



**Report to the Audit and Governance  
Committee**

**Report Reference: AGC-006-2009/10.**

**Date of meeting: 22 June 2009.**

**Portfolio: Finance & Economic Development**

**Subject: Review of the Effectiveness of the System of Internal Audit**

**Responsible Officer: Joe Akerman (01992 564446)**

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**Recommendations**

(1) To note the review of the effectiveness of the system of internal audit, undertaken by the officer Corporate Governance Group for 2008/09, in the context of the Council's Governance Statement; and

(2) To scrutinise the officer review and consider the effectiveness of the system of internal audit in 2008/09.

**Executive Summary:**

The Accounts and Audit Regulations include a requirement for the Authority to carry out an annual review of the effectiveness of its system of internal audit as part of the wider review of the effectiveness of the system of governance. This report summarises the officer review undertaken for 2008/09 by the Corporate Governance Group, to assist the Committee in assessing the effectiveness of the system of internal audit on behalf of the Authority.

This Committee has previously considered the options for conducting the annual review, and resolved as follows:

(i) that the system of Internal Audit be reviewed by the Corporate Governance Group, using information on performance and effectiveness provided by the Chief Internal Auditor in conjunction with a self-assessment based upon the checklist in the CIPFA Code of Practice; and

(ii) that the outcome of the review be reported to this Committee for scrutiny and approval.

**Reason for Proposed Decision:**

To provide the Committee with the opportunity to scrutinise the officer review.

**Other Options for Consideration:**

In practice there is no alternative to conducting a review of the effectiveness of the system of internal audit, as it is a statutory requirement. The options surround the means by which the review is conducted, which has been the subject of detailed consideration in the past.

**Report:**

1. Regulation 6 of the Accounts and Audit Regulations requires the Council to maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with proper internal audit practices. In EFDC the "system" of

internal audit consist primarily of the work of the Internal Audit Team, although supervisory processes in all services provide a control and risk management function that could be defined as contributing to the system of audit. For this purpose, however, the work of the Internal Audit Team is seen as the focus of the review of effectiveness.

2. The Council is required to carry out an annual review of the effectiveness of its system of internal audit, as part of a wider review of the effectiveness of the system of governance. It is the responsibility of the Authority to undertake the review, and not the External Auditor. The Audit and Governance Committee is the most appropriate body to oversee the review of the system of Internal Audit, as it is independent of the management of the Authority.

3. The framework for the review should demonstrate that the Internal Audit service is:

- (a) meeting its aims and objectives;
- (b) compliant with the CIPFA Code of Practice;
- (c) effective, efficient and continuously improving; and
- (d) adding value and assisting the Authority in meeting its objectives.

4. Furthermore, the framework must include, but not be limited to:

- (a) a comprehensive set of targets to measure performance;
- (b) user feedback for each individual audit and periodically for the whole service;
- (c) internal quality reviews to be conducted periodically to ensure compliance with the CIPFA Code of Practice; and
- (d) an action plan to implement improvements.

5. The objective of these measures is to ensure that the performance and effectiveness of the Internal Audit service improves over time, in terms of both the achievement of targets and the quality of service provided to the user. Two years ago the Committee reviewed the CIPFA checklist to enable compliance with the Code of Practice to be monitored. The main issue arising from that review was the need to update the Audit Manual, which was completed in the first quarter of 2008/09. Furthermore, the Authority is now fully compliant with the Code in relation to the operation of an audit committee.

6. The effectiveness of internal audit should, however, not solely be judged by the extent of compliance with the Code of Practice. The review is primarily about effectiveness, not process. In essence the need for the review is to ensure that the opinion in the annual report of the Chief Internal Auditor may be relied upon as a key source of evidence in the Governance Statement.

7. The effectiveness of the system of internal audit should include the effectiveness of the Audit and Governance Committee itself (to the extent that its work relates to internal audit), in addition to the performance of the Internal Audit Team. The Committee has previously considered a report that assessed the structure and functions of the Committee against CIPFA's Audit Committee toolkit and self-assessment checklist. Following evaluation of the results, the operation of this Committee and its structures had compared favourably with the criteria within the toolkit, and the work undertaken by the Committee in 2008/09 has consolidated this position.

8. Measures of effectiveness put in place by the Chief Internal Auditor are largely based on existing reports and performance indicators, generally designed to measure outputs and outcomes. The key effectiveness measures are:

- completion of the annual audit plan (Local Performance Indicator);
- productive audit time as a percentage of total time (LPI);
- cost per audit day (LPI);
- achieving client service satisfaction (LPI);
- completion of audits within budgeted days; and
- finding an improvement in control during each follow-up audit.

9. The measures referred to in the previous paragraph are monitored by Senior Management and Members via the following reporting processes:

- Preparation of Annual Internal Audit Plan;
- Periodic monitoring reports of the Chief Internal Auditor, including:
  - Monitoring reports including Audit Plan progress;
  - Reports on significant findings;
  - Local performance indicators as referred to above; and
  - Results of customer satisfaction surveys; and
- Annual report and opinion of the Chief Internal Auditor.

