

# Great Aycliffe Town Council

## Internal Audit Code of Practice



**Finance Section**

**May 2008**

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## **1.0 Introduction**

1.1 The purpose of this Audit Manual is as follows:

- To provide a statement of the purpose, powers and objectives of the Council's Internal Audit Service (Internal Auditor).
- To specify the standards, procedures to be followed, and the documentation to be used by the Internal Auditor.
- To act as a reference source for the Internal Auditor with respect to required standards and procedures.
- To act as a training manual and reference source for all future Internal Auditors.

## **2.0 Terms of Reference**

2.1 The Internal Auditor is an independent appraisal function which must be provided to the Council as a requirement of The Accounts and Audit Regulations 2003. The Regulations specifically require that:

“a relevant body shall maintain an adequate and effective system of internal audit of their accounting records and control systems”.

2.2 The Internal Auditor is required to objectively examine, evaluate and report on the adequacy of the internal control systems as a contribution towards ensuring that the Council's financial management arrangements are sound, that it has an effective system of internal financial control including the management of risk and the prevention and detection of fraud and that it has put in place arrangements for securing economy, efficiency and effectiveness in its use of resources.

2.3 To this end it is the responsibility of the Internal Auditor to evaluate and report on the soundness and adequacy of the internal controls in promoting the following:

- The completeness, accuracy, and reliability of records for the production of effective management information and accounts.
- Compliance with the Council's established and approved policies, procedures and regulations.
- The protection of all of the Council's assets and interests.
- The securing of best value and value for money in the provision of all services.

### **3.0 Internal Audit Policy**

- 3.1 In order to meet Internal Audit objectives, as detailed in the above Terms of Reference, the Internal Auditor has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Internal Audit in Local Government 2006. The Code details the duties and responsibilities of Internal Auditors as well as the standards expected of them.
- 3.2 The Internal Audit Service is independently assessed by the Council's external auditors, the Audit Commission, periodically and it is judged whether the Internal Audit Service is complying with the terms of The Code.

### **4.0 Standards and Independence**

- 4.1 In order for the Internal Auditor to provide an audit service of the highest standard it is essential that he or she enjoys sufficient independence in the conduct of their work. This means independence in terms of organisational status and personal objectivity.
- 4.2 Independence can only be secured through adequate scope, authority and objectivity. In order to achieve these criteria the Internal Auditor must be completely independent of the services and systems which they audit. The Internal Auditor must be free to determine their own objectives and priorities.
- 4.3 The Internal Auditor must have the necessary access and the freedom to report to all senior management, including the Town Clerk, Finance Manager, Corporate and Policy Officer and members of the Council's Audit Sub Committee.
- 4.4 The Internal Auditor should operate with an objective attitude of mind, and must be free from any conflict of interest arising from personal or professional relationships, pecuniary or other interests, or any other undue influences. They should be free to exercise judgement, express opinions, and present recommendations with complete impartiality.

### **5.0 Staffing and Training**

- 5.1 It is the responsibility of the Finance Manager and the Internal Auditor to maintain a staffing structure which allows the fulfilment of Internal Audit Plan.
- 5.2 It is the responsibility of the Finance Manager to ensure that the training requirements of the Internal Auditor are identified and the relevant training provided.

- 5.3 The training requirements of the Internal Auditor are assessed as part of the Council's Personal Development Review process which was itself developed as a requirement of the Investors in People accreditation. The Internal Auditor receives an annual appraisal in which training and development needs are discussed and assessed, which results in an individual training plan.
- 5.4 This helps to fulfil the responsibility placed on the Finance Manager in the Accounting Practices Boards Guidelines for Internal Audit to ensure that:
- The training requirements of the Internal Auditor are identified, coordinated and kept under review.
  - Adequate training programmes are in place for the Internal Auditor

