

Review of Internal Audit

Blackburn with Darwen Borough Council

Audit 2008/09

September 2009



Contents

Summary report	3
Detailed report	7
Appendix 1 – Action Plan	14

Status of our reports

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors/members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
 - any third party.
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Summary report

Introduction

- 1 This report summarises our review of the Council's Internal Audit section. The Audit Commission's Code of Audit Practice requires us to review and report on:
 - the Council's financial statements and its statement of internal control; and
 - whether the Council has made proper arrangements for securing economy, efficiency and effectiveness.
- 2 Internal Audit has a key role to play in relation to both these areas. It is a function of the Council's management arrangements which is intended to confirm that the Council's systems of internal financial control are adequate and effective.
- 3 We, therefore, make an assessment of the effectiveness of Internal Audit as a management control by checking its compliance with professional requirements.

Background

- 4 Each year when planning our work we assess Internal Audit and, normally in every third year, we undertake a more detailed review against professional standards to confirm that the section complies with the requirements of the CIPFA 'Code of Practice for Internal Audit in Local Government in the UK'.

We have agreed with the Council's officers to undertake the detailed review this year, as the previous assessment undertaken by the Council's former auditors in 2007 identified that five of the eleven professional standards were not then being met.

- 5 A key element of our review is an evaluation of the extent to which Internal Audit meets professional and statutory requirements, set out in the CIPFA Code, which sets out standards for Internal Audit, as detailed in Table 1 overleaf.

Table 1 CIPFA Internal audit code areas

Organisational standards	Operational standards
1. Scope of Internal audit	7. Audit strategy and planning
2. Independence	8. Undertaking audit work
3. Ethics for internal auditors	9. Due professional Care
4. Audit Committee	10. Reporting
5. Relationships	11. Performance, quality and effectiveness
6. Staffing, training and continuing professional development	

Source - CIPFA Code of Practice for Internal Audit in Local Government in the UK

Audit approach

- 6** In undertaking our assessment we worked closely with the Internal Audit section. They completed a self assessment against the CIPFA standards and we used this as the basis for our review. This was supplemented by a review of Internal Audit documentation, including a sample review of specific assignments.

Main conclusions

- 7** In June 2007 the Council's former auditors Grant Thornton concluded that Internal Audit failed to meet five of the eleven professional standards of the CIPFA Code of Practice for Internal Audit in local government. Our current review has concluded that some two years later these same five standards are still not being met. In particular there needs to be a clearer link between the Council's risk-based framework and the risk based Internal Audit plan. Documentation on audit files needs to be improved and files need to show proper evidence of management review.
- 8** There have been mitigating factors which have hindered improvement in some of these standards. Following the review of Internal Audit in 2007 the Council approved a significant increase in the establishment from seven to 14 staff. However as that recruitment process was about to get underway it became caught up in the Council's job evaluation exercise, delaying the recruiting of new staff by almost 12 months. The Council did recruit new members of staff at auditor, principal auditor and manager level by early 2009 but has been unable to recruit an additional manager to support the Head of Audit in managing the team and programme of audit work. As a short term measure contract staff have been used in 2008/09 to ensure key aspects of the audit plan have been completed. More recently a more formal partnering arrangement has been entered into with a professional firm of auditors to provide additional short term support.

Summary report

- 9 We have summarised our findings in Table 2 below and set out the areas where Internal Audit is still not meeting professional standards.

Table 2 Key findings

Standard	Compliant?	Key Observations
Scope of Internal audit	✓	Standard met
Independence	✓	Standard met.
Ethics	✓	Standard met.
Audit Committee	✓	Standard met A well established audit committee is in place that provides robust and appropriate challenge
Relationships	✓	Standard met; Good Relationships exist with external audit with regular consultation occurring; and There are good relationships with management and members
Staffing and Training	✗	Standard not met Internal audit has only recruited additional staff by early 2009 and there is still one manager vacancy New staff will require training to ensure they achieve skills and competencies required at each level
Audit Strategy and Planning	✗	Standard not met Need to clarify the link between the Council's risk based framework and the risk based audit plan
Undertaking Audit Work	✗	Standard not met Ensure documentation on audit files is adequate to allow for re-performance testing to be conducted and clearly links to the work planned
Due Professional Care	✗	Standards not met Audit files need to show proper evidence of management review
Reporting	✓	Standard met Audit reports are clear, concise and produced in a consistent format

Standard	Compliant?	Key Observations
Performance, Quality and Effectiveness	✘	Standard not met Ensure the performance and quality standards set out in the audit manual are implemented and evidenced.

