards for Internal Audit, as detailed in Table 1 below.

**Table 1 CIPFA Internal audit score areas**

Organisational standards	Operational standards
1. Scope of Internal audit	7. Audit strategy and planning
2. Independence	8. Undertaking audit work
3. Ethics for internal auditors	9. Due professional Care
4. Audit Committee	10. Reporting
5. Relationships	11. Performance, quality and effectiveness
6. Staffing, training and continuing professional development	

Source: CIPFA Code of Practice for internal Audit in Local Government in the UK

# Audit approach

- 8 In undertaking our assessment we worked with the Internal Audit section to establish the policies and procedures in place and to review a sample of the work carried out.
- 9 Our audit approach included:
  - a review of documentation provided by the Council;
  - completion of the CIPFA Internal Audit Code Compliance Checklist;
  - review of individual audit files; and
  - discussions with the Principal Auditor.

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# Main conclusions

- 10** Our review has concluded that there is scope to improve in a number of areas in order to fully comply with the requirements of the CIPFA Code of Practice for Internal Audit. Internal Audit is an important element of the control environment within a Council and it is important to be able to demonstrate compliance with all areas of the Code.
- 11** We have specifically assessed Internal Audit against the 11 standards within CIPFA's Code and our findings are shown in the detailed report below. Our overall conclusion is that although the Internal Audit service appears to meet the needs of the Council, Internal Audit does not fully comply with all areas of the Code and we are unable to place reliance on the work of Internal Audit where it is relevant to our audit objectives.
- 12** We will work with Internal Audit and the Council to secure improvement in order for us to be able to rely on Internal Audit's work in future years.

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# Detailed report

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## Organisational standards

### Standard 1: Scope of Internal Audit

- 13** The scope of Internal Audit has been formally defined by the Council in the Internal Audit Terms of Reference, approved in November 2006. These terms of reference establish the section's responsibilities and objectives, organisational independence, accountability, reporting lines and relationships. The role of Internal Audit in its contribution to an effective control environment is clearly set out.

### Standard 2: Independence

- 14** There is scope for improvement to ensure Internal Audit is sufficiently independent of the activities it reviews. The Terms of Reference state that internal auditors have no operational responsibilities. Our understanding is that internal auditors do currently have some operational responsibilities in terms of the risk register, insurance claims and some work in the accountancy section. Whilst this may be acceptable if the person doing the work is not involved in any audit of that work, the Terms of Reference need to reflect this. Independence may be compromised if internal audit staff work on any of the key financial systems.
- 15** Internal Audit staff must ensure they are not involved in any decisions in relation to controls within the financial systems. This could potentially compromise their independence if internal audit staff carried out audit work involving testing those controls.
- 16** Internal Audit staff are not currently required to complete an annual declaration of interests. There is a potential risk that staff may have an interest that impacts on their independence.

Recommendation
<b>R1</b> An annual declaration of interests needs to be completed by all audit staff.
<b>R2</b> Ensure where auditors have operational duties they do not complete audit work on any of the operational areas they work on, and update the Terms of Reference to reflect this.

### Standard 3: Ethics for internal auditors

- 17** Internal auditors are aware of the aims and objectives of the Council and use previous audit work and discussions with staff to ensure they are aware of any particular risks relevant to the audit work they are undertaking. Staff are reminded of their ethical responsibilities during staff appraisal meetings.

- 18** We would expect the Internal Audit section to have in place a formal process of staff rotation and to set this out within the Terms of Reference. However, we acknowledge this can be difficult in smaller Internal Audit sections so the Council needs to consider how best to ensure staff retain their independence when regularly working on the same areas of audit year on year.

#### **Standard 4: Audit Committee**

- 19** Member scrutiny of the Council's internal audit function has been carried out by the Audit Committee since 2006. Establishing an independent audit committee in this way is CIPFA's preferred model for local authorities. Internal Audit has an effective working relationship with the Committee, which approves the annual Audit Plan and monitors progress against it, providing an important component of the Council's internal control environment.
- 20** The Principal Auditor regularly attends meetings of the Audit Committee and contributes to the agenda, including the production of quarterly and annual reports which allow the Committee to review the effectiveness of the section.

#### **Standard 5: Relationships**

- 21** Internal Audit has developed a good relationship with members. There is no clearly set out protocol for working with management and members within the Terms of Reference. It would be good practice to hold more frequent discussions with Heads of Service to inform audit planning. The timing of the audit work is not agreed in advance with the service area, although if there is an issue, the audit can be rearranged.
- 22** We need to work with Internal Audit to establish a formal protocol to specify the nature of the relationship between internal and external audit.

