Report

Subject	: Review of the Effectiveness of the System of Internal Audit
Report to	: Audit Committee
Date	: Wednesday 18 June 2008
Author	: Estelle Sherry, Audit Manager

1   Background

1.1   The amendments to the Accounts and Audit Regulations 2006 require an annual review of the Effectiveness of the System of Internal Audit. Since these regulations were published, no little practical guidance has been produced by the Department of Communities and Local Government (DCLG). The Institute of Public Finance, the commercial arm of CIPFA, has however published guidance for practitioners. This guidance suggests a mixture of approaches in order to obtain a rounded view. Salisbury District Council has developed a self-assessment template, drawn from the CIPFA Code of Practice for Internal Audit in Local Government 2006, which has been completed by the Audit Manager. This template has been used by CIPFA as a model for other councils to follow.

2   Review for 2007/08

2.1   The approach for this year's review includes the following:

- Self-assessment against the template.
- Consideration of the CIPFA Code of Practice published December 2006.
- Results of the client satisfaction survey conducted in 2007.
- Results of the CIPFA benchmarking carried out in 2007.
- Opinion of the Audit Commission in the Annual Audit and Inspection Letter and Use of Resources judgements.

2.2   Although the effectiveness of the system of internal audit should include the effectiveness of the Audit Committee itself, to the extent that its work relates to internal audit, the effectiveness of the Audit Committee is considered separately. During 2007, the Audit Committee conducted a self assessment of its effectiveness using a toolkit provided by CIPFA. The results were reported in the Audit Committee Annual Report on 8th April 2008. No shortcomings in the interaction of Internal Audit with the Audit Committee were identified.

3   **Results of Self-Assessment**

3.1   Appendix A shows the results of the self-assessment and areas for development. The assessment shows effective performance in most areas. The key areas for development are to:

- Monitor the escalation procedures developed to help address delays in receiving management responses in response to audit assignments.
- Develop the scope of audit work to include greater emphasis on efficiency improvements.

4   **CIPFA Code of Practice**

4.1   The Terms of Reference approved by the Audit Committee on 4th April 2007 was reviewed against the revised Code of Practice in detail. A high level of compliance was confirmed and any areas for development were incorporated within the self-assessment above.

5   **Client Satisfaction Survey**

5.1   Appendix B includes the results of the client satisfaction survey that was conducted in October 2007. The format used was developed by the CIPFA Audit Benchmarking Club, although some customisation was possible. The survey was sent to 52 managers, including corporate management team, service unit heads and team leaders, who have had recent experience of internal audit work. A total of 21 responses were received, although not all respondents answered all the questions.

5.2   The survey asked respondents to rate the importance of each statement or question on a scale of high, medium or low, as well as rating performance as either excellent, good, adequate, less than adequate, weak or poor. Of the 29 statements or questions asked, Internal Audit's performance was scored 27 good and 2 adequate.

5.3   No specific actions were required as a result of the survey but the results have reinforced the need to ensure that all risks identified through audit assignments are relevant and appropriate across the full range of risk categories.

6   **CIPFA Benchmarking**

6.1   Salisbury has participated in the benchmarking club since 2002. The benchmarking outcomes include comparative data on costs, audit coverage and staffing. The table below shows key indicators against the average of the 39 shire districts participating in the club. The data is for 2006/07.

Indicator	Units	Salisbury	Average
Pay cost per auditor	£'000	41.3	37.7
Overhead cost per auditor	£'000	12.8	13.8
Total cost per auditor	£'000	54.1	50.7
Days per auditor	Days	188	175
Cost per day	£	294	295
Days per £m gross turnover	Days	7.78	10.12
Cost per £m gross turnover	£0	2,285	2,881

6.2   Although cost comparisons do not provide any evidence of effectiveness, they help to understand the overall performance of the team. The team consists of qualified staff and no trainees. As such, pay costs are above average and days per auditor (output) is also above average. It should be noted that the costs include the purchase of 22 days IT Audit services from Deloitte and Touche. The council's expenditure on audit is below average when the gross expenditure of the council is considered.

