

# Wolverhampton City Council

# OPEN INFORMATION ITEM

## Audit Committee

Date **11.04.11**

Originating Service Group(s)

**DELIVERY**

Contact Officer(s)/

**PAT MAIN**    **BRIAN BURGESS**

Telephone Number(s)

**4410**            **4460**

Title

**INTERNAL AUDIT EFFECTIVENESS REVIEW**

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## RECOMMENDATION

1. Members are asked to receive PricewaterhouseCooper's report and to note that quarterly updates on progress towards implementing their recommendations will be presented to the Committee.

Representatives from PricewaterhouseCoopers will be in attendance at this meeting to present their report.

## 1. **PURPOSE**

- 1.1 To present the findings arising from PricewaterhouseCooper's recent review of internal audit and to report the proposed arrangements for taking their recommendations forward, including providing quarterly updates on progress to this Committee.

## 2. **BACKGROUND**

- 2.1 During 2010/2011 the Council's external auditors, PricewaterhouseCoopers LLP (PwC), carried out a review of the council's internal audit arrangements against best practice.
- 2.2 This was a wide-ranging study covering many aspects internal audit activities, including:
- A review of quantitative data – cost, days and CIPFA benchmarks.
  - Review of the 2010/11 internal audit plan.
  - Review of how the plan is delivered, including work on fraud.
  - Review of assignment and audit reporting.
  - An assessment of the quality of internal audit files, and quality procedures in the team.
  - Holding workshops with the internal audit team.
  - Considering the role of the Audit Committee.
  - Considering the governance and management of the service.
  - Questionnaires from officers and Members.

## 3. **REPORT DETAILS**

- 3.1 The full report by PwC runs to 53 pages and a copy has been made available to all members of the Committee for information. A copy of the Executive Summary is attached at Appendix 1.
- 3.2 In summary PwC's key findings and recommendations are as follows:

<b>Ref</b>	<b>Recommendation</b>	<b>Priority</b>
1	Address inefficiencies in the internal audit plan.	HIGH
2	Create a more risk-focused internal audit plan.	HIGH
3	Provide pro-active fraud awareness training.	MEDIUM
4	Create investigative specialism within the internal audit team.	MEDIUM
5	Consideration of open plan environment.	LOW
6	Consideration of paid accounts process.	HIGH
7	Introduction of timescales for internal audit reporting.	LOW
8	Increase service involvement in clearing reports.	HIGH
9	Introduction of automated audit software and consideration of further specialisms.	MEDIUM
10	Introduction of Key Performance Indicators and a robust quality	MEDIUM

Ref	Recommendation	Priority
	assurance framework.	
11	Improve compliance with the CIPFA Code of Internal Audit.	MEDIUM
12	Introduction of a new internal audit Charter.	HIGH
13	Consideration of Audit Committee preparation and practice.	HIGH
14	Provision of Member training.	MEDIUM
15	Introduction of CIPFA guidance compliant Audit Committee role and remit.	HIGH
16	Consideration of independent membership of Audit Committee.	HIGH

#### Next Steps

- 3.3 The report and recommendations have been discussed with the Chair and Vice Chair of the Committee and the internal audit team is now developing an Action Plan to take them forward. This plan will be reported to Audit Committee at its next meeting and quarterly progress updates will be presented to future meetings.

### **3. FINANCIAL IMPLICATIONS**

- 3.1 There are no direct financial implications arising from the report; any costs of the action required to address PwC's recommendations will be reported as necessary when the Action Plan is implemented  
[PM/04042011/S]

### **4. LEGAL IMPLICATIONS**

- 4.1 There are no direct legal implications arising from the content of this report although, of course, there may be legal consequences arising from the individual recommendations in the report.  
[MW/05042011/W]

### **5. EQUAL OPPORTUNITIES IMPLICATIONS**

- 5.1 There are no specific equal opportunity implications.

### **6. ENVIRONMENTAL IMPLICATIONS**

- 6.1 There are no specific environmental implications.

### **7. SCHEDULE OF BACKGROUND PAPERS**

PwC report, *Internal Audit Effectiveness*, 2011

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# *Executive Summary*

## Introduction

This review was commissioned by the Chief Executive, Chief Financial Officer and Director for Regeneration & Environment to consider the effectiveness of the internal audit function and the role of the Audit Committee. This report is based on discussions with members and officers of the Council, a questionnaire, attendance at meetings, a review of documentation, and a workshop with the internal audit team.

The Comprehensive Spending Review (CSR) on 20 October 2010, announced cuts across local government equating to 7.1% per annum until 2013/14, placing a significant burden for savings on authorities. These savings will have to be met across all services with pressure placed firmly on back office functions to prove their value.

It was in the lead up to this announcement that PwC was engaged to independently and objectively assess the effectiveness of the internal audit function of Wolverhampton City Council against best practices.

