



INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

# Bury MBC

Review of Internal Audit

14 March 2006 - DRAFT REPORT

AUDIT

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# 1 Executive summary

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## 1.1 Overall conclusions

From the review of Internal Audit we have concluded that the section is an integral part of Bury Metropolitan Borough Council (BMBC) and contributes to the overall internal control arrangements.

Internal Audit has developed good practice in a number of areas, including:

- 1 developing the Audit and Risk Management Charter;
- 1 consulting senior management in the development of the audit plan;
- 1 Issuing a final audit opinion each year;
- 1 identifying training needs through a well documented appraisal process;
- 1 the need for staff to complete Certificate of Independence forms; and
- 1 reviewing all work undertaken in the Internal Audit section and spot checks being performed by the Chief Internal Auditor to assess the quality of work.

The table overleaf outlines our assessment of whether Internal Audit has met the standards in CIPFA's Code of Practice for Internal Audit, that the section has chosen to adopt.

## 1 Executive summary (cont.)

Standard	Whether Internal Audit has met the standard
Scope of Internal Audit	Achieved
Independence	Achieved
Audit Committee or Equivalents	Achieved *
Relationships	Achieved
Staffing, Training and Development	Achieved
Audit Strategy	Partly achieved
Management of Audit Assignments	Achieved
Due Professional Care	Achieved
Reporting	Achieved *
Quality Assurance	Achieved

The table shows nine areas where Internal Audit has achieved the standard. There are two areas (\*) where further developments will improve compliance with the standards. These are discussed in the body of the report.

Developments in the audit strategy in order to meet the standards include:

- 1 making proactive work performed in fraud risk areas more explicit;
- 1 introducing prioritised recommendations in reports; and
- 1 developing and completing an Internal Audit Manual.

# 1 Executive summary *(cont.)*

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## 1.2 The way forward

The action plan that accompanies this report (section 13) will be followed up during the course of our 2006/07 audit work.

## 2 Introduction

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### 2.1 Internal Audit

Internal Audit is an assurance function that primarily provides an independent and objective opinion to the organisation on the control environment comprising risk management, control and governance by evaluating its effectiveness in achieving the organisation's objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources.

### 2.2 Background

Internal Audit (now named Audit and Risk Management) at BMBC is a long established section managed by the Head of Audit and Risk Management, who reports to the Director of Finance and E-Government in the Chief Executive's department.

Internal Audit comprises 11 full time equivalent staff members who have a range of experience and relevant qualifications. However, one of the Internal Audit posts is currently vacant. A post has been created for a risk manager, however, at the time of our review this post was still vacant.

### 2.3 Audit approach

We have reviewed Internal Audit's work against the standards in the CIPFA Code of Practice for Internal Audit in Local Government, as listed below. More details of what each standard requires, the good practice demonstrated by BMBC and the scope for improvement are in the relevant sections of this report.

- 1 scope of internal audit (section 3);
- 1 independence (section 4);
- 1 audit committees or equivalent (section 5);
- 1 relationships (section 6);
- 1 staffing, training and development (section 7);
- 1 audit strategy (section 8);

## 2 Introduction *(cont.)*

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- 1 management of audit assignments (section 9);
- 1 due professional care (section 10);
- 1 reporting (section 11); and
- 1 quality assurance (section 12).

We established the arrangements in place and evaluated their adequacy in practice by discussions with Internal Audit officers and reviewing Internal Audit documents such as:

- 1 audit plans;
- 1 audit working papers/files;
  - 1 debtors
  - 1 treasury management
  - 1 income control
- 1 audit reports;
- 1 audit charter; and
- 1 Internal Audit manual.

This review has not focused on the detailed work completed by Internal Audit.

## 3 Scope of Internal Audit

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### 3.1 The Standard

To achieve full effectiveness the terms of reference should be formally defined and should establish Internal Audit's responsibilities and objectives, reporting lines and rights of access.

The standard also states that:

- 1 provision should be made to form an opinion on key systems operated for other bodies
- 1 the scope of Internal Audit should be dependent on the results of the organisation's risk management processes
- 1 arrangements should be in place to ensure all cases of suspected fraud and corruption are referred to Internal Audit.

