



INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

# Lancaster City Council

Review of Internal Audit

April 2009

AUDIT

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# Executive Summary

## Overall conclusions

From the review of Internal Audit we have concluded that the section contributes to the overall internal control environment of Lancaster City Council.

Internal Audit has developed good practice in a number of areas, including:

- developing a detailed Internal Audit Charter that sets out aims, objectives and responsibilities;
- developing effective working relationships with Management Teams and the Audit Committee;
- operating as an appropriately staffed Internal Audit team in terms of numbers, grades, qualification levels and experience;
- the competency Framework for assessing Internal Auditors; and
- the use of standard working papers and report templates on each internal audit assignment.

The table below outlines our assessment of whether Internal Audit has met the standards in CIPFA's Code of Practice for Internal Audit.

Standard	Whether Internal Audit has met the standard
Scope of Internal Audit	Partially met
Independence	Partially met
Ethics for Internal Auditors	Partially met
Audit Committees	Met
Relationships	Met
Staffing, Training and Continuing Professional Development	Met
Audit Strategy and Planning	Met
Undertaking Audit Work	Met
Due Professional Care	Partially met
Reporting	Met
Performance, Quality and Effectiveness.	Met

## Executive Summary *(continued)*

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The table shows the areas where Internal Audit has met and partially met the standard. Further arrangements are required to fully meet all of the standards. Areas where improvements should be made include:

- developing an annual certificate for staff to complete to register independence, compliance with ethical behaviour, confidentiality and to show an understanding of the fraud guidelines;
- distributing the Annual Audit Plan to the Departmental Management Teams; and
- introduction of a formal quality assurance process.

### **Way forward**

The recommendations included within this report are consolidated in the form of an action plan. We will follow up the actions taken as part of our 2008/09 audit.

# Introduction

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## Internal Audit

Internal Audit is an assurance function that primarily provides an independent and objective opinion to the organisation on the control environment by evaluating its effectiveness in achieving the organisation's objectives. The control environment comprises risk management, control and governance. 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.

## Background

Internal Audit at Lancaster City Council (Lancaster CC) is managed by the Internal Audit Manager, who reports to the Head of Financial Services.

Internal Audit comprises 4.81 full time equivalent staff members who have a range of experience and relevant qualifications.

The Internal Audit service is provided across all departments as set out in the three year strategic audit plan.

## Audit approach

Our approach in reviewing the Internal Audit section is to:

- evaluate whether Internal Audit meet the required professional standards. This is completed cyclically;
- update our understanding of the quality of Internal Audit work. This is completed annually;
- annually review specific pieces of Internal Audit work on which we seek to place reliance.

We have reviewed Internal Audit's work against the required standards in the CIPFA Code of Practice for Internal Audit in Local Government 2006, as listed below.

More details of what each standard requires, the good practice demonstrated by Lancaster CC and the scope for improvement is in the relevant sections of this report.

- Scope of internal audit
- Independence
- Ethics for Internal Auditors
- Audit Committees

## Introduction *(continued)*

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- Relationships
- Staffing, training and continuing professional development
- Audit strategy and planning
- Undertaking audit work
- Due professional care
- Reporting
- Performance, quality and effectiveness.

We gained an understanding of the arrangements in place and evaluated their adequacy in practice through discussions with Internal Audit officers and reviewing the following documents:

- Audit plans
- Internal Audit Charter
- Audit working papers/files:
  - Ordering and Payments
  - NNDR (Business Rates)
  - Performance Management
- Audit reports
- Financial regulations
- Internal Audit manual

# Scope of Internal Audit

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## The Standard

CIPFA guidance states that to achieve full effectiveness the terms of reference of Internal Audit should be formally defined and should establish responsibilities and objectives, reporting lines and rights of access.

The standard also states that:

- provision should be made to form an opinion on key systems operated for other bodies;
- the scope of Internal Audit should be dependant on the results of the organisation's risk management processes;
- arrangements should be in place to ensure all cases of suspected fraud and corruption are referred to Internal Audit.

