

Wolverhampton City Council

**OPEN DECISION ITEM**

Audit Committee

Date **18 July 2011**

Originating Service Group(s)

**DELIVERY**

Contact Officer(s)/

**B BURGESS**

**R MORGAN**

Telephone Number(s)

**4460**

**5612**

Title/Subject Matter

**REVIEW OF THE EFFECTIVENESS OF THE SYSTEM OF  
INTERNAL AUDIT 2010/2011**

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**RECOMMENDATIONS**

1. That Members of the Audit Committee receive the report and consider whether they need to make further enquiries with Directors and Senior Managers as they feel appropriate to obtain assurances on the system of Internal Audit in place.
2. That, if Members of the Audit Committee are satisfied with the arrangements and the review process, then they formally approve the report as satisfactory completion of the review to discharge their responsibility under Regulation 6 of the Accounts and Audit Regulations 2011 to review the system of Internal Audit.

## **1. PURPOSE AND BACKGROUND**

1.1 The Accounts and Audit Regulations (2011) require audited bodies to conduct a review at least once a year of the effectiveness of its system of internal control. In addition, Regulations 4 and 6 of the aforementioned Regulations place a number of additional requirements on audited bodies with regard to the responsibility for financial management and internal audit. These requirements are as follows:

### **Responsibility for financial management**

#### **Regulation 4**

(1) The relevant body is responsible for ensuring that the financial management of the body is adequate and effective and that the body has a sound system of internal control which facilitates the effective exercise of that body's functions and which includes arrangements for the management of risk.

(2) The relevant body must conduct a review at least once in a year of the effectiveness of its system of internal control.

(3) The findings of the review referred to in paragraph (2) must be considered –

(a) in the case of a larger relevant body, by the members of the body meeting as a whole or by a committee, and

(b) in the case of a smaller relevant body, by the members of the body meeting as a whole,

and following the review, the body or committee must approve an annual governance statement, prepared in accordance with proper practices in relation to internal control.

(4) The relevant body must ensure that the statement referred to in paragraph (3) accompanies -

(a) any statement of accounts it is obliged to prepare in accordance with regulation 7, or

(b) any accounting statement it is obliged to prepare in accordance with regulation 12.

### **Internal audit**

#### **Regulation 6**

(1) A relevant body must undertake 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.

(2) Any officer or member of a relevant body must, if the body requires –

(a) make available such documents and records as appear to that body to be necessary for the purposes of the audit; and

(b) supply the body with such information and explanation as that body considers necessary for that purpose.

(3) A larger relevant body must, at least once in each year, conduct a review of the effectiveness of its internal audit.

(4) The findings of the review referred to in paragraph (3) must be considered, as part of the consideration of the system of internal control referred to in regulation 4(3), by the committee or body referred to in that paragraph.

1.2 The requirement to review Internal Audit does not specify what the review should consist of, nor does it state who should undertake this task. The current policy with regard to reviewing the effectiveness of the system of Internal Audit was established in April 2007 when it was agreed that:

- the CIPFA Code of Practice for Internal Audit in Local Government 2006 be formally adopted as the standard by which Internal Audit is assessed in Wolverhampton.
- Members of the Audit Committee receive and consider the results of the review to discharge the responsibility under Regulation 6 (of the previous Regulations) to review the system of Internal Audit.

1.3 This report provides the Committee with references to existing procedures, sources of information and measures in place in order to assist in being able to reach a conclusion on the adequacy and effectiveness of the Internal Audit Service.

## **2. DETAILS**

### **2.1 Existing Processes and Sources of Assurance**

2.1.1 The Council's arrangements for Internal Audit are contained within the Constitution (Financial Procedure Rules paragraph C.1), which states that:

“The Section 151 Officer shall ensure that an adequate and effective internal audit of all Council activities is carried out in accordance with the most recent CIPFA Statements on Internal Audit Practice and relevant legislation.”

