

Audit Summary Report

July 2008



# **Internal Audit Assessment**

**Southampton City Council**

**Audit 2007/08**

External audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services.

Audit in the public sector is underpinned by three fundamental principles.

- Auditors are appointed independently from the bodies being audited.
- The scope of auditors' work is extended to cover not only the audit of financial statements but also value for money and the conduct of public business.
- Auditors may report aspects of their work widely to the public and other key stakeholders.

The duties and powers of auditors appointed by the Audit Commission are set out in the Audit Commission Act 1998, the Local Government Act 1999 and the Commission's statutory Code of Audit Practice. Under the Code of Audit Practice, appointed auditors are also required to comply with the current professional standards issued by the independent Auditing Practices Board.

Appointed auditors act quite separately from the Commission and in meeting their statutory responsibilities are required to exercise their professional judgement independently of both the Commission and the audited body.

### **Status of our reports**

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors/members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

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## Introduction

- 1 Under the Accounts and Audit Regulations 2003, the Council is responsible for ensuring that:
  - its financial management is adequate and effective and that it has a sound system of internal control which facilitates the effective exercise of functions and includes arrangements for the management of risk; and
  - it maintains an adequate and effective system of Internal Audit of its accounting records and of its system of internal control in accordance with the proper Internal Audit practices.
- 2 Under the Code of (external) Audit Practice, we are required to place reliance upon the work of Internal Audit whenever possible to support our conclusions. This helps to minimise any overlap of internal and external audit work and ensure the most effective use of the total audit resource applied to the Council's affairs. However, the emphasis of our approach is on ensuring that Internal Audit meets its own standards, and not on seeking to influence its programme for our own objectives.
- 3 The importance of the Internal Audit function has been further emphasised by the requirement for an Annual Governance Statement (AGS) to be included in the Council's Financial Statements. The AGS needs to be supported by assurance that appropriate controls are in place and operating effectively, and we would expect Internal Audit to provide a significant part of this assurance.
- 4 In order to assess the level of confidence we can have in Internal Audit's work, we carry out an annual assessment of their performance and consider whether they meet the standards set down in the CIPFA Code of Internal Audit Practice 2006. This has also been adopted as the measure for the Use of Resources assessment, which requires as a minimum that:

*'The council has an Internal Audit function that operates in accordance with the CIPFA Code of Practice for Internal Audit in local government'.*
- 5 In most years, our review is achieved through considering changes in arrangements and processes, and reviewing key audit files. However, at least once every three years, we carry out a comprehensive review which covers all aspects of the CIPFA standards. This year we have we have followed up on the issues that we have previously reported as an interim measure.

## Background

- 6 A full review of the Internal Audit function was undertaken in 2005 and this was updated in 2007. This year we have carried out a follow-up review to assess the progress made against the partly met standards from 2007, and our conclusions are summarised below.

## Audit approach

- 7 Our assessment of Internal Audit has been informed by discussions with the Chief Internal Auditor and Internal Audit Manager. We have reviewed key documentation, progress reports and the action taken on our previous recommendations. We have also carried out detailed reviews on a selection of audit files.

## Main conclusions

- 8 Since our initial review in 2005/06, the Council has made significant progress in improving its internal audit arrangements, and the recommendations we made at that time are now fully implemented. Following revisions to the Code in 2006 additional recommendations were made in June 2007 and most of these are fully implemented. The two recommendations that are not fully implemented are included in the action plan that is attached to this report. The most notable achievements at this stage are the raising of the status of internal audit within the organisation, the introduction of an audit manual, the establishment of clear terms of reference and a strategy for delivery of audit services, development of an appropriate staffing structure with a high proportion of qualified posts, and a fully risk-based approach to audit.
- 9 Table 2 sets out a summary of our conclusions against each of the CIPFA standards, where they were only partly met at the last assessment in 2006/07.

**Table 1 Summary of our assessment of IA against the CIPFA standards**

<b>Standard</b>	<b>2006/07 Met Yes or Partly</b>	<b>2007/08 Met Yes or Partly</b>	<b>Change</b>	<b>Comments</b>
Scope of Internal Audit	Partly	Partly	↔	This standard is met except that the audit protocol for working with the PCT has not been finalised and audit access rights have not been secured through all partnership agreements.
Ethics for Internal Auditors	Partly	Yes	↑	Feedback is now sought from Auditees on their perception of the objectivity and independence of internal audit. Staff are reminded annually of their ethical responsibilities through team meetings.
Relationships	Partly	Partly	↔	This standard is met except that the protocol for working with the PCT has not been finalised and protocols for working with other regulators or for establishing dialogues with them are currently being developed.
Staffing, training and continuing professional development	Partly	Yes	↑	Internal Audit is now adequately staffed. Although there are some gaps in the staffing structure, arrangements have been made with external agencies to fill these gaps as the need arises. Competency statements are now in place for all staff.
Undertaking audit work	Partly	Yes	↑	The new risk-based audit approach is now fully embedded and files are much more structured and consistent. The audit manual is in place.
Due professional care	Partly	Yes	↑	A monitoring and review process has been introduced and files are now of a consistently high standard.
Performance, quality and effectiveness	Partly	Yes	↑	This standard has been met except that data is not yet available to demonstrate the performance Internal Audit over time.

