

**REPORT OF:** CHIEF FINANCIAL OFFICER

**TO:** ACCOUNTS AND AUDIT COMMITTEE

**DATES:** 26<sup>th</sup> July 2018

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## **EFFECTIVENESS OF THE SYSTEM OF INTERNAL AUDIT 2017/18**

### **PURPOSE OF REPORT**

1. To provide the Accounts and Audit Committee with various forms of assurance to enable a review of the effectiveness of the Council's system of internal audit to be undertaken.

### **RECOMMENDATIONS**

2. It is recommended that the Accounts and Audit Committee review the effectiveness of the Council's system of internal audit as it applied in 2017/18 using the sources of assurance presented in this report.
3. Councillors are asked to consider the attendance statistics at paragraph 25 and 26 and to determine whether there are any actions can be taken to improve attendance at the Committee.

### **REASONS FOR RECOMMENDATION**

4. For the Committee to consider and assess the outcomes from a review of the effectiveness of the system of internal audit.

### **ISSUE**

#### **Background**

5. Regulation 5 in Part 2 of the Accounts and Audit Regulations 2015 states:

*A relevant authority must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance.*

6. The regulations also include the requirement for the Council to conduct a review of the effectiveness of its system of internal control and to prepare an Annual Governance Statement (AGS). The findings of the review should be considered by a Committee of the Council (in Pendle's case, it is this Committee). The AGS for 2017/18 is included in the Statement of Accounts presented for approval elsewhere on this agenda.

7. This report sets out various areas of assurance that have been relied upon when reviewing whether the system of internal audit is effective. The sources of assurance are outlined below.

### **The System of Internal Audit**

8. The definition of Internal Audit is:-

*Internal audit 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.*

9. The key components of the Council's system of Internal Audit as it operated during 2017/18 included:-
- An independent and objective Internal Audit Team comprising appropriately experienced and qualified staff;
  - A Strategic Internal Audit Plan to guide the medium term planning for the Internal Audit Team;
  - An agreed Annual Internal Audit plan prepared using a risk based approach;
  - The Accounts and Audit Committee which is independent of the Executive and has, amongst other things, responsibility for monitoring the delivery of the Internal Audit plan and the implementation of audit recommendations;
  - The scope for the Internal Audit Manager to report directly to management and Councillors where there are circumstances that require this to happen.
10. The information provided below outlines various forms of assurance for the Committee when considering the effectiveness of the system of internal audit. This report should be considered in conjunction with the Annual Internal Audit report and Annual Governance Statement presented elsewhere on the agenda for this meeting.

### **Compliance with Public Sector Internal Audit Standards**

11. The work of Internal Audit must be conducted in compliance with Public Sector Internal Audit Standards (PSIAS) which were adopted from April 2013. The PSIAS standards comprise Attribute Standards (ranging from the Purpose, Authority and Responsibility of Internal Audit to having a Quality Assurance and Improvement Programme) and Performance Standards (including Managing the Internal Audit Activity, Audit Planning and Performance and communicating the results of the work undertaken).
12. Compliance with the PSIAS provides an indication of the effectiveness of the system of internal audit and in recognition of this, there is a checklist against which local authorities can self-assess compliance, this is done annually and we can report ongoing compliance.
13. An external assessment of Internal Audit was also carried out in November 2016 (reported to Committee in January 2017) to check amongst other matters compliance with the checklist. There are 327 questions on CIPFA LGAN Checklist with the Standards. The report from the Peer Review team determined that the internal audit service conformed to the standards. The Peer Review identified 4 points for consideration into the service's Quality Assurance & Improvement Programme (QAIP). An update in relation to these points is provided below:

PSIAS Ref	Report ref	Point For Consideration	Responsible	Action
2330 Documenting Information	3.3.1	The employment of Furness Audit Ltd as providers of IT audit did not include the provision of working papers or specific assurance on the application of the PSIAS requirements in the Audit. When employing other assurance providers it would assist in the demonstration of compliance if the external supplier provided supporting working papers for retention or a statement of conformance with the PSIAS.	Audit Manager	Mersey Internal Audit Agency currently provides the Council with a computer audit service. Specific assurance was obtained on application of PSIAS.
1110 Organisational Independence	3.3.2	The PSIAS requires the inclusion of the chief executive and the chair of the audit committee in the performance appraisal of the Chief Audit Executive. In Pendle's case this would require input from the Strategic Director and Chair of the Accounts and Audit Committee in the appraisal of the performance of the Audit and Performance Manager in respect of his internal audit duties.	Audit Manager	Currently Section 151 Officer responsible for performance review of the Internal Audit Manager.
2240 Engagement Work Programmes	3.3.3	There should be a process of approval of work programmes prior to implementation for the audit and the prompt approval of subsequent alterations to the work programmes.	Audit Manager	Approval process has been implemented for all audit reviews.
2330 Documenting Information	3.3.4	The Audit and Performance Manager has set standards for access and retention of audit records, these should be considered for formal recording in a procedure or policy, specific to the requirements of the service and Council.	Audit Manager	All audit records currently held securely on the Council's network. Formal recording process will be adopted in line with GDPR regulations and the Council's retention policy.

PSIAS Action Table - External Peer Review November 2016

## External Audit

14. Grant Thornton, the Council's External Auditor, have not yet completed their audit of the Council's accounts for 2017/18 as at the day of writing this report. The vast majority of it has been completed, however, with regular liaison meetings occurring between Financial Services staff and Grant Thornton auditors throughout the process. The audit undertaken by Grant Thornton is not designed to test all internal controls or identify all areas of control weakness, however, if as part of their testing they identify any control weaknesses, they report these to the Council.
15. Based on the discussions with Grant Thornton as at today (16/07/18) there were no such control weaknesses that they wished to highlight. Should this position change, details will be reported at the meeting within the Audit Findings Report from Grant Thornton which is presented elsewhere on this agenda.

16. In respect of their assessment of the internal audit service in 2016/17, Grant Thornton concluded in their report to the Committee in March 2017 as follows:-

*Overall, we have concluded that the internal audit service provides an independent and satisfactory service to the Council and that internal audit work contributes to an effective internal control environment.*

17. In 2017/18 there is no equivalent assessment and conclusion, however, external audit have not identified Internal Audit as an area that is high risk and therefore requiring additional inspection and scrutiny.

### **Audit Manager's Opinion – System of Internal Control**

18. Annually, the Audit Manager is required to give an opinion on the adequacy of the Council's internal controls based on the work undertaken by Internal Audit during the year. As reported in the Annual Governance Statement (AGS) the overall opinion expressed by the Internal Audit Manager for 2017/18 states that:-

*"Internal Audit reports on both Corporate Governance and Internal Control arrangements. The Internal Audit Manager was satisfied through the review of internal control during 2017/18 that internal control in the Council is good, although it is not possible to provide absolute assurance about the overall system of internal control"*

19. An indication of the strength on internal controls across the Council's systems and processes is that there were no audits subject to a 'limited assurance' opinion in 2017/18.

### **Performance Indicators**

20. A range of local performance indicators was established to measure the performance of Internal Audit. A summary of the performance indicators for 2017/18 is provided in the Internal Audit Annual report elsewhere on this agenda.

### **Client Satisfaction**

21. After the completion of each individual audit assignment, the Audit Manager issues a client satisfaction questionnaire to each auditee along with the final audit report. The purpose of the questionnaire is to obtain information from auditees about a range of issues including:-
- Conduct of the Auditor
  - Effectiveness of the Audit
  - Timeliness of Reporting
22. The Auditee is required to rank performance on each criterion giving an overall assessment score. In 2017/18, the average score for all questionnaires was 93.0% satisfaction compared to a Key Performance Indicator (KPI) target of 90%.

