KPMG

External Assessment of Internal Audit – Follow-up

Powys County Council

—

April 2016

Contents

Document Classification: KPMG Confidential

Executive summary

Executive Summary

Background & Introduction

Internal Audit represents a key source of assurance for local authorities and is essential in ensuring that officer and members are provided with a clear and independent assessment of the effectiveness of controls. An effective Internal Audit function enables the Authority to make informed decisions about improvements required to the control environment. It also assists in the management's and the Audit Committee's responsibility to ensure that a sound system of control is in operation.

The provision of internal audit services to the public sector, including local authorities, is required to comply with the provisions of the *Public Sector Internal Audit Standards* (PSIAS), as supplemented by CIPFA's *Local Government Application Note* (LGAN). These standards are based upon the *International Standards for the Professional Practice of Internal Auditing* as developed by the Chartered Institute of Internal Auditors.

One of the key requirements of the PSIAS is that the internal audit service is subjected to an independent and external assessment of its compliance with the standards every five years. In relation to this, KPMG undertook an assessment of Powys Council Council's (the Council) Internal Audit Service (the Service) during 2014 and published our findings in November 2014. Whilst this report concluded that the Internal Audit Service was generally compliant with the standards, there were a number of areas where further improvements were required in order to achieve full compliance. As a result of this, we raised 17 recommendations aimed at enhancing compliance with the standard.

The purpose of this report is to provide an assessment of the progress that has been made in implementing these recommendations and the impact that this has had on the Service's compliance with the standards.

Audit Scope

Our 2014 assessment consisted of a detailed review of the way in which the Council undertook internal audit work and the interaction of the Service with the wider Council in order to:

— determine and assess the performance and effectiveness of the Internal Audit function against the Standards;

— determine the adequacy of resources to deliver the audit plan, including specialist resources;

— advise the s151 Officer on whether the number of audit days and coverage in the plan is appropriate and whether there is appropriate coverage of `fundamental` systems;

— highlight areas of good practice; and

— check alignment between the risk register and the audit programme.

In undertaking the assessment against the Standards we made use of the LGAN Compliance Checklist which categorises the Standards into the following areas:

— Definition of Internal Auditing;

— Code of Ethics;

— Attribute Standards; and

— Performance Standards.

In undertaking this follow-up review we considered the progress made by the Council in relation to each of the recommendations raised in our November 2014 report. Please note that we have not re-performed a full assessment of the Service and have proceeded on the assumption that those areas where compliance was previously achieved have remained compliant.

Executive Summary (cont.)

Objectives & Audit Approach

As set out in our engagement letter dated 26 June 2015, the objectives of this review were:

— to determine and assess the progress made in implementing the recommendations raised as a result of our previous assessment of the performance and effectiveness of the Internal Audit function against Public Sector Internal Audit Standards;

— to highlight areas of good practice developed through the implementation process; and

— to advise the S151 Officer and Audit Committee of the overall position in enhancing the delivery of the Internal Audit Service as a result of our earlier assessment.

Our work consisted of face-to-face interviews, observations and documentation review. In order to complete our assessment of the progress made by the Service in implementing out recommendations we met with the following officers:

— Cllr John Morris (Audit Committee Chair)

— Cllr John Brautigam (Audit Committee Vice Chair)

— Jeremy Patterson (Chief Executive)

— David Powell (Strategic Director Resources)

— Jason Lewis (Head of Professional Services and Commissioning)

— Mark Evans (Head of Business Services)

— Susan Bolter (Head of Regeneration, Property & Commissioning)

— Nigel Brinn (Head of Highways, Transport & Recycling)

— Stuart Mackintosh (Leisure and Recreation Services Manager)

— Ian Halstead (Internal Audit Manager)

Overall Conclusion

Our work identified that the Service has made substantial progress towards the implementation of those recommendations raised in our November 2014 report. Of the 17 recommendations raised, 11 have been fully implemented with the remaining six being in progress (see page 7 and Appendix 1 for further analysis). Where recommendations are in progress the remaining actions to be taken generally require input and action from the wider Council and are no longer solely within the control of the Service.