## **6.0 Relationships**

- 6.1 The Internal Auditor is responsible for developing and maintaining a wide range of constructive relationships with Members, service managers, other officers and external agencies and in particular the Audit Commission. This is primarily to encourage co-operation between service managers and the Internal Auditor in order to make best use of the available audit resources.
- 6.2 In particular, the relationship between the Finance Manager and Internal Auditor and the Audit Commission, must be focussed on close co-operation and co-ordination of audit resources to achieve the best results. The Audit Commission place reliance on the work of the Internal Auditor when forming the annual audit opinion.
- 6.3 The Internal Auditor must be tactful and exercise discretion in carrying out their duties, and must render assistance and advice to clients when requested. The Internal Auditor must ensure that any sensitive matters arising from their audit work are treated with the utmost confidentiality.
- 6.4 It is the responsibility of the Internal Auditor to ensure that the elected members are kept aware of the role, responsibilities and on-going Internal Audit work, by reporting to the Council's Audit Sub-Committee.

## **7.0 Due Care**

- 7.1 The Internal Auditor is expected to perform their work with the necessary diligence, competence, care and skill in order to demonstrate due care. They are also bound to act with integrity, and to discharge their duties in an honest, fair, and truthful way. In order to demonstrate this, the Internal Auditor must be able to evidence that their work has been performed in a way that is consistent with the relevant professional standards i.e. The CIPFA Code of Practice.
- 7.2 The Internal Auditor must be beyond reproach in the execution of their duties. They must be free from bias, prejudice and undue influence and must never place themselves in a position where personal interests conflict with their professional duties. Any such interests must be declared. Gifts and other rewards should never be accepted.

## **8.0 The Annual Audit Plan**

- 8.1 The Finance Manager and Internal Auditor have a responsibility to plan, control and direct the work of the Internal Audit Service. The main objectives of the planning process are as follows:
- To determine priority areas and audit objectives and to identify the most cost effective way of achieving them.
  - To control and direct audit work.
  - To ensure that audit work is concentrated in the most critical or high risk areas.
  - To ensure that audit work is completed in accordance with predetermined targets.
- 8.2 It is essential that Internal Audit, in accordance with professional standards, plans, controls, and records its work. An Audit Plan is produced annually which involves balancing the audit work to be carried out against the staffing hours available. In order for audit work to be effective it must be adequately planned and subsequently controlled.
- 8.3 In addition to providing a means of matching internal audit staffing resources to audit priorities, the Annual Audit Plan also provides the following:-
- A performance target and a basis for monitoring and control and thus demonstrating best value.
  - A method of communicating audit plans and justifying the use of audit resources to management and Members.

- 8.4 The Plan is prepared by the Internal Auditor and the Finance Manager and is submitted to the Audit Sub-Committee for approval. The Plan is monitored on a monthly basis and a quarterly progress report is taken to the Audit Sub-Committee. The Plan is updated at the end of every year and an indicative three year rolling programme of work is now in place. A copy of the current three year rolling Audit Plan is attached at Appendix 1.
- 8.5 The plan is prepared by calculating the man hours available, taking into account annual leave and bank holidays, training, and a contingency for unplanned issues, and then prioritising the required audit work according to the following criteria:-
- Outstanding audits carried forward from the previous year;
  - The level of risk if the audit was not carried out;
  - Whether the area is a major source of income or expenditure for the Council;
  - Past experience;
  - The recommendations and follow up of previous audits;

All key systems and service areas are audited annually.

A formal risk assessment exercise is not currently undertaken to prioritise audit work, although risk management arrangements are in place corporately and a corporate risk register is in place.

- 8.6 Any necessary amendments to the plan e.g. as a result of additional work arising during the year etc, are made towards the end of a financial year and some audits may then be rolled forward into the next years plan. All amendments are approved by the Audit Sub-Committee.
- 8.7 The work of the Internal Auditor is also incorporated into the Finance Service Plan, which defines the role of the Finance Service and how it contributes towards the Council's Strategic Aims and Targets and monitors the performance of the service including the Internal Audit Service.

