Internal Audit Review

Cheshire East Council

Audit 2009/10

September 2010

audit
commission

Contents

Status of our reports

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors/ members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

Summary report

Introduction and background

1   Internal Audit is one of the most important features of a council's internal control environment. It is an assurance function that provides an independent and objective opinion on a council's control environment and provides assurance on internal controls through its annual audit plan. It examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economical, efficient and effective use of resources.

2   International Standards of Auditing (ISA+ 610) require us to consider and understand the activities of Internal Audit. This helps us plan our audit and develop an effective audit approach.

3   CIPFA's 'Code of Practice for Internal Audit in Local Government in the United Kingdom 2006' (the Code) sets out the standards expected of internal audit teams at local councils. The code describes the 11 organisational and operational internal audit standards. In May 2010, CIPFA issued a draft statement (the CIPFA statement) on the role of the head of internal audit, emphasizing the importance of this role. It states that the head of audit occupies a critical position in any organisation in helping it to achieve its objectives. The head of internal audit does this by giving assurance on internal control arrangements and playing a key role in promoting good corporate governance.

Table 1   Internal Audit Standards

Based on CIPFA's Code of Practice for Internal Audit in Local Government in the United Kingdom 2006

Organisational standards	Operational standards
Scope	Audit strategy
Independence	Undertaking audit work
Ethics	Due professional care
Audit Committee	Reporting
Relationships	Quality assurance
Staffing, training and development	

4   Cheshire East Council (the Council) came into existence on 1 April 2009. During its first year significant time and effort was expended in establishing the organisation. This included the review and implementation of new structures; appointment of staff; maintaining business continuity and managing the relocation of several hundred staff and a number of departments and teams.

5   For Internal Audit this meant establishing a new internal audit team and drafting and implementing an internal audit strategy and supporting plans, procedures and processes. In addition, Internal Audit has provided assistance to other parts of the Council and senior management, through its transitional audit work programme and day to day support and guidance to staff and managers.

Audit approach

6   The overall objective of our review was to ensure the Council's Internal Audit meets professional and statutory requirements for the year ended 31 March 2010. We designed our review based on the organisational standards in the Code of Practice. Our work consisted of:

- review of documentation provided by the Council;

- review of three individual audit assignment files;

- discussions with the Head of Internal Audit & Compliance (HIAC) and Internal Audit Managers; and

- review of information arising through other parts of our audit.

7   The HIAC also completed a self-assessment, which we used to inform our review.

Main conclusions

8   Overall, good progress was made in developing the Council's Internal Audit arrangements during the year ended 31 March 2010. The Internal Audit team is well placed to act as an assurance function, delivering an independent and objective opinion on the Council's control environment and assurance on internal controls through its annual audit plan.

9   Our review identified that Internal Audit met seven of the eleven CIPFA standards during the year. Of the other four standards; these were assessed as partially met mainly because the arrangements implemented had not been fully embedded or operational throughout the whole year.

10 We made a number of recommendations, highlighting areas where further development is needed to ensure that Internal Audit's future performance meets CIPFA standards. Key areas for further development include:

- implementation of a performance management and quality assurance programme for the internal audit service;

- review the role of the Council's Audit Committee against the CIPFA self-assessment checklist; and

- identification of audit staff training needs via the new employee performance and development scheme.

11 Our assessment of the compliance with each standard is shown overleaf (table 2).

Table 2   Summary of compliance with standards

The Council's Internal Audit has met or partially met the requirements of CIPFA's Code of Practice for Internal Audit in Local Government in the United Kingdom 2006

Organisational Standards	Compliance	Operational Standards	Compliance
Scope	Met	Audit strategy	Met
Independence	Met	Undertaking audit work	Met
Ethics	Met	Due professional care	Met
Audit Committee	Partially met	Reporting	Met
Relationships	Partially met	Performance, quality and effectiveness	Partially met
Staffing, training and development	Partially met		

12 Detailed findings are set out in the following section. Appendix 1 summarises our recommendations in an action plan.

Compliance with standards

Standard 1: Scope of Internal Audit

This standard covers the terms of reference of internal audit, the scope of work undertaken (including non audit work) and arrangements for the notification and investigation of suspected or detected fraud, corruption or improprieties.

13 Terms of Reference (TOR) for Internal Audit were drawn up and approved by the Governance & Constitution Committee in June 2009. The TOR covers all the key areas defined in the Code. The HIAC plans to advise the Audit Committee of the need to review the TOR on a regular basis.