10. The Council's Internal Audit Team issue a survey sheet after each main audit, and these are used in calculating one of the Team's local performance indicators, as well as providing feedback on Services' perception of the quality of the work. An annual survey of Service Directors, based on a CIPFA model and comprising 41 questions, was administered by the Performance Improvement Unit for 2008/09, in order to provide a greater degree of independence as requested by Members. The survey was sent to 29 managers, all of whom had recent experience of Internal Audit work. A total of 16 responses were received by the deadline set, although not all respondents answered all of the questions. On a scale *excellent, good, adequate, less than adequate, weak, or poor*, the average rating of Internal Audit was good for 40 questions and adequate for 1. There were no average scores at the extremes of the scale, unlike in 2007/08 when there were 5 average scores of 'excellent'. The overall average rating of Internal Audit was good. Additional comments on the work of Internal Audit were invited, and where provided were constructive and showed a good level of engagement with the audit process.

11. In the past, the Audit Commission conducted a full review of the adequacy and effectiveness of internal audit every three years, although each year some Internal Audit work would be reviewed and reliance placed on it where appropriate. The Council's current External Auditors conduct a thorough review of the quality of Internal Audit's work on financial systems each year, in assessing the extent of reliance that can be placed on the work, in the context of their audit of the Council's Statutory Accounts.

12. The review by External Audit does not cover all elements of the system of internal audit and, therefore, in the Audit Commission's view, cannot be relied upon to fulfil the requirements of the Regulations in relation to the annual review of effectiveness. The Council's External Auditors, PKF (UK) LLP, have reviewed the work of Internal Audit in 2008/09, as far as it relates to the key controls on the main financial systems, and will be reporting their findings later in the year.

13. The review of effectiveness does not specifically include the value for money of the Internal Audit Team. Whilst this is an important issue in itself (and is a local performance indicator for the Team), the focus of this review is on the delivery of the internal audit service to the required standard in order to produce the required outcome i.e. a reliable assurance on internal control and other governance arrangements, and the management of risks in the authority.

## Review of Effectiveness of the System of Internal Audit 2008/09

14. The Council's Corporate Governance Group has undertaken the review of EFDC's Internal Audit Service in 2008/09 utilising the following main sources of evidence:

- Annual report and opinion of the Chief Internal Auditor;
- A review of the Internal Audit Service against CIPFA standards using a check list provided in the guidance;
- A review of Internal Audit monitoring reports for 2008/09;
- Comments from the Chief Executive and Deputy Chief Executive following their consideration of individual audit report summaries;
- The role of the Corporate Executive Forum monitoring the work of Internal Audit and any significant internal control issues raised in their reports;
- Consideration of significant corporate control issues highlighted in audit reports, discussed within the Management Board;
- Performance by Internal Audit against local performance indicators;
- Feedback from Senior Managers in an annual survey; and
- The Internal Audit Section Business Plan and work plans.

## Corporate Assessment by the Audit Commission

15. The Internal Control element of the Audit Commission's Use of Resources assessment assesses whether an authority has effective arrangements to ensure proper use of public funds and manages its risks. EFDC scored 3 out of 4 for Internal Control in the 2008 review, which maintained the position from 2007 and means that the Authority is consistently above minimum requirements, and is performing well. Within the overall Use of Resources score for 'Internal Control' in 2007/08, the Authority increased its score for the specific category '*maintaining a sound system of internal control*', from 2 to 3 (performing well). Internal Audit contributed to the improved score in several areas. Of the 238 District Councils, 148 have scored a level 3 overall for internal control and only 6 have reached level 4.

## Summary of Findings

16. The Internal Audit Section can demonstrate that it has a good understanding of the functions of the Council and has achieved the Council's objective to identify improvements to its control systems. The performance of the Unit has remained close to its key targets and in particular has met the key work plan target in 2008/09. The Council's External Auditors were able to place reliance on the work of Internal Audit when conducting their first formal review of the Team's work as part of their review of the 2007/08 accounts.

17. The work of the Audit and Governance Committee, with independent membership, makes an important contribution to the independent review of internal and external audit processes, as part of the Council's arrangements for securing further improvements in its systems of governance, including internal control. The Annual Report of the Audit and Governance Committee for 2008/09 demonstrated the range of issues addressed during the year.

18. It is felt that the current Audit Committee complies with the key features of an Audit Committee as expressed by CIPFA, specifically that the Committee has:

- A strong Chairman displaying depth of skills and interests;
- An unbiased approach to its work;
- The ability to challenge the Executive when required; and
- A membership that is objective, independent and knowledgeable.

19. In the opinion of the officers attending the Audit and Governance Committee, the support given by Members, in particular by insisting on responses to audit recommendations being timely, is invaluable in reinforcing the message of sound governance.

20. Having considered these issues, in particular the performance of the Internal Audit Team in achieving 95% of its work plan target in 2008/09, the Corporate Governance Group is satisfied that the Authority's system of Internal Audit was effective during 2008/09.

**Resource Implications:**

From existing resources.

**Legal and Governance Implications:**

Within the report.

**Safer, Cleaner and Greer Implications:**

No specific implications.

**Consultation Undertaken:**

Corporate Governance Group.

**Background Papers:**

CIPFA Audit Code of Practice.

**Impact Assessments:**

The annual review of the effectiveness of the system of Internal Audit needs to provide assurance that effective risk management measures are in place. This is demonstrated both by the specific audit of risk management processes undertaken by Internal Audit each year, and the emphasis on risk assessment when compiling the annual audit plan. There are no equalities impacts.