As a result of the actions taken by the Service, and on the assumption that areas previously assessed as compliant have remained so, compliance is now achieved in relation to 194 of the 209 (93%) PSIAS standards (see page 8 and Appendix 2 for further analysis).

One specific areas where further progress is required is in relation to the focus on the Service. Through our discussions with service users we identified that there is a strong desire for the Service to assume a more strategic role within the Council and become more heavily involved in providing timely assurance on the completion of key projects. This represents a substantial change from the historic role of the Service and one which is being seen across the sector, both as a development of internal auditing and as a result of funding reductions meaning that the internal audit resources are having to be more carefully targeted in order to maximise value.

Structure of this report

The remainder of this report sets out our findings in more detail. The appendices include details of the current status for each recommendation deemed to be still in progress.

Acknowledgement

We would like to thank all staff and Members we have seen during this review for their help and assistance.

Detailed Findings

Detailed Findings

Status of Recommendations

We have set out below an assessment of the progress that the Service has made in implementing each of the recommendations raised in our November 2014 report. Each recommendation raised was assigned a priority rating in accordance with the following table.

Further details in relation to those recommendations deemed to be in progress are provided in Appendix 1.

Priority rating for recommendations raised					
High	**High priority** - A significant weakness in the system or process which is putting the organisation at serious risk of not achieving its strategic aims and objectives. In particular: significant adverse impact on reputation; non-compliance with key statutory requirements; or substantially raising the likelihood that a strategic risks will occur. Recommendations in this category usually require immediate attention.	**Low**	**Medium priority** - A potentially significant or medium level weakness in the system or process which could put the organisation at risk of not achieving its strategic aims and objectives. The issue could potentially have an adverse impact on the organisation's reputation or increase the likelihood of strategic risks occurring, if not addressed.	**Medium**	**Low priority** - Recommendations which could improve the efficiency and/or effectiveness of the system or process but which are not vital to achieving the organisation's strategic aims and objectives. These are generally issues of good practice that we consider would achieve better outcomes.

Recommendation Status	High Priority	Medium Priority	Low Priority	Total
Raised	-	7	10	**17**
Completed	-	4	7	**11**
In Progress	-	3	3	**6**

Detailed Findings (cont.)

Compliance with PSIAS

Our November 2014 report identified a limited number of areas of non-compliance with the Standards as well as a number of areas of partial compliance where there was scope for further improvement. As a result of the actions taken by the Service in response to the recommendations raised we have updated the assessment below.

In completing this assessment we have assumed that were compliance was previously achieved this has remained so. We have not undertaken a full assessment of the Service as part of this follow-up exercise.

Standard's Category	Compliant		Partially Compliant		Non-Compliant		Recommendations (Appendix 1)
	Current	Previous	Current	Previous	Current	Previous	
1 Definition of Internal Auditing	2	2	-	-	-	-	
2 Code of Ethics	5	5	-	-	-	-	
3.1 Purpose, Authority & Responsibility	6	4	-	1	-	1	
3.2 Independence & Objectivity	24	21	-	2	-	1	
3.3 Proficiency & Due Professional Care	14	10	1	5	-	-	Recommendation 3
3.4 Quality Assurance & Improvement Programme	26	20	-	2	-	4	
4.1 Managing the Internal Audit Activity	30	27	8	9	1	3	Recommendations 10 & 11
4.2 Nature of Work	15	14	-	1	-	-	
4.3 Engagement Planning	30	28	-	2	-	-	
4.4 Performing the Engagement	12	11	-	1	-	-	
4.5 Communicating Results	28	25	1	2	-	2	
4.6 Monitoring Progress	-	-	4	4	-	-	Recommendation 17
4.7 Communicating the Acceptance of Risks	2	2	-	-	-	-	
Total	**194**	**169**	**14**	**29**	**1**	**11**	

Appendices

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Appendix 1 – Recommendations in Progress

We have repeated below those recommendations raised in our November 2014 report which are deemed to still be in progress. For each of these recommendations we have provided an update on the current position.

