



INFRASTRUCTURE AND GOVERNMENT

Review of Internal Audit

Bury MBC

November 2009

AUDIT

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1. Executive Summary

1.1 Overall Conclusion

Internal Audit at Bury Metropolitan Borough Council (BMBC) is a long established department that is well integrated in the Council. The function carries out a wide range of reviews across the Council, the findings of which are used to form an opinion on the overall control framework. They also have involvement in investigating fraud, corruption or improper conduct that is suspected or detected. In conclusion, the Internal Audit function contributes to the Council's system of internal control.

From the review of Internal Audit the following good practice points have been identified:

- 1 Terms of Reference and an Internal Audit Manual, that details the role of Internal Audit, are in place.
- 1 Internal Audit maintain good relationships with management through consultation in relation to planning and reporting.
- 1 A wide range of performance indicators have been introduced and are reported regularly to Audit Committee.
- 1 Internal Audit provide an opinion on the overall control framework annually.
- 1 All audit staff maintain independence, are aware of their ethical responsibilities and have received adequate training to fulfil their role.

Internal Audit have achieved the standard in each of the 11 areas set out in the CIPFA Code of Practice on Internal Audit in Local Government in the United Kingdom. However, there are five areas (*) where further developments will enhance current compliance with the standards. These are discussed in the body of the report.

| Standard | Conclusion |
|--|------------|
| Scope of Internal Audit | Achieved* |
| Independence | Achieved |
| Ethics for Internal Auditors | Achieved |
| Audit Committee | Achieved* |
| Relationships | Achieved |
| Staffing, Training and CPD | Achieved |
| Audit Strategy and Planning | Achieved* |
| Undertaking Audit Work | Achieved* |
| Due Professional Care | Achieved |
| Reporting | Achieved* |
| Performance, Quality and Effectiveness | Achieved |

1. Executive Summary (continued)

1.2 The Way Forward

The action plan that accompanies this report (section 14) will be followed up during the course of our 2009/10 audit work.

1.3 Follow Up of Previous Recommendations made

During the 2005/06 review of Internal Audit, we made a number of recommendations. Since this review we have followed up these recommendations to ensure that they have been implemented.

| | Implemented | Partially implemented | Outstanding | Total |
|------------------------|-------------|-----------------------|-------------|-------|
| Recommendations | 10 | 1 | 0 | 11 |

2. Introduction

2.1 Definition of Internal Audit as per the Code

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

Every three years we, as external auditors, are required to review Internal Audit against the CIPFA Code of Practice. Our last review took place in 2005/06. In the interim years we revisit and update this assessment to assist us in our assessment of whether we are able to place reliance on the work of Internal Audit.

Internal Audit at BMBC is a long established section managed by the Head of Internal Audit, who reports to the Director of Finance and E-Government in the Chief Executive’s department, via the Head of Strategic Finance. Since our last review the Head of the service has changed. In addition, the service has been implementing the recommendations we previously raised.

Internal Audit comprises nine full time equivalent staff members who have a range of experience and relevant qualifications.

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 Ethics for Internal Auditors (section 5);
- 1 Audit committees (section 6);
- 1 Relationships (section 7);
- 1 Staffing, training and development (section 8);
- 1 Audit strategy and planning (section 9);
- 1 Undertaking audit work (section 10);
- 1 Due professional care (section 11);
- 1 Reporting (section 12); and
- 1 Performance, Quality and Effectiveness (section 13).

2. Introduction (continued)

We established what arrangements were in place in relation to each of the standards of the code and evaluated their adequacy in practice through discussions with Internal Audit officers and reviewing Internal Audit documents such as:

- 1 audit plans;
- 1 audit working papers/files including:
 - Debtors;
 - Housing benefit; and
 - Council tax valuations.
- 1 audit reports;
- 1 Internal Audit terms of reference; and
- 1 Internal Audit manual.

This review has focused on the approach used by Internal Audit rather than the detailed testing undertaken by Internal Audit.

3. Scope of Internal Audit

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

3.2 Good Practice Points

Formal terms of reference are in place that clearly define the objectives and responsibilities of Internal Audit, the reporting lines and their rights of access.