7   Opinion of the Audit Commission

7.1   The council scored 3 out of 4 for the Internal Control element of its 2007 Use of Resources assessment. This means that the council is achieving consistently above minimum requirements and is performing well in relation to:

- Managing its significant business risks;
- Ensuring arrangements are in place to maintain a sound system of internal control; and
- Ensuring arrangements are in place that are designed to promote and ensure probity and propriety in the conduct of its business.

7.2   The Internal Control element of the assessment requires Internal Audit to operate in accordance with the CIPFA Code of Practice as a minimum requirement. Of the 238 District Councils assessed, 112 or 47% of councils scored level 3; only 5 councils have achieved a level 4 assessment.

8   Conclusions

8.1   The effectiveness of Internal Audit has been examined from a number of angles. The key characteristics of an effective internal audit service are set out in Appendix A with the self-assessment and action points. One of the prerequisites of being effective is compliance with the CIPFA Code of Practice and this is in place.

9   Recommendation

9.1   The Committee is asked to take a view on the effectiveness of the system of internal audit in the council and suggest any areas for improvement.

10.   Implications:
- Financial   : None
- Legal   :   The council has a duty to maintain an adequate and effective system of internal audit having due regard to the CIPFA code of practice.
- Human Rights   : None
- Personnel   : None
- Community Safety: None
- Environmental Impact: None
- Council's core values: Excellent service, being open and honest

Self Assessment of Internal Audit

A. CODE OF PRACTICE		
Standard	**Evidence of achievement**	**Areas for development**
Ethics • Integrity • Objectivity • Competence • Confidentiality	Individual performance is assessed through the council's Progressive Employee appraisal system and there are no concerns.	
Scope of internal audit • Terms of reference • Scope • Responsibilities in respect of other organisations • Fraud and corruption	Terms of reference reflect the latest CIPFA Code of Practice and were approved in April 2007. Scope of audit work takes into account risk management processes and resource levels are reviewed annually. Responsibilities in respect of other organisations are identified in the terms of reference. Audit responsibilities in relation to fraud are defined in the terms of reference. A review of fraud risk standards was conducted in 2007.	Limited work is undertaken in relation to other organisations. Fraud investigation has limited provision within the audit plan.
Independence • Organisational independence • Status of head of internal audit • Independence of individual auditors and contractors	Internal Audit has direct access to those charged with governance through the Audit Committee. Management reports are presented in own name. No conflict of interest exists between operational responsibilities and audit. Audit work is rotated within the team. Contractors (IT audit) do not have any other roles within the council.	The Head of Financial Services provides line management rather than a member of the corporate management team. This was specifically considered when the terms of reference were agreed. Compensating controls have been agreed as adequate.

Standard	Evidence of achievement	Areas for development
Audit Committee • Reporting to the Audit Committee • Relationship with the Audit Committee	All areas identified in the Code of Practice are reported to the Audit Committee. All Audit Committee meetings are attended by the Head of Audit and an annual meeting is held with the Chair of the Audit Committee.	
Relationships • Management • Other auditors • Other review bodies	Service managers are consulted on the audit plan and on the scope of each audit. Management and internal audit responsibilities are defined in relation to fraud and corruption matters. A client satisfaction survey was carried out in 2007. Good working relations have been established with external audit, including consultation on the annual audit plan and opportunities for joint working. Sharing of information is undertaken with other internal review agencies, principally Scrutiny reviews.	
Staffing, training and development	The internal audit team have a high level of qualifications and audit experience. Continuing professional development is supported through training and other developmental activities.	
Audit Strategy	The Audit Strategy was approved by the Audit Committee in January 2006. The Annual Audit Plans are approved by Audit Committee in April each year. The Audit Strategy and the Audit Plans are prepared in accordance with the CIPFA Code of Practice.	

