

INTERNAL AUDIT AND AUDIT COMMITTEE ENGAGEMENT

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Executive Summary:

At its meeting in September the Audit Committee requested a report to consider the mechanisms of how Internal Audit engages with and gives suitable assurance to the Audit Committee.

1. Recommendation(s)

- 1.1 That the Committee comment on the Charter (Annex A), the Strategy (Annex B) and gives its views on the options set out within this report.

2. Issues

- 2.1. Internal Audit is provided via MKSP in accordance with the Public Sector Internal Audit Standards (PSIAS) and relevant legislation eg Local Government Act 1972 and the Accounts and Audit Regulations.
- 2.2. Whilst these requirements set relevant standards there remains scope to tailor Internal Audit processes and approach to the needs of the organisation. The standards and approach adopted by Internal Audit is usually enshrined within a Charter and Strategy. As part of the service review within MKSP the IA service, its processes, structures and policies are being reviewed.
- 2.3. This report seeks to set out the draft IA Charter and Strategy for comments and also provide some choices for the committee to express views on areas where the service can apply different approaches.
- 2.4. The key context for these issues is the PSIAS which became applicable from April 2013. The Committee was provided with a summary of the key issues within PSIAS at its meeting on 10th April 2013. The Committee resolved to perform the role of 'Board' as defined by the PSIAS. Under the PSIAS the Board became responsible for approving the internal audit charter, strategy and audit plans.
- 2.5. As reported to the Committee in April 2013 the PSIAS are less concerned with 'line management arrangements and more focused on the independent function and reporting of IA. Thus the Committee's views are invited on the areas set out below.
- 2.6. It is worth highlighting that the Audit Committee is not the sole key stakeholder with respect to IA and it is important to highlight that the issues set out within this report need to be consulted with the Cabinet Members and Corporate Leadership Team / Senior Officers.

2.7. The Charter and Strategy are attached at Annex A and Annex B for comments from the Committee.

2.8. Additionally the review of IA following its transfer to MKSP is considering several options for MKC to determine the Audit approach to be adopted in several areas of IA process. The Committee's views are invited on the following:

2.9. Service Principles

2.9.1. Annex C sets out an over-view of some service principles which could be included within the Internal Audit Handbook or new Customer Charter. These seek to set out the key commitments considered necessary to support the effective delivery of a robust and high quality IA service.

2.9.2. The approach set out seeks to identify key stages within the Audit Plan process and methodology applied to individual audits to define the key issues that:

- IA will commit to delivering
- Management will commit to deliver
- Audit Committee will commit to provide

2.9.3. Members views are invited.

2.10. Audit Reports

2.10.1. CIPFA guidance advises that:

Audit Committees should not normally be provided with the full text of internal audit reports. There are several reasons for this including that:

- Audit reports are mainly concerned with operational details, while audit committees and members should have a focus on the strategic or corporate assurances ie normally restricted to assurance that the organisation's systems of internal control are adequate and that action is taken to ensure that any short comings are rectified promptly.
- Developing a constructive working relationship with managers may be much more difficult for internal audit if complete audit reports are sent to members as a matter of course. If this does happen, managers may become more defensive and internal audit will be less able to promote further improvements in internal control and value for money.
- Members should not be over concerned with adverse internal audit conclusions if reasonable recommendations suggested by internal audit have been accepted and these have been promptly implemented.
- However, if major internal control weaknesses are discovered these should be reported to the audit committee as this may indicate general weaknesses in the management of the section or the department concerned. Audit findings that appear to show a common thread of similar weaknesses throughout the organisation should also be reported to the audit committee.

2.10.2. Previously however Members have highlighted interest in developing strategic / corporate assurance through better understanding of individual audit issues and reports. Therefore the following sections provide some areas the Committee can consider to aide that strategic role.

2.10.3. Individual Audit Terms of Reference

Currently ToR's are discussed with the client service officers only. It is important to highlight that the PSIAS places a clear responsibility on the HoIA to be supported in auditing whatever they feel necessary to audit.

