



Committee and date

Audit Committee

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Item No

11

Public

ANNUAL REVIEW OF THE EFFECTIVENESS OF THE SYSTEM OF INTERNAL AUDIT

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Summary

The purpose of this report is to demonstrate that the Council has an effective system of internal audit. This is in compliance with Regulation 4 of the Accounts and Audit Regulations 2003 amended in 2006. This requires relevant bodies to conduct an annual review of the effectiveness of its system of internal audit and for the Audit Committee to review its findings.

Recommendations

Members are asked to consider the contents of this report and to endorse the conclusion that the Council has an effective system of internal audit in place.

Report

Background

1. The Accounts and Audit Regulations 2003 amended in 2006, introduced a requirement on the Council to undertake an annual review of the effectiveness of its system of internal audit and to report the findings of this review to the Audit Committee. The Chartered Institute of Public Finance and Accountancy Audit Panel issued the following definition of 'system of internal audit':

“The framework of assurance available to satisfy a local authority that the risk to its objectives, and the risks inherent in undertaking its work, have been properly identified and are being managed by controls that are adequately designed and effective in operation.”

2. This guidance also sets out the key elements of the system of internal audit as:
 - The process by which the control environment and key controls have been identified – the organisation's risk management system.
 - The process by which assurance has been gained over controls – its coverage of the key controls and key assurance providers.
 - The adequacy and effectiveness of the remedial action taken where there are deficiencies in controls, which will be led by the Audit Committee or its equivalent and implemented by management.
 - The operation of the audit committee and the internal audit function to current codes and standards.

Review of Effectiveness of Internal Audit

3. Each of the four elements of the system of internal audit as defined by CIPFA's Technical Audit Panel have been set out below, with an explanation of the ways in which Shropshire Council has interpreted these for its own circumstances.

The Risk Management System

4. The Council's established and comprehensive risk management framework, as laid out in the Risk Management Strategy, is an important tool to ensure the effective delivery of key priorities across corporate, strategic, service and operational plans. Risk management is also a key element in the performance management framework, partnership working and project management.
5. Clear arrangements are in place for identifying, managing, reporting and reviewing risks at the strategic and operational levels and there is an established mechanism for cascading significant risks from service and operational plans on to the corporate risk register.
6. Elected members are involved in strategic risk management through regular reporting of risks to the Cabinet and more directly in the management of significant strategic risks in their Portfolio area. Members are appropriately equipped to undertake their risk management responsibilities effectively through training at induction sessions and specific training, e.g. Audit Committee, Safeguarding training, Code of Conduct training and similar activities. The Leader of the Council is the Member Risk Champion.
7. The Council Management Team has a clear leadership role through the regular review of current and future risks, receiving risk reports against strategic objectives and completing regular horizon scanning through strategic risk workshops. The strategic risk register mirrors the corporate objectives and directorate business risks are managed through representatives on the Risk Management Group which meets quarterly. Specific risk management workshops are also undertaken on major projects, for example, the Extra Care PFI project.
8. The Council's Risk Management Strategy is available on the Council's web-site and is regularly reviewed by the Cabinet.

9. A risk management workshop has been held at least annually for the Local Area Agreement involving all partners. A risk register is developed for all delivery groups and the key cross cutting risks are monitored on a regular basis. With the development of the new Shropshire Partnership Community Strategy a risk management workshop will be held in place of the Local Area Agreement workshop on an annual basis.
10. To ensure risk management is embedded throughout the Authority monthly general awareness training sessions are held which are open to all staff. In addition, more directorate specific training is carried out which includes senior management training. A suite of risk management publications are available in both hard copy and from the comprehensive Risk Management and Insurance web site.
11. Audit Committee received a report at its meeting on the 24th March 2010 from the Audit Manager. It was reported that following a review of the Risk Management Framework, the overall control environment for the system of Risk Management was assessed as good which is the top level of assurance.