## Good practice at Lancaster CC

Internal Audit has recently developed terms of reference that have been agreed with the Council's Audit Committee. The terms of reference set out the objectives and responsibilities of the service. Internal Audit plans for the terms of reference to be reviewed and reported annually to the Audit Committee.

Internal Audit has developed an audit approach which encompasses the risk management processes of Lancaster CC. Meetings are held with Service Heads to explore service objectives, risks identified on the risk register and other sources of assurance. These meetings are used to identify potential audit areas and then to scope those areas identified.

Internal Audit carry out proactive fraud work, for example, as part of the 2008/09 audit plan a review is being undertaken of the fraud arrangements across the Council. Internal Audit also take part in the National Fraud Initiative. The approach taken by the Council encompasses people wider than Internal Audit, which raises the profile of this work.

## Scope for improvement

The Financial Regulations set out the need and responsibilities for effective Internal Audit, however, there is no reference to the Internal Audit Charter, either as a separate document or as an appendix.

Financial regulations explain that any instances of fraud must be reported to Internal Audit, in line with the procedures set out in the Authority's fraud strategy. However, the fraud strategy states it should be reported to an 'appropriate manager or Internal Audit Manager, if necessary'. Our review of this strategy has revealed that it has not been updated since 2002.

## Scope of Internal Audit *(continued)*

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### **Recommendation 1**

The Financial Regulations should be expanded to give reference to the Internal Audit Charter either as a separate document or as an appendix.

### **Recommendation 2**

Lancaster CC should ensure that the Anti Fraud Strategy is regularly updated and approved to ensure that all staff are following the correct procedures in relation to reporting suspected cases of fraud to Internal Audit.

### **Overall assessment**

The overall assessment is that the standard has been partially met. This assessment has been made on the basis that the scope for improvement identifies only some areas of non-compliance with the standard.



# Independence

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## The Standard

The CIPFA standards states that Internal Audit should be sufficiently independent of the activities that it audits to enable auditors to perform their duties in a manner which facilitates impartial and effective professional judgements and recommendations. Internal auditors should have no operational responsibilities.

The status of Internal Audit and the Head of Internal Audit and the rights of access to records, assets, personnel and premises have significant impact on the ability of Internal Audit to maintain its independence.

## Good practice at Lancaster CC

Internal Audit has prepared a three year Strategic and Business Plan and annual audit plan in liaison with the service's customers that has been presented to the Audit Committee.

Only the Internal Audit Manager has operational duties, such as the role of deputy s151 officer. Individual Internal Auditors have no operational duties.

## Scope for improvement

The Internal Audit Manager is joint Deputy s151 Officer with the Accountancy Services Manager. As this role is an operational role, there is potential for conflicts of interest. This potential conflict should be acknowledged and plans to mitigate any conflict should be developed and included in the Internal Audit Manual and Strategic and Business Plan.

The declarations of interest for Internal Audit staff, other than the Internal Audit Manager and the Principal Auditor, have not been up-dated since 1999/2002. These should be up-dated on a regular basis. It is best practice for declarations of interest to apply to all staff appointed within the Internal Audit function.

## Recommendation 3

The Internal Audit Manager performs a dual role, which could create a conflict of interest. This should be acknowledged and plans to mitigate any conflict should be developed and included in the Internal Audit Manual and Strategic and Business Plan.

## Overall assessment

The overall assessment is that the standard has been partially met. This assessment has been made on the basis that the scope for improvement identifies some areas of non-compliance with the standard.

# Ethics for Internal Audit

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## The Standard

The CIPFA standard notes that the Head of Internal Audit should regularly remind Internal Audit staff of their ethical responsibilities. The standard notes four main principles that should be observed:

- integrity;
- objectivity;
- competence; and
- confidentiality.

## Good practice at Lancaster CC

The Internal Audit Charter picks up on the four core principles (that is, integrity, objectivity, competence and confidentiality) outlined in the standard.

Work of auditors is supervised by senior auditors and audit managers within the section. This ensures that support is available where auditors may have less experience in an area being audited.

Employee development plans are in place to ensure that auditors are equipped with the skills, and are therefore competent, to carry out their duties.

## Scope for improvement

There is no record held within Internal Audit that confirms whether staff have received regular ethics and independence guidance. In addition, declarations of interest for staff below the Principal Auditor are not mandated.

### Recommendation 4

In order to comply with the Code of Conduct for Local Government, the Internal Audit team should be issued with ethics guidance and declare any interests that compromises their position as an Internal Auditor. This could be done by completing an annual certificate to register independence, compliance with ethical standards, confidentiality and to acknowledge understanding of the fraud procedures.

## Overall assessment

The overall assessment is that the standard has been partially met. This assessment has been made on the basis that the scope for improvement identifies some areas of non-compliance with the standard.

# Audit Committees

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## The Standard

The CIPFA standard states that the main objective of an audit committee or equivalent is to independently contribute to the organisation's overall process for ensuring that an effective internal control environment is maintained. The primary focus of this work has historically related to internal financial control matters such as the safeguarding of assets, the maintenance of proper accounting records and the reliability of financial information. With the requirement to make wider the statements on internal control (or Annual Governance Statement), organisations are increasingly looking to audit committees to provide assurance on wider arrangements relating to all internal controls.

## Good practice at Lancaster CC

Lancaster CC has an Audit Committee which meets regularly. Terms of reference states that the Audit Committee will review summary Internal Audit reports, receive annual reports and approve Internal Audit plans and strategy. This has been confirmed through the review of Committee papers.

The Internal Audit Manager attends all Audit Committee meetings.

Lancaster CC is a member of the Lancashire District Audit Group that analyses/benchmarks performance of the service against similar services around the Lancashire region.

## Scope for improvement

Although Internal Audit distributes post audit customer satisfaction questionnaires, response from its customers is optional.

The Audit Committee does not currently receive any performance information in relation to Internal Audit's work, such as the proportion of recommendations accepted by management. Internal Audit should liaise with the Audit Committee to assess the Committee's appetite for such information. This could assist Audit Committee's assessment of the effectiveness of Internal Audit.

## Recommendation 5

Internal Audit should actively pursue non receipt of post audit customer satisfaction questionnaires after the completion of audit work.

## Audit Committees *(continued)*

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### **Recommendation 6**

Internal Audit should liaise with the Audit Committee to assess the Committee's appetite for performance information in relation to the work of Internal Audit.

### **Overall assessment**

The overall assessment is that the standard has been met. This assessment has been made on the basis that the scope for improvement identifies only non-significant areas for improvement that would further improve the achievement of the standard.

# Relationships

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## The Standard

The CIPFA standard states that Internal Audit should seek to co-ordinate Internal Audit plans and activities with line managers, other Internal Auditors, external audit, inspection bodies and other review agencies to ensure the most effective audit coverage is achieved and duplication of effort is minimised.

## Good practice at Lancaster CC

Timing of audit work is agreed with departmental contacts prior to the audit visit except where the visit is an unannounced visit.

Prior to the issuing of the final audit report, recommendations are discussed with management and adjustments are made where appropriate. Reports are issued when all recommendations have been approved.

The Internal Audit Manager reviews progress of the implementation of recommendations on a quarterly basis. The results are reported to the Audit Committee.

Meetings take place between Internal Audit and External Audit to coordinate the managed audit process and to avoid the duplication of work, wherever possible. This relationship is developing well.

## Scope for improvement

Although the annual audit plan is presented to the Audit Committee, copies are not currently distributed to the Departmental Management Teams. However, as the plan develops Internal Audit will keep in contact with Service Heads in identifying areas for audit and scoping pieces of work.

### Recommendation 7

Internal Audit should distribute the annual audit plan to the Departmental Management Teams. This would give them the opportunity to feed this information back to an operational level.

## Overall assessment

The overall assessment is that the standard has been met. This assessment has been made on the basis that the scope for improvement identifies only non-significant areas for improvement that would further improve the achievement of the standard.

