



**Committee:
Governance & Audit
Committee**

**Date: 7th November
2017**

Subject: Review of the Effectiveness of Internal Audit

Report by:

Director of Resources

Contact Officer:

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Purpose / Summary:

To review and report on the effectiveness of the internal audit service provided by Assurance Lincolnshire.

RECOMMENDATION(S): To agree with the conclusion that the Council has effective internal audit arrangements in place.

IMPLICATIONS

Legal: None

Financial: FIN/MT/46/18

Staffing: None – externally provided internal audit service

Equality and Diversity including Human Rights: None

Risk Assessment: None

Climate Related Risks and Opportunities: None

Title and Location of any Background Papers used in the preparation of this report:

None.

Call in and Urgency:

Is the decision one which Rule 14.7 of the Scrutiny Procedure Rules apply?

i.e. is the report exempt from being called in due to urgency (in consultation with C&I chairman)

Yes

No

x

Key Decision:

A matter which affects two or more wards, or has significant financial implications

Yes

No

x

1. Executive Summary

- 1.1. The Council is required to assess the effectiveness of its Internal Audit (IA) service on a regular basis. IA is provided by Assurance Lincolnshire, part of Lincolnshire County Council.
- 1.2. The determination of effectiveness is arbitrary; there is no prescribed method by which it should be assessed. This review has drawn on empirical evidence, where it exists and has consulted key stakeholders. It has looked at the organisational impact that IA has had on the authority, both in terms of its auditing function (and associated reports and recommendations) and also with regard to its consultancy service which the Council has utilised. The report also recognises the work the Head of Internal Audit (HIA) has undertaken to help Members understand and develop their role through the Governance & Audit Committee.
- 1.3. The conclusion the report draws is that the Council does have an effective IA service. It is independent, professional, has appropriate relationships with Members and senior officers; alerts the Council to areas of control weakness and provides support in addressing those issues.
- 1.4. The quality of the service provided by IA, as assessed by managers and key Members across the Council is a key indicator of its effectiveness. Post audit questionnaires (covering audit planning; audit reports and communication) are issued by IA and the responses are collated. In 2016/17 there was a 75% response rate with all aspects scoring very good or excellent.
- 1.5. The result of external assessment of IA also forms part of the picture of overall effectiveness. External assessment has replaced the annual self-assessment exercise which was undertaken by the service. In 2016/17 IA was subject to an external quality assessment which was undertaken to assess conformity with the UK Public Sector Internal Audit Standards (PSIAS). No areas of non-compliance were identified. The assessor commented:

“I identified no areas of non-compliance with the standards that would affect the overall scope or operation of the internal audit activity, nor any significant areas of partial non-compliance. As part of my review I was asked to compare the Assurance Lincolnshire Partnership against other authorities for whom CIPFA has undertaken PSIAS reviews. There is little that I can add to the excellent work that you are already doing and I have already requested examples of some of your core documents to share with others”

The external assessment report was shared with Management Team and the Governance & Audit Committee. The findings have informed the service's Continuous Improvement Plan which has also been shared with Management Team and the Governance & Audit Committee.

- 1.6. Timeliness and the scheduling of audits has been identified as an issue in the past year; the cause of which has been identified as being due to internal Council processes. As a result there was a 20% reduction in coverage of the 2016/17 audit plan; equating to 40 days unused. While this did not impair the

ability of the HIA to provide her annual opinion on governance arrangements within the Council, work has been undertaken to address matters with all audits for 2017/18 already scheduled; scoping arrangements reviewed and Management Team review and approval arrangements re-examined. Additionally the Governance & Audit Committee have been reminded of their responsibility to monitor progress against the yearly audit plan and to seek explanation for any deviations.