Controls Assurance

12. The Audit Committee, and ultimately, the Council seeks assurance that controls have been adequately designed and are operating effectively in practice. This assurance is available from a variety of sources including both external regulators and Internal Audit.
13. Internal Audit have in place a rigorous risk based audit planning mechanism which allows a four year risk based strategic plan to be produced. The plan for the period 2009/2013 was reported to Audit Committee together with a presentation to the Audit Committee by the Head of Audit on how the strategic plan is produced and how it is reviewed annually as part of producing the annual audit plan. The Audit Risk planning model has been amended to take account of all the Council's key risks recorded in the risk register when producing the four year strategic plan. This will ensure that all areas and risks will be considered when determining Internal Audit activity, not just the financial risks. It must be noted however, that there is still a responsibility for Internal Audit to give the Section 151 Officer assurance on the adequacy of the financial systems in operation.
14. The resulting controls assurance is reported to each meeting of the Audit Committee and is summarised in an Internal Audit Annual Report, the report for 2009/10 also appears on this agenda. Reports for previous committees and years are available on the Council's website.
15. Additional assurance is also available to the Council from the work of its various external regulators, such as the Care Quality Commissioner and the Audit Commission, and other external bodies that provide assurance over specific areas of the Council's controls such as health and safety.

Use of Resources – Auditor Judgement

16. Another key element of measuring the effectiveness of internal audit is the independently assessed Use of Resources Judgement completed by the Audit Commission. The quality and effectiveness of internal audit work is assessed as part of the authority's Comprehensive Area Assessment. Internal Audit work is included in the governing the business element of the Use of Resources assessment.
17. The arrangement in 2009 for the assessment criteria changed to a broader, more strategic assessment and therefore results are not comparable to previous years. In 2009 the Council scored a three out of four in respect of the key line of enquiry: 'Does the organisation manage its risks and maintain a sound system of internal control?' Areas where the Council performed particularly well were reported to the Audit Committee in February 2010 and included the comment that a sound system of internal control is in place led by a strong Audit Committee and effective internal audit service. This has led to a strong assurance framework.'

Remedial Action

18. The Council's Audit Committee considers external and internal audit reports and the Committee requests management responses to any significant issues reported, including reporting the progress made in implementing audit recommendations. Members of the Council's Management Team and senior officers have attended the Audit Committee to provide management responses in relation to a number of reports.
19. Action plans relating to these reports are monitored at the most appropriate level within the Council to ensure the required action is undertaken to improve the operation of the relevant service area. The internal audit service follows up the issues it raises and recommendations it makes and reports on progress.
20. Examples of internal audit work and remedial action that have been scrutinised by the Audit Committee include reports on Revenues and Benefits issues, Housing Benefits claim production, Housing Rent Arrears and National Fraud Initiative (NFI) work.

The operation of the Audit Committee and Internal Audit function to current codes and standards.

21. The Council has a well established Audit Committee, which operates in accordance with best practice. Its terms of reference and associated working practices are aligned with those suggested by CIPFA. Its members receive regular training on the role of the committee and how they can best support this, as well as the roles of internal and external audit. Periodically it undertakes a self-assessment exercise and seeks to improve the way in which it operates and has most recently done this in November 2009. From this the committee identified the following actions:

- i. To introduce a discussion item at a future meeting enabling committee to input into the external audit work programme.
- ii. To receive at least annually, a report in respect of all fundamental recommendations made as a result of Internal Audit work.

It was also clarified that external auditors regularly attended Audit Committee providing members with the opportunity to call a private meeting if required.

22. The Committee provide an annual Assurance Report to Council to summarise its work and opinion on internal controls. This can be located on another report on your agenda, Internal Audit Annual Report 2009/10.

Internal Audit Performance

23. The following information is set out to demonstrate Internal Audit's performance in the year.

Compliance with CIPFA Code of Internal Audit Practice

24. The Audit Commission has reviewed Internal Audit against the Code and is satisfied that it complies 99%. The 1% non-compliance relates to some minor non audit works that, in the Audit Commissions views, does not distract from the main business.

Benchmarking

25. Benchmarking is accepted as a key method for comparing performance across a range of councils providing similar services. Internal Audit have been members of the CIPFA Audit Benchmarking Club since its inception. The information it provides is seen as invaluable in helping us check our performance against our peers and best in class.
26. The benchmarking exercise is conducted every year and requires data in respect of the audit plan, budget costs, staffing levels, auditor qualifications, training, etc. It provides a comprehensive set of results against other Council's Internal Audit sections delivering a similar service.
27. The attached benchmarking report, see **Appendix A**, compares Shropshire with all Counties.
28. The results are mainly provided as tables and charts to compare our figures with the group average. The average is the unweighted mean value of the group. The benchmarking report is divided into five sections:

Section 1 – Cost Analysis: shows the analysis of audit costs for 2008/09 actuals and 2009/2010 estimates. The main benchmarks are cost per audit day, cost per £m turnover and chargeable days per auditor.

Section 2 – Audit Coverage: looks at audit days per £m gross revenue turnover and the split by type of audit. It then goes on to analyse the days spent on fundamental financial systems, operational risks and corporate governance.

Section 3 – Staffing: shows salary bandings and staff qualifications.

Section 4 – Time Series: shows performance over time compared with the tier average. The time series shown are for cost per £m gross revenue turnover, cost per audit day, audit days per £m gross revenue turnover, cost per auditor and chargeable days per auditor.

Section 5 – Quartiles: compares Shropshire’s figures with the quartile figures for the tier of authority.

29. The 2009/10 actuals will not be available until this year’s benchmarking reports have been received in late August, early September. Results will also be available comparing ourselves with Unitary Councils for the first year of the new Council.
30. Key performance indicators from Appendix A are shown below:

Quartile Figures

Counties

2008/09 Actual		
	Shropshire	County Average
Cost/auditor £'k		
Pay	£41.9	£42.4
Overheads	£7.6	£10.8
Total	£49.5	£52.0
Days per Auditor	186	173
Cost per Day (Net to LA)	£253	£299

2009/10 Estimate		
	Shropshire	County Average
Cost/auditor £'k		
Pay	£40.9	£42.5
Overheads	£6.6	£9.4
Total	£47.5	£50.6
Days per Auditor	177	178
Cost per Day (Net to LA)	£272	£281

31. Whilst with any benchmarking data some caution with interpretation should be exercised. The CIPFA Benchmarking Club is well established and has been considerably refined and improved since its inception so it is recognised as being a reliable set of comparative performance indicators. The data identifies Shropshire as performing well with its County peers, particularly in cost per day and days of audit delivered per auditor.

Reporting

32. All audit assignments are subject to formal feedback to management. Draft reports are issued to the managers responsible for the area under review for agreement to the factual accuracy of findings and recommendations. After agreement, a formal implementation plan containing management's agreed actions and comments is issued to relevant officers. Follow up reviews capture evidence of implementation of recommendations.

Quality Assurance/Customer Feedback Survey

33. Within Internal Audit all work is reviewed by a senior auditor to ensure all work complies with Internal Audit's standards and that the recommendations made are supported by the audit work undertaken before any audit reports are released from the section. This is seen as a fundamental part of ensuring audit quality and that clients receive reports which are both informative, useful and add value to their work processes and procedures.
34. In addition to the above, a customer feedback survey form is sent out with the majority of audits completed. These are important, as the feedback on the quality of audit service is a key part of ensuring the work meets client expectations and that the quality of audit work is maintained.
35. The form asks auditee's to score the audit work and the report they have received over the following criteria:
- Pre-audit arrangements.
 - Post-audit briefing.
 - Audit coverage/scope of the audit.
 - Timeliness of production of report.
 - Accuracy and clarity of report.
 - Practicality of recommendations.
 - Professionalism of approach.
 - Communication skills.
 - Timeliness, competency, pleasant manner.
36. Each auditee is asked to score the audit work and report on a scale as follows:
- 1 = excellent
 - 2 = good
 - 3 = average
 - 4 = weak

The lower the score the better the feedback received.

37. The results of the customer surveys have been analysed over the last five years and the average scores are identified in the table below:

Analysis of Customer Feedback Survey Forms

Average Score

Item Being Scored	31.03.06	31.03.07	31.03.08	31.03.09	31.03.10	Direction of Travel
Pre-audit arrangements	1.7	1.6	1.7	1.6	1.5	↑
Post-audit briefing	1.5	1.6	1.7	1.6	1.5	↑
Audit coverage/scope of the audit	1.5	1.6	1.5	1.5	1.4	↑
Timeliness of production of report	1.6	1.5	1.8	1.8	1.7	↑
Accuracy and clarity of report	1.5	1.6	1.5	1.5	1.4	↑
Practicality of recommendations	1.9	1.7	1.6	1.6	1.6	=
Professionalism of approach	1.2	1.2	1.3	1.3	1.3	=
Communication skills	1.2	1.3	1.3	1.3	1.3	=
Timeliness, competence, manner	1.2	1.2	1.2	1.3	1.2	↑
Overall average	1.5	1.5	1.5	1.5	1.4	↑
Number of forms returned	86	58	48	60	63	

