Report Title:	External Review of Internal Audit (October 2016)				

Issue Identified	Recommended Action – Red, Amber Green	Agreed	To be Implemented By:		Comments
			Officer	**Date**	
RESOURCES **Supervision** Supervision of an internal audit assignment is not always evidenced within internal audit files. A formal file review document is completed by a supervisor following exit meetings or production of a draft report, with supervision during an audit being conducted through discussion and monthly 121 meetings.	The nominated supervisor should ensure and evidence that active supervision is maintained and documented throughout the assignment process through recording involvement and instructions on the review form. A suggested format for diarising supervision which is used within peer providers is attached as Appendix 1	Part	IAC Manager/ Senior Auditors	Ongoing	There is already a formal review process in place. A standard file review form is completed at the end of an audit that records any queries/issues/further work required that are outstanding. Once these issues have been satisfactorily resolved the review form is signed off and the close out meeting can be held with the relevant manager. Teams are small and there is regular dialogue amongst team members as an audit progresses. It is felt that recording these conversations would be time consuming and wouldn't add anything to the process. However, if any significant issues arise during audits then these will be documented as part of the file review.
	File review forms should be introduced at DDDC as part of a standard approach.	Y	IAC Manager	Immediate	Internal Audit Consortium Manager to introduce file review forms at DDDC

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COMPETENCY **Governance and standards** The Internal Audit Manual is a comprehensive document which refers to the PSIAS but does not sufficiently reference the processes that audit staff should follow in conducting assignments to the various standards. We feel that this would help to elevate the understanding and status of internal audit if the key standards within the PSIAS were fully documented within the document.	The Internal Audit Manual could be beneficially improved by referring directly to those PSIAS standards that **must** be followed and providing detailed advice regarding expectations, particularly in respect of each area.	Y	IAC Manager	August 2017	IAC Manager to review and update audit manual to include more detail in respect of specific PSIAS standards. Internal audit staff all have a copy of the standards however a copy of the PSIAS Standards will be appended in the audit manual
COMPETENCY **Internal Audit Planning** Whilst planning is based upon a risk model as required by the PSIAS, the process largely depends on an assessment devised by internal audit; this shows a financial bias and the use of different definitions of risk impact to those approved within the Council risk management strategy; rather than reflecting the wider and accepted risk issues being recognised by the	a) Audit Plans should be constructed to achieve the objectives of the department as set out in the Internal Audit Charter and the audit planning process designed to reflect the same through transparent alignment with the Council wide approach to risk management.	Yes	IAC Manager	For 17/18 IA Plan	The Council's strategic and operational risk registers are already used to inform the audit plan. The IAC Manager sits on risk management groups. Directors, Service Managers and the Risk management Group are consulted in respect of the content of the plan. Areas in the plan are already identified as High, Medium or Low risk however the 2017/18 Internal Audit plan will be presented to more clearly demonstrate the links with the Council's risk registers. Non- financial areas are already

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Council. There should be a direct and identified link between the internal audit plan content discussed with Audit Committees which aligns with the Council's risk management systems; beneficially reflecting both identified controls and assurances available. The risk based reasoning for inclusion of the assignment in the audit plan should be evident (why is there a need for independent assurance?) and in turn this should drive the preparation of the terms of reference for each assignment as recorded within the Audit Brief.					identified for review e.g. health and safety, safeguarding, gas servicing. A number of other Council's audit plans have been obtained and this has not identified any significant gaps in the Consortium's audit plans. There are a range of other assurances in place including the Performance Management Framework and the Annual Governance Statement which provide assurance and identify potential weakness. The process will continue to be refined.
	b)The internal audit planning process should further identify other sources of assurance that are available and upon which Councils can place reliance.	Y	IAC Manager	August 2017	IAC Manager to meet with Directors/Heads of Service/ raise at CMT/quarterly Directorate meetings to identify and document other sources of assurance that are available upon which the Council can place reliance. The results of this exercise can then be used to further inform the basis for the internal audit plan.
	c) The starting point for the development of the Audit Brief should be a preliminary discussion with management regarding the inherent and residual risks relevant to the audit area under review. It may aid assignment planning if the management objectives for	Y	IAC Manager/ Senior Auditors	April 2017	In the majority of cases a start- up meeting is already held with managers and the audit coverage discussed. The current audit brief and start up meeting can be developed to focus more upon the risks associated with the areas being tested/key controls and any links to operational risk registers and service plans.