- 1.7. The service offers good value for money in terms of costs per day and the number of audit days required to deliver the audit plan. Furthermore external audit are able to rely on the work of IA where appropriate which saves the Council external audit fees.
- 1.8. IA also provides added value in a number of ways. These include its access to a wide range of specialists to draw upon for audit work/consultation (e.g. Fraud, Risk, Insurance, Health Safety); its understanding of the business and the level of accessibility due to the on-site provision of audit staff
- 1.9. An area that has dramatically improved since the last in-depth review of the effectiveness of the service is the benefit the Council has gained from the findings contained within audit reports. Over recent years, great emphasis has been placed on ensuring that recommendations are acted upon and implemented. This has seen the number of outstanding recommendations fall from over 100 (three years ago) to a figure of zero as reported within IA's annual report for 2016/17. This is a substantial improvement and demonstrates the value that managers now place on the service IA provide and also upholds the overall integrity of the auditing discipline.
- 1.10. The final element of a truly effective IA service is the function and role of the audit committee. Considerable work has gone into improving the way the Governance & Audit committee works and the efforts made are evident. The Committee has benefitted from effective Chairmanship; interest in the subject matter on the part of all Committee members and by posing challenge to and the seeking of assurance from officers. On-going training for Members has been provided on a regular basis which has been well attended. Additionally the Committee is encouraged to undertake self-assessment to gauge its effectiveness.

2. Background

- 2.1. The Accounts and Audit regulations require the Council to review its IA function. This year's review has been a comprehensive exercise, including interviews with key stakeholders. It is anticipated that for the next two years a lighter touch will be sufficient.
- 2.2. IA services are provided to the Council by Assurance Lincolnshire (part of Lincolnshire County Council).

3. Methodology for the Review

- 3.1. Measuring “effectiveness” is not an exact science and there is no prescribed methodology to follow. To assess the effectiveness of the service and support provided by IA, evidence upon which to form a judgement has been collated from a variety of sources as set out in the table below. If the IA function was well managed, properly resourced and complied with the PSIAS, it would be reasonable to assume that they were likely to be effective in the execution of their function.

Evidence	Source
Compliance with Public Sector Internal Audit Standards	Findings of External Quality Assessment (Sept 2016)
Performance against audit standards	Assessment by Director of Resources
Delivery against audit plan	Progress reporting to G&A committee. Internal Audit Annual Report 2016/17 Findings and recommendations within reports
Feedback from key stakeholders	Questionnaire and interviews
Benchmarking	Comparison against other authorities and audit providers

4. Internal Audit in Context

4.1. Combined Assurance Model

4.1.1 The purpose of IA is to provide independent assurance designed to add value and improve how the Council operates. Assurance Lincolnshire have developed an award winning model of using all assurance functions across the Council, including that of management and corporate functions and 3rd parties. This is used to develop an assurance map which shows what assurance IA can obtain from other sources.

4.1.2 In brief, IA populates the assurance map in the first instance, using high level risk assessment against areas falling within the following categories: critical activities, fundamental systems, key projects, emerging and strategic risks. This is based on a mixture of standard audit requirements, intelligence gained by the auditors in the course of field work and discussion with team managers and corporate strategic priorities articulated in the Corporate Plan and other key strategic documents. The findings are reviewed by the Council’s Management Team who provide final determination and analysis, commentary and context around them. A report is produced for Governance & Audit Committee to review.

4.1.3 Using this approach, IA are able to plan their audits to make the best use of their resources and to ensure critical systems and key strategic risks are adequately covered within the minimum number of days.

4.2 Additionally, IA have recently incorporated consultancy work into their offer. Acting in the capacity of a 'critical friend' this supports their customers as they initiate and develop key projects or reviews of processes by providing objective assessment of the planned initiatives and progress made. During the recent past, such support has been provided for WLDC.

5. How Internal Audit Works

5.1. Staffing

5.1.1 Assurance Lincolnshire is made up of staff working in a collaborative arrangement drawn from Lincolnshire County Council, East Lindsey District and City of Lincoln Councils. Its functions cover business development, audit, counter-fraud, risk management and insurance and health and safety. This benefits WLDC as it has access to specialist skills if required.

5.1.2 The principal staff working on the WLDC caseload are the HIA, supported by an Audit Team Leader, a Principal Auditor and two Senior Auditors. All work carried out for WLDC is supervised by the HIA. Staff are rotated periodically to ensure they do not become too close to the client. All staff are professionally qualified, through either CIPFA, AAT or IIA. All staff have personal development plans and participate regularly in continuing professional development.

5.2. Development of Annual Audit Plan

5.2.1 This is done with reference to the aforementioned Combined Assurance model; corporate priorities and strategic risks. The draft plan is discussed with Management Team and through a process of constructive challenge a final plan is drawn up which is signed off and owned by Management Team. Although the HIA will listen to the views of Management Team, ultimately it is her decision on which areas require audit investigation. There is evidence that HIA displays sufficient independence to set the audit plan according to perceived risk rather than management requirements. This is an essential factor for an internal audit function to be effective.

