

Report to: Audit Committee
Date of meeting: 26 September 2007
Report of: Audit Manager
Title: Internal Audit – Terms of Reference

1.0 **SUMMARY**

1.1 This report sets out the revised Terms of Reference for Internal Audit.

2.0 **RECOMMENDATIONS**

2.1 The revised Terms of Reference for Internal Audit be approved.

Contact Officer:

For further information on this report please contact: Barry Austin, Audit Manager.
telephone extension: 8032 email: barry.austin@watford.gov.uk

Report approved by: Janice Maule, Director of Finance.

3.0 **DETAILED PROPOSAL**

3.1 The purpose, authority and responsibility of Internal Audit should be formally defined by the Council and should be consistent with the standards set out in the Chartered Institute of Public Finance's (CIPFA) *Code of Practice for Internal Audit*.

3.2 In November 2005 this Committee approved the current Terms of Reference which were based on guidance set out in CIPFA's 2003 *Code of Practice*.

3.3 The 2003 *Code* reflected the requirements of the Accounts and Audit Regulations 2003. These regulations were amended in 2006 and CIPFA amended its *Code of Practice*. This has in turn led to the latest revision of Internal Audit's Terms of Reference.

3.4 The new Terms of Reference incorporate minor changes in response to wording changes in the Accounts and Audit Regulations e.g. "proper internal audit practices" becomes "proper practices in relation to internal control". They also include minor amendments identified when Internal Audit's operating procedures were compared to the new standards required by the 2006 *Code of Practice*. The results of this comparison are reported elsewhere on the agenda.

4.0 **IMPLICATIONS**

4.1 **Financial**

4.1.1 The Head of Finance comments that there are no financial implications in this report.

4.2 **Legal Issues** (Monitoring Officer)

4.2.1 The Head of Legal and Democratic Services comments that there are no implications not covered by this report.

4.3 **Potential Risks**

4.3.1 Failure to introduce the proposed changes could lead to criticism by an external assessor for not adopting the revised standards.

Appendices

Appendix A – Internal Audit Terms of Reference

Background Papers

The following background papers were used in the preparation of this report. If you wish to inspect or take copies of the background papers, please contact the officer named on the front page of the report.

Code of Practice for Internal Audit in Local Government in the United Kingdom 2006

File Reference

None

WATFORD BOROUGH COUNCIL

INTERNAL AUDIT SERVICE

TERMS OF REFERENCE

Introduction

These Terms of Reference describe the purpose, authority and principal responsibilities of the Internal Audit Service.

Definition of Internal Audit

The CIPFA *Code of Practice for Internal Audit, 2006*, defines Internal Audit 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 adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources”.

Authority

The Accounts and Audit (Amendments) (England) Regulations 2006 state:
“A relevant body shall maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control, and any officer or member of that body shall, if the body requires-
(a) make available such documents of the body which relate to its accounting and other records as appear to that body to be necessary for the purpose of the audit; and
(b) supply the body with such information and explanation as that body considers necessary for that purpose.”

The need to comply with these Regulations is recognised in the Council’s Financial Procedure Rules which provide for Internal Audit to have access to all records, documents, assets, premises and control systems. Internal Audit also has the right to obtain such information as it considers necessary to fulfil its responsibilities. This right of access applies to records etc of contractors or other external service providers and is written into revised contract procedures.

Objectives

Internal Audit’s broad objectives are to support the achievement of the Council’s objectives by:

- delivering a comprehensive and professional internal audit service across the Council, providing assurance on the effectiveness of the internal control environment
- assisting management in the effective discharge of their responsibilities
- promoting best practice across the Council.

Responsibilities

Given that the scope of Internal Audit is to review and report on the Council’s control environment, the key responsibilities are to:

- 1 Understand Council objectives and the key risks to their achievement.
- 2 Comment on the effectiveness of the Council’s corporate governance arrangements which includes the risk management process (how the risks to achieving the Council’s objectives are identified, assessed and managed).

- 3 Review, appraise and report upon:
 - the adequacy and effectiveness of the systems of financial, operational and management control and the risk any weaknesses pose to the control environment
 - the extent of compliance with, relevance of and financial effects of policies, standards, plans and procedures established by the authority and the extent of compliance with external laws and regulations
 - the extent to which the assets and interests are acquired economically, used effectively, accounted for and safeguarded from losses of all kinds arising from waste, extravagance, inefficiency, poor value for money, error, fraud or other cause
 - the suitability, accuracy, reliability and integrity of financial and other management information, accounts and data and reporting and accountability processes.
- 4 Raise awareness in services of those risks which may affect the operational effectiveness of individual systems.
- 5 Report as necessary on the development and implementation of the Council's policies in order to achieve its key objectives.
- 6 Review arrangements for achieving value for money in the delivery of Council services.
- 7 Integrate the investigation of frauds and irregularities with the work of the Benefit Fraud Team and jointly promote fraud awareness across the Council. Be alert in all work to the potential risk of fraud.

The Audit Manager, in conjunction with the Head of Legal and Democratic Services, will decide whether cases of fraud or corruption are serious enough to warrant referring to the Police.
- 8 Provide advice on an ad-hoc or formal basis as required. Other consultancy type work will not be actively sought due to pressure on existing resources and will only be carried out with the approval of the Audit Committee.
- 9 Provide an annual opinion on the adequacy and effectiveness of the control environment, including where key systems are being operated or key services provided a) on behalf of other organisations by the Council or b) by other organisations on behalf of the Council.
- 10 In the case of 9 b) the Audit Manager will determine how assurance on the control environment will be obtained. This will be either by way of reliance on the work of other internal auditors or by the Internal Audit Service carrying out the work itself. If the latter, the Audit Manager will arrange for access rights to staff and records of the organisation.
- 11 Members of the Internal Audit Service will be expected to contribute to the general management and conduct of Council business through membership of working groups etc where audit expertise can make a positive contribution.