## **9.0 Conducting an Audit**

9.1 The following section of the Audit Manual provides detailed guidance on the conducting of an audit, from the original planning of the systems and audit testing, through to the reporting of audit conclusions and recommendations. The conducting of an audit is broken down into the following areas:-

- Audit Programmes / Audit Overviews
- Systems Notes / System Matrices
- Audit Testing
- Audit Working Papers and Evidence
- Audit Reports
- Audit Files

## **10.0 Audit Programmes / Overviews**

10.1 Prior to the commencement of each audit, the manager of the service area should be informed in advance of the audit, and of the work to be carried out by issuing an Audit Overview which will summarise the following:

- The scope and objectives of the audit
- The key areas and controls that will be reviewed
- The nature of the audit tests planned for each area of the audit
- The planned dates of the audit and estimated number of days
- The Action Plan from the previous audit with any outstanding issues that need to be followed up

At this stage the manager can also suggest to the Internal Auditor any areas which they would like to be looked at in addition to the scheduled audit work. However, the likely impact of any additional work requested on the Audit Plan will need to be assessed.

10.2 The objectives for each audit and the specific audit testing that must be carried out are documented in an Audit Programme. The Internal Auditor should acquaint themselves with the Audit Programme before commencing the audit.

The Audit Programme should be reviewed and updated at the conclusion of each individual audit, to take into account any changes to the system or service area, any identified weaknesses in internal controls, key staff changes, risk assessment, specific problems etc.



## **11.0 System Notes / System Matrices**

11.1 All major systems audits should have a set of System Notes or a Systems Flowchart which describe the system and its key internal controls as well as an up to date copy of the Audit Commission System Based Audit Matrix, if available, which provides the starting point for any of these audits, as far as these are relevant to a Town Council.

System Notes should be checked with the appropriate service manager at the commencement of the audit, and signed off.

11.2 System Notes and Matrices should be in place for the following major systems audits:-

- Payroll
- Accounts Payable
- Accounts Receivable
- Cash and Banking

## **12.0 Audit Testing**

12.1 Audit testing should generally be carried out in accordance with the Audit Programme.

12.2 An appropriate sample size will need to be chosen for each individual audit test, in order for the auditor to be satisfied as to the accuracy and efficiency of the system and internal controls under review. It is rarely necessary to test check every transaction i.e. the entire population.

12.3 The test checks carried out should generally conform to the following principles:

- Test checks should normally be applied to all areas of the audit programme, unless there are clear reasons as to why testing should not be carried out.
- A sufficient number of transactions should be tested to provide reasonable assurance of the accuracy or otherwise of the entire population.
- The sample to be tested should be chosen to include transactions from across the entire audit period under review, unless there is good reason to concentrate audit activity in one particular period.

- The sample size, level of coverage, and sampling method should be justified and should take into consideration exceptional and material items.
- Where errors are found in a sample consideration needs to be given to extending the testing, depending on the number and significance of the errors.

12.4 The Internal Auditor should always form a judgement on the most appropriate way to approach audit testing i.e. evidence gathering, for each individual audit. The Internal Auditor does not need to adhere to existing audit programmes if circumstances suggest an alternative or supplementary approach is necessary.

12.5 The Internal Auditor should also maintain a sense of proportion and context with regards to audit findings. A distinction must be made between those queries which indicate system weaknesses and those which relate to trivial or isolated errors.

### **13.0 Audit Working Papers and Evidence**

13.1 Each audit test should be supported by a working paper detailing the type of test carried out, reasons for the test, sample size, supporting records and evidence and the key results and any important findings.

13.2 All working papers should be numbered and cross referenced to the main audit report.

13.3 It is the responsibility of the Internal Auditor to ensure that the evidence used in support of any audit conclusions reached is sufficient, relevant and reliable.

### **14.0 Audit Reports and Action Plans**

14.1 The primary purpose of issuing audit reports is to provide management with an opinion on the adequacy or otherwise of the internal control environment and to inform management of significant audit findings, conclusions and recommendations. It is important that audit reports are clear, concise, and based on sufficient, relevant, reliable evidence.