Standard	Evidence of achievement	Areas for development
Management of Audit Assignments • Approach • Recording • Follow up	A risk-based approach is followed and an audit opinion given. Internal audit procedures are based on the CIPFA manual. Standards of working paper evidence are determined by the Head of Audit. Record retention is set by the Head of Audit. A follow up process is used to identify management actions arising from audit assignments.	The follow up process is weakened by the delay in receiving responses from some managers. Escalation procedures have been developed to help to address this.
Due professional care • Conduct • Organisational arrangements	All internal auditors are aware of their individual responsibilities for due professional care. Arrangements are in place to monitor this: • Head of Audit reviews all audit work and draft reports prior to issue. • Staff annual appraisals and training. • The council's whistleblowing arrangements.	
Reporting • Assignment reporting • Annual reporting	Audit reports follow the CIPFA Code of Practice requirements for assignment reporting, except that risks are reported and recommendations are not explicitly made. An annual report to support the Statement on Internal Control / Governance Statement is provided to the Audit Committee in accordance with the Code.	

Standard	Evidence of achievement	Areas for development
Quality Assurance • Management of internal audit • Internal quality review • External quality review	The CIPFA manual for internal audit is consulted. Performance measures are identified and reported to the Audit Committee through the Annual report. 96% of the Audit Plan was achieved in 2007/08. Appraisal of staff is undertaken and use made of 'The Effective Internal Auditor' guidance. Internal quality reviews are undertaken by the Head of Audit for all audit work. An external quality review was undertaken by the Audit Commission in 2008. An annual assessment of the work of internal audit is undertaken by the Audit Commission, who have reported that internal audit meets the CIPFA Code of Practice.	Whilst continuing to ensure the substantive achievement of the audit plan, respond effectively to key risks and problems arising during the year.

B. CHARACTERISITICS OF EFFECTIVENESS		
Standard	**Evidence of achievement**	**Areas for development**
Understand Internal Audit's position in respect of the organisation's other sources of assurance and plan work accordingly.	Internal audit identifies other sources of assurance and takes these into account when preparing the Internal Audit Plan. The position of Internal Audit is clearly set out in the Assurance Framework and the Assurance Plan.	
Understand the whole organisation, its needs and objectives.	The Audit Plan demonstrates how audit work will provide assurance in relation to the council's objectives. Individual audit assignments identify risks to the achievement of the council's objectives.	Develop the scope of audit work to include greater emphasis on efficiency improvements.
Be seen as a catalyst for change at the heart of the organisation.	Internal Audit provides advice and support on corporate developments, such as the corporate governance review, risk management and ethics. Individual assignments can be a catalyst for change.	Attitudes to change within the council will impact on Internal Audit's success in this area.
Add value and assist the organisation in achieving its objectives.	Internal Audit demonstrates added value through individual audit assignments and corporate work.	
Be involved in service improvements and projects as they develop, and work across internal and external boundaries to understand shared goals and individual obligations.	Internal Audit provide help and advice on request and support specific projects.	
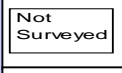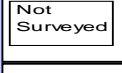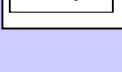
Standard	Evidence of achievement	Areas for development
Be forward looking – knowing where the organisation wishes to be and be aware of the national agenda and its impact.	Individual audit assignments use examples of best practice. When identifying risks, changes on the national agenda are reflected. The audit section is abreast of new developments in the field of audit, risk management and corporate governance and this is disseminated to other parts of the council.	
Be innovative and challenging – shaping the values and standards of the organisation; providing internal inspection and validation and encouraging service managers to take ownership of processes, systems and policy.	Internal Audit has taken an innovative approach to its reporting arrangements by focusing on risks. Managers are encouraged to develop their own responses to the identified risks, so as to promote greater ownership of the control environment amongst managers.	
Ensure the right resources are available – the skills mix, capacity, specialism and qualifications/experience requirements all change constantly.	Resourcing is considered throughout the year. Arrangements are in place to obtain specialist input on IT audit.	

Audit Customer Satisfaction Survey

Section 1 - Performance Summary
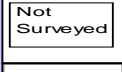
1 Audit Services

Internal audit undertakes work in a number of different areas. In respect of the following areas, where would you like to see them concentrate their efforts and how well do they currently perform?