14 As part of the planning process, Internal Audit staff met with all Heads of Service and CMT members to determine the scope and focus of audit work. Planning also took account of the Council's developing assurance and risk management arrangements.

15 The HIAC recognised early the need for a strong focus on shared services and partnership working. A principal auditor post with specific responsibilities for shared services and partnerships was established. The transition audit plan was prepared in conjunction with Cheshire West and Chester Council's (CWAC) Internal Audit team. Detailed discussions took place with CWAC Council about the audit of the financial shared services hosted by CWAC and these arrangements are still being developed.

16 Appropriate procedures were put in place for dealing with fraud and corruption and the respective responsibilities of Internal Audit and management have been made clear. Although the Principal Auditor (Fraud) post was vacant during 2009/10, there was sufficient experience within the audit team to undertake the work required.

Standard 2: Independence

This standard covers the independence of the internal audit function and its staff as well as the status of internal audit within the wider organisation.

17 In a deliberate move, Cheshire East Council (the Council) placed Internal Audit outside the line management of the Section 151 officer in order to ensure appropriate independence and status within the organisation. For most of the year, the HIAC reported directly to the Head of Policy and Performance, who was a member of the Corporate Management team. Since December 2009 the HIAC has reported directly to the Chief Executive.

18 The HIAC's right of access to officers and members of the Council was established in the Terms of Reference and in the Financial Procedure Rules. The HIAC also has responsibility for the Compliance Unit (risk and business continuity) but the work of the unit is kept separate from that of Internal Audit to avoid apparent conflicts. The HIAC also confirmed that there were no significant budgetary constraints in year which adversely impacted the activities of the internal audit function.

Compliance with standards

19 Internal Audit needs to ensure it is independent of the areas it audits. All Internal Audit staff completed declaration of interest forms which were reviewed by the HIAC. No conflicts of interest were identified during this exercise.

Standard 3: Ethics for Internal Auditors

This standard covers the arrangements in place to ensure that internal audit work is conducted with integrity, objectivity, competence and confidentiality

20 The Council is a new organisation and trust and confidence has taken time to establish. However, early feedback to the HIAC from heads of service has been positive. Planning meetings and other meetings between the HIAC, audit managers and service managers were used as part of the confidence building process. This process could be further bolstered through the use of feedback questionnaires to assess the effectiveness of audit assignments and delivery.

21 Internal auditors need to be perceived as being objective and free from conflicts of interest. Audit staff objectivity can be safeguarded by ensuring that audit staff do not undertake audit work in areas where they have previously had operational roles and that audit staff are regularly rotated between areas of work so as to reduce the potential threat of over familiarity. Although there was no formal rotation policy in place, the HIAC took the opportunity in year to rotate staff away from areas that they had previously worked on under the predecessor authorities.

22 Internal auditors also need to demonstrate competence in carrying out their work and to ensure that any information they receive in carrying out their duties remains confidential, although this requirement should not limit or prevent Internal Audit from reporting within the Council. The HIAC made staff aware of these requirements through team events and team briefings. The requirements were also set out in 'Risk Based Audit Procedures' document and the draft audit manual.

Recommendations	
R1	Consider using questionnaires for feedback on audit assignments.
R2	Develop a procedure for rotating audit staff between teams and areas of responsibility.

Standard 4: Audit Committees

This standard covers the purpose of the Audit Committee and its relationship with internal audit.

23 During 2009/10, the Council's Governance and Constitution Committee (the Committee) undertook the functions of an audit committee. However the terms of reference of the Committee included relatively brief references to audit committee functions. The Committee approved the Internal Audit strategy, annual audit plans and received reports on audit findings. The HIAC attended the quarterly meetings to deliver progress reports on audit delivery and any other relevant audit issues.

24 The HIAC also had regular, six weekly, meetings with the Chair of the Committee and met with the Leader of the opposition within the Council and the leader of the Liberal Democrats. There were opportunities for private meetings between the Committee and the HIAC throughout the year.

25 Late in the year, the Council agreed to set up a separate Audit committee to enhance members' oversight of financial accounting and reporting within the Council. The Audit committee met for the first time in June 2010. Once the committee has established its role, it should undertake a review of its own remit and effectiveness using the CIPFA self assessment checklist.