# Staffing, Training and Continuing Professional Development

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## **The Standard**

The CIPFA standard states that Internal Audit should be appropriately staffed in terms of numbers, grades, qualification levels and experience, having regard to its objectives and to the CIPFA standards. Internal auditors should be properly trained to fulfil their responsibilities and should maintain their professional competence through an appropriate ongoing development programme.

## **Good practice at Lancaster CC**

Internal Audit is staffed appropriately in terms of experience, grades, qualifications and specialist knowledge. The Internal Audit function has five staff (four of which are full time employees). The Internal Audit Manager is a member of the Chartered Institute of Public Finance Accountants and all other officers are members of the Association of Accounting Technicians.

All Internal Audit staff receive an annual Employee Development and Performance Appraisal Interview that considers strengths and areas for development in the future. Staff Development Interviews identify training requirements that are entered into an individual's Performance Appraisal Development Action Plan.

Internal Audit have created a Competency Framework against which individual auditors are assessed on a six monthly basis.

Personal specifications include relevant experience and personal attributes required for Internal Audit staff.

## **Scope for improvement**

We have not identified any scope for improvement in relation to this area of the standard.

## **Overall assessment**

The overall assessment is that the standard has been met. This assessment has been made on the basis that we have not identified any areas with scope for improvement in relation to this standard.

# Audit Strategy & Planning

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## The Standard

The CIPFA standard states that the audit strategy is the high-level statement of how the Internal Audit service will be delivered and developed. It can be presented as a document in its own right or integrated into an existing document, such as the business or service plan. To implement the audit strategy, Internal Audit should prepare a risk-based audit plan.

## Good practice at Lancaster CC

Internal Audit has produced a draft three year strategic and business plan that has been presented to and approved by the Audit Committee.

Internal Audit's audit plan is risk-based, incorporating information from each departmental risk register. The plan identifies the resource requirements to implement the plan. Appropriate levels of contingency are built into the plan to reflect emerging risks and changing priorities.

## Scope for improvement

None of the strategic documents that have been written by Internal Audit give reference to Internal Audit's involvement in the preparation of the Annual Governance Statement, review of corporate governance arrangements, risk management processes and key internal system controls.

The audit plan presented to the Audit Committee does not document the scope of the work being undertaken on the systems and other areas of the audit plan. Best practice is to highlight to Audit Committee a brief description of the scope and objective of individual audit assignments, where this does not conflict with the nature of the assignment.

## Recommendation 8

Internal Audit should develop the strategic and business plan to include Internal Audit's input into the Annual Governance Statement, corporate governance arrangements, risk management processes and key internal system controls.

# Audit Strategy and Planning *(continued)*

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## **Recommendation 9**

The annual audit plan presented to the Audit Committee may benefit from giving a brief description of the scope and objective of individual audit assignments, where this does not conflict with the nature of the assignment.

## **Overall assessment**

The overall assessment is that the standard has been met. This assessment has been made on the basis that the scope for improvement identifies only non-significant areas for improvement that would further improve the achievement of the standard.



# Undertaking Audit Work

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## **The Standard**

The CIPFA standard states that the management of audit assignments should ensure audit assignments have appropriately detailed briefs. A systematic approach should be applied in conducting the assignment. All assignments should be documented to the standard required by the Head of Internal Audit. The Head of Internal Audit should also identify arrangements for following up previous audit findings.

## **Good practice at Lancaster CC**

Internal Audit assignments are recorded on standard documents and working papers. Before work commences a work brief is completed and approved stating the objectives, methods, time budgets and allocation of responsibilities for each assignment.

The Internal Audit Manual contains guidance on the required standards for working papers and audit documentation. The Internal Audit Manual has a section dedicated to Audit Documentation.

The Internal Audit Manager has implemented monitoring arrangements to follow up progress on implementation of recommendations made in the audit reports. Where the system opinion is assessed as weak/limited, the Audit Committee is informed on a quarterly basis of progress on the introduction of recommendations.