5.2.2 Once the audit plan has been agreed by Management Team it is presented to the Governance & Audit Committee for final approval. The audit plan can be amended throughout the year as new risks and issues come to light – these can be signaled by IA, the Chair of the Governance & Audit Committee, any of the statutory officers, or by Management Team. However, any deviations (removals/additions) from the original plan have to be carefully managed; with the Governance & Audit Committee playing a key role in monitoring delivery of the plan and questioning the rationale for any deviations. There is evidence of deviation (additions and deletions) over the past three years, which provides assurance that the system is sufficiently flexible and communication lines are sufficiently robust to respond to emerging potential threats. However, 2016/17 saw the number of audit days decrease due to a number of deletions from the original plan. A significant decrease in both the number of audits conducted and audit days completed can impair HIA's ability to provide the

Council with independent assurance over some of its key risks and critical business systems and ultimately make it difficult to form an overall an opinion on the effectiveness of the Council's governance framework.

5.2.3 For 2017/18 the Audit Plan was developed within a new framework as agreed by the Director of Resources and HIA. This re-enforces the protocol that audits are conducted into critical areas of business activity.

5.3. Process of Conducting Reviews

5.3.1 Once the plan is agreed, the individual reviews are undertaken during the course of the year. IA put together an indicative scope and then meet with the auditee to agree where they can add value/assess key risks/provide assurance. Wherever possible, scopes are produced and agreed as early as possible in advance of the audit commencing. The scope forms the basis of the client brief, which is then agreed by Management Team. This is useful as a combination of operational and strategic insights add value to the final brief.

5.3.2 Reviews are generally carried out by the senior and principal auditors and each review is overseen by the HIA. Once a review is completed the draft report is prepared within 10 working days and is then sent to the auditee for the factual accuracy to be checked and a management response to be provided. When feedback from the auditee has been considered (which may result in amendments of facts) the amended draft is sent to Management Team for discussion. The review by Management Team tends to be a full and frank discussion of the findings and recommendations, with some constructive challenge. The aim of the exit meeting is to secure management action and ownership; which is designed to improve the control environment.

5.3.3 Following this, the report is finalised and then goes through for recommended actions to be loaded onto the Council's audit actions monitoring system for implementation within the agreed timescales.

5.4. Progress Reporting and Follow Up

5.4.1 Both Management Team and the Governance & Audit Committee receive quarterly updates on the work progressed by IA. This includes an overview of the findings of each completed audit; with additional information provided in cases where limited or no assurance conclusions have been made. A quarterly tracker, which picks up any overdue recommendations, is also produced by IA which is cross-referenced against local records. Explanations are provided for both Management Team and the Governance & Audit Committee in instances where any actions are not completed by the original anticipated completion date.

5.4.2 Any activity audited that receives a less than substantial assurance rating is scheduled to receive a follow-up audit within 12 months. This ensures that remedial actions to improve matters are implemented and associated risks are mitigated.

6. Findings

6.1. As set out at 3.1 above, the methodology for the review is based on the assessment of IA's performance against:

- a) Compliance with Public Sector Internal Audit Standards
- b) Performance Against the Audit Charter
- c) Delivery Against the Audit Plan
- d) Feedback from Key Stakeholders
- e) Benchmarking

6.2. Compliance with Public Sector Internal Audit Standards

6.2.1 PSIAS were originally defined in a document published by CIPFA and the government in April 2013. These were revised from April 2016. In September 2016, an [external review](#) of Assurance Lincolnshire's Internal Audit Service was conducted to assess compliance with the PSIAS. The review entailed an in depth self-assessment against the standards. Its findings, which provided assurance that the IA service provided is compliant, was shared with the Governance & Audit Committee in November 2016. The main points are summarised below:

Standard	Elements	Conform?
Definition of Internal Auditing	Set out in a clear and concise manner	Yes
Code of Ethics	Integrity, objectivity, confidentiality, competency	Yes
Mission	Clearly set out the purpose of the function	Yes
Core Principles of Internal Audit	Defined and demonstrated	Yes
Attribute Standards	Purpose, authority and responsibility Independence & objectivity Proficiency and due professional care Quality assurance and improvement programme	Yes
Performance Standards	Managing the Internal Audit activity Nature of work Engagement planning and performing the engagement Communicating results Monitoring progress Communicating the acceptance of risks	Yes

6.2.2 Whilst the external review concluded that IA comply with the required standards and provide an exemplar service, a number of recommendations were made to further strengthen compliance with the standards. These recommendations have been incorporated into IA's Continuous Improvement Plan which has been shared with Management Team and also the Governance & Audit Committee.