2.1.2 The Division follows the CIPFA Code of Practice for Internal Audit in Local Government 2006 which covers the following areas:

- Scope of Internal Audit
- Independence
- Ethics
- Audit Committees
- Relationships
- Staffing, Training and Continuing Professional Development
- Audit Strategy and Planning
- Undertaking Audit Work
- Due Professional Care
- Reporting
- Performance, Quality and Effectiveness

- 2.1.3 A comprehensive review of the work of Internal Audit has been carried out by the Head of Audit Services against the above criteria and, whilst it is considered that the Division can demonstrate general compliance with the Code, a number of areas for further development have been identified as shown at Appendix A and B to this report.
- 2.1.4 There is a well established process for planning and reporting on the work of internal audit. The Audit Committee approves the audit plan and receives regular reports on matters of significance which may affect the overall assurance given on the system of internal control. In addition, the service is subject to review from both internal clients and externally through, for example, the Council's external auditors who have undertaken a comprehensive review of the effectiveness of Internal Audit in the latter stages of 2010/11 as previously reported to Audit Committee in April 2011. A project plan has been drafted to address the recommendations contained within the report and regular reports on progress will be submitted to members during the year. The Division has also taken part in the CIPFA Benchmarking exercise for a number of years and, in general, compares favourably with other authorities. Finally, all audit reports consider risk to the organisation and an opinion on the overall level of control is provided for each individual audit or system examined. This also extends to the overall level of assurance which is provided within the Internal Audit Annual Report and Annual Governance Statement, both of which are considered by members of the Audit Committee.
- 2.1.5 In addition to the review carried out as detailed above in paragraph 2.1.3 members may gain assurance on the effectiveness of the system of internal audit from a number of other sources, including:
- The Constitution (overall governance arrangements)
  - Management Structure – Directors and Statutory Officers
  - Audit Committee and Selection of Paid Accounts/Monitoring of Investigations Sub-Committee (terms of reference, reports submitted)
  - Best Practice initiatives – CIPFA FM Model
  - Other review agencies – Ofsted, CQC, IIP
  - Audit Commission - CAA reviews
  - External Audit reports
  - Internal Audit clients – Directors, Senior Managers, Head Teachers, Pension Fund
  - Partners
  - Results of FMSiS reviews
  - Accountable Body Status (GOWM)
  - Annual Report
  - Health and Safety arrangements
  - Training provided (e.g. awareness and briefing sessions for Audit Committee).

### **3. FINANCIAL IMPLICATIONS**

- 3.1 There are no financial implications arising from the recommendations in this report.  
[DM/08072011/U]

### **4. LEGAL IMPLICATIONS**

- 4.1 The report is submitted to comply with the Accounts and Audit Regulations (2011).and associated statutory instruments which are issued from time to time.  
[MW/11072011/H]

**5. EQUAL OPPORTUNITIES IMPLICATIONS**

5.1 There are no direct equal opportunities implications arising from this report.

**6. ENVIRONMENTAL IMPLICATIONS**

6.1 There are no direct environmental implications arising from this report.

**7. SCHEDULE OF BACKGROUND PAPERS**

7.1 Accounts and Audit Regulations (2011)  
CIPFA Code of Practice for Internal Audit (2006) - Standards  
Wolverhampton City Council Constitution

## CIPFA Code of Practice - Standards

2006 Code standard	Evidence of Achievement	Areas for development
<p><b>1. Scope of Internal Audit</b></p> <ul style="list-style-type: none"> <li>• Terms of reference</li> <li>• Scope</li> <li>• Responsibilities in respect of other organisations</li> <li>• Fraud and corruption</li> </ul>	<p>Terms of reference reflecting current Code of Practice were approved by authority on 16 April 2007.</p> <p>Scope of audit work takes into account risk management processes and wider internal control.</p> <p>The terms of reference identify responsibilities in respect of other organisations, including all key partnerships and LAAs.</p> <p>Terms of reference define audit responsibilities in relation to fraud.</p>	<p>Specific references to the responsibilities of internal audit in relation to fraud are required.</p>
<p><b>2. Independence</b></p> <ul style="list-style-type: none"> <li>• Organisational independence</li> <li>• Status of Head of Internal Audit</li> <li>• Independence of individual internal auditors</li> <li>• Independence of internal audit contractors</li> </ul>	<p>The Head of Audit Services has direct access to those charged with governance through the Audit Committee as contained in the Council's Financial Regulations.</p> <p>Reports are made in own name to management and to Audit Committee.</p> <p>No conflict of interest between operational responsibilities and audit has been identified.</p> <p>Rotation of audit work within the team is the norm.</p> <p>Contractor IT auditor firm does not have any other role within the authority.</p>	<p>The Head of Audit Services reports to the Assistant Chief Executive following the Senior Management re-structure in 2010/11. The reporting line will be further reviewed during 2011/12.</p> <p>Not applicable - IT audit function carried out internally.</p> <p>Possible use of independent IT auditors may be made in the future.</p>

