Annex 1

Tonbridge & Malling Borough Council

Internal Audit
Manual

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Preface

The purpose of this audit manual is to provide an overview of the internal audit procedures operating within Tonbridge and Malling Borough Council.

The Internal Audit Section is part of the Finance Department and is situated in room 34 of the west wing of the old Gibson Building. The section consists of four full time posts (although one is currently occupied by job share post) – please see section 1.2.3 for the organisation chart and reporting lines. The section is mainly automated and uses a mix of both general software for word processing, spreadsheet, etc, and specialist audit software for data interrogation, etc.

1   Code of Practice, Objectives and Scope

1.1   Code of Practice

The CIPFA Code of Practice for Internal Audit in local government 2006 governs the objectives, scope and working arrangements of the internal audit unit.   It provides clarification of the Auditing Practices Board's guideline on internal audit in local government.

1.2   Objectives

The objectives of Internal Audit are to:

- ⱱ   Independently review and appraise systems of control throughout the authority and its activities
- ⱱ   ascertain the extent of compliance with procedures, policies, regulations and legislation
- ⱱ   provide assurance to management that their agreed policies are being carried out effectively
- ⱱ   facilitate good practice in managing risks
- ⱱ   recommend improvements in control, performance and productivity in achieving corporate objectives
- ⱱ   review the value for money processes, Best Value arrangements, systems, and units within the Authority
- ⱱ   work in partnership with the external auditors
- ⱱ   identify fraud as a consequence of its reviews and to deter crime.

1.2.1   Internal Audit Charter

The audit charter A1 clearly identifies the purpose, authority and responsibilities of Internal Audit and Management in assisting to maintain and develop the Council's system of internal controls.

1.2.2   Authority

Two principal pieces of legislation impact upon Internal Audit within the Authority. Section 151 of the Local Government act 1972 requires every local authority to make arrangements for the proper administration of its financial affairs and to ensure that one of the officers has responsibility for the administration of those affairs. Within Tonbridge and Malling Borough Council the S151 Officer is a Director whose responsibility is the finance department.

Specific authority of Internal Audit within Tonbridge and Malling Borough Council is detailed in the Council's Financial Procedure rules, part 4,

section 7, located within the Councils Constitution. A2

Section 5 of the Accounts and Audit Regulations 1996 (England and Wales). States that "a relevant body shall maintain an adequate and effective system of internal audit of their accounting records and control systems. Any officer or member of the body shall, if the body requires, make available such documents of the body which relate to their accounting and other records as appear to that body to be necessary for the purpose of the audit and shall supply the body with such information and explanation as that body considers necessary for that purpose."

Authority for the production and execution of the audit plan and subsequent audit activities rests with the Chief Internal Auditor, after consultation with the Council's Corporate Management Team. Internal Audit has unrestricted access to all records (whether manual or computerised), cash, stores and other property, and may enter property or land, to obtain explanations. Such access is granted on demand and without any prior notice.

1.2.3 Organisation

The Charter sets out the right of Internal Audit to report in its own name and its freedom of access to all senior officers. Internal Audit is able to report to all levels of the Authority, in particular, to the Chief Executive and the Section 151 Officer.

A chart showing Internal Audits position in the authority can be viewed within the Audit Charter Section 5.

1.3 Scope

Internal Audit's activities are conducted in accordance with the authority's strategic objectives and established policies and procedures. Internal Audit complies with the standards set by CIPFA and the Institute of Internal Auditors (IIA). The CIPFA audit manual can be viewed at A3

1.3.1 Risk Management

Tonbridge and Malling Borough Council has created a Risk Management Strategy, A4 It is concerned with the management of risks within its control to safeguard employees, protect assets, preserve and enhance service delivery to the population, maintain effective stewardship of public funds and promote a favourable corporate image.

Risk management and Internal Audit share a number of features:

- they are based on principles of quality management
- they require a co-ordinated and integrated approach across all areas of corporate activity
- everyone in the chain of service needs to be involved in the process.

Internal audit and risk management, as systems for controlling risks that threaten the assets and objectives of the authority, form a complementary and valuable partnership.

