PERFORMANCE AUDIT

A job worth doing

Raising the standard of internal audit in Scottish councils

Contents

The Accounts Commission

The Accounts Commission is a statutory, independent body, which through the audit process, assists local authorities in Scotland to achieve the highest standards of financial stewardship and the economic, efficient and effective use of their resources. The Commission has five main responsibilities:

■ securing the external audit
■ following up issues of concern identified through the audit, to ensure satisfactory resolutions
■ reviewing the management arrangements which audited bodies have in place to achieve value for money
■ carrying out national value for money studies to improve economy, efficiency and effectiveness in local government
■ issuing an annual direction to local authorities which sets out the range of performance information which they are required to publish.

The Commission secures the audit of 32 councils and 34 joint boards (including police and fire services). Local authorities spend over £9 billion of public funds a year.

Audit Scotland

Audit Scotland is a statutory body set up in April 2000, under the Public Finance and Accountability (Scotland) Act 2000. It provides services to both the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Executive and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

Audit Scotland prepares reports for local government on behalf of the Accounts Commission.

The Commission welcomes comments and enquiries about its reports. Comments on this report should be directed to John Lincoln, Martin Christie or Douglas Black, in Performance Audit, Audit Scotland.

Acknowledgements

Key points

The study assessed the level of councils' compliance with the CIPFA Code of Practice for Internal Audit in Local Government …

... when assessed against the CIPFA Code, we found that there is room for improvement in all councils, but some performed significantly better than others.

... Comhairle nan Eilean Siar, East Ayrshire, East Renfrewshire and West Lothian almost fully complied with the Code.

... Argyll & Bute, East Dunbartonshire, Inverclyde and Shetland complied with fewer than half of the standards in the Code.

... almost two thirds of councils (20) complied with more than 70% of the standards in the Code.

Councils invest £9.3 million a year in internal audit services, employing 265 staff …

... there is considerable variation in the number of internal audit staff employed among councils of similar size.

... every Scottish council has its own internal audit service resourced by in-house staff. This contrasts with the NHS where consortia of in-house staff provide internal audit services to eight health board areas. The private sector provides internal audit services in the remaining seven health board areas.

Features most commonly found in the better performing councils, which were usually absent in the poorer performing councils, included …

... the presence of an audit committee, or equivalent, to hold internal audit to account and ensure agreed audit recommendations are implemented.

... the use of comprehensive risk assessment to determine the council's internal control priorities and the work of internal audit.

... a richer skill-mix, which may be reflected in above-average unit staff costs, but not necessarily higher total audit costs.

... annual reporting by the chief internal auditor giving an overall assessment of internal controls.

All councils need to take action to improve …

... effective internal audit sections can look forward to the challenges and opportunities presented by the greater use of audit committees, the proposals to introduce internal control statements, the growth in e-commerce, and Best Value.

... all councils should use this report, and their local external audit reports, to achieve full compliance with the Code.

... where the room for improvement is significant, there is a strong case for councils undertaking a fundamental appraisal of options for securing effective internal audit provision, including testing what the market might provide.

... external auditors will be monitoring council improvement actions.

Executