

<b>NAME OF COMMITTEE</b>	<b>AUDIT COMMITTEE</b>
<b>DATE</b>	<b>5<sup>TH</sup> APRIL 2012</b>
<b>REPORT TITLE</b>	<b>INTERNAL AUDIT STRATEGY &amp; TERMS OF REFERENCE – 2012/13</b>
<b>Report of</b>	<b>S.151 OFFICER CHIEF INTERNAL AUDITOR</b>
<b>WARDS AFFECTED</b>	<b>ALL/CORPORATE</b>

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**Summary of report:**

The purpose of this report is to allow the Audit Committee to review the Internal Audit Strategy 2012/13, and seek their approval for the document as required by the CIPFA 'Code of Practice for Internal Audit in Local Government' (2006).

The standards for proper practice for internal audit are contained in the CIPFA Code of Practice. The Chief Internal Auditor maintains an Audit Manual which reflects these standards and sets out the procedures expected of the Council's Internal Audit team.

Both the Code of Practice and Audit Manual require that the Terms of Reference and Audit Strategy are presented to the Audit Committee for review and approval. These documents are discussed in the report with the updated Audit Strategy attached at Appendix A.

**Financial implications:**

None, within the existing budget for internal audit.

**RECOMMENDATIONS:**

**That the Audit Committee review and approve the Internal Audit Strategy 2012/13.**

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## **1. BACKGROUND**

- 1.1 The Accounts and Audit Regulations, 2003 (Regulation 6) and 2006 state that:  
*"A relevant body shall maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with the proper practices."*
- 1.2 For the purposes of the Regulations, proper practice is that contained in the CIPFA 'Code of Practice for Internal Audit in Local Government' (2006). A copy of this document has been made available to the members of the Audit Committee.
- 1.3 The Chief Internal Auditor maintains an Audit Manual which sets out the standards and procedures expected of the team and has been updated to reflect the requirements of the 2006 Code of Practice. It is not intended to present the latest version, Audit Manual 2012, to the Audit Committee because of the detailed nature of the document.
- 1.4 However both the Code of Practice and Audit Manual 2012 require that the Terms of Reference and Audit Strategy are presented to the Audit Committee for review and approval.

## **2. AUDIT STRATEGY 2012/13 (Appendix A)**

- 2.1 Standard 7 of the CIPFA Code of Practice requires the Chief Internal Auditor to produce an audit strategy, and this is also reflected in the Council's Internal Audit Manual 2012.
- 2.2 The Strategy is a high-level statement of how the internal audit service will be delivered and developed in accordance with the Terms of Reference and how it links to the organisational objectives and priorities.
- 2.3 It should be kept up to date with the organisation and its changing priorities and communicate the contribution that Internal Audit makes to the organisation and includes:
  - Internal Audit objectives and outcomes;
  - How the Chief Internal Auditor will form and evidence his or her opinion on the control environment to support the system of Internal Control and Annual Governance Statement;
  - How Internal Audit's work will identify and address significant local and national issues and risks;
  - How the service will be provided, i.e. internally, externally, or a mix of the two; and
  - The resources and skills required to deliver the strategy.
- 2.4 The Code says that the Strategy should be approved, but not directed, by the Audit Committee.

### 3. INTERNAL AUDIT: TERMS OF REFERENCE

3.1 The Terms of Reference were updated and presented to the Audit Committee in April 2010 with the following headings:

- Statutory Requirements;
- Internal Audit's Purpose, Authority and Responsibility;
- Independence;
- Audit Management;
- Scope of Internal Audit's Work;
- Audit Reporting; and
- Audit Committee.

3.2 The Terms of Reference state that the Chief Internal Auditor '*will advise the Audit Committee on behalf of the Council on the content of the terms of reference and the need for any subsequent amendment. The terms of reference should be approved and regularly reviewed by the Audit Committee*'.

3.3 The Chief Internal Auditor has reviewed the Terms of Reference presented to the April 2010 Committee and concluded that there are no changes required for 2012/13, but will present the document again to members at its third anniversary April 2013 regardless of its status.