14.2 The aims of every audit report should be the following:

- To provide a formal record of the work undertaken and any changes agreed between the service manager and the Auditor.
- To provide management with details of the main outcomes of the audit including the conclusions and recommendations made in order to improve performance and internal control.

- 14.3 An Audit Report should be produced in respect of every audit examination in the following standard format:-

*Introduction:*

Showing the scope, purpose and extent of the audit.

*Audit Objectives:*

Showing the objectives of the audit and the testing to be carried out.

*Overall Audit Opinion:*

Summarising the main conclusions and recommendations from the audit and indicating whether the systems showed strong or weak internal controls. A summary of the level of risk which the findings were deemed to pose i.e. low, medium, or strong.

*Findings from Previous Audit:*

Details issues highlighted in the previous audit and action taken to implement audit recommendations and any follow up work required

*Findings from Current Audit:*

Detailed findings from the current years audit broken down by audit objective and showing all testing carried out cross referenced to working papers. Each finding should carry a risk weighting as described above.

*Conclusions & Recommendations:*

Summarising the degree of reliability which can be placed on the main system controls and the recommendations which logically flow from these conclusions.

- 14.4 A copy of the Audit Report should be sent to the manager of the service area or system being audited, immediately following the conclusion of the audit and a follow up meeting arranged to discuss and agree and agree the final Audit Report.
- 14.5 Following agreement of the Audit Report with the relevant manager an Action Plan should be issued which should have details of the date the recommendations were agreed, the proposed date for implementation, and the officer responsible for implementation. The Action Plan should then be formally signed off by the manager.

- 14.6 In the event of a service manager refusing to recognise or implement a significant audit finding or recommendation, the issue should be brought to the attention of the Finance Manager and the Town Clerk, and ultimately the Audit Sub Committee. The issue should be resolved either by the implementation of the recommendation, or recognition and acceptance by the Finance Manager and Town Clerk and / or Audit Sub Committee of the risks involved in not implementing the recommended action.
- 14.7 All Audit Reports will be subject to a quality review process at the end of the audit review and prior to the issue of the initial audit report. The Finance Manager will complete the quality review and in doing so ensure that the audit work fulfilled the audit objectives and agree and sign off the findings, conclusions and recommendations.
- 14.8 The Internal Auditor will also ensure that arrangements are in place to monitor the progress made with the implementation of significant audit recommendations as set out in Audit Action Plans. It is the responsibility of management to action recommended changes to systems. Internal Audit follow up work will be geared towards reviewing management action. The timing and extent of any follow up work will depend on the importance and nature of the recommendations made.

## **15.0 Audit Files**

- 15.1 In order to evidence the fact that an internal audit has been completed from the planning stage through to conclusions, recommendations and reporting, all audit files should contain the following documentation:
- A System Note detailing the main features of the system being reviewed;
  - An Audit Commission System Matrix (major systems only);
  - An Audit Programme detailing the audit testing to be carried out;
  - An Audit Overview;
  - Previous Audit Reports and Action Plans;
  - Current Audit Report and Action Plans;
  - Audit Working Papers ;

## 16.0 Major Systems Audits

16.1 The definition of a system for these purposes is as follows:

*“a series of procedures processes and controls aimed at achieving a specific objective”.*

One of the main results of carrying out the annual programme of systems audits is that it allows the Internal Audit Service to form an opinion on the overall internal control environment operating within the Council as required under the Account & Audit Regulations.

16.2 All systems audits carried out by the Internal Audit Service should be carried out to the necessary professional standards and undertaken in accordance with the following criteria:

- Carry out an initial evaluation of the full extent of the system.
- Compile detailed documentation recording the system structure, processes, procedures and document flow.
- List the control objectives and identify the internal controls.
- Assess the internal controls.
- Draw up compliance and substantive testing programmes.
- Carry out analytical review.
- Carry out compliance testing.
- Carry out substantive testing.
- Give a considered opinion on the reliability and effectiveness of the system.
- Report the results to the Town Clerk, Finance Manager and Audit Sub Committee.