- 10** On a positive note there are a number of strengths that Internal audit can continue to build on, in particular:
- arrangements are in place that allow Internal Audit to demonstrate its independence and objectivity;
 - there are effective relationships in place with management, members and external audit; and
 - audit reports are well structured and give a firm conclusion to management on the area reviewed.
- 11** However, it is a matter of concern that five areas of professional standards are still not being met two years after a review by our predecessors drew the same conclusion. Subject to the Council's response to our recommendations we will need to consider what further action may be required for the purposes of our function as external auditor to the Council.

The way forward

- 12** The recommendations arising from our review are detailed in the attached action plan at Appendix 1. Our view is that the recommendations should be implemented as a matter of urgency. We intend to follow up progress on these recommendations and next year reassess Internal Audit on the five competencies where it is currently not yet reaching the required standard
- 13** We wish to thank the Head of Audit and Assurance and his Internal Audit team for their co-operation and assistance during the review process.

Detailed report

Organisational standards

Standard 1: Scope of Internal Audit

- 14** The terms of reference for Internal Audit are formally set out in the Council's constitution. A revised terms of reference for Internal Audit has been drawn up to comply with recent changes to the Standard. The Council formally approved these on 30 April 2009. The revised terms of reference include reference to assurance and access rights for partnership and joint working arrangements operated by the Council.

Standard 2: Independence

- 15** Internal Audit is independent of the Council's operational activities, enabling the service to make impartial and effective professional judgements and recommendations.
- 16** Internal Audit is sufficiently independent of the activities it reviews. Audit staff do not have any operational responsibilities which might impact on their independence. The status of Internal Audit within the Council allows it to demonstrate independence, with clear access and reporting arrangements to officers and members.
- 17** CIPFA's recent statement on the role of the Finance Director recommends that either the Chief Executive (Head of Paid Service) or Director of Finance (S151 officer) should manage the Internal Audit function. The Council has revised its senior management structure, with the Director of Finance now being S151 officer and among other duties, managing Internal Audit.

Standard 3: Ethics for internal auditors

- 18** Arrangements are in place to ensure that internal auditors demonstrate integrity, objectivity, competence and confidentiality.
- 19** CIPFA guidance suggests that audit staff should be regularly rotated across audit areas in order to demonstrate continuing objectivity. Due to low staffing numbers in the recent past, it has not always been possible to follow this guidance. This requirement should be attainable for future assignments as audit staff numbers have recently increased.

Standard 4: Audit Committee

- 20 Member scrutiny of the Council's internal audit function is carried out by the Audit Committee. Internal Audit has an effective working relationship with the Committee, which approves the annual Audit Strategy and Plan and monitors progress against it.
- 21 The Committee provides an important component of the Council's internal control environment by providing independent scrutiny of Internal Audit, and by monitoring progress against the internal audit plan. The Head of Audit and Assurance regularly attends meetings of the Committee and contributes significantly to the agenda, including training for members, quarterly monitoring and annual reports

Standard 5: Relationships

- 22 Internal Audit has effective relationships with management, members and with external audit. These relationships allow the audit function to continue to improve its delivery of the audit, its reputation and independence.
- 23 Our attendance at Audit Committees confirms that Internal Audit has good relationships with members and takes an active role in training members of the committee. The revised terms of reference for Internal Audit now formally define the channels of communication with members and describe how such relationships should operate, as required by CIPFA.
- 24 We meet regularly with Internal Audit to keep each other informed of current developments. We aim to place increasing reliance on the work performed by Internal Audit in the future as they continue to progress towards meeting all of the CIPFA Standards. This issue will continue to be discussed and monitored at our future meetings.
- 25 Standard 5 requires internal audit to consider its relationships with other internal auditors and with external regulators. For this Council, internal audit arrangements for new joint working projects such as MAA and BSF are at an early stage and will need to be developed to ensure that all parties are aware of their responsibilities. Similar arrangements will be required for the regulatory and inspection agencies that will interact with the Council in the future.