1.3.2 Corporate Governance

Internal Audit plays an important role in the corporate governance arrangements of the authority. This authority has produced a Local Code of Corporate Governance A5. Risk Management is firmly embedded within the organisation. There are both Strategic and Operational Risk Registers which are updated at least yearly.

2   Relationships

2.1   Organisational Relationships

2.1.1 Management

The Chief Internal Auditor or the Principal Internal Auditor consults with management when preparing audit briefs. Where appropriate, the documents are amended to reflect comments received from management. However, care is taken to ensure that the independence and objectivity of Internal Audit is not compromised.

Internal Audit is often approached by clients for either financial advice, assistance or to carry out enquiries, which do not form part of the agreed plan. The Chief Internal Auditor or the Principal Internal Auditor formally agrees variations or additional work with the clients. Factors taken into account in the decision include the nature of the work, the available resources and current progress against the audit plan.

A contingency element is built in to enable the audit plan to be flexible enough to accommodate unforeseen additional work.

2.1.2 Audit Committee

Internal Audit will report to an appropriate member forum. The role of the audit committee can be viewed here A6 and their Terms of Reference can be viewed here A7

2.1.3 Section 151 Officer (Local Government Act 1972 – England and Wales)

The Chief Internal Auditor will have a direct reporting line arrangement to the responsible Section 151 Officer (Proper Officer) and will meet with that officer on a regular and frequent basis. The essence of the relationship between the Chief Internal Auditor and the Responsible Officer is that of a partnership with the common goal of ensuring the probity and effectiveness of the authority's financial arrangements and internal control systems.

2.2 External Relationships

2.2.1 External Audit (Currently The Audit Commission)

The relationship between Internal Audit and the Audit Commission takes account of their differing roles and responsibilities. Internal Audit is an independent appraisal function within the Authority. The External Auditor has a statutory responsibility to express an independent opinion on the financial statements and stewardship of the Authority.

The Chief Internal Auditor liaises with the Audit Commission to:

∇ foster a co-operative and professional working relationship
∇ reduce the incidence of duplication of effort
∇ ensure appropriate sharing of information
∇ co-ordinate the overall audit effort.

In particular the Chief Internal Auditor will discuss the Internal Audit Plan to facilitate External Audit planning. Hold quarterly meetings to discuss performance, make all reports and working papers available and gain knowledge of the Audit Commission's programme and methodology.

2.2.2 External Inspection Bodies

There are a number of inspection bodies, which Internal Audit occasionally comes into contact with, Internal Audit will seek to foster constructive working relationships with such bodies, particularly where internal audit reviews are undertaken on, or may be relevant to, the area under inspection.

3 Staffing and Training

3.1 Staffing

The Internal Audit Plan determines both the skills and resources required to deliver efficient and effective internal audit.

The Chief Internal Auditor is professionally qualified with a wide experience of internal audit and is responsible for ensuring that staff are recruited and trained to the appropriate skill level to deliver the audit plan. Staff members are encouraged to continuously develop both professionally and personally, to respond to changing demands on audit skills.

The Chief Internal Auditor is a Member of the Institute of Internal Auditors (MIIA), Member of the Association of Accounting Technicians (MAAT) and is a Master of Science (Msc).

The Principal Internal Auditor is a Member of the Association of Chartered Certified Accountants (ACCA), Member of the Association of Accounting Technicians (MAAT) and is a Member of the Institute of Internal Auditors (MIIA).

The two Senior Auditors (job share) have completed the Accounting Technician Exams.

The Internal Audit Assistant is studying towards the Accounting Technicians Exams.

3.2 Training

Internal Audit supports the need for training and development on both a professional and technical level. Technical training, involving courses or seminars are undertaken as required within the limitations of the Council's training budget. Ongoing management of Internal Audit training is the responsibility of the Chief Internal Auditor and the Principal Internal Auditor. These responsibilities include:

ᵥ ensuring training requirements are regularly reviewed
ᵥ identifying suitable training providers to meet training needs
ᵥ monitoring the quality and effectiveness of the training provided.
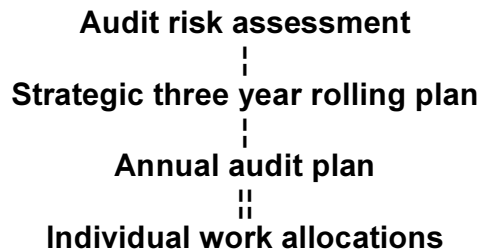
4 Planning

4.1 Purpose of Audit Planning

The Chief Internal Auditor and The Principal Internal Auditor are responsible for producing an annual plan based upon risk assessment, to prioritise the work required to take into account the relative risks in the Authority's activities and systems.

