

Internal Audit Annual Report 2012/13

To: Audit and Governance Committee

Date: 25 June 2013

Main Portfolio Area: Finance and Governance

Author of report: Brian Parsons, Head of Audit Partnership

Classification: Non-Exempt

Ward: n/a

SUMMARY

The report is provided in order to allow the Audit and Governance Committee to consider the work of the Internal Audit Team over the financial year 2012/13 and the opinion of the Head of Audit Partnership in relation to the Council's control environment, in the context of the Annual Governance Statement.

The Audit and Governance Committee must consider whether the outcomes of the Internal Audit work and the other matters referred to in this report provide evidence of a substantial level of internal control within the Authority, which can inform the Annual Governance Statement for 2012/13.

The Audit and Governance Committee must decide whether the matters referred to in the report provide evidence of an effective internal audit.

LINK TO STRATEGIC COMPASS

The report covers a number of aspects of the value quadrant.

Report status

For decision

Route to Implementation/Timetable:

The recommendation will come into effect immediately.

BACKGROUND/INTRODUCTION

The Public Sector Internal Audit Standards

1. A report on the new Public Sector Internal Audit Standards was provided to the Audit and Governance Committee meeting on 5 March 2013. The Standards became effective from 1 April 2013. This report has therefore been written to reflect the requirements which necessitate that:
 - The chief audit executive must confirm to the board, at least annually, the organisational independence of the internal audit activity.
 - The chief audit executive must deliver an annual internal audit opinion and report that can be used by the organisation to inform its governance statement.
 - The annual internal audit opinion must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control.
 - The annual report must incorporate:
 - the opinion;
 - a summary of the work that supports the opinion; and
 - a statement on conformance with the Public Sector Internal Audit Standards and the results of the quality assurance and improvement programme.
 - Progress against any improvement plans, agreed following external assessment, must be reported in the annual report.

The Annual Internal Audit Report

Independence

2. Internal Audit is provided through Mid Kent Audit, which is a shared service partnership between Ashford, Maidstone, Swale and Tunbridge Wells.
3. Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.
4. At Tunbridge Wells, the Head of Audit Partnership (HAP) has direct and unrestricted access to senior management and the Audit and Governance Committee. Reports to Heads of Service are issued in the name of the HAP who is responsible for the final content of the report.
5. The Head of Audit Partnership reports directly to the Audit and Governance Committee, the final content of the report being solely his prerogative. The HAP has free and unfettered access to the Chief Executive and the Chair of the Audit and Governance Committee.
6. Any potential threats to independence are managed at the individual auditors, engagement, functional and organisational levels.

7. Organisationally the Head of Audit Partnership reports to the Head of Finance and Governance who is a member of the management board. On no occasion has the Head of Finance and Governance or the management board sought to restrict the scope of audit work or to change any report prepared by the HAP.
8. It is considered that Internal Audit is organisationally independent and fully meets the necessary standard for independence and objectivity.

The annual internal audit opinion

9. It is the opinion of the Head of Audit Partnership that substantial reliance can be placed on the overall adequacy and effectiveness of the Council's framework of governance, risk management and control. This opinion covers the period from 1 April 2012 to date.
10. The opinion takes account of all related projects including the reliance on other assurance providers; principally the external auditors Grant Thornton (and previously the assurance provided by the Audit Commission).
11. The opinion takes account of the risk, control and governance framework.
12. The evidence to support the opinion is contained within this report. The opinion and this report can be used by the Council to inform its governance statement.
13. The Annual Governance Statement will be provided to the September meeting of the Audit and Governance Committee.
14. The Accounts and Audit Regulations 2011 also require that the Council 'must, at least once a year, conduct a review of the effectiveness of its internal audit'. It is considered that this report provides evidence of the effectiveness of internal audit and the Committee is therefore asked to treat consideration of this report as 'the review'.

