

Review of Internal Audit

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Division and Local Member: All

1. Summary/link to the Annual Plan

- 1.1. A professional, independent and objective internal audit service is one of the key elements of good governance in local government. Internal audit forms a part of the governance that provides assurance on all areas of the County Plan. In our assurance framework, based on CIPFA and ALARM, internal audit is the third (and last) “line of defence” on assurance matters.
- 1.2. In addition, there is an obligation under various pieces of legislation for the County Council to ensure that it has an effective internal audit function.
- 1.3. To ensure that our internal audit function (as provided by the South West Audit Partnership) remains “adequate and effective”, officers carry out an annual review of SWAP’s performance. For 2016/2017, this process has again been assisted by pieces of assurance from other organisations.

2. Issues for consideration

- 2.1. Members are asked to note and comment on the review carried out by Somerset County Council officers and independent validation into the effectiveness of the internal audit function from the South West Audit Partnership in 2016/2017.

3. Background

3.1. Statutory requirements

The statutory requirements for internal audit have not changed:-

- The Accounts and Audit (England) Regulations state that “A relevant body must undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control.”
- Section 151 of the Local Government Act 1972 states that every local authority in England and Wales should “make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the proper administration of those affairs.” CIPFA has defined “proper administration” in that it should include “compliance with the statutory requirements for accounting and internal audit”.

3.2. CIPFA

The CIPFA Statement on the Role of the Chief Finance Officer in Local Government states that the Chief Finance Officer (CFO) must:

- Ensure an effective internal audit function is resourced and maintained;
- Ensure that the authority has put in place effective arrangements for internal audit of the control environment;
- Support the authority's internal audit arrangements; and;
- Ensure that the Audit Committee receives the necessary advice and information, so that both functions can operate effectively.

3.3. Public Sector Internal Audit Standards (PSIAS)

These Standards have been in force since 1st April 2013 and have recently been updated and applied from 1st April 2016, applying the Institute of Internal Auditors (IIA's) International Standards to the UK public sector.

The objectives of the PSIAS are to define the nature of internal auditing, and to set basic principles for carrying out internal audit in the UK public sector.

They establish a framework for providing internal audit services, which add value to the organisation, leading to improved organisational processes and operations, and establish the basis for the evaluation of internal audit performance and to drive improvement planning.

The Standards apply to all internal audit service providers, whether in-house, shared services or outsourced. They also set out the expected behaviour with a Code of Ethics.

As part of the June 2017 review, SCC officers have considered how SWAP complies with these standards, particularly the "Attribute Standards" or "Performance Standards", which have not changed in the new Standards.

These provide a ready checklist for us to consider our Internal Audit functions against. Within each Attribute or Performance Standard, are a number of requirements that we have tested SWAP against. The most pertinent ones are set out below as assurance examples in the table below.

3.4.

Public Sector Standard	Illustration of SWAP compliance
Purpose, Authority and Responsibility	<p>The Standard requires this to be formally defined in an internal audit charter.</p> <p>This is reviewed annually by SWAP and presented to Audit Committee alongside the Internal Audit Plan for the forthcoming year.</p> <p>The Charter includes all requirements of the Standard, such as the responsibilities of the auditor and management, and the reporting lines open to the auditor, including the “unreserved right to report directly to the Leader of the Council, the Chairman of the Audit Committee, the Council’s Chief Executive or the External Audit Manager”.</p>
Independence and Objectivity	<p>SWAP has absolute organisational independence as a separate legal entity, and Directors appointed by the partners are non-executive.</p> <p>By reporting to the Audit Committee (the Standard uses the term “board”) directly and publically, this removes any possibility of inappropriate SCC management interference.</p> <p>Access to all levels within SCC (as above) also increases this compliance with this Standard.</p> <p>This also ensures that the internal auditor do not have to “subordinate” their judgement, which is another Standard test.</p>
Proficiency and Due Professional Care	<p>SWAP is staffed by an increasingly higher proportion of qualified auditors, who direct work from any junior staff members. All SWAP officers in senior posts are suitably qualified.</p> <p>SWAP’s audit delivery processes have been independently assessed and meet all professional expectations. SWAP’s methodology as they carry out their audit work is highly suitable in driving the auditor to meet this Standard.</p>

Quality Assurance and Improvement Programme (QAIP)	SWAP has had a QAIP since before the Standard came into effect. This is regularly reviewed by SWAP managers and the Board of Directors.
Managing the Internal Audit Activity	<p>SWAP is heavily involved in the planning work ahead of the Internal Audit Plan, which includes our risk-based priorities. The Plan looks at other sources of assurance that are available.</p> <p>SWAP is able to comment on the audit days (i.e. resources) allocated to the Internal Audit Plan, and has done so in the past when audit days were reduced to confirm that it can provide an annual opinion.</p> <p>The partnership arrangements make it less probable that the work will suffer from unexpected loss of staff. Our plan and processes include the necessary annual audit opinion and for it to be brought to the Audit Committee in public session.</p>
Nature of Work	<p>SWAP audit reports always “include appropriate recommendations for improving the governance process” and such key objectives as “communicating risk”.</p> <p>SWAP audit reports also consider key areas in this Standard such as “information technology governance”.</p>
Engagement Planning	<p>SWAP always provides a Terms of Reference for each piece of work, with the necessary discussion and agreement of the relevant SCC manager.</p> <p>Each Term of Reference will include a preliminary assessment of the risks. The scope (and days allocated) of SWAP audits ensures that they cover sufficient work to address the agreed-upon objectives.</p> <p>Should this not be the case as the work is delivered, this is reviewed and additional days allocated as required.</p>

<p>Performing the Engagement</p>	<p>Our Financial Procedures make the necessary provision for SWAP to access all necessary information to perform the audit.</p> <p>There is an agreed escalation process, endorsed by Audit Committee, to deal with any poor clienting by SCC officers.</p> <p>SWAP's audit methodology and supervision by senior auditors provides the necessary assurance on ensuring objectives are met and on quality.</p>
<p>Communicating Results</p>	<p>Individual audits include a "close-out" meeting with the relevant managers to report findings and to discuss recommendations.</p> <p>All opinion audits are subject to a rating system from Substantial to No Assurance.</p> <p>Communication on completed audits and key risks and findings are provided quarterly to Audit Committee.</p> <p>Overall results for a financial year are given in the annual opinion.</p>
<p>Monitoring Progress</p>	<p>The reports to Audit Committee also detail the progress on the Internal Audit Plan overall, and the assurance levels that have been given.</p>
<p>Communicating the acceptance of risks</p>	<p>If the internal auditor believes that managers are accepting a level of risk that is unacceptable to the organisation, the Charter sets out the availability of communication routes open to the auditor.</p>

Our own internal review of the Standards concludes that SWAP complies with the Public Sector Internal Audit Standards in all significant respects.

3.5. External Validation

Confidence in SWAP also comes from a number of external sources:-

i) The Devon Audit Partnership reviewed SWAP in March 2016, to ensure that it complied with the applicable standards. This was at SWAP's own request, following a self-assessment process. The IIA's Quality Assessment Manual suggests a scale of three ratings, "Generally Conforms," "Partially Conforms," and "Does Not Conform." "Generally Conforms" means that an internal audit activity has a charter, policies, and processes that are judged to be in conformance with the Standards.

Part of the external validation process involved speaking with a wide range of partner officers to seek their thoughts and views on how SWAP meets expected targets, and their view on the quality of service being provided. In addition, interviews took place with SWAP executive, management and staff to discuss arrangements and to confirm that SWAP's expected practices are being operated in practice. SWAP's approach to risk assessment and audit planning processes, audit tools and methodologies, engagement and staff management processes, and a representative sample of the internal audit activity's workpapers and reports were reviewed.

Devon Audit Partnership concluded that "SWAP is a well-established provider of professional internal audit services to a number of public sector organisations. The internal audit activity meets the Standards and SWAP management regularly look to ways to improve the service they provide (e.g. by developing the "healthy organisation" approach) and add value to all of their partners and clients. A well-developed Quality Assurance Improvement Plan is in place that captures areas for development and provides a good record of progress against targets. Consequently, our comments and recommendations are intended to build on an already efficient and effective internal audit provider."

As a result, Devon Audit Partnership's "overall opinion that the internal audit activity **generally conforms** with the Standards and Code of Ethics".