Importance   **Performance**

Not Surveyed	1.1 Advice and guidance on policies/procedures	Not Surveyed
Not Surveyed	1.2 Review of compliance with policies/procedures	Not Surveyed
Not Surveyed	1.3 Internal Control Reviews	Not Surveyed
Not Surveyed	1.4 Review of completed capital projects	Not Surveyed
Not Surveyed	1.5 Value for Money Reviews	Not Surveyed
Not Surveyed	1.6 Review of security of corporate assets	Not Surveyed
Not Surveyed	1.7 Audit of IT systems and controls	Not Surveyed
Not Surveyed	1.8 Facilitating the risk management process	Not Surveyed
Not Surveyed	1.9 Investigation of Allegations	Not Surveyed

2 Audit Staff

Based on your contact with internal audit staff in the past year how well do you rate them in the following areas?

Importance   **Performance**

HI	2.1 Professionalism	Good
HI	2.2 Positive Attitude	Good
Not Surveyed	2.3 Unbiased and Objective	Good
HI	2.4 Ability to establish positive rapport	Good
HI	2.5 Knowledge of key policies and procedure	Good
HI	2.6 Knowledge of the operation	Good
ME	2.7 Knowledge of the IT systems	Good

3 Conduct of Audits

Based on your experience how well does Internal Audit plan and carry out individual audits?

Importance   **Performance**

HI	3.1 The timing of audits is appropriate	Good
HI	3.2 Audit objectives and procedures are discussed prior to commencement of the audit	Good
HI	3.3 Opportunity is given to change/comment on the audit brief	Good
HI	3.4 Audits focus on significant risks	Good
HI	3.5 Business concerns and perspectives are adequately considered during the review	Good
HI	3.6 Auditors take care to minimise disruption to operations	Good
HI	3.7 Auditors' requests for information are reasonable	Good
HI	3.8 Auditors discuss issues with managers as they arise	Good
ME	3.9 The Audit Manager attends meetings to discuss audit findings	Good

4 Audit Reporting

The final product of an audit is the report. How do you rate our reporting process?

**Importance**   **Performance**

HI	4.1 Reports are well written and easily understood	Good
HI	4.2 Reports are factually correct	Good
ME	4.3 There is no delay in issuing reports	Good
HI	4.4 Conclusions are appropriate and supported by adequate evidence	Good
HI	4.5 Recommendations are constructive, practical and cost effective	Adequate
HI	4.6 Responses to issues raised are appropriately reflected in the report	Adequate

5 Customer Service

As customers of Internal Audit how do you rate us in the following areas?

Importance   **Performance**
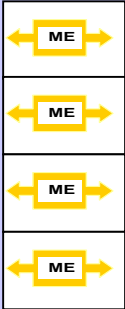
| ME → | 5.1 | The degree of interaction with Internal Audit management | Good |

| ME → | 5.2 | Fostering of service department participation | Good |

| ME → | 5.3 | Response to special requests | Good |

| ME → | 5.4 | The extent to which Internal Audit meet your needs | Good |

Good

6 Overall rating of Internal audit

7 Authority Specific Topics

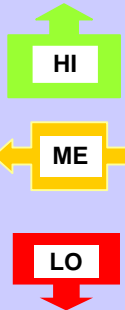**Importance**   **Performance**
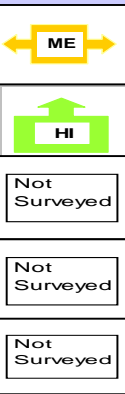
| ME → | 7.1 | Does Internal Audit help you to manage your risks more effectively? | Good |

| HI | 7.2 | How do you rate Internal Audit's recent emphasis on risks rather than recommendations? | Good |

| Not Surveyed | 7.3 | | Not Surveyed |

| Not Surveyed | 7.4 | | Not Surveyed |

| Not Surveyed | 7.5 | | Not Surveyed |

Importance Key

HI   High

ME   Medium

LO   Low