**Report to:**   **Audit Sub-Committee**

**Subject:**   **Internal Audit Strategy**

**Date:**   **12th September 2005**

**Author:**   **Manager of Resource Services**


## 1. PURPOSE OF REPORT

To produce a revised Internal Audit Strategy, which reflects the needs of the Authority.


## 2. BACKGROUND

The Authority has previously produced four-year strategies based upon a plan of audit activity to cover all systems and all departments during that period.

The previous four-year strategy had been extended to ensure a good level of internal audit service until March 2005.

The use of risk analysis in creating annual audit work plans has been put in place for the year 2005/06 and is reflected in the Internal Audit Strategy.


## 3. SUMMARY

The attached document sets out how the Internal Audit Service will be delivered and how assurance can be obtained from the work undertaken.

The Internal Audit Strategy also details the resources required and available together with the qualifications and experience required to provide an effective Internal Audit Service.

## 4. CONCLUSION

Members are asked to note and to make comments, where appropriate, upon the Internal Audit Strategy.

# Gedling Borough Council

# Internal Audit Strategy
## 2005

## Background

In the past Gedling Borough Council has had an Internal Audit Strategy based upon a four-year cycle of audits. This ensured that within the four-year period all key financial systems within each department were audited and tested. In addition to this resources were allocated to undertaking departmental and specialist audits.

The last four-year plan was created for the years 1999/2000 through to 2002/2003 and this was extended to cover the 2003/04 to 2004/05 periods.

Previously the strategy would include annual audit plans for the four-year period based upon broad risk assessments. These risk assessments took account of the size of the system (transaction volumes and values) and the internal Audit knowledge and experience of Manager of Resource Services. The Audit Commission reviews the strategy, but has commented on the level of subjectivity in the risk analysis.

When Strategic and Operational risk assessments of all of the Authority's activities are undertaken and reviewed on an ongoing basis, the use of a four-year strategic plan is questionable. How could a four-year plan accurately reflect the risks being identified during the period? It could be possible that a new risk identified in year 1 of the plan is not audited until year 5 (year I of the subsequent plan). These are questions that CIPFA also suggest Authorities consider when creating their strategic plans.

It is therefore prudent and practical to have annual audit risk assessments, which create and direct annual audit plans.

This document sets out the Internal Audit Strategy for the Authority. It is compromises of two parts. The first deals with how the service will be delivered and the second deals with the more detailed planning of resources and audit risk assessments.

# Strategy Statement

The overall strategy of Internal Audit is:

***"To deliver a risk-based audit plan in a professional, independent manner, to provide the Authority with an opinion on the level of assurance it can place upon the internal control environment, and to make recommendations to improve it."***

The terms of reference for Internal Audit are summarised within the Financial Regulations of the Authority.

# PART 1

## Statutory basis for Internal Audit

The requirement for an Internal audit function for Local Authorities is implied by section 151 of the Local Government Act 1972, which specifically requires that authorities " make arrangements for the proper administration of their financial affairs". Regulation 6 of the Accounts and Audit Regulations 2003 more specifically requires that "a relevant body shall maintain an adequate and effective system of internal audit of its accounting records and a system of internal control in accordance with proper internal audit practices".

## Definition and Objective

Internal Audit is an assurance function that primarily provides an independent and objective opinion to the Authority on the control environment comprising risk management, control and governance, by evaluating its effectiveness in achieving the Authority's objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources.

From 2004 the Authority is required to provide a Statement on Internal Control within the Statement of the Accounts. Internal Audit will form an important and integral part of providing this assurance.

**Status**

Internal Audit is responsible to the Head of Finance for line management purposes, and in delivery of the statutory financial responsibilities of the Chief Financial Officer (s 151). However, Internal Audit is independent in its planning and operation, and has no responsibility for delivering or managing non-audit services.

