

## General Release

<b>REPORT TO:</b>	<b>GENERAL PURPOSES &amp; AUDIT COMMITTEE</b> <b>29th June 2016</b>
<b>AGENDA ITEM:</b>	<b>11</b>
<b>SUBJECT:</b>	<b>Internal Audit Review of Effectiveness 2015/16</b>
<b>LEAD OFFICER:</b>	<b>Assistant Chief Executive (Corporate Resources and Section 151 Officer)</b>
<b>CABINET MEMBER</b>	<b>Councillor Simon Hall</b> <b>Cabinet Member for Finance and Treasury</b>
<b>WARDS:</b>	<b>All</b>
<b>CORPORATE PRIORITY/POLICY CONTEXT:</b>  The Council is required by the Audit and Account Regulations 2015 to review the effectiveness of the Council's Internal Audit function when preparing the Annual Governance Statement 2015/16. The Annual Governance Statement is published alongside the Annual Accounts.	
<b>FINANCIAL SUMMARY:</b> The Internal Audit contract for 2015/16 was a fixed price contract of £358,000 and appropriate provision was made within the budget for 2015/16.	
<b>FORWARD PLAN KEY DECISION REFERENCE NO:</b> N/A	

### 1. RECOMMENDATION

- The Committee is asked to review and comment on the Assistant Chief Executive (Corporate Resources and Section 151 Officer)'s assessment of the internal audit function

### 2. EXECUTIVE SUMMARY

2.1 This report details the Assistant Chief Executive (Corporate Resources and Section 151 Officer)'s review of the effectiveness of the Council's internal audit. In assessing Internal Audit's effectiveness the Council has used the following criteria and sources of information:

- Public Sector Internal Audit Standards
- Internal Audit performance
- Stakeholders Feedback
- External Audit opinion.

### 3. System of review

- 3.1 The Accounts and Audit Regulations 2015 require the Council to review, at least annually the effectiveness of its internal audit function. The findings of this review need to be considered and published as part of the Committee's review of the effectiveness of the systems of internal control. This in turn forms the basis of the Committee's consideration of the Annual Governance Statement.
- 3.2 The Internal Audit service is one of the key foundations of the Council's Assurance Framework and governance structure, therefore the Committee needs to be satisfied that the function is effective in ensuring it can place reliance on the Council's internal control systems.
- 3.3 The Assistant Chief Executive (Corporate Resources and Section 151 Officer) has completed a review of the internal audit service and that is now reported to the Committee.
- 3.4 For the purposes of the review the internal audit service was defined as the service provided by Mazars PSIA Ltd via the internal audit contract and the small in-house client team that leads and manages the contract. The current contract for internal audit services was let in April 2008 for a period of seven years with an option for a three year extension. In January 2012 an extension of that contact to March 2018 was agreed on a recommendation from the then Corporate Services Committee.
- 3.5 A peer review by another London Borough's Head of Internal Audit was conducted during the course of 2015/16 to assess the extent to which the Council's internal audit service complied with the Public Sector Internal Audit Standards. This showed that the Council's Internal Audit service *Generally Conforms* to the standards and details are included later in this report.

### 4. Internal Audit Performance 2015/16

- 4.1 A key measure of the Internal Audits service's effectiveness is the action taken in implementing audit recommendations. The Council's target for audit recommendations implemented at the time of the follow-up audit is 80% for all priority 2 & 3 recommendations and 90% for priority 1 Recommendations.
- 4.2 The use of targets is accompanied by a stringent approach to the follow up process with tighter timescales for follow up work to commence linked to the level of assurance. Table 1 details the performance in all follow up work completed for audits carried out in 2011/12 through to 2014/15.

**Table 1: Implementation of Audit Recommendations to date**

Performance Objective	Target	Performance 2011/12	Performance 2012/13 (to date)*	Performance 2013/14 (to date)*	Performance 2014/15 (to date)*
Percentage of priority one recommendations implemented at the time of the follow up audit	90%	100%	100%	100%	84%
Percentage of all recommendations implemented at the time	80%	93%	93%	88%	78%

of the follow up audit					
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\* Audits are still being followed up for 2012/13, 2013/14 & 2014/15 therefore the percentage will change.

