

## NORTH YORKSHIRE COUNTY COUNCIL

### AUDIT COMMITTEE

27 June 2013

#### REVIEW OF THE EFFECTIVENESS OF INTERNAL AUDIT 2012/13

##### Report of the Corporate Director – Strategic Resources

#### 1.0 PURPOSE OF REPORT

- 1.1 To advise Members of the process and the outcomes of the 2012/13 review of the effectiveness of the County Council's internal audit arrangements.

#### 2.0 BACKGROUND

##### Legislative Requirements

- 2.1 The Accounts and Audit Regulations 2011 require the County Council to conduct, at least once a year, a review of the effectiveness of its internal audit arrangements, and to report the findings of this review to the Council or an appropriate committee. The process is intended to form part of the wider review of the effectiveness of the system of internal control which is necessary to prepare the Annual Governance Statement.

- 2.2 The Regulations require that the Council:

*“must undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control”.*

- 2.3 For 2012/13, the proper practices for internal audit were those contained within the CIPFA Code of Practice for Internal Audit in Local Government (the Code of Practice)<sup>1</sup>.

##### Defining Internal Audit

- 2.4 In the Code of Practice, internal audit is defined as:

*“an assurance function that provides an independent and objective opinion to the organisation on the control environment, by evaluating its effectiveness in achieving the organisation's objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources.”*

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<sup>1</sup> The CIPFA Code of Practice for Internal Audit in Local Government was replaced on 1 April 2013 by the Public Sector Internal Audit Standards.

As such internal audit forms an essential part of the County Council's corporate governance arrangements.

- 2.5 Since April 2009, internal audit has been provided under contract by Veritau Ltd, a company wholly owned by the County Council and the City of York Council, with the service being provided under a formal "shared service" arrangement. During 2012/13, specialist computer audit was sub-contracted to PricewaterhouseCoopers. This review takes full account of this framework for the provision of the service.
- 2.6 The principal functions of internal audit are to:
- (a) provide assurance to Members, chief officers, other key stakeholders and the wider community on the effectiveness of the governance arrangements and internal controls at the County Council;
  - (b) provide advice and make recommendations to improve controls and/or address the poor or inappropriate use of the Council's resources;
  - (c) examine and evaluate the probity, legality and value for money of the Council's activities;
  - (d) act as a visible deterrent against all fraudulent activity, corruption and other wrong doing;
  - (e) respond to and investigate any instances of suspected fraud or corruption;
  - (f) assist the Audit Committee in the performance of its functions as set out in its Terms of Reference.
- 2.7 The Code of Practice sets out eleven standards (or principles) for the establishment of a professional service. Each principle is supported by detailed guidance. The principles covered the following areas:
- (a) Scope of Internal Audit (Terms of Reference and scope of work)
  - (b) Independence
  - (c) Ethics for Internal Auditors
  - (d) Audit Committees (including Internal Audit's relationship with the Audit Committee)
  - (e) Relationships (with management, elected Members and other auditors, regulators and inspectors)
  - (f) Staffing, Training and Continuing Professional Development
  - (g) Audit Strategy and Planning
  - (h) Undertaking Audit Work
  - (i) Due Professional Care
  - (j) Reporting
  - (k) Performance, Quality and Effectiveness
- 2.8 The best practice guidance states that the review of the effectiveness of internal audit should also include consideration of the effectiveness of the Audit Committee itself (to the extent that its work relates to internal audit) as well as the performance of the audit provider. A separate review of the Audit Committee's effectiveness was

undertaken by the Audit Committee Working Party and the results were reported in April 2010. Following that review, an action plan was prepared and various changes and improvements made. There have been no significant changes in the Audit Committee's arrangements since that date, other than a new membership following County Council elections in May 2013, and so a further review is not considered necessary at this stage.

### **Who Should Undertake the Review?**

- 2.9 The Regulations require either the Council itself, or a committee of the Council, to review the effectiveness of internal audit. The County Council has delegated this responsibility to the Audit Committee and included it in the terms of reference for the Committee. The main reasons for this are:
- (a) it is a core responsibility of the Audit Committee to approve internal audit plans and monitor the work of the service;
  - (b) the Audit Committee is independent of the management of the County Council;
  - (c) the annual report and the opinion of the Head of Internal Audit are considered by the Audit Committee;
  - (d) the external auditor reports to the Audit Committee and is therefore able to highlight any deficiencies in internal audit arrangements;
  - (e) the review of the effectiveness of internal audit feeds into the Annual Governance Statement which is also considered by the Committee.
- 2.10 However, a key point to note is that it is the responsibility of the County Council to conduct the annual review of internal audit effectiveness; it is not a review that is carried out by the external auditors as part of their audit of the accounts. Whilst the external auditors will review elements of internal audit work, the purpose is generally to assess the degree of reliance which they can place upon that work.
- 2.11 As in previous years, the review of the effectiveness of internal audit has been undertaken jointly with the City of York Council and in consultation with the respective Audit Committee Chairs. This ensures consistency and avoids unnecessary duplication of work by the two council's client officers. The review has also been extended to take account of the expansion of the Veritau's internal audit provision to include five of the North Yorkshire district councils.

### **Scope of the Review**

- 2.12 The review is primarily about effectiveness, not process. The review is primarily needed to ensure that the opinion contained in the Annual Report of the Head of Internal Audit can be relied upon as a key source of evidence for the Annual Governance Statement. The focus of the review has, therefore, concentrated on the delivery of the internal audit function to the required professional standards in order to produce the required outcome i.e. a reliable assurance on internal control and the management of risks in the council, rather than an assessment of value for money.
- 2.13 Other sources of assurance that the Committee receives, from which it can take a view on the effectiveness of the service include:

- (a) regular outturn reports on Internal Audit work and related performance measures;
- (b) the Annual Report of the Head of Internal Audit (which is a separate item on this Agenda);
- (c) the Internal Audit Plan (the 2013/14 Plan was approved at the April 2013 meeting of this Committee);
- (d) reports from the external auditor (in so far as they relate to the work of internal audit).

### 3.0 **2012/13 REVIEW OF THE EFFECTIVENESS OF INTERNAL AUDIT**

3.1 For the purposes of this review, the following work has been completed:

- (a) the Code of Practice self assessment checklist has been refreshed so as to identify any significant changes in the degree of compliance against the Code (compared to 2011/12);
- (b) a customer satisfaction survey has been completed (by senior managers in the County Council and Veritau's other client councils);
- (c) the progress made to address any issues identified in the 2011/12 review of effectiveness has been assessed;
- (d) the views of the external auditors have been sought regarding the extent to which they can place reliance upon the work of internal audit;
- (e) other factors regarding the quality of the service have been considered as appropriate.

3.2 The results of the review are set out in **Appendix 1** to this report.

3.3 There were two areas for further improvement identified in last year's review, as follows:

- (a) further work was required to fully embed the updated counter fraud arrangements (to support the more proactive approach to the identification of fraud risks and the investigation of all suspected fraud by a single dedicated team)
- (b) further work was required to establish a clear framework for obtaining assurance from other partner organisations (to support audit work involving the County Council's significant partnerships)

3.4 Good progress has been made to enhance counter fraud capabilities, particularly within adult social services. Fraud awareness training has been provided to finance and operational staff where fraud risks are considered to be high. More effective procedures have been established to enable suspicious activity to be reported for possible investigation. New techniques have also been adopted for investigating cases where fraud has been identified. Further work is however required to ensure that fraud investigations can properly support the County Council's own disciplinary procedures, where applicable. Similarly, it is recognised that HR can support counter fraud activities by providing improved intelligence about possible risks. An action plan has therefore recently been agreed to improve integration between Veritau's counter fraud team and HR.

