



Leicester
City Council

WARDS AFFECTED
All

Audit and Risk Committee

30 July 2014

Review of the Effectiveness of the System of Internal Audit 2013-14

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 2013-14.

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 upon which it (the Council) can place reliance.

3. Summary

3.1. Leicester City Council's Finance Division includes the Internal Audit team which carries out reviews of financial and management systems and seeks to provide assurance to management on the effectiveness of their management controls. Recommendations are made to improve systems and procedures, as appropriate, with the aim being to reduce the Council's exposure to unacceptable levels of 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 15 April 2014.

- 3.4. The Accounts and Audit Regulations 2011 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, the Chartered Institute of Public Finance and Accountancy CIPFA issued their 'Guidance Note on the Review of the Effectiveness 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. Work continues to ensure that both strategic and operational risk registers are complete and topical as part of the Strategy. As part of the 2014 Strategy, work continues to ensure that risk management becomes truly embedded within the council at all levels. The progress of this work is reported to each meeting of this Committee in the Risk Management and Insurance Services update.

- The Internal Audit team 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 (currently KPMG) in relevant aspects of their work. Currently, the Internal Audit manager is carrying out a self-assessment of the service against the Public Sector Internal Audit Standards, the result of which will be reported to this committee at its meeting on 29 September 2014.
 - The Internal Audit Plan reflects a risk-based approach consistent with the requirements of the 'Public Sector Internal Audit Standards'.
 - Customer satisfaction returns continue to indicate an acceptable level of satisfaction with the audit team for individual pieces of work, though there continues to be 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 regional practitioner meetings with a view to keeping abreast of best practice.
 - The team remains adequately resourced, especially in view of the budget pressures facing the whole of the City Council. The team 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 not part of Internal Audit and reports separately to the Head of Revenue and Benefits, who is currently reviewing the management of fraud at the Council. 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 team's work 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 CIPFA in their 2005 publication *'Audit Committees: Practical Guidance for Local Authorities'* and as subsequently amended. The Director of Finance attends these meetings and the Committee's annual report to the Council (21 November 2013) 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 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. (*Colin Sharpe, Head of Finance*).

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. (*Kamal Adatia, City Barrister and Head of Standards*).

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. (*Duncan Bell, Senior Environmental Consultant*).

6. **Other Implications**

Other implications	Yes/No	Paragraph referred
Equal Opportunities	No	-
Policy	No	-
Sustainable and Environmental	No	-
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. Tony Edeson, Head of Internal Audit and Risk Management
Caroline Jackson, Head of Revenue and Benefits
Steve Jones, Internal Audit Manager

8. Background Papers – Local Government Act 1972

- 8.1. Files held in Internal Audit.

9. Report Author/Officer to Contact

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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.

1. Sources of Evidence

1.1. 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 KPMG 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 statistics produced by Internal Audit during the course of 2013-14;
- Comparative analysis of some statistical measures of the service with those of comparable local authorities (via CIPFA benchmarking);
- 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*.

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

2. Risk Management Strategy

2.1. The strategy and policy have been reviewed and updated. Following their earlier acceptance by the Executive (as in 2011, 2012 and 2013)) these were brought to the Audit and Risk Committee at its meeting on 19 February 2014 seeking approval of the strategy and policy.

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- 2.2. 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 or damage 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 governance assurance statement.
- 2.3. Whilst much progress has been achieved during the past four years since the introduction of the Risk Management Strategy and Policy, work still needs to continue to fully embed risk management within the Council. 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 with pressures on budgets continuing and the inevitable, continuing impact on services.

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

- 3.1. The annual Internal Audit Plan was prepared before the start of the 2013-14 financial year. This is a 'high level', generic plan outlining in broad terms the areas of coverage. It is supplemented with detailed quarterly plans focussing on the specific audits to be undertaken within these areas. This allows the work of the audit team to be directed toward those areas of highest risk as the Council's overall risk profile changes throughout the year. This is important as a means of establishing the extent to which internal audit reports can give assurance on the overall system of internal control.
- 3.2. As audit resources are finite, the audit plans are significantly focused on the highest-risk activities, subject to other sources of review and assurance (such as external audit) and previous Internal Audit work and findings. Specialist areas of coverage, including contract audit and core financial systems, have been maintained. The Council's investment in specialist IT audit has strengthened with the recruitment in year of an IT technical specialist.
- 3.3. The 2013-14 Annual Report of Internal Audit will be presented to this Committee at its meeting on 29 September 2014. Progress reports
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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 will be presented to meetings of the Committee on a regular basis.