The Chief Internal Auditor (Manager of Resource Services) shall have direct access to the Chief Executive, all levels of management and elected members. Internal Auditors shall have authority to:

- Enter at all reasonable times any Council establishment
- Have access to all records, documents, information and correspondence relating to any financial and other transaction as considered necessary
- Evaluate the adequacy and effectiveness of internal controls designed to secure assets and data to assist management in preventing and deterring fraud
- Request explanations as considered necessary to satisfy themselves as to the correctness of any matter under examination
- Require any employee of the Council to produce cash, materials or any other Council property in their possession or under their control
- Access records belonging to third parties, such as contractors or partners, when required and appropriate

**Delivery of the Audit Service**

The Manager of Resource Services is responsible for delivering the audit service in accordance with its terms of reference. To ensure that this can be achieved, there are appropriate arrangements for:

- Determining and planning the work to be carried out (i.e. an audit plan based on an assessment of risk)

- Providing the resources required to deliver the audit plan (principally the level of staff and external input), the necessary skills (both in general audit and technical areas) and support facilities (such as IT facilities, equipment and management and administration processes).

- Ensuring a level of service that meets the requirements of the External Auditors and which complies with the Internal Audit Code of Practice.

Detail on the risk assessments used, the planning of resources and the code of practice is given in Part 2 of this document.

## Statement on Internal Control

Internal Audit has a key role to provide assurance to support the Statement on Internal Control.

**Appendix A** is a diagrammatic representation to the assurance process at Gedling Borough Council.

Internal Audit provides assurance through the audit work undertaken. Each report gives an auditor judgement on the level of internal control within the system being audited and reported on. Each of these assurance statements influence the Assurance Statement given by the Manager of Resource Services within the Annual Audit Report.

The Statement of Assurance given by the Manager of Resource Services is further supported by the individual assurance provided by Heads of Service, Heads of Unit, Deputy Chief Executive, Monitoring Officer, Chief Financial Officer and Chief Executive. In addition to this is the assurance obtained from external agencies reviews of the authority (e.g. Planning Inspectorate, Housing Benefit Inspectorate).

Ultimately Internal Audit is strategically placed to ensure that all significant issues are included within the Statement on Internal Control as Internal Audit should be knowledgeable of all significant issues that provide a risk to the Authority.

# PART 2

## Risk Management

Over the past eight years Risk Management within the Authority has been developing and is now a core element of the activities that the Authority undertakes. Since 2003 there has been a strategic risk register in place, which is reviewed by Senior Management Team and reported to members as part of the Corporate Governance procedures.

In 2004 departmental Operational Risk registers were created and these are reviewed on an ongoing basis, with an annual review in September, which informs the budget process.

Risk assessments have been included in the evaluation of budget growth bids for the past 3 years and in 2004 were refined further to reflect the process and risk assessment methodology being used in the Corporate and Operational Risk assessments.

All of this valuable information on the risks that the authority face have to influence the Internal Audit Strategy and Annual Audit Plans. To exclude them would have no regard for the organisation in its achievement of its mission and objectives.

## Audit Strategy

The Audit Strategy is an over-arching document which details how the Internal Audit Service will be provided and how resources are applied to fulfil those service requirements.

This will be a document, which is adapted to meet changes in the business needs of the authority, regularly reviewed, and significant changes will be reported on to Audit Sub-Committee.

There is no need to include 4 year plans of audit activity this is now replaced with the need to undertake annual audit assessments and create annual audit plans, thereby creating continuous audit planning

## Audit Risk Assessments

Whilst Corporate and Operational Risk registers are informative they alone cannot be used to assess the organisations audit risks. They can however, be used to highlight new risks and areas that the audit risk assessment should include. They also provide a system, which requires auditing in its own right.

Audit risk assessments need to be more transparent and less subjective than the previous methods of assessment. However, the elements of the previous assessment such as volume of transactions, values and audit opinion still need to be included.