There is an anti-fraud and corruption policy in place that defines the role of Internal Audit in detecting fraud during the course of their audit work and also the arrangements in place to ensure that the Head of Internal Audit is informed of suspected or detected fraud, corruption or improper conduct.

3.3 Scope for Improvement

Whilst terms of reference are in place, they have not been formally approved and reviewed by the Audit Committee since July 2007.

The terms of reference have not been updated to include Internal Audit's role in suspected or detected instances of money laundering. The terms of reference could also include the involvement of Internal Audit in the Fraud Response Team at the ALMO, Six Town Housing and the Council's Governance Panel.

Recommendation 1

Terms of reference should be reviewed and approved by the Audit Committee on an annual basis.

Recommendation 2

Terms of reference should be updated to reflect Internal Audit's new role in relation to detected and suspected instances of money laundering.

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 of scope for improvement were identified.

4. Independence

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 Points

All members of the Internal Audit team complete an annual certificate of independence that identifies any conflicts of interest that may exist.

Internal Audit have no operational duties therefore there is no conflict of interest as a result of a self review threat.

The Head of Internal Audit has been involved in the best value review of transport for the last 18 months. He has communicated with us and the Director of Finance & E-Government to ensure that the role taken on did not create a conflict of interest.

The Head of Internal Audit has the freedom to report to those charged with governance which enhances the independent nature of the Internal Audit function.

4.3 Overall assessment

The overall assessment is that the standard has been achieved.

5. Ethics for Internal Auditors

5.1 The Standard

Internal Audit should observe the four main principles of integrity, objectivity, competence, and confidentiality in the course of their work to ensure they comply with their ethical responsibilities.

5.2 Good Practice Points

Auditors are provided with ethical guidance when completing their annual certificate of independence.

All members of the audit team have the knowledge, skills and experience to carry out work in a competent manner, and can be rotated across reviews to maintain high levels of objectivity.

All members of the audit team are qualified auditors, therefore are also required to comply with the ethical codes of their professional institutes.

5.3 Overall Assessment

The overall assessment is that the standard has been achieved.

6. Audit Committee

6.1 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, as part of the Annual Governance Statement, organisations are increasingly looking to audit committees to provide assurance on wider arrangements relating to all internal controls.

6.2 Good Practice Points

Key Internal Audit documents, such as Internal Audit plan, audit reports and annual report, are presented to the Audit Committee.

The Committee also receives a quarterly assurance statement, which forms part of the Governance Framework of the Council.

The Audit Committee meet on a regular basis and Internal Audit always attend the meeting and contribute to the agenda, this facilitates an effective working relationship between the two.

6.3 Scope for Improvement

Internal Audit provide the Audit Committee with a range of information performance monitoring information, this includes progress reports of performance against audit plan and a range of performance indicators. This does comply with the requirement of the standard, however the compliance could be strengthen through ensuring that the Members of the Committee find the level and type of information adequate for their needs.

Recommendation 3

Internal Audit should carry out a formal exercise to determine if Members of the Audit Committee are satisfied with the level and type of performance monitoring information provided to them and to identify any additional information required.

6.4 Overall Assessment

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

7. Relationships

7.1 The Standard

Internal Audit is involved in a wide range of relationships, the quality of which impacts on the effective delivery of the audit service. Internal Audit should maintain good relationships with management, other internal auditors, external auditors, regulators and elected members.

7.2 Good Practice Points

Internal Audit maintain good working relationships with the Council's management through consulting key officers during the planning process, recording the scope and timing of audit work and prior to finalising reports.

Internal Audit meet regularly with External Audit. This is a good working relationship which results in both parties being able to rely on each others work in order to avoid duplication of effort.

Internal Audit are also members of a number of AGMA working groups, such as the Chief Internal Auditors. This allows the function to share knowledge with and learn from other auditors in order to develop Internal Audit services across Greater Manchester.

7.3 Overall Assessment

The overall assessment is that the standard has been achieved.

8. Staffing, Training and Continuing Professional Development

8.1 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.

