



Committee and Date

Audit Committee

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Item

12

Public

INTERNAL AUDIT STRATEGY

Responsible Officer Ceri Pilawski

e-mail: Ceri.pilawski@shropshire.gov.uk

Tel: 01743 252027

1. Summary

This report proposes some minor changes to the Internal Audit Strategy. It does not yet take account of any refinements proposed in the UK Public Sector Internal Audit Standards which are still under development.

2. Recommendations

The Committee are asked to consider and endorse, with appropriate comment, the contents of this report.

REPORT

3. Risk Assessment and Opportunities Appraisal

- 3.1 An Audit Committee has a key function in ensuring and maintaining effective corporate governance arrangements are in place in the Council. The Internal Audit Strategy provides evidence of such arrangements in respect of the provision of the Internal Audit function and has been updated to reflect legislative changes in the Accounts and Audit Regulations 2011.
- 3.2 The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998. There are no direct environmental, equalities, consultation or climate change consequences of this proposal.

4. Financial Implications

- 4.1 Internal Audit budgeted net costs for 2012/13 are £727,000.
- 4.2 External Audit costs for 2011/12 are £273,000.
- 4.3 In 2012/13 2,560 planned chargeable days are available for Shropshire Council audit work.

5. Background

- 5.1 Best practice dictates that there should be an audit strategy as set out in the Code of Practice for Internal Audit in Local Government in the United Kingdom, 2006 (CIPFA). This document is used as the basis to review the effectiveness of the internal audit service by external auditors. The strategy was introduced in 2009/10 and it is felt appropriate to review it at the same time as the Internal Audit Terms of Reference.
- 5.2 An audit 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 aims. The strategy expands upon the Terms of Reference and both documents should be read as a whole, they are further supported by the Internal Audit Manual.
- 5.3 The strategy will communicate the contribution that Internal Audit makes to the Council and includes:
 - Internal Audit's vision, purpose and values;
 - How internal audit will approach work;
 - How the Audit Service Manager (Head of Audit) has formed and evidenced their opinion on the control environment to support the annual statement on internal control;
 - How internal audit's work will identify and address significant local and national issues and risks;
 - How the service will be provided, i.e. internally, external, or a mix of the two;
 - The resources and skills required to deliver the strategy.
- 5.4 The Strategy has been refreshed with some minor changes. It does not yet take account of the impact if any, of the Public Sector Internal Audit Standards which are under development for introduction from April 2013. These are not expected to propose significant changes to the delivery of Internal Audit and therefore to the strategy. Their impact once known will be brought to a future meeting. Members are asked to consider and approve the proposed amendments to the Internal Audit Strategy. A copy of the Strategy with changes identified in bold and underlined is attached as **Appendix A**.

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

Shropshire Transitional Corporate Plan 2010/13

Code of Practice for Internal Audit in Local Government in the United Kingdom, 2006 (CIPFA)

Accounts and Audit Regulations 2011

Cabinet Member (Portfolio Holder)

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

Local Member All

Appendices

A - Internal Audit Strategy (Revised November 2012)



INTERNAL AUDIT STRATEGY

“To provide assurance on internal controls to ensure the most economical, effective and efficient use of resources on behalf of Shropshire Council and for everyone who lives or works in the county.”

1 Introduction

1.1 Management is responsible for establishing and maintaining appropriate risk management processes, control systems, accounting records and governance arrangements i.e. the control environment. Internal audit plays a vital part in advising the Council that these arrangements are in place and operating properly. On behalf of the Council, internal audit review, appraise and report on the efficiency, effectiveness and economy of these arrangements. This document outlines the Internal Audit Strategy which will culminate in the Head of Audit's opinion on the adequacy of the Council's control environment.

2. Background: The Council

2.1 Shropshire has a vision to:

“Improve significantly the quality of life, for Shropshire people by working together”.

2.2 In order to deliver this Shropshire Council has three key aims:

- Enterprise and growth, with strong market towns and rebalanced rural settlements
- Responding to climate change and enhancing our natural and built environment and;
- Healthy, safe and confident people and communities

2.3 To endorse the vision and aims Shropshire Council's values determine the culture of the organisation, intent and direction of the way we deliver services to our customers as well as what we deliver.

We will:

- Focus on meeting our customers' needs.
- Value each other and achieve more by working and learning together.
- Use the resources we have responsibly **and make them count.**
- Recognise the value difference can make and treat everyone with respect.
- Build trust by expressing ourselves openly and honestly.

2.4 In the work of Internal Audit we aim to contribute to management's achievement of the vision, corporate aims and delivery against the values.

3. **Background: Regulatory**

3.1 The requirement for an internal audit function is contained in the Accounts and Audit Regulations 2011 which require the Council to:

“under take an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control”.

3.2 The internal audit service also assists the Section 151 Officer in discharging their delegated responsibilities under Section 151 of the Local Government Act 1972 which requires that authorities:

“make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs”.

