



DERBY CITY COUNCIL

**AUDIT AND ACCOUNTS
COMMITTEE
28 JUNE 2007**

Report of the Acting Corporate
Director - Resources

ITEM XX

EFFECTIVENESS OF THE SYSTEM OF INTERNAL AUDIT

RECOMMENDATION

- 1.1 To review the sources of assurance and comment on the effectiveness of the system of internal audit.
- 1.2 To request that the Head of Audit and Risk Management brings to a future meeting of the Committee an update on the developments outlined in the report.

SUPPORTING INFORMATION

- 2.1 The Accounts and Audit (Amendment) (England) Regulations 2006 state that “the relevant body shall, at least once in each year, conduct a review of the effectiveness of its system of internal audit’. The regulations go on to state that the findings of this review be considered by a committee of the relevant body, or by members of the relevant body as a whole, as part of the wider consideration of an organisation’s system of internal control.
- 2.2 Internal Audit is one of the key areas of assurance for the Audit and Accounts Committee and therefore has a significant impact on the Council’s Statement on Internal Control. It is important that the Committee gain assurance that Internal Audit itself is effective.
- 2.3 The regulations and guidance relating to the assessment of the system of internal audit allow for different methods of review but it is accepted that where an Audit Committee exists that this would be an appropriate body to conduct the review. The regulations also do not define the extent of the ‘system of internal audit’ i.e. should it also include the arrangements for risk management, the Audit Committee itself and how the monitoring of the implementation of audit recommendations is carried out by senior management?
- 2.4 As this is the first year of this requirement there is little guidance or best practice available. However, the Audit and Accounts Committee is considered to be an appropriate body to review the effectiveness of the system of internal control, although other methods of review can be considered.
- 2.5 This report sets out various areas of assurance that the Audit and Accounts Committee can look to rely on when reviewing whether the system of internal audit is effective.

- 2.6 The Accounts and Audit Regulations 2003 and subsequent amendments have put greater emphasis on internal audit's role beyond looking at just financial controls.
- 2.7 Internal Audit is therefore a key source of assurance to the Audit and Accounts Committee when it considers the Council's Statement on Internal Control (a requirement of the regulations).

CIPFA Code of Practice for Internal Audit in Local Government in the UK 2006

- 2.8 This publication updates the 2003 Code. It reflects the changes arising from the amendments to the Accounts and Audit Regulations in 2006 and practice relating to corporate governance that further emphasise the importance of internal audit to the proper management of organisations. It more closely aligns practice with current approaches for auditors, particularly in respect of developments in risk management and the impact on planning internal audit activity. All principal local authorities' internal audit sections should comply with the requirements set out in this Code.
- 2.9 The Code of Practice contains eleven standards as follows:
- Scope of Internal Audit
 - Independence
 - Ethics for Internal Auditors
 - Audit Committees
 - Relationships
 - Staffing, Training and Continuing Professional Development
 - Audit Strategy and Planning
 - Undertaking Audit Work
 - Due Professional Care
 - Reporting
 - Performance, Quality and Effectiveness.
- 2.10 These standards are summarised in a checklist that is attached as Appendix 2. The Head of Audit and Risk Management has completed answers to the checklist that members of the Committee are asked to consider as part of their review of the effectiveness of the system of Internal Audit. It is proposed that this assessment against the Code of Practice will be done annually.
- 2.11 The current assessment highlights a number of areas where further developments are required ...
- There is no formal strategy document in existence for Internal Audit at present. Although the elements of an Audit Strategy document exist, they need to be pulled together into one structured document. There is an IT Audit Strategy document in place.
 - While the Internal Audit Section has adopted the CIPFA Audit Manual and tailored it to the individual needs of the Section, the review and updating of the contents are infrequent.
 - The Head of Audit and Risk Management is reviewing the current structure of the Section to meet the changing demands being placed on it.

Performance Measures for Internal Audit

- 2.12 The main performance measure for the internal audit section is % completion of the audit plan. The annual target is 90%, which was a measure previously stated in the CPA Use of resources criteria. In 2006/7, Internal Audit achieved 89% completion of the plan. The Head of Audit and Risk Management is currently in the process of developing new performance measures for internal audit that will demonstrate the effectiveness of the internal audit service.