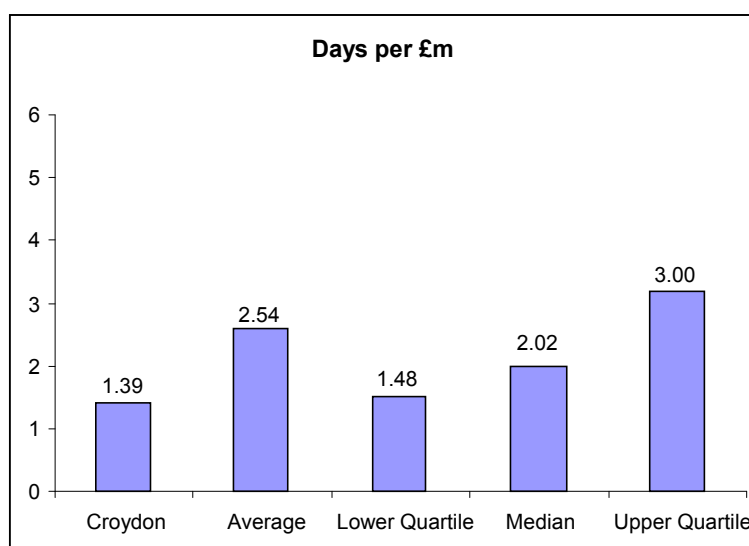
4.3 Table 2 details the Internal Audit service performance against key targets for 2015/16. Delivering 100% of the audit plan in-year is an excellent performance that few London Boroughs manage and this is the tenth year running that this has achieved at Croydon.

**Table 2: Internal Audit Performance**

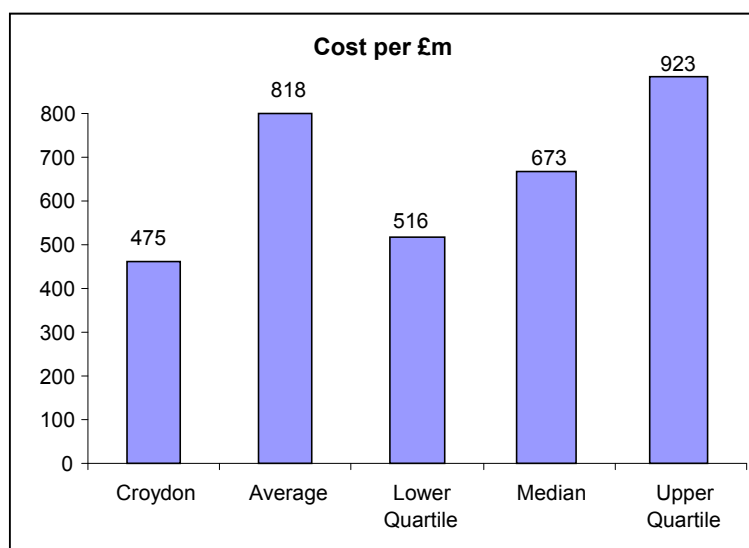
Performance Objective	Annual Target	Annual Performance	RAG
% of planned 2015/16 audit days delivered	100%	<b>100%</b>	<b>G</b>
% of 2015/16 planned draft reports issued	100%	<b>100%</b>	<b>G</b>
Number of 2015/16 planned draft reports issued	102	<b>102</b>	<b>G</b>
% of draft reports issued within 2 weeks of exit meeting with the Client	85%	<b>85%</b>	<b>G</b>
% of staff with full qualifications engaged on audit	40%	<b>41%</b>	<b>G</b>

4.4 To ensure the Council continuously improves its Internal Audit service, the Council participated in the CIPFA Audit Benchmarking Club 2015. A range of performance data and information relating to the Internal Audit service was compared, to nine other London Boroughs, in relation to cost and audit coverage. The headlines were that the Council was below average in relation to the number of audit days per £m gross turnover and the cost per chargeable day. These resulted in a better than average audit cost per £m gross turnover.

4.5 In addition, the Internal Audit Service was benchmarked with 43 unitary authorities within the benchmarking club from across England & Wales. The performance for 2014/15 is shown in the following graphs



This shows that because of its risk focused approach to internal audit, Croydon uses proportionately fewer days per £M of council gross expenditure than most other unitary authorities.



This shows that the combination of well focused activity and reasonable costs per day results in costs per £M of council gross expenditure which are below the lower quartile for unitary authorities nationally.

## 5. Stakeholder Feedback

5.1 The added value of internal audit and a key measure of their effectiveness is stakeholder feedback. The auditee of every audit is asked to complete a customer satisfaction survey. There was only a 12% response rate for audits carried out in 2015/16. This is down from the previous year and may reflect the added pressure that services are currently under. The summary results are shown in table 3.

5.2 The overall score for 2015/16 was 81% which is slightly below the previous year (82%). This, however, compares with 75% when we started to measure in 2006/07.

5.3 Where adverse comments are received these are followed up individually with the auditee to identify if there are learning points in relation to the individual auditor, a specific audit, or the audit process in general.

**Table 3: Customer satisfaction**

	<b>2015/16 Good or Very Good</b>
Usefulness of the audit	75%
Effectiveness of audit in covering key areas	75%
Duration of audit	67%
Feedback of findings and the opportunity to provide explanations	83%
Presentation & Clarity of reports	92%
Accuracy of findings in audit reports	83%
Value of the report and the recommendations	75%
Assessment of auditors knowledge	75%
Assessment of auditors professionalism	92%
Accessibility of the auditor and the audit service	92%

## 6. Public Sector Internal Audit Standards (PSIAS)

- 6.1 The PSIAS require that “external assessments must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organisation.”
- 6.2 “An independent assessor or assessment team means not having either a real or an apparent conflict of interest and not being a part of, or under the control of, the organisation to which the internal audit activity belongs.”
- 6.3 In London, the London Audit Group has organised a system of peer review, with 32 of the 33 London Boroughs agreeing to take part. Reviews will be carried out by suitably qualified individuals or teams from other members of the group across a 5 year cycle.
- 6.4 This review of internal audit was carried out by the Head of Internal Audit at the London Borough of Harrow. Her qualifications for conducting this review are: She is a member of Chartered Institute of Internal Auditors with 32 years’ experience of local government internal audit including 25 years’ experience in internal audit management.
- 6.5 The review was informed by file and documentary evidence, customer feedback surveys and interviews with the Chief Executive and Assistant Chief Executive as well as the previous Chair and Vice Chair of this committee.
- 6.6 The review concluded that: **Based on the work carried out it can be confirmed that internal audit at the London Borough of Croydon GENERALLY CONFORMS with the UK Public Sector Internal Audit Standards.**
- 6.7 The only observations made were classed as **minor** and these are set out in appendix 1.
- 6.8 In addition to a review of conformance with the standards, the review sought to gain an understanding of stakeholder views of the impact of the service. Based on interviews with four key stakeholders and a review of the customer surveys from other Chief Officers it is concluded that:
- The service is very well regarded particularly by key stakeholders
  - The internal audit service is delivered with professionalism
  - Internal audit activity is seen to have a positive impact on change and continuous improvement to business processes
  - Internal audit activity promotes appropriate ethics and values within the organisation
- 6.9 The majority of the respondents “generally agreed” with the statements about the internal audit service in the survey. The following are some of the comments made

on the survey returns:

- “I have generally found the internal audit process a positive experience that creates the time and focus to look at current process and practice and examine whether this is still the best or most appropriate way to deal with matters. It has helped to identify weaknesses in adopted processes and encourages change where appropriate to reduce corporate risk.”
- “I think internal audit do what is needed for the best of the organisation and do it well.”
- “Generally I feel that the internal audit function is well managed and adds value to the organisation.”
- “The experience has always been positive, helpful, decisive and has highlighted and dealt with any issues systematically. Positive changes are made as a result of any issues being raised.”

