



Nottinghamshire
County Council

Report to Audit Committee

30 November 2011

Agenda Item:

REPORT OF SERVICE DIRECTOR (FINANCE)

TERMS OF REFERENCE FOR INTERNAL AUDIT

Purpose of the Report

1. To advise Members of the Committee of proposed changes to the Terms of Reference for Internal Audit.

Information and Advice

2. The Terms of Reference for Internal Audit were last revised in July 2007. Since then, there have been a number of changes in the organisational structure of the Authority, in addition to changes in the Accounts and Audit Regulations. Following the appointment of a new Service Director (Finance), he has decided that the Head of Internal Audit should report directly to him, to more closely meet the requirements of CIPFA's Code of Practice for Internal Audit in Local Government in the United Kingdom.
3. The Terms of Reference have been amended to reflect these changes and are set out in Appendix 1. The deleted parts have been ~~struck through~~ and the additions are shown in **bold italics** for clarity.
4. The main changes are:-
 - a) The post of 'Head of Internal Audit' now has responsibility for Internal Audit and will report directly to the Service Director (Finance). This follows the streamlining of the organisational structure.
 - b) The Terms of Reference now refer to the Accounts and Audit Regulations 2011 (paragraphs 1.1 and 3.2)

Other Options Considered

5. No other options were considered.

Reason/s for Recommendation/s

6. The Terms of Reference for Internal Audit have become out-dated and need to be revised.

Statutory and Policy Implications

7. This report has been compiled after consideration of implications in respect of finance, equal opportunities, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

8.

RECOMMENDATION

1. The revised Terms of Reference for Internal Audit are agreed.

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Constitutional Comments (KK 1/11/11)

9. The proposals within this report are within the remit of the Audit Committee.

Financial Comments (JMB 28/10/11)

10. There are no financial implications arising from this report or its recommendation.

Background Papers

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972:

CIPFA's Code of Practice for Internal Audit in Local Government in the United Kingdom.

Electoral Division(s) and Member(s) Affected

All

Terms of Reference for Internal Audit

1. INTRODUCTION

- 1.1 These terms of reference define Internal Audit's role within the County Council. They accord with the requirements and guidelines of the Local Government Act 1972, the Accounts and Audit Regulations ~~2006~~ **2011**, CIPFA's Code of Practice for Internal Audit *in Local Government in the United Kingdom* and the County Council's Financial Regulations.

2. RESPONSIBILITIES AND OBJECTIVES

- 2.1 Internal Audit is an assurance function that primarily provides an independent and objective opinion to the County Council on the control environment comprising the system of governance, risk management and control by evaluating its effectiveness in achieving the organisation's objectives.
- 2.2 It objectively examines, evaluates and reports on the adequacy of the Authority's entire control environment as a contribution to the proper, economic, efficient and effective use of resources.

In particular it:

- (a) examines and assesses financial and other systems and procedures
 - (b) provides management and Members with advice and assurance to assist them in the effective discharge of their responsibilities
 - (c) plans audit work having regard to the Authority's corporate plans.
 - (d) provides an annual Internal Audit opinion on the effectiveness of the Authority's control environment.
- 2.3 In addition, the Section undertakes internal consultancy work, carries out suspected irregularity investigations and provides an audit service, on a contract basis, to specific external clients.
- 2.4 In carrying out consultancy work, the Internal Audit role is to assist management in the achievement of the Authority's objectives. The work involved may cover facilitation, process design, training, advisory services and investigatory work. For most assignments, specific terms of reference will be drawn up to define the scope and limits of the work involved. In overall terms, in order to ensure it can deliver its assurance work, Internal Audit aims

to limit its consultancy and irregularity work to approximately 10% of its available resource.

