



Leicester
City Council

WARDS AFFECTED
All

Audit and Risk Committee

16 July 2013

Review of the Effectiveness of the System of Internal Audit 2012-13

Report of the Director of Finance

1. Purpose of Report

- 1.1. This report presents the findings of the annual review of the effectiveness of the Council's system of internal audit for 2012-13.

2. Recommendations

- 2.1. The Committee is recommended to:
- a) Accept the findings of this review, and
 - b) Conclude that the Council has an effective system of internal audit on which it (the Council) can place reliance.

3. Summary

- 3.1. Leicester City Council's Finance Division includes the Internal Audit team which carry out reviews of financial and management systems and reports to management on the effectiveness of their processes and controls. Recommendations are made to improve systems and procedures, as appropriate, with the aim being to reduce the Council's exposure to financial and other risk.
- 3.2. As such, Internal Audit is an integral part of the Council's overall system of internal control, which is the means by which the Council ensures resources are used effectively and for their intended purposes.
- 3.3. Another fundamental component of the Council's system of internal audit is the Audit and Risk Committee. The Committee has an essential role to play in providing independent assurance on the effectiveness of the Council's system of internal control as a contribution to the Council's governance arrangements as reported in the Annual Governance Statement. The process for this was outlined in a report on the Council's Assurance Framework and the Annual Review of the Committee's Terms of Reference, the latest annual review of which was approved by the Committee at its meeting on 9 April 2013.

- 3.4. Legislation¹ requires that the Council:
- *'shall undertake an adequate and effective system of internal audit of its accounting records and of its systems of internal control in accordance with the proper practices in relation to internal control',*
- and
- *'...must, at least once in each year, conduct a review of the effectiveness of its internal audit.'*
- 3.5. This review is part of a wider annual review of the system of internal control, also required by the Regulations, following which a report is to be submitted to your Committee and the outcome included in the Council's Annual Governance Statement. The purpose is to give the Council assurance that reliance can be placed upon the overall system of internal audit including the work of both the Internal Audit team and the Audit and Risk Committee.

4. Report

- 4.1. In 2009, CIPFA² issued a guidance note³ on the review of the system of internal audit, defining this system as:
- 'The framework of assurance available to satisfy a local authority that the risks to its objectives, and the risks inherent in undertaking its work, have been properly identified and are being managed by controls that are adequately designed and effective in operation.'*
- 4.2. In practice, this comprises:
- The organisation's risk management strategy and policy
 - The process of coverage of key controls and key assurance providers, both internal and external
 - The adequacy and effectiveness of remedial action taken where defects in control have been identified
 - The operation of the Audit and Risk Committee and the Internal Audit team in accordance with current codes and standards.
- 4.3. This review of the system of Internal Audit uses the above definition. The results of the review are set out below in Appendix 1.
- 4.4. In my opinion, the Council has an effective system of internal audit, though there is always room for improvement. The key conclusions from the review are:
- The Council's Risk Management Policy and Strategy have been reviewed, updated and approved by the Strategic Management Board and the Executive and was noted by the Audit and Risk Committee. The reshaping of the process to reflect the revised organisational structure of the Council, following the Senior Management Review, is now fully embedded. Work continues to ensure that both strategic and operational risk registers are

¹ Accounts and Audit Regulations 2011 (regulations 6(1) and 6(3))

² Chartered Institute of Public Finance and Accountancy

³ *Guidance Note on the Review of the Effectiveness of the System of Internal Audit 2009*

complete and topical as part of the Strategy. As part of the 2013 Strategy revisions, work will continue to ensure that risk management becomes truly embedded within the organisation at all levels. The progress of this work is reported to each meeting this Committee in the Risk Management Action Plan as part of the Risk Management and Insurance Services update.

- The Internal Audit team meets all of the professional standards by which it is judged. It has maintained actions taken to implement recommendations made by the Audit Commission in their last independent review of the service, and Internal Audit work continues to be relied on by the External Auditors in relevant aspects of their work.
- The Internal Audit Plan reflects a risk-based approach consistent with the requirements of the CIPFA *Code of Practice for Internal Audit in Local Government in the United Kingdom*.
- Customer satisfaction returns continue to indicate a good level of satisfaction with the audit team for individual pieces of work, though there is still a low level of response.
- The team is endeavouring to improve both productivity and the time management of individual audit assignments further. They take an active part in CIPFA audit benchmarking as well as any regional practitioner meetings with a view to keeping abreast of best practice.
- The section remains adequately resourced, especially in view of the budget pressures facing the whole of the City Council. The section continues to provide the various technical disciplines within internal audit, such as the audit of IT as well as the more traditional emphasis on financial control and probity.