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	the area under review were also identified. This should result in the formation of a direct link with the Authority's risk register and the key mitigating controls highlighted, thereby aiding the understanding and ability of members of the Audit Committee to contribute to the assurance agenda.				
COMPETENCY **Training** The department has an experienced team of internal audit staff whose training needs are assessed through regular 121 meetings and appraisal and development meetings. Most staff have a relevant qualification, although only the IACM and one other member of staff have a recognised CCAB or IIA certification. The team attend routine meetings of various groups locally and regionally and use is	a) Consideration should be given to those areas within the training matrix which reflect greatest need for routine mandatory training of a professional or technical nature. These may relate to areas such as Data Protection or health and Safety where it is important for all staff to have a firm understanding or specific training relating to internal audit such as risk based internal audit or reporting.	Y	IAC Manager	Ongoing	Audit staff have regular data protection and safeguarding training and undertake corporate training as available/required. The Consortium will continue to take advantage of the Corporate training provided. Consideration will continue to be given to the provision of other training in relation to technical and professional areas within the confines of the budget available. Consideration will be given to further risk training for the audit team. One member of the team is studying for their IIA qualification.

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made of dedicated cost effective training that is available. The IACM ensures that available budgets are used to best effect. Whilst the IA team have identified technology related issues given the nature of cyber risk it is felt that this is a weakness that should be addressed.	b) There is a need for the Consortium to be able to provide assurance relating to IT risks given the increasing complexity of technology and associated controls. It is therefore essential that appropriate professional training is supported for a member of the team or that the service is acquired externally in order to deliver on the assurance needs of the consortium members.	Y	IAC Manager	As required	Consideration will be given to the identification and utilisation of external specialist support e.g. DCC or Derby City internal auditors where it is felt this is required. All four Councils are currently subject to independent PSN compliance on an annual basis which provides robust independent assurance concerning those aspects of the network covered by this testing.

COMPETENCY
 	
Control evaluation
The IAC uses the following gradings for the assessment of controls included within the testing schedule.
 	
Good – A few minor recommendations (if any)
Satisfactory – minimal risk; a few changes identified where changes would be beneficial
Marginal – a number of areas have been identified for improvement
Unsatisfactory – Unacceptable
	The Consortium should consider the merits of moving to expression of the control in environment in the form of:-
	  a) The appropriateness of the control environment having regard to the significance of the risks involved – adequate/inadequate, and
	  b) Whether the control is being consistently applied – effective/ineffective
		Y	IAC Manager	April 17	The IAC Manager to investigate alternative assessment wording based on levels of assurance. Consideration to be given to introducing revised assessment terminology from April 2017. Any proposals will be subject to discussions with the Audit Committees of the four Councils concerned to ensure a standard grading approach is retained.
					
					Client officers are however of the view that the existing grading arrangements do serve to give them a clear view of the position in respect of each service and that the use of 5 categories does

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risks identified, changes should be made **Unsound** – Major risks identified; fundamental improvements are required Our view would be that this represents an overly complex structure for expression of an opinion on the control environment and the nature of the issue identified against which a recommendation will be made. Standard practice is for each control to be assessed in terms of its adequacy and effectiveness, with the subsequent recommendation being graded as risk based (see Delivery 3b/c)					allow an accurate summary. They are able to focus on the three weaker assessments as those areas which have significant issues/ risks which need to be addressed. In this sense the current 5 level grading system provides a clear picture of where action is necessary. However, current thinking is to grade reviews based on levels of assurance.
DELIVERY **Focus on pre-identified controls** Assignments are dominated by previously identified controls emanating from CIPFA control matrices which are then tested to specified testing levels rather than provide focus on significant risk and associated key controls	Internal audit working papers should focus on major risks to the Council that have been identified and discussed with the auditee. Assignment briefs should therefore reflect assessment of risks as defined within the Councils risk impact definitions and then	Part	IAC Manager/ Senior Auditors	Ongoing	The basis of most test schedules have been derived from CIPFA control matrices and therefore cover the most significant risks as well as a range of other controls. The audit testing to be undertaken is discussed with the relevant manager at the start of the audit and updated following these discussions to include any concerns/ areas of risk identified by the manager. The test schedules also cover areas

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identified and evaluated as part of the documentation process. Benefits would be achieved through increased focus on agreed "local" key controls relating to the business critical risks and then tested according to the materiality of their contribution to the Council's risk management framework. Whilst the current testing is robust, documented and well evidenced it may not provide assurance relating to the most significant risks to which the service is exposed.	consider the controls that are required to mitigate that risk within the risk appetite of the Council. An example risk based Assignment Brief is included as Appendix 2.				that may not be "major" risks but are non the less still important. Audit briefs and opening meetings with managers can be developed to focus more on risk areas and more specific links to operational risk registers and service plans. Audit test schedules to continue to be adapted to reflect these risks. Consideration will be given to further risk training for the audit team.

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DELIVERY **Methodology and use of walk-through tests** For core financial systems, systems documentation exists and is we understand supported by flowcharts, in accordance with para 8.1.1 of the Internal Audit Manual. For other audits whilst it is accepted the system notes exist mostly in the form of notes within the evidence collected, files do not contain an outline of the system as specified in the internal audit manual as stage 4 of the above and there is therefore a reliance on previously constructed testing schedules to define the scope of the audit. As the risk environment, service provision, staff in post and therefore systems change it is considered important that each audit commences with providing a documented oversight of the component parts of the system in which key controls that are to be relied upon for the purposes of providing an opinion are documented and tested using a walk through test.	a. Auditors should complete at least a system note at the start of each audit in order to outline an overview of the processes being reviewed in order to aid understanding and the structure of the audit and provide an understanding of the system to aid supervision and the efficient conduct of future audits.	Part	All audit staff	April 17	A permanent file will be set up for each area of review in to which system notes, flow charts, staffing structures etc. will be saved. Sample documentation and system, notes are already routinely placed on file to evidence the processes in place whilst undertaking sample testing.
	b. The internal audit manual should specify the minimum standards requirements for file structure and content for electronic files in order to aid supervision. These may be planning and communication, systems documentation and identified procedures, fieldwork (control summaries supported by testing and evidence) and reporting. (Refers to section 9.3.3 of the internal audit	Y	IAC Manager	August 17	The structure of the electronic files for each audit review will be developed to ensure a consistency of approach amongst the Consortium members.

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	manual)				
DELIVERY **Audit Opinions -** ***Recommendations*** These are currently developed and assessed by each internal auditor, and reviewed by the Audit Manager prior to release of the draft report (sometimes subsequent to discussion of findings at an 'exit meeting' at which the grading of recommendations may have been discussed). This system relies on personal judgement	a)Audit supervisors should formally agree the grading of recommendations prior to the conduct of exit meetings.	Y	IAC Manager/ Senior Auditors	Ongoing	This is already completed as part of the file review process.

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related to 'Priority' for which no definition exists to articulate the meaning of High, Medium or Low. The definitions used by internal audit to support opinions therefore lack clarity and should be more closely linked with each Authority's risk appetite and the definitions of impact risk being used to embed risk management thinking within the organisation. The basis for grading of recommendations should as a result influence the overall	b)Risk definitions used by internal audit should be developed to reflect the risk appetite within each organisation, and the definitions of impact and likelihood used by the Council. These should be used by each internal auditor to grade the recommendation and discuss the level of risk to which the organisation is exposed with each auditee at the exit meeting	Y	IAC Manager	April 17	Definitions will be developed for High, Medium and Low internal audit recommendations linked to risk. This will aid in reducing subjectivity and increase consistency. It is also important that the audit reports identify and report all significant risk. Management can then take an informed view as to whether to accept or reject such risk, and to ask the question as to whether the risk appetite should be reviewed.
opinion for each audit directly, for example if a risk falling into a definition of the highest category is identified (potential for death, loss greater than £500k) then the assurance level given is reduced. Any risk of this nature should automatically trigger a negative audit opinion of 'limited assurance'.	c) Consideration should be given to removing the need to include 'low' rated recommendations in formal audit reports; alternatively reflecting on these in a side letter to the manager. This would aid the profile of internal audit through concentrating on things that really matter in relation to significant risk as defined within risk management policies.	N			This approach would lead to the risk that low priority recommendations are not even considered by managers. Managers can already disagree recommendations if they feel the risk is too low given the resource available etc. It is up to managers to set the risk appetite of the Council.

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DELIVERY ***Audit Opinions - Overall opinions*** These are currently based upon the personal judgement of each auditor, within the definitions specified as relating and subject to review by the supervisor and IACM of the draft report prior to release. The overall opinion also appears to be loosely based on the aggregate number of recommendations made and not the level of risk identified. The current is for the opinion to reflect the reliability of the internal controls operating in the system / area reviewed was assessed as good* / satisfactory* / marginal* / unsatisfactory* / unsound*.	a) The grading of recommendations should be based upon the level of risk exposure identified within the review and reflect the highest ranked recommendation being reported upon. Best practice would reflect: - Where a fundamental risk (red) is identified that no/limited assurance is given. - Where significant risks (amber) are identified then adequate assurance is given, and - Where 'merits attention' (green) risks are identified these are not referred to in the report and substantial assurance is given	Part	IAC Manager	April 17	Definitions will be developed for the use of High, Medium and Low when grading recommendations. This will help to ensure consistency based on levels of risk.

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Wider best practice provides for three levels of opinion being substantial, adequate or limited as this provides a clearer indication to stakeholders of the level of assurance that can be gained. This opinion can then be aligned directly with the nature of the risks being identified and the grading of those recommendations being made.	b) Reducing the levels of opinion to three would provide a clearer indication of the assurance being provided and represent a more straight-forward approach for internal audit staff to administer.	Part	IAC Manager	April 17	Consideration will be given to alternative wording for audit opinions based on assurance and risk levels. The Midlands Audit Group has been surveyed to establish the levels of audit opinion utilised by other audit sections. After consultation with client officers and consortium staff it is felt that four levels of opinion is more appropriate. A report will be taken to the January 17 Audit Committees in respect of a proposed revised levels of opinion based on assurance levels.
DELIVERY **Report format** The Consortium currently provides a detailed report which is then summarised appropriately to inform other meetings within the Council at Officer and Member levels. It would not be appropriate to comment negatively on this approach particularly as positive feedback regarding internal audit performance can be seen in the return of satisfaction surveys during 2016/17 and was gained	The Consortium should consider whether focusing on risk as a basis for reporting would allow movement towards an 'executive summary' approach which highlights only significant risks. This may help further build the profile of internal audit and allow greater efficiency within the team through reducing the time consumed in report production and clearance.	N			Managers have not liked this approach in the past as reports were seen as focusing purely on the negative. Current feedback from customer satisfaction surveys on the current reporting style is positive. Where a marginal or worse conclusion is reached the main issues / risks will be summarised in a paragraph under the conclusion. The majority of reports are already short.

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in meetings with officers as part of the EQA. However, internal audit reports are 'lengthy' and in developing an increasingly risk based approach consideration could be given to moving to an exceptions based executive summary highlighting significant risks.					
DELIVERY **Auditee feedback** At the time of the review feedback questionnaires had been received in respect of 24 audits undertaken during 2016/17, all received scores in excess of 80% with the only areas showing as requiring improvement relating to:- - Were recommendations practical and useful, and - Sufficient to remedy weaknesses identified in the report	The IACM should continue to monitor feedback as it moves towards an increasingly risk focused so that as changes are made to internal audit practices; these can be aligned with improvements in the way internal audit value is perceived.	Y	IAC Manager	March 18	All customer satisfaction surveys are reviewed with a view to taking on board any learning points. Surveys are also used as a discussion point with Auditors at EPD's and 1:1's As the Consortium further develops risk based auditing the customer satisfaction survey will be reviewed to ensure that it is still collecting relevant feedback.
DELIVERY **Annual Report** The IACM produces an Annual Audit report which summarises	In alignment with recommendations made earlier the internal audit plan should be constructed so that the IACM is able to	Y	IAC Manager	2016/17 audit opinion	The internal audit work during the year is used as the basis upon which to formulate the annual audit opinion. The audit plan is risk based and devised to cover a broad range of the

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the years' work and includes analysis of performance. The opinion reflects '*In respect of the main financial systems, Appendix 1 shows that internal controls were found to be operating satisfactorily or well, giving an overall confidence in the internal control system operating in relation to these systems*' . The form required by the PSIAS requires a wider statement which '*must also include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the board*'.	provide a wider assurance to each Authority in support of the governance statement. Best practice is that the Annual Report should also contain reference to all significant risks and therefore co-ordination with and an understanding of issues being raised the range of assurances available is essential in order to meet this broader scope. In this way the Annual report can be used to support the Council's Governance Statement.				Council's activities and functions. This enables the IAC Manager to produce an opinion on the control environment as a whole. However, the annual internal audit opinion will be developed to take in to account other significant risks that may not have been covered by the audit plan in a particular year. The Annual Governance Statement and strategic risk register will be utilised to do this.
DELIVERY **Reports produced by the IACM** It is considered good practice that the IACM is involved in conducting assignments particularly in relation to high risk areas but in such circumstances appropriate arrangements should be made for 'supervision' and clearance of reports.	In circumstances where the IACM undertakes a review personally arrangements should be made for a second person review of the file.	Y	Senior Auditors	Immediate	Where the IAC Manager undertakes an audit, a quality review will be undertaken by a senior Auditor

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DELIVERY **Derbyshire Dales DC** Whilst it is recognised that arrangements for this Council are outside of the core Consortium arrangements. It would be beneficial for the established internal audit processes contained within the Internal Audit Manual to be applied as this will aid consistency of approach, training and supervision.	Standardised procedures should be implemented regarding: - The use of Audit Briefs, - Working paper review, and - The approach to IT audit	Y	IAC Manager and Senior Auditor	Immediate	