External Audit

- 2.13 The Council's External Auditors carry out a review of the work of Internal Audit on an annual basis. This review informs them as to whether they can place reliance on the work of internal audit particularly in relation to the Council's main financial systems. If they are happy to do so, then their work in these areas can be reduced as the opinion of the internal auditor can be relied upon.

CPA Use of Resources

- 2.14 As part of the Use of Resources Assessment, the Council is assessed on the effectiveness of its Internal Control. This assessment includes specific key lines of enquiry relating to internal audit and the effectiveness of the Audit Committee. The Council was rated at Level 3 (out of 4) for internal control.

Effectiveness of the Audit and Accounts Committee

- 2.15 The Audit and Accounts Committee is a key element in the Council's system of internal audit. At the meeting on 7 December 2006, the Committee reviewed and approved a self-assessment checklist produced by CIPFA which is designed to measure the effectiveness of an audit committee. The checklist demonstrated that this Committee reflects current guidance and follows best practice.

For more information contact:	Richard Boneham, Head of Audit and Risk Management, 01332 255688 richard.boneham@derby.gov.uk
Background papers:	None
List of appendices:	Appendix 1 – Implications Appendix 2 – Code of Practice - Checklist

IMPLICATIONS

Financial

1. None directly arising.

Legal

2. None directly arising.

Personnel

3. None directly arising.

Equalities impact

4. None directly arising.

Corporate priorities

5. None directly arising.

CODE OF PRACTICE - INTERNAL AUDIT CHECKLIST - 2006

Y = YES, P = PARTIAL, N = NO.

Code Ref		Y	P	N	Comments
1	SCOPE OF INTERNAL AUDIT				
1.1	Terms of Reference				
1.1.1	Do terms of reference:				Contained in the Council's Financial Procedure Rules
	a) establish the responsibilities and objectives of Internal Audit?	√			
	b) establish the organisational independence of Internal Audit?	√			
	c) establish the accountability, reporting lines and relationships between the Head of Internal Audit and:				
	i) those charged with governance?	√			
	ii) those parties to whom the Head of Internal Audit may report?	√			
	d) recognise that Internal Audit's remit extends to the entire control environment of the organisation?	√			
	e) identify Internal Audit's contribution to the review of the effectiveness of the control environment?	√			
	f) require and enable the Head of Internal Audit to deliver an annual audit opinion?	√			
	g) define the role of Internal Audit in any fraud-related or consultancy work [see also 1.3.2)?		√		
	h) explain how Internal Audit's resource requirements will be assessed?			√	
	i) establish Internal Audit's right of access to all records, assets, personnel and premises, including those of partner organisations, and its authority to obtain such information and explanations as it considers necessary to fulfil its responsibilities?	√			
1.1.2	Does the Head of Internal Audit advise the organisation on the content and the need for subsequent review of the terms of reference?		√		
1.1.3	Have the terms of reference been formally approved by the organisation?	√			Full Council
1.1.3	Are terms of reference regularly reviewed?		√		

Code Ref		Y	P	N	Comments
1.2	Scope of Work				
1.2.1	Are the organisation's assurance, risk management arrangements and monitoring mechanisms taken into account when determining Internal Audit's work and where effort should be concentrated?	√			
1.2.3	Where services are provided in partnership has the Head of Internal Audit identified: a) how assurance will be sought? b) agreed access rights where appropriate?			N/A	
1.3	Other Work				
1.3.1	Where Internal Audit undertakes consultancy and/or fraud and corruption work, does it have the: a) skills, and b) resources to do this?	√	√		
1.3.2	Do the terms of reference define Internal Audit's role in: a) fraud and corruption? b) consultancy work?		√ √		
1.4	Fraud and Corruption				
1.4.2	Has the Head of Internal Audit made arrangements, within the organisation's anti-fraud and anti-corruption policies, to be notified of all suspected or detected fraud, corruption or impropriety?	√			Financial Procedure Rules Fraud response plan
2	INDEPENDENCE				
2.1	Principles of Independence				
2.1.1	Is Internal Audit: a) independent of the activities it audits? b) free from any non-audit [operational) duties?	√	√		
2.1.2	Where internal audit staff have been consulted during system, policy or procedure development, are they precluded from reviewing and making comments during routine or future audits?		√		
2.2	Organisational Independence				
2.2.1	Does the status of Internal Audit allow it to demonstrate independence?		√		
2.2.2	Does the Head of Internal Audit have direct access to: a) officers? b) members?	√ √			

Code Ref		Y	P	N	Comments
2.2.2	Does the Head of Internal Audit report in his or her own name to members and officers?	√			
2.2.3	a) Is there an assessment that the budget for Internal Audit is adequate? b) Does any budget delegated to service areas ensure that: i) Internal Audit adherence to the Code is not compromised? ii) the scope of Internal Audit is not affected? iii) Internal Audit can continue to provide assurance for the Statement on Internal Control?			√ N/A	
2.3	Status of the Head of Internal Audit				
2.3.1	Is the Head of Internal Audit managed by a member of the corporate management team?			√	
2.5	Independence of Internal Audit Contractors				
2.5.1	Does the planning process recognise and tackle potential conflicts of interest where contractors also provide non-internal audit services?			N/A	
2.6	Declaration of Interest				
2.6.1	Do audit staff make formal declarations of interest?	√			
2.6.2	Does the planning process take account of the declarations of interest registered by staff?	√			
3	ETHICS FOR INTERNAL AUDITORS				
3.1	Purpose				
3.1.1	Does the Head of Internal Audit regularly remind staff of their ethical responsibilities?			√	
3.2	Integrity				
3.2.1	Has the internal audit team established an environment of trust and confidence?	√			
3.2.2	Do internal auditors demonstrate integrity in all aspects of their work?	√			
3.3	Objectivity				
3.3.2	Are internal auditors perceived as being objective and free from conflicts of interest?	√			
3.3.3	Is a time period set by the Head of Internal Audit for staff where they do not undertake an audit in an area where they have had previous operational roles?			√	
3.3.4	Are staff rotated on regular/annually audited areas?			√	

Code Ref		Y	P	N	Comments
3.4	Competence				
3.4.1	Does the Head of Internal Audit ensure that staff have sufficient knowledge of: a) the organisation's aims, objectives, risks and governance arrangements? b) the purpose, risks and issues of the service area? c) the scope of each audit assignment? d) relevant legislation and other regulatory arrangements that relate to the audit?	√ √ √ √			
3.5	Confidentiality				
3.5.1	Do internal audit staff understand their obligations in respect to confidentiality?	√			
4	AUDIT COMMITTEES				
4.1	Purpose of Audit Committee				
4.1.1	Does the organisation have an independent audit committee?	√			
4.2	Internal Audit's Relationship with the Audit Committee				
4.2.1	Is there an effective working relationship between the audit committee and Internal Audit?	√			
4.2.2	Does the committee approve the internal audit strategy and monitor progress?			√	No strategy at present
4.2.2	Does the committee approve the annual internal audit plan and monitor progress?	√			
4.2.4	Does the Head of Internal Audit: a) attend the committee and contribute to its agenda? b) participate in the committee's review of its own remit and effectiveness? c) ensure that the committee receives and understands documents that describe how Internal Audit will fulfil its objectives? d) report on the outcomes of internal audit work to the committee? e) establish if anything arising from the work of the committee requires consideration of changes to the audit plan, or vice versa? f) present the annual internal audit report to the committee?	√ √ √ √ √ √			
4.2.5	Is there the opportunity for the Head of Internal Audit to meet privately with the audit committee?	√			