6.3. Performance Against Audit Charter

6.3.1 The Audit Charter sets out the nature of the IA function and details the roles and responsibilities of IA, Management and the Governance & Audit Committee. It is a key policy document in support of audit arrangements. The [Audit Charter](#) was updated this year to reflect the revised PSIAS which came into force from April 2016 and was approved by the Governance & Audit Committee in March 2017.

6.3.2 The Charter incorporates the following eight considerations:

1. The purpose of Internal Audit	5. How management can assist the internal review process
2. The scope of Internal Audit	6. The audit reporting framework
3. How independence and objectivity are assured	7. The quality of service and duty of professional care
4. Internal Audit responsibilities and objectives	8. Core principles

6.3.3 The Director of Resources has assessed how well IA is fulfilling its role and discharging its responsibilities. He has concluded that IA is behaving in accordance with the undertakings set out within the Charter.

6.3.4 The HIA attends Management Team meetings to discuss the Audit Plan, to agree scopes of major audits and to discuss draft recommendations of major audits. Monthly liaison meetings with the Director of Resources and the HIA/Audit Team Leader also take place to discuss performance and progress and identify emerging risks. IA provide regular progress reports to the Governance & Audit Committee advising them of work against the plan completed during the period, other significant work, audits in progress, performance information and any other matters of interest; thus helping them keep abreast of relevant emerging guidance and legislation. The HIA, together with the external auditors, have undertaken a programme of training for Governance & Audit Committee members to enable them to fulfill their role effectively.

6.3.5 It is acknowledged that from the management side there are two areas which could be strengthened and these will assist the process of IA. These are:

- a) Keeping amendments to the internal audit plan to a minimum.
- b) Management Team to improve the speed of throughput, evaluation and sign off, of completed audit reports.

6.4. Delivery Against Audit Plan

6.4.1 In 2016/17, IA delivered 88% of the audit plan within year. Performance information is regularly reported to Management Team and the Governance & Audit Committee. Whilst the field work on all audits on the plan had been completed by the end of the year, some of the audits were started later than

scheduled and clearance of some of the audits through Management Team was not as efficient as required. Steps have been taken to improve matters

through the early scoping of audits, swift escalation of issues affecting progress and delivery against the plan, no unilateral decisions taken to deviate from the original plan and robust monitoring and scrutiny undertaken by the Governance & Audit Committee.

