

Report to: **Audit and Best Value Scrutiny Committee**

Date: **29 November 2006**

By: **Deputy Chief Executive and Director of Corporate Resources**

Title of report: **Triennial Review of Internal Audit**

Purpose of report: **To appraise the Committee of the results of the recent Audit Commission review of East Sussex County Council's Internal Audit Service**

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## **RECOMMENDATIONS**

**The Committee is asked to note the findings from the Audit Commission's report.**

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### **1. Financial Appraisal**

1.1 There are no direct financial implications arising from this report. However, the Audit Commission's continued reliance on the work of Internal Audit contributes to the level of risk discount on the Council's audit and inspection fees, which at 24% for 2006/07, is near the maximum allowed.

### **2. Supporting Information**

2.1 Attached is the report from the Audit Commission following their recent triennial review of East Sussex County Council's Internal Audit Service. This is very positive outcome for the service as it confirms Internal Audit's compliance with professional standards and the Audit Commission's continuing reliance on the work of Internal Audit under the new International Standards for Auditing regime.

2.2 It is reassuring to note that the review makes no recommendations for improvement in terms of compliance. Internal Audit will however, continue with the improvements identified in the strategic audit plan and business plan.

2.3 Under the Accounts and Audit Regulations 2006, the Council is required to carry out an annual review of the effectiveness of its system of internal audit. The Triennial Review of Internal Audit is one of the key sources of assurance that Members and officer can rely upon when carrying out that review.

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Background documents: none

## Internal Audit Review

East Sussex County Council

Audit 2005-2006

External audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services.

Audit in the public sector is underpinned by three fundamental principles:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements but also value for money and the conduct of public business; and
- auditors may report aspects of their work widely to the public and other key stakeholders.

The duties and powers of auditors appointed by the Audit Commission are set out in the Audit Commission Act 1998 and the Local Government Act 1999 and the Commission's statutory Code of Audit Practice. Under the Code of Audit Practice, appointed auditors are also required to comply with the current professional standards issued by the independent Auditing Practices Board.

Appointed auditors act quite separately from the Commission and in meeting their statutory responsibilities are required to exercise their professional judgement independently of both the Commission and the audited body.

Status of our reports to the Council

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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## Introduction

1 Being able to place reliance on the work of Internal Audit is a key theme in our audit approach and in order to do this, we have to carry out a full review of Internal Audit every three years. Furthermore, International Standard on Auditing (ISA+) 610 (Considering the work of Internal Audit) requires us to perform 'an assessment of the Internal Audit function when internal auditing is relevant to the external auditor's risk assessment'.

## Background

2 Such a review was due in the 2005/06 audit year and was particularly timely in that it coincided with our revised audit approach brought about by the introduction of the International Standards on Auditing in 2005. Our review was completed between January and April 2006.

## Audit approach

3 Our approach to the review was based on the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Internal Audit and ISA+610 and our objective therefore was to establish that the Internal Audit department is structured and operating in accordance with that Code and the ISA. To this end we reviewed the Internal Audit function against ten criteria under two headings:

### Organisational standards

- Scope
- Independence
- Audit Committees or equivalent
- Relationships with management, other auditors and other review bodies
- Staffing, training and development

### Operational standards

- Audit strategy
- Management of audit assignments
- Due professional care
- Reporting
- Quality assurance



4 Our work on Organisational Standards consisted mainly of obtaining and reviewing documents that evidenced the various criteria. Our work on Operational Standards consisted mainly of reviewing specific work undertaken by Internal Audit on the following material systems: General Ledger, Accounts Payable, Accounts Receivable and Treasury Management. This review also formed the basis of our pre-statement testing work on these systems.

Main conclusions

5 The detailed conclusions we reached under each of the ten headings are set out in Appendix 1.

6 Our key conclusions are as follows.

- Internal Audit has appropriate status and is highly regarded within East Sussex County Council. It was noted that line management regularly sought Internal Audit input and advice on a range of issues. There are no constraints placed on Internal Audit and it has access at all times to the highest level of management.
- The scope of the Internal Audit function is unrestricted, reports are issued on all audit work and recommendations resulting from those reports are acted upon by management.
- Internal Audit work is properly planned, supervised, reviewed and documented. It was notable that the annual audit plan is prioritised clearly on an assessment of the risk arising from each service area/system and members are fully briefed and can influence the plan before publication.
- Internal Audit staff are appropriately and adequately qualified and approach their work in a highly professional manner.

7 We had one concern about whether the many and varied roles undertaken by the Assistant Director - Audit and Performance, who heads the Internal Audit function within the Council, might possibly lead to a conflict of interest. In discussion with the Assistant Director - Audit and Performance we were able to conclude that this risk is mitigated because:

- The Principal Audit Manager has day to day responsibility for all audit reviews; and
- The Principal Audit Manager and his colleagues have direct and unrestricted access to the Section 151 officer and the body that performs the functions of an audit committee.

8 Our overall conclusion is that Internal Audit provides an effective service. It has a positive reputation and standing within the Council which allows it to contribute fully to



the corporate governance framework. We can rely on the work of Internal Audit where it is relevant to, and has an impact on, our external audit work.

## Appendix 1 – Detailed conclusions

### Organisational standards

#### Scope

The purpose, authority and responsibility of Internal Audit is formally defined in Terms of Reference which are consistent with the Code and establish clear objectives, reporting lines and responsibilities.

#### Independence

We were able to conclude that the Internal Audit function meets the principles of independence contained in the Code and enjoys appropriate status within the Council.

#### Relationships

Internal Audit has established effective working relationships with management and external audit. A protocol is currently being developed for occasions where it is necessary to work with Internal Audit functions within other councils.

#### Audit Committee

We were able to conclude that Internal Audit fulfilled its obligations to the Audit and Best Value Scrutiny Committee which performs the function of an audit committee in accordance with the Code.

#### Staffing, training and development

Internal Audit staff are appropriately and adequately trained

and qualified and there are sufficient numbers to undertake and complete an extensive annual audit plan.

## Operational standards

### Audit strategy

The Assistant Director - Audit and Performance develops an annual audit strategy which covers how the service will be delivered, the resources and skills necessary for delivery and how the assurance for the annual statement on internal control will be demonstrated. The strategy is approved by the Authority.

### Management of assignments

Assignments are planned and undertaken in accordance with the Code and where recommendations have been made for management action, these are followed up.

### Due professional care

We concluded that assignments are handled with due professional care as defined in the Code.

## Operational standards

### Reporting

Audit work is reported upon to the relevant managers in a clear and constructive manner. Findings are discussed with management and prioritised to clearly represent the risk attached.

The Assistant Director - Audit and Performance reports on a quarterly and an annual basis on Internal Audit's progress against the work planned for the year.

### Quality assurance

There is an extensive quality manual available to all Internal Audit staff on the Council's intranet that covers all the criteria contained within the Code.