Code Ref		Y	P	N	Comments
5	RELATIONSHIPS				
5.1	Principles of Good Relationships				
5.1.2	Is there a protocol that defines the working relationship for Internal Audit with: a) management? b) other internal auditors? c) external auditors? d) other regulators and inspectors? e) elected members?	√ √ √ √ √			
5.2	Relationships with Management				
5.2.1	Does the Head of Internal Audit seek to maintain effective relationships between internal auditors and managers?	√			
5.2.2	Is the timing of audit work planned in conjunction with management?	√			
5.3	Relationships with Other Internal Auditors				
5.3.1	Do arrangements exist with other internal auditors that include joint working, access to working papers, respective roles and confidentiality?			√	
5.4	Relationships with External Auditors				
5.4.2	Is it possible for Internal Audit and External Audit to rely on each other's work?		√		Not a 2-way process
5.4.3	Are there regular meetings between the Head of Internal Audit and the External Audit Manager?	√			
5.4.3	Are the internal and external audit plans co-ordinated?		√		
5.5	Relationships with Other Regulators and Inspectors				
5.5.1	Has the Head of Internal Audit sought to establish a dialogue with the regulatory and inspection agencies that interact with the organisation?		√		Only Ext Audit and AC
5.6	Relationships with Elected Members				
5.6.1	Do the terms of reference for Internal Audit define the channels of communication with members and describe how such relationships should operate?			√	
5.6.1	Does the Head of Internal Audit maintain good working relationships with members?	√			
6	STAFFING, TRAINING AND CONTINUING PROFESSIONAL DEVELOPMENT				
6.1	Staffing Internal Audit				

Code Ref		Y	P	N	Comments
6.1.1	Is Internal Audit appropriately staffed (numbers, grades, qualifications, personal attributes and experience) to achieve its objectives and comply with these standards?			√	
6.1.1	Does the Head of Internal Audit have access to appropriate resources where the necessary skills and expertise are not available within the internal audit team?		√		
6.1.2	Is the Head of Internal Audit professionally qualified and experienced?	√			
6.1.2	Does the Head of Internal Audit have wide experience of internal audit and management?	√			
6.1.3	a) Do all internal audit staff have up-to-date job descriptions? b) Are there person specifications that define the required qualifications, competencies, skills, experience and personal attributes for internal audit staff?	√	√		Currently being reviewed
6.2	Training and Continuing Professional Development				
6.2.1	a) Has the Head of Internal Audit defined the skills and competencies for each level of auditor? b) Are individual auditors periodically assessed against these predetermined skills and competencies? c) Are training or development needs identified and included in an appropriate ongoing development programme? d) Is the development programme recorded, regularly reviewed and monitored?	√	√ √ √		
6.2.2	Do individual auditors maintain a record of their professional training and development activities?		√		
7	AUDIT STRATEGY AND PLANNING				
7.1.1	a) Is there an internal audit strategy for delivering the service? b) Is it kept up to date with the organisation and its changing priorities?			√ N/A	
7.1.2	Does the strategy include: a) Internal Audit objectives and outcomes? b) how the Head of Internal Audit will form and evidence his or her opinion on the control environment? c) how Internal Audit's work will identify and address local and national issues and risks? d) how the service will be provided, i.e. internally, externally, or a mix of the two? e) the resources and skills required to deliver the			N/A	

Code Ref		Y	P	N	Comments
	strategy?				
7.1.3	Has the strategy been approved by the audit committee?			N/A	
7.2	Audit Planning				
7.2.1	Is there a risk-based plan that is informed by the organisation's risk management, performance management and other assurance processes?	√			
7.2.1	Where the risk management process is not fully developed or reliable, does the Head of Internal Audit undertake his or her own risk assessment process?	√			
7.2.1	Are stakeholders consulted on the audit plan?	√			
7.2.2	Does the plan demonstrate a clear understanding of the organisation's functions?	√			
7.2.3	Does the plan: a) cover a fixed period of no longer than one year? b) outline the assignments to be carried out? c) prioritise assignments? d) estimate the resources required? e) differentiate between assurance and other work? f) allow a degree of flexibility	√ √ √ √ √ √	√		
7.2.4	If there is an imbalance between the resources available and resources needed to deliver the plan, is the audit committee informed of proposed solutions?	√			
7.2.4	Has the plan been approved by the audit committee?	√			
7.2.5	If significant matters arise that jeopardise the delivery of the plan, are these addressed and reported to the audit committee?	√			
8	UNDERTAKING AUDIT WORK				
8.1	Planning				
8.1.1	a) Is a brief prepared for each audit? b) Is the brief discussed and agreed with the relevant managers?	√ √			
8.1.1	Does the brief set out: a) objectives? b) scope? c) timing? d) resources? e) reporting requirements?	√ √ √ √ √	√ √		
8.2	Approach				
8.2.1	Is a risk-based audit approach used?	√			