8.2 Good Practice Points

Internal Audit is appropriately staffed both in terms of numbers and experience. Bury also have a very stable staff base which means that all members of the team have a good knowledge of the Council and the system's used.

When compared in CIPFA's benchmarking exercise, Bury's Internal Audit function have an appropriate level of staff.

Staff attend various training courses based on their individual needs and adequate training records are maintained by the Head of Internal Audit. Needs are identified through the staff appraisal process.

We have confirmed with the Head of IA the qualifications of each member of the team and are satisfied that these are adequate.

8.3 Overall Assessment

The overall assessment is that the standard has been achieved.

9. Audit Strategy and Planning

9.1 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.

9.2 Good Practice Points

Internal Audit take risk into consideration when determining their annual audit plan. This is done through the use of both the corporate risk register and departmental risk registers, to ensure that they focus their plan on the areas that pose the greatest threat to the achievement of the Council's objectives.

9.3 Scope for Improvement

The audit plan currently states the name of the review but does not give any specific detail regarding the scope or objectives of the audit. This could result in a lack of clarity and understanding between what Internal Audit are planning to do and what key officers and committee members are expecting them to do.

Recommendation 4

Additional detail should be added to the annual audit plan to provide management and committee members with a clearer understanding of the work Internal Audit will undertake. This should include a brief description of the work to be performed and the objectives of the audit, where this does not conflict with the nature of the assignment concerned.

9.4 Overall Assessment

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

10. Undertaking Audit Work

10.1 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.

10.2 Good Practice Points

Internal Audit have agreed work plans in place for each review carried out that provide all necessary detail, such as objectives, budgets and supervision responsibilities.

Internal Audit use standard documentation when completing their audit work, this ensures that audit working papers are sufficiently complete and detailed to enable an experienced auditor with no previous connection to the audit to ascertain work performed and to re-perform if necessary.

10.3 Scope for Improvement

From discussion with Internal Audit and review of performance monitoring information it has been established that management generally accept and implement the recommendations made during Internal Audit reviews. Where they do not, Internal Audit will raise this through the appropriate reporting lines, usually at Audit Committee.

However, this process is not formally documented. It would be beneficial to Internal Audit, Audit Committee members and management if the process for raising issues where recommendations have not been implemented was specifically documented in the terms of reference to clarify the role of each party and aid understanding of the process.

Recommendation 5

The arrangements in place for Internal Audit to report to Audit Committee where their recommendations have not been implemented should be formally documented in the Internal Audit terms of reference.

10.4 Overall Assessment

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

11. Due Professional Care

11.1 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.

11.2 Good Practice Points

Internal Audit have sound procedures, such as the quality review process, in place to ensure that audit staff maintain high professional standards, both in relation to ethical responsibilities and quality of work.

The Internal Audit manual details the specific procedures in place for individual auditors to disclose suspicions of fraud, corruption or improper conduct.

11.3 Overall Assessment

The overall assessment is that the standard has been achieved.

12. Reporting

12.1 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; and
- 1 a summary of Internal Audit's performance.

12.2 Good Practice Points

Since our last review of Internal Audit, when we raised recommendations around the methods of reporting used, the reports produced by Internal Audit have changed significantly. Reports now use a traffic light system and are in a condensed format. These changes have been well received by Audit Committee members.

Internal Audit consult with management prior to the finalisation of all Internal Audit reports. Management are required to complete an action plan and provide their responses to recommendations before the report is presented to Audit Committee, this strengthens the reporting process.

The Head of Internal Audit provides a detailed annual report to Audit Committee in which an opinion on the overall effectiveness of the internal controls is provided.

As noted in section 6.2 the Audit Committee also receives quarterly assurance statements which build up to the annual report.

12.3 Scope for Improvement

As mentioned above, the Head of Internal Audit prepares an annual audit report, the finding and opinions given in this report are then used in the preparation of the Annual Governance Statement that the Council is required to prepare.

However, Internal Audit Terms of Reference make no mention of this report and still refer to the Statement of Internal Control. Additionally, there is no mention of Internal Audit's involvement in the preparation of this statement in the Internal Audit Strategy for 2008/09.