#### **Recommendation**

- R3** Draw up a more explicit protocol for working with management, elected members and external audit.

#### **Standard 6: Staffing, training and continuing professional development**

- 23** Internal Audit is appropriately staffed in terms of qualifications, personal attributes and experience to achieve its objectives and comply with the requirements of the CIPFA standards. Internal Auditors are working towards a professional qualification or have appropriate experience.
- 24** There are person specifications for the roles of senior auditor, audit technician and clerical assistant in place which set out at a high level the skills and competencies required for each grade. The year end appraisal process assesses internal audit staff against the required skills and competencies for the job and is used to identify any learning and development needs.

### Operational standards

#### Standard 7: Audit strategy and planning

- 25** The Internal Audit Strategy was approved by the Audit Committee in June 2006 and sets out objectives for the Internal Audit section. The strategy has not been updated since that time and refers to the Statement of Internal Control rather than the Annual Governance Statement. The strategy should be expanded to give more detail on how Internal Audit will plan and deliver their work including:
- how the head of internal audit will form and evidence his opinion on the control environment;
  - more detail on how Internal Audit's work will identify and address local and national issues and risks;
  - how the service will be provided, i.e. internally, externally, or a mix of the two; and
  - the resources and skills required to deliver the strategy.
- 26** The planning of audit work is underpinned by a risk based assessment, informed by the Council's risk management processes and linked to the Council's objectives. The plan is approved by members, and any matters which could affect the plan are reported. There is scope for improvement in terms of stakeholders being consulted on the Audit Plan.

#### Recommendation

- R4** The Audit Strategy needs to be updated to refer to the Annual Governance Statement, and expanded to include all areas within the Code.

#### Standard 8: Undertaking audit work

- 27** A sample of two audit assignments were selected for review. We found that the standard of documenting and evidencing within the files could be improved to set out more clearly how the work undertaken supported the conclusions in the report.
- 28** An audit brief needs to be included within the file and updated for each audit. The audit brief should clearly set out the timing, resources and reporting requirements. There is currently no audit manual in place so the audit brief needs to more clearly set out how the objectives of the audit will be achieved, for example there is no sampling guidance or clear guidance as to what is required for each objective to be met. Although the Audit Plan is prepared on a risk basis there is no evidence that the individual audit tests are selected on this basis.
- 29** Within the files we looked at there was no evidence of review of the audit work by another auditor. We have been advised that internal audit staff's work is separately reviewed by the Principal Auditor and have seen very high level examples of this, but we have not seen any evidence of review of the Principal Auditor's work. Review of work needs to be clearly evidenced and retained on the file. A standard review sheet

could be used to demonstrate the review of work and that any review points have been cleared to the reviewer's satisfaction.

- 30 Understanding of the work completed could be improved if lead schedules were prepared for each audit. These should state the test to be completed, and link to the System Control Evaluation (SCE), description of the work completed and the conclusions reached. The summary of testing could then be linked to this with explanations of why and how the samples have been selected.
- 31 Within the files are tables which summarise the testing carried out and the results. These are cross referenced to the appendices of the final report which sets out the detail of the testing. However there is no supporting evidence and/or source documentation on the file to demonstrate this testing. Formal guidance on the sizes of samples to be should be made available to auditors and a standard approach should be developed across all audits.

Recommendation	
<b>R5</b>	The audit brief for each audit should clearly set out how the objectives of the audit will be achieved including timing, resources, reporting requirements and sample size guidance.
<b>R6</b>	Ensure that review of audit work is clearly evidenced including any review points raised and how these are addressed.
<b>R7</b>	Ensure there is sufficient evidence on file to support the judgments made and conclusions reached.
<b>R8</b>	Develop a standard approach clearly setting out how sample sizes are determined and ensure this is applied across all audits.

### Standard 9: Due professional care

- 32 The Internal Audit Code of Ethics sets out the requirements for audit staff to be fair, impartial, and work to appropriate standards. There is scope to improve this by including the requirement for audit staff to disclose any non compliance with the ethics standards and to specify that staff should not use any information gained from the course of the audit for personal use.
- 33 Although the Principal Auditor monitors and reviews the work of the other auditors to ensure that due professional care is maintained, there was no evidence of review of the Principal Auditor's work. See recommendations made within Standard 8.