Code Ref		Y	P	N	Comments
8.2.3	Does the audit approach show when management should be informed of interim findings where key (serious) issues have arisen?		√		
8.2.4	Does the audit approach include a quality review process for each audit?	√			
8.3	Recording Audit Assignments				
8.3.1	Has the Head of Internal Audit defined a standard for audit documentation and working papers?	√			
8.3.1	Do quality reviews ensure that the defined standard is followed consistently for all audit work?	√			
8.3.2	Are working papers such that an experienced auditor can easily: a) identify the work that has been performed? b) re-perform it if necessary? c) see how the work supports the conclusions reached?	√ √ √			
8.3.3	Is there a defined policy for the retention of all audit documentation, both paper and electronic?		√		
8.3.3	Do all retention and access policies conform to appropriate, legislation, i.e. Data Protection Act, Freedom of Information Act, etc and any organisational requirements?		√		
8.3.3	Is there an access policy for audit files and records?		√		
9	DUE PROFESSIONAL CARE				
9.2	Responsibilities of the Individual Auditor				
9.2.1	Are there documents that set out the requirements on all audit staff in terms of: a) being fair and not allowing prejudice or bias to override objectivity? b) declaring interests that could be perceived to be conflicting or could potentially lead to conflict? c) receiving and giving gifts and hospitality from employees, clients, suppliers or third parties? d) using all reasonable care in obtaining sufficient, relevant and reliable evidence on which to base conclusions? e) being alert to the possibility of intentional wrongdoing, errors or omissions, poor value for money, failure to comply with management policy or conflict of interest? f) having sufficient knowledge to identify indicators that fraud or corruption may have been committed? g) disclosing all material facts known to them which, if not disclosed, could distort their reports or conceal unlawful practice? h) disclosing any non-compliance with these	√ √ √ √ √ √ √			

Code Ref		Y	P	N	Comments
	standards? i) not using information they gain in the course of their duties for personal use?	√ √			
9.3	Responsibilities of the Head of Internal Audit				
9.3.1	Has the Head of Internal Audit established a monitoring and review programme to ensure that due professional care is achieved and maintained?	√			
9.3.2	Are there systems in place for individual auditors to disclose any suspicions of fraud, corruption or improper conduct?	√			
10	REPORTING				
10.1	Principles of Reporting				
10.1.1	Is an opinion on the control environment and risk exposure given in each audit report?	√			
10.1.3	Has the Head of Internal Audit determined the way in which Internal Audit will report?	√			
10.1.4	Has the Head of Internal Audit set out the standards for internal audit reporting?	√			
10.1.5	Are there laid-down timescales for reports to be issued?	√			
10.2	Reporting on Audit Work				
	Do the reporting standards include:				
10.1.4	a) format of the reports?	√			
10.1.4	b) quality assurance of reports?	√			
10.2.2	c) the need to state the scope and purpose of the audit?	√			
10.2.1	d) the requirement to give an opinion?	√			
10.1.4	e) process for agreeing reports with the recipient?	√			
10.2.1	f) an action plan or record of points arising from the audit and, where appropriate, of agreements reached with management together with appropriate timescales?	√			
10.2.3	Does the audit reporting process include discussion and agreement of reports?	√			
10.2.4	Has the Head of Internal Audit determined a process for prioritising recommendations according to risk?	√			
10.2.5	Are areas of disagreement recorded appropriately?	√			
10.2.5	Are those weaknesses giving rise to significant risks that are not agreed drawn to the attention to senior management?	√			
10.2.6	Is the circulation of each audit report determined when preparing the audit brief?	√			
10.2.6	a) Does the reporting process include details of	√			

