

Audit Committee

08 November 2019



Title	Effectiveness of the system of Internal Audit		
Purpose of the report	To note		
Report Author	Internal Audit Manager, Punita Talwar		
Cabinet Member	Councillor Tony Harman	Confidential	No
Corporate Priority	Financial Sustainability		
Recommendations	There are no recommendations		
Reason for Recommendation	Not Applicable		

1. Key issues

- 1.1 'Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes'. (Definition of Internal Auditing - Public Sector Internal Audit Standards - PSIAS)
- 1.2 The mission of Internal Audit is 'to enhance and protect organisational value by providing risk-based and objective assurance, advice and insight'. (PSIAS)
- 1.3 Public Sector Internal Audit Standards (PSIAS) 2017 have been adopted by the Certified Institute of Public Financial Accounting (CIPFA) and apply to internal audit service providers working within the public sector, whether in-house, shared services or outsourced.
- 1.4 The latest CIPFA statement on 'The Role of the Head of Internal Audit' (published April 2019) places greater emphasis on the organization's responsibility to support the role of internal audit in order to enable the function to effectively meet its expected professional standards. Therefore, this is an important consideration in reviewing internal audit effectiveness.
- 1.5 PSIAS set out core principles for the Professional Practice of Internal Auditing which taken as a whole articulate internal audit effectiveness.

1.6 Requirements relating to quality assurance are set out in the PSIAS, with an extract highlighted below:

'The chief audit executive must develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit activity. The quality assurance and improvement programme must include both internal and external assessments'. (In PSIAS the 'Head of Internal Audit' role is referred to as the Chief Audit Executive. At Spelthorne, the Internal Audit Manager represents the 'Chief Audit executive' for the purposes of PSIAS).

1.7 As set out above an 'External Quality Assessment' for Internal Audit is a requirement under the Public Sector Internal Audit Standards (PSIAS) and should be undertaken once every five years as a minimum. An external review process was undertaken during quarter 3 of 2018/19 through a three way reciprocal arrangement with two other local authorities in Surrey. All Auditors undertaking the review at respective sites were suitably qualified (holding either CMIIA or CCAB qualifications) with extensive internal audit experience. The external assessment focussed on compliance with the Public Sector Internal Audit Standards (PSIAS) and the International Professional Practices Framework (IPPF) on which PSIAS is based. It focussed primarily on the 2017/18 financial year. The outcome of the review for Spelthorne including the overall positive conclusions of the assessor (generally conforms to PSIAS requirements) and any action plans were reported to members of the Audit Committee in November 2018. Several areas of good practice were identified at the time of the External Quality Assessment with some examples set out below (these are also referred to under Internal Audit Effectiveness for 2018/19 as they are still relevant).

- Risk based audit plan
- Risk scoring / prioritising of assignments since 2018
- Regular monitoring of audit performance
- Periodic reporting to the Audit Committee
- Methodical and thorough working papers supporting audit findings
- Detailed and effective quality review of audit assignments
- Delivery of a varied audit work programme with robust supervision and review

Some improvement actions from the external review have been fully addressed whilst other areas are in progress. This is discussed in more detail at section 1.10 of this report. Resourcing, capacity issues and unplanned work (referred to also in Internal Audit's Service Plan for 2019/20) have not enabled full completion of the action plan, but the Internal Audit Manager will endeavour to address these in the coming months by March 2020.

1.8 As part of the annual process for assessing Internal Audit Effectiveness the Internal Audit Manager has completed a detailed PSIAS self-assessment checklist primarily focussed on the 2018/19 period whilst acknowledging further developments. Examples of Internal Audit Effectiveness for 2018/19 are highlighted below, as ascertained from the self-assessment process. These provide examples of conformance with Public Sector Internal Audit Standards (PSIAS) and demonstrate how the function has added value.

1.9 Internal Audit Effectiveness – 2018/19

1.9.1 Risk Based Audit Planning – A risk based approach is applied to determine the annual audit plan of activity to be undertaken each year through consultation with Group Heads and Managers, consideration of the Corporate Risk Register, any known system weaknesses or vulnerabilities and all known auditable areas (audit universe). The plan is approved by Audit Committee (March) and used to evaluate (through risk assessment) and improve the effectiveness (through delivery of agreed audit recommendations) of risk management, control and governance processes within the organisation. A varied work programme is in place (covering a broad range of systems/functions/corporate cross cutting reviews) which aligns with best practice. As new risks emerge the audit plan objectives are reviewed and reprioritised. During 2018/19 there was a significant period of resource shortage in the team (between April and October 2019, essentially a reduction of 1 FTE from a team of 1.75 FTE) and therefore reprioritising of the plan took place considering the higher risk areas.