Internal Audit has recently developed the Audit Working Papers, including the introduction of an electronic issues log, where the Supervisor and Auditor can raise and resolve issues. This acts as an electronic record of the review process.

Audit briefs are also signed off electronically by the Supervisor to evidence that the brief has been agreed with the departmental manager(s).

## **Scope for improvement**

We have not identified any scope for improvement in relation to this area of the standard.

## **Overall assessment**

The overall assessment is that the standard has been met. This assessment has been made on the basis that we have not identified any areas with scope for improvement in relation to this standard.

# Due professional care

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## The Standard

The CIPFA standard states that due professional care is the care and skill that prudent and competent Internal Auditors will apply in performing their duties:

- Due care is working with competence and diligence. It does not imply infallibility.
- Due professional care is the use of audit skills, knowledge and judgement based on appropriate experience, training (including continuing professional development), ability, integrity and objectivity.

Due professional care should be appropriate to the objectives, complexity, nature and materiality of the audit being performed.

## Good practice at Lancaster CC

Review of individual Internal Audit assignments did not identify any cases where there were concerns that facts had been incorrectly recorded or reported.

## Scope for improvement

Internal Audit has a set of ethical standards that staff are expected to follow however staff are not currently required to periodically sign that they will abide by the ethical standards.

As stated in recommendation 4, Internal Audit staff should complete an annual certificate to register independence, compliance with ethical standards, confidentiality and to acknowledge understanding of the fraud procedures.

## Overall assessment

The overall assessment is that the standard has been partially met. This assessment has been made on the basis that the scope for improvement identifies some areas of non-compliance with the standard.

# Reporting

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## The Standard

The CIPFA standard states that the Head of Internal Audit should determine the way in which audit assignments and their results will be reported, subject to the CIPFA standards and the requirements of those charged with governance. An important requirement is to formally report annually on a number of factors which include:

- an opinion on the overall adequacy and effectiveness of the organisation's internal control environment;
- a summary of the audit work undertaken to formulate the opinion;
- a statement on whether Internal Audit comply with the CIPFA standards;
- a summary of Internal Audit's performance.

## Good practice at Lancaster CC

Internal Audit reports an annual opinion to the Audit Committee on the internal control environment of the Council. This report details the sources of assurance to come to this opinion. In addition, regular reports are taken to Audit Committee during the year regarding progress in gaining evidence for the 'assurance opinion'.

Final versions of Internal Audit reports are presented in a timely fashion after recommendations have been agreed. Recommendations made in Internal Audit reports are given ratings depending on their significance to the Council.

Internal Audit reporting arrangements are set out in the terms of reference for the service and have been agreed by the Audit Committee.

## Scope for improvement

As noted in recommendation 6, Internal Audit should assess what information the Audit Committee requires in relation to the performance of the Internal Audit function.

## Overall assessment

The overall assessment is that the standard has been met. This assessment has been made on the basis that the scope for improvement identifies only non-significant areas for improvement that would further improve the achievement of the standard.

# Performance, Quality and Effectiveness

## The Standard

The CIPFA standard states that the work of Internal Audit should be controlled at each level of operation to ensure that a continuously effective level of performance, compliant with the CIPFA standards, is being maintained.

Internal Audit should develop a quality assurance programme designed to gain assurance by both internal and external review that the work of Internal Audit is compliant with the CIPFA standards and achieves its objectives, and to sustain a commentary on compliance with these standards in the annual audit report.

## Good practice at Lancaster CC

Internal Audit has tailored the CIPFA Internal Audit manual to reflect circumstances at Lancaster CC. The Audit Manual is available to all staff on the shared network drive.

Internal Audit are reviewed annually by the external auditors for the purposes of the financial statements audit, to allow reliance to be placed upon the work of Internal Audit. This review would highlight any concerns the external auditors have with the work and processes of Internal Audit to both the Internal Audit Manager and the Audit Committee.

## Scope for improvement

Lancaster CC is a member of the Lancashire District Audit Group that analyses performance of the service against similar services around the Lancashire region. This results of this benchmarking exercise are not formally presented to the Audit Committee.