38. The completion of the feedback form is not mandatory, but it is very useful. If auditee's do not send a feedback form a process is in place to remind auditee's to return the survey, given its importance to assessing the impact of the teams work. Overall the results are very similar to last year and demonstrate a positive direction of travel in the majority of cases, showing services delivered consistently at a high level.
39. The information is also used at each auditor's annual performance appraisal to identify weaknesses or where improvements can be made in their scores. Any issues relating to skills or competences can be picked up as part of their personal development plan and appropriate training put in place.
40. During the last year, the following compliments and comments have been received in respect of the audit service from both questionnaires and directly.

41. **Summary of Compliments and Comments**

- a) "Yet again, a good example of audit paying dividends! Many thanks" *Manager*
- b) "PC...This is fantastic - you are now officially our favourite person! Have done a quick test on it and all seems to be (working) well - I really can't thank you enough! Many, many, many thanks!" *Manager*

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|----|--|-------------------------------|
| c) | “KH - Thanks for your hard work, it is much appreciated” | <i>Senior manager</i> |
| d) | “Customer survey attached. Excellent as ever” | <i>Senior manager</i> |
| e) | “Thank you, EW, for all your help” | <i>School finance manager</i> |
| f) | “As usual, a very useful audit, the results from which will help the organisation improve its risk management processes.” | <i>Senior manager</i> |
| g) | “KW was very helpful in her approach to completing this audit. The information provided a number of areas for improvements and clear actions. Adopted a very professional manner.” | <i>Manager</i> |
| h) | “Thank you.” | <i>Manager</i> |
| i) | “Audit continues to be helpful.” | <i>Manager</i> |
| j) | “Would have liked report earlier.” | <i>Head teacher</i> |
| k) | “A very useful process. Our auditor has continued to be extremely helpful in assisting our school in continuous improvement, many thanks.” | <i>Head teacher</i> |
| l) | “A quicker response following the audit.” | <i>Head teacher</i> |
| m) | “I feel that it should be possible to complete the report in less than 3 months. This time delay is disappointing.” | <i>Head teacher</i> |
| n) | “Helpful advice.” | <i>Head teacher</i> |

42. Comments in the main have been very positive. A number of comments in relation to school audits have provided a useful learning point. Highlighting that we still need to improve on the turn around of reports from completion of fieldwork to issue which is reflected in some of the comments above.

43. A major problem we have experienced is the flexibility of our approach with schools allowing them to dictate their assessment dates when their evidence files were ready; this has caused a backlog of work at the end of the year resulting in a bottleneck in the review process. Since all schools have been assessed on at least one occasion, we are this year booking school assessments to spread out the work more evenly, thereby reducing the bottleneck and improving report turnaround times.

Summary

44. There are a number of mechanisms in place that provide assurances on the effectiveness of the system of internal audit and support the guidance by demonstrating that:
- The Council's control environment and key controls have been identified – the Council has a sound risk management system.
 - The process is identified by which assurance has been gained over controls – including key controls;
 - Any remedial action taken is adequate and effective and led by the Audit Committee and implemented by management.
 - The Audit Committee and Internal Audit comply with current codes and standards.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)

None used

Human Rights Act Appraisal

The recommendations contained in this report are compatible with the provisions of the Human Rights act 1998

Environmental Appraisal

N/A

Risk Management Appraisal

A lack of an effective Internal Audit Service could lead to weaknesses in the Council's Internal Control systems not being identified.

Community / Consultations Appraisal

N/A

Cabinet Member

Keith Barrow, Leader of the Council and Brian Williams, Chairman of Audit Committee

Local Member

All

Appendices

Appendix A – CIPFA Audit Benchmarking Club 2009 report, Shropshire County Council compared with Counties