Standard 6: Staffing, training and continuing professional development

- 26 Standard 6 states that Internal Audit should be appropriately resourced to meet its objectives. It should have appropriate numbers of staff in terms of grades, qualifications, personal attributes and experience or have access to appropriate resources in order to meet its objectives and to comply with these standards. In 2006/07 Internal Audit failed to meet this standard and continues to work towards meeting these requirements.
- 27 In 2006/07 there were three vacancies in Internal Audit and a further four posts were identified in a restructuring plan. This apparent under resourcing of the service was one of the main factors for the service failing to meet the standard in that year. Management acknowledged this issue and approved further resources. However recruitment has been delayed due to a number of reasons beyond the control of Internal Audit.

Detailed report

- 28** Most of the vacancies have been filled by early 2009, but there remains one vacancy for a manager to assist the Head of Audit and Assurance. As these posts were only filled during the early part of 2009, additional external resources were employed to ensure that the plan for 2008/09 was achieved. We will need to re-assess this standard once the new staff have been in post for a time.
- 29** The Head of Audit and Assurance has defined the skills and competencies required for each level of auditor. However, the process of periodic assessments against these skills and competencies, training and development needs and monitoring of development programme for individuals has yet to be demonstrated in practice. Arrangements for maintaining individual auditors' records of their professional training and development activities have not yet been formalised.

Recommendations

- | | |
|-----------|--|
| R1 | Finalise the recruitment of staff in accordance with the approved Internal Audit restructuring plan. |
| R2 | Set formal and regular performance appraisals, training and development programmes and monitoring of individuals' progress |
| R3 | Formalise arrangements for maintaining individual auditors' records of their professional training and development activities. |

Operational standards

Standard 7: Audit strategy and planning

- 30** The Audit Committee has approved the Internal Audit strategy and plan for 2008/09. There are three areas of weakness which need to be addressed in order to fully meet this standard.
- 31** Firstly, although there is a risk based audit plan in place, links to the council's own risk management framework are unclear. The audit plan should demonstrate how high risk areas identified in the corporate risk registers have been considered in determining potentially high risk areas in the audit plan and subsequent audit assignments.
- 32** Secondly, under current arrangements there are ongoing discussions held with service department managers in order to identify risks and emerging issues for service areas. These arrangements need to be formalised and discussions should take place at regular intervals to keep the audit strategy and audit plan up to date with the Council's changing priorities.

- 33** Thirdly, the internal audit strategy for 2008/09 could be clearer in a number of areas to fully demonstrate:
- measurable objectives and outcomes;
 - how national risks will be identified and addressed;
 - how the service will be provided; and
 - the resources and skills required to deliver the strategy.

Recommendations	
R4	Clarify links between the council's risk management framework and the risk based audit plan
R5	Formalise arrangements to demonstrate that management have been consulted when preparing and updating the audit strategy and audit plan.
R6	Ensure that future audit strategies clearly demonstrate: <ul style="list-style-type: none"> • measurable objectives and outcomes; • how national risks will be identified and addressed; • how the service will be provided; and • the resources and skills required to deliver the strategy.

Standard 8: Undertaking audit work

- 34** The Standard requires that for individual audit assignments, an appropriate brief should be prepared, discussed and agreed with relevant managers. There should be a risk-based audit approach and the work should be adequately recorded. In 2006/07 the Internal Audit service failed to meet the requirements of this standard and continues to show weaknesses in this area.
- 35** We selected a sample of audit assignments for detailed review. For each audit assignment reviewed there was a terms of reference document on file. The terms of reference are discussed with management in order to agree the scope, objectives, risks, reporting protocols and timings of the assignment. This is an important part of the planning process to help improve audit delivery and maintain relationships with management. In practice the terms of reference is not always signed or approved electronically via email and it is not always clear whether managers have agreed all the terms included included.
- 36** The Head of Audit and Assurance has established a set of standard working papers to be used for each audit assignment. From the sample files reviewed, the file structure follows the standard set out in the audit manual but standard working papers have not always been used.

Detailed report

37 A number of areas of weakness were identified in recording audit work, as follows:

- links to corporate risks and key control are not always clear;
- working papers are not always referenced;
- work completed does not always appear to satisfy the planned outline of work to be undertaken;
- little or no systems documentation, and where documentation is on file it unclear whether this has been reviewed and updated;
- files contain personal information such as names and addresses of individuals included in sample tests;
- it is unclear where samples are selected from, how sample size was determined, if the sample is random, what the population size is; and
- various testing summaries are in use and it is unclear what tests have been performed on each sample item.

Recommendations

R7 Ensure that service managers agree the terms of reference for each audit assignment.

R8 Ensure all audit files:

- clarify and evidence links to corporate risks;
- reference working papers to show links to planning brief, key controls and work performed;
- include up to date systems documentation;
- delete any personal information from sample testing;
- set clear instruction for sample sources, calculating sample sizes and selecting samples; and
- include standard testing summaries which clearly show links between the audit brief, sample testing and conclusions drawn.

Standard 9: Due professional care

38 The Standard requires that audit work should be carried out with competence and diligence, using appropriate skills, knowledge and judgement.

39 The audit manual sets out the requirements for audit staff to be fair, impartial, and work to appropriate standards. The manual also sets out the monitoring and review arrangements to ensure that due professional care is maintained. In 2006/07 the Internal Audit service failed to meet the requirements of this standard as there was only weak evidence of management review of work. This issue continues to be an area of concern for the current year.

- 40** From a sample of files reviewed we found that the quality control sheets are signed off by the Head of Audit and Assurance. However we found no evidence of detailed reviews of working papers. For a detailed review we would expect to see individual working papers signed off by a supervisor and a review sheet identifying queries raised from the review process and their subsequent clearing. More importantly, work identified in the initial planning sheet has not always been performed, but there is no evidence that this was identified from the quality review process.

Recommendation

- R9** Implement and evidence management review of audit assignments in accordance with the audit manual.

Standard 10: Reporting

- 41** Internal Audit reporting provides an independent and objective opinion on the Council's control environment and prompts management to implement agreed actions.
- 42** Audit reports are clearly structured and give firm conclusions to management about their opinion of the area reviewed. The factual content of reports is agreed with service managers, and a clear action plan for implementing recommendations is drawn up and formal commitment obtained. There are arrangements in place to monitor the implementation of audit recommendations.

Standard 11: Performance, quality and effectiveness

- 43** Standard 11 requires the Head of Audit and Assurance to
- establish and update an audit manual which complies with the CIPFA Code;
 - ensure work is allocated to appropriately skilled and experienced staff; and
 - implement a performance management and quality assurance framework.
- 44** The audit manual sets out appropriate arrangements for performance and quality to ensure compliance with the Code, both for individual audits and for the internal audit service as a whole.
- 45** We reviewed a sample of audit assignments to assess whether work has been allocated to appropriately skilled and experience staff. For most of 2008/09 audit assignments were performed by a limited number of staff because the new staff had not been recruited. It will be important to ensure that there are adequate arrangements to supervise and review the work of new audit staff to ensure that quality levels are achieved. We will need to revisit this area once new staff have become established, in order to gain assurance that audit work is undertaken by staff with the appropriate skills, experience and competence.
- 46** The audit manual sets out standards for performance, quality and effectiveness. From our review of files there is little evidence that these standards are implemented in practice. Audit management documentation is not used for every assignment, in particular post audit assessment forms were not completed for the sample of files reviewed.

Detailed report

47 In 2006/07 the Internal Audit service was unable to demonstrate that it had a rigorous performance management and quality framework in place. We are aware the service is continuing to develop arrangements to meet this Standard. The quality assurance programme needs to include, for example, targets to measure performance and quality reviews of assignments take place. The Head of Internal Audit should formally report on the results of the performance management and quality assurance programme to the Audit Committee, at least in the annual audit report.

Recommendations

R10 Implement and evidence the performance management and quality framework as set out in the audit manual.

R11 Report at least annually on the results of the performance management and quality assurance programme to the Audit Committee.