Recommendation
R3 Use the Audit Committee self-assessment checklist to ensure all requirements are adequately covered.

Standard 5: Relationships

This standard covers the relationships between internal audit and management, other internal auditors, elected members, external auditors and other regulators and inspectors.

26 Protocols defining how Internal Audit will work with management, members, external audit, other auditors and review agencies are in place and are set out in the Internal Audit strategy document and Internal Audit's terms of reference. A working protocol has also been agreed between the Audit Commission and Internal Audit.

27 The early focus in this area during 2009/10 was to develop effective working relationships with departmental management and at director level. Planning meetings were held with service managers to agree terms of reference and timing of work for individual audit assignments.

28 Arrangements were also put in place to support joint working with other local councils' audit teams locally. Audit Managers from the Council's Internal Audit team met with their counterparts from Cheshire West and Chester Council regularly to share:

- audit findings; and
- working on the Galileo planning system and cross over audits.

29 There is scope to further develop joint working with the Cheshire West & Chester audit team around the audit of shared services. There may also be benefits from establishing dialogue with the regulatory and inspection agencies that interact with the Council.

Recommendation
R4 Assess the benefits of establishing dialogue with relevant regulatory and inspection agencies.

Standard 6: Staffing, training and development

This standard covers the resourcing of the internal audit function and continuing training and development of audit staff.

30   Due to local government reorganisation, the Council's audit function was reviewed and a new structure implemented during 2009/10. People specifications and job descriptions were drawn up for all audit posts. Staff were appointed to the new structure based on the new job and qualification requirements. Most staff appointed were either qualified or in training. During 2009/10 there were some vacancies within the team which impacted on the delivery of the audit plan. These posts have now been filled.

31   The HIAC is qualified with a range of experience in internal audit as well as wider financial management roles. The majority of the internal audit team are also experienced auditors. While the HIAC defined the required skills and competencies for the audit team; individual training needs assessments for all members of staff were not planned for completion until late in the year, after the introduction of the Employee Performance and Development Scheme.

Recommendation
R5   Identify training needs of audit staff via the new employee performance and development scheme.

Standard 7: Audit strategy and planning

This standard covers the internal audit strategy for delivering internal audit services and annual audit planning

32   The Council's Internal Audit strategy was approved by the Governance and Constitution Committee in September 2009. The strategy covers all the requirements listed in 7.1.2 of the code including objectives and service delivery.

33   The strategy was underpinned by an annual internal audit plan. For 2009/10 the audit plan was effectively split into two parts. The initial plan for first five months focused on local government reorganisation risks. For the second half of the year - a more traditional risk based plan was approved based on an assessment of key risks and issues identified in discussions heads of service and directorate management teams. This risk based plan produced was designed to implement the audit strategy and was approved in September.

34   In January 2010, the HIAC presented an updated audit plan for approval by the Governance and Constitution Committee. The plan was revised to take account of resource issues and to changes in the prioritisation of work during the final quarter of the year.

Standard 8: Undertaking audit work

This standard covers the delivery of audit assignments including the audit approach and planning and recording of work carried out on individual assignments.

35 Internal Audit records its work using an electronic system (Galileo). The supporting document 'Risk based audit procedures' describes the required documentation for each audit assignment. During the year, work was undertaken to produce an Audit Manual with two iterations available to staff in year. The manual was updated again in March 2010 at which time a document retention policy was also agreed.

36 Our review of individual assignments confirmed there was a brief for each audit assignment. The brief sets out the objectives, scope, risks, timing, staffing and reporting requirements for each audit.

37 Our file review shows that Internal Audit's approach is risk based. During each audit auditors bring key issues to the attention of the relevant managers so they can take corrective action quickly and to avoid any surprises at the end of the audit. The Galileo system also includes arrangements for quality review of audit assignments.

38 All the files in our sample followed a similar format and the internal audit section has a standard approach to its work. The systematic use of the Galileo system for recording audit work helps and the format and content of working papers enables re-performance of work, if necessary. The working papers are satisfactory and supported by suitable evidence. We found good evidence that work is reviewed appropriately. Overall Internal Audit staff complete and record their work line with professional standards.

39 Access to audit files is largely automated through Galileo and managed by access rights. The system is managed by Cheshire East for both Cheshire East and Cheshire West and Chester Councils but hosted by the latter. Access rights to information on the system were reviewed during the year to ensure that the Councils could only access their own records.