### Standard 10: Reporting

- 34 Audit reports are clearly structured and give firm conclusions to management to support the opinion of the area reviewed. Whilst service managers are required to acknowledge receipt of reports and agree to recommendations, there is no formal written procedure for agreeing the factual content of reports with service managers

## Detailed report

prior to issue. When reviewing files, we identified that in one case although recommendations were made, there was no action plan included in the report. There should be a clear policy in place setting out the requirements for:

- discussing and agreeing reports with managers and recording this process;
- identifying where follow up action is required;
- monitoring progress against recommendations; and
- a process for escalating issues when recommendations are not implemented by the agreed date.

- 35** Internal Audit produce an annual report to support the Annual Governance Statement. The report summarises the work undertaken in the year. There is scope to expand this report to confirm the actual work undertaken compared to planned work, to comment on compliance with the standards of the Code and to communicate the results of the Internal Audit quality assurance programme.

### Recommendation

**R9** Clearly set out Internal Audit's policy in terms of reviewing reports, follow up visits and monitoring of implementation of recommendations.

**R10** There is scope to improve the annual report by including a comparison of actual work to planned work, comment on compliance with the standards of the Code and communicate the results of the Internal Audit quality assurance programme

### Standard 11: Performance, quality and effectiveness

- 36** Policies and procedures have been established mainly by reference to the Audit Manual produced by CIPFA. The Council should consider developing its own audit manual tailored to Ribble Valley's requirements to guide audit staff in performing their duties and complying with the Code. We acknowledge that this may need to be a gradual process given the size of the Internal Audit section. Such a manual could include guidance on working papers and sample sizes, etc. as recommended above in the section on standard 8.
- 37** From our sample review of assignments, we have gained assurance that audit work is undertaken by staff with the appropriate skills, experience and competence. There is only very high level evidence of the supervision and review of work to ensure that quality levels are maintained and this does not include the Principal Auditor's work. See recommendations under standard 8.
- 38** The Principal Auditor advised us that the performance of internal auditors is discussed with service managers after the audit has been completed. There is no formal quality assurance programme in place leading to a risk that the work of Internal Audit may not meet quality standards, be effective and efficient, continuously improve or provide value for money. Quality standards need to be put into place and performance against these monitored.

**Recommendation**

**R11** Consider developing an audit manual to include guidance on how to carry out the day to day audit work and the quality standards that must be adhered to.

**R12** A quality assurance process should be put into place to ensure the internal audit service meets its aims & objectives, is compliant with quality standards, and continually improves.

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# The Way Forward

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- 39** In light of the results of our review, we are currently unable to place reliance on the work carried out by internal Audit. We will work with Internal Audit to help them progress towards meeting the CIPFA standards, in order for us to be able to place reliance on their work in future years. We will share the results of our work and testing - specifically in the area of key financial systems - in order that we can develop a closer working relationship.
- 40** We will review the actions taken by Internal Audit in light of our recommendations in 12 months time and carry out a 'light touch' review of Internal Audit at that time to ascertain the progress made against the recommendations.

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# Appendix 1 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
7	R1 An annual declaration of interests needs to be completed by all audit staff.	3				
7	R2 Ensure where auditors have operational duties they do not complete audit work on any of the operational areas they work on and update the Terms of Reference to reflect this.	3				
8	R3 Draw up a more explicit protocol for working with management, elected members and external audit.	2				
9	R4 The Audit Strategy needs to be updated to refer to the Annual Governance Statement, and expanded to include all areas within the Code.	2				
10	R5 The audit brief for each audit should clearly set out how the objectives of the audit will be achieved including timing, resources, reporting requirements and sample size guidance.	3				
10	R6 Ensure that review of audit work is clearly evidenced including any review points raised and how these are addressed.	3				
10	R7 Ensure there is sufficient evidence on file to support the judgments made and	3				

## The Way Forward

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
	conclusions reached.					
10	R8 Develop a standard approach clearly setting out how sample sizes are determined and ensure this is applied across all audits.	3				
11	R19 Clearly set out Internal Audit's policy in terms of reviewing reports, follow up visits and monitoring of implementation of recommendations.	2				
11	R10 There is scope to improve the annual report by including a comparison of actual work to planned work, comment on compliance with the standards of the Code and communicate the results of any Internal Audit quality assurance programme	1				
12	R11 Consider developing an audit manual to include guidance how to carry out the day to day audit work and the quality standards that must be adhered to.	2				
12	R12 A quality assurance process should be put into place to ensure the internal audit service meets its aims & objectives, is compliant with quality standards, and continually improve.	3				