1.9.2 Assurance Framework & Independence - Internal Audit is not responsible for control systems or their implementation. Responsibility for effective internal control and risk management rests with the management of the Council, as they represent the first line of defence in the overall assurance framework. Internal Audit have continued to encourage managers to provide assurance that controls in their functions/services are operating effectively using various approaches. Firstly Internal Audit have populated assurance templates (where appropriate) through discussion with Management to facilitate the identification and assessment of risks for specific functions/areas under review. This methodology also supports risk based auditing thereby adding value to the audit process and the Council. This process could be enhanced further if Management consistently provide a reasonable level of input to the process by giving due consideration to risks in their respective functions, so this will continue to be encouraged to promote greater Management ownership. Secondly, Group Heads and Managers are requested to sign off internal audit reports for their respective areas to confirm that reports are factually correct and controls are operating as described. In the majority of cases these are signed off by the relevant Group Head or MAT member, albeit there have been a few cases where Management have not signed off reports.

Internal Audit represents the third line of defence in the Council's overall assurance framework and provides independent assurance to management and councillors that the Council's key risks are being properly managed, with advice on enhancing the control environment and addressing weaknesses where necessary. The Internal Audit Manager attended a MAT Plus meeting in June 2019 to raise awareness amongst Group Heads and the Corporate Management Team on the 'Role of Internal Audit', promoting the importance of audit independence. This will be followed up with a further session to promote understanding of the role.

Consideration is given to all sources of assurance for each area in the Audit Plan as this will influence time allocations/areas of focus for the audit. Regular assurance reporting to Audit Committee summarising work undertaken and assurance ratings granted for planned audits has taken place.

Preparation of an overall assurance framework (map) incorporating the three lines of defence is resource intensive and in line with best practice the strategic management team will be responsible for owning this framework and allocating resources to undertake the groundwork for this corporate task. As an improvement suggestion, any such framework does need to be developed over time, requiring input from various Services including Internal Audit.

- 1.9.3 Independent Audit Opinion - Based on Internal Audit work undertaken, the Internal Audit Manager provided to the Audit Committee an overall evidence based audit opinion on the Council's internal control environment, risk management arrangements and governance framework to support the Annual Governance Statement for 2018/19. This is a key outcome of internal audit activity, and was contained in the Annual Audit report presented to the July 2019 Audit Committee.
- 1.9.4 Follow Up of Audit Recommendations - To promote greater management ownership of controls and risk mitigating actions, Group Heads and Deputy Chief Executives (as appropriate) are required to provide confirmation that agreed audit recommendations for their respective functions have been implemented. The Internal Audit Manager reports the direction of travel in implementing audit recommendations to Management Team and Audit Committee (Annual Audit Report and Interim Audit Report). This approach was endorsed by Management Team in 2017 and continues to work reasonably well. Audit recommendations are also followed up at every audit review where appropriate.
- 1.9.5 Quality Assurance and Improvement Programme – Internal Audit's activity and performance is managed through the Council's performance management framework as well as periodical reporting to the Audit Committee (3 times a year). The internal audit service plan outlines the key performance data that will measure delivery of the service. Service and personal targets are monitored periodically through appraisals and 1-1's. An external quality assessment of Internal Audit activity has been undertaken in November 2018 (see earlier reference) and a review of the 'Effectiveness of Internal Audit' is undertaken annually and reported to Management Team and Audit Committee. All audits undertaken are subject to a robust quality review process by the Internal Audit Manager, giving due regard to compliance with audit processes and methodologies set out in PSIAS when performing engagements, ensuring that audit findings and conclusions are supported. These combined mechanisms provide opportunities to identify ongoing improvements in working practices, staff development, as well as highlight achievements. The revised Audit Charter (2019) gives reference to these mechanisms and how the quality of Internal Audit is monitored and managed.
- 1.9.6 Scrutiny and review – There is periodical reporting of Internal Audit activity to the Audit Committee (3 times a year). External Audit assess the work of Internal Audit at interim and final audit stages, and all final internal audit reports issued during 2018/19 were submitted to External Audit at their

request. There is also regular dialogue between Internal and External Audit during the year through quarterly liaison meetings with the s151 Officer which also provides an opportunity to highlight any system control weaknesses/risks/fraud or irregularity cases. The current External Auditors (BDO) also attend every Audit Committee.

