

TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

25 June 2007

Report of the Director of Finance

Part 1- Public

Delegated

1 CIPFA CODE OF PRACTICE FOR INTERNAL AUDIT

Summary

This report informs Members of the review carried out against the latest Code of Practice for Internal Audit checklist. In addition as a result of this review changes have been identified to the Audit Charter and the report recommends that this Committee approves adoption of the revised Charter.

1.1 Introduction

- 1.1.1 The CIPFA Code of Practice for Internal Audit has been always been used as a benchmark as best practice for the provision of Internal Audit.
- 1.1.2 Although compliance with the Code was not mandatory the Audit Commission used it as a basis for their review of Internal Audit.
- 1.1.3 The Accounts and Audit Regulations 2003 required the s151 Officer of the Council to ensure that "proper practice" exists in the internal controls of the Council.
- 1.1.4 The Department for Communities and Local Government, circular (03/226 – issued August 2006) (s7 & s8) defines proper practice to include compliance with the Code of Practice for Internal Audit, published by CIPFA.

1.2 New Code of Practice

- 1.2.1 The new Code was issued by CIPFA in December 2006.
- 1.2.2 One of the significant additions to the Code is a checklist to benchmark compliance with the Code. Compliance with the checklist will be used by the Audit Commission in their assessment of Internal Audit as part of the Key Lines of Enquiry process.
- 1.2.3 This checklist has been reviewed by the Chief Internal Auditor in order to identify those areas where this Council is not considered to be compliant with the Code of Practice. A copy of the review is attached with the identified actions required to be fully compliant **[Annex 1]**.

- 1.2.4 The numbering of the checklist refers to the relevant sections of the Code of Practice and is therefore not consecutive.
- 1.2.5 A considerable number of the required actions can be achieved by an update to the Internal Audit Terms of Reference. These are contained within the Audit Charter. This Charter requires an annual review by the Audit Committee so this report covers the review of the Audit Charter at the same time. The proposed revised Audit Charter is attached **[Annex 2]**.

1.3 Scope of Work

- 1.3.1 The first area identified as requiring addressing is in section 1.2.3 of the Code. This question refers to the Chief Internal Auditor's role in ensuring that satisfactory controls exist in partnership working. The CIA is required to identify how assurances can be sought and that agreed access rights exist where appropriate.
- 1.3.2 The Code recognises the increasing use of partnerships in the provision of services. The agreements for partnerships do not always have the same extent of legal framework as contracts and are therefore considered to be of a higher risk.
- 1.3.3 An addition to the Audit Charter (s4.2) has been made for the Chief Internal Auditor to "Review, appraise and report on the arrangements in place for partnerships."

1.4 Fraud and Corruption

- 1.4.1 The Council has had in place Anti-Fraud Policies and a Confidential Reporting Code for a number of years. In practice any alleged improprieties are investigated by the Chief Internal Auditor and the outcomes reported back to the Director of Finance and Chief Executive. Since the formation of the Audit Committee a report of the outcome of allegations made under the Confidential Reporting Code has also been reported to Members.
- 1.4.2 The new Code of Practice requires that the Chief Internal Auditor is notified of all instances of suspected or detected fraud, corruption or impropriety. Although this is what happens in practice it was not contained in any Council policies.
- 1.4.3 In order to meet this requirement Members will see in a separate report to this Committee that an addition has been made as s8.2 of the Confidential Reporting Code that reads "All suspected or detected fraud, corruption or impropriety will initially be investigated by the Chief Internal Auditor who will report the outcome of his findings to the Chief Executive".

1.5 Principles of Independence

- 1.5.1 The Code (s2.1.2) requires that where internal audit staff have been consulted during system, policy or procedure development, are they precluded from reviewing and making comments during routine or future audits.

- 1.5.2 In practice this is normally achieved by the Chief Internal Auditor being consulted in these stages and the reviews being undertaken by another auditor. The management review of the audit is carried by the Principal Auditor. There may be occasions where Internal Audit staff provide advice on a new system and there is a possibility that the individual may then be asked to undertake a review of that system.
- 1.5.3 Due to the size of the authority it is impossible to preclude auditors from ever undertaking a review of a system that they have been involved in implementing. However, in order to meet this requirement the Charter has been amended in s7.8 to preclude an auditor from carrying out the first audit review of any system that have been consulted on.

1.6 Organisational Independence

- 1.6.1 Section 2.2 of the Code requires the Head of Internal Audit to report in his own name to the Audit Committee in order to demonstrate independence. Within the Council's Constitution, I am specified as the Head of Internal Audit given that I have line management responsibility for the function. However, I believe that the intention behind the Code is that it is the 'Chief Internal Auditor' who is able to report in his/her own name to demonstrate and offer some form of independent view to the Committee.
- 1.6.2 The protocol of the Council has always been for officers to report in the name of their Chief Officer. I have discussed this with the Chief Executive and the Monitoring Officer and we have agreed that the Chief Internal Auditor will report on specific audit matters to the Audit Committee in his own name in the future.
- 1.6.3 As a result the Audit Charter has been amended at s7.6 to read "Although the Director of Finance is the Line Manager for Internal Audit all reports relating to Internal Audit matters from the Internal Audit Section will be sent independently in the name of the Chief Internal Auditor."