## **7. External Audit**

- 7.1 As part of their interim audit work, the council’s external auditor gave the following report on internal audit to this committee at its meeting in March 2016:

“We have completed a high level review of internal audit's overall arrangements. Our work has not identified any issues which we wish to bring to your attention. We have also reviewed internal audit's work on your key financial systems to date.”

“Overall, we have concluded that the internal audit service provides an independent and satisfactory service and that internal audit work contributes to an effective internal control environment.”

## **8. Conclusion**

- 8.1 A comparison of the benchmarking indicators with the performance and impact indicators demonstrates a cost effective service delivering value for money.

## **9. FINANCIAL & RISK CONSIDERATIONS**

- 9.1 The Internal Audit contract for 2015/16 was a fixed price contract of £358,000 and appropriate provision was made within the budget for 2015/16. There are no additional risk considerations than those within the report.

(Approved by: Lisa Taylor – Assistant Director of Finance and Deputy S151 Officer)

## **9. COMMENTS OF THE SOLICITOR TO THE COUNCIL**

- 9.1 The Solicitor to the Council comments that the review of Internal Audit will meet the requirements for financial statements covered by the Accounts and Audit Regulations 2015.

(Approved for and on behalf of Gabriel MacGregor, Head of Corporate Law, Acting Council Solicitor & Acting Monitoring Officer)

## **10. HUMAN RESOURCES IMPACT**

- 10.1 There are no immediate human resource considerations arising from this report for LBC staff or workers.

(Approved by: Michael Pichamuthu, HRBP on behalf of Heather Daley, Director of HR)

## **11. CUSTOMER FOCUS, EQUALITIES, ENVIRONMENTAL, CRIME AND DISORDER REDUCTION & HUMAN RIGHTS IMPACTS**

- 11.1 Any impacts in relation to these areas are detailed in the strategic and departmental risk register. The process of managing risk through the risk register mechanism ensures that all impacts are considered and managed.

## **12. FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS**

- 12.1 The publicity requirements for the financial statements referred to in this report mean that they will for part of the Council's Publication Scheme maintained under the Freedom of Information (FOI) Act.

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**CONTACT OFFICER:** Richard Simpson, Assistant Chief Executive  
(Corporate Resources and Section 151 Officer)

**BACKGROUND DOCUMENTS:** None

Minor observations from the Peer Review of Internal Audit

	Minor Observation	Response and Action	Responsible Officer	Due Date
1.	<p>PSIAS require that “if independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment”.</p> <p>The Head of Governance (the chief audit executive) has operational responsibility for elements of governance (Scheme of Delegation and training) and the Corporate Anti-Fraud Team. Whilst this is not unusual in the Local Government it means that independent assurance on these functions cannot be provided by internal audit. Although the audit charter recognises that the HIA has responsibility for governance and anti-fraud it does not make it clear that this therefore precludes internal audit from providing independent assurance on these areas. This should be recognised in the audit charter and consideration given to how independent assurance can be obtained. “Assurance engagements for functions over which the chief audit executive has responsibility must be overseen by a party outside the internal audit activity.”</p>	<p>This was identified at the time of the review and the updated Charter reviewed by GPAC at the meeting in March 2016 included the following additional paragraph to address this point:</p> <p>The Head of Internal Audit does not currently have responsibility for any other service area or function other than internal audit, governance and anti-fraud. Arrangements will be made to ensure that these areas are subject to independent review.</p>	Head of Governance	Done
2.	<p>PSIAS outlines examples of the chief audit executive reporting functionally to the board, one of which is the board approving the risk based internal audit plan. It also requires that “The chief audit executive must communicate the internal audit activity’s plans and resource requirements, including significant interim changes, to senior management and the board for review and approval.”</p>	<p>This will be considered before the plan for 2017/18 comes to this committee in March 2017.</p>	Head of Governance	March 2017