Current regulations do not allow External Audit to use Internal Audit work to inform their own opinions and therefore they place a lower level of reliance on Internal Audit than previously. Nonetheless, BDO have already expressed an interest in referring to Internal Audit working papers where deemed beneficial to avoid duplication of effort. No issues of concern have been raised by External Audit (BDO) for 2018/19 at this stage.

1.9.7 Declaration of Interest – An annual declaration of interest submission is a requirement for all officers at Spelthorne in accordance with the staff code of conduct. This ensures that any potential conflicts of interest or matter that may impair their ability to be impartial and unbiased in performing their duties are appropriately managed. No conflicts of interest have been declared during 2018/19 from Internal Auditors' submissions.

1.9.8 Reporting and Positioning - The Internal Audit Manager reports directly to the Section 151 Officer (Deputy Chief Executive) who is part of the strategic management team, with a dotted line to the Chief Executive. The Internal Audit Manager also has a functional reporting relationship to the Audit Committee Chair as a non-executive board member. The Internal Audit Charter states 'Internal Audit will have unrestricted access to the Audit Committee, Chief Executive, Members of Council, the Deputy Chief Executives and all employees of the authority'. The Internal Audit Manager is confident that the reporting lines allow the Internal Audit activity to fulfil its responsibilities and will continue to liaise and meet regularly with the highest levels of the organisation ("PSIAS requires the Internal Audit Manager to be appropriately positioned, reporting at the highest levels of the organisation" - Audit Charter).

1.9.9 Proficiency and Due Professional care– The Internal Audit Manager holds a professional auditing qualification from the Chartered Institute of Internal Auditors and has full chartered status (CMIIA). The Senior Auditor joined Spelthorne in November 2018 and is currently studying for the Certified Internal Auditor (CIA) professional qualification. Contracted audit resource was used to plug skills gaps in some areas to supplement in-house skills and knowledge (such as undertaking an ICT Audit Needs Assessment to inform future ICT Audit planning), or to fill resource shortages. The Internal Audit Manager is confident that Internal Audit possesses or has the means to obtain, the skills, knowledge, or other competencies required to deliver its responsibilities, although the wider issue in terms of Internal Audit being adequately resourced to effectively fulfil its responsibilities in a council that now has a significant commercial property portfolio and is undertaking ongoing property development activity, has been raised previously and is referred to again under section 1.10 of the report. Training and seminars are promoted/attended to keep abreast with auditing skills and technical expertise, ensuring continuous professional development. Auditors also adhere to codes of conduct and relevant standards/principles/frameworks/linked to their membership of professional bodies such as the Chartered Institute of Internal Auditors (CIIA) and the Certified Institute of Public Finance

and Accountancy (CIPFA). This includes due consideration of ethical principles, such as the 2018 CIPFA Standard of Professional Practice (SOPP) on Ethics (for which training was attended in June 2019) and the Chartered Institute of Internal Auditor's Global Code of Ethics. Auditors have been reminded at regular intervals of the importance of complying with Auditor Code of Ethics, in particular the core principles around independence, objectivity, integrity and confidentiality.

1.9.10 Non – Audit Work - The Internal Audit Charter (revised June 2019) sets out that appropriate safeguards will be put in place to ensure Internal Audit independence is not compromised from the Internal Audit Managers involvement in Corporate tasks/'Non-Audit' Work referred to below.

1.9.11 Corporate (Non-Audit Work) - Corporate Risk Management - The Internal Audit Manager coordinates and updates the Council's Corporate Risk Register, which represents the Councils most significant risks, reporting three times a year to members of the Audit Committee and Cabinet. The Audit Committee monitors risks raised in the Corporate Risk Register and Managers have attended the committee on some occasions to advise on how they are addressing risk mitigating actions. The efficiencies associated with Internal Audit's role in coordinating the Corporate Risk Register have been highlighted to Management Team and Audit Committee, for example significant risk exposures and control/governance issues identified from audit work can be considered for inclusion on the Corporate Risk Register to enable greater visibility, regular monitoring and review. Similarly, the Corporate Risk Register is used to inform the internal audit process including annual planning. This matter is also elsewhere in this report.

1.9.12 Corporate (Non-Audit Work) - Corporate Counter Fraud – The Internal Audit Manager has continued to take a lead in promoting and coordinating counter fraud measures through preparation of growth bids (and more recently a business case), oversight and coordination, high level contract monitoring through liaison with colleagues, collation and reporting of counter fraud returns for submission to Surrey County Council. Significant payback/returns are continuing to be achieved from the counter fraud work and as at 31.3.19 the cumulative return for Spelthorne in terms of notional savings to the public equates to almost £2.5m (since the start of the Surrey Fraud Partnership in January 2015 and shared across SBC, Surrey CC and Surrey Police) with estimated cashable savings for Spelthorne of £482k. Spelthorne's cumulative fraud return as at 31.3.19 was the third highest across the eight Surrey Partners who participate in the Surrey Counter Fraud Partnership Initiative and Spelthorne's Business Rates return which stands at £1,089,060 (notional savings) remains the highest across this group. Specifically for the 2018/19 period, the overall savings to the public purse equated to £890k with cashable savings for Spelthorne amounting to £154k.

Spelthorne continues to procure counter fraud resource/services from Reigate and Banstead to target areas which are likely to generate greater financial payback (business rates and housing) and a further growth bid prepared by the Internal Audit Manager in November 2018 has been secured from 2019/20 for 3

years. Collaborative working has produced positive outcomes particularly in Housing with enhanced verification checks for new claims. Referrals to Reigate for 2018/19 have demonstrated significant returns for Housing equating to notional savings to the public purse of £702k (using calculation rates applicable at the time). The wider social benefits need to be considered for Housing (as well as financial returns) e.g. where tenancies are retrieved due to sub-letting or housing applications are found to be fraudulent, this ensures that more social housing is available for those people who are genuinely in need of a home, leading to a reduction in housing applicant waiting times and reduced temporary accommodation (B &B) costs. There have also been wider benefits for Spelthorne's Housing team with opportunities to enhance learning and skills in this area. Opportunities to further address business rates tax avoidance and evasion continue to be explored.

1.10 Progress in implementing improvement actions highlighted previously

Improvement actions highlighted previously from the quality assessment process (external and internal) are set out below, together with a status update.

1.10.1 The Audit Charter should be refreshed and shared with senior management and the audit committee.

Status – Fully Implemented. The Audit Charter sets out the purpose, authority, responsibility and organisational independence of the Council's Internal Audit function, in accordance with the mandatory UK Public Sector Internal Audit Standards. The charter sets out the nature of services that internal audit will provide and how internal audit will help the organisation to achieve its objectives. A full review and refresh of the Audit Charter was undertaken in June 2019 giving due regard to requirements sets out in the PSIAS. This was reported to Management Team in July 2019 and approved by the Audit Committee on 25.7.19. It is intended that the Charter will be reviewed biennially going forward and reported to Management Team and Audit Committee at the appropriate time of year.

1.10.2 The audit manual, and other documents, should be reviewed to ensure they are current and reflect existing procedures.

Status – In Progress. The processes and procedures set out in the comprehensive manual and documents in use are still considered relevant and act as a reference point for all team members. Where necessary updates and fine tuning will be undertaken by 31 December 2019. A process flowchart is already held regarding the audit process.

1.10.3 An Audit Strategy should be adopted to supplement the audit charter and set out how the audit service will be delivered and developed.

Status – Outstanding. It has been deferred until further clarity is established on whether additional audit resource is to be approved by the Council's Management

Team and Members from 2020/21 onwards as part of the growth bid process. This will help determine how the audit service will be delivered and the extent to which it can be developed. The strategy document will also clearly set out the purpose and vision of Internal Audit and its links to organisational objectives and priorities.

1.10.4 Consideration should be given to adopting a Quality Assurance Improvement Process (QAIP) to ensure the audit function continuously performs in accordance with the Charter

Status - At the time this action was raised, the Internal Audit Manager agreed with the external assessor that further development of the QAIP needs to be proportionate to the size of the Audit function. Also where appropriate cross referencing to existing processes which contribute to the QAIP will continue, such as the annual effectiveness review as this provides a good indication of adherence to the Audit Charter, as well as the Performance Management framework. Where there is scope to further formalise the QAIP this will be considered going forward.