### 4. LEGAL IMPLICATIONS

4.1 Accounts and Audit Regulations 2006.

### 5. FINANCIAL IMPLICATIONS

5.1 None, within existing budgets.

### 6. RISK MANAGEMENT

6.1 The risk management implications are:

<b>Opportunities</b>	<b>Benefits</b>
To provide an adequate and effective system of internal audit operating in accordance with the proper practices contributes to the overall control environment (system of internal control and governance framework) and the Annual Governance Statement.	An internal audit plan considering all areas of risk to the Council contributes to the overall control environment (system of internal control and governance framework) and the required Annual Governance Statement.

<b>Issues/Obstacles/Threats</b>	<b>Control measures/mitigation</b>
<p>Audit's objectives and responsibilities do not reflect the Accounts and Audit Regulations 2003 and 2006 requirements of providing an adequate and effective system of internal audit in accordance with the proper practices.</p>	<p>The Audit Strategy updated and presented to the Audit Committee annually is a high level statement of how the internal audit service will be delivered in accordance with the Terms of Reference.</p> <p>An Audit Manual documenting the audit processes is maintained and reflects the CIPFA 'Code of Practice for Internal Audit in Local Government' which sets out the standards that internal audit is expected to achieve.</p>

<b>Corporate priorities engaged:</b>	All
<b>Statutory powers:</b>	Section 111 Local Government Act 1972; and Accounts and Audit Regulations 2003 and 2006.
<b>Considerations of equality and human rights:</b>	No specific equality and human rights issues arising from this report.
<b>Biodiversity considerations:</b>	No specific biodiversity issues arising from this report.
<b>Sustainability considerations:</b>	No specific sustainability issues arising from this report.
<b>Crime and disorder implications:</b>	No specific crime and disorder issues arising from this report.
<b>Background papers:</b>	Internal Audit Terms of Reference – Audit Committee April 2010; South Hams District Council Internal Audit Manual - 2012
<b>Appendices attached:</b>	Appendix A – Internal Audit Strategy 2012/13



**Internal Audit Strategy 2012/13**

# **South Hams District Council**

## **Internal Audit Strategy**

### **Introduction**

The Accounts and Audit Regulations, 2003 (Regulation 6) and 2006 state that:

*"A relevant body shall maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with the proper practices."*

For the purposes of the Regulations, proper practice is that contained in the CIPFA 'Code of Practice for Internal Audit in Local Government' (2006).

Standard 7 of this Code requires the Chief Internal Auditor to produce an audit strategy, and this is reflected in the Council's Internal Audit Manual 2012, which states that the Strategy:

- Is a high-level statement of how the internal audit service will be delivered and developed in accordance with the Terms of Reference and how it links to the organisational objectives and priorities. The strategy can be presented as a document in its own right or integrated into an existing document, such as the business or service plan. It sets the context within which more detailed plans can be developed. The strategy should be kept up to date with the organisation and its changing priorities;
- Will communicate the contribution that Internal Audit makes to the organisation and should include:
  - (a) Internal Audit objectives and outcomes;
  - (b) how the Chief Internal Auditor will form and evidence his or her opinion on the control environment to support the Annual Governance Statement;
  - (c) how Internal Audit's work will identify and address significant local and national issues and risks;
  - (d) how the service will be provided, i.e. internally, externally, or a mix of the two; and
  - (e) the resources and skills required to deliver the strategy.
- Should be approved, but not directed, by the Audit Committee.

### **Internal Audit Objectives and Outcomes**

The primary objective of the Internal Audit team is to provide an independent and objective opinion to the Council on the control environment by evaluating its effectiveness in achieving the organisation's objectives through examining, evaluating and reporting on the adequacy of the control environment as a contribution to the proper, economic, efficient use of resources.

To achieve this primary objective, the Council's Chief Internal Auditor aims to fulfil the statutory responsibilities for Internal Audit by:

## **South Hams District Council**

### **Internal Audit Strategy**

- Identifying all of the systems, both financial and non financial, that form the Council's control environment and contribute to it meeting its obligations and objectives – the 'Audit Universe';
- Creating an audit plan that will enable Internal Audit to carry out reviews covering all of the Audit Universe over a period of 5-years, prioritised through a risk assessment;
- Translating the 5-year audit plan into an annual plan by reassessing the risk for each audit area against emerging risks and the Council's Risk Registers;
- Undertaking individual audit reviews, to the standards set by CIPFA's Code of Practice for Internal Audit, to independently evaluate the effectiveness of internal control;
- Providing managers with an opinion on and recommendations to improve the effectiveness of risk management, control and governance processes as to:
  - the extent to which the Council's assets and interests are accounted for and safeguarded from losses of all kinds;
  - the completeness, suitability, reliability and integrity of financial and other management information developed within Council (Data Quality);
  - the systems established to ensure compliance with policies, plans, procedures, laws and regulations, i.e. rules established by management of the Council or externally. These include in particular the Council's Contract and Financial Procedure Rules;
  - whether operations are being carried out as planned and objectives and goals are being met.
- Providing managers with advice and consultancy on risk management, control and governance processes;
- Liaising with the Council's external auditors to ensure efficient use of scarce audit resources through the avoidance of duplication, and to enable them to place reliance upon the work of Internal Audit; and
- Providing the Council through the Audit Committee with an opinion on internal control as a contribution to the System of Internal Control and Annual Governance Statement.

#### **Opinion on Internal Control**

As stated above one of the key objectives of Internal Audit is to communicate to management within the Council information that provides an independent and objective opinion on their control environment and risk exposure, and to prompt management to implement agreed actions.

Significant issues and risks are to be brought to the attention of the S.151 Officer and Deputy as and when they arise. For routine work a written monthly report summarising the main issues from all audit reports and the performance of the Internal Audit team is to be provided by the Chief Internal Auditor copied to these officers. A formal monthly meeting must also be held to discuss issues arising and other matters.

The Chief Internal Auditor must report progress against the annual audit plan and any emerging issues and risks to the Audit Committee quarterly in a format agreed between the parties.

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The Chief Internal Auditor must also provide a written annual report to the Audit Committee timed to support their recommendation to approve the Annual Governance Statement to the Council.

The Chief Internal Auditor's annual report to the Audit Committee must:

- (a) Include an opinion on the overall adequacy and effectiveness of the Council's control environment;
- (b) Disclose any qualifications to that opinion, together with the reasons for the qualification;
- (c) Present a summary of the audit work from which the opinion is derived, including reliance placed on work by other assurance bodies;
- (d) Draw attention to any issues the Chief Internal Auditor judges particularly relevant to the preparation of the Annual Governance Statement;
- (e) Compare the work actually undertaken with the work that was planned and summarise the performance of the internal audit function against its performance measures and targets; and
- (f) Comment on compliance with these standards and communicate the results of the internal audit quality assurance programme.

### **Local and National Issues and Risks**

The audit planning process is subject to a risk assessment at all stages of the process: the 5-year plan; annual plan and individual audit reviews.

Prioritising the 5-year plan is completed using a risk assessment scoring methodology that takes account of: the £k value; inherent risk (definition below); political sensitivity; when last audited; and the impact on other systems.

Updating the original risk assessment above to create an annual audit plan includes taking account of emerging risks, both local and national, through consideration of the:

- Council's Risk Registers;
- Minutes of the Council, Executive, Scrutiny Panels and Senior Management Team;
- issues arising from the previous year's audit reviews, including those covering the Risk Management and Corporate Governance frameworks (Annual Governance Statement);
- National issues highlighted by professional bodies such as CIPFA's Finance Advisory Network (FAN), National Anti Fraud Network (NAFN) or the Council's external auditor; and
- Liaison with other Internal Audit teams on a formal and informal basis.

A further risk assessment is required at the commencement of each individual audit review to establish the level of testing required. This considers:

- When the system was last audited, the results of that review and whether the recommendations made have been implemented;
- Any changes to the system since the last audit;



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### **Internal Audit Strategy**

- The results of an analytical review (comparison of the data for the year of audit with the previous year's equivalent, taking account of expected changes);
- The inherent risk: the level of risk to the Council of the system if there were no controls in place, such as the vulnerability to fraud and if there are any known incidents of fraud;
- The quality, experience and morale of officers involved in the system; and
- Impact on the control environment of service reviews by managers and the results of any relevant performance indicators.

#### **Provision of Internal Audit**

The Internal Audit service is provided on behalf of the Council by a small team of in-house auditors. Past benchmarking of the cost of Internal Audit when compared with other Councils has shown that it is a cost effective service that continues to meet the requirements of its stakeholders.

The Chief Internal Auditor has established policies and procedures in an Audit Manual to guide staff in performing their duties and complying with the latest available CIPFA Code of Practice. The manual is regularly reviewed and updated to reflect changes in working practices and standards.

#### **Performance Management and Quality Assurance**

The CIPFA Standards and the Council's Audit Manual state that performance, quality and effectiveness should be assessed at two levels:

- (a) For each individual audit; and
- (b) For the internal audit service as a whole.