3. **SCOPE**

3.1 The scope of Internal Audit's work covers the entire internal control environment of the Authority including all its operations, resources, services and responsibilities in relation to other bodies. It involves reviewing, evaluating, reporting and delivering an opinion on the control environment established by management to:

- (a) establish and monitor the achievement of the organisation's objectives
- (b) identify, assess and appropriately manage the risks to achieving the organisation's objectives
- (c) facilitate policy and decision making
- (d) ensure the economical, effective and efficient use of resources
- (e) ensure compliance with established policies, procedures and regulations
- (f) safeguard the Authority's assets and interests from losses of all kinds, including those arising from:
 - fraud, irregularity or corruption
 - waste, extravagance and inefficient administration and other causes
- (g) ensure the integrity and reliability of management information, accounts and data, including internal and external reporting and accountability processes.

3.2 Internal Audit's work will also cover ~~corporate governance issues~~ ***the Local Code on Corporate Governance***, which are a key part of the Authority's ***internal*** control environment. Overall, the results of Audit work will allow the ~~Service Manager~~ ***Head of Internal Audit*** to deliver an audit opinion on the effectiveness of the Authority's internal control environment ***and contribute to the Annual Governance Statement***, as required by the Accounts and Audit Regulations ~~2006~~ ***2011***.

3.3 Responsibility for the design and correct operation of internal controls rests with departmental managers. Internal Audit is not a substitute for effective internal control. Its task is to carry out an independent review of the soundness of internal control systems to highlight weaknesses and recommend improvements where necessary. Accountability for the response to the advice and recommendations of Internal Audit lies with management, who either accept and implement the advice or formally reject it. Where

specific Internal Auditors have advised on the development of systems or policy, they will be precluded from carrying out audits on these areas.

- 3.4 Internal Audit's work may also cover key systems which are being operated, or key systems provided, on behalf of other organisations by the Authority or by other organisations on behalf of the Authority. Any such arrangements will be identified via liaison with management.
- 3.5 Where services are provided in partnership, assurance will be sought from sample reviews of the arrangements in place including contractual relationships and performance management.

4. **RIGHT OF ACCESS**

- 4.1 To undertake the work involved, Internal Auditors have unrestricted access to all the Authority's, and partner organisations', personnel, premises, documents, records, information and assets. They have authority to access all computer data as part of their work, including that registered under the Data Protection Act.
- 4.2 Internal Auditors are authorised to obtain such information and explanations they consider necessary from any employees or agents of the Authority to fulfil their objectives and responsibilities.
- 4.3 They have rights of access to any data required for their work that is owned by the Authority, or that is processed or held elsewhere by third parties.
- 4.4 The ~~Service Manager~~ **Head of Internal Audit** has the right of direct access to the ~~Strategic Director of Resources~~ **Service Director (Finance)**, Chief Executive and Members including the Chair of the Audit Committee.

5. **INDEPENDENCE**

- 5.1 The Internal Audit Section is organised so that it is independent of the activities that it audits and free from any non audit duties. Because of this, the Section can provide impartial and unbiased professional opinions and recommendations. Internal Audit is free to plan, undertake and report on its work, as the ~~Service Manager~~ **Head of Internal Audit** deems appropriate.
- 5.2 The status of the Head of **Internal** Audit is sufficient to allow the effective discussion of audit strategies, plans, results and improvement plans with Senior Management in the organisation.
- 5.3 Internal Audit is accountable to the ~~Strategic Director of Resources~~ **Service Director (Finance)** and the Authority's Audit Committee, both being involved in determining its priorities. It reviews the resources available to it on a regular basis to ensure that it has sufficient resources to fulfil its

responsibilities, reporting the results of the review to the Audit Committee, as part of its annual planning process.

- 5.4 Regular contact occurs with the ~~Strategic Director of Resources~~ **Service Director (Finance)** - the Authority's Section 151 Officer, and the Authority's Monitoring Officer as the key officers with statutory responsibilities in relation to the internal control environment.

6. **AUDIT COMMITTEE RESPONSIBILITIES**

- 6.1 Internal Audit has a responsibility to report to the Authority's Audit Committee. The Committee is chaired by a Member of the Opposition and consists of eleven members. The Committee meets ~~three~~ **five or six** times a year and has clear terms of reference. It reviews both Internal and External Audit work throughout the Authority and contributes to the organisation's overall process for ensuring that an effective internal control environment is maintained.

