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Argyll and Bute Council

Internal audit needs assessment,
strategic plan 2002-3 to 2004-5 and
annual plan 2002-2003

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1 Introduction

The purpose of this document is to inform the audit committee of proposed plans for the Council's internal audit service for the three years ending in 2005. The strategic and annual internal audit plans reflect internal audit's understanding of the needs of the Council based on a review of the strategic and business issues facing the Council at this time, together with knowledge of the local government.

1.1 Scope

1.1.1 Section 95 of the Local Government Act 1972 requires authorities to 'make arrangements for the proper administration of their financial affairs and shall secure that the proper officer has responsibility for those affairs.' Additionally, Scottish Office circular 5/85 states that effective internal audit cover is regarded as a matter of good practice. The prime responsibility of the internal audit function at Argyll and Bute Council is to provide members, the audit committee, chief executive officer and Council management with an effective assessment of the adequacy and effectiveness of its internal control systems. Responsibility for internal controls rests fully with Council management.

1.1.2 The scope of internal audit covers all of the Council's internal control systems, covering all activities – financial and non-financial. The work is to be performed in accordance with the CIPFA *Code of Practice for Internal Audit in Local Government in the United Kingdom* ('the Code'). This requires the internal audit function to provide an objective assessment of the adequacy, reliability and effectiveness of the Council's internal control system.

1.2 Terms of reference

1.2.1 Internal audit will operate to terms of reference agreed with the Council's audit committee. In accordance with the Code, these terms of reference will:

- Establish responsibility and objectives of internal audit;
- Establish the position of internal audit within the organisation;
- Define the scope of internal audit; and
- Establish internal audit's right of access to all records, assets, personnel and premises, and its authority to obtain such information and explanations, as it considers necessary to fulfil its responsibilities.

1.2.2 Internal audit's terms of reference will be prepared based on guidance from the Code. This will ensure full coverage of the Council's operations is included within the coverage of internal audit and sufficient authority is given.

1.2.3 Internal audit performance measures will be reported against annually to the audit committee.

2 Audit needs assessment

An audit needs assessment defines the various areas and topics requiring audit, and ranks them in order of priority, thus ensuring that audit resources are efficiently and effectively targeted. It further enables the audit committee to review the effect of any decision it makes regarding audit scope and resources. Additionally, Council management and internal audit are able to determine the level of internal audit work which is appropriate to enable a reasonable level of assurance to be given on the Council's systems of internal control.

2.1 Methodology

2.1.1 The process of preparing the audit needs assessment involved:

- identifying key areas of the Council's activities;
- obtaining the views of senior management to gain a view of strategic and business risk, and the specific areas which should be considered high risk;
- assessing the vulnerability (risk) and controls effectiveness of each area of work;
- grouping these for audit purposes;
- determining the periods over which all systems will be audited;
- estimating the resources required to meet audit needs.

2.1.2 The needs assessment process considers the inherent risk and effectiveness of controls associated with each system and results in the allocation of a 'total risk' score for each. The number of audit days is subsequently determined based upon this score, while also using knowledge and judgement to decide whether the audit frequency and days are appropriate.

2.1.3 The following factors were considered in allocating risk factors to specific areas:

- ✓ **materiality** - an assessment of financial size;
- ✓ **inherent risk** - the risk associated with a particular activity due to its very nature, and the level of sensitivity attached to a possible breakdown in the effective operation of that system;
- ✓ **controls effectiveness** - an assessment of the degree of control that management currently has over the inherent risks; and
- ✓ **management views** - from discussions with senior management an assessment was made of any areas of particular concern. Previous audit experience of the internal control risk was also considered in this assessment.

2.1.4 In producing the needs assessment, internal audit considered both the financial and non-financial systems operating within the Council. Both of these categories are of critical importance in terms of managing the Council's activities and meeting the mission and objectives of the Council.

2.1.5 A risk score based on the above factors was allocated to each system, along with management's assessment of the

effectiveness of the controls in place for these risks. These are set out in appendices one to three, although it should be noted that assessment is a continuing process and factors may well change overtime.