The operational purpose of audit planning is to:

ᵥ determine priorities
ᵥ control and direct audit work
ᵥ match the audit work required to the resources available.

The overall audit planning process is a cascade of planning elements, as follows:

Audit risk assessment
ⅰ
Strategic three year rolling plan
ⅰ
Annual audit plan
ⅱ
Individual work allocations

4.2 Risk Assessment

The Internal Audit resources required for Tonbridge and Malling Borough Council are assessed using an audit risk assessment. The risk assessment is initiated by analysing the complete breakdown of all the services provided by the Authority. Having identified all the areas to be reviewed using their Risk Registers, are assessed as either (1) High, (2) Medium or (3) Low risk. High risk areas are audited yearly, medium are audited biannually and low are audited every 3 years.

The activities within each band are then examined and audit days assigned. This gives an audit need that is compared with the resources available, after allowing for unavailable audit hours such as:

ᴠ annual leave
ᴠ sickness
ᴠ staff development and training
ᴠ team administration and management
ᴠ quality assurance
ᴠ benchmarking

A contingency provision is also included in the plan to allow for any changes in circumstances after the risk assessment is completed, such as emergency responsive work or special investigations.

4.3 Strategic Plan and Annual Plan

The next step is to draft a strategic 3-year plan A8. The period it covers should enable all major systems and areas of activity to be audited. The strategic plan is used as the target to be achieved by Internal Audit. It is subject to an annual review and sets out the audit objectives, types of audit, activities subject to audit, frequency, and audit days required for each activity.

4.4 Controlling

Achievement of the annual plan is the responsibility of Chief Internal Auditor, who divides the audit plan into sections. In doing this, the following is considered:

ᴠ Estimated audit days available. Account is taken here of staff holidays, planned study leave, sickness leave, training, etc.
ᴠ Priorities.
ᴠ Audit rotation.
ᴠ Time of year.

The annual audit plan is approved by the Director of Finance in consultation with the Audit Commission, by the Corporate Management Team and by Cabinet following which, it is communicated to each employee within Internal Audit.

The Chief Internal Auditor is responsible for monitoring the achievement of the audit plan. To help monitor and control the plan, all audit staff use a time recording system. Analysis of staff time is produced by the time recording system, which allows comparison of actual output against the audit plan A9. Quarterly the Chief Internal Auditor prepares a report for the Section 151 Officer and the Corporate Management Team, outlining the percentage of programmed work completed against target.

4.5 Rolling Forward the Strategic Plan

The strategic plan acts as a guide to the planning of specific reviews and the achievement of the Internal Audit objectives. The Chief Internal Auditor monitors the plan on a continuous basis and gives consideration to:

- results of previous audits
- changes in Internal Audit resources
- a basis for assigning work to auditors
- a comparison of work done with work planned
- the basis for a review of future Internal Audit workload
- A means for management to adequately supervise each audit and to review progress.

5 The Audit Process

5.1 Preparation for an Audit

Planning is critical to the success of each audit review, the aim is to ensure that the proposals satisfy both Internal Audit's and the client's requirements. Time is set aside for this stage of the audit, which identifies priorities, objectives and allocates resources. This exercise ensures that auditors understand the client's business and audit materiality. It determines the scope and objectives of the audit review and identifies how the audit is to be undertaken. The Chief Internal Auditor or the Principal Internal Auditor undertakes the preparation of the audit brief.

5.1.1 Research

It is essential for the relevant auditor to gain an understanding of the system under review. Sources of information include:

- audit files and working papers (including extraction of follow-up points from previous reviews)
- legislation
- authority policy documents and financial regulations
- reports to members
- financial records
- organisation chart
- computer applications.

