

TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

23 January 2011

Report of the Director of Finance

Part 1- Public

Delegated

1 CIPFA PAPER: 'AUDITING IN AN ECONOMIC DOWNTURN' AND REVIEW OF ALLOCATION OF AUDIT RESOURCES IN 2012/13

Summary

This report informs Members of a document published by CIPFA evaluating the impact of the current financial situation and suggests ways of adapting to the new working environment.

1.1 Introduction

1.1.1 Attached at **[Annex 1]** is a paper produced by the CIPFA Better Governance Forum entitled 'Auditing in an Economic Downturn'. The paper discusses the impact of the financial downturn on the work of Internal Audit. It highlights that there is an expectation that Internal Auditors will contribute to addressing the challenges that the situation brings to local authorities.

1.1.2 Whilst Internal Audit (IA) must continue to meet their primary function of providing assurance over controls, there is an increased expectation that they should also promote best practice in the areas that they audit.

1.1.3 The paper highlights a number of areas where Internal Audit can be affected. The non-highlighted points are areas that we consider are already covered or will not have an impact on the audit plan.

1.2 Impact on Audit Plan 2012/13

1.2.1 Members are aware that the Council faces a significant challenge in identifying and implementing savings of circa £3m within the next few years. Resources from across the Council will need to be directed into this activity to ensure we are able to achieve the targets set. It is my view that the skill set of the internal audit team will be invaluable to this process.

1.2.2 Accordingly, the Management Team and I are of the view that some of the audit resources should be redirected, in the forthcoming year, to assist with the review of processes and operations in order to identify potential efficiency savings.

1.2.3 The Chief Internal Auditor is of the view that the plan for 2012/13 will still allow for sufficient risk based work to be undertaken in order to provide an adequate level of testing on which to provide an assurance statement.

1.2.4 **Members are asked to agree with this approach**, and if agreed, the Audit Plan for 2012/13, which is due to be presented to the Audit Committee in April, will reflect the redirection of resources.

1.3 Auditing in an Economic Downturn – CIPFA paper

1.3.1 The Audit Manager has considered the content of the document and has identified the following areas for consideration in the audit planning process for the forthcoming year.

1.3.2 The points in **bold** are the areas identified as having the most impact on the approach of Internal Audit (IA) in 2012/13: -

- 1) **The profile of IA has been raised and auditors are now expected to think beyond financial controls and compliance with them; instead they need to provide independent assurance over the whole control environment.**
- 2) **IA expected to assess the present challenges (caused by the economic downturn) and provide assurance on how well these specific risks are managed.**
- 3) IA may need to review its own processes to ensure they are efficient and effective.
- 4) Auditors need to be aware of the impact of the economic downturn on the morale, availability and co-operation of staff within the services they are auditing.
- 5) Sickness absence both outside and within IA may increase as a result of staff reductions, reduced progression opportunities and pay freezes.
- 6) **Auditors need to make sure they are making the best use of Computer Assisted Audit Techniques to provide maximise the efficiency and coverage of audit work.**
- 7) IA may need to improve communication with clients and specifically audit reporting; auditors need to focus reports on assurance on the controls that are important to clients and present findings in clear, easy to understand way.
- 8) **The increase in commissioning of services (as opposed to direct delivery) means IA may need to do more procurement/contract audit work.**

- 9) **IA need to ensure they are up to date with new service delivery arrangements and relationships within the local authority to ensure right of audit access is maintained.**
- 10) Increasing global financial/banking issues mean IA need to be alert to the impact of treasury management.
- 11) As economic conditions change, the risk culture and appetite of organisation might change and this may impact on the controls in place and the compliance with controls as well as the appetite to improve control processes.
- 12) **Audit plans should be aligned to needs of management at all levels and this may mean some traditional topics (i.e. financial systems) should drop out of the plan.**
- 13) The Audit Committee should be made aware of this change and the implications of reducing or changing the focus of this work.
- 14) The scope of individual audits may need to be reviewed to include specific operational or reputational risks for example in addition to financial risks.
- 15) IA should increase the level of Risk Management work it does and may consider change management processes.
- 16) **The audit plan should focus more on the risks that are critical to the business, rather than simply financial or compliance risks, with increased emphasis on: operational risks, effectiveness of risk management, proactive anti-fraud work, cost reductions and reputational risks.**
- 17) Many internal audit sections are moving away from an annual plan and have a more flexible approach to planning as priorities change during the year.
- 18) **Management may expect internal auditors to identify and consider areas where cost savings are available.**
- 19) **IA may need to undertake fewer but more in-depth cross-cutting audits in order to identify savings are robust and can be applied across the public body.**
- 20) **Service reorganisations and reductions in staff could mean less scope for internal checks or segregation of duties within the service areas which increases the risk of fraud and error.**
- 21) Changing processes and structures also means that long established reliable systems may need to be revisited in order to provide assurance that controls are still in operation.

- 22) Internal audit may be required to assess the plans for service reorganisation and redesign. In particular, it may have to test the assumptions made regarding savings to be made and the accuracy of the accounting procedures used to ensure that the proposals are robust and viable and contain sufficient “scenario planning”.
- 23) Although many organisations employ project managers to ensure the successful implementation of plans and projects, internal auditors are often called on to assess the plans and act as a “critical friend” during the process.
- 24) **One area which public sector bodies may see an increase in is fraud. Management may increasingly depend upon internal audit to monitor and investigate incidences of fraud as and when they arise, but this will have a consequential impact on the other work of the section.**
- 25) Within the organisation, officers may take advantage of lax internal controls to perpetrate fraud and it is important that the boundaries set within financial and contract procedure rules and delegated powers are monitored and adhered to. Internal audit also needs to be aware that employees (and members) may seek to abuse their position for personal gain
- 26) **Public Sector may be subject to organised attacks including: alteration of cheque payees, which may only be identified when the correct payee contacts the organisation to query non-payment, contact from companies for payment of an invoice relating to goods not received or ordered/unsolicited invoices, letters submitted to creditors sections to inform them of changes to bank details which prove to be fraudulent, cheque “cloning”.**

1.4 Legal Implications

- 1.4.1 The Internal Audit Section must comply with the Accounts and Audit Regulations and compliance with the CIPFA Code of Practice for Internal Audit meets this requirement. The document identifies that there must be sufficient work undertaken to fulfil this role.

1.5 Financial and Value for Money Considerations

- 1.5.1 The document identifies a number of areas where the skills of internal audit can be used to identify risk and opportunities beyond the conventional financial risk considerations.

1.6 Risk Assessment

- 1.6.1 The audit process is risk based and the audit plan will continue to be prepared on a risk based assessment basis.

1.7 Equality Impact Assessment

1.7.1 No impact identified

1.8 Recommendations

1.8.1 Members are **RECOMMENDED** to concur with the Management Team's view that some audit resources will be used in the forthcoming year to review processes and operations in order to identify potential efficiency savings.

Background papers:

CIPFA Discussion paper "Auditing in an Economic Downturn"

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Chief Internal Auditor

| Screening for equality impacts: | | |
|---|--------|------------------------|
| Question | Answer | Explanation of impacts |
| a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community? | No | |
| b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality? | No | |
| c. What steps are you taking to mitigate, reduce, avoid or minimise the impacts identified above? | | |

In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above.