



DERBY CITY COUNCIL

**AUDIT AND ACCOUNTS  
COMMITTEE  
27 SEPTEMBER 2007**

# ITEM 10

Report of the Head of Audit and  
Risk Management

## **COMPLIANCE WITH THE CIPFA CODE OF PRACTICE FOR INTERNAL AUDIT**

### **RECOMMENDATION**

- 1.1 To approve the Internal Audit Strategy.
- 1.2 To note the progress made on the areas identified that needed further development in order to comply with the Code of Practice.

### **SUPPORTING INFORMATION**

- 2.1 At the meeting on 28 June 2007, this Committee received a report on a review of the effectiveness of the system of internal audit within the Council. This annual review is required by the Accounts and Audit (Amendment) (England) Regulations 2006.
- 2.2 One of the key components of the system of internal audit is the work of the Council's Internal Audit section in providing the basis for the assurance or opinion on internal control in the Head of Audit and Risk Management's annual report. The CIPFA Code of Practice for Internal Audit in Local Government in the UK defines how Internal Audit should carry out its functions. Therefore the Internal Audit section needs to be able to demonstrate its level of compliance with the Code. The Head of Audit and Risk Management completed a checklist on compliance with the Code for members of the Committee to consider as part of their review of the effectiveness of the system of Internal Audit at the June meeting. This assessment highlighted a number of areas where further developments are required. The Committee requested that the Head of Audit and Risk Management produced update reports on the progress made with these further developments.
- 2.3 The Code sets out the definitions and principles (the standards) which establish how a professional internal audit service should operate in the modern local government context. It provides a framework for measurement, management and monitoring of the function.
- 2.4 The key development areas identified by the Head of Audit and Risk Management in relation to compliance with the Code that are currently being addressed are:

## Standard 2: Independence

Standard 2.3 (Status of the Head of Internal Audit) states that:

*“The position of the Head of Audit in the management structure should reflect the influence he or she has on the control environment and he or she should not report to or be managed at a lower organisational level than the corporate management team”.*

Since 1997 the Internal Audit section has been part of the Corporate Finance Division with the Head of Service being directly managed by the Assistant Director. The new Corporate Director of Finance has now made changes to the functional responsibilities of the Assistant Director – Corporate Finance post, resulting in the Head of Audit and Risk Management reporting directly to the Corporate Director of Resources. This complies with Standard 2.3.

## Standard 7: Audit Strategy and Planning

Standard 7.1 (Audit Strategy) states that:

*“The Head of Internal Audit must produce an audit strategy.”*

It was reported to the June meeting that there was no formal strategy document in existence for Internal Audit. Although the elements of an Audit Strategy document existed, they needed to be pulled together into one structured document. An Audit Strategy has been developed and is attached at Appendix 2. The Standard states that “The strategy should be approved, but not directed, by the Audit Committee”. The production of the Audit Strategy is a Resources Department Business Plan objective for 2007/8. The target is to obtain formal approval of the Strategy by the Audit and Accounts Committee at its September meeting.

## Standard 11: Performance, Quality and Effectiveness

Standard 11.1 (The Principles of Performance, Quality and Effectiveness) states that:

*“The Head of Internal Audit should establish policies and procedures in an audit manual to guide staff in performing their duties and complying with this Code. The manual should be regularly reviewed and updated to reflect changes in working practices and standards.”*

The Internal Audit Section has adapted the CIPFA Model Internal Audit Manual for use. It is held on the section’s local drive on the server and is available to all audit staff. However, the manual has not been reviewed on a regular basis and does not accurately reflect the current working practices of the Section. The review and updating of the audit manual has been included as an objective for the Section in 2007/8. The target date for completion of this objective is 31 March 2008.

2.5 The Audit Strategy will be reviewed on an annual basis by the Head of Audit and Risk Management and then brought to this Committee for approval.

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<b>Background papers:</b>	None
<b>List of appendices:</b>	Appendix 1 – Implications Appendix 2 – Internal Audit Strategy

<b>IMPLICATIONS</b>
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**Financial**

1. None directly arising.

**Legal**

2. None directly arising.

**Personnel**

3. None directly arising.

**Equalities impact**

4. None directly arising.

**Corporate objectives and priorities for change**

5. None directly arising.

**Derby City Council**  
**Internal Audit Strategy 2007/08 to 2009/10**

September 2007

## 1. Introduction

- 1.1 This document sets out the overall strategy for the Council's internal audit service for the current year 2007/8 and the strategic approach to delivering internal audit services to 2009/10.
- 1.2 Section 151 of the Local Government Act requires the authority (through its chief financial officer) to ensure the proper administration of the Council's financial affairs. The work of the internal audit function supports the appointed S151 officer in this. Internal Audit assists managers to administer the Council's finances in a sound manner related to the associated risks, and it provides information and assurance to the Corporate Director of Resources on the extent of proper administration.
- 1.3 The Accounts and Audit Regulations 2003, as amended in 2006, sets out the requirements for local authorities for internal audit;