Summary of the work that supports the opinion

15. The opinion on the control environment is principally formed through the results of Internal Audit work during the financial year.
16. Seventeen significant audit projects were completed between April 2012 and March 2013 and are listed at Appendix 2. Thirty auditor-days were lost to the team during the year through sickness. This is an exceptional situation compared with previous years where very low levels of sickness were recorded. This is the equivalent of losing two or three audit projects during the year.
17. Seventeen audits represent 77% of the revised audit plan. Action is currently being taken to improve performance for 2013/14. The team also carry out a number of other audit functions and these are shown at the end of appendix 2.
18. Appendix 2 shows the 'control assurance' i.e. the audit opinion for each audit. A table showing the definition of the respective control assurance opinions is shown as Appendix 3.

19. Three of the audit projects did not include a control assurance assessment as it was not appropriate to the project. These projects were the Audit Commission's National Fraud Initiative, an internal review of the Money Laundering Policy and an investigation relating to an officer in the Planning team.
20. The work of the Internal Audit Team has established that for the majority (64%) of the areas examined, satisfactory controls were in place at the time of the original audit.
21. Where weaknesses have been identified the appropriate Head of Service has since agreed the action to be taken to rectify those weaknesses.
22. The external auditors have been able to place reliance on the work of Internal Audit.

The results of external audit work during 2012/13

23. The main part of the external auditor's work relates to the Council's financial accounts. The auditors will be considering the accounts for 2012/13 shortly. The External Auditor has not raised any issues with Internal Audit that would give concern in relation to the Council's internal controls.
24. The external auditor's Annual Audit Letter for 2011/12 (which was reported to the meeting of the Audit and Governance Committee on 26 September 2012), commented that 'The Council continues to demonstrate strong financial management and has robust arrangements in place to ensure value for money'.

The Council's risk management arrangements

25. The Annual Strategic Risk Report appears elsewhere on the agenda for this evenings' meeting.
26. The current register shows eight risks, being:
 - Growth
 - Funding Streams
 - Partnerships
 - Joint Services
 - Organisational Resilience
 - Information and Communication Technology
 - Political Environment
 - Local Authority Mortgage Scheme
27. The risk management process requires that the allocated 'risk owners' must complete management action plans, which are subject to review and amendment every six months.
28. The risk register is a living document and is kept under review throughout the year and is amended when necessary to reflect changes in the risk environment. Risk reports are considered by Cabinet and Audit & Governance Committee Members throughout the year.

29. Internal Audit takes the role of facilitators of the risk management process but do not have responsibility for the individual risks or for the corporate risk register.

The effectiveness of internal audit process

30. Heads of Service are required to respond to every audit report where recommendations are made, by completing an action plan which sets out the action that will be taken to address the audit recommendations. The response is assessed for adequacy; to ensure that the proposed actions are sufficient and that any weakness will be addressed within a reasonable period.
31. Five reports were issued during 2012/13 relating to areas where a 'limited' control assurance was assessed as being in place. The responsible Head of Service subsequently completed an action plan setting out comprehensive and timely actions to address the audit recommendations.
32. Internal Audit carries out a follow-up to each audit to ensure that the actions have been taken in practice.
33. Eleven follow-ups took place during 2012/13. These are shown at Appendix D, which also shows the 'direction of travel', i.e. the improvements in control that occur as a result of the internal audit process.
34. Based on the generally prompt and positive responses received from senior management and the results of follow-up work, it is considered that senior management is effective in resolving control weaknesses.
35. It is considered that the internal audit process is effective.

Informing the Annual Governance Statement (AGS)

36. The opinion of the Head of Internal Audit on the internal control environment is particularly relevant to the preparation of the Annual Governance Statement. In that context, it should be noted that there are two audit reports which have corporate or significant implications where only limited control assurance was found to be in place at the end of the financial year. Both reports were completed in the latter part of the financial year and have not yet been followed-up. Therefore, consideration should be given by the Head of Finance and Governance to including the relevant issues within the Annual Governance Statement. The audit subjects are:
- Compliance with Contract Procedure Rules
 - Royal Victoria Place
37. The Internal Audit reports and the completed management action plans relating to both subjects appear elsewhere on the agenda, as exempt items.