5.1.2 Production of the Audit Brief

The audit brief, an example can be viewed at A10 sets out the details of each review, including the objectives and notes of any issues for the auditor to consider. The brief is formally agreed and authorised by the client and Chief Internal Auditor or the Principal Internal Auditor prior to the commencement of the audit work.

The purpose of the brief is to ensure that the terms and details of the audit are agreed and understood. The client is able to comment on the brief and request if they would like the audit to cover any other areas.

5.2 Audit Control and Review

5.2.1 File Review

In order to ensure consistency and compliance with professional standards and audit procedures, it is essential that all audit work is effectively supervised at all stages of the audit and reviewed and signed off by the Chief Internal Auditor or The Principal Internal Auditor at its conclusion. A copy of the review sheets can be viewed at A11 and A12

This process is designed to ensure that:

ᴠ all work undertaken complies with the requirements of professional best practice
ᴠ work programmes are completed
ᴠ audit files are complete and properly structured
ᴠ appropriate audit techniques have been used
ᴠ all working papers adequately support the findings, conclusions and recommendations of the report to which they relate
ᴠ the related audit report is complete, accurate, objective, clear, concise, constructive and timely
ᴠ the objectives of the audit assignment are met within the allocated time budgets or that appropriate time variations have been authorised.

5.3 Working Papers and Files

Working papers (the top sheet can be viewed at A13) provide the essential evidence on which any audit report is based. The term 'working papers' covers all the schedules, analyses and documents prepared and gathered during the audit. They must:

ᴠ record the work done and evidence gathered
ᴠ provide details of problems encountered

ᴠ demonstrate a methodical approach
ᴠ support the conclusions and recommendations of the audit report
ᴠ facilitate the review of the audit
ᴠ create background and reference material for future audits

Working papers must be:

ᴠ legible
ᴠ clear with using clear English
ᴠ concise, but with sufficient detail
ᴠ objective
ᴠ cross-referenced
ᴠ relevant
ᴠ referenced back to source.

Working papers must not contain:

ᴠ gratuitous comments
ᴠ jargon, buzz words or unexplained abbreviations
ᴠ speculation, unsupported or anecdotal evidence

Working papers should enable an experienced auditor with no previous knowledge of the particular system to reach the same conclusions as the actual auditor.

5.4   Audit Evidence

Independent documentary evidence carries more weight than anecdotal verbal reports. Indirect verbal evidence from third parties should always be independently validated if it is necessary to place reliance upon it. Good quality evidence in the form of working papers and detailed notes of interviews is essential. Audit working papers and files form one of the main review and assessment tools available to the Chief Internal Auditor and external reviewers of Internal Audit, such as the Audit Commission.

5.5   Audit Files

All audit files are structured and properly maintained. They include:

ᴠ audit briefs
ᴠ system notes
ᴠ audit reports
ᴠ all correspondence i.e. advice/guidance, memos
ᴠ working papers and evidence

Audit files are maintained securely at all times. In view of the constraints imposed by the Data Protection Act, any computer prints containing personal information, which are not pertinent to the audit are destroyed at the end of the relevant audit. See A14 for the basic audit procedures.

5.6   Audit Techniques

The techniques detailed below may be of assistance in some types of audit review.

5.6.1   Testing

When carrying out an audit, the auditor is concerned with evaluating the systems of internal control.

Compliance Testing

This test provides evidence about the operation of internal controls; as it is the control, which is tested. An important feature is that, for each item examined, the control either operates or it does not. It is a part of the systems-based approach and provides evidence about the effectiveness of the operation. If the tests expose exceptions, these are fully investigated. Internal controls should operate effectively at all times and any deviation suggests a control weakness, which must be reported upon. Compliance tests include enquiry, observation and inspection of documents.

Substantive Testing

These tests are designed to give direct evidence as to the completeness, accuracy and validity of records, account balances, etc. Substantive tests include analytical review, substantive sampling, observation and enquiry, inspections and re-performance of internal controls.

5.6.2   Computer Assisted Audit Techniques

Internal audit techniques have benefited from the growth of computer technology. IDEA is a specialised interrogation package used by Internal Audit, it assists in the examination of large databases, by performing specific tests or extracting samples for follow up testing.