## Detailed Report

### Assessment against the CIPFA standards

#### Scope of Internal Audit

**APB Guidance:** *to achieve full effectiveness the scope of the Internal Audit function should provide an unrestricted range of coverage of the organisation's operations, and the internal auditor should have sufficient authority to allow access to such records, assets and personnel as are necessary for proper fulfilment of responsibilities.*

**Internal Audit partly meets this standard.**

- 10 We raised concerns in 2005, that the scope of the audit work may be limited through the audit planning process, as the annual programme of work was not based on a formal risk assessment. In addition, we were concerned about the limited degree to which IA was working in consultation with, and was accountable to, senior management and members. We are pleased to report that all of these key issues have now been addressed.
- 11 The Council has established formal terms of reference for IA, which meet the required standards. A comprehensive IA strategy has been adopted, which sets out in detail the Council's assurance and monitoring mechanisms, including risk management arrangements. Audit work is now fully risk-based, and there is regular reporting of audit issues to senior management and members.
- 12 The main area remaining for attention relates to partnerships. Partnership assurances and access rights are covered in the IA strategy and also in the recent key partnership agreements (eg the LAA), however not all partnership agreements set up before the strategy was approved contain protocols for assurances or access rights. The memorandum of understanding with the PCT is under development to enable reliance to be placed on assurance by other auditors, this is still in draft.
- 13 All IA staff have received fraud and corruption awareness training. Internal Audit's fraud response plan specifically states that the CIA should be notified of any suspected or detected fraud, corruption or impropriety.

#### **Recommendations**

*R1 Finalise the memorandum of understanding with the PCT to enable reliance to be placed on assurance provided by other auditors.*

*R2 Review partnership agreements currently in place to identify whether they include protocols for assurances and access rights, and update agreements as necessary.*

## Ethics for Internal Auditors

**CIPFA principle:** *Internal Auditors should demonstrate integrity in all aspects of their work and should not be unduly influenced by personal interests or the views of others. They should apply knowledge, skills and experience to their work, seeking additional advice and support where necessary to ensure work is carried out competently, and must safeguard the information they receive in carrying out these duties.*

**Internal Audit meets this standard.**

- 14 The Council's new IA arrangements recognise the need to ensure that the principles of integrity, objectivity, competence and confidentiality are observed by all staff.
- 15 Whereas previously audit staff specialised in areas and therefore completed the same audits each year, the practice from 2007/08 is that staff will be rotated. Where a member of staff has had a previous operational role within a department, they are restricted from auditing within that department for an appropriate period.
- 16 IA staff are reminded annually ethical responsibilities, and ethics are included in the internal audit manual.
- 17 We found no evidence that IA are not perceived by auditees as being objective and free from conflicts of interest. This is further supported by the feedback questionnaire, introduced in April 2007.



## Relationships with management, other auditors and other review bodies

**CIPFA Principle:** *The head of Internal Audit should seek to co-ordinate Internal Audit plans and activities with line managers, other internal auditors, External Audit, inspection bodies and other review agencies to ensure the most effective audit coverage is achieved and duplication of effort is minimised.*

**Internal Audit partly meets this standard.**

- 18 Progress has been made against this standard for communication with management since our 2005 review. The CIA holds consultation meetings with individual Executive Directors and attends Chief Officers Management Team (COMT) meetings each quarter. The audit strategy covers working relationships with management and elected members and is equivalent to a protocol.
- 19 External relationships could be improved further. The memorandum of understanding (protocol) for working with the PCT is still in draft (see recommendation R1), and there are no protocols for working with other regulators and inspectors. In practice there is limited dialogue with other bodies eg Ofsted, although any reports produced are taken into account by IA.
- 20 There is a good working relationship between internal and external audit, and regular meetings are held to share knowledge and to ensure work plans are co-ordinated. We will not be placing reliance on the work of IA to reduce our testing in 2007/08, but will seek to do so going forward as the IA change programme is now predominantly completed.