ToR's are not discussed in the context that a client can object or refuse for an area to be audited. However the service perspective can be invaluable in informing the HoIA views on what, if anything, should be audited and subsequently risk assessed. It also provides an opportunity to audit other associated matters that for little if any additional resource adds value to the individual audit.

At present Members are not usually consulted on ToR. The IA service undertakes over 100 audits annually. Consultation with Members (either or both the Audit Committee and or Cabinet) must not delay the audits being undertaken but could provide more context for the HoIA in planning individual work.

2.10.4. Report Structure

Currently the IA service produces individual Audit Reports that:

- Summarise the scope and background of the work
- Give an overall assurance Opinion as required by professional standards supported by a traffic light (Red, Amber, Green) assessment of the key areas of control agreed within the Terms of Reference
- Explain the basis for the opinion and outline the key findings based upon evidence, issues and risks, in the conclusion
- Give a summary of detailed findings against each objective
- Provide a Management Action Plan documenting more detail on issues identified, risks, agreed actions, responsible officer and target dates.

The Committee are asked to highlight any areas in the current report format that they find particularly helpful or any issue / layout or structure that would improve the report for Members..

2.10.5. Publication

The Committee has been consistent in applying a policy that all reports will be published. A process is completed to advise CLT, Committee members and Cabinet members of reports scheduled to be published.

The process has 3 implications:

- (1) It enhances the view that IA work (and thus the adequacy of governance arrangements within those areas audited) is transparent to give the public and stakeholders confidence in the IA process and its findings.
- (2) It can cause anxiety within services and on occasion may reduce the level of co-operation and information that is volunteered to IA.
- (3) It requires administrative resource to schedule, advise and ensure publication. This is offset against the savings achieved because the reports are readily available and no specific resource is needed to provide a requested report.

The Committee could:

- determine no reports be published unless FOI requests are made (providing an administrative saving)
- determine reports not be routinely published unless the Committee (or Cabinet) requests their publication
- continue with the current policy of all reports be published.

2.10.6. Production of Final Reports

Recently the Committee has highlighted a concern regarding the content of some IA final reports published / issued. Some Members of the Committee have expressed concerns regarding how members can have confidence that the published report is, to use a common audit phrase, 'the unvarnished truth'.

Assurance is gained in 2 ways:

- (1) the professional assurance from the HoIA
- (2) the process applied to evolve a draft report to its final format.

At present Members have an ability to review draft reports, to gain that assurance, but only once the final has been issued. A neighbouring authority has recently introduced a Member panel that considers every draft report, involving both IA and the service management, when the report is still draft. There is an obvious tension between the relevant guidance (ie CIPFA) outlined in 2.10 and this approach.

It is possible to create a sub-group or working group from the Audit Committee, perhaps chaired by an independent member, that could adopt that approach.

Several factors are considered relevant:

- Whilst it could be considered such a process would / could protect the HoIA from undue influence the reverse could also be perceived. The need for the HoIA to be able to report in her own name irrespective of that groups views must be documented.
- The work of any sub-group to consider draft reports will need to respect the key role of the Audit Committee to maintain its strategic view of Audit assurance.
- This will undoubtedly place additional time pressures on Members.
- The group would need to meet, at least initially, every 2-3 weeks for such meetings to be manageable
- Such a group would need to be a confidential meeting and such confidentiality adhered to.
- Such a group could include a Cabinet Member
- Such a group could be chaired by an independent member of the Committee (to avoid misperceptions of politicisation of IA issues)
- Such a group must not unduly delay the audit processes if the Audit Plan is to be completed within existing resources.

2.10.7. Member views on the above areas are invited.

2.11. Audit Opinion

2.11.1. The PSIAS require a formal Audit Opinion (on the adequacy of controls audited) to be included within every report for every area audited.