The documents also state that the Chief Internal Auditor 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 CIPFA Code of Practice;
- (c) Meeting internal quality standards;
- (d) Effective, efficient, continuously improving; and
- (e) Adding value and assisting the organisation in achieving its objectives.

This performance management and quality assurance framework must include, but not be limited to:

- (a) A comprehensive set of targets to measure performance, developed in consultation with appropriate parties. Performance measures should be included in any service level agreement. The Chief Internal Auditor should measure, monitor and report appropriately on the progress against these targets;
- (b) Seeking user feedback for each individual audit and periodically for the whole service;
- (c) A periodic review of the service against the strategy and the achievement of its aims

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- and objectives. The results of this should inform the future strategy;
- (d) Internal quality reviews to be undertaken periodically to ensure compliance with this Code and the audit manual; and
- (e) An action plan to implement improvements.

The following table shows the key performance indicators used by the service.

Once collated the indicators must be reported to the S.151 Officer on either a monthly or annual basis in line with collection and to the Audit Committee quarterly and/or annually. Performance indicators should be presented with prior year's equivalent to aid comparison.

*Table 1: Internal Audit Key Performance Indicators*

	<b><u>Current Target, and, Frequency of Measure</u></b>
➤ Achievement of the annual audit plan.	90% Covalent Monthly
➤ Percentage of draft audit reports issued within 10 working days of the completion of the audit.	100% Annually
➤ Percentage of final audit reports issued within 10 working days of the discussion and agreement of the draft audit report.	100% Annually
➤ Reliance of work of IA by the external auditor	Yes/No Annually
➤ Customer Survey: Responses Received; Audit Planning - Consultation; Objectives Quality of Audit Report - Clarity; Accuracy; Value; Presentation Communication - Feedback; Helpfulness; Professionalism; Timeliness.	90% Annually 90% Annually 90% Annually
➤ Overall cost, with/without oncosts/recharges	£ Annually
➤ Average cost per audit day: direct costs, and with/without oncosts/recharges.	£ Annually £ Annually
➤ The percentage of audit reports where the agreed recommendations were satisfactorily actioned, or follow up indicator to align with other audit teams to be agreed later with the Chairman and reported to the Committee.	90% Annually

Performance indicators or targets may be amended from time to time with the prior agreement of the Audit Committee.

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The Chief Internal Auditor needs to ensure that the performance and the effectiveness of the service improve over time, in terms of both the achievement of targets and the quality of the service provided to the user.

### **West Devon Borough Council (Shared Service)**

The Internal Audit team consists of 3 whole time posts, the Chief Internal Auditor, Senior Auditor and an Auditor. These posts are employed by South Hams District Council but staff costs are shared on a proportionate basis with West Devon Borough Council, based on the internal audit team delivering an audit plan of 95 days to West Devon Borough Council. The shared internal audit service is providing an annual saving of £20,000 to South Hams District Council.

Separate Terms of Reference and Audit Strategy Documents are presented to the West Devon Borough Council's Audit Committee.

### **Collaboration with Teignbridge District Council (Shared Service)**

Several years ago the Shared Service Joint Steering Group considered the proposals of a business case for a shared service presented by South Hams (SHDC), Teignbridge (TDC) and West Devon District/Borough Councils.

For SHDC and TDC the accepted proposal was for an extension of the collaboration between the internal audit teams with exchange of audit resources, skills, training and key documents.

Details are available in the related report to the Audit Committee (minute reference: A14/08). At this meeting members also accepted in principle of the mutual assurance of the high priority of both Councils' audit plan in times of crisis, subject to the specific approval of the Chairman. TDC Audit Committee made the same commitment.

This arrangement has not been formally rescinded and therefore continues.

## **Resources and Skills**

### **Resources**

The CIPFA Standards and the Council's Audit Manual states that:

- Internal Audit must be appropriately staffed in terms of numbers, grades, qualifications and experience, having regard to its responsibilities and objectives, or have access to the appropriate resources;
- The Internal Audit service shall be managed by an appropriately qualified professional with wide experience of internal audit and of its management;
- The Chief Internal Auditor should be of the calibre reflecting the responsibilities arising from the need to liaise with members, senior management and other professionals.