## Staffing, training and continuing professional development

**CIPFA principles:** *Internal Audit should be appropriately staffed in terms of numbers, grades, qualification levels and experience having regard to its objectives and to CIPFA standards. Internal auditors should be properly trained to fulfil their responsibilities and should maintain their professional competence through an appropriate ongoing development programme.*

**Internal Audit meets this standard.**

- 21 We expressed concerns in our 2005 review about the adequacy of senior and experienced staff to support the newly appointed Head of Internal Audit, the low proportion of professionally qualified staff and the sufficiency of overall resources to deliver the audits and participate in continuing professional development. Since our initial review the Head of Internal Audit has been replaced by a new CIA, who is experienced in both internal audit and management.
- 22 A robust staffing establishment has been agreed, with an appropriate proportion of qualified posts. The majority of posts have now been filled, and there are arrangements in place with external bodies to provide specialist services as required.
- 23 Competencies have been defined for each level of auditor, and each piece of work undertaken is assessed against these competencies. These assessments are used for annual performance assessments and to identify individual training needs.

## Undertaking audit work

**CIPFA statements:** *For each audit assignment, a brief should be prepared, discussed and agreed with relevant line managers. These briefs should establish the objectives, scope and timing for the assignment and its resource and reporting requirements. Assignments intended to provide an audit opinion should be undertaken using a risk-based systematic approach. Internal Audit should follow up on management action arising from its assignments. Where follow-up reveals changes that would impact on the original audit opinion the revised opinion should be reported to the appropriate level of management.*

**Internal Audit meets this standard.**

- 24 We made a number of recommendations associated with this standard following our 2005 review. This year, we have reviewed 4 audit files to determine whether our recommendations have been implemented and IA work is now compliant with standards. Our sample was chosen to include a selection of audit staff.
- 25 In previous years, IA's work has been systems/compliance focussed rather than based on a risk assessment. A risk based approach has been adopted for 2007/08 onwards.
- 26 Terms of reference are prepared for each audit assignment, and showed evidence of agreement either by being signed or electronically.
- 27 The audit strategy sets out the quality review process for each audit and also the method for reporting findings.
- 28 The standard for audit documentation and working papers is set out in the audit strategy. From the sample tested, this is now being followed consistently.
- 29 There is a defined policy for the retention of documentation and for access to audit documents which complies with appropriate legislation.

## Due professional care

**CIPFA Principles:** *Due professional care is the care and skill that prudent and competent internal auditors will apply in performing their duties. Due professional care should be appropriate to the objectives, complexity, nature and materiality of the audit being performed. Due care is working with competence, diligence and the use of audit skills, knowledge and judgement based on appropriate experience, training (including continuing professional development), ability, integrity and objectivity).*

**Internal Audit meets this standard.**

- 30 The CIPFA Code cites a range of requirements that should be placed on individual audit staff in order to demonstrate due professional care. The Council has now covered all of these requirements in various key documents.
- 31 The CIA has established a monitoring and review programme to ensure that due professional care is maintained. Our review has shown that audit files are now of a consistently high standard.
- 32 There are arrangements in place to disclose suspicions of fraud, corruption or improper conduct, and these are covered by the Council's whistleblowing policy.

## Performance, quality and effectiveness

**CIPFA principles:** *Internal Audit work should be controlled at each level of operation to ensure that a continuously effective level of performance, compliant with CIPFA standards, is being maintained. The head of Internal Audit should develop a quality assurance programme designed to gain assurance by both internal and external review that the work of Internal Audit is compliant with these standards and achieves its objectives, and to sustain a commentary on compliance with these standards in the annual audit report.*

**Internal Audit meets this standard.**

- 33 In our 2005 report we recommended the identification of key performance measures for regular monitoring and reporting and establishment of appropriate arrangements for periodic independent quality reviews.
- 34 IA is monitored against an agreed set of KPIs, which are reported to the Audit Committee. Software to facilitate performance reporting is being implemented.
- 35 Feedback is obtained from auditees for each assignment completed and periodically for the IA service as a whole.
- 36 The Head of Internal Audit from the Isle of Wight Council is currently undertaking a peer review. The results of this work are not yet available.
- 37 The Council has developed and implemented an audit manual.

## Appendix 1 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
7	R1 Finalise the memorandum of understanding with the PCT to enable reliance to be placed on assurance provided by other auditors.	2	Chief Internal Auditor	Yes	Consultation will recommence with the PCT with a view to establishing an appropriate memorandum of understanding by October 2008.	31 October 2008
7	R2 Review partnership agreements currently in place to identify whether they include protocols for assurances and access rights, and update agreements as necessary.	3	Solicitor to the Council	Yes	<p>The requirement for audit rights (internal and external) within partnership agreements is to be written into the Council’s new “Partnership Protocol”.</p> <p>Within the protocol, Executive Directors will be required to ensure audit rights are written into all new partnership agreements. The protocol will require Executive Directors to review all existing partnership arrangements to ensure governance arrangements meet the Council’s standards, enabling audit rights to be included where this is not currently the case.</p>	<p>31 October 2008</p> <p>Ongoing</p>