4.5. The Council's approach to counter-fraud work continues, for the time being, through the provision of a dedicated Corporate Counter Fraud team, although this function is no longer part of Internal Audit and reports separately to the Head of Finance (Financial Control). The management of Fraud at the Council is currently under review. As well as investigating a number of high-profile matters during the year, the team has delivered fraud awareness training to managers and staff during the year. An annual update on the activity of the fraud teams work at LCC is brought to this Committee.

4.6. The Audit and Risk Committee meets all of the indicators of being an effective audit committee as set out by CIPFA⁴. The Director of Finance attends most meetings or is represented by the Head of Finance (Financial Control). The Committee's annual report to the Council⁵ concluded that:

'...the Audit and Risk Committee made a significant contribution to the good governance of the City Council. Through its work, it has reinforced the Council's systems of internal control and

⁴ *Audit Committees: Practical Guidance for Local Authorities*, CIPFA 2005

⁵ Audit and Risk Committee 4 December 2012, Council 24 January 2013.

internal audit and has given valuable support to the arrangements for corporate governance, legal compliance and the management of risk.'

- 4.7. Therefore, it is concluded that the City Council has an effective system of internal audit.

5. FINANCIAL, LEGAL AND OTHER IMPLICATIONS

5.1. Financial Implications

The audit system is a key component of the Council's financial management and corporate governance systems.

5.2. Legal Implications

The conduct of a review of the Council's internal audit process is a statutory requirement under the Accounts and Audit Regulations 2011.

5.3. Climate Change Implications

This report does not contain any significant climate change implications and therefore should not have a detrimental effect on the Council's climate change targets. (*Helen Lansdown, Senior Environmental Consultant - Sustainable Procurement*)

6. Other Implications

Other implications	Yes/No	Paragraph referred
Equal Opportunities	No	-
Policy	No	-
Sustainable and Environmental	No	Appendix 1 at 4.2, 8.2
Crime and Disorder	Yes	4.5 and Appendix 1 section 11
Human Rights Act	No	-
Elderly/People on low incomes	No	-
Corporate Parenting	No	-
Health Inequalities	No	-
Risk Management	Yes	The whole report concerns the internal audit process, a main purpose of which is to give assurance to Directors and this Committee that risks are being properly identified and managed appropriately by the business.

7. Consultations

7.1. None.

8. Background Papers – Local Government Act 1972

8.1. Files held in Internal Audit.

9. Report Author/Officer to Contact

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1. **Objectives of Review**

The review is designed to examine sources of evidence, and thereby determine whether or not the Council's system of internal audit is sufficiently effective for the Council to be able to place reliance on its assessment of the system of internal control.

2. **Sources of Evidence**

2.1. The following information was used to assess the system of internal audit:

- Review of the Risk Management Strategy and Policy, along with progress made in implementing it;
- The Internal Audit plan, annual report of Internal Audit and other reports to the Audit and Risk Committee on the delivery of the Internal Audit Plan;
- An assessment of the effectiveness of reporting on audit work in providing assurance on actions taken to address control deficiencies;
- Reliance placed on Internal Audit's work where relevant by the Audit Commission (pre October 2013) and KPMG (post October 2013) as the Council's external auditor;
- Self-assessment of compliance by Internal Audit with recognised professional standards;
- Analysis of Internal Audit client satisfaction returns;
- Key performance indicators and statistics produced by Internal Audit during the course of 2012-13;
- Comparative analysis of some statistical measures of the service with those of comparable local authorities;
- Review of the Council's arrangements for preventing and detecting fraud and corruption;
- An assessment of the work of the Audit and Risk Committee against the best practice set out in the CIPFA publication *Audit Committees - Practical Guidance for Local Authorities*.

2.2. The remainder of this paper considers and assesses each of the sources of evidence in turn.

3. **Risk Management Strategy**

3.1. The strategy and policy have been reviewed and updated. Following their earlier acceptance by the Executive (and before that the

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Cabinet⁶) reports were brought to the Audit and Risk Committee at its meetings on 9 February 2011, 8 February 2012 and 7 February 2013 seeking approval of the strategy and policy and all subsequent updates.