Regard should also be taken of other assurance agencies work, risk analysis using the authority's risk matrix model, time since last audit and third party sensitivity. These elements can be categorised into three main headings; size, control and detection.

**Appendix B** gives an example of the Audit Risk Assessment model being used to create the Annual Audit Plan. This model was presented to Audit sub-committee on 9th June 2005, where it was agreed that any changes to the way in which the model operates would be reported back for approval.

## Annual Audit Plan

From the Audit Risk Assessment model an annual audit plan is automatically produced. Based upon the duration of the previous audit and the priority ranking the total number of days is calculated.

The only variances to this calculation would be for specific contingencies. For example carry-forward audits, new IT systems or an area of specific concern, where the assessment model does not allocate what is considered to be sufficient audit days by the Manager of Resource Services. These contingencies should be kept to an absolute minimum and additional allocations separately identified.

Once the Audit Risk Assessment model has calculated the days required for each audit and in total this can be used to create quarterly plans for individual auditors.

The Annual Audit Plan is reported to Audit Sub-Committee for their input and approved by the Head of Finance. A copy of the approved annual plan will be made available on the Authority's website and the approved 2005/06 plan is included as **Appendix C**.

## Internal Audit Resources

**Resources Available**

The current structure for the Resource Services Section is as follows:

> 1 x Manager (28 hours)
> 1 x Principal Auditor (18.5 hours)
> 1 x Resource Management Officer (18.5 hours)
> 3 x Internal Auditors (2 full time, 1 x 18.5 hours)
> 1 x Risk Management Administrator

The section is also responsible for Insurance, Risk Management, Business Continuity and Corporate Governance monitoring. These duties undertaken by the Manager, the Resource Management Officer and the Risk Management Administrator.

**Appendix D** gives details on the Audit Resources available expressed as Audit Man Days.

Currently, the section is using savings from the vacancies of Principal Auditor and the part-time Auditor to finance Audit days being purchased from the County, under a partnership arrangement and for a scheme to develop CIPFA trainees under a partnership arrangement with the East Midlands Local Government Association. The latter scheme demonstrates the authority's continued commitment to train suitably qualified staff. The scheme is due to continue until December 2006.

**Resource Matching**

It is possible that the audit days required by the Audit Risk Assessment Model do not match the actual resources available within the section and its arrangements with other partners.

Under Resourced

Where there appears to be an under resource issue this should be investigated further. If the shortage is less than 30 days then the duration allocated to audits, particularly low priority audits should be reviewed to see if these could be altered without compromising the audit time required to give a satisfactory level of assurance.

Where there is a shortage is greater than 30 days, the Manager of Resource Services should determine whether the resources are sufficient to allow a robust audit opinion on the state of the internal control environment. If, in the opinion of the Manager of resource Services, there are insufficient resources available, this must be reported to the Head of Finance and Audit Sub-Committee. The likely outcomes of such a report might include the provision of additional resources to review the identified risks or an acceptance that an increased level of risk must be borne by the Authority.

Where a shortage is identified year on year then a full review of Internal Audit resources should be undertaken.

Over Resourced

Where there appears to be an over resource issue this should also be investigated further. If the surplus is under 30 days then the duration allocated to audits, particularly high priority audits should be reviewed to see if these could be altered without compromising the effectiveness of the audit section.

Where the surplus is greater than 30 days the Manager of Resource Services, through consultation with senior management and members, should undertake a review to ascertain whether there are any additional areas that would benefit from audit work or if any audits required in the following year could be brought forward.

Where a surplus is identified year on year then a full review of Internal Audit resources should be undertaken.

## Qualifications and Experience

The following minimum requirements relate to the Internal Audit posts:

Manager of Resource Services

CCAB qualified, preferably CIPFA or IIA with experience

Principal Auditor

CCAB part qualified or IIA or MAAT with experience

Internal Auditors

IIA or MAAT or experience

Currently the section has a CIPFA qualified manager, CIPFA trainee and two internal auditors who are well experienced in audit and one is part qualified CIMA. The work undertaken by the County is carried out by minimum MAAT qualified staff.