Recommendation
R6 Ensure regular review of the retention of audit documentation to ensure that it continues to meet all legislative requirements.

Standard 9: Due professional care

This standard covers the principles of due professional care and responsibilities of internal audit staff and the head of internal audit.

40   During the year all audit staff had access to the Code of Practice for Internal Audit in Local Government in the United Kingdom 2006 which sets out requirements in relation to exercise of due professional care. In addition audit staff were reminded of the need for professional objectivity at regular team meetings and received reminders on declarations of interest, gifts and hospitality. All internal audit staff made declarations of interests for the year and these were reviewed by the Head of Audit. Audit staff were also made aware of the procedures in place to capture whistle blowing allegations and disclosure of suspected frauds.

41   The HIAC set out a review programme to in the 'Risk Based Audit Procedures' document to monitor and maintain standards of professional care within the audit team. Review of specific assignments by audit managers and team leaders should enable the identification of any significant breaches of due professional care.

42   The draft Audit Manual also sets out what is expected from staff in relation to ethics and due professional care.

Standard 10: Reporting

This standard covers reporting of audit work and follow up audits as well as annual reporting and presentation of the audit opinion.

43   The document entitled 'Risk Based Auditing Procedures' sets out specific requirements about the:

- format and content of internal audit reports;
- quality assurance of reports;
- the requirement to give an opinion;
- the process for agreeing reports and action plans with recipients; and
- follow up and escalation procedures.

44   Audit reports use a traffic light system to give an opinion on exposure to risk at assignment level. Audit staff received training in the principles of the system to ensure that they applied the approach consistently.

45   We found that audit files included proper evidence and working papers to support the main conclusions in reports. Our review of assignments confirmed that reports are:

- issued quickly;
- discussed and agreed with managers.

46   Where weaknesses result in significant risks, there were arrangements in place to report matters upwards to Corporate Management Team.

47 In June 2010, the HIAC issued her first annual report for Cheshire East Council. It set out the HIAC's opinion on the overall adequacy and effectiveness of the Council's control environment and a summary of work delivered to support the opinion. This report was produced to support the Council's Annual Governance Statement and covered the expected areas set out in the Reporting Standard. Arrangements were also in place during the year to enable the HIAC to report interim findings.

Standard 11: Performance, quality and effectiveness

This standard covers quality assurance procedures for audit work and arrangements for monitoring performance and effectiveness of the internal audit function.

48 The HIAC prepared a draft Audit Manual for the Council's Internal Audit team with a planned implementation date of March 2010. The draft Manual included guidance on carrying out audit assignments and made reference to the need for auditors to compliance with the Code of Practice.

49 When audit managers assign work to auditors, they are required to ensure that staff have suitable skills, experience and competence to complete those assignments. Internal Audit staff are also required to be appropriately supervised including:

- coaching (where needed)
- monitoring of progress with assignments; and
- supervisory review of work.

Our review of a sample of audit assignments did not identify any issues around adequacy of skills or levels of supervision.

50 However, a performance management and quality assurance programme was not fully in place for 2009/10. The HIAC began developing performance and effectiveness monitoring arrangements to assess the internal audit service and individual audit assignments but these were not fully embedded for the entire year. The HIAC is considering using questionnaires on individual audits or annual surveys to further develop performance review arrangements for Internal Audit.

Recommendation
R7 Finalise the implementation of arrangements to assess how effectively the Internal Audit service is performing.
R8 Develop a performance management and quality assurance programme to ensure compliance with the Code of Practice and against the strategy. The programme should include as a minimum: - performance targets; - use of feedback, and - reviews.

Appendix 1 – Action plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
7	R1 Consider using questionnaires for feedback on audit assignments.					
7	R2 Develop a procedure for rotating audit staff between teams and areas of responsibility.					
8	R3 Use the Audit Committee self-assessment checklist to ensure all requirements are adequately covered.					
8	R4 Assess the benefits of establishing dialogue with relevant regulatory and inspection agencies.					
9	R5 Identify training needs of audit staff via the new employee performance and development scheme.					
10	R6 Ensure regular review of the retention of audit documentation to ensure that it continues to meet all legislative requirements.					

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
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12	R8 Develop a performance management and quality assurance programme to ensure compliance with the Code of Practice and against the strategy. The programme should include as a minimum: • performance targets; • use of feedback, and • reviews.					

The Audit Commission

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