2006 Code standard	Evidence of Achievement	Areas for development
<ul style="list-style-type: none"> <li>• Declaration of interest</li> </ul>	<p>Auditors are required to declare interests and have been vetted.</p> <p>References are taken up for all appointments when employed.</p> <p>All staff are required to be CRB checked.</p>	<p>Annual declarations of interest to be considered.</p>
<p><b>3. Ethics</b></p> <ul style="list-style-type: none"> <li>• Integrity</li> <li>• Objectivity</li> <li>• Competence</li> <li>• Confidentiality</li> </ul>	<p>Staff appraisal system considers these issues; no significant points have been identified.</p> <p>Staff have been made aware of ethics requirements.</p> <p>Guidance on ethics has been circulated.</p> <p>Guidance is circulated periodically.</p>	<p>Annual circulation to be introduced during 2011/12.</p> <p>Changes have been made with regard to office layout to improve confidentiality. Further work to be considered regarding introduction of a 'clear desk' policy along with 'hot-desking'.</p>
<p><b>4. Audit Committee</b></p> <ul style="list-style-type: none"> <li>• Purpose of the Audit Committee</li> <li>• Internal audit's relationship with the Audit Committee</li> </ul>	<p>Terms of reference have been formally approved (21 September 2005) and are regularly reviewed.</p> <p>Delegations reviewed annually.</p> <p>Terms of reference include responsibility for the review of the annual governance statement.</p> <p>Audit Committee approves and monitors audit strategy and plan.</p> <p>Head of Internal Audit attends meetings, reports on the outcome of internal audit work, identifies necessary changes to the audit plan, and presents an annual report and opinion.</p>	<p>A formal review of the Audit Committee's terms of reference was deferred at the Audit Committee meeting on 11 April 2011 to allow implications of the PwC Review of Internal Audit Effectiveness to be considered. The terms of reference and roles and responsibilities of the Committee will be subject to review during 2011/12 to ensure that there is clarity of focus and that the Committee operates effectively on a strategic level.</p>

2006 Code standard	Evidence of Achievement	Areas for development
	<p>Assurance on the internal control and risk management framework is provided. (See Audit Committee papers).</p> <p>Regular communication (formal and informal) is maintained between the Head of Internal Audit and Chairs of Audit Committee/Selection of Paid Accounts/Monitoring of Audit Investigations Sub-Committee.</p>	
<p><b>5. Relationships</b></p> <ul style="list-style-type: none"> <li>• with management</li>   <li>• with other internal auditors</li>   <li>• with external auditors</li>   <li>• with other regulators and inspectors</li>   <li>• with elected Members</li> </ul>	<p>Managers are consulted on the audit plan and on the scope of each audit. (Evidence is on audit files).</p> <p>Ongoing dialogue with Directors through regular attendance at Divisional Management Teams (Lead auditor nominated for each Directorate).</p> <p>Responsibilities for managers and internal audit are defined in relation to internal control, risk management and fraud and corruption matters.</p> <p>Good working relations established with external audit, including consultation on plan and opportunities for joint working.</p> <p>Meetings between internal and external audit are held on a regular basis.</p> <p>Sharing of information is undertaken with other internal review agencies.</p> <p>There is liaison with external regulators and inspectors.</p> <p>The responsibilities of internal audit staff and Members, particularly those of the Audit Committee are understood.</p>	<p>Develop dialogue with Assistant Directors following Senior Management Re-structure</p> <p>As above.</p> <p>Develop Black Country Audit Group during 2011/12.</p> <p>Meetings to be formalised in 2011/12 with an agenda for each meeting.</p>