5.6.3 Statistical Sampling

Sampling is inevitable due to the large volume of transactions, which require auditing. The selection process and the test result evaluation are an important part of the auditor's work. There are various techniques available when selecting samples of data.

Random Sampling

This technique ensures that every item within a population has an equal chance of being selected.

Systematic Sampling

Selects every nth item from a population after a random start.

Cluster and Multi-Stage Sampling

A random sample is selected from a population, from which further samples are taken and subjected to analysis.

6 Audit Reporting

6.1 Audit Reports

The audit report (an example can be viewed at A15) is an important part of the whole audit process and the culmination of the work undertaken. It communicates the results of the audit review to management in a clear, concise and factual manner. Recommendations are made where appropriate and given a priorities which can be viewed at A16. It also gives a control assurance level which is the Auditors opinion on the system, the different opinions can be viewed at A17. The confidentiality of internal audit reports depends upon their nature.

There are two types of audit reporting:
- draft report, promotes discussion on the findings and recommendations
- final audit report, once all matters have been agreed at draft report stage.

The audit report is structured to draw the attention of the reader to the most significant matters.

6.2 Discussion of Reports

The Chief Internal Auditor or the Principal Internal Auditor reviews draft reports before they are sent to the client. The draft report is initially sent to the contact officer to confirm the accuracy of the findings and ensure that

the recommendations are reasonable.

Prior to the issue of the final report, any amendments are made. If any of the recommendations are not accepted, management should explain the reasons why and these comments are also detailed within the report. In certain circumstances it may be necessary to widen or limit the circulation of the report. The Auditor and Chief Internal Auditor or The Principal Internal Auditor agree the distribution of the final report.

6.3   Follow-up

Each final audit report will contain an agreed action plan (an example could be viewed at A18) for management to implement. The recommendations are recorded on to the Reports List A19 along with the agreed actions and the due date for the follow up action. This forms the basis of a follow-up review aimed at reviewing the implementation of the agreed recommendations by due date. Follow-up reviews assess the managerial action, which has been taken. Recommendations with a priority of high or medium will be followed up and re-tested within six months to a year of the planned implementation date. If the recommendations have not been implemented, this will be reported to the relevant Chief Officer. If after this process the recommendation has still not been implemented then it will be reported to the Audit Committee.

7   Types of Audit

7.1   Internal Control

7.1.1   Management Responsibility for Internal Control

Management requires complete and accurate records to assist in:
v   controlling operational activities
v   safeguarding assets
v   preventing or detecting errors, frauds or other irregularities
v   preparing financial statements
v   complying with legislation, etc.

Management therefore needs to maintain internal controls designed to ensure the completeness and accuracy of records and the validity and reliability of the entries they contain. The cost of implementing and operating internal controls must be balanced against the risks and benefits expected to be derived from them.

7.1.2   The Auditor's Use of Internal Control

The auditor's objective in evaluating and testing controls is to determine the degree of reliance that may be placed on the system under review. If

the auditor is reasonably assured that the internal controls are effective, the extent of compliance and substantive tests may be limited. However, due to the limitations in any system of internal control, it will always be necessary to perform some compliance testing.

7.1.3 Types of Internal Control

The following list describes some of the types of control:

- Organisational control. There should be a plan of the Authority, defining and allocating responsibilities, reporting lines, delegation of responsibility and authority.
- Segregation of duties. The segregation reduces the risk of manipulation or error and increases the degree of checking as the work of one officer checks or is complementary to that of another.
- Physical control. Security and adequate insurance, etc.
- Authorisation and approval. Authorisation limits should be established.
- Personnel. Qualifications, selection, training and personal characteristics of personnel involved are important features to be considered in establishing any control system. References should be taken up on all employees.
- Supervision. Internal check on work performed, targets reached, etc.
- Management controls. These controls are exercised outside the routine of the system and will include the overall supervisory controls.
- Accounting. Budgetary control.

7.2 Types of Audit

7.2.1 Systems Based Audit

This audit is designed to check the actual internal controls in place within a system's procedures and determine whether they are adequate and functioning correctly.