### 3.2 Good practice at BMBC

Internal Audit has developed a Charter, which forms the terms of reference, and has discussed this with BMBC's management. The Internal Audit Charter sets out the definition of Internal Audit, the section's objectives, including the approach to audits, Internal Audit's access rights, what standards will be followed and the section's responsibilities. This helps to establish the section within the Council.

Internal Audit has developed an audit approach which encompasses the risk management processes of BMBC.

Internal Audit's responsibilities have recently been extended to include Six Town Housing, the recently formed Arm's Length Management Organisation of the Authority. Internal Audit has a separate Service Level Agreement with Six Town Housing for the provision of this service, however, in 2006/07 this audit will be conducted under the Strategic Housing Unit under the s151 officer.

### 3.3 Scope for improvement

Whilst a Charter has been developed and discussed with management, this has not yet been approved by the Audit Committee. In addition, the charter does not form part of the Constitution of the Council nor is it referred to.



### 3 Scope of Internal Audit (*cont.*)

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The Internal Audit Charter documents areas of Internal Audit's work, for instance fraud and irregularity, but no further details are provided. Good practice and examples from other authorities show a greater level of detail is provided. For example, the Charter could explain what a systems audit entails, so for example documenting systems and testing that system to ensure it is operating as documented. Or what the role of Internal Audit is in the fraud and irregularity audit work. Internal Audit has demonstrated good practice here, however, with the development of the service level agreements.

#### **Recommendation 1**

Internal Audit need to ensure the Charter is approved by the Audit Committee and then referred to in BMBC's Constitution. The Charter should be reviewed and approved by the Audit Committee on a regular basis.

#### **Recommendation 2**

Internal Audit should improve the documentation in the Charter of the different types of work that they undertake.

#### **3.4 Overall assessment**

The overall assessment is that the standard has been achieved. This assessment has been made on the basis that no significant areas with scope for improvement were identified.

## 4 Independence

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### 4.1 The Standard

Internal Audit should be sufficiently independent of the activities that it audits to enable auditors to perform their duties in a manner which facilitates impartial and effective professional judgements and recommendations. Internal auditors should have no operational responsibilities.

The status of Internal Audit and the Head of Internal Audit, and the rights of access to records, assets, personnel and premises have significant impact on the ability of Internal Audit to maintain its independence.

### 4.2 Good practice at BMBC

Individual internal auditors have no operational duties.

The Audit and Risk Management Charter and the Constitution of the Council promote independence by providing sufficient rights to access and where necessary the rights to report directly to the Chief Executive.

Ethical guidance and *Certificates of Independence* are issued to each member of the section for completion to identify any areas where independence may be threatened.

### 4.3 Scope for improvement

Internal Audit has been advising management during the implementation of the new financial systems at the Council. For example, advising the Authority on what steps to take to ensure the smooth migration of data. As Internal Audit were merely offering advice there were no specific areas for improvement noted, however, Internal Audit should ensure that mechanisms are in place to maintain independence, especially in areas where they are assisting the Authority. If appropriate mechanisms are not in place this could threaten Internal Audit's ability to remain objective.

#### Recommendation 3

Internal Audit should ensure appropriate mechanisms are in place in areas where the section is assisting the Authority.

## 4 Independence (*cont.*)

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### 4.4 Overall assessment

The overall assessment is that the standard has been achieved. This assessment has been made on the basis that no significant areas with scope for improvement were identified.

## 5 Audit Committees or Equivalent

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### 5.1 The Standard

The main objective of an audit committee or equivalent is to independently contribute to the organisation's overall process for ensuring that an effective internal control environment is maintained. The primary focus of this work has historically related to internal financial control matters such as the safeguarding of assets, the maintenance of proper accounting records and the reliability of financial information. With the requirement to make wider the statements on internal control, organisations are increasingly looking to audit committees to provide assurance on wider arrangements relating to all internal controls.