12. Reporting (continued)

Recommendation 6

The terms of reference be updated to refer to the Annual Governance Statement and that a section on Internal Audit's role in the preparation of this statement is included in the Internal Audit Strategy. This should include detail on how the Head of Internal Audit forms his opinion on the Council's control environment.

12.4 Overall Assessment

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

13. Performance, Quality and Effectiveness

13.1 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.

13.2 Good Practice Points

There is an Internal Audit manual in place that provides detail on all aspects of Internal Audit, documenting the process for planning, control evaluation, testing and reporting. This document is available to all members of the Internal Audit team and will aid them in completing their audit work.

Internal Audit have robust supervision and review procedures in place to ensure that a high level of quality is maintained in all work that is carried out by the team, including audit work and specific investigations.

Internal Audit have introduced a comprehensive set of performance indicators that include both qualitative and quantitative measures of performance. These are regularly reported to Management and Audit Committee.

Internal Audit is a member of the CIPFA benchmarking group. This involves providing a range of information relating to the audit plan, types of review etc. Internal Audit then receive reports results comparing their performance to the average performance across the group.

13.3 Overall Assessment

The overall assessment is that the standard has been achieved.

14. 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 |
|---|----------|--|--|---|
| Terms of reference should be reviewed and approved by the Audit Committee on an annual basis. | Low | The Terms of reference have now been reviewed (Nov. 2009) and will be reviewed annually and presented to the February Audit Committee along with the Audit Plan. | Head of Internal Audit | Now complete. |
| Terms of reference should be updated to reflect Internal Audit's new role in relation to detected and suspected instances of money laundering. | Low | Update completed Nov. 2009. | Head of Internal Audit | Now complete. |
| Internal Audit should carry out a formal exercise to determine if Members of the Audit Committee are satisfied with the level and type of performance monitoring information provided to them and to identify any additional information required. | Low | A recommendation will be added to the PI report asking the Audit Committee to decide whether the performance information provided is adequate. | Head of Internal Audit Director of Finance & E-Government | As soon as possible – next PI report. |
| Additional detail should be added to the annual audit plan to provide management and committee members with a clearer understanding of the work Internal Audit will undertake. This should include a brief description of the work to be performed and the objectives of the audit, where this does not conflict with the nature of the assignment concerned. | Low | The scope and objective of audit assignments to be included in the Audit Annual Plan. | Head of Internal Audit | As soon as possible – next Audit Annual Plan. |
| The arrangements in place for Internal Audit Committee where the recommendations have not been implemented should formally documented in the Internal Audit terms of reference. | Low | Terms of reference have been updated. | Head of Internal Audit | Now complete. |

14. Management Action Plan (continued)

| Recommendation | Priority | Response | Responsibility | Due Date |
|---|------------|---|-------------------------------|----------------------|
| <p>That the terms of reference are update to refer to the Annual Governance Statement and that a section on Internal Audit's role in the preparation of this statement is included in the Internal Audit Strategy. This should include detail on how the Head of Internal Audit forms their opinion on the Council's control environment.</p> | <p>Low</p> | <p>Terms of reference updated and Audit Strategy updated.</p> | <p>Head of Internal Audit</p> | <p>Now complete.</p> |

15. Follow up findings

| Recommendation | Priority | Status |
|--|----------|--------------|
| 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 | Implemented. |
| Internal Audit should improve the documentation in the Charter of the different types of work that they undertake. | Medium | Implemented. |
| Internal Audit should ensure appropriate mechanisms are in place in areas where the section is assisting the Council. | High | Implemented. |
| 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 | Implemented. |
| The Fraud and Irregularity section of the Internal Audit manual should be completed to ensure auditors are aware of all the issues in this area. | Medium | Implemented. |
| 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 | Implemented. |
| Internal Audit should ensure a written protocol for dealing with the Police is agreed and adopted. | Low | Implemented. |
| Internal Audit should ensure that training records are updated on a regular basis, to ensure that training is obtained on a timely basis. | Medium | Implemented. |
| 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 | Implemented. |

15. Follow up findings (continued)

| Recommendation | Priority | Status |
|---|----------|----------------------------|
| 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 | Partially – see Section 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. | Medium | Implemented. |