2006 Code standard	Evidence of Achievement	Areas for development
<p><b>6. Staffing, training and development</b></p>	<p>Regular updates on resources are provided to Audit Committee.</p> <p>The skills and competencies required of each post have been determined. (Job Descriptions and Person Specifications refers).</p> <p>Actual skills and competencies have been assessed and a gap analysis completed. (See skills assessment matrix).</p> <p>Individual training and development plans have been agreed through the appraisal process and are being delivered. (See training plan).</p> <p>Professional staff are required to complete CPD.</p> <p>Comparison with other authorities is undertaken via annual CIPFA Benchmarking.</p>	<p>Job Descriptions and Person Specifications will be reviewed in line with new corporate proforma.</p> <p>Appraisals need to be done for each piece of work in order to help to identify development needs.</p>
<p><b>7. Audit Strategy and Planning</b></p>	<p>The Audit Strategy forms part of the Annual Service Plan, from which annual work plans and resources are considered.</p> <p>The risk-based Audit Plan has been prepared in accordance with the strategy and includes reference to key corporate risk registers where appropriate.</p> <p>Audit resources are reviewed on an on-going basis and issues are reported to Audit Committee as required.</p> <p>The Audit Plan is approved by the Audit Committee on an annual basis.</p> <p>Regular updates on progress are provided to Audit Committee.</p>	<p>Greater emphasis to be placed on audit of areas where key corporate risks have been identified.</p> <p>Review of staffing requirements to be undertaken during 2011/12</p>

2006 Code standard	Evidence of Achievement	Areas for development
<p><b>8. Undertaking Audit Work</b></p> <ul style="list-style-type: none"> <li>• Planning</li>   <li>• Approach</li>   <li>• Recording and Assignments</li> </ul>	<p>An annual plan is drafted and agreed with Directors prior to approval by Audit Committee.</p> <p>An audit brief is prepared and agreed with management for each audit.</p> <p>A risk-based approach is used and an audit opinion is given on all work.</p> <p>Issues are discussed with management through designated audit points of contact on a timely basis.</p> <p>Standards of working papers are specified and checked as part of the file review.</p> <p>Adequate working papers supporting conclusions drawn and recommendations made are maintained and retained in accordance with defined policy.</p> <p>Reports are issued to appropriate managers in accordance with defined policy.</p>	<p>Regular dialogue with Directors and attendance at Divisional Management Teams will be undertaken during 2011/12.</p> <p>A comprehensive risk based assessment will be carried out for the 2012/13 audit plan year.</p> <p>Standards to be reviewed during 2011/12</p> <p>A reporting protocol was considered by Corporate Management Team during 2010/11. Further consideration of alternative format and circulation of Audit reports will be undertaken in 2011/12 in conjunction with Strategic Executive Board and Corporate Delivery Board.</p>
<p><b>9. Due Professional Care</b></p> <ul style="list-style-type: none"> <li>• Responsibilities of the individual auditor</li> </ul>	<p>All internal auditors are aware of their individual responsibilities for due professional care through membership of respective professional bodies.</p> <p>A whistle-blowing procedure is maintained and auditors are made aware of the process followed.</p>	<p>Training programme for all staff to be introduced.</p>

2006 Code standard	Evidence of Achievement	Areas for development
<ul style="list-style-type: none"> <li>Chief Internal Auditor reviews all audit files and reports.</li> </ul>	<p>Suitable file review arrangements are in place at Principal Auditor level.</p> <p>Head of Audit (or Senior Audit Manager in his absence) signs off all reports.</p>	<p>A quality assurance review process is proposed to ensure consistent application of standards for audit work.</p>
<ul style="list-style-type: none"> <li>Responsibilities of the Head of Internal Audit</li> <li>Appraisal and training.</li> </ul>	<p>As defined in the relevant professional codes, Council Financial Regulations and Job Description.</p> <p>Work is assigned so as to avoid potential conflicts of interest.</p> <p>Planned audit work is subject to appraisal. Development needs are identified during the appraisal process.</p>	<p><b>All</b> work to be subject to appraisal.</p>
<p><b>10. Reporting</b></p> <ul style="list-style-type: none"> <li>Reporting on audit work</li> </ul>	<p>Audit reports give an opinion on risks and controls, using approved methodology</p> <p>Scope of the audit is set out in report</p> <p>Recommendations are prioritised according to risk.</p> <p>Draft reports are discussed with management and action plans agreed in response to recommendations made.</p> <p>Reports are issued to appropriate managers.</p> <p>Where necessary, issues are referred to risk manager.</p> <p>Assurances are sought from managers on delivery of agreed actions.</p> <p>An escalation procedure has been defined and is used as appropriate (see reports to Audit Committee).</p>	<p>Review of methodology and opinions to be undertaken during 2011/12.</p> <p>Future circulation of reports is to be agreed within a revised reporting protocol to be agreed by Strategic Executive Board.</p>