There is currently no formal quality assurance process above and beyond the assignment level review. Such a quality assurance process would provide an independent check of files to ensure work has been performed in line with the Code of Practice and Internal Audit Manual.

## Recommendation 10

Internal Audit should introduce a formal quality assurance process above and beyond assignment level review. This process should select assignment files at random to ensure that files meet the required consistent standards.

## Overall assessment

The overall assessment is that the standard has been met. This assessment has been made on the basis that the scope for improvement identifies only non-significant areas for improvement that would further improve the achievement of the standard.

# Management Action Plan

The recommendations from this review are to be addressed by Lancaster CC as shown in the table below.

Recommendation	Priority	Response	Responsibility & due date
1. The Financial Regulations should be expanded to give reference to the Internal Audit Charter either as a separate document or as an appendix.	Low	Agreed. Arrangements will be made to include this in the next update of the Financial Regulation	IAM 30/09/09
2. Lancaster CC should ensure that the Anti-Fraud Strategy is regularly updated and approved to ensure that all staff are following the correct procedures in relation to reporting suspected cases of fraud to Internal Audit.	Medium	Agreed. The Strategy is scheduled for review in 2009/10.	IAM 30/09/09
3. The Internal Audit Manager performs a dual role, which could create a conflict of interest. This should be acknowledged and plans to mitigate any conflict should be developed and included in the Internal Audit Manual and Strategic and Business Plan.	High	Agreed. This will be addressed in the 2009/10 IA Strategy and Business Plan	IAM 30/06/09
4. In order to comply with the Code of Conduct for Local Government, the Internal Audit team should be issued with ethics guidance and declare any interests that compromises their position as an Internal Auditor. This could be done by completing an annual certificate to register independence, compliance with ethical standards, confidentiality and to acknowledge understanding of the fraud procedures.	Medium	Agreed. A reminder of ethical standards required under the Code of Practice was discussed at the IA Team Meeting on 7th April 2009.  Newly drafted Annual Certificates to register independence, compliance with ethical standards, etc are to be completed in April 2009.	IAM 30/04/09

## Management Action Plan *(continued)*

Recommendation	Priority	Response	Responsibility & due date
5. Internal Audit should actively pursue non receipt of post audit customer satisfaction questionnaires after the completion of audit work.	Low	Agreed. Customer satisfaction questionnaires and procedures are to be reviewed and refreshed during 2009/10.	IAM 30/06/09
6. Internal Audit should liaise with the Audit Committee to assess the Committee's appetite for performance information in relation to the work of Internal Audit.	Low	Agreed. IAM will liaise with the Audit Committee Chairman prior to the June meeting of the Audit Committee and seek a decision on the level of performance information to be provided at that meeting.	IAM 30/06/09
7. Internal Audit should distribute the annual audit plan to the Departmental Management Teams. This would give them the opportunity to feed this information back to an operational level.	Low	Agreed.	IAM 30/06/09
8. Internal Audit should develop the strategic and business plan to include Internal Audit's input into the Annual Governance Statement, corporate governance arrangements, risk management processes and key internal system controls.	Low	Agreed. The IA S&B plan will incorporate reference to Internal Audit's input into the Annual Governance Statement, corporate governance arrangements, risk management processes and key internal system controls. This will be presented for consideration by the Audit Committee on 30 June 2009.	IAM 30/06/09
9. The annual audit plan presented to the Audit Committee may benefit from giving a brief description of the scope and objective of individual audit assignments, where this does not conflict with the nature of the assignment.	Low	Agreed. To be addressed in the 2009/10 Audit Plan to be presented to Audit Committee in June 2009.	IAM 30/06/09

## Management Action Plan *(continued)*

Recommendation	Priority	Response	Responsibility & due date
10. Internal Audit should introduce a formal quality assurance process above and beyond assignment level review. This process should select assignment files at random to ensure that files meet the required consistent standards.	Low	Agreed. To be implemented during 2009/10.	IAM 30/09/09