1.7 Declaration of Interest

- 1.7.1 Section 2.6.1 requires all audit staff to make formal declarations of interest. Section 2.6.2 requires the planning process take account of the declarations of interest registered by staff.
- 1.7.2 This requirement is met partially by staff compliance with the general Code of Conduct. However, in order to meet the specific requirement of the Code the Charter has been amended in s4.5 to read "Internal Audit staff will be required to complete an annual declaration of any interests that could influence their adherence to the four principles in section 4.3 above. Any declared interests will be taken into account in the allocation of work from the Audit Plan".

1.8 Objectivity

- 1.8.1 Section 3.3.3 asks if there is a time period set by the Head of Internal Audit for staff where they do not undertake an audit in an area where they have had previous operational roles.
- 1.8.2 Normally a new auditor would not carry out the next review of the system that they have worked on. This requirement has not been recorded in the Charter so an amendment has been added as s7.9 to read “Where a new member of the Audit Team has been appointed from a post elsewhere in the Authority they will be precluded from carrying out the next audit of that system.”
- 1.8.3 Section 3.3.4 requires that staff are rotated on regular/annual audit areas. This happens in practice where possible but has not been confirmed in writing. In order to meet this requirement s7.10 of the Charter has been added to read “Where it is considered practical audits of the main accounting systems will be rotated between auditors to maintain the independence of the review.”

1.9 Internal Audit’s Relationship with the Audit Committee

- 1.9.1 Section 4.2.4 sets out the Chief Internal Auditor’s relationship with the Audit Committee. Sub-section (b) asks if the Chief Internal Auditor participates in the Committee’s review of its own remit and effectiveness.
- 1.9.2 The Audit Committee was formed in 2006 and has not yet carried out a review of its remit and effectiveness.
- 1.9.3 In order to meet this requirement it is recommended that the Audit Committee Chair and Chief Internal Auditor report to the Audit Committee annually on the work and effectiveness of the Committee.

1.10 Principles of Good Relationships

- 1.10.1 This part of the Code asks if there a protocol that defines the working relationship for Internal Audit with:
- (a) management
 - (b) other internal auditors,
 - (c) external auditors,
 - (d) other regulators and inspectors,
 - (e) elected members.
- 1.10.2 The protocols for working relationships are contained within a number of different documents such as the staff Code of Conduct and the Constitution.
- 1.10.3 In order to simplify the evidential process an addition has been made to the Charter to cover these working relationships in sections 6.6 and 6.7.

1.11 Staffing Internal Audit

- 1.11.1 This section questions how up to date job descriptions and personal specifications are. These tend to be updated as vacancies occur and are out of date. However, the annual appraisal clearly defines objectives and training needs for each individual member of staff.
- 1.11.2 It is intended to update job descriptions and person specifications in line with the annual appraisal of staff.

1.12 Responsibilities of the Individual Auditor

- 1.12.1 Section 9.2.1 relates to a number of ethical issues. These are contained within a number of documents such as Code of Ethics and the Confidential Reporting Code.
- 1.12.2 The Principal Auditor is undertaking a revision of the Internal Audit Manual this year and will include reference to these documents in order to provide evidence of compliance with the Code.

1.13 Principles of Performance, Quality and Effectiveness

- 1.13.1 This section, 11.1 deals with the content of an audit manual. The section has an audit manual but this is being updated by the Principal Auditor and will be fully compliant with these requirements.

1.14 Performance and Effectiveness of the Internal Audit Service

- 1.14.1 Section 11.3.2 of the Code covers the performance management of the Internal Audit Section.
- 1.14.2 The section currently reports to Members on the audit plan coverage, implementation of audit recommendations and the results of quality control questionnaires. It is considered that these measures partially meet these requirements.
- 1.14.3 Where there is a current void in performance measurement is in comparison to other authorities. The Kent Audit Group is currently developing a set of guidelines to enable a limited benchmarking exercise to take place.

1.15 Legal Implications

- 1.15.1 The Council has a statutory duty to comply with the Accounts and Audit Regulations 2003. Compliance with this Code of Practice is recognised as providing "proper procedures".
- 1.15.2 A failure to comply with the Code of Practice could lead to an external review determining that the Council does not have proper accounting procedures in place.

1.16 Financial and Value for Money Considerations

1.16.1 As the Code forms part of the annual external audit inspection regime then failure to comply with it could result in additional inspection costs.

1.17 Risk Assessment

1.17.1 The Code of Practice is designed to set a standard for Audit performance to be measured against. A failure to comply with the Code of Practice would lead to adverse external reports and would prevent the Audit Commission from being able to rely on the work of Internal Audit.

1.18 Recommendations

1.18.1 It is **RECOMMENDED** that:

- 1) the Audit Committee Chair and Chief Internal Auditor report to the Audit Committee annually on the work and effectiveness of the Committee; and
- 2) Members approve adoption of the revised Audit Charter.

Background papers:

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Code of Practice for Local Government Internal Audit
in England and Wales 2006 (CIPFA, London)

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