Performance of the internal audit function against its performance measures and targets

38. During 2012/13 the internal audit function had two principal internal performance targets. The targets were:
 - Completion of the annual internal audit plan (90% target)
 - Achievement of customer care targets (85% positive response target)
39. The initial target for completion of audit projects within the internal audit plan for 2012/13 was 24 projects; however the target was reduced during the year to 22 to reflect the particularly high level of sickness among audit staff.
40. In practice the number of projects completed during 2012/13 was 17, which is 77% of the revised target of 22. Action to address the underperformance is being taken.
41. Customer surveys are issued to clients (service managers) following each internal audit to assess satisfaction with the audit service. The responses have been very positive. Positive levels of satisfaction help to confirm that customers/clients value the service that they receive.
42. An annual survey of Chief Executives/Directors and Heads of Service is carried out across the four-way Internal Audit Partnership in order to obtain responses on the quality of the internal audit service. The most recent survey was carried out in June 2013.
43. The survey of the partner Chief Executives/Directors focuses on satisfaction with the overall service. Of the eleven responses received (which represents all of those in this category), the answers to the question 'Are you satisfied with the service that you receive from Internal Audit', five were 'satisfied' and six were 'very satisfied'.
44. The survey of Heads of Service produced twenty-one responses over the four-way partnership, of which eight were 'satisfied' with the service and eleven were 'very satisfied' (two responders did not answer the question).
45. The survey of Heads of Service is quite detailed and includes questions on the quality of the various elements of the audit process. The main purpose of the survey is to identify aspects of the service that can be improved. The detailed responses will therefore be very carefully reviewed over the coming months and action will be taken to introduce improvements where appropriate.

Statement on conformance with the Public Sector Internal Audit Standards (PSIAS) and the results of the quality assurance and improvement programme

46. As stated earlier, the PSIAS has only been in place since 1 April 2013.
47. The PSIAS sets out the standards that the Internal Audit team has to comply with in order to meet the statutory requirement. A copy of the PSIAS has been provided to each auditor and each auditor has confirmed that they have 'read, understood and will work to the Public Sector Internal Audit Standards'.

48. The PSIAS requires that a Quality Assurance and Improvement Programme is in place. This requires both internal and external assessments. The internal assessments include ongoing monitoring of the performance of the internal audit activity, which is already in place, and 'periodic self-assessments or assessments by other persons within the organisation with sufficient knowledge of internal audit practices. CIPFA has recently published a 'Local Government Application Note for the United Kingdom Public Sector Internal Audit Standards', which includes a checklist. It is intended to use the checklist to aid periodic self-assessments of conformance with the Standards.
49. The PSIAS also require that an external assessment must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organisation. It is intended to seek an external assessment later in the year. The proposals for doing so will be reported to a future meeting of the Audit and Governance Committee.
50. The implementation of the PSIAS on 1 April 2013 means that aspects of the current service arrangement need to be changed in order to ensure full compliance. It is intended that the necessary actions will be taken during the current financial year so that the service will fully comply by 31 March 2014 at the latest. In particular, Internal Audit is required to operate to an approved Charter. It is intended that a draft Charter will be prepared and brought to the meeting of the Committee in September for approval.

Assurance levels

51. Internal Audit use 'assurance levels' or assurance statements to provide the overall audit opinion for the service or area that has been reviewed. The use of an assurance level is consistent with the requirement for managers (and Members) to consider the degree to which controls and processes can be relied upon to achieve the objectives of the reviewed activity. There are four assurance levels, as set out at Appendix D. The consistent use of assurance levels allows a balanced view to be taken of the overall adequacy of control within the Council.
52. In the financial year 2012/13, a total of fourteen audit reports included an assurance assessment for the area that had been audited (three did not). The initial assurance assessments were categorised as follows:

	2012/13	Previous year
High	0	0
Substantial	9	6
Limited	5	10
Minimal	0	0
Not given	3	7
Total	17	23

53. The collective assurance level, which can be extracted from the audit work performed during 2012/13, provides considerable evidence to support the statutory Annual Governance Statement, with 64% of the reports having a positive assurance assessment, identifying control assurance as 'substantial' at the time of the audit.