## What is internal audit?

The Institute of Internal Auditors (IIA) defines internal auditing as "... an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations."

The IIA explains that internal auditors should "bring a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."

Local Government internal auditors have tended to focus on compliance-related issues. Elsewhere in the public sector and widely in the private sector, where risk management and corporate governance are more embedded, internal auditors are already far more focused on value for money, strategic risks and issues; audit has a more corporate profile and regularly meets with and reports to senior officers, members and regulators.

Local government internal audit services have to adapt to meet the challenges of a radically evolving economic climate. The Comprehensive Spending Review will radically change how local authorities prioritise and operate, and internal audit has a valuable role in providing assurance in times of significant change.

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## Assessing the effectiveness of internal audit at Wolverhampton

Our review consisted of:

- A review of quantitative data – cost, days and CIPFA benchmarks.
- Review of the 2010/11 internal audit plan.
- Review of how the plan is delivered, including work on fraud.
- Review of assignment and audit reporting.
- An assessment of the quality of internal audit files, and quality procedures in the team.
- Holding workshops with the internal audit team.
- Considering the role of the Audit Committee.
- Considering the governance and management of the service.
- Ten questionnaires from officers and members, providing evidence for each part of our work.

Each of these considerations is summarised below, followed by a summary of our findings under four headings of effectiveness - role, scope, value and quality.

### *Quantitative data*

The internal audit team has 22.8 FTE for 2010/11. In 2009/10, the internal audit function delivered 3,130 days of audit against an original plan of 2,816 days (11% over budget), at a cost of £1.086 million. The number of chargeable days per auditor (159) was 7.0% lower than CIPFA benchmarks, with the overall cost of the function per £'million of turnover (£1,255) 31.4% higher than the same benchmarks. Delivery of each chargeable day of audit time cost the Council £334 in 2009/10 against a benchmark average of £308.

The internal audit plan for 2010/11 is estimated to cost £1.184 million, an increase of 9.0% on 2009/10. The number of chargeable audit days delivered is expected to increase by 13.1% to 3,540.

### *The internal audit plan*

The Council's internal audit plan, while designed to reflect the structure and size of the departments within the Council, is not structured to reflect the key risks of the Council and, in its current form, cannot provide management or the Audit Committee with adequate assurance over the effectiveness of risk management, control, and governance processes.

In addressing the design of the internal audit plan, management will also need to consider the structure of the internal audit team to ensure that this is aligned in the most effective and efficient manner. For example, the use of specialised auditors to deliver audit work on more complex key risk areas will help the function enhance its provision to stakeholders across the Council.



### *Delivery of the internal audit plan*

The Council has significant resource available to deliver the internal audit plan, but there are considerable opportunities to utilise this resource more efficiently.

We have identified a number of potential efficiencies in the plan which will help to ensure that time can be more directed towards the Council's key risk areas. These savings amount to approximately £350,000 per annum, on the basis of the average cost per day and the number of days which could be released, as follows:

- Not carrying work on audits brought forward from previous years (£128,000);
- Implementing a more controls focused, risk-based audit plan to enable the paid accounts process to cease (£54,000);
- Reducing management and administration time to CIPFA benchmark levels (£40,500);
- Reducing the time taken to follow up prior year audits (£18,000); and
- The recent Government announcement scrapping the Financial Management Standard in Schools (FMSiS) will reduce the internal audit burden by up to 350 days (equating to over £110,000 per annum), although the Authority will need to consider what alternative assurance it requires in this area.

Additionally, the introduction of an automated working paper system would enable staff to provide a more focused and efficient audit to customers.

### *Audit reporting*

Internal audit reports both to internal stakeholders and to the Audit Committee on a regular basis. Reports have remained in the same format for a number of years and the function has recognised that these could be enhanced by refreshing their approach and format. This provides an opportunity for stakeholders to influence the style and format of internal audits reports to ensure that they more closely meet their needs in the future.

### *Quality assurance*

The internal audit function conducts a rigorous review process for all reports prior to issue. While an important process, there is inconsistency in the manner in which the process is undertaken, with only 50% of stakeholders agreeing that reports were of a high quality. The delays which have occurred as a result of this review process reduce the value which the reports provide to stakeholders.

The function has an opportunity to introduce a standardised quality assurance process, including internal performance targets, to ensure that high quality, valuable reports are issued on a timely basis to stakeholders. A well-drafted process would, additionally, assist the function in achieving full compliance with the *CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom* ("the CIPFA Code").

## ***Governance and management***

Internal audit reports to the s151 officer and also to the Audit Committee, which highly values internal audit. This strong relationship enhances the ability of the Committee to fulfil its role.