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The approved Internal Audit establishment for the Council consists of 3 whole time posts, the Chief Internal Auditor, Senior Auditor and an auditor. As the Auditor is also the European Grants officer, audit time of 180 days has been contributed to the plan in prior years, with other time accounted for separately. As the European Grant work now is mainly audit related work on the RDPE Local Action Groups (LAGs), the decision was taken for 2012/13 to include all of the posts time and time related overheads in the 2012.13 audit plan.

With a target of completion of 90% of the annual audit plan, this level of staffing has proved to be adequate to date.

### **Shared Services - West Devon and Teignbridge**

No additional staff resource has been made available to the South Hams team in providing **West Devon Borough Council** with 95 days of service. This arrangement has been enabled by reducing the frequency of lower priority audit work to once in 5 years from the previous 3 year duration and critically examining the approach to some of the significant financial systems, such as benefits, with the external auditor. The decision was taken following liaison with the Audit Commission and ensuring that the CIPFA Code of Practice does not prevent such a change.

The ongoing issue is whether the coverage is sufficient to enable the Chief Internal Auditor to provide an opinion on the Council's control environment. This can be achieved particularly with an increased time allowed for follow up work to be thoroughly completed (taking coverage into a second year), and ensuring that sample testing in the other larger systems such as creditors and debtors includes areas not covered annually.

In addition the regular reassessment of the plan, based on emerging risk, will bring forward work on areas covered once in 5 years if significant changes occur.

### **Dealing with Alleged Fraud**

The main threat to completing the targeted % of the annual audit plan is the requirement for Internal Audit to investigate fraud. A contingency budget is built into the audit plan to provide cover for such eventualities, as well as other unexpected tasks such as advice to managers on control or internal financial regulations, contributions to the setting up of new systems or unexpected additional work on planned audits.

In extreme cases the contingency budget may prove insufficient for large scale investigations. In the circumstances where this occurs and where there is likely to be an impact on the remainder of the annual audit, the Chief Internal Auditor must discuss the situation with the s.151 Officer to enable a decision to be made to seek additional temporary resources if appropriate. The same comment applies to other staffing shortages brought about by long term sickness absence, vacant posts etc.

### **Mutual Assurance for/by Teignbridge District Council**

As discussed above under the title 'Provision of Internal Audit', the Audit Committee has accepted (as has TDC's Audit Committee) that the teams will mutually assure the high

## **South Hams District Council**

### **Internal Audit Strategy**

priority work of each others plan in the time of crisis, with the specific approval of the Chairmen. This has not been formally rescinded by members at either Council.

In practical terms, such work will reduce the available resources for low priority audit work for the team providing assistance. However, the outcome may be the delivery of plans to an acceptable level at both Councils, without the additional cost of external resources. It is the responsibility of the audit managers of SHDC and TDC, in association with the S.151 Officer and the Chairman of the Audit Committee, to ensure that making additional resources available to the other team does not result in a shortfall in audit coverage that may undermine the System of Internal Control.

#### **Skills**

The Chief Internal Auditor's duty is to recruit staff with the appropriate professional background, personal qualities and potential. He or she is responsible for ensuring that up-to-date job descriptions exist that reflect roles and responsibilities and that person specifications define the required qualifications, competencies, skills, experience and personal attributes.

Internal Audit staff must also be properly trained to fulfil all their responsibilities. The Chief Internal Auditor will periodically assess individual auditors against these predetermined skills and competencies using the Council's formal appraisal system.

Any training or development needs identified will be included in an appropriate ongoing development programme that is recorded and regularly reviewed and monitored both within and outside of the appraisal process. A copy of the appraisal training programme will be sent to personnel with the appraisal as the corporate system requires.

Time will be allowed within the annual audit plan to allow internal audit staff to receive the relevant training.

In addition, the Chief Internal Auditor will allocate work to reflect the skills and experience required for the specific task, although it is essential that a balance is struck between knowledge and client relationships built through continuity and the need for audit staff to develop by auditing areas that they have not previously covered.

In some circumstances, there may be a skill shortage within the Internal Audit team as a whole e.g. specialist audit areas such as technical computer audit. Where this applies the advice of specialists should be sought from within the Council, from colleagues at Teignbridge District Council or other neighbouring Councils or the external auditor.

In extreme situations, the services of a consultant may need to be bought in but the Chief Internal Auditor will only do this with the consent of the s.151 Officer. The Audit Committee will be informed in such cases.

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