No.	Rating	Recommendation	Management's Original Response	Current Status
3	Medium	**Redesign of Internal Audit Focus** Our discussions highlighted an interest in moving away from traditional compliance work in favour of more high level assurance work linked to the key risks faced by the Council. In light of this, the Council should consider the desired purpose of the Internal Audit Service. In doing so, recognition should be given to the value of both the provision of assurance on core functions (e.g. Finance Systems) and in relation to key, and emerging, strategic and service-based risks. This should be formally articulated through the Internal Audit Charter. In order to achieve this it will be essential that the development of a robust risk management process is completed as a matter of priority. Until this is completed, the Head of Internal Audit should ensure that planning discussions include consideration of managements' views on key risk areas even if these are currently not documented in formal risk registers.	The Charter will be changed to accentuate the focus on risk based, added value and core service auditing. **Responsible officer:** Ian Halstead, Internal Audit Manager **Implementation Date:** 31 December 2014 A proposal for the re-modelling of the Internal Audit team will be put forward to support the changes recommended in this report. In addition, other models of service deliver will be explored. **Responsible officer:** Ian Halstead, Internal Audit Manager and Jason Lewis, Head of Professional Services **Implementation Date:** 31 October 2014 Key business risks will be considered as part of the on-going liaison and planning process with Senior Managers. **Responsible officer:** Ian Halstead, Internal Audit Manager **Implementation Date:** 31 January 2015	A revised internal audit charter has been presented to, and approved by, the Audit Committee. In addition, key business risks were considered as part of the planning process and direct links were incorporated into the audit plan. The internal audit service has been restructured with the specific aim of addressing the needs of the Council, however a further restructure is forthcoming which will progress this further. Discussions with the Chief Executive Officer, Strategic Director Resources and Head of Professional Services & Commissioning indicated that there continues to be a desire for further changes to the delivery model. This was also supported by our wide discussions with the Audit Committee Chair and Vice Chair who expressed a desire for an increased strategic role for the service.

Appendix 1 – Recommendations in Progress (cont.)

No.	Rating	Recommendation	Management's Original Response	Current Status
10	Low	**Audit Delivery** The Head of Internal Audit should review those engagements which were not delivered within the target timeframe to identify any underlying causes. Corrective action should then be taken to increase the number of engagements which are delivered within the agreed targets.	The current performance management framework will be re-designed to provide management information to ensure that assignments are timely. **Responsible officer:** Ian Halstead, Internal Audit Manager **Implementation Date:** 31 December 2014	A process is in place to collect management information on the timeliness of audit reports. This information is available for the individual performance reviews. However, the collection of such information is inefficient and resource intensive. Discussions are ongoing to enter an agreement with another Welsh local authority in order to use the same audit software (MKI Insights) which will help to facilitate this process. This is expected to be concluded as part of the 2016/17 Business Plan.
11	Medium	**Risk Management & Assurance Mapping** We are aware that the Council is already in the process of developing a more robust risk management system. Once this has been completed, an Assurance Mapping process should be developed which links to the risk management process and identifies the various assurance sources available to the Council in relation to its key risks.	Internal audit will consider other sources of assurance to ensure that limited resources are applied effectively. **Responsible officer:** Ian Halstead, Internal Audit Manager **Implementation Date:** 31 March 2015	Other forms of assurance are considered as part of the internal audit planning process. These include the risk register, budgetary reports and performance assessment information. The Council does not, however, carry out any form of assurance mapping.

Appendix 1 – Recommendations in Progress (cont.)