### **The Accounts and Audit Committee**

23. As indicated above, the system of Internal Audit is broader than the role of Internal Audit and also incorporates the work undertaken by the Accounts and Audit Committee.

24. The Accounts and Audit Committee, has Terms of Reference approved by the Council and has met regularly during the 2017/18 financial year. Over the year, the Committee considered, amongst other things, reports from Internal and External Audit as well as matters such as the Council's Treasury Management, Corporate Governance and Risk Management activities.

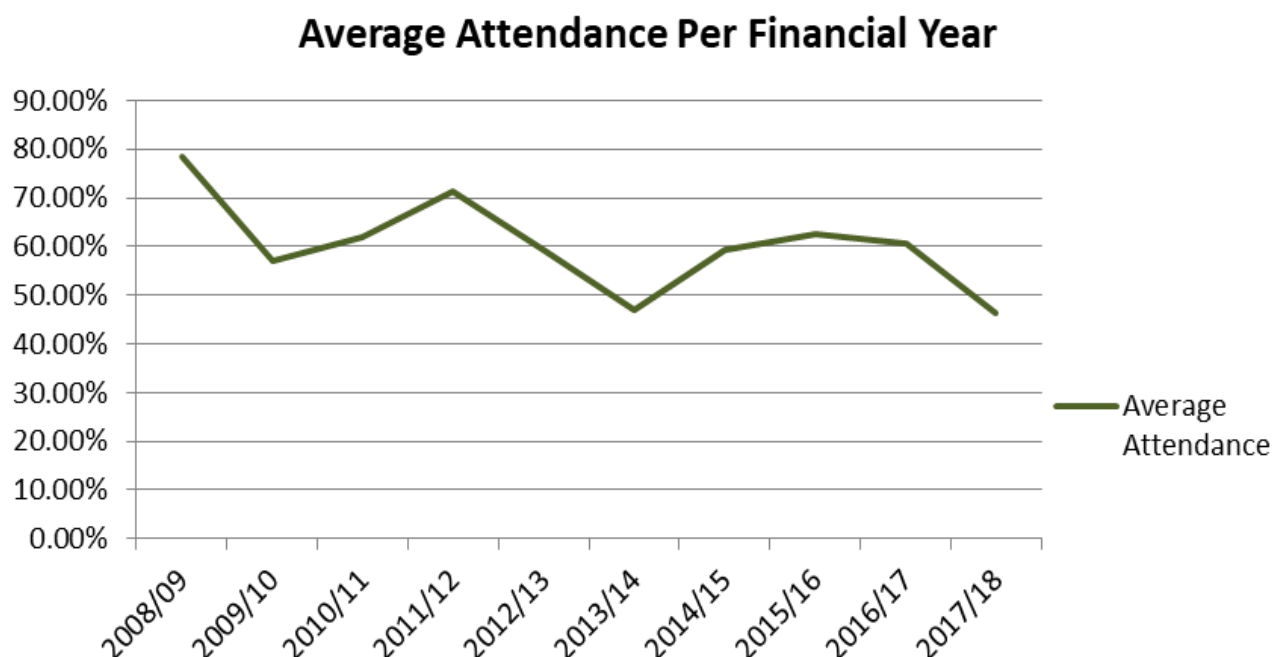
25. Attendance statistics for the Committee are shown in the table below:-