16.3 Once the system controls have been evaluated detailed testing can be carried out. The testing of individual transactions and balances is known as substantive testing. The degree of testing to be carried out will depend on how sound the internal controls are.

16.4 The main objectives of internal controls are as follows:

- To ensure adherence to the management policies and procedures implemented in order to achieve strategic and Aims and Objectives of the Council.
- To safeguard the assets of the Council and to ensure that all resources are deployed with the principle aim of securing value for money in the provision of all services.
- To ensure that all management information is relevant, reliable and complete by in turn ensuring, as far as possible, that all records are complete and accurate.
- To ensure compliance with statutory requirements.

16.5 Before any detailed testing is carried out the Internal Auditor should complete an analytical review exercise which involves comparing key data and statistics from current and prior periods. Any significant fluctuations between periods should be identified and investigated. This exercise also covers budgetary control and the investigation of material variations between budgeted and actual income and expenditure.

## **17.0 Regularity Audits**

17.1 The Internal Audit Service is committed to carrying out a number of annual regularity or probity audits, in addition to the systems audit work. These audits must also be carried out to the necessary professional standards.

17.2 The purpose of these regularity audits is to examine individual transactions to ensure that they are valid, authorised and intra vires. The level of checking required will depend on the area under review and the internal controls in place and should be detailed in the Audit Programme.

## **18.0 Fraud Investigation**

18.1 The Council has an approved Anti-Fraud and Corruption Policy and a Confidential Reporting Policy, which are designed to help prevent and detect fraud and corruption. These policies are supported by a Fraud Reporting and Investigation Procedure which outlines mechanism for reporting fraud and the procedures to be followed in the event of a suspected fraud.

- 18.2 The Internal Auditor is familiar with these documents and the procedures to be followed when they are involved in the investigation of a suspected fraud.
- 18.3 All circumstances which suggest possible fraud or theft must be fully investigated.
- 18.4 In the event of such circumstances it is essential that no rash or premature action or investigative work is undertaken. Immediately it is suspected that something is unsatisfactory the Internal Auditor should consult with the Finance Manager and / or the Town Clerk.
- 18.5 Prior to leaving the section involved the Auditor should attempt to establish as many of the current and historical facts as possible. Where cash or stocks are involved the Auditor should establish the details of the remainder in hand prior to departing and any key documents or records should be removed if they are in danger of being destroyed, removed or altered.
- 18.6 All investigative work should be conducted in accordance with the principles detailed in the Council's Fraud Reporting and Investigation Procedure, within the Anti Fraud and Corruption Strategy.

## **19.0 Value for Money Studies**

- 19.1 The Internal Audit Service has always had an important role to play in the area of value for money and the Internal Auditor is aware that this is an area where there is scope for the audit service to demonstrate the constructive role it can play. The emphasis on greater economy, efficiency and effectiveness is one of the driving forces behind the best value regime.
- 19.2 The Internal Audit Service in the conduct of its work is ideally placed to suggest areas of potential improvement to management. When carrying out audit work the Internal Auditor should report any areas that warrant further investigation as a potential value for money study or Best Value Review to the Finance Manager and / or Town Clerk.

## **20.0 Information and Communications Technology Audit**

- 20.1 This involves the audit of the Council's Information and Communications Technology arrangements and the technical aspects of the Council's business processes.

- 20.2 The Council has outsourced the management of support of its ICT infrastructure, to an external provider, therefore the Council has limited responsibility for ICT. Technology Services Group (TSG) currently manage the Council's ICT arrangements, and are responsible for documenting the Council's ICT processes and ensuring that appropriate controls are in place.
- 20.3 The Internal Auditor therefore carries out a limited role in auditing the Council's specific ICT arrangements, focussing instead on systems based testing in respect of the major IT systems such as Pegasus Opera 2 and Torex.