## Code of Practice for Internal Audit

In 2003 CIPFA published a new code of practice for Internal Audit in Local Government in the United Kingdom. This publication update the Code issued in 2000, based upon the then Audit Practices Committee 1990 internal auditing guideline.

The new code took into account significant changes in the nature, scope and practice of internal audit that has taken place since 1990.

The revised code defines Internal Audit as follows:

"Internal Audit is an assurance function that primarily provides an independent and objective opinion to the organisation on the control environment comprising risk management, control and governance by evaluating its effectiveness in achieving the organisations objectives. It objectively examines, evaluates and reports on the

adequacy of the control environment as a contribution to the proper, economic and efficient use of resources."

The code consists of standards in two groupings. The first encompasses the organisational and structural aspects of internal audit; the second encompasses the activity and operation of internal audit.

| Organisational Standards | Operational Standards |
|---|---|
| 1 Scope of Internal Audit | 6 Audit Strategy |
| 2 Independence | 7 Management of audit assignments |
| 3 Audit Committees or equivalent | 8 Due professional care |
| 4 Relationships with Management, other auditors and other review bodies | 9 Reporting |
| 5 Staffing, training and development | 10 Quality assurance |

In addition to this the Code introduces a new section on ethics for Internal Auditors. This sets minimum standards for the performance and conduct of all Internal Auditors.

The Audit Commission undertakes an annual review of the Internal Audit function and the quality of its work. When undertaking the review they ensure compliance with the Code and where relevant make recommendations on how compliance can be improved or developed further. A detailed review of Internal Audit work is also undertaken every 3-4 years.

**Statement on Internal Control**

**Assurance Process at Gedling Borough Council**

| Responsible Officers | |
|---|---|
| CFO & Council | Statement of Accounts |
| Chief Exec & Leader | Statement on Internal Control |
| Manager of Resource Services | Internal Audit Assurance Statement |
| Chief Exec., Deputy Chief Exec., CFO & Monitoring | Chief Executive Statement — Deputy CE Statement — Chief Financial Officer Statement — Monitoring Officer Statement |
| Heads of Service/Unit & Mgr of Resource Services | Departmental Statements from Heads of Service And Head of Unit |

**INTERNAL AUDIT**

**RISK ASSESSMENT MODEL**

Example given: Leisure Income

| | | Score 1-5 | Weighting | Total | max | Weighted Score |
|---|---|---|---|---|---|---|
| **Internal Audit Risk Assessment Model** |
| | | | | | | |
| | **SIZE** | | | | | |
| A | Value of budget | 3 | 2 | 6 | | |
| B | No. of Employees | 4 | 1 | 4 | | |
| C | Impact per risk matrix | 2 | 3 | 6 | | |
| D | Volume of transactions | 5 | 1 | 5 | | |
| | | | | | | |
| | **Total size score** | | | **21** | **35** | **0.6** |
| | | | | | | |
| | **CONTROL** | | | | | |
| F | Impact – mgt & staff | 4 | 2 | 8 | | |
| G | Third Party sensitivity | 2 | 1 | 2 | | |
| H | Std of internal Control | 4 | 3 | 12 | | |
| J | Likelihood per risk matrix | 3 | 3 | 9 | | |
| | | | | | | |
| | Total Control Score | | | **31** | **45** | **0.6889** |
| | | | | | | |
| | **DETECTION** | | | | | |
| K | Effectiveness of audit | 3 | 1 | 3 | | |
| L | Duration of audit | 3 | 2 | 6 | | |
| M | Time since last review | 3 | 2 | 6 | | |
| N | Other review agencies | 3 | 2 | 6 | | |
| | | | | | | |
| | Total Detection Score | | | **21** | **35** | **0.6** |
| | | | | | | |
| Multiply each sections weighted total by each other and then by 200 | |
| | | | | | | |
| | **Weighted Final Score** | | **50** |