### 5.2 Good practice at BMBC

A review of Audit Committee papers identified Internal Audit regularly update the Audit Committee on the progress on their plan and all their reports go to the Audit Committee. Overall Internal Audit believes that the relationship with the Audit Committee is good.

### 5.3 Scope for development

Internal Audit produce qualitative information for the Director of Finance and E-Government on a monthly basis. To strengthen the effectiveness of the Audit Committee's review of Internal Audit's performance this information should be summarised and presented to Audit Committee.

#### **Recommendation 4**

Internal Audit should present the qualitative information produced for the Director of Finance and E-Government to the Audit Committee on a periodic basis.

### 5.4 Overall assessment

The overall assessment is that the standard has been achieved. This assessment has been made on the basis that the scope for development identifies an area where Internal Audit currently comply with the standard but need to ensure that information is circulated to a wider audience.

## 6 Relationships

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### 6.1 The Standard

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

### 6.2 Good practice at BMBC

The audit plan is prepared on the basis of discussions with Chief Officers. Once the plan has been developed this is taken to the management board for approval.

The timing of audit assignments is agreed with the relevant officer where this does not conflict with the nature of the assignments.

The Authority's external auditors are new and the relationship between external and internal audit is developing well.

### 6.3 Scope for improvement

Internal Audit has a contact in the Police, although it is noted this regularly changes. Internal Audit should not allow this to stop them agreeing a formal written protocol for dealing with the Police, not only for itself but for the whole Council. A formal written protocol will ensure that both the Police and Internal Audit know what the procedure is for communicating. This will formalise the relationship making communication channels clearer.

#### Recommendation 5

Internal Audit should ensure a written protocol for dealing with the Police is agreed and adopted

### 6.4 Overall assessment

The overall assessment is that the standard has been achieved. This assessment has been made on the basis the scope for improvement only identifies a minor area of non compliance with the standard.

## 7 Staffing, Training and Development

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### 7.1 The Standard

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

### 7.2 Good practice at BMBC

Overall Internal Audit is staffed appropriately in terms of grades and qualifications, although it is noted that there are some vacancies.

Internal Audit staff have attended appropriate training courses where necessary and training needs are monitored through the use of a documented appraisal process.

### 7.3 Scope for improvement

Internal Audit maintains records of training undertaken by staff in the section and training needs identified, however, upon inspection of these during the review it was identified that these records were out of date by a number of months.

#### Recommendation 6

Internal Audit should ensure that training records are updated on a regular basis, to ensure that training is obtained on a timely basis.

### 7.4 Overall assessment

The overall assessment is that the standard has been achieved. This assessment has been made on the basis the scope for improvement is a minor area of non compliance with the standard.

## 8 Audit Strategy

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### 8.1 The Standard

The audit strategy is the high-level statement of how the Internal Audit service will be delivered and developed. It can be presented as a document in its own right or integrated into an existing document, such as the business or service plan. To implement the audit strategy, Internal Audit should prepare a risk-based audit plan.

### 8.2 Good practice at BMBC

Internal Audit has produced an audit plan which contains Internal Audit's strategy.

Internal Audit's audit plan is risk-based and has sections to identify the resources required and the resources available. Internal Audit recognises the need to remain flexible and to reprioritise the plan if required, although a formal contingency is not in place.

### 8.3 Scope for improvement

The audit plan is risk-based, however Internal Audit needs to ensure documentation is available that shows how the risk based approach has been applied in developing the audit plan.

The annual audit plan produced by Internal Audit does not document with sufficient information the areas to be covered. Monthly plans are produced within the team and these do provide further details of the work to be performed. The monthly plans are for the audit teams' purposes.

The audit strategy does not separately assess fraud risk. Fraud risk should be separately assessed to identify the need for proactive fraud work. At present all proactive fraud work is carried out in the course of normal audits, rather than having it explicitly stated on the plan.

During 2005 Internal Audit has been involved with the Authority's implementation of new financial systems. Internal Audit needs to ensure where they are involved, the audit planning documentation is updated to reflect the reason for their involvement.