## **21.0 Contracts, Tendering and Procurement Audit**

- 21.1 This involves the audit of the systems used to control the Council's annual capital programme, and any other major procurement activity, including the individual audit of any capital project with a value in excess of £25,000.
- 21.2 The Council's Scheme of Administration includes the Standing Orders for Contracts and Procurements which set out the corporate rules and regulations governing the procurement of goods, materials, services and works.
- 21.3 The Internal Auditor must be familiar with these corporate rules and regulations and need to understand how they apply to the systems being audited.

## **22.0 Internal Control and Corporate Governance**

- 22.1 It is a statutory requirement of the Accounts and Audit Regulations 2003 for the Council to carry out an annual review of the effectiveness of its system of internal control and include a Statement of Internal Control in the Statement of Accounts. This review is now incorporated within the wider ranging requirement to undertake an annual review of the Council's corporate governance arrangements.
- 22.2 The Council has a responsibility to embrace the general principles of good Corporate Governance as exemplified in the framework and guidance provided by leading professional bodies including the Chartered Institute of Public Finance (CIPFA) and the Society of Local Authority Chief Executives (SOLACE).
- 22.3 The Council is now required to review annually governance arrangements, maintain a local code of governance, including arrangements for reviewing its effectiveness, and to prepare an Annual Governance Statement to report publically on the extent to which the Council has complied with the code



- 22.4 The reviews of the effectiveness of the Council's internal control and corporate governance arrangements are significantly informed by the work of the Internal Auditor.
- 22.5 The Internal Auditor through their work has an important role to play in promoting the seven key principles underpinning the required standards and good corporate governance:
- Selflessness
  - Integrity
  - Objectivity
  - Accountability
  - Openness
  - Honesty
  - Leadership
- 22.6 The Council's Scheme of Administration includes Standing Orders and Financial Regulations which set the corporate governance rules and regulations to govern the discharge of its duties. A key role of the Internal Audit Service is to provide an opinion as to compliance with the Scheme of Administration.
- 22.7 The Council has also approved a number of policy and strategy documents which govern corporate behaviour in a number of areas; these include:
- Members Code of Conduct
  - Officers Code of Conduct
  - Register of Members Interests
  - Risk Management Strategy
  - Anti-Fraud and Corruption Policy
  - Confidential Reporting Policy
- 22.8 The Internal Auditor must be familiar with these documents and should understand how they interface with day to day audit work and how the Internal Audit Service can support the aims of these corporate policies.
- 22.9 The role of the Internal Audit Service is to provide management with an opinion on the effectiveness of overall internal control and financial probity; the reliability of management and performance information; compliance with statutory requirements and the Scheme of Administration; and the effective use of resources. This in itself is fundamental to the Council's approach to corporate governance, best value and performance management.

## **23.0 Risk Management**

- 23.1 An essential feature of good corporate governance is the development of comprehensive risk management policies and procedures. The requirement to have adequate risk management policies and systems is also specified in the Accounts & Audit Regulations.
- 23.2 Risk management means the identification, evaluation, prioritising and management of risk. In a period of significant change, and with the introduction of new legislation affecting the Council, the Council must ensure that all significant operational and strategic risks, which could affect the delivery of its corporate objectives, are identified. Once identified a corporate risk register and action plan must be developed to manage each risk.
- 23.3 The Internal Audit Service will review the Council's risk management arrangements on an annual basis as part of the overall audit plan and will use as far as possible the principles of risk assessment in order to compile the annual audit plan and to focus audit resources on specific risk areas.

## **24.0 Update of Audit Manual**

- 24.1 This Audit Manual will be updated annually to account for any changes to legislation, service provision, and audit policy or practices.
- 24.2 Last Update: May 2008  
Responsible Officer: Internal Auditor – K.Bertram  
Reviewing Officer: Finance Manager – D.Austin.