No.	Rating	Recommendation	Management's Original Response	Current Status
15	Low	**Application of Assurance Gradings** Consider how the assurance grading reflects both the impact on the area of operations under review and the wider Council. Potential solutions may include, but are not limited to: — Providing two levels of assurance, one for the Council and one for the areas under review, in the body of the Report; — Communicating the overall Council impact separately when issuing the report to Heads of Service, Strategic Directors and other senior officers; or — Setting out the Council level impact in quarterly updates and the annual reports. In determining the approach it will be essential to ensure that the needs and expectations of management are taken into account.	The assurance ratings will be revised to reflect the difference between an impact on a service area and the impact on the wider Council. **Responsible officer:** Ian Halstead, Internal Audit Manager **Implementation Date:** 31 December 2014	The introduction of Heat Maps into the template audit reports goes someway towards resolving this matter. These maps plot risk versus control. Further work is ongoing, however, in order to clarify the way in which reports for specific areas of operations (e.g. individual schools) are rated to show both the impact for the school and the overall impact to the Council. Potential solutions being considered include: — Providing additional narrative in the covering emails that issue the report; and — Providing Council level ratings in the annual report and progress reports. A key consideration in this, which is recognised by the Internal Audit Manager, is the need to ensure that providing a higher level of assurance at a Council level does not prevent appropriate corrective action at the individual service or area being audited.

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Appendix 1 – Recommendations in Progress (cont.)

No.	Rating	Recommendation	Management's Original Response	Current Status
16	Low	**Roles of Audit Committee and Working Group** Formally document the split of roles between the Audit Committee and the Internal Audit Working Group. In doing so, consider the roles and responsibilities in question, the extent to which it is appropriate to delegate these to a working group and what should be retained by the Committee. A minimum level of reporting to the Audit Committee should be determined. This should include both the Annual Audit Plan and the Annual Internal Audit Report. In addition, more regular reports may also be included in relation to the delivery of the plan and performance against targets. Given the creation of the Internal Audit Working Group it is not expected that the Audit Committee will receive the reports arising from individual reviews. The Audit Committee forward work plan should also be reviewed in order to identify those meetings which are not scheduled to consider matters relevant to the Internal Audit Service. Where such meetings are identified, consideration should be given to exempting the Head of Internal Audit from attending the meeting so that time and resources can be more dedicated to other matters.	A report will be presented to the Audit Committee formalising the role and responsibilities of the Audit Committee and the Internal Audit Working Group. The report will consider areas of good practice both within and outside of the public sector. **Responsible officer:** Ian Halstead, Internal Audit Manager **Implementation Date:** 31 March 2015	The role of the Audit Committee and its working groups is currently being reviewed by the Democratic Services Team. This review will cover both the make-up of the Audit Committee as a whole as well as the role that working groups play in delivering the Committee's responsibilities.

Appendix 1 – Recommendations in Progress (cont.)

No.	Rating	Recommendation	Management's Original Response	Current Status
17	Medium	**Recommendation Tracking Process** The Head of Internal Audit should develop a process whereby management are supported in monitoring the implementation of recommendations raised by Internal Audit. This could be achieved by way of maintaining a list of all recommendations raised and requesting management to periodically provide updates against those recommendations within their area of responsibility. By maintaining the list themselves, the Internal Audit Service would be able to ensure that it is both accurate and complete, whilst recognising that it is for management to ensure that implementation is achieved. For significant recommendations, or those relating to adverse reports, the Internal Audit Service should undertake a validation of the updates provided by management so as to provide assurance that corrective actions have been appropriately completed,	A process will be developed that allows Services to be made aware of audit recommendations so that they can track actions within their area of responsibility. A separate process will be undertaken by internal Audit to validate that key actions have been delivered. **Responsible officer:** Ian Halstead, Internal Audit Manager **Implementation Date:** 31 December 2014	A process exists that collects recommendations on a spreadsheet that has been submitted to services via executive management team. This was completed for 2015/16 and is ongoing for 2016 17. Despite this, interviews with Heads of Service indicated that they were unaware of the process. The process itself is inefficient and resources intensive. Negotiations are taking place with another Welsh Authority to partner on their audit management system. The plan is to use a separate client portal that is used to complete action plans and self - track audit recommendations.

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Appendix 2 – Analysis of Powys CC's Compliance with PSIAS

We have set out below an analysis of the number of LGAN checklist provisions where the Service demonstrated compliance at both our November 2014 Assessment and following our review of progress made towards the implementation of recommendations raised.
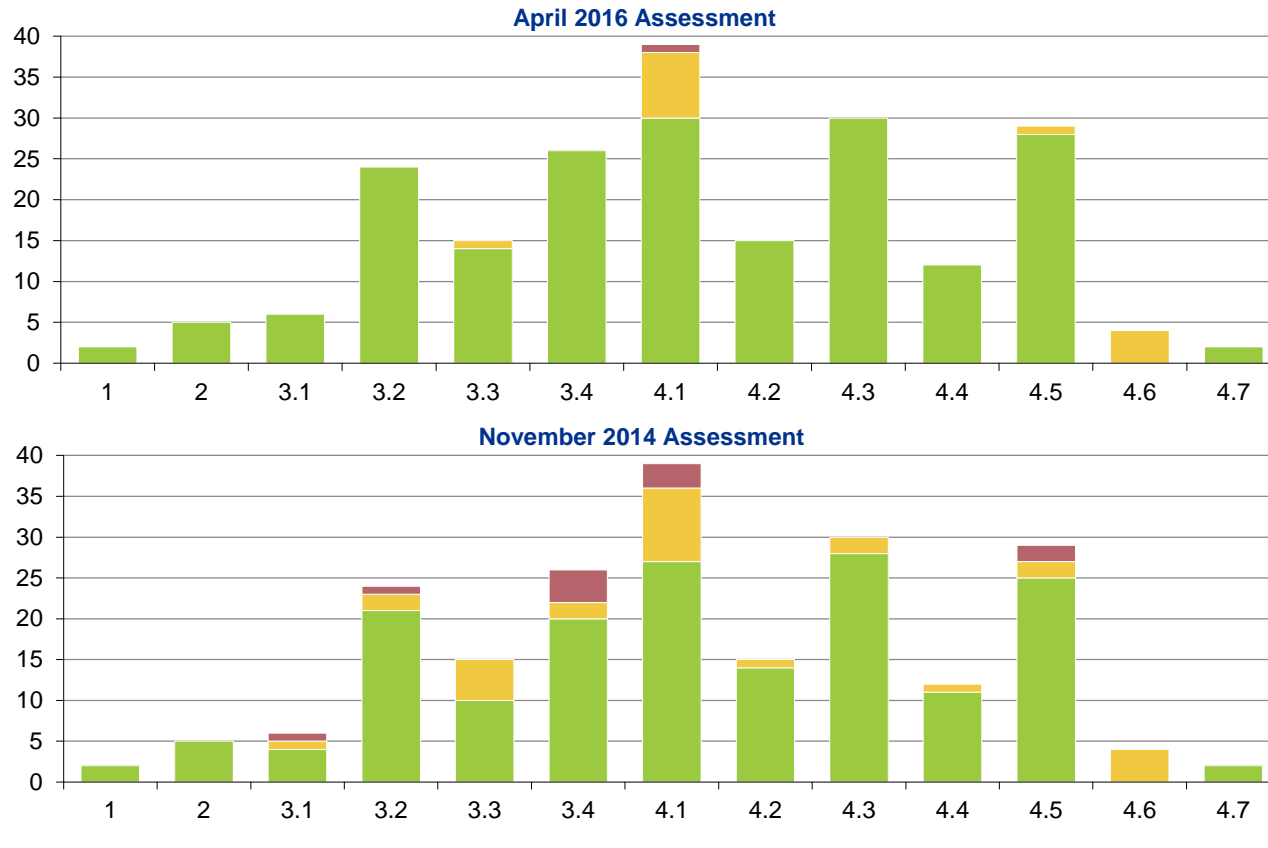
April 2016 Assessment

November 2014 Assessment

Areas of Standards per LGAN

1	Definition of Internal Auditing
2	Code of Ethics
3.1	Purpose, Authority & Responsibility
3.2	Independence & Objectivity
3.3	Proficiency & Due Professional Care
3.4	Quality Assurance & Improvement Programme
4.1	Managing the Internal Audit Activity
4.2	Nature of Work
4.3	Engagement Planning
4.4	Performing the Engagement
4.5	Communicating Results
4.6	Monitoring Progress
4.7	Communicating the Acceptance of Risks

■ Non Compliance
■ Partial Compliance
■ Compliant

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# Appendix 2 – Analysis of Powys CC's Compliance with PSIAS (cont.)