Performance Information

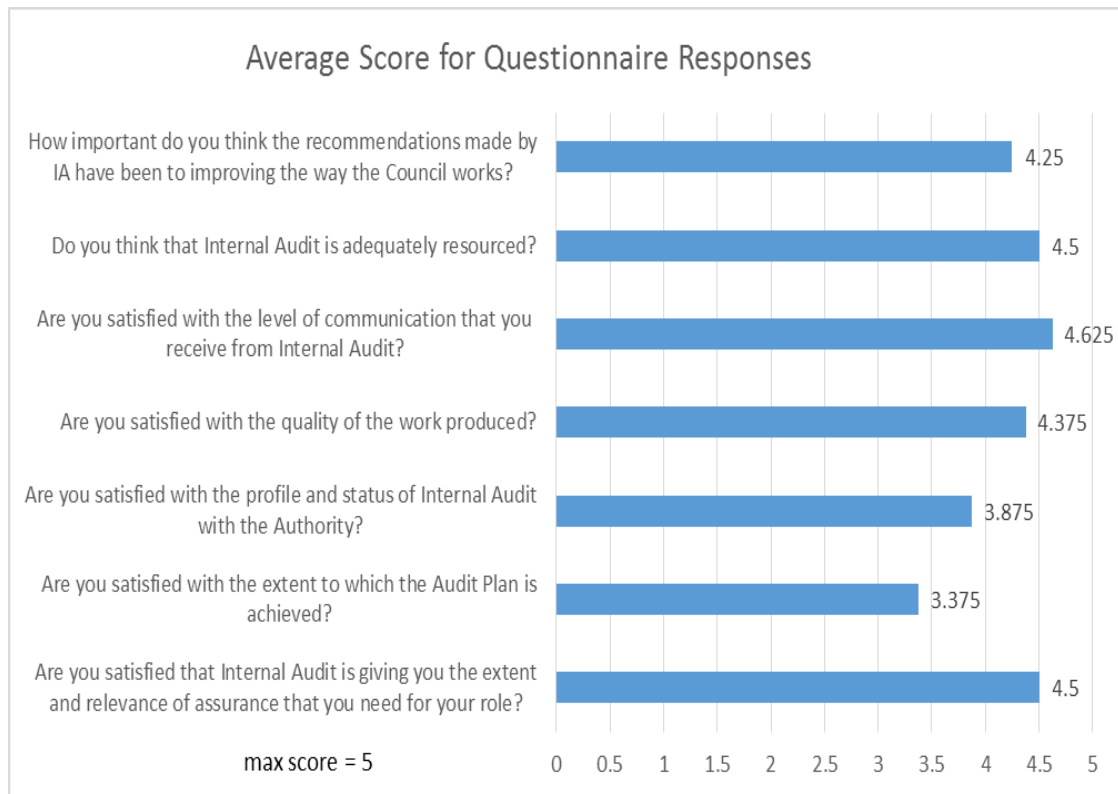
Performance Indicator	Target	Actual 2016/17
% of Plan Completed	100%	88%
% of Key Financial Systems Completed	100%	66%
% Recommendations Agreed	100%	100%
% Recommendations Due Implemented	100%	100%
Draft Report Issued Within 10 Working Days	100%	77%
Final Report Issued Within Five Working Days of Management Team Sign Off	100%	100%
Period taken to Complete Audit Within Two Months From Fieldwork	80%	55%
Client Feedback on Audit	Good/Excellent	Excellent

6.4.2 Whilst the audit plan is, in the main, being delivered, that in itself does not mean that IA is being effective. The measure of effectiveness is surely whether or not governance related matters are working effectively within the Council and that IA are identifying areas of weakness and supporting improvements. At the time of the last in-depth report, the Council had received a red rating for governance. In the intervening period the Council has made significant changes to its processes, organisational structure and approach to ensuring that governance is a core concern of all staff and its key elements are applied in a consistent manner. IA have actively supported the Council in improving matters. The work undertaken has resulted in the HIA reporting improvements, to the extent that for the last two years the Council's arrangements for governance, risk management and control have all been assessed as performing well.

6.5. Feedback from Key Stakeholders

6.5.1 Key stakeholders were interviewed as part of the review and asked to complete a short questionnaire. The questionnaire asked a number of questions about the context of audit and will be used to further develop the way the Council makes use of the work of IA.

6.5.2 The chart below shows the average score for the questions shown. The highest potential score is five. The responses show that most respondents were very satisfied with the service provided by IA and believed that IA had been effective in moving the Council forwards.



6.5.3 The two aspects recording scores of below four and are therefore worthy of comment were:

- a) Satisfaction with the profile and status of IA within the Authority
- b) Satisfaction with the extent to which the Audit plan is achieved

6.5.4 The reasons for the non-achievement of the 2016/17 audit plan have been documented earlier and remedies have been put in place to ensure that the causal issues that have been identified will be addressed.