3.2. The updated strategy sets out its objectives as follows:

- To provide Members and officers with risk management reports that give a comprehensive picture of the Council's risk profile;
- To assist the Council and its partners to adopt a 'fit for purpose' methodology towards identification, evaluations and control of risks and to help ensure those risks are reduced to an acceptable level;
- To ensure that transparent and robust systems are in place to track and report upon existing and emerging risks which potentially could cause loss to the Council;
- To help further integrate risk management into the culture and day-to-day working of the Council and ensure a cross-divisional/operational approach is applied;
- To provide reliable information on which to base the annual strategic and operational risk and governance assurance statements.

3.3. Whilst much progress has been achieved during the past three years, more work still needs to take place to fully embed risk management within the Council's processes and procedures. A degree of reassessment will be required to adapt prevailing processes to dovetail into and meet the new challenges that will arise from continuing organisational reorganisations following the approval of this year's budget and its inevitable, continuing impact on services.

4. Internal Audit Plan, Annual Report and reporting to the Audit and Risk Committee

4.1. The Internal Audit Plan was prepared before the start of the 2012-13 financial year. In line with the CIPFA Standards⁷, it was based on a formal risk assessment, which is important as a means of establishing the extent to which internal audit reports can give assurances on the overall system of internal control.

4.2. As audit resources are finite, the audit plan is significantly focused on the highest-risk activities, subject to other sources of review and assurance (such as external audit) and previous Internal Audit work

⁶ 17th January 2011, 4th January 2012 and 15th January 2013

⁷ *Code of Practice for Internal Audit in Local Government in the UK*, published by the Chartered Institute of Public Finance and Accountancy 2006

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and findings. Specialist areas of coverage including IT audit and core financial systems have been maintained, albeit with reduced resources.

4.3. The 2012-13 Annual Report of Internal Audit will be presented to this Committee at its meeting in September 2013. Progress reports have been submitted to the Committee throughout the year. These reports identified audit work done and its outcomes, with specific reference to any matters of concern. Progress reports of this kind are now planned to be presented to every planned meeting of the Committee.

4.4. The reporting of audit work in this way stimulates a greater degree of action by officers to address audit findings and this should, in time, promote an improved internal control environment. As well as discussion of matters referred to in Internal Audit's own reports, the Committee has received specific reports from service management on:

- Housing Tenancy and Benefit Fraud (Committee 17 July 2012)
- Building Schools for the Future (Committee 17 July 2012)
- De Montfort Hall – Management Improvement Plan (Committee 4 December 2012)
- Property Services – Former Bishop Street Post Office (Committee 7 February 2013)
- Property Services – Vacant Premises (Committee 9 April 2013).

4.5. Internal Audit continues to achieve the stipulated performance target of 80% completion by the Internal Audit plan by the end of the financial year. This is measured at two levels; completion of the original plan as agreed, and delivery of the revised 'plan' including modifications resulting from additional commissioned audits and cancellations of those no longer necessary (for example, because of changes of central government policy). Following the changes to Internal Audit planning in 2013 – 14 this will be the last time this split reporting needs to take place.

5. The effectiveness of reporting on audit work in providing assurance on actions taken to address control deficiencies

5.1. The reporting to the Audit and Risk Committee makes a significant contribution in this respect. These reports identify Internal Audit reports finalised in the period under review and present a high level summary of Internal Audit's conclusions including the overall trends in the level of assurance Internal Audit can give on the strength of controls in operation.

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5.2. In addition, Internal Audit prepares an annual Summary of Internal Audit Conclusions, which is submitted after the end of each financial year to the Strategic Management Board and the Audit and Risk Committee. At the time of writing, the Summary for 2012-13 is scheduled to come to this Committee in September. These reports have been produced for a number of years and have always been well received and there is nothing to indicate that this will not be the case for 2012-13.

6. Reliance on Internal Audit by the External Auditor

6.1. The Council's external auditors have hitherto periodically reviewed the Internal Audit function. During 2009 they carried out their last review, which was reported to the Audit and Risk Committee at its meeting on 3 February 2010.

6.2. The auditor's assessment concluded that Internal Audit fully or substantially met nine of the eleven CIPFA standards⁸, and partially met the other two. No standards were assessed as not being met. An action plan to improve compliance further was prepared and recommended actions have been implemented where applicable.

6.3. There has not been a further external audit review of Internal Audit since 2009 and the Audit Commission, prior to its demise, had previously indicated that these reviews will no longer be undertaken. In future years, therefore, there will be a process of self-assessment against the CIPFA standards. This has been done and a summary is given at paragraph 7 below.