	<p>The internal audit charter, strategy and plan currently goes to the General Purposes &amp; Audit Committee annually with the recommendation to “approve the Internal Audit Charter and Strategy and to note the plan of audit work”. Consideration should be given to changing the wording of this recommendation to reflect the requirement for the ‘board’ to approve the plan.</p>			
3.	<p>The PSIAS Code of Ethics applies to both individuals and entities that provide internal auditing services. The Public Sector requirement under the Code of Ethics states that “internal auditors who work in the public sector must also have regard to the Committee on Standards of Public Life’s <i>Seven Principles of Public Life...</i>”</p> <p>The assessment identified that confirmation was last received from Mazars in June 2014 that all internal audit staff confirmed that they had read, understood and comply with the Institute of Internal Auditor’s Code of Ethics and the Nolan principles. For in-house staff confirmations were obtained that they are aware and comply with the Code of Ethics in January 2013. It is understood that action is already in progress to obtain up to date confirmations.</p>	Confirmation has now been obtained from the contractor and relevant in-house staff	Head of Governance	Done
4.	<p>PSIAS state that “The internal audit activity’s plan of engagements must be based on a documented risk assessment, undertaken at least annually.”</p> <p>Whilst an annual process takes place to develop the internal audit plan which is based on risk this does not appear to be documented. Consideration should be given to documenting the risk assessment.</p>	This may not be as straightforward as it seems, but it will be considered before the plan for 2017/18 comes to this committee in March 2017	Head of Governance	March 2017

5.	<p>PSIAS state that “The risk-based plan must take into account the requirement to produce an annual internal audit opinion.....”</p> <p>That the CAE considers the Annual Internal Audit Plan enables him to deliver an annual opinion however this is not stated in the cover report under purpose that is considered by GPAC. The following action was identified: “CAE cover report to Annual Internal Audit Plan for GPAC to refer to it as part of purpose, being designed to enable to CAE to provide an annual opinion.”</p>	<p>This change will be made at the next review before the plan for 2017/18 comes to this committee in March 2017.</p>	<p>Head of Governance</p>	<p>March 2017</p>
6.	<p>The PSIAS Code of Ethics requires that ‘Internal auditors apply the knowledge, skills and experience needed in the performance of internal auditing services.</p> <p>Mazars’ internal audit staff receive an induction into internal audit however it was reported by the Mazars’ Engagement Manager that induction to the organisation (Croydon Council) consists of a briefing before each audit. In addition the follow comments were made by two senior managers directly involved in the areas subject to internal audit review:</p> <p><i>“My slight concern sometimes is the level of knowledge of some of the auditors, in relation to both Croydon and the bigger Public Sector / Local Government agenda.”</i></p> <p><i>“I wonder if the auditors, especially the younger or less experienced ones, need more extensive briefing.”</i></p> <p>Consideration should be given to strengthening the process of induction for Mazars internal audit staff to Croydon Council.</p>	<p>Contractor staff who are new to Croydon will be asked to complete the new on-line induction course that has been developed by the OD team for Croydon council staff.</p>	<p>Head of Governance</p>	<p>Done and on-going</p>

7.	<p>PSIAS state <i>“The chief audit executive must establish policies and procedures to guide the internal audit activity.”</i></p> <p>An Internal Audit Manual is in place for Mazars’ internal audit staff who undertake the majority of the internal audit work. The Head of Governance confirmed that there is no separate manual for in-house staff however they do follow a number of the same policies and procedures as Mazars’ staff e.g. report issuing. It should be ensured that in-house staff have access to the Mazars’ audit manual, that audit methodologies not covered by the manual i.e. for schools, are formally established.</p>	<p>Audit methodologies for all types of internal audit are sufficiently similar for this not to be necessary. To all intents and purposes, the Mazars audit manual covers all of the audit work undertaken by the contractor and the in-house team.</p>	Head of Governance	N/A
8.	<p>The PSIAS Code of Ethics requires internal auditors to “respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.”</p> <p>Policies in respect of document confidentiality, retention requirements and the release to internal and external parties have been developed and form part of the Mazars’ Internal Audit Manual. These were checked for consistency with Croydon’s policies at the time the contract was let but have not been checked since. Consideration should be given to ensuring that these policies remain consistent with council’s policies on confidentiality and retention.</p>	<p>This review has now been undertaken. No issues were found.</p> <p>In addition, work will soon be commencing on a new contract and specification and this issue will be taken account of in any new arrangements.</p>	Head of Governance	Done