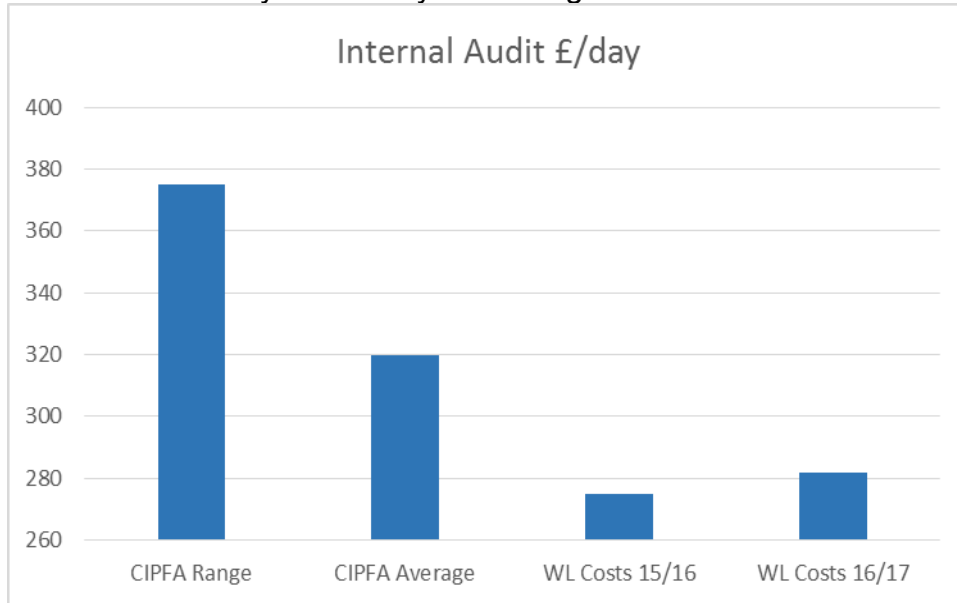
6.5.5 With regards to the profile and status of IA within the Authority, it was considered that Members' access to IA could be improved. Currently the HIA and her officers attend Chair's Briefs and Governance & Audit Committee meetings and are available for Members to discuss matters. Annually, following a Governance & Audit Committee meeting, Members meet with Assurance Lincolnshire and External Audit. Additionally, the HIA has been approached by and met with individual Members. Wider awareness across all Members of such availability may have to be considered.

6.6. Benchmarking

6.6.1 Using CIPFA data, desk based research has established that across their contributory cohort of local authorities, CIPFA have calculated that internal audit costs per day in 2015/16 were in the range of £260 to £375. The average cost per day was calculated to be £320. This compares to the daily charge for WLDC of £275 during the same period; 14% less than the average

fee paid across the CIPFA cohort and 27% less than the highest cost point within the CIPFA range. In itself this suggests that in terms of costs, WLDC receive a very competitive offer from IA.

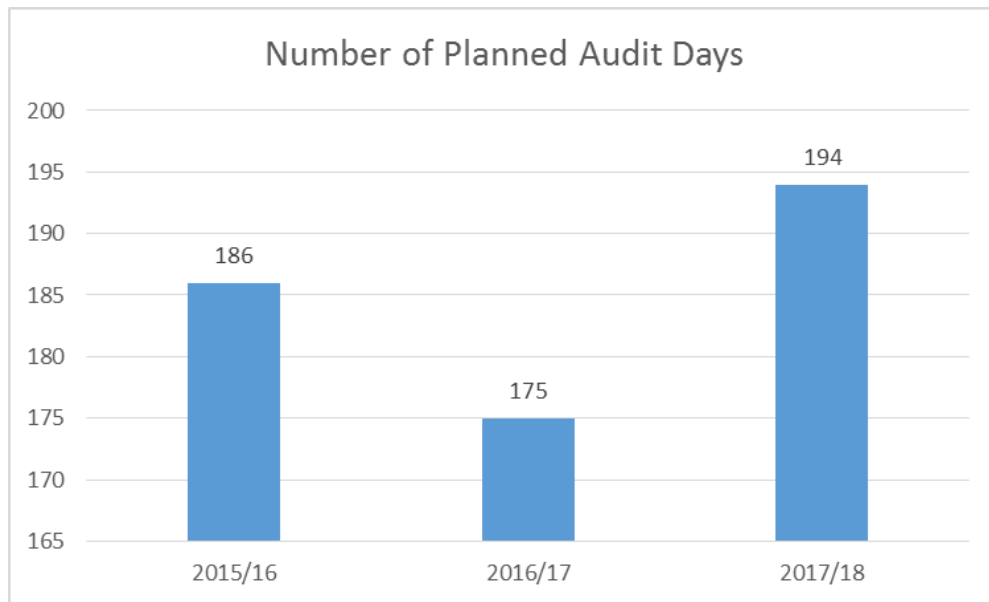
6.6.2 The day rate of £275 had been fixed for the previous five years up to 2016/17 and was increased to £282 (an increase of 2.5%) for 2016/17 and 2017/18. Fees for 2018/19 and beyond have yet to be agreed.