## 8 Audit Strategy (cont.)

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### Recommendation 7

Internal Audit should ensure the risk based approach to developing an annual plan is documented to show how the plan is developed. This should also include subsequent amendments to the plan.

### Recommendation 8

The annual audit plan should provide more information on the scope and objective of individual audit assignments, where this does not conflict with the nature of the assignment.

### Recommendation 9

Internal Audit should make proactive fraud work more explicit in audit plans and work, as at present this is carried out as part of each assignment.

### 8.4 Overall assessment

The overall assessment is that the standard has only been partly achieved. This assessment has been made on the basis the scope for improvement identifies significant areas of non compliance with the standard.



## 9 Management of Audit Assignments

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### 9.1 The Standard

The management of audit assignments should ensure audit assignments have appropriately detailed briefs. A systematic approach should be applied in conducting the assignment. All assignments should be documented to the standard required by the Head of Internal Audit. The Head of Internal Audit should also identify arrangements for following up previous audit findings.

### 9.2 Good practice at BMBC

Internal Audit's working papers are sufficiently complete and detailed to enable an experienced internal auditor, with no previous connections with the audit assignment, to ascertain from them what work was performed and to support the conclusions reached.

Internal Audit has implemented timely and adequate arrangements to follow up work conducted.

### 9.3 Scope for improvement

Guidance was not present in the audit manual in relation to the performance of controls evaluation. It is understood that Internal Audit use the CIPFA matrices to assess the adequacy of controls, so this could be explained in the audit manual. In addition, where certain tests have been undertaken and others have not, individual files have not documented the methodology for the selection.

#### Recommendation 10

Guidance in relation to controls evaluation should be inserted in the Internal Audit Manual. In addition, the methodology behind the selection of audit tests should also be documented on the audit file.

### 9.4 Overall assessment

The overall assessment is that the standard has been achieved. This assessment has been made on the basis the scope for improvement only identifies a minor area of non compliance with the standard.

## 10 Due Professional Care

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### 10.1 The Standard

Due professional care is the care and skill that prudent and competent internal auditors will apply in performing their duties.

- 1 Due care is working with competence and diligence. It does not imply infallibility.
- 1 Due professional care is the use of audit skills, knowledge and judgement based on appropriate experience, training (including continuing professional development), ability, integrity and objectivity.

Due professional care should be appropriate to the objectives, complexity, nature and materiality of the audit being performed.

### 10.2 Good practice at BMBC

All work conducted by Internal Audit is subject to a quality assurance review by a more senior officer in Internal Audit. This process is documented on the audit file.

The review of individual Internal Audit assignments, conducted as part of this review, did not identify any cases where there were concerns that facts had been incorrectly recorded or reported.

### 10.3 Scope for improvement

Procedures have been laid out in the Fraud and Irregularity section of the Internal Audit manual for auditors if they suspect fraud, corruption or improper conduct. However, it was noted that this section of the Internal Audit manual was not complete, as the section on Authority/Audit policies had no text within the section.

#### Recommendation 11

The Fraud and Irregularity section of the Internal Audit manual should be completed to ensure auditors are aware of all of the issues in this area.

## 10 Due Professional Care *(cont.)*

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### 10.4 Overall assessment

The overall assessment is that the standard has been achieved. This assessment has been made on the basis the scope for improvement only identifies a minor area of non compliance with the standard.

# 11 Reporting

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## 11.1 The Standard

The Head of Internal Audit should determine the way in which audit assignments and their results will be reported, subject to the CIPFA standards and the requirements of those charged with governance. An important requirement is to formally report annually on a number of factors which include:

- 1 an opinion on the overall adequacy and effectiveness of the organisation's internal control environment
- 1 a summary of the audit work undertaken to formulate the opinion
- 1 a statement on whether Internal Audit comply with the CIPFA standards
- 1 a summary of Internal Audit's performance.

## 11.2 Good practice at BMBC

Internal Audit reports include:

- 1 purpose and scope of the audit
- 1 recommendations
- 1 agreed action.