2006 Code standard	Evidence of Achievement	Areas for development
	<p>Where necessary, the opinion is revised in light of the delivery of agreed actions.</p> <p>The report includes the opinion on the control environment and any qualifications to that opinion.</p>	
<ul style="list-style-type: none"> <li>• Annual reporting</li> </ul>	<p>The work on which the opinion is based is set out in the report.</p> <p>The report highlights significant issues.</p> <p>An annual report to support the Annual Governance Statement is presented to the Audit Committee.</p> <p>Interim issues reports are submitted to the Audit Committee.</p>	<p>Format of reporting key issues to Directors and Audit Committee to be reviewed.</p> <p>Annual report scheduled for 18 July 2011 meeting.</p> <p>Interim assurance reports will be submitted throughout the year advising of how the opinion is developing.</p>
<p><b>11. Performance, quality and effectiveness</b></p> <ul style="list-style-type: none"> <li>• Principles of performance, quality and effectiveness</li> <li>• Quality assurance of audit work</li> <li>• Performance and effectiveness of the internal audit service</li> </ul>	<p>Policies and procedures are defined in an audit manual.</p> <p>Audits are assigned according to the skills mix required and so that there is adequate supervision</p> <p>Internal review of all audit files is undertaken by Principal Auditors (See file review forms).</p> <p>Performance measures are defined and results reported to Audit Committee in the annual report.</p> <p>Client satisfaction surveys are issued with each final report and are summarised in annual report submitted to Audit Committee.</p> <p>An annual assessment of the work of internal audit is undertaken by the external auditor. (See management letter).</p>	<p>A quality assurance review process is proposed to ensure consistent application of standards for audit work.</p> <p>Use of TEN Performance Manager to monitor performance indicators.</p> <p>Consider report to Audit Committee on results of CIPFA Benchmarking.</p>

**CIPFA Code of Practice - Characteristics of Effectiveness**

Characteristic of 'effectiveness'	Evidence of achievement	Areas for development
Understand its position in respect to the organisation's other sources of assurance and plan its work accordingly.	Internal audit identifies other sources of assurance and takes this into account when preparing the internal audit plan.	Obtain independent assurances from third parties and partner organisations.
Understand the whole organisation, its needs and objectives.	The audit plan demonstrates how audit work will provide assurance in relation to the authority's objectives.  Individual audit assignments identify risks to the achievement of those objectives.	
Be seen as a catalyst for change at the heart of the organisation.	Supportive role of audit for corporate developments such as corporate governance review, risk management and ethics.  Individual assignments may be catalyst for change.	
Add value and assist the organisation in achieving its objectives.	Demonstrated through individual audit assignments and also corporate work.	Consider more attention to value for money issues in audits.
Be involved in service improvements and projects as they develop, working across internal and external boundaries to understand shared goals and individual obligations.	Internal audit provides help and advice on request and supports specific projects identified in plan and on ad hoc basis.	Provide assurance and support as necessary in support of the organisation's major Programmes.
Be forward looking – knowing where the organisation wishes to be and aware of the national agenda and its impact.	When identifying risks and in formulating the plan changes on the national agenda are considered.  The audit section maintains awareness of new developments in the services it audits, risk management and corporate governance and disseminates this knowledge to other parts of the local authority.	Maintain regular contact with Assistant Directors on key risks in conjunction with the Corporate Risk Group.  Obtain wider involvement with partners, particularly on governance and risk issues.  Provide increased support to partnership working.
Be innovative and challenging – shaping the values and standards of the organisation; providing internal inspection and validation and encouraging service managers to take ownership of processes, systems and policy.	Audit Services has adopted a proactive approach to working with key clients. This has included establishing single points of contact to work with Departmental Management Teams to ensure audit resources are properly focused and there is a buy-in o the Audit Plan. In addition, Audit Services proactively seek input into key corporate projects and programmes to provide assurance and support as appropriate.	Consider alternative methods of reporting in line with Directors' requirements (e.g. presentations, summaries, action plans).  Continue to seek Audit Services' involvement on key corporate projects and programmes (e.g. Improvement Programme).

<b>Characteristic of 'effectiveness'</b>	<b>Evidence of achievement</b>	<b>Areas for development</b>
Ensure the right resources are available – the skills mix, capacity, specialism and qualifications/experience requirements all change constantly.	<p>Reports on resources are submitted to Audit Committee.</p> <p>Arrangements are in place to obtain specialist input on IT audit as required.</p>	