The below analysis shows the level of compliance achieved as a percentage of the total number of provisions included within the LGAN checklist.


April 2016 Assessment

November 2014 Assessment

Areas of Standards per LGAN

1	Definition of Internal Auditing
2	Code of Ethics
3.1	Purpose, Authority & Responsibility
3.2	Independence & Objectivity
3.3	Proficiency & Due Professional Care
3.4	Quality Assurance & Improvement Programme
4.1	Managing the Internal Audit Activity
4.2	Nature of Work
4.3	Engagement Planning
4.4	Performing the Engagement
4.5	Communicating Results
4.6	Monitoring Progress
4.7	Communicating the Acceptance of Risks

- Non Compliance
- Partial Compliance
- Compliant

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Appendix 3 - Sector Analysis

KPMG has recently undertaken an analysis of the use of internal audit throughout the local government sector. We have included below and on the following pages extracts from this analysis that are of relevance to this review. The full report will be distributed separately.

In light of the funding cuts that have been imposed upon local authorities, the way in which internal audit services are delivered has had to be reassessed in order to reduce costs whilst continuing to deliver the required level of assurance to service users. We have set out below an analysis of the way in which this has impacted upon the volume of audit work undertaken at individual authorities:
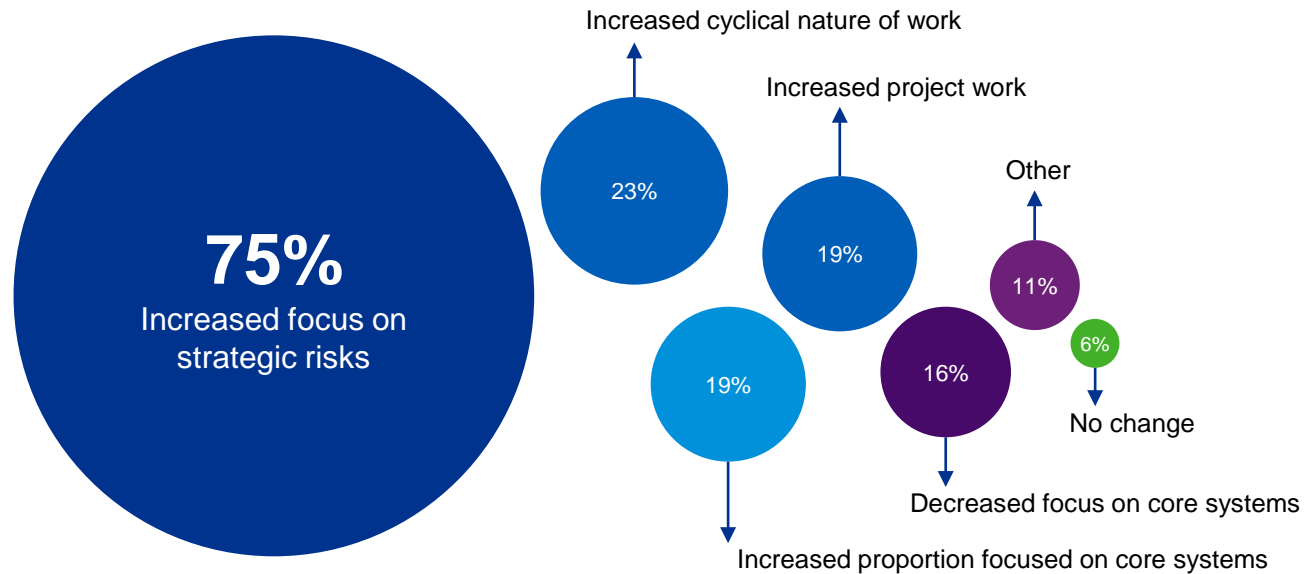