## 11.3 Scope for development

An interim review of the Statement of Internal Control was presented to the Audit Committee by the Director of Finance and E-Government on 31 January 2006. Whilst this reviewed the progress against the action plan it did not include an interim opinion given by Internal Audit on the control environment of the Authority, which is a requirement of the Code.

Internal Audit reports do not include prioritised recommendations. Prioritised recommendations help to identify the respective risk of the issues raised.

## 11 Reporting (*cont.*)

### Recommendation 12

As required by the CIPFA standard, Internal Audit should formally issue:

- 1 an interim opinion on the overall adequacy and effectiveness of BMBC's internal control environment
- 1 any qualifications to the opinion.

### Recommendation 13

Internal Audit should introduce prioritisation to recommendations in reports.

#### 11.4 Overall assessment

The overall assessment is that the standard has been achieved. This assessment has been made on the basis that the scope for development identifies areas where compliance with best practice would enhance the reporting processes.

## 12 Quality Assurance

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### 12.1 The Standard

The work of Internal Audit should be controlled at each level of operation to ensure that a continuously effective level of performance, compliant with the CIPFA standards, is being maintained.

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 the CIPFA standards and achieves its objectives, and to sustain a commentary on compliance with these standards in the annual audit report.

### 12.2 Good practice at BMBC

Individual audit assignments are reviewed by a more senior member of staff independent to those who conducted the work.

Spot checks are performed by the Chief Internal Auditor on random Internal Audit assignments to ensure that quality has been maintained during the audit process.

Internal Audit is monitored by the Director of Finance and E-Government on a wide range of both quantitative and qualitative performance indicators.

Internal Audit issue a questionnaire to the audit clients after the assignment has been completed and the results from these questionnaires feed into the performance indicators monitored by the Director of Finance and E-Government.

### 12.3 Scope for improvement

During the review it was noted that Internal Audit has their own Internal Audit Manual, which is not complete, and the section also use the CIPFA best practice manual. This may create inconsistencies within the section if staff are unsure about which manual to use. Internal Audit should use one Internal Audit Manual by either completing the existing local Internal Audit Manual or by developing a new manual based on the best practices suggested by CIPFA.

Internal Audit currently presents a number of performance indicators to the Director of Finance and E-Government. The Audit Committee's ability to assess the performance of Internal Audit would be enhanced if this information was summarised and provided to the members of the Audit Committee. This issue is discussed at section 5 of the report.

## 12 Quality Assurance *(cont.)*

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### **Recommendation 14**

Internal Audit should adopt one manual and use the chosen manual consistently.

### **12.4 Overall assessment**

The overall assessment is that the standard has been achieved. This assessment has been made on the basis the scope for improvement only identifies a minor area of non compliance with the standard.

## 13 Management Action Plan

The recommendations from this review are to be addressed by BMBC as shown in the table below.

Recommendation	Priority	Response	Responsibility	Due date
Internal Audit need to ensure the Charter is approved by the Audit Committee and then referred to in BMBC's Constitution. The Charter should be reviewed and approved by the Audit Committee on a regular basis.	Low	<ul style="list-style-type: none"> <li>1 Agreed :-</li> <li>1 Will seek Committee Approval for Audit Charter</li> <li>1 Will arrange for inclusion in Council Constitution.</li> <li>1 Will review and present to Audit committee annually</li> </ul>	<ul style="list-style-type: none"> <li>1 Head of Audit and Risk Management</li> <li>1 Head of Audit and Risk Management</li> <li>1 Head of Audit and Risk Management</li> </ul>	<ul style="list-style-type: none"> <li>1 June 2006</li> <li>1 July 2006</li> <li>1 Yearly - June</li> </ul>
Internal Audit should improve the documentation in the Charter of the different types of work that they undertake.	Medium	<ul style="list-style-type: none"> <li>1 Agreed</li> </ul>	<ul style="list-style-type: none"> <li>1 Group Auditors</li> </ul>	<ul style="list-style-type: none"> <li>1 April 2006</li> </ul>