Code Ref		Y	P	N	Comments
	circulation of that particular audit report? b) Is this included in the brief for each individual audit?	√			
10.2.7	Does the Head of Internal Audit have mechanisms in place to ensure that: a) recommendations that have a wider impact are reported to the appropriate forums? b) risk registers are updated?	√	√		
10.3	Follow-up Audits and Reporting				
10.3.1	Has the Head of Internal Audit defined the need for and the form of any follow-up action?	√			
10.3.2	Has the Head of Internal Audit established appropriate escalation procedures for internal audit recommendations not implemented by the agreed date?	√			
10.3.3	Where appropriate, is a revised opinion given following a follow-up audit and reported to management?		√		
10.3.4	Are the findings of audits and follow-ups used to inform the planning of future audit work?	√			
10.4	Annual Reporting and Presentation of Audit Opinion				
10.4.1	Does the Head of Internal Audit provide an annual report to support the Statement on Internal Control?	√			
10.4.2	Does the Head of Internal Audit's annual report: a) include an opinion on the overall adequacy and effectiveness of the organisation's control environment? b) disclose any qualifications to that opinion, together with the reasons for the qualification? c) present as summary of the audit work from which the opinion was derived, including reliance placed on work by other assurance bodies? d) draw attention to any issues the Head of Internal Audit judges particularly relevant to the preparation of the Statement on Internal Control? e) compare the actual work undertaken with the planned work and summarise the performance of the internal audit function against its performance measures and targets? f) comment on compliance with the standards of the Code? g) communicate the results of the internal audit quality assurance programme?	√ √ √ √ √ √ √			
10.4.3	Has the Head of Internal Audit made provision for interim reporting to the organisation during the year?	√			
11	PERFORMANCE, QUALITY AND				

Code Ref		Y	P	N	Comments
	EFFECTIVENESS				
11.1	Principles of Performance, Quality and Effectiveness				
11.1.1	Is there an audit manual?	√			
11.1.1	Does the audit manual provide guidance on: a) carrying out day-to-day audit work? b) complying with the Code?	√ √			
11.1.1	Is the audit manual reviewed regularly and updated to reflect changes in working practices and standards?			√	
11.1.2	Does the Head of Internal Audit have arrangements in place to assess the performance and effectiveness of: a) each individual audit? b) the internal audit service as a whole?		√ √		
11.2	Quality Assurance of Audit Work				
11.2.1	Does the Head of Internal Audit have a process in place to ensure that work is allocated to auditors who have the appropriate skills, experience and competence?	√			
11.2.2	Does the Head of Internal Audit have a process in place to ensure that all staff are supervised appropriately throughout all audits?	√			
11.2.2	Does the supervisory process cover: a) monitoring progress? b) assessing quality of audit work? c) coaching staff?	√ √ √			
11.3	Performance and Effectiveness of the Internal Audit Service				
11.3.1	Does the Head of Internal Audit have a performance management and quality assurance programme in place?	√			
11.3.2	Does the performance management and quality assurance framework include as a minimum: a) a comprehensive set of targets to measure performance: i) which are developed in consultation with appropriate parties? ii) which are included in service level agreements, where appropriate? iii) against which the Head of Internal Audit measures, monitors and reports appropriately on progress? b) user feedback obtained for each individual audit and periodically for the whole service? c) a periodic review of the service against the strategy and the achievement of its aims and objectives, the results of which are used to	√ √	√	√	

Code Ref		Y	P	N	Comments
	inform the future strategy? d) Internal quality reviews to be undertaken periodically to ensure compliance with this Code and the audit manual? e) an action plan to implement improvements?	√	√		
11.3.3	Does the Head of Internal Audit compare the performance and the effectiveness of the service over time, in terms of both the achievement of targets and the quality of the service provided to the user?		√		
11.3.1	Do the results of the performance management and quality assurance programme evidence that the internal audit service is: a) meeting its aims and objectives? b) compliant with the Code? c) meeting internal quality standards? d) effective, efficient, continuously improving? e) adding value and assisting the organisation in achieving its objectives?		√ √ √ √	√	
11.3.4	Does the Head of Internal Audit report on the results of the performance management and quality assurance programme in the annual audit report?	√			
11.3.5	Does the Head of Internal Audit provide evidence from his or her review of the performance and quality of the internal audit service to the organisation for consideration as part of the annual review of the effectiveness of the system of internal audit?	√			