2.11.2. There are a range of methods by which the opinion can be based / given. Currently the IA service applies a system that categorises an audit into one of 4 categories – Weak, Limited, Satisfactory or Good. The service currently does not apply a standard or formulaic definition of these categories, but explains in the conclusion the reasoning behind the opinion given. However, a broad definition of each is given below:

- *Weak : The control system is absent or has fundamental weaknesses with major areas of risk.*

- Limited : *There are very significant weaknesses in key areas in the system of control; there is a risk of loss, fraud, impropriety, damage to reputation or that objectives won't be achieved.*
- Satisfactory : *The control system is basically sound but there are several minor weaknesses or a significant weakness resulting in moderate levels of risk.*
- Good : *There is a sound system of control. Although there may be a small number of minor weaknesses there are no major areas of risk*

2.11.3. Those categories are applied from a professional judgement of the auditor based on all factors and then discussed within the draft report.

2.11.4. Some IA services apply a more formulaic approach eg if evidence showed less than 60% of controls operating properly a Weak opinion applies. This is not recommended as it removes the professional judgement and legitimate service perspective where certain control areas are more significant than others.

2.11.5. However such formula could be used to provide some context to discussions at draft report stage regarding a fair Audit Opinion.

2.11.6. Additionally the narrative of those opinions varies across IA services. Some alternative examples are given on Annex D.

2.11.7. The Committee's views are invited

2.12. Monitoring

2.12.1. The Committee receives various IA updates throughout the year and usually to every meeting.

2.12.2. The Committee could choose to reduce these updates or vary the information provided. At present the reports are detailed in respect of audits in progress, completed etc as well as IA performance measures and staffing issues. A more summarised or exception based update report could be provided for example a brief overview with accompanying detailed annexes as provided currently.

2.12.3. At the September meeting Members, with respect to the Highways issue, expressed concern that previously audited services reporting a Weak or Limited Audit Opinion were not obvious. Whilst these are reported in detail within every update report (both as final report and follow up) they are not highlighted.

- 2.12.4. If it assists the Committee, every update report could include a specific section listing all audits with a Weak or Limited opinion 'until that opinion can be properly revised, based on evidenced testing, to be at least Satisfactory'.
- 2.12.5. The Committee is invited to highlight any information it may wish to receive in less detail or not be reported.
- 2.12.6. The Committee is invited to highlight any theme it feels should be added to periodic reports.

2.13. Training / Member Relationships

2.13.1. Training is provided to Committee Members (and other Members) via adhoc specific workshops and brief outlines that preface certain reports as they are presented to the Committee. Mindful of some comments made by Members at the September meeting, there is an opportunity to use training to provide a forum by the relationships between Members and Officers from IA can also be enhanced.

2.13.2. Options include:

- Regular pre-defined training workshops in advance of every meeting
- Workshops involve / be attended by IA staff from all levels to gain a better understanding of Member issues and become known to Members
- A (or some) whole 'Training day' be assigned for training attended by all Members and IA staff.
- A more creative / unusual approach for a workshop involving a 'speed dating' style of inter-action.

This would be delivered by IA staff individually. Members would rotate through a 5 minute topic with an Auditor then move onto another through a 30 minute session followed by a 10-15 minute Member feedback.

2.13.3. Members views are invited.

3. Implications

3.1. Policy

The attached options and views will influence the development of IA processes and policies for MKC.

3.2. Resources and Risk

As above

N	Capital	N	Revenue	N	Accommodation
N	IT	N	Medium Term Plan	N	Asset Management

3.3. Carbon and Energy Management

None

3.4. Legal

None

3.5. Other Implications

None .

N	Equalities/Diversity	N	Sustainability	N	Human Rights
N	E-Government	N	Stakeholders	N	Crime and Disorder
N	Carbon and Energy Policy				

Background Papers:

Annex A - Draft Internal Audit Charter

Annex B – Draft Internal Audit Strategy

Annex C – Key Commitments

Annex D – Sample Audit opinions