## Management Action Plan (cont.)

Recommendation	Priority	Response	Responsibility	Due date
Internal Audit should ensure appropriate mechanisms are in place in areas where the section is assisting the Authority.	High	1 Agreed - Any advice and assistance which may possibly conflict with Audit's independence will be discussed at weekly progress meetings between Group Auditors and Head of Audit and Risk Management	1 All audit staff	1 Wef March 2006
Internal Audit should present the qualitative information produced for the Director of Finance and E-Government to the Audit Committee on a periodic basis.	Low	1 Agreed – quarterly performance information will be provided to each Audit Committee	1 Head of Audit and Risk Management	1 June 2006

## Management Action Plan (cont.)

Recommendation	Priority	Response	Responsibility	Due date
Internal Audit should ensure a written protocol for dealing with the Police is agreed and adopted.	Low	1 Agreed – will formalise the relationship with the Police and produce a written protocol	1 Head of Audit and Risk Management and the Director of Finance and E-Government	1 June 2006
Internal Audit should ensure that training records are updated on a regular basis, to ensure that training is obtained on a timely basis.	Medium	1 Agreed 1 Consult with Training and Development Section 1 Update current training records 1 Conduct in year reviews	1 Head of Audit and Risk Management 1 Head of Audit and Risk Management 1 Head of Audit and Risk Management and Group Auditors	1 June 2006 1 August 2006 1 Dec 2006

## Management Action Plan (cont.)

Recommendation	Priority	Response	Responsibility	Due date
Internal Audit should ensure the risk based approach to developing an annual plan is documented to show how the plan is developed. This should also include subsequent amendments to the plan.	High	1 Agreed	1 Head of Audit and Risk Management and Group Auditors	1 To start April 2006 and end March 2007
The annual audit plan should provide more information on the scope and objective of individual audit assignments, where this does not conflict with the nature of the assignment.	High	1 Agreed	1 Head of Audit and Risk Management and Group Auditors	1 To start April 2006 and end March 2007

## Management Action Plan (cont.)

Recommendation	Priority	Response	Responsibility	Due date
Internal Audit should make proactive fraud work more explicit in audit plans and work, as at present this is carried out as part of each assignment.	Medium	1 Agreed	1 Head of Audit and Risk Management	1 Dec 2006
Guidance in relation to controls evaluation should be inserted in the Internal Audit Manual. In addition, the methodology behind the selection of audit tests should also be documented on the audit file.	Medium	1 Agreed 1 The audit manual will be updated accordingly 1 Testing methodology will be recorded on audit files	1 Head of Audit and Risk Management 1 All audit staff	1 Dec 2006 1 Wef April 2006

## Management Action Plan (cont.)

Recommendation	Priority	Response	Responsibility	Due date
The Fraud and Irregularity section of the Internal Audit manual should be completed to ensure auditors are aware of all of the issues in this area.	Medium	1 Agreed – the manual will be updated accordingly	1 Head of Audit and Risk Management	1 Dec 2006

## Management Action Plan (cont.)

Recommendation	Priority	Response	Responsibility	Due date
<p>As required by the CIPFA standard, Internal Audit should formally issue:</p> <ul style="list-style-type: none"> <li>1 an interim opinion on the overall adequacy and effectiveness of BMBC's internal control environment</li> <li>1 any qualifications to the opinion.</li> </ul>	Medium	<ul style="list-style-type: none"> <li>1 Agreed an interim position statement will be produced and presented to the Audit Committee.</li> </ul>	<ul style="list-style-type: none"> <li>1 Head of Audit and Risk Management</li> </ul>	<ul style="list-style-type: none"> <li>1 Oct 2006</li> </ul>

## Management Action Plan (cont.)

Recommendation	Priority	Response	Responsibility	Due date
Internal Audit should introduce prioritisation to recommendations in reports.	Medium	1 Agreed methods of prioritising recommendations to be researched and the most appropriate adopted	1 Head of Audit and Risk Management and Group Auditors	1 April 2007
Internal Audit should adopt one manual and use the chosen manual consistently.	Low	1 Agreed	1 Head of Audit and Risk Management	1 Dec 2006