Volume of Work
- 11%
- 23%
- 66%
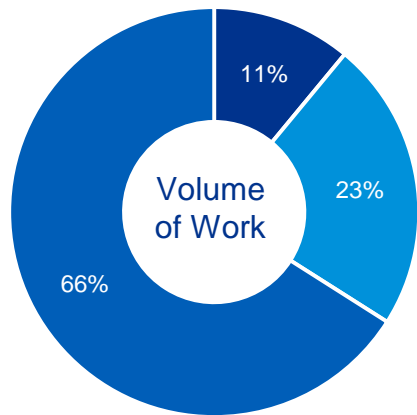
Increased over last three years
Decreased over last three years
Little or no change

Increase 38%
Decrease 63%

Change in Audit Days
2014/15 – 2015/16
- 35%
- 4%
- 10%
- 10%
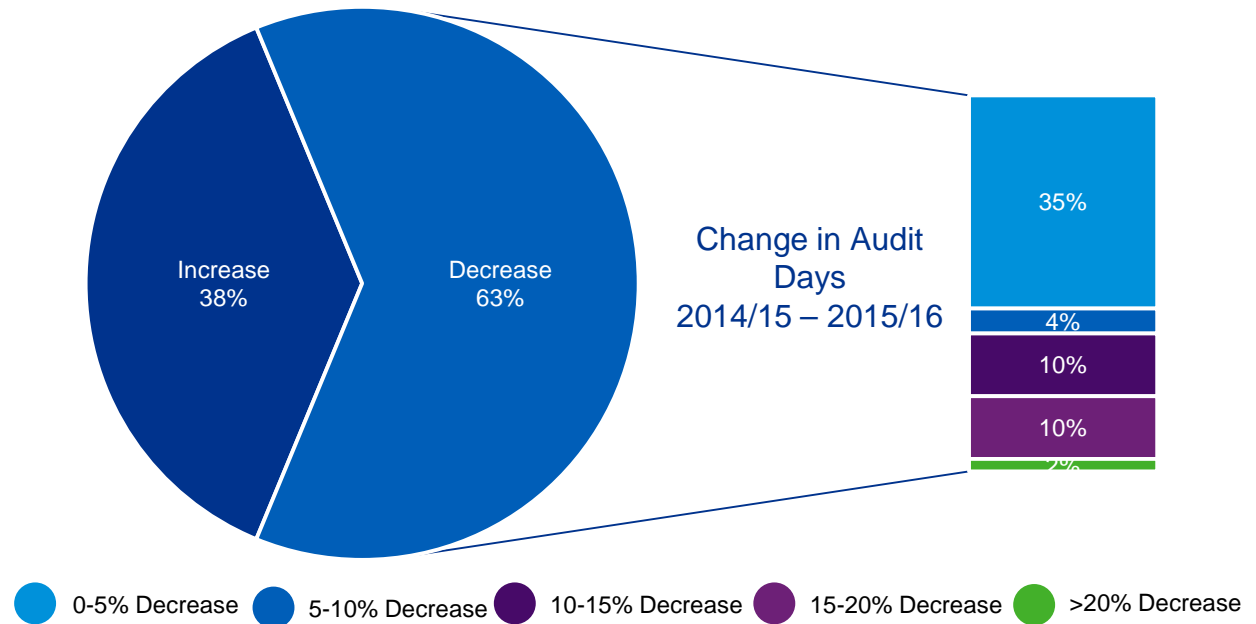
0-5% Decrease
5-10% Decrease
10-15% Decrease
15-20% Decrease
>20% Decrease

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Appendix 3 – Sector Analysis (cont.)

The reduction in the volume of audit work undertaken has in turn created the need to reassess the way in which audit resources are focused and audit plans delivered. Without the such reassessment there is a significant risk that the level of assurance provided to service users (including both management and audit committees) will be insufficient. We have set out below an analysis of how different authorities have addressed this pressure:

75%
Increased focus on strategic risks

23%

Increased cyclical nature of work

Increased project work

19%

Other

11%

6%

No change

19%

16%

Decreased focus on core systems

Increased proportion focused on core systems

In implementing these changes authorities have generally adopted a delivery model which more directly focuses on strategic risks and objectives. This aligns with the desire expressed by service users interviewed as part of this review to see the Service assume a more strategic role in the Council's operations.

KPMG

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