Reporting of Internal Audit work to the Audit and Governance Committee

54. Internal Audit work is reported at six-monthly intervals. An interim report, showing the first six months work of the financial year 2012/13, was provided to the Audit and Governance Committee meeting on 21 November 2012. A number of the audit projects shown in Appendix B have therefore already been brought to the attention of the Committee.

Other issues - Staffing

55. The team of operational auditors comprises two staff. Each auditor is expected to complete twelve audit projects during the year.
56. Under the partnership arrangement, the extent of audit management for the Tunbridge Wells audit service is the equivalent of 0.8 full time employees. The management resource is used for audit planning, review of audit reports, supervision, strategic management, risk management and reporting to the Audit and Governance Committee and to the Management Board.
57. The total staffing establishment for Internal Audit at Tunbridge Wells is therefore 2.8 FTE. It is considered that this level of resources is 'de minimis' level and any reduction in resource would place the Council's statutory duty to provide an effective internal audit in doubt.

WHAT IS THE ISSUE THAT REQUIRES A DECISION?

58. The outcomes of Internal Audit work and the opinion of the Head of Internal Audit help to demonstrate to the people of Tunbridge Wells that the Council has good governance, risk and control processes in place. Members are asked to confirm that they agree with the opinion of the Head of Audit Partnership.

WHO HAVE WE CONSULTED AND HOW? (OR WHO WILL WE CONSULT FOLLOWING THE DECISION?)

59. The internal audit process involves consultation with Heads of Service and other staff before, during and after each audit.

HOW WILL THE DECISION BE COMMUNICATED?

60. The decision will appear in the minutes of the meeting. The decision will be referenced in the Annual Governance Statement.

WHAT ALTERNATIVE ACTION COULD WE TAKE? (where appropriate)

61. There is a requirement that an annual report and opinion is provided to the Audit and Governance Committee. However, the Audit and Governance Committee could choose not to agree with the opinion of the Head of Audit Partnership.

CONCLUSIONS

62. The report is provided in order to allow the Audit and Governance Committee to consider the work of the Internal Audit Team over the financial year 2012/13 and the opinion of the Head of Audit Partnership in relation to the Council's control environment, in the context of the Annual Governance Statement.
63. The Audit and Governance Committee must consider whether the outcomes of the Internal Audit work and the other matters referred to in this report provide evidence of a substantial level of internal control within the Authority, which can inform the Annual Governance Statement for 2012/13.
64. The Audit and Governance Committee must decide whether the matters referred to in the report provide evidence of an effective internal audit.
65. The report is intended to provide sufficient information to justify/explain the opinion of the Head of Audit Partnership and to confirm that an effective internal audit process is in place.

RECOMMENDATIONS:

- (1) That the Head of Audit Partnership's opinion that substantial reliance can be placed on the overall adequacy and effectiveness of the Council's framework of governance, risk management and control be noted;
- (2) That the results of the work of the Internal Audit Team over the period April 2012 to March 2013, as shown in Appendix B be noted and that this is the prime evidence source for the Head of Internal Audit's opinion;
- (3) That it be agreed that the summary of the work and the other matters referred to in this report supports the opinion and that the report can be used to inform the Annual Governance Statement for 2012/13;
- (4) That the improvements in control that occur as a result of the audit process be noted; and
- (5) That the effectiveness of the Council's internal audit service be considered as part of the consideration of this report, and members express an opinion accordingly.

REASON FOR RECOMMENDATIONS:

The recommendations are based on the work of the Internal Audit team over the financial year 2012/13 as summarised in this report.

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Name of Director/Head of Service

William Benson
Chief Executive

Lee Colyer
Head of Finance and Governance

Background Papers

Internal Audit Reports

APPENDICES TO REPORT

Appendix A - Cross Cutting Issues
Appendix B - Internal Audit Projects Completed 2012/13
Appendix C - Control Assurance definitions
Appendix D - Follow-up reviews – Direction of travel