**“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 internal audit practices...”**

- 1.4 The Code of Practice for Internal Audit in Local Government provides a professional definition of what internal audit is;

*“Internal Audit is an assurance function that primarily provides an independent and objective opinion to the organisation on the control environment comprising risk management, internal control and governance 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 resources.”*

## 2. Purpose of the Strategy

- 2.1 The purpose of the audit strategy is to put in place an approach that will enable Internal Audit to be managed in a way which will facilitate:
- How the service is delivered
  - The provision to the Council, through the Audit and Accounts Committee of an overall opinion each year on the Council's risk management, control and governance, to support the Statement of Internal Control
  - Audit of the Council's risk management, control and governance systems through audit plans in a way which affords suitable priority to the Council's objectives and risks
  - The identification of audit resources required to deliver an audit service which meets required professional standards

- The relative allocation of resources between assurance, fraud related and consultancy services provided by Internal Audit.

### **3. Current Internal Audit Approach**

- 3.1 The current audit process is mainly functionally driven – the audit ‘universe’ consists of a mix of activities, cross service or corporate risk and financial audits, where processes such as payments, payroll etc are separately identified for audit.
- 3.2 Delivery of the plan is through in-house resources, including assurances from other assurance providers. The current plan is based on a one year cycle based on an underlying risk assessment. The inherent risks existing within each area are then identified for audit as part of the audit planning process.
- 3.3 Internal Audit reviews the Council’s fundamental financial systems each year. The Council’s External Auditor assesses the extent to which reliance can be placed on the work of Internal Audit. Councils are awarded “managed audit” status if certain standards, including reliance on audit work, are achieved. This enables the External Auditor to reduce the work they carry out, thus cutting their charges to the Council and avoiding duplication. The financial systems are audited using a systems based approach with the addition of an assessment of any other risks that impinge on the area.
- 3.4 Separate time allocation is allowed in the audit plan for fraud, consultancy activities, advice & guidance and follow up audits. The plan is prepared on the basis of audit need, and is then compared to existing audit resources to identify whether any shortfalls exist.

### **4. Main Drivers for Developing a Formal Strategy**

- 4.1 The work of the Internal Audit section responds to a number of needs, some of a statutory nature, some related to supporting others, and some arising from within the Council itself.
- 4.2 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’. This is a statutory requirement and is part of the wider annual review of the effectiveness of the system of internal control.
- 4.3 The requirement to meet the service scope and standards set out in the CIPFA Code of Practice for Internal Audit in Local Government as updated in 2006. The Code of Practice is an all-encompassing document, however the following have been picked out as particularly relevant in setting the strategic direction for the Council’s internal audit function:
  - The scope of work to encompass the whole of the internal control environment of the Council.
  - Work to be undertaken in a risk-based manner.
  - The Head of Internal Audit must annually provide an opinion on the internal control environment – this means that work of an appropriate nature must be

conducted throughout the year by Internal Audit to allow the Head of Internal Audit to form such an opinion.

- Work to be undertaken by suitably trained and experienced staff.

The Section's compliance with the Code will be assessed by the External Auditor and this will be reported to Audit and Accounts Committee.

- 4.4 As part of the Use of Resources Assessment, the Council is assessed on the effectiveness of its Risk Management arrangements, Internal Control and probity and propriety. This assessment includes specific key lines of enquiry relating to risk registers, internal audit, the effectiveness of the Audit Committee and effectiveness of counter fraud measures. The Council's Use of Resources rating is dependent on the score allocated to each key line of enquiry.
- 4.5 The CIPFA/SOLACE guidance note "Delivering Good Governance in Local Government is intended to be best practice for developing and maintaining a locally adopted code of governance. Internal Audit has a major role to play in assessing the Council's governance framework.

## **5. What Internal Audit Needs To Do**

- 5.1 In meeting these drivers and organisational needs, Internal Audit will:
- Provide an assurance on the Council's internal control system, and hence there is need to audit areas of financial and non-financial risk as this will encompass some of the key governance systems.
  - Audit the main financial systems and other systems related to possible material mis-statements, regardless of comparative risk.
  - Deliver risk based assurance on those controls that manage significant risks.
  - Fully comply with best practice as defined by CIPFA in the Code of Practice 2006,
  - Better integrate the outcomes and other information gathered as part, of the internal audit process, with the risk management processes of the Council.
  - Maintain ongoing effective relationships with the new External Auditor and deliver complimentary plans of work so as to deliver an efficient audit service collectively, for the Council.
  - Ensure that appropriate resources, suitably experienced, and with skills to deliver the whole plan of work are maintained within Internal Audit.
  - Improve the efficiency and effectiveness of operations of the service.
  - Promote good corporate governance and control practices and contribute to a good governance culture.
  - Work in a positive manner alongside clients, supporting them in the effective management of risk and service delivery.
  - Contribute to embedding risk management throughout the Council's processes.
  - Contribute to the development and maintenance of an effective counter fraud culture within the Council.