1.10.5 The report accompanying the annual audit plan should indicate whether audit resource currently available is sufficient to meet the audit need ('need' as determined from the audit planning process), highlighting any anticipated resource shortfall.

Status – Fully Implemented. This approach was adopted for the 2019/20 audit planning process and the anticipated resource shortfall reported to the corporate management team in March 2019. The corporate management team's preferred direction was to reprioritise and reduce the audit plan coverage for 2019/20, focussing on what was more realistically achievable within current resource available. Discussions were also held with regards aligning future requests for additional audit resources to the budget growth bid process timetable.

1.10.6 Internal Audit to undertake a review of Organisational Ethics in 2019/20 as this is a requirement under PSIAS i.e. to evaluate the design, implementation and effectiveness of the organisation's ethics related objectives, programmes and activities.

Status – A review of organisational Culture (also aimed to incorporate some aspects of Ethics) was proposed as part of the 'audit need' document reported to the corporate management team in March 2019. Following the requirement to reprioritise the list of proposed audits for 2019/20, it was agreed that this area would be deferred to 2020/21.

1.10.7 Organisational Independence - To arrange at least one independent meeting a year between the Internal Audit Manager and the Chair of the Audit Committee as well as regular more informal liaison.

Status – Fully Implemented. In order to preserve internal audit's independence and objectivity, the Internal Audit Manager has met independently with the Chair of the Audit Committee and opportunities for informal liaison are available. This took effect from June 2019 to coincide with the appointment of the new Audit Committee Chair.

1.10.8 Corporate Risk Management – Given that the Internal Audit Manager is responsible at Spelthorne for coordinating and updating the Council’s Corporate Risk Register which falls under the category of corporate non-audit work, discussions to be held to confirm whether such arrangements are to continue and if so alternative arrangements to be considered for reviewing the effectiveness of the organisation’s corporate risk management processes (i.e. cannot form part of the Internal Audit planned activity to ensure independence is not compromised) .

Status – Partially Actioned. The issue was raised and discussed at Corporate Risk Management Group and subsequently with the Chief Executive and s151 Officer (December 2018) where it was decided that the Internal Audit Manager should continue to coordinate periodical review of the Corporate Risk Register and that at some future point options for this process to be independently reviewed/audited by someone with appropriate expertise could be considered. Scope for audit colleagues at other Surrey authorities to undertake this as part of a reciprocal arrangement may be limited given that at those authorities periodical review of the corporate risk register is not undertaken by Internal Audit and therefore consistent benefits may not be gained from such an exercise. It also seems appropriate that any such review is undertaken once Spelthorne are further developed in its corporate risk management approach (this has been elaborated on previously during discussions with the Chief Executive and s151 Officer).

1.11 Further Proposed Improvements (At October 2019)

1.11.1 To implement any outstanding actions set out under 1.10 above.

1.11.2 The latest CIPFA statement on ‘The Role of the Head of Internal Audit’ (published April 2019) places greater emphasis on the organization’s responsibility to support the role of internal audit in order to enable the function to effectively meet its expected professional standards. This statement is therefore insightful for the Strategic Management Team and Audit Committee, as well as the Internal Audit Manager in striving for continued effectiveness.

1.11.3 Reporting and Positioning – To set up periodical joint meetings with the Chief Executive and Section 151 Officer to ensure timely communication of relevant issues . (“PSIAS requires the Internal Audit Manager to be appropriately positioned, reporting at the highest levels of the organisation” - Audit Charter).

1.11.4 Assurance Framework Preparation of an overall assurance framework (map) incorporating the three lines of defence is resource intensive and in line with best practice the strategic management team will be responsible for owning this framework and allocating resources to undertake the groundwork for this corporate task. As an improvement suggestion, any such framework does need to be developed over time, requiring input from various Services including Internal Audit.

2. Options analysis and proposal

2.1 Not Applicable.

3. Financial implications

3.1 Resources required (staff time) to implement improvement plan actions should be contained within existing budgets as far as possible.

4. Other considerations

4.1 Not Applicable.

5. Timetable for implementation

5.1 Improvement Plan actions aim to be prioritised and delivered by 30 September 2020 subject to resource availability.

Background papers: Public Sector Internal Audit Standards

Appendices: There are none.