Year	Date of Meeting	Attendance
2008/09	26th June 2008	85.7%
	25th Sept 2008	71.4%
	15th Jan 2009	85.7%
	24th March 2009	71.4%
2009/10	29th June 2009	57.1%
	29th Sept 2009	57.1%
	27 <sup>th</sup> Jan 2010	57.1%
	24 <sup>th</sup> March 2010	57.1%
2010/11	28 <sup>th</sup> June 2010	71.4%
	28 <sup>th</sup> Sept 2010	42.9%
	19 <sup>th</sup> Jan 2011	71.4%
	30 <sup>th</sup> March 2011	Meeting Cancelled
2011/12	20th July 2011	57.1%
	28th Sept 2011	100.0%
	18th Jan 2012	71.4%
	28th March 2012	57.1%
2012/13	9 <sup>th</sup> July 2012	50.0%
	26 <sup>th</sup> Sept 2012	50.0%
	30 <sup>th</sup> Jan 2013	87.5%
	18 <sup>th</sup> March 2013	50.0%
2013/14	15th July 2013	50.0%
	25th Sept 2013	62.5%
	29th Jan 2014	37.5%
	31st March 2014	37.5%
2014/15	23 <sup>rd</sup> July 2014	87.5%
	29 <sup>th</sup> Sept 2014	62.5%
	28 <sup>th</sup> Jan 2015	50.0%
	24 <sup>th</sup> March 2015	37.5%
2015/16**	22 <sup>nd</sup> July 2015	50.0%
	28 <sup>th</sup> Sept 2015	85.7%
	27 <sup>th</sup> Jan 2016	57.1%
	22 <sup>nd</sup> March 2016	57.1%
2016/17	28 <sup>th</sup> July 2016	71.4%
	28 <sup>th</sup> Sept 2016	57.1%
	25 <sup>th</sup> Jan 2017	71.4%
	21 <sup>st</sup> March 2017	42.9%
2017/18	31 <sup>st</sup> July 2017	71.4%
	28 <sup>th</sup> Sept 2017	28.6%
	25 <sup>th</sup> Jan 2018	42.9%
	20 <sup>th</sup> March 2018	42.9%

*\*\* In July 2015 the Council agreed that from 1st August 2015, membership of the Accounts and Audit Committee would reduce from 8 to 5 Councillors plus two independent members.*

26. As can be seen from the table above and the graph below, the level of attendance continues to fluctuate. Indeed, 2017/18 saw a lower attendance rate and the lowest average attendance rate for the financial year when compared to the records above starting with 2008/09. The lowest attendance was in September 2017 when only two elected members attended. Councillors are asked to consider this issue and to determine whether there are any actions can be taken to improve attendance at the Committee.

**Graph to compare the average attendance rate per financial year since 2008/09**



27. The appointment of 2 independent members has brought additional skills and knowledge to the working of the Committee with persons appointed who each have considerable experience of audit and financial management.
28. On a related issue, as most of the current Accounts and Audit Committee are new to the role, further work is required to help the Committee identify and address any training requirements and to provide a framework against which it can assess its own effectiveness. Councillors are asked to consider this and note that a further report on this will be brought back to the next meeting of this Committee.

### **Summary**

29. The Committee will appreciate, there is no one source of assurance that can demonstrate the effectiveness of the overall system of internal audit. As a result, various sources of assurance have been presented in this report which it is considered, when taken together, demonstrate an effective system of internal audit.
30. There are a number of documents that provide the supporting evidence to this conclusion which include the following:

- The agreed Annual Internal Audit plan prepared using a risk based approach.
- The Annual Governance Statement contained within the Statement of Accounts (elsewhere on this agenda).
- Our External Auditor's reports providing expert and independent inspection and scrutiny.

31. The Committee is therefore requested to consider and accept the evidence provided here as providing assurance on the overall effectiveness of the Council's arrangements in 2017/18.

## **IMPLICATIONS**

### **Policy**

32. There are no policy implications arising directly from the recommendations of this report.

### **Financial**

33. There are no financial implications arising directly from the contents of this report.

### **Legal**

34. The Accounts and Audit Regulations 2015 require the Council to maintain an effective Internal Audit function.

### **Risk Management**

35. There are no risk management implications arising directly from the recommendations of this report.

### **Health and Safety:**

36. There are no health and safety issues arising directly from the recommendations of this report.

### **Sustainability:**

37. There are no sustainability issues arising directly from the recommendations of this report.

### **Community Safety:**

38. There are no community safety issues arising from this report.

### **Equality and Diversity:**

39. There are no equality and diversity issues arising from this report.

## **APPENDICES**

None.