3.3 The regulations, and related guidance, are contained in various CIPFA publications but particularly the Code of Practice for Internal Auditors in Local Government in the UK 2006 (the Code). We operate in accordance with these standards which lay down far-reaching requirements regarding systems of internal control and the standards to which Internal Audit should operate. They require the Council to:

- Have a sound system of internal control.....which includes arrangements for the management of risk.
- Conduct a review at least once a year of the effectiveness of its system of internal control.
- Prepare and publish an Annual Governance Statement.

The Regulations and Code require a much wider role for internal audit compared to the historical focus on financial systems. The scope of internal audit therefore encompasses virtually every management control system, covering every risk in corporate and departmental risk registers. These requirements aim to bring local government practices into line with the private sector and other parts of the public sector.

3.4 It is best practice to regularly review the terms of reference for the internal audit service. This document was approved by the Audit Committee and is reviewed annually. The Terms of Reference of Internal Audit provide further details and are an integral part of the strategy.

4. **Definition of internal audit**

4.1 The Code defines internal audit as:

“an assurance function that primarily provides an independent and objective opinion to the organisation on the control environment, 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."

Whilst audit's main role is to provide an opinion on the control environment, the Code states that internal audit may also undertake non-assurance work at the request of the organisation, subject to there being no impact on the core assurance work and the availability of skills and resources. This can include advice, training, facilitation and fraud or irregularity related work.

4.2 The Code defines the control environment as comprising the systems of governance, risk management and internal control. The key elements of the control environment include:

- "Establishing and monitoring the achievement of the organisation's objectives.
- The facilitation of policy and decision-making ensuring compliance with established policies, procedures, laws and regulations – including how risk management is embedded in the activity of the organisation, how leadership is given to the risk management process, and how staff are trained or equipped to manage risk in a way appropriate to their authority and duties.
- Ensuring the economical, effective and efficient use of resources, and for securing continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.
- The financial management of the organisation and the reporting of financial management.
- The performance management of the organisation and the reporting of performance management."

Our mission, purpose and values

5.1 Our mission is:-

"To provide assurance on internal controls to ensure the most economical, effective and efficient use of resources on behalf of Shropshire Council, our external clients and everyone who lives and works in the county".

5.2 As a modern effective internal audit service our aspirations are to:

- Provide assurance on and monitor the control framework.
- Add value and assist the organisation in achieving its objectives with the knowledge of where the Council wishes to be and aware of the national agenda issues that impact on the audit plan of the Council.

- Be innovative and challenging, supporting initiatives i.e. lean systems review programme.
- Help to shape the high ethics and standards of governance of the Council.
- Seek opportunities for sharing best practice with other organisations' auditors and working with other bodies on preventing and detecting fraud (e.g. NFI).
- Work in partnership with other support services.
- Be pro-active rather than reactive.

5.3 Key drivers of this strategy are to meet the needs of our customers and to comply with the CIPFA Code, as outlined earlier. Our customers will continue to be affected by a variety of local and national issues:

- Increased growth in partnerships, for example with health and the private sector.
- Ever increasing use of technology to deliver services.
- Flexible working arrangements to make more effective use of resources.
- The introduction of new ways for customers and the public to access and influence services.
- Pressure to reduce the cost of services especially administrative and support functions whilst improving the quality and effectiveness of delivery.

These, and other developments, will mean increased pressure on the audit service to review existing systems and provide advice on new and complex initiatives within existing resources.

5.4 To deliver on our vision we will:

- Add value and make best use of our resources by focussing on key risks facing our customers.
- Continue to develop our staff to ensure we are fully equipped to respond to our customers' demands.
- Continue to work with Audit Committee Members to deliver a dedicated training programme.
- Review our practices and procedures against best practice and continue to invest in modern technology to improve efficiency and effectiveness.

- Continue to be pro-active rather than reactive as resources allow, by providing training to our customers, advice at workshops, meetings and working parties.
- Continue to work in partnership with clients to improve controls, performance and add value.
- Listen to feedback from our customers so as to improve the service.

6. Audit approach: How we work, forming and evidencing an opinion on the control environment.

6.1 After applying a full risk assessment methodology (Section 7) to select areas for review. In accordance with the Code, most individual assignments are undertaken using the risk based systems audit approach, the key elements of which are listed below:-

- Identify and record the objectives, risks and controls.
- Establish the extent to which the objectives of the system are consistent with higher level corporate objectives.
- Evaluate the controls in principle to decide whether or not they are appropriate and can be reasonably relied upon to achieve their purpose.
- Identify any instances of over and under control.
- Determine an appropriate strategy to test the effectiveness of controls, i.e. through compliance and/or substantive testing.
- Arrive at conclusions and produce a report, leading to management actions as necessary and providing an opinion on the effectiveness of the control environment.