- 6.2 The Committee reviews, agrees and comments upon a number of areas including:

- (a) the annual review of the effectiveness of the Authority's system of internal control
- (b) Internal Audit's terms of reference
- (c) Internal Audit's Annual Report, (including the opinion of the Authority's systems of internal control)
- (d) Internal Audit's Strategy, Annual Plan and Progress against the Plan (including key findings and recommendations)
- (e) External Audit's Annual Audit Letter, Annual Plan and progress reports
- (f) Reports on the implementation of Internal Audit recommendations
- (g) Reports on relevant Audit Commission and other public sector publications concerning general audit developments
- (h) Any significant audit issues that may arise within the Authority
- (i) the annual statement of accounts via the External Auditor's report on issues arising from the audit of the accounts
- (j) the Council's Financial Regulations and anti fraud and anti corruption strategies.

- 6.3 The ~~Head of Service and Service Manager~~ **Head of Internal Audit** attends every meeting and presents Internal Audit reports to the Committee.

7. **SUSPECTED IRREGULARITY INVESTIGATIONS**

- 7.1 In accordance with the Authority's Financial Regulations, Internal Auditors carry out investigations into suspected financial irregularities potentially involving fraud and corruption. All managers have an obligation to maintain an effective internal control system within their areas of work, and this includes a

responsibility for the prevention and detection of fraud, corruption and other irregularities as well as managing the risks of fraud or corruption.

- 7.2 However, Internal Auditors when conducting audit assignments are alert to circumstances, such as control weaknesses, that could allow fraud. If any evidence of fraud or other irregularity is discovered the relevant line manager is informed.
- 7.3 Managers are required to inform Internal Audit immediately if a fraud or other irregularity is suspected. In such cases, they should ensure that:
- Any supporting information or other evidence is secured
 - Confidentiality is maintained so as not to prejudice any subsequent investigation.
- 7.4 Internal Audit will consider each suspected fraud or irregularity and determine whether to investigate it itself or to resolve it by another means eg referral to the Police, as appropriate. An established link exists with the Police which allows both formal and informal liaison on any suspected irregularity issues. Formal referral occurs after consultation with Legal Services. It is the responsibility of the relevant line manager to determine what action to take as a result of the investigation.
- 7.5 The ~~Service Manager~~ **Head of Internal Audit** may carry out other special investigations, including suspected non financial irregularities, at the request of the ~~Strategic Director of Resources~~ **Service Director (Finance)** or other Senior Managers.

8. INTERNAL AUDIT STANDARDS

- 8.1 Internal Audit operates in accordance with the Code of Practice for Internal Audit in Local Government *in the United Kingdom* issued by CIPFA. Compliance with the Code is reviewed regularly both by the ~~Head of Service~~ **Head of Internal Audit** and the External Auditor.
- 8.2 A thorough recruitment process, in accordance with the Authority's procedures, applies to the appointment of Audit staff, to ensure the Section has the appropriate professional skills and experience to fulfil its objectives. The ~~Service Manager~~ **Head of Internal Audit** must be a qualified accountant with at least 5 years audit and managerial experience. Similarly, the ~~Group Managers~~ **Audit Team Leaders** should be appropriately qualified with at least 3 years audit and managerial experience. The qualifications and skills required for all posts are detailed in job descriptions and person specifications maintained by the ~~Service Manager~~ **Head of Internal Audit**.

8.3 Internal Auditors are provided with the appropriate training to fulfil their responsibilities and maintain their professional development and competence. The ~~Service Manager~~ **Head of Internal Audit** monitors the overall training provided to Internal Audit staff.

9. INTERNAL AUDIT STRATEGY

9.1 Internal Audit work is planned at all levels of operation in order to establish priorities, achieve objectives and ensure the efficient and effective use of audit resources.

9.2 The ~~Service Manager~~ **Head of Internal Audit** produces an Internal Audit Strategy consisting of a three year plan and an annual plan. The plans are developed in consultation with the ~~Strategic Director of Resources~~ **Service Director (Finance)**, **Corporate Directors** and Senior Managers. The Strategy details how assurance will be demonstrated. In addition, the Strategy reviews whether the Internal Audit Section's resources are sufficient to complete the audit work necessary allowing the ~~Service Manager~~ **Head of Internal Audit** to raise resourcing issues with both the ~~Strategic Director~~ **Service Director (Finance)** and Audit Committee if necessary.

9.3 The Internal Audit plans are subject to annual revision and approval by the ~~Strategic Director of Resources~~ **Service Director (Finance)** for reporting to the Audit Committee. These plans include an element of contingency to allow Internal Audit to be responsive to changes in conditions and to requests for assistance from managers. They also take account of the Authority's assurance, risk management and monitoring processes with the aim of identifying and evaluating any residual risks, not covered by appropriate control mechanisms, that need to be included in the Internal Audit Plan. The Plan process also involves assessing, through ongoing liaison with management and External Audit, any new developments or significant changes in the Authority's responsibilities. The External Auditor's Plan of work is also taken into account in determining the Internal Audit Strategy.

9.4 Objectives are prepared for each routine Internal Audit assignment and are normally discussed with relevant line managers before the work is started. Internal Audit will usually give reasonable notice to the relevant manager of the start of an audit and will minimise any disruption to the smooth running of the area under review. However, Internal Audit reserves the right to make unannounced visits where the ~~Service Manager~~ **Head of Internal Audit** considers it necessary.

9.5 The Section adopts a structured approach to all its work including the use of a risk based systematic approach, where appropriate, for opinion audits.

10. **INTERNAL AUDIT REPORTING**

- 10.1 Internal Audit reports its findings to appropriate managers, who have a responsibility to respond promptly to the reports' recommendations. Recommendations are risk ranked and reports contain an audit opinion on the area and control environment reviewed. There are four separate audit opinions, namely sound, satisfactory, unsatisfactory and unsound. If an opinion is unsatisfactory or unsound, a follow-up audit is carried out approximately six months later to ensure that the recommendations have been implemented.
- 10.2 Where the opinion is sound or satisfactory, the Internal Audit Section reviews the implementation of agreed recommendations the next time the area is audited. In the case of unsatisfactory and unsound opinions, if the recommendations have still not been implemented when the follow-up audit is carried out, then this is reported to the Audit Committee who raise the issue with the relevant Managers concerned.
- 10.3 Audit reports are circulated to the relevant Cabinet Members and Opposition Members and Audit Committee Members so that they are aware of audit findings in their areas of responsibility. Members can raise queries on reports as appropriate by contacting the ~~Service Manager or Internal Audit Staff~~ **Head of Internal Audit or Audit Team Leaders** direct on issues which concern them. This direct access by Members to Internal Audit applies in any situation where Members wish to raise any issues of concern with Internal Audit.

11. **RELATIONSHIPS**

- 11.1 The ~~Service Manager~~ **Head of Internal Audit** co-ordinates Internal Audit Plans and activities with the External Auditors to ensure the most efficient use of the total resources devoted to audit work. Regular liaison meetings take place during the course of the year and a Joint working agreement ensures effective co-operation.
- 11.2 Internal Auditors foster constructive relationships with Members, managers and others involved in the areas being audited, and also with other review and specialist agencies that it may encounter as part of its work.
- 11.3 Liaison with managers takes place at key stages of the audit process namely planning, undertaking, reporting and responding to, audits. The guiding principle adopted throughout is one of assistance in the achievement of the Authority's objectives.

12. **QUALITY OF SERVICE**

- 12.1 The ~~Head of Service~~ **Head of Internal Audit** reviews the work of the Section to provide assurance that it conforms with the relevant standards and requirements of these Terms of Reference.
- 12.2 The Internal Audit Section takes the following actions to provide a quality service:
- Adopts a flexible risk driven approach
 - Works in partnership with managers and staff to develop and maintain adequate and reliable systems of internal control
 - Continually seeks to improve the effectiveness and efficiency of its services in consultation with managers from across the Authority
 - Maintains an effective Audit Manual detailing procedures and processes to be followed
 - Monitors and reports on specific performance indicators and targets
 - Carries out an internal quality review to ensure standards are being met.
- 12.3 The quality and scope of Internal Audit work is also regularly reviewed by the Authority's External Auditors.