There have been no detrimental changes in SWAP's internal audit work or approach since this date, and therefore reliance can be placed on this review.

ii) The Devon Audit Partnership's continues to act as the internal auditor to SWAP. They have just reported (May 2017) on the accounting arrangements for the South West Audit Partnership (SWAP) for the financial year ended 2016/17. This is a positive report, and has been included as Appendix B to this report.

iii) SWAP's external auditor, PKF Francis Clark, has just completed its work on the SWP accounts for 2016/2017, in compliance with the requirements of the Companies Act 2016. There were no issues reported and the accounts gave a "true and fair view".

iv) Grant Thornton, as part of their work, reported to Audit Committee in March 2017 that they had "completed a high level review of internal audit's overall arrangements" and concluded that "our work has not identified any issues which we wish to bring to your attention". This is consistent with all previous external audit reports.

v) SWAP has recently won the innovation in audit award at Public Finance event. This is the first time that CIPFA have held such an event and this is excellent public recognition. The judges commented "We really liked the Healthy Organisation themed reviews and behavioural model, which tackled important issues around assurance fatigue and systemic failure. It also demonstrated the benefits of a partnership, but firmly grounded in each organisations governance approach."

vi) SWAP is a finalist in the Municipal Journal Achievement Awards for Excellence in Governance and Scrutiny (the results will be known before Audit Committee meets).

3.6. Development within SWAP

As a company, SWAP continues to develop since it became operational on 1st April 2013. It continues to be a sought-after service, and Powys, Cheltenham Cotswolds and West Oxfordshire have joined as partners in the last financial year. Cheltenham Borough Homes and UBICO are also now receiving services from SWAP, although they are not a partner. Altogether, some 24 partners and other clients now use SWAP's services.

SWAP and its Directors have been focussing on marketing in the last financial year, facilitated by external advice, and are looking at how to continue the expansion of both partner and non-partner income. SWAP now has a formal Marketing Strategy in place.

The Board of Directors meets regularly and agendas include a maintained risk register and a Quality Assessment Improvement Plan (QAIP). This plan captures all actions arising from peer reviews and progress to achieve the agreed management actions.

The Board of Directors also review a large number of performance indicators in addition to those listed in Appendix A in what is termed a Balanced Scorecard, including timeliness and delivery, customer feedback questionnaires, financial issues and staff sickness levels.

Directors receive regular training about their roles, and about the responsibilities of being a Director.

3.7. Review Process

The review process was undertaken by the Strategic Manager – Financial Governance, and overseen by the Director of Finance and Performance. It considered the statutory obligations, the governance arrangements for SWAP, and also looked at the key performance indicators on the Audit Partnership's delivery (set out in Appendix A).

From the performance indicators that are set out in Appendix A, officers conclude that SWAP continues to meet its own high performance standards.

There are further notable positives that have arisen from this review:-

- SWAP has again been able to maintain its average day rate at £244. (Members will recall that the number of audit days purchased was reduced from 1,701 to 1,533 in 2015/2016, hence the reduction in charge to the County Council).
- Somerset County Council no longer participates in the CIPFA Audit Benchmarking process, but previous information shows that this was £75 below the national average of £319 in 2013/2014. The CCAN survey in 2015/2016 suggested an average of £278 per day, but this was from a smaller sample of only 16 respondents.
- SWAP continues to show financial stability and resilience, which provides comfort for our future service. It has absorbed the loss of audit days from SCC and other partners over the last few years.
- The team that supports Somerset County Council are increasingly knowledgeable about the services they audit, and increasingly able to help officers to identify risks and management actions as a result.
- There is a noticeable increase in Senior Leadership Team members making requests for SWAP time. This suggests an increasing confidence in their role amongst key officers.
- Somerset County Council has access to specialist audit and related services through SWAP, which continue to be of a uniformly high standard, such as IT audit and anti-fraud expertise.
- SWAP has remained highly responsive in responding to changing circumstances at Somerset County Council, and has been very flexible in how they deploy resources to meet necessary changes in the audit plan.
- SWAP has been extremely helpful in running and monitoring the progress of "Partial" audits through the Audit Committee review process and through JCAD.
- Despite a higher level of Partial audits as we tackle high-risk areas, the level of satisfaction with the audit work has actually increased.

3.8. Conclusion

The officer conclusion is that the South West Audit Partnership continues to provide an adequate and effective internal audit function for Somerset County Council, and can demonstrate good value for money.

4. Consultations undertaken

- 4.1. Informal discussions were had with some other client officers and members of the Board of Directors of the South West Audit Partnership.

5. Implications

- 5.1. All contained within the report.

6. Background papers

- 6.1. "Public Sector Internal Audit Standards – Applying the IIA International Standards to the UK Public Sector"
- 6.2. "South West Audit Partnership (SWAP) - External Quality Assessment of SWAP Internal Audit Activity"
- 6.3. Previous internal audit reports to the Audit Committee, including the Internal Audit Plan and Charter (March 30th 2017).

Note For sight of individual background papers please contact the report author.