6.6.3 Other useful metrics could include the number of days allotted to the IA plan. This information is not available via benchmarking, but local data is at hand. The premise being that the fewer days required could in itself be viewed as a measure of effectiveness: if we are still receiving adequate assurance and are using fewer audit days one might conclude that the Council has an effective audit service.

6.6.4 The chart below shows the number of days allotted to the IA Plan for the period 2015/16 to 2017/18. It shows that there was a reduction of 11 days between 2015/16 and 2016/17. For 2017/18, 194 days have been set aside. On the face of it, this represents an increase of 19 days, (11%) and therefore a potential indicator of a reduction in the effectiveness of the service received. However, the increase is accounted for three follow-up audits requested by the Council, following the reporting of limited assurance findings within the initial audit reports.

6.6.5 Caution should be applied however to placing an over-reliance on the number of planned audit days as a measure of effectiveness. Different audits are done year on year, the Council's risks change, as do its policies, personnel and key programmes of work; all meaning that in any given year the number of days can rise and fall.



6.6.6 As part of the Assurance Lincolnshire partnership a number of other benefits accrue:

- a) Easier and more cost effective to audit joint working/cross cutting reviews (e.g. shared services)
- b) Sharing best practice across partner sites to complete audits quickly and focusing on key areas of concern/risk
- c) Innovative Audit Approach - "Combined Assurance" feeding directly into documents such as the Annual Governance Statement and Internal Audit Annual Plan
- d) Offer of consultancy services to provide objective opinion/advice on the development and outcomes of key programmes
- e) Wider range of specialists to draw upon for audit work/consultation (e.g. Fraud, Risk, Insurance, Health Safety)
- f) Understanding the business - LA operated service with a proven track record – flexibility – responsive
- g) Accessibility – on-site provision of audit staff
- h) Provision of training for Governance & Audit Committee members
- i) Risk awareness and risk appetite work
- j) Close working with external audit e.g. Assurance Lincolnshire take on Housing Benefit subsidy and other work to help reduce additional external audit fees

7. Conclusion

7.1 The overall view of IA is that it is an effective, value for money service with whom the Council enjoys a good relationship. It is sufficiently independent and professional to provide an objective arm's length appraisal of control weaknesses; but is at the same time regarded as approachable and is used particularly by Members as a tool to provide assurance on matters of concern.

- 7.2 The audit service is well run and conforms to all necessary standards. There is a culture of continuous improvement and regular quality assurance work is undertaken. The externally led Quality Assurance exercise the service partook in provided a positive finding and highlighted exemplar work which was recommended as best practice.
- 7.3 The terms of the relationship with the Council are set out within the Audit Charter, which clearly defines the roles and responsibilities of all parties. IA fulfill their role according to the terms of the Charter, although there are some aspects of the part management play which need strengthening on the part of the Council. Plans are in place to address these matters.
- 7.4 The audit plan is compiled based on an assessment of risk, materiality and drawing on other forms of assurance through an award winning model known as the Combined Assurance model. The plan was mostly discharged in 2016/17, with issues arising as a result of deletions to the original plan and delays in sign off of completed audit reports.
- 7.5 The consultancy support that IA provide has been utilised by the Council and has been beneficial in supporting programme development and providing objective opinion.
- 7.6 Since the last in-depth review, there is clear evidence of real improvements in organisational practices, structures, procedures and behaviours arising as a direct result of recommendations made by IA. In this respect the function has proved to be effective.
- 7.7 When compared with other authorities the daily chargeable rate is favourable and the number of audit days required is appropriate. In addition there are a number of value added benefits gained by the Council from being part of the wider Assurance Lincolnshire partnership.
- 7.8 The success of IA as a service is in no small part due to the skill and professionalism of the HIA. The Council recognises the investment she has made in delivering an effective audit service to West Lindsey and in helping West Lindsey become a better Council.
- 7.9 Having an effective audit function is not in itself sufficient; it is one aspect of the overall control framework. The Council must maintain its current level of effectiveness in responding to the issues highlighted in audit reports. Additionally the Governance & Audit Committee must continue to fulfil its scrutiny role and hold the executive to account when governance related weaknesses arise or are highlighted. All elements should combine to ensure that the maximum benefit is derived from the work of IA.

8. Recommendation

- 8.1 Members are asked to agree with the conclusion that the Council has effective internal audit arrangements in place.