3.4. 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:

- Project/Programme Assurance Process (Committee 24 October 2013)
- Regulation of Investigatory Powers (RIPA) Performance Report (Committee 24 October 2013)
- National Fraud Initiative – Annual report (Committee 14 November 2013)
- Corporate Compensation Policy (Committee 15 April 2014).

3.5. Internal Audit remained on course to achieve its target level of completion of planned audits during the year, despite the fact that the planned 2013-14 main financial systems work could not be completed until after the year-end. This has been planned for 2014-15 to take place at the start of the financial year so that this situation does not arise in future years.

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

4.1. 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.

4.2. 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 2013-14 is scheduled to come to this Committee on 29 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 2013-14.

5. Reliance on Internal Audit by the External Auditor

- 5.1. The Council's external auditors have 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.
- 5.2. The auditor's assessment, at that time, concluded that Internal Audit fully or substantially met nine of the eleven CIPFA standards, 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.
- 5.3. 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 and the Public Sector Internal Audit standards. This has been done and a summary is given at paragraph 7 below. The Head of Internal Audit and Risk management is also in discussion with Derby City and Norfolk County Councils with a view to 'peer group' reviews in future years.
- 5.4. The External Auditors continue to place 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 2012-13, referring to work done in 2013-14, concluded that *'The work was to a good standard and the conclusions well evidenced, allowing us to place reliance on their work'*.

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

- 6.1. As noted at paragraphs 4.1 above and 6.2 below, Internal Audit operates to the CIPFA *Code of Practice for Internal Audit in Local Government in the UK* and the 'new' Public Sector Internal Audit Standards. These are recognised as the professional standards for internal audit in all UK local authorities. They set out a number of standards, covering the scope of internal audit, independence, 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.

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- 6.2. A self-assessment review was completed in May 2013 and the conclusion was that all of the Standards continued to be met. There were 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*).
- 6.3. Action to address these was included within the Internal Audit 2013–14 Action Plan. A further self-assessment review (to include changes suggested as part of the ‘new’ Public Sector Internal Audit Standards is currently being carried out.

7. Internal Audit Client Satisfaction Returns

- 7.1. 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 over 90% in each of the last three years. However, there remains a poor level of response from clients (returns in the mid-teens) 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. Performance Measures and Statistics

- 8.1. 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.
- 8.2. 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. Performance remains 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. Around 70% of reports issued in the past

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three years have been issued within the target of 15 days from the end of fieldwork. Pleasingly, an increasing number of final reports have been issued within the 15 day target of the draft report over the same period. In line with Internal Audit practice such delays are agreed, where possible, with the audit client.

- The productivity of individual auditors is also measured by the number of chargeable days (annualised) per full-time equivalent member of staff. This sits below the levels targeted although efforts are in hand to improve the level of productivity, which still remains below the average (180) for comparable unitary authorities.

9. Comparative Analysis

9.1. 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 authorities:-

- In 2012-13 audit cost per £m turnover was below average for Leicester City Council (£469 compared with average £761). 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 2013/14 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.

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

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

10.2. The Corporate Counter-Fraud Team was, until September 2012, part of Internal Audit. However, when the Internal Audit shared service

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with the County Council was proposed, this team moved and now reports to the Head of Revenue and Benefits.

- 10.3. The Revenue 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 are also now engaged by the Insurance team to help investigate (and prosecute) insurance fraudsters.
- 10.4. The Council has an Anti-Fraud, Bribery and Corruption Policy and Strategy, which is reviewed and updated when necessary. The latest revision was approved by the Audit and Risk Committee at its meeting on 7 February 2013, with the latest review almost complete and the revised Policy and Strategy coming to this Committee on the 29 September 2014.
- 10.5. The work of the counter-fraud teams is regularly reported to the Audit and Risk Committee, usually at its meetings in July and December. 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 also coordinates the City Council's participation in the National Fraud Initiative (NFI), which is a nationwide data-matching exercise.
- 10.6. As well as the 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.
- 10.7. 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, with the latest revised version scheduled to be presented to this Committee at its meeting on 3 December 2014.

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

- 11.1. 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.

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

11.3. 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 Internal Audit's performance and the outcomes of audit work and management's response to that; and,
- The Committee receives reports from KPMG 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.

12. Conclusion

12.1. 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.