## **6. How We Will Do This**

- 6.1 **Review of the whole internal control environment** - We will deliver a comprehensive plan of audit reviews such that the key elements of the internal control environment, including non-financial areas are covered on a cyclical basis. This will be evidenced through our annual audit plan. We will use this evidence from



this work to deliver an annual opinion on the internal control environment to the Audit and Accounts Committee.

- 6.2 **Review of Main Financial & Material Systems** - As part of our “joined up working” with External Audit we will review of controls in the Council’s main financial systems. This will reduce the level of testing that External Audit need to do, which in turn keeps the External Auditor’s fees charged to the Council at the agreed level.
- 6.3 **A System of Risk-Based Auditing** - is fundamental to our ability to comply with the assurance framework requirements that must be in place to comply with professional standards. We will continue to develop our risk based approach so as to ensure it is effective in providing assurance to managers within the Council and to Members. We will identify and review those areas which are most significant to the control of those risks that threaten the achievement of the Council’s objectives/priorities.
- 6.4 **Compliance with Best Practice** – we are developing a methodology to measure our achievement of compliance with the Code of Practice. We will monitor ourselves against these professional standards and endeavour to rectify any gaps.
- 6.5 **Relationship with Risk Management** - We are not responsible for the management of the Council’s risks; this is entirely the responsibility of the management. However, Internal Audit will take account of the corporate risk management processes in our reviews of the control of risks. We will endeavour to emphasise the importance of risk management to all managers as part of the delivery of our service.

Internal Audit staff provide advice on internal control and the management of risks. We do this not only as part of their designated audit reviews but in response to direct approaches to us by clients seeking help and support. This helps to ensure the sound and effective control of business, strategic and operational risks within the Council.

Through our work we are assisting managers to better understand risk management and the feedback from the audit work will enable them to keep their registers up-to-date and relevant. This is an important educational / informative role that adds value to the organisation.

The Head of Audit and Risk Management is responsible for advising on the corporate risk management methodology and for developing the processes for recording the risks.

- 6.6 **Relationship with External Auditor** – we will always endeavour to work with the External Auditor and share plans so as to deliver an effective corporate assurance service to the council. We will maintain a process of regular liaison meetings with the External auditor.
- 6.7 **Appropriate Resources** – we will endeavour to maintain an effective staffing resource to undertake the planned workload. We will apply staff in the most effective way in accordance with their experience and skills and in accordance with the Code of Practice. The section is being re-structured to better meet the requirements being placed on it. We are also looking at developing a partnering arrangement with another internal audit supplier to ensure that we can maintain the necessary level of resources to achieve the audit plan.

We will develop the skills and competencies of our staff through a systematic development and training process. This will be addressed under the Achievement and Development scheme.

- 6.8 **Efficiency Improvements** – we will utilise technology and benchmark working practices with the specific objective of improving our efficiency and performance. We will seek to minimise the time spent on audits whilst at the same time delivering effective audits. Our efficiency will also support more efficient service delivery by our clients as we try to minimise disruption and distraction to normal service delivery. We will continue to develop this. We will comment on the efficient, economic and effective use of resources where appropriate in our internal audit work.

**Promoting Good Corporate Governance** – in all we do we will seek to promote good corporate governance, including in the giving of advice and the assessment of internal controls. We will also contribute to both the Council's counter fraud culture and policy and strategy through a programme of anti-fraud checks, and by reviewing the policy and strategy. We will promote this via our work, on our web pages and in coordination with the External Auditor and other key governance managers within the Council. We will develop new ways of working by exploring the use of data matching between Council systems.

**Good Customer Service** - we will continue to strive to be responsive to our customers and their individual needs and to add value to the organisation where it can. This will be achieved through acting as a control assurance function providing assurance to managers and to the organisation as a whole on the state of its internal control arrangements. We also add value by pointing out inefficiencies and by supporting managers in the management of risk, which increases the overall likelihood of successful service, target and objective achievement.

## 7. **What are our Objectives/Service Targets**

### Internal Audit Objectives 2007/8:

- Publish a risk management handbook.
- Produce an internal audit strategy.
- Develop a methodology for continuous auditing and data matching.
- Review and develop the approach to FMSIS.

### Corporate Finance Objectives 2007/8 – Contributory Role:

- Put systems and working practices in place that will at least retain the delivery of a Use of Resources score of 3 in 2007 and 2008.
- Develop financial training and education programmes for budget managers, Members and accountants to include financial systems and financial procedure rules.

Service targets for 2007/8

	2006/7 Actual	2007/8 Target	2008/9 Target	2009/10 Target
Chargeable audit days as % of days potentially available	70.6%	72%	72%	72%
The review of the completed audit work by Audit Manager/Assistant Audit Manager within 6 weeks	N/A	85%	90%	95%

We will review other potential service targets for inclusion from April 2008, such as customer satisfaction, number of qualified staff, and the number of training days.