However, due to a perception of diminishing value provided by the function and the tensions which exist between officers and Members within the Audit Committee, internal audit is not held in sufficient regard among senior management to enable it to perform its role effectively. This has resulted in both weak communication lines and a loss of frequent direct reporting to the Corporate Management Team and Chief Executive.

## ***Internal audit workshop***

Separate workshops were held for internal audit management and staff to produce a SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis.

The team is passionate about its role within the Council and keen to demonstrate the value it can offer to Members, senior management and Council staff. A highly trained and skilled workforce, coupled with high team morale were identified as the key drivers towards potential improvements.

## ***Role of the Audit Committee***

The Council's Audit Committee, consisting of eight elected Members, has existed since 2005. It meets ten times a year and is attended by a number of senior officers as well as the external and internal auditors. The Committee's role is to provide assurance to Council on the effectiveness of internal control (including oversight of the Annual Governance Statement) and to ensure that internal audit supports the Council's responsibilities for governance, risk management and control.

The Committee is very well attended by Members and receives regular reports from officers. We noted that Members are engaged with the processes of the Committee, putting detailed questions to officers on a regular basis.

However, there is a high degree of tension between officers and members at meetings of the Committee. Our discussions suggest that Members are seriously concerned about internal control, while officers feel that the Committee's scrutiny is over-zealous.

This appears to have resulted in a stalemate situation in which:

- The Committee feels it necessary to meet very frequently (meetings are generally quarterly in other authorities);
- The Committee is engaged in detailed paid accounts reviews, supported by internal audit;
- Officers are defensive, do not always respect the Audit Committee process and are at times ill-prepared and uncomfortable about questioning at the Committee; and
- The Committee finds that issues are slow to be resolved, requiring them to be addressed repeatedly at the Committee.

This situation is expensive, is not providing the assurance Members need, is stressful for officers, and there is the risk that key control issues are missed because of a focus on too much of the detail, and not enough effective reporting on corporate risks.

Because of this situation, internal audit is in a difficult position. The function is regularly praised by the Committee, but is seen as part of the problem by officers.



## Summary of effectiveness

Taking our work together, the following is a representation of our views over the four attributes of internal audit effectiveness, as detailed within Appendix D:

### Role – sufficient power and influence?

- Good access to Audit Committee Members.
- Flexible resource for the Council - meeting short-notice audit demands.
- The function requires support through increased corporate awareness of its potential to add value to the Council.
- The capacity to deliver exists, but the function perceives that it does not have power within the organisation to make a difference.
- The close relationship with the Audit Committee puts the function in a difficult position.
- The function does not report frequently enough to the Council, Corporate Management Team or Chief Executive.
- There is inefficient reporting to the Audit Committee as a result of a lack of clarity and understanding of Members' roles.

### Scope – broad enough to provide assurances?

- Staff have a strong working knowledge and experience of the Council and its systems.
- The function needs a more strategic role with a greater focus on strategic risks.
- The current scope of the plan is too traditional.
- The paid accounts work appears inappropriate.
- The function requires enhanced specialist knowledge.
- The level of anti-fraud training and awareness needs to be increased.

### Value – meeting expectations of value added?

- Provides Audit Committee with knowledge of ongoing issues.
- Significant work to provide assurance on compliance with local and national policies and procedures.
- The function does not measure or report on performance.
- The resourcing levels and subsequent costs of the function appear high based on local-area benchmarks.
- The review of reports is time-consuming.
- The audit plan includes significant inefficiencies.

### Quality – high quality process and outputs?

- Staff are either fully CCAB qualified or training towards such a qualification.
- The function has not set adequate measures of its performance.
- Audit Committee reports are not sufficiently comprehensive to provide Members with assurance over the operation of internal controls.
- Audit papers are manually collated rather than using automated working paper software.

Table 1 - Issues highlighted by review



We have considered the characteristics of a best practice internal audit function (detailed further in Appendix D) and have assessed the Council’s internal audit function against the four domains on the previous page on a scale varying from “Immature” (a function with none or few of the characteristics of a global best practice internal audit function) to “Leading” (a function demonstrating the majority of these characteristics).

Figure 1 highlights the current performance of the Council’s internal audit function based on the results of our review; the performance which we have assessed the Council could accept as providing sufficient comfort to management and elected Members; and the performance of a best practice organisation within the public sector:

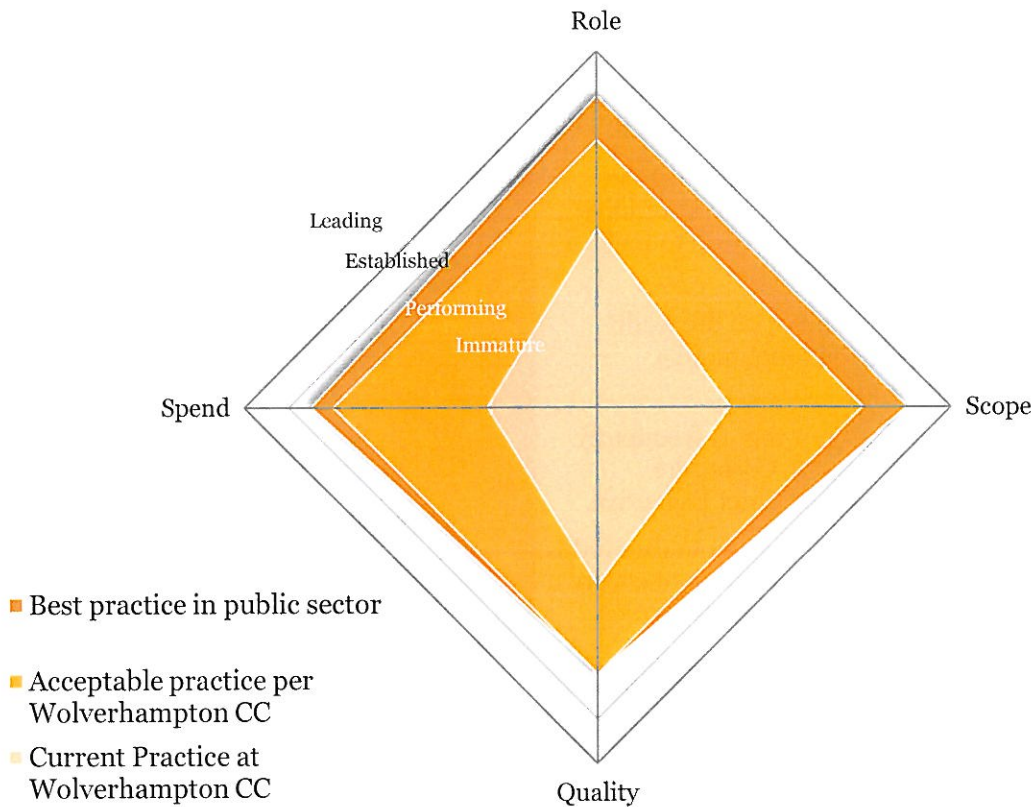


Figure 1 - Internal Audit Maturity Assessment

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## Conclusion

A concerted effort is required to continue to develop a more constructive and efficient process to build on the efforts which have already been made by the Council. This requires members and officers to work together to change the work of the Committee. This should involve:

- Officers providing a comprehensive view of control in the authority, supported by internal and external audit, the issues faced and plans for rectification;
- Once this is in place, members should be able to cease the paid accounts work and focus on internal control more broadly;
- A review of the skills and training required for Audit Committee Members to take more of an oversight role.
- External membership should be seriously considered, as the change required is significant and requires expertise and resolve; and
- Officers and Members holding pre-meetings with the Chair of the Committee about 10 days to two weeks before the Committee to review the papers to be presented, their content, and the further preparation needed before the Committee to ensure focused debate within Committee meetings themselves.

The Members of the Committee recognise that such an approach would provide them with more comfort over the operation of internal controls and processes.

In addition, through adoption of a more efficient, effective and focused plan, the function could realise savings of approximately £350,000 per annum, by:

- Not carrying work on audits brought forward from previous years;
- Implementing a more controls focused, risk-based audit plan to enable the paid accounts process to cease;
- Reducing management and administration time to CIPFA benchmark levels;
- Reducing the time taken to follow up prior year audits; and
- Ceasing work on the Financial Management Standard in Schools (although the Authority will need to consider what alternative assurance it requires in this area).

Internal audit will be more effective if the steps set out above are taken, but the function also needs to provide more value and be more effective if it is to take a proper role in a refreshed regime.

## Summary of Recommendations

The table below provides a summary of the recommendations raised within the report. These are provided in more detail later in the report.

Ref	Recommendation	Priority
1	Address inefficiencies in the internal audit plan.	High
2	Create a more risk-focused internal audit plan.	High
3	Provide pro-active fraud awareness training.	Medium
4	Create investigative specialism within the internal audit team.	Medium
5	Consideration of open plan environment.	Low
6	Consideration of paid accounts process.	High
7	Introduction of timescales for internal audit reporting.	Low
8	Increase service involvement in clearing reports.	High
9	Introduction of automated audit software and consideration of further specialisms.	Medium
10	Introduction of Key Performance Indicators and a robust quality assurance framework.	Medium
11	Improve compliance with the CIPFA Code of Internal Audit.	Medium
12	Introduction of a new internal audit Charter.	High
13	Consideration of Audit Committee preparation and practice.	High
14	Provision of Member training.	Medium
15	Introduction of CIPFA guidance compliant Audit Committee role and remit.	High
16	Consideration of independent membership of Audit Committee.	High