Our role is, through a risk based approach, to provide assurance to management on the effectiveness of internal controls and the control environment which is given in the Audit Service Manager's (Head of Audit's) annual opinion. In turn this supports an opinion on whether risks and opportunities relating to the corporate aims and new operating model principles are being managed effectively. This opinion is a source of assurance which feeds into the Audit Committee's Annual Report to Council and the Council's Annual Governance Statement. To reduce duplication of effort we will work in partnership and place reliance on assurance work completed elsewhere in the Council.

6.2 The use of a computerised audit management and working papers system is being implemented to streamline working practices which are based upon best professional practice.

7. Risk Assessment Methodology

7.1 The methodology adopted in preparing the audit plan is a step process as follows:-

- a) Identify the **strategic** audit universe, i.e. all potentially auditable areas by reference to the Council's plans, aims, priorities, risk registers, structures, budgets and discussions with senior officers.
- b) To risk score and rate all audit areas using an internally developed risk model taking into account a range of factors including gross expenditure and income figures, risk rating, volume of transactions, level of devolution, delegation, externalisation, systems stability, complexity and technology, control environment, potential for fraud, political sensitivity, delivery of corporate objectives and the external auditor requiring assurance.
- c) To use the risk score to determine frequency of audits.
- d) To calculate the total number of audit days available deducting commitments and allowances for non-assurance work, contingencies for advisory, unplanned (i.e. unforeseen commissioned) work and special investigations leaving the bulk of time available for risk based audits.
- e) Matching the risk based model resource requirements with actual resources available and assessing the adequacy of coverage necessary to deliver the annual audit opinion. Considering the benefits of any externally provided support, as demands require, to supplement the mix of resources required to deliver the planned work.

7.2 To maximise the benefits of limited audit resources, achieve savings for the Council in external audit fees and avoid duplication of audit work, the service liaises closely with the Council's external auditors. Our objective is for external auditors to fully rely on our work and to agree a split of work on fundamental financial systems that are acceptable to both parties.

7.3 The process adopted is consistent with that advocated in the CIPFA Model Audit Manual and ensures that the audit plan addresses the key risks facing the Council.

7.4 A continuing role of internal audit is to review and support the risk management process. Risk management is embedded and increasingly the audit process is based upon the Council's own assessment of risk as contained in the corporate and directorate risk registers.

8. Audit Plan

8.1 **From the audit universe**, the annual audit plan **is prepared** based on past history and knowledge, discussions with senior officers in each of the service areas for them to highlight key issues, changes to systems procedures, routines and areas where they have concerns. Detailed discussions are also held with the Section 151 Officer and the external auditors. Account will also be taken of the strategic and operational risk registers to ensure that no key risks are overlooked. In addition the Audit Service Manager regularly attends various professional

networking meetings which highlight the wider issues affecting local government internal audit which will need to be reflected in the internal audit plan.

8.2 The Annual Audit Plan balances the following requirements:

- The need to ensure the approved plan is completed to a good practice level (currently at least 90%).
- The need to ensure that systems audits with a high risk ranking should be completed and fundamental financial systems audits agreed with External Auditors are completed irrespective of risk score.
- The need to appropriately review other strategic and operational arrangements.
- The need to complete assurance work around the Schools Financial Value Standard to allow the Section 151 Officer to sign off the Section 52 Statement.
- An allocation to undertake proactive counter fraud work and actively participate in the National Fraud Initiative.
- A contingency allocation:-
 - To conduct special investigations based on historical trend patterns.
 - Of uncommitted time available to deal with unplanned issues that may need to be investigated.
 - Of time to support key projects and developments throughout the year, examples of which include the **transfer of services to ip&e and transformation projects**, and to respond to officers ad hoc requests for help and advice on internal control and financial management issues.

8.3 Finally, the plan is intended to be flexible. There will inevitably be circumstances where the Audit Service Manager, in agreement with the Section 151 Officer, will have to amend the annual audit plan e.g. when a major irregularity investigation is required, risks change or a specific project becomes a matter of priority. The plan includes a reasonable amount of contingency time to cope with the usual level of demand but there may be cases where individual lower priority audits have to be rescheduled because of competing priorities. Throughout the year the plan will be updated to ensure it remains relevant. In year changes to the plan to reflect such changes are accepted as best practice and agreed and approved by the Section 151 Officer.

8.4 This audit plan, therefore, is not set in “tablets of stone”. It will be constantly monitored and will need revising and updating as circumstances change. The Audit Committee will be kept informed of any significant changes to and progress against the plan through regular progress reports. The Section 151 Officer has the authority to agree changes to the base Audit Plan.

9.0 **Conclusion**

- 9.1 By use of the framework set out above, the Section 151 Officer, the Audit Service Manager and the Audit Committee aim to provide a strategy which will ensure that audit services are provided to the standard which effectively meets the needs of Shropshire Council.