- 3.5 Progress has also been made to enhance joint working with other internal auditors as a possible source of assurance, particularly in respect of the County Council's significant partnerships. The expansion of Veritau's services to include five of the North Yorkshire district councils has assisted this process especially where those partnerships involve some or all of the district councils. Regular liaison meetings continue to be held with the other public sector internal audit providers operating within North Yorkshire, including the two main NHS internal audit teams and Harrogate Borough Council (who provide internal audit services to the two remaining district councils). Contacts have also been established with a number of the housing associations operating in the area although this has so far been limited to sharing information about possible frauds. It is however recognised that further work is required in order to maintain existing working relationships and explore opportunities for joint working and information sharing. This need is reflected in Veritau's current business plans.
- 3.6 In respect of the service provided to the County Council, it is my view (as the S151 Officer) that the quality of internal audit work has been maintained, and the performance of Veritau has continued at a high standard during the year. This view is based on my regular contact with the Head of Internal Audit and other members of the internal audit team, the reports which have been received during the period, the results of other ad-hoc work and feedback from other directorate colleagues. Whilst it is almost inevitable that there will be some operational issues during the course of a year, where matters have arisen then these have been addressed in a timely and constructive manner. I am therefore satisfied that I can continue to place reliance on the work of Veritau and the opinion of the Head of Internal Audit.
- 3.7 The external auditors, Deloitte have also provided the following feedback:
- No matters of concern have been raised with the S151 Officer or the Audit Committee by the External Auditor regarding internal audit matters during 2012/13
- There were no matters raised regarding internal audit arrangements in the External Auditor's Annual Audit Letter 2011/12, which was reported to this Committee in December 2012
- The External Auditor was asked for specific feedback on the work of the Internal Audit Service, and has provided the following comments:
- (a) we maintain an open dialogue with internal audit that allows us to share areas of concern between internal and external audit
  - (b) internal audit work constructively with external audit, for example:
    - a resident query passed by external to internal audit for comment
    - the offer that the external auditor will assist internal audit with assurance mapping
  - (c) we have not identified any significant areas of concerns based on our review of the reports produced by internal audit that are relevant to the financial statement audit

3.8 In respect of the service provided to the City of York, the external auditor is the Audit Commission. In respect of 2012/13, they completed a more general assessment of internal audit, and whilst in the context of the service provided to the City of York, this does provide some further assurance about the effectiveness of Veritau more generally.

3.9 Specifically the assessment looked at:

- compliance with CIPFA standards
- levels of competence, by reference to qualifications and experience
- the scope of Internal Audit's planned work programme and
- delivery against plan to date.

The assessment included a more detailed review, on a sample basis, of some individual assignments. There were no significant areas of non compliance.

#### 4.0 **CONCLUSION**

4.1 Based on the results of this review, the County Council's internal audit arrangements are considered to be operating in accordance with accepted professional best practice, and remain effective. The Committee can therefore continue to place reliance on the internal audit arrangements operating within the County Council when considering the draft Annual Governance Statement for 2012/13.

#### 5.0 **CONSULTATION**

5.1 This review has been conducted by the Corporate Director – Strategic Resources in liaison with the City of York Council and in consultation with the Chair of the Audit Committee.

#### 6.0 **RECOMMENDATION**

6.1 Members are asked to note, and comment on the results of the review of the effectiveness of the County Council's internal audit arrangements.

6.2 Members are asked to determine whether there are issues arising from their assessment of the Internal Audit Service and its support to the Committee, and whether there are matters that require change or further development.

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7 June 2013

## REVIEW OF INTERNAL AUDIT EFFECTIVENESS – 2012/13

- 1 This report sets out the results of the review of internal audit effectiveness for 2012/13 in terms of the service provided by Veritau. As this is a shared service and to avoid unnecessary duplication a single review has been carried out encompassing all of the company's client councils (ie North Yorkshire County Council, the City of York Council, Hambleton District Council, Richmondshire District Council, Ryedale District Council, Scarborough Borough Council and Selby District Council). It should be noted that Veritau's audit systems and working practices are applied consistently across each of the client councils and so there should not be any significant difference in the standard or quality of the service.
- 2 The review of effectiveness should however include consideration of other factors which are likely to be specific to individual councils, for example the status of internal audit within the organisation, the relationship between the external and internal auditors and the effectiveness of the audit committee (to the extent that its work relates to internal audit). These issues will be addressed separately, where applicable.
- 3 The review of internal audit effectiveness has considered the following sources of information:

### Update of Code of Practice Self Assessment Checklist

- 4 For 2012/13, the proper practices for internal audit were those contained within the CIPFA Code of Practice for Internal Audit in Local Government (the Code of Practice)<sup>1</sup>. The Code of Practice sets out eleven standards (or principles) for the establishment of a professional service. Each principle is supported by detailed guidance. The principles covered the following areas:
  - (a) Scope of Internal Audit (Terms of Reference and scope of work)
  - (b) Independence
  - (c) Ethics for Internal Auditors
  - (d) Audit Committees (including Internal Audit's relationship with the Audit Committee)
  - (e) Relationships (with management, elected Members and other auditors, regulators and inspectors)
  - (f) Staffing, Training and Continuing Professional Development
  - (g) Audit Strategy and Planning
  - (h) Undertaking Audit Work
  - (i) Due Professional Care
  - (j) Reporting

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<sup>1</sup> The CIPFA Code of Practice for Internal Audit in Local Government was replaced on 1 April 2013 by the Public Sector Internal Audit Standards.