6.4. The External Auditors have, however, placed reliance on Internal Audit work during the year, particularly for audit testing in support of grant certifications. The Auditor's Annual Report on the Certification of Grants and Returns for 2011-12⁹, referring to work done in 2012-13, concluded that '*The work was to a good standard and the conclusions well evidenced, allowing us to place reliance on their work*'.

7. Internal Audit self-assessment of compliance with professional standards

7.1. As noted at paragraphs 4.1 and 6.2 above, Internal Audit operates to the CIPFA *Code of Practice for Internal Audit in Local Government in the UK*. These are recognised as the professional standards for internal audit in all UK local authorities. They set out eleven standards, covering the scope of internal audit, independence,

⁸ *Code of Practice for Internal Audit in Local Government in the UK*, published by the Chartered Institute of Public Finance and Accountancy 2006

⁹ Considered by the Audit and Risk Committee 14th March 2012.

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ethics, the audit committee, internal audit's relationships (such as with management and the external auditors), staffing and training, the audit strategy and planning, undertaking of audit work, due professional care, reporting and performance, quality and effectiveness. These are in turn assessed against many individual criteria and are now used as the basis of a self-assessment of the Council's internal audit team.

7.2. A self-assessment review has been completed in May 2013 and the conclusion is that all of the Standards continue to be met. There are a few detailed specific areas where improvements are needed, including:

- Arrangements for the seeking of audit assurances for services acquired by the Council through partnership arrangements (*CIPFA standard 1.2.3*)
- The development of the Internal Audit strategy post the failed shared service (*4.2.2, 7.1.1*)
- Clearer documentation of certain working protocols which apply in practice, e.g. communication between Internal Audit and elected members (*5.6.1*) and communication of the results of audit quality assurance review (*10.4.2*).

7.3. Action to address these will be put in hand as part of the Internal Audit 2013 – 14 Action Plan..

8. Internal Audit Client Satisfaction Returns

8.1. Internal Audit's main method of gauging clients' views of its work is analysis of the satisfaction survey returns issued at the end of each audit. These indicate satisfaction levels of 93% for 2012-13, a slight decrease on the position at the end of 2011-12 (98%). However, there remains a poor level of response from clients (15% of forms issued this year were returned, compared to 13% last year) which means that it is unsound to draw firm conclusions from this statistic. Having said that, it is likely that material dissatisfaction with the service would be made known in other ways and this has not been the case in the present year.

8.2. Internal Audit's work on EMAS was again (for the tenth successive year) well received. The EMAS external assessor¹⁰ stated in his latest report on the Council's continuing overall accreditation for EMAS that the work and support of Internal Audit was greatly appreciated.

¹⁰ LRQA report November 2012.

9. Performance Measures and Statistics

9.1. The Internal Audit team produces performance measures and statistics during the course of the year on a monthly basis, together with time analysis showing time spent on individual audit reviews.

9.2. Key findings of these statistics are:

- The team continues its endeavours to maintain its performance in respect of delivering its annual plan, but has struggled to maintain the extent to which individual audits have kept within their time budgets. At 56% this has fallen from last year's 60% and thus remains well below the target of 70%. One could argue that part of this is for reasons beyond Internal Audit's direct control but that does not alter the need to tighten up performance against this measure.
- Performance in respect of issuing reports has been relatively consistent over time. 68% of 2012-13 reports (70% in 2011-12) issued so far have been issued within the target of 15 days from the end of fieldwork. Pleasingly, 63% (49% last year) of final reports have been issued within the 15 day target of the draft report. In line with Internal Audit practice such delays are agreed, where possible, with the audit client.
- The productivity of individual auditors as measured by the number of chargeable days (annualised) per full-time equivalent member of staff has deteriorated further in 2012-13 after improvements in recent years. It rose from 163 (2008-9) to 174 (2009-10); 176 for 2010-11; fell back to 169 for 2011-12; and now stands at 147. A factor in the shortfall between March 2011 and October 2012 could be the uncertainty around the failed shared service and a lack of on-site 'leadership' in the absence of a Head of Function. This is, therefore, hopefully a temporary effect and efforts are in hand to improve the level productivity, which still remains below the average (180) for comparable unitary authorities.

10. Comparative Analysis

10.1. The Internal Audit section is a member of the CIPFA audit benchmarking club and compares its performance with that of other local authorities. It is always difficult to draw conclusions from such exercises, although the findings appear to confirm that, when compared with other similar non-metropolitan unitary authorities¹¹:

- In 2012-13 audit cost per £m turnover was below average for Leicester City Council (£469 compared with average £761).

