

## ITEM NO: 10

<b>DECISION-MAKER:</b>	AUDIT COMMITTEE		
<b>SUBJECT:</b>	REVIEW OF THE EFFECTIVENESS OF THE SYSTEM OF INTERNAL AUDIT		
<b>DATE OF DECISION:</b>	28 <sup>TH</sup> JUNE 2007		
<b>REPORT OF:</b>	CHIEF INTERNAL AUDITOR		
<b>AUTHOR:</b>	Name:	Sarah Dennis	Tel: 023 80 834255
	E-mail:	Sarah.l.dennis@southampton.gov.uk	

### STATEMENT OF CONFIDENTIALITY

NOT APPLICABLE

### SUMMARY

With effect from 1 April 2006, the Accounts and Audit (Amendment) (England) Regulations 2006 placed a requirement on the Council to, at least once a year, conduct a review of the effectiveness of its system of internal audit. To assist the Committee in discharging this requirement on behalf of the Council, this paper summarises the measures currently in place to monitor internal audit effectiveness and proposes an approach for future reviews.

### RECOMMENDATIONS:

- (i) That the Audit Committee reviews the effectiveness of the system of internal audit using the sources of assurance detailed in this report.
- (ii) That the Audit Committee agrees a way forward to enable the Council to conduct future reviews of the effectiveness of internal audit, to include: a peer review from another Council via their head of internal audit; and, a review of the effectiveness of the Audit Committee against good practice guidance.

### REASONS FOR REPORT RECOMMENDATIONS

1. The Accounts and Audit Regulations 2006 state that the Council 'shall, at least once in each year, conduct a review of the effectiveness of its system of internal audit'. This review is part of the wider annual review of the effectiveness of the system, of internal control and as such should be referred to the Audit Committee.

### CONSULTATION

2. Consultation with the Audit Commission to determine how the review should be conducted.

### ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

3. None

### DETAIL

4. From 1 April 2006, the Accounts and Audit Regulations placed a new requirement on authorities to conduct an annual review of the effectiveness of the system of internal audit. The regulations do not specify how this should be achieved, however, it is considered that the annual review can be informed, both by any review of internal audit by the external auditors and the results of any measures of effectiveness of internal audit agreed with the Audit Committee.
5. The CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom 2006 [the Code] recommends that *“The Head of Internal Audit should have in place a performance management and quality assurance framework to demonstrate that the internal audit service is:*
  - a) *Meeting its aims and objectives*
  - b) *Compliant with the Code*
  - c) *Meeting internal quality standards*
  - d) *Effective, efficient, continuously improving*
  - e) *Adding value and assisting the organisation in achieving its objectives.”*
6. Meeting aims and objectives

The aims and objectives of the system of internal audit are defined in the Internal Audit Strategy and the Internal Audit, Risk and Assurance Business Plan. The key objective for internal audit in 2006/07 was to implement an Action Plan, produced following a comprehensive review of internal audit against CIPFA’s Code of Internal Audit Practice 2003 by the Audit Commission in November 2005, and designed to address non-compliance with the Code. Progress was actively monitored by the Executive Director of Resources, the Standards and Governance Committee and latterly, the Audit Committee. All actions, with the exception of the following, were successfully delivered:

  - Action: Ensure that Internal Audit has the appropriate resources, in both numbers and skills, to meet the CIPFA standards and provide the Council with the assurance it needs.

Position: The internal audit service was restructured in October 2006. To date, it has not been possible to directly fill all vacant posts within the agreed structure with the service operating with a resource short-fall of 6.2 FTE (42%) at the 31<sup>st</sup> March 2007.
7. Compliance with the Code

As above, the system of internal audit was not fully compliant with the Code throughout 2006/07 although was working towards full compliance with the Code. The Code was revised in December 2006. Internal audit conducted a self-assessment against the revised Code and has put in place a new Action Plan that aims to ensure full compliance with the revised Code by

December 2007.