# INTERNAL AUDIT

## PLANNED ACTIVITY 2005/06

|  | | **PLANNED DAYS** |
|---|---|---|
| **DAYS AVAILABLE** | | 799 |
| LESS: | | |
| Bank Holidays and Annual Leave | 108 | |
| Sickness | 10 | |
| Training | 59 | |
| Vacancies | 0 | |
| Meetings/Admin | 54 | |
| Management | 32 | |
| | | (263) |
| **AUDIT DAYS AVAILABLE** | | **536** |
| | | |
| **PLANNED ACTIVITY** | | |
| Key Financial Systems | 231 | |
| Other Financial Systems | 47 | |
| Departmental Audits | 110 | |
| Specialist Audits | 148 | |
| **Total Planned Activity** | | **536** |

# INTERNAL AUDIT

## Detailed Activity 2005/06

| AUDIT AREA | PRIORITY (Per Risk Assessment) | Audit Days |
|---|---|---|
| **KEY FINANCIAL SYSTEMS** | | |
| Housing Benefits | 2 | 30 |
| Capital | 3 | 15 |
| Housing Rents | 3 | 15 |
| Housing Repairs | 3 | 15 |
| Council Tax | 3 | 15 |
| NNDR | 3 | 15 |
| Leisure Income | 3 | 15 |
| FMS | 3 | 10 |
| Officers Disbursements | 4 | 10 |
| Insurance & Inventory | 4 | 10 |
| Cash Receipting | 4 | 10 |
| Payroll | 4 | 10 |
| Debtors | 4 | 10 |
| Creditors | 4 | 10 |
| Lending & Borrowing | 4 | 5 |
| Bank Accounts | 4 | 5 |
| C/fwd from 2004/05 Insurance & Inventory | | 11 |
| Finishing from 2004/05 various | | 20 |
| | | **231** |
| **OTHER FINANCIAL SYSTEMS** | | |
| HB Performance Standards | 3 | 20 |
| Supporting People | 3 | 12 |
| VAT | 4 | 5 |
| Leasing | 4 | 5 |
| Cash-ups Leisure | 4 | 3 |
| Cash-ups Finance | 5 | 2 |
| | | **47** |
| **DEPARTMENTAL** | | |
| Personnel & Organisational Development | 2 | 30 |
| Housing | 23 | 15 |
| Leisure | 3 | 15 |
| Direct Services | 3 | 15 |
| Planning & Environment | 3 | 10 |
| Legal & Democratic Services | 3 | 10 |
| Finance | 3 | 10 |
| Cabinet Office | 4 | 5 |
| | | **110** |

| SPECIALIST | | |
|---|---|---|
| Computer Audit | 2 | 30 |
| Contract Systems | 3 | 15 |
| Performance Indicators | 3 | 10 |
| Contingency | 4 | 30 |
| Contract Final Account | 4 | 15 |
| Data Protection | 4 | 5 |
| Risk Management/Corporate Governance | 5 | 5 |
| Performance Indicators additional resource | | 10 |
| New Financial Systems – testing | | 20 |
| Contract – Departmental Work | | 8 |
| | | **148** |
| **GRAND TOTAL** | | **536** |

# INTERNAL AUDIT

## RESOURCES AVAILABLE

|                                  |      | **DAYS** |
|----------------------------------|------|----------|
| **DAYS AVAILABLE**               |      | 875      |
|                                  |      |          |
| LESS:                            |      |          |
|                                  |      |          |
| Bank holidays & Annual Leave     | 131  |          |
| Sickness                         | 12   |          |
| Training                         | 40   |          |
| Meetings/ Admin                  | 60   |          |
| Management                       | 32   | (275)    |
|                                  |      |          |
| **TOTAL DAYS AVAILABLE**         |      | **600**  |