(k) Performance, Quality and Effectiveness

- 5 A detailed self assessment exercise to assess compliance against the CIPFA Code of Practice for Internal Audit was undertaken in 2010/11. The self assessment has been reviewed and updated on an annual basis since that date. With the exception of the areas identified in paragraph 8 below, the service is considered to be fully compliant.
- 6 During 2012/13, the priority has been to establish a new company to deliver internal audit services to five of the North Yorkshire district councils. The new company, Veritau North Yorkshire (VNY) commenced trading on 1 April 2012. The existing audit systems, procedures and operating practices have been adopted by the new company so that there is now a consistent approach to audit work across all the member councils and other external clients.
- 7 With the exception of some minor changes to operational arrangements and the format of audit reports there have been no significant developments since the date of the last review. Adherence with the professional standards set out in the Code of Practice has therefore been maintained.
- 8 Those aspects of the current internal audit arrangements which have previously been identified as not fully complying with the Code of Practice are listed below:

Note: F indicates full compliance, P indicates partial compliance and N indicates non compliance

Ref	Standard	P / N	Current Status
<b>3</b>	<b>Ethics for Internal Auditors</b>		
<b>3.3</b>	<b>Objectivity</b>		
3.3.4	Are staff rotated on regular / annually audited areas.	F	Operating arrangements were previously considered to be only partially compliant. However, staff rotation has increased significantly in the last few years. This process has continued through 2012/13 with the expansion in the number of client councils. Auditors are therefore increasingly working across different client councils and service areas. However, staff rotation still has to be balanced with the need to maintain a level of continuity and to ensure that the knowledge gained by auditors of each system or service area is used effectively. This balance will be kept under review in 2013/14.
<b>5</b>	<b>Relationships</b>		
<b>5.3</b>	<b>Relationships with Other Internal Auditors</b>		
5.3.1	Do arrangements exist with other internal auditors that include joint	P	The method of obtaining assurance from partner organisations will vary depending on the relationship between the client council and the

Ref	Standard	P / N	Current Status
	working, access to working papers, respective roles and confidentiality?		partner in question. Good working relationships exist between Veritau and the other principal audit providers in the area (for example – the NHS internal audit providers in North Yorkshire). Other arrangements tend to be limited and informal in nature. However, the need for a formal joint working protocol has been recognised in these situations and is included in the company's 2013/16 Business Plan.
<b>5.5</b>	<b>Relationships with Other Regulators and Inspectors</b>		
5.5.1	Has the Head of Internal Audit sought to establish a dialogue with the regulatory and inspection agencies that interact with the organisation?	P	This occurs on an ad-hoc basis but is not considered to be of significant importance.
<b>10</b>	<b>Reporting</b>		
<b>10.3</b>	<b>Follow-up Audits and Reporting</b>		
10.3.3	Where appropriate, is a revised opinion given following a follow-up audit and reported to management?	N	Veritau does not consider that it is appropriate to revise an opinion. However, account will be taken of the progress made by management to address control weaknesses and to complete agreed actions when providing the annual audit opinion.
<b>10.4</b>	<b>Annual Reporting and Presentation of Audit Opinion</b>		
10.4.2	Does the Head of Internal Audit's report:		
	Communicate the results of the internal audit quality assurance programme?	P	Given Veritau's contractual position, this information is considered to be more relevant to the individual client officers in each council. Such information is provided as necessary.

### Customer Satisfaction Surveys

- 9 In accordance with the Code of Practice, Veritau carries out customer survey reviews as a normal part of the audit process. An annual survey of senior managers in each client council is also carried out to assess overall customer satisfaction with the quality of work being undertaken. These surveys are dealt with in turn below.
- 10 At the close of each audit, the responsible service manager of the area being audited is asked for feedback. The service manager is asked a series of questions about the conduct of the audit and about whether they were satisfied with the overall outcome. The level of satisfaction in 2012/13 (based on 119

surveys returned during the year) was 99.2%. This compares with 100% satisfaction in 2011/12.

- 11 In the annual survey, senior managers were asked to rank the individual elements of the service provided by Veritau (including internal audit, counter fraud and information governance). A total of 35 surveys were returned. The results were generally consistent between the client councils and with the results of similar surveys conducted in previous years.
- 12 For the purposes of this review, the scores for internal audit and counter fraud have been summarised as follows:

	1	2	3	4	N/A
<b>Internal Audit Services</b>					
1.1 The quality of planning and the overall coverage of the audit plan	3	24	3		5
1.2 The provision of advice and guidance	6	23	5		1
1.3 The conduct and professionalism of audit staff	21	11	2		1
1.4 The ability of audit staff to provide unbiased and objective opinions	16	16	2		1
1.5 The ability of audit staff to establish a positive rapport with customers	14	19			2
1.6 The auditors' overall knowledge of the system / service being audited	1	25	6		3
1.7 The auditors' ability to focus on the areas of greatest risk	5	23	3	1	3
1.8 The arrangements made to agree the scope and objectives of the audit	9	19	3	1	3
1.9 The auditors' ability to minimise disruption to the service being audited	11	17	3		4
1.10 The communication of issues found by the auditors during their work	8	22	1		4
1.11 The quality of feedback at the end of the audit	6	22	3		4
1.12 The auditors' ability to communicate their findings in the audit report	7	21	4		3
1.13 The accuracy, format, length and style of audit reports	5	18	8	1	3

	1	2	3	4	N/A
1.14 The time taken to issue audit reports	5	18	9		3
1.15 The relevance of audit opinions and conclusions	5	22	4	1	4
1.16 The extent to which agreed actions are constructive and practical	5	22	5		3
1.17 The quality of IT audit (provided on behalf of Veritau by PWC)	2	10	1	1	21
<b>The overall rating for the Internal Audit services</b>	5	24	3		3
<b>Counter Fraud Services</b>					
3.1 The preparation and maintenance of counter fraud policies and strategies	4		1		17
3.2 The communication of fraud risks to managers and other stakeholders	3		3		17
3.3 The provision of advice on measures to prevent fraud and corruption	3	1	3		16
3.4 The identification of possible fraud and error	3	1	2		17
3.5 The receipt and handling of fraud referrals	2	2	3		16
3.6 The investigation of suspected fraud	4	1	2		16
3.7 The conduct and professionalism of counter fraud staff	4	3	1		15
3.8 The investigators' knowledge of legislation, policies and procedures	3	2	1		17
3.9 The quality of feedback during and at the end of fraud investigations	3	3		1	16
3.10 The time taken to complete fraud investigations	1	4		2	16
3.11 The outcomes from fraud investigations	3	2	1	1	16
3.12 The overall reporting of counter fraud activities and work done	3	2	1	1	16

	1	2	3	4	N/A
<b>The overall rating for the Counter Fraud services</b>	3	1	1	1	17

Key:

1 = Excellent

2 = Good

3 = Satisfactory

4 = Poor

N/A = Not answered

Note – the number of surveys received is lower for counter fraud because not all the client councils receive this service.

- 13 For internal audit, the majority of the responses were either excellent or good. Whilst it is not considered to be a significant problem, the number of 'satisfactory' responses for questions 1.13 and 1.14 suggests that there is however further scope to improve the accuracy and timeliness of audit reporting. Where particular issues were highlighted or comments made then these will be addressed with the relevant audit team and/or client council. For counter fraud, the majority of respondents did not answer the questions. This reflects the fact that only certain managers generally have regular contact with this aspect of the service. Where responses were provided then there is however more of a divergence of opinions. It is recognised that further developmental work is therefore required in this area, particularly in respect of communications and turnaround times..

### **Client Liaison**

- 14 As part of ongoing client liaison arrangements, Veritau audit managers will meet regularly with senior officers in each client council. Whilst the specific arrangements differ between the councils, the S151 officer is always a main point of contact. Other key contacts may include the chief executive, the monitoring officer and/or other members of the corporate management team in each council. As such, these senior managers are well placed to assess the overall effectiveness of the audit service, and also how Veritau deal with any issues which may arise during the course of work. No specific matters of concern have been raised about the standard or quality of audit work through these client arrangements during 2012/13.

### **External Audit**

- 15 Similarly, no matters of concern have been raised with the S151 officer or the relevant audit committee by the external auditors, at any of the client councils. In some cases, the external auditors have provided specific comments on the work of internal audit and these are reported separately to the relevant council.