The key stages of a systems-based audit are:
- assess how internal controls are operating in a system, thereby forming a view on whether reliance can be placed upon the system
- provide management with assurances that systems are adequately meeting the purposes for which they were designed
- provide constructive and practical recommendations to strengthen systems and address identified risks
- use findings to feed into an overall opinion on the control framework, thereby fulfilling S151 responsibilities.

7.2.2 Probity and Regularity Audits

These audits are undertaken where the area for review is considered high risk, either for dealing with cash income or a weakness in controls. The

aim of the review is to ensure that the transactions within the system are being processed correctly or that all transactions are valid, processed accurately and properly authorised.

The audit provides an assurance to client management on the proper and effective administration of their area of responsibility.

7.2.3 Value for Money (VFM) Auditing

These audits are designed to evaluate an operational area, examining the method of service delivery to test the resource inputs and outputs. Such a review focuses on the effective and efficient use of resources to ensure the most economic output at the right quality. The primary responsibility for achieving good VFM lies with management, but Internal Audit has a key role in helping to discharge this responsibility.

7.2.4 Computer Audit

This involves the evaluation of internal controls concerning the computer environment within the Authority. A degree of computer audit is covered for some applications within the normal system audit, as computers form a vital part of Council systems.

7.2.5 Fraud Investigation

The primary responsibility for the prevention and detection of fraud and corruption rests with management, it is an inherent part of every auditor's duties to be aware of the potential for fraud in the ongoing conduct of their duties.

The investigations must be properly planned to achieve the desired outcome. All information is treated in the strictest confidence and all audit evidence is to a high standard. Any interviews, which are undertaken by audit, must be compliant with the Police and Criminal Evidence Act. The Council has adopted a strategy to safeguard against fraud and corruption and they must be observed during the investigation.

Once the fraud investigation is completed the nature of the fraud should be reviewed and the system evaluated and controls introduced to ensure that it is not possible to repeat the fraud in the future.

Various policies are listed here with a hyperlink.
A20 Anti Fraud and Corruption Policy
A21 Anti Money Laundering Policy
A22 Benefits Anti Fraud Policy
A23 Confidential Reporting Code

8   Quality and Due Care

8.1   Quality Management

8.1.1   Audit and Professional Standards

All internal audit work is performed in accordance with the Auditing Practices Board Guidance on Internal Audit and the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom. Individual members of staff also comply with the relevant standards and guidelines issued by their professional body the Institute of Internal Auditors.

8.2   Quality Assurance

The Chief Internal Auditor ensures that the standards and processes contained within this manual are reviewed and updated annually to ensure that they remain modern and relevant to the needs of the Council.

The Audit Commission undertakes independent reviews to measure and evaluate the effectiveness of the internal audit function and reports the results to the Chief Executive.

In order for Internal Audit to monitor, and, where necessary, to improve its performance where appropriate, a satisfaction survey form is sent to the client at the conclusion of each appropriate individual planned/unplanned audit. An example can be viewed here A24

8.3   Due Care

Internal Audit performs its duties with integrity, diligence, competence, care and skill to a level sufficient to demonstrate due care. All internal audit staff should maintain a sufficient level of objectivity when performing audits.   Following a review internal audit can normally provide a reasonable assurance regarding the outcome, however not an absolute assurance.

To demonstrate that due care has been exercised, internal audit ensures that sufficient evidence exists to show that work has been performed in a way, which is consistent with the CIPFA standards. Internal Audit ensures that all staff all skilled in dealing with people and in effective communication both oral and written.

Internal Audit ensures that it demonstrates a high standard of professional conduct at all times, by maintaining an impartial view and avoiding conflicts of interest. The maintenance and monitoring of the overall quality

and professional performance standards of the Internal Audit unit is the responsibility of the Chief Internal Auditor and the Principal Internal Auditor.

9.   Performance Management

In order to demonstrate continuously improving services, as required by best value and best practice, the section must effectively measure its performance. The measurement must show the starting point and the improvement achieved. As a result, the section has adopted Kent Audit Group performance indicators, which are calculated and reported upon each year to the group.

The performance measurement provides information for year on year comparisons to be made and assists in the overall business planning for the service. Management information falling out of this process is therefore used to plan for the future and to determine the resources required to continuously improve the service provided by Internal Audit.