¹¹ Per CIPFA Audit Benchmarking Club 2011

This represents a significant reduction on the costs in the previous year, however.

- Net cost per chargeable day is slightly higher than average, whereas cost per auditor per year is slightly lower than the average (£350/321 and £52k/£56k respectively).
- Leicester achieved 143 (176 in 2010-11) chargeable days per auditor in 2012-13 compared with an average of 173. The benchmark target for remains 180 days per auditor.

The CIPFA Audit Benchmarking Club endeavours to ensure that the comparisons are made on a like-with-like basis but there is always a risk of differences in interpretation by those submitting data. However, the benchmarking returns are the best source of comparative data available and the financial pressures make comparisons of this kind increasingly important.

11. Review of the Council's arrangements for preventing and detecting fraud and corruption

11.1. The Council has for many years had a specialist counter-fraud function. This has consisted of two main elements, a Corporate Counter-Fraud Team and a separate Revenues and Benefits Investigations Team. Between them, these two teams conduct investigations into fraudulent activity of all kinds against the City Council.

11.2. The Corporate Counter-Fraud Team was until September 2012 a part of Internal Audit. However, with the advent of the Internal Audit shared service with the County Council, this team was split from Internal Audit and now reports separately to the Head of Finance (Financial Control). Following the failure of the shared service, the appointment of the Head of Internal Audit and Risk management in October 2012 and a review of fraud management at the Council, this situation is likely to change in 2013.

11.3. The Revenues and Benefits Investigations Team provides a specialist investigation service primarily for Housing and Council Tax Benefit fraud, working under regulations applicable to the Housing Benefits service. This team have recently begun to be engaged by the Insurance team to help investigate (and successfully prosecute) insurance fraudsters.

11.4. The Council has an Anti-Fraud, Bribery and Corruption Policy and Strategy, which is reviewed annually and updated when necessary. The latest revision was approved by the Audit and Risk Committee at its meeting on 7 February 2013.

11.5. The work of the counter-fraud teams is regularly reported to the Audit and Risk Committee, the latest such report being considered at

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that same meeting in February. The overall context remains a zero-tolerance approach to fraud against the Council, with a determination to prevent and detect fraud and deal with the culprits accordingly. In addition to direct investigation work, the Corporate Counter-Fraud Team provides fraud awareness training to groups of staff and managers. It also coordinates the City Council's participation in the National Fraud Initiative (NFI), which is a nationwide data-matching exercise.

11.6. In addition to the two teams mentioned above, the Council's Trading Standards service conducts investigations into various aspects of business malpractice, such as counterfeit goods and sales of licenced merchandise to under age children. Though not aimed at fraud against the Council, its activities are an important part of the Council's response to fraudulent activity within the City. The service's work is included in the annual counter-fraud reporting to the Audit and Risk Committee.

11.7. Finally, the Council has had a whistle-blowing policy for a number of years, to allow members of staff to report concerns or allegations of fraud and other malpractice in confidence. Following a number of high-profile referrals, which led to significant investigations, the policy became part of a wider Disclosure Policy which was brought to the Audit and Risk Committee for consideration and approval at its meeting on 18 October 2012.

12. Review of the Effectiveness of the Audit and Risk Committee

12.1. In its publication *Audit Committees - Practical Guidance for Local Authorities*, CIPFA provided a self-assessment checklist to assist Councils in reviewing the effectiveness of their Audit Committees.

12.2. Using this checklist, it is considered that the Audit and Risk Committee meets all the requirements for an effective Audit Committee.

12.3. In summary:

- The Committee meets regularly and its chairmanship and membership are sufficiently independent of other functions in the Council. Meetings are conducted constructively, are free and open and are not subject to political influences.
- The Committee's terms of reference, which were formally revised and approved during the year, provide a sufficient spread of responsibilities covering internal and external audit, risk management and governance.
- The Committee plays a sufficient role in the management of Internal Audit, including approval of the audit plan, review of

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Internal Audit's performance and the outcomes of audit work and management's response to that.

- The Committee receives reports from the Audit Commission as the Council's external auditor and maintains an overview of the external audit process including the fees charged.

However,

- It is acknowledged that Committee members need suitable training. Arrangements have been made to provide training on a relevant topic at the beginning of every meeting of the Committee. The Committee is subject, of course to the risk of turnover of membership each municipal year, which is an inevitable consequence of the political environment in a local authority.

13. Conclusion

13.1. Drawing all of the above together, it is concluded that Leicester City Council has a sufficiently effective system of internal audit for the Council to be able to place reliance on its assessment of the system of internal control.