8. The Audit Commission carries out an annual assessment of the performance of internal audit every year and every three years, conducts a comprehensive review that covers all aspects of the Code. The review carried out in March/April 2007 broadly concurred with the conclusions of the internal audit self-assessment in that there are still some key areas to be addressed or fully embedded, meaning that there are areas of the revised Code that are not fully complied with. The full report is available elsewhere on this agenda.
9. Meeting internal quality standards  
Both the self-assessment and Audit Commission assessment against the revised Code judged internal audit to be partly-compliant with the standards for quality. Work has commenced in the year in drawing up an internal audit manual to provide guidance on quality standards in carrying out day-to-day audit work and compliance with the Code. A system of quality checks has been put in place to ensure all internal audit work is appropriately supervised and reviewed throughout all audits to monitor progress, assess quality and coach staff.
10. Effective, efficient, continuously improving  
The Audit Commission's *'Use of Resources Auditor Judgement 2006/07'* (December 2006) noted that "Internal Audit has significantly strengthened its approach and is restructuring to ensure more effective delivery." The theme score for Internal Control rose from 1 to 2.
11. The Audit Commission's Internal Audit Assessment report states that "the Council has made significant progress in improving its internal audit arrangements".
12. Other than the Audit Commission's review work, there is no historic information available on the effectiveness or efficiency of internal audit. A suite of performance indicators has been developed to enable comparison of the performance and effectiveness of the service over time in terms of both achievement of targets and quality of service provided. Performance data for 2006/07 will be used as the benchmark. These performance measures are to be reported to the Audit Committee within the regular "Status of Work" report. In addition, the Council is to participate in the CIPFA Benchmarking Club for Internal Audit Services for the first time in 2007/08. The results of this exercise will be reported to this Committee.
13. Adding value and assisting the organisation in achieving its objectives  
The Internal Audit Strategy 2007-2011 is designed to demonstrate how the internal audit service seeks to add value to the Council and to assist the Council in achieving its objectives. The Annual Audit Plan for 2006/07 demonstrates intended audit coverage of the Council's objectives. The 2006/07 audit plan was substantially completed, with any amendments approved by this Committee (please see Chief Internal Auditor's *Annual Report and Opinion*, also on this agenda).
14. Informal client feedback has been sought in respect of audit work carried out in 2006/07 and the delivery mechanism has been adapted to meet client

needs. Formal client feedback is to be sought by means of a “client feedback survey” for all reviews from 2007/08 onwards.

15. Role of the Audit Committee

The system of internal audit incorporates more than just the operation and delivery of the internal audit service. Management’s response to internal audit and the effectiveness of the Audit Committee are also key elements of the process.

16. The Audit Committee was established as a full committee in December 2006 and has adopted terms of reference that reflect current good practice guidance. Since December 2006, internal audit has been reporting on its progress and the impact of its work through its “Status of Work” report to the Chief Officers’ Management Team and the Audit Committee. Members of the Committee are able to call Heads of Service and/or Executive Directors to account when considering their responses to individual audit reports. The Committee also monitors the performance of internal audit through review of the “Status of work” report and other reports provided from time to time.

17. Options for future reviews

The improvements to monitoring arrangements outlined above will provide the Audit Committee with further information on which to base their assessment of the effectiveness of the system of internal audit in future years. In addition, it is proposed that:

- a) The Chief Internal Auditor seeks a peer review from another Council via their head of internal audit. This would be a cost effective solution (possible quid pro quo) and would enable exchange of good practice. Any reciprocal arrangement would need to be reflected in the Annual Audit Plan.
- b) The Audit Committee undertakes a review of its effectiveness against good practice guidance in recognition of its contribution to the effectiveness of the system of internal audit.

**FINANCIAL/RESOURCE IMPLICATIONS**

**Capital**

18. None

**Revenue**

19. None

**Property**

20. None

**Other**

21. None

## **LEGAL IMPLICATIONS**

### **Statutory power to undertake proposals in the report:**

22. Accounts and Audit (Amendment) (England) Regulations 2006 places a requirement on the Council to, at least once a year, conduct a review of the effectiveness of its system of internal audit. The above arrangements are intended to meet those responsibilities.

### **Other Legal Implications:**

23. None

## **POLICY FRAMEWORK IMPLICATIONS**

24. None

**SUPPORTING DOCUMENTATION**

**Appendices**

1.	None
2.	

**Documents In Members' Rooms**

1.	None
2.	

**Background Documents**

Title of Background Paper(s)

Relevant Paragraph of the  
Access to Information  
Procedure Rules / Schedule  
12A allowing document to be  
Exempt/Confidential (if  
applicable)

1.	None	
2.		

**Background documents available for inspection at:** Internal Audit Office, North Block  
Basement, Civic Centre

E-mail: Sarah.l.dennis@southampton.gov.uk

**FORWARD PLAN No:** N/A

**KEY DECISION? N/A**

--	--

**WARDS/COMMUNITIES AFFECTED:**

Not applicable