Appendix 1 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
Standard 6: staffing, training and continuing professional development						
9	R1 Continue to recruit staff in accordance with the approved Internal Audit restructuring plan.	3	Head of Audit and Assurance	Yes	Recruitment to take place in Autumn 2009, appointed staff planned to be in post no later than January 2010.	January 2010
9	R2 Set formal and regular performance appraisals, training and development programmes and monitoring of individuals' progress	3	Head of Audit and Assurance	Yes	Performance appraisals for all staff were completed in July 2009. Training and Development plans were agreed in August 2009. Reviews will take place every six months with all scheduled reviews being completed by December 2009.	Completed
9	R3 Formalise arrangements for maintaining individual auditors' records of their professional training and development activities.	2	Head of Audit and Assurance	Yes	The Council already has processes in place to establish and maintain training and development records for all staff. The Head of Audit and Assurance has recently ensured these records are comprehensive and up to date for his staff.	Completed

Appendix 1 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
Standard 7: audit strategy and planning						
10	R4 Clarify links between the council's risk management framework and the risk based audit plan	3	Head of Audit and Assurance	Yes	Internal Audit has electronic records demonstrating these links. The 2010/11 Audit Plan will explicitly refer to the integration of the corporate risk register and framework with Internal Audit's risk based assessments.	April 2010
10	R5 Formalise arrangements to demonstrate that management have been consulted when preparing and updating the audit strategy and audit plan.	2	Head of Audit and Assurance	Yes	The Head of Audit and Assurance has recently established a series of formal meetings with Directors, with formal minutes and records being taken. These meetings are now taking place.	Completed
10	R6 Ensure that future audit strategies clearly demonstrate: <ul style="list-style-type: none"> measurable objectives and outcomes; how national risks will be identified and addressed; how the service will be provided; and the resources and skills required to deliver the strategy. 	3	Head of Audit and Assurance	Yes	The Head of Audit and Assurance has recently revised the current audit strategy. He will work with the Council's external auditors to fully understand and implement their recommendations and ensure that the Council's 2010/11 audit strategy complies with best practice. This will be presented to the Audit Committee for approval in April 2010.	April 2010

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
Standard 8: undertaking audit work						
11	R7 Ensure that service managers agree the terms of reference for each audit assignment.	2	Head of Audit and Assurance	Yes	Procedures have been put in place to ensure that service managers agree and sign the terms of reference.	Completed
11	R8 Ensure all audit files: <ul style="list-style-type: none"> clarify and evidence links to corporate risks; reference working papers to show links to planning brief, key controls and work performed; include up to date systems documentation; delete any personal information from sample testing; set clear instruction for sample sources, calculating sample sizes and selecting samples; and include standard testing summaries which clearly show links between the audit brief, sample testing and conclusions drawn. 	3	Head of Audit and Assurance	Yes	Internal Audit is reviewing its policies, procedures and practices. The Council's strategic partner Grant Thornton is currently facilitating workshops for audit managers and staff. These are scheduled for completion in October 2009. The workshops cover flowcharting, system notes, basic file keeping, sampling techniques, post audit performance reviews, assignment time and quality management, assignment management forms, report contents and format, basic approaches to risk based auditing, CIPFA Code of Practice and the Audit Manual. Improved practices will be introduced on completion of these workshops, with the Head of Audit and Assurance then comprehensively reviewing all files and working papers to ensure compliance.	October 2009
Standard 9: due professional care						
12	R9 Implement and evidence of management review of audit assignments in accordance with the audit manual.	3	Head of Audit and Assurance	Yes	The Head of Audit and Assurance will undertake comprehensive management reviews on completion of the training and development workshops in October 2009.	October 2009

Appendix 1 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
Standard 11: performance, quality and effectiveness						
13	R10 Implement and evidence the performance management and quality framework as set out in the audit manual.	3	Head of Audit and Assurance	Yes	The Head of Audit and Assurance will implement and evidence this framework on completion of the training and development workshops in October 2009.	October 2009
13	R11 Report at least annually on the results of the performance management and quality assurance programme to the Audit Committee.	2	Head of Audit and Assurance	Yes	Quarterly reports will be presented to the Audit Committee in future.	December 2009

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