Responsibilities of Other Services (Including Fraud)

The existence of the Internal Audit Service does not diminish the responsibility of service managers to maintain adequate systems of internal control that ensure that services are provided in a secure, efficient and well ordered manner. This includes managing the risk of fraud and corruption by ensuring that controls are in place for prevention and detection. Audit procedures alone cannot guarantee that fraud will be detected.

Standards

The Accounts and Audit (Amendment) (England) Regulations 2006 refer to “proper practices in relation to internal control”. Guidance to the Regulations states that “proper practices” are included in the Code of Practice for Internal Audit issued by CIPFA. The Internal Audit Service will perform to the standards laid down in the Code. It will also follow other guidance issued, for example, by CIPFA, the Audit Commission and the Institute of Internal Auditors.

Adherence to these standards will be monitored by the Audit Manager, by the external auditors and by best practice benchmarking with other internal audit teams.

Feedback on the Service’s performance will be sought from the appropriate line manager at the conclusion of every audit. There will also be an annual exercise to obtain feedback on the service as a whole.

Every effort will be made to preserve objectivity by ensuring that all members of the audit team are free from any conflicts of interest and do not undertake any non-audit duties.

The Audit Committee will receive an annual report on the effectiveness of the system of internal audit.

Independence

If Internal Audit is to function in an effective and objective manner it is vital that it is seen to be independent of those activities which it audits and has no executive responsibilities. To ensure this, Internal Audit will operate within a framework that allows:

- unrestricted access to the Chair of the Audit Committee, other elected Members as necessary, the Mayor, the Head of Paid Service and senior management
- the Audit Manager having the right to meet the Audit Committee in private should the need ever arise
- reporting in its own name
- separation from other service responsibilities.

Audit will, if deemed appropriate, review systems under development without prejudicing its ability to subsequently independently audit such systems.

The duties of individual auditors will be rotated to avoid potential conflicts of interest and/or possible complacency brought about by familiarity with the activity under audit. This will be subject to the practicalities of rotation within a small team and the need for auditors to acquire the expertise in a particular field that can only be achieved over time.

Whenever a contractor is appointed to provide internal audit services the Audit Manager will implement a vetting process to ensure that, if that contractor also provides non-audit services to the Council, there are no potential conflicts of interest.

In the event of a member of staff from another council service being appointed as an internal auditor, the Audit Manager will ensure that person does not normally carry out audit in the area of previous operational responsibility within a period of two years.

The Risk and Insurance Manager reports to the Audit Manager, although the Director of Finance is the lead officer on risk management. The Audit Manager will not become involved in insurance related matters and will only provide a lead on risk management. Day to day implementation of the risk management framework will remain the responsibility of the Risk and Insurance Manager. This will ensure that Internal Audit retains its independence when auditing risk management arrangements.

The Fraud Manager, who will retain day to day responsibility for management of the benefit fraud investigation team, also reports to the Audit Manager. The two managers will work together in promoting fraud awareness and Internal Audit staff will participate in the investigation of non-benefit fraud.

Planning

In order to effectively discharge the Service's responsibilities the Audit Manager will prepare an annual audit plan based on an assessment of risks faced by the Council. Consultation will take place with the external auditors and corporate and service level management. The plan will be subject to formal approval by the Audit Committee.

Reporting

A formal report will be issued at the completion of every audit.

Every report will include an opinion on the control environment and degree of risk exposure.

Draft reports will be sent to the line managers responsible for the activity under review for agreement to the factual accuracy of the issues raised in the report. A plan of action for remedying any weaknesses highlighted in the draft report will be agreed.

Once agreement has been reached, the final report will be issued. Copies of this version will automatically go to the Head of Service for the area under review, the line manager with direct responsibility, members of the Corporate Management Board and the external auditors.

Effective follow-up arrangements will be put in place to ensure that audit recommendations are implemented.

A quarterly report outlining progress against the audit plan, performance against key service performance indicators and issues arising from audit work will be presented to the Audit Committee.

The Audit Manager will issue an annual report to the Audit Committee giving an opinion on the effectiveness of the control environment.

The Audit Manager reports to the Director of Finance (Section 151 Officer). Monthly meetings will be held between the two officers to discuss progress, current issues etc.

Resources

The Audit Manager will be responsible for maintaining an audit team of sufficient size, knowledge, skills and experience to enable him to discharge his responsibilities and to implement the Audit Plan. Any shortfall in resources will be raised with the Director of Finance with a view to seeking temporary or permanent additional staff. Should this resource not be available the consequences will be assessed and reported to the Audit Committee.

If it becomes necessary to use an internal audit contractor the Audit Manager will be responsible for avoiding or managing any perceived conflicts of interest should that contractor also provide non-audit services to the Council.

The Audit Manager will be professionally qualified and the other members of the team will be qualified or will be expected to study for membership of the Institute of Internal Auditors or other relevant qualification. All staff will be experienced in internal audit work, preferably for a local authority.

The development and training needs of all staff will be continuously reviewed in accordance with Service requirements and the principles set out in the Council's performance appraisal procedures.

Upon request from the Director of Finance appropriate specialists from other services will be made available to assist in any audit or study requiring specialist knowledge.

September 2007