2.1.6 For financial systems, internal audit have included an assessment of materiality, however, in assessing priorities for non-financial systems, value for money and consideration of management arrangements, internal audit have excluded the financial materiality rating and used a rating for 'management priority/experience'.

2.1.7 Each independent element within the risk assessment was awarded a ranking between one and five, with five being the highest risk. *Controls* were ranked in a similar way, with five being for the least effective controls. The *materiality* rating was also scored out of five, with five being for the highest values and *management views* were rated between three for high priority and a one for normal priority. Internal audit have weighted the risk scores, with inherent risk having greater weight. Financial systems are therefore rated between nil and 50. The non-financial, value for money and operational management arrangements are rated between nil and 44. Higher scores are therefore more likely to need reviewing. These scores were based on discussions with Council management.

2.1.8 This overall assessment is therefore determined using a combination of the risk factors, management comment and internal audit's experience of individual systems and the environment in which they operate.

2.2 Specific issues identified

2.2.1 In completing this needs assessment, internal audit met with the senior management in the Council to identify specific areas of risk where audit resources should be allocated.

2.2.2 Following these discussions, which included both current and potential issues across the whole Council, internal audit identified a number of possible review areas. These include the following:

- Education private public partnership (PPP)
- Housing stock transfers;
- Waste management PPP;
- Leisure activities;
- Contribution to Best Value reviews;
- Review of governance and risk management processes;
- Review of performance indicator systems and PMP;
- Specific reviews of departments;
- Capital accounting;
- Housing benefits; and
- Non-domestic rates.

2.3 Resources required

2.3.1 Internal audit have produced the needs assessment which is shown at appendix four. This covers the higher risk areas in the next three years. The assessment indicates that adequate audit coverage can be met with 1,441 days (including KPMG partnership time). This is subject to agreeing the specific internal audit scope and objectives of each assignment to cover necessary risks and additional requests from management and the audit committee.

2.3.2 In considering the needs assessment, the audit committee may determine whether:

- additional resources should be provided; and/or
- audit scope or timescales, and hence assurance, should be modified.

2.3.3 Internal audit believe this provides adequate audit coverage for the Council and reflects the developments occurring in the Council over the next three years.

2.3.4 Whilst the needs assessment has been prepared on the basis of information provided and discussions held, it should be recognised that the results of the work undertaken during each period will influence the needs assessment for future years and may require a level of input which is either higher or lower than that now proposed.

2.3.5 Appendix 5 sets out the number of available audit days based on the number of internal audit posts.

2.4 Supporting Argyll and Bute Council objectives

2.4.1 The Council's overall aim is to play a full part in improving the quality of life and opportunities for the people of Argyll and Bute.

2.4.2 In providing the audit committee and management with assurance over the Council's key financial and operational systems and input to Best Value and value for money reviews, internal audit will contribute to the Council achieving its goals.

2.4.3 Internal audit will contribute to the Council's aims and objectives in accordance with the Council's defined values.

2.4.4 A key influence on the work of internal audit is the report by the value for money report produced by Accounts Commission. Action points from this report are being addressed by internal audit to ensure the most value to provided to the Council.

3 Detailed strategic and annual internal audit plans

The main components of the strategic internal audit plan are considered in this section, included within this is the draft annual internal audit plan (appendix four) for 2002-2003 for consideration by the audit committee.

3.1 Strategic internal audit plan

3.1.1 The strategic plan provides a framework within which the internal audit work is carried out and ensures that internal audit resources are effectively planned and controlled. It should be seen as a flexible management tool which meets the following objectives:

- a clear view of the workload of the internal audit team;
- a base for assessment of the adequacy and future deployment of audit resources;
- a yardstick against which progress and performance can be measured;
- providing authority to act once it is approved by the audit committee; and
- a permanent record of the factors considered and judgements made.

Core financial systems

3.1.2 These are the systems fundamental to the financial management of the Council because of their size and importance and so include significant systems such as income and expenditure streams.

3.1.3 These financial systems include:

- Budgetary control;
- Capital accounting;
- Capital contracts;
- Cash collection and income banking;
- Council tax and non-domestic rates;
- Housing and Council tax benefits;
- Housing rents;
- Payroll;
- Purchases, tendering and certifications;
- Treasury management; and
- Sundry debtors.

Non financial systems

3.1.4 Although it will always remain a key audit requirement for a continuous review of financial systems, internal audits approach will also focus on non-financial systems and specific strategic and business issues. The Code requires that internal audit not only look at the financial systems but also other systems of management control used to ensure the Council's objectives are met.

Department reviews

- 3.1.5 As part of systems reviews, internal audit will cover a range of issues which will require contact with the Council's departments, both central and devolved. Internal audit will seek to carry out reviews of departments as shown in the plan or requested by Council management.

Computer audit

- 3.1.6 In view of the significance of information technology for controlling Council activities and providing management information, the risk ranking in the needs assessment and comments by Council management, internal audit will include reviews over general IT controls, security and IT strategy which are in place. Audit focus in this area will be co-ordinated with KPMG specialists and the external auditor, Audit Scotland.

Value for money (VFM) reviews

- 3.1.7 The economic, efficient and effective use of resources in all areas is fundamental in ensuring that the Council can operate successfully on an ongoing basis. As internal auditors, in reviewing and appraising systems and controls, internal audit will also evaluate the control arrangements established and operated by the Council's management to achieve VFM.
- 3.1.8 Specific areas offering scope for a VFM review have been reported in the appendix. These reviews will focus on ensuring activities, processes and services operate efficiently and effectively.

Best Value and performance indicators (PI's)

- 3.1.9 The best value framework requires local authorities to deliver robust, challenging reviews of their functions in order to secure improvements in service delivery. Councils have to ensure they have robust systems for ensuring appropriate performance management and monitoring.
- 3.1.10 Internal audit will contribute to best value and performance measurement through input to reviews currently planned and through assessing systems for ensuring performance. Internal audit can test and challenge performance management systems (financial and non-financial PI's) to contribute to best value.

Audit follow-up

- 3.1.11 For internal audit to be as effective as possible, its recommendations need to be implemented. To provide assurance that this is happening, a provision of time is included within the strategic plan to enable internal audit to monitor pro-actively the progress made towards implementing agreed audit recommendations.
- 3.1.12 There will be a follow-up exercise undertaken each year to assess the extent of progress made on past internal audit recommendations.

Contingency

- 3.1.13 Contingency audit time is to allow for input into unforeseen events which, by their nature, cannot be planned for, for example:
- notification of frauds, significant weaknesses or loss;
 - consideration of controls for new or amended systems; and
 - reviews of significant breakdown of internal control which cannot be accommodated within planned audits.
- 3.1.14 Clearly, the extent to which any contingency will arise depends on the soundness of the Council's systems of control and the incidence of fraud or irregularity.
- 3.1.15 It is important that a flexible approach is adopted in determining internal audit resources and therefore internal audit has built in a contingency element to plan. This is approximately 10% of the total planned time.
- 3.1.16 Where, due to the nature or extent of the skills required, consideration will be given to using external specialist skills.
- 3.1.17 Such contingency work might include specific investigations or the provision of specialist advice and assistance on certain matters.

The strategic and annual internal audit plans translate the results of the needs assessment exercise into a detailed schedule of assignments. Over the planned period, these assignments will address the areas of risk identified by the needs assessment and will allow internal audit to provide an annual assurance statement on the Council's overall control framework.

3.2 Annual internal audit plan

- 3.2.1 The draft plan for 2002-2003 is shown at appendix four and includes a brief summary of the broad objectives for each the assignment.
- 3.2.2 The annual plan breaks down the areas identified in the needs assessment and strategic plan into the proposed areas of coverage for 2002-2003. Consideration has been given both to the comments made by management and the time since an area was last audited. The plan has been structured to help ensure that reviews provide a service to the audit committee and Council management by:
- identifying and assessing the system of internal control;
 - assessing compliance with established and expected standards of controls and procedures; and
 - making recommendations designed to improve internal control. This approach allows internal audit to examine all key controls and also to identify value for money issues or opportunities within systems work.
- 3.2.3 As part of managing the internal audit function, issues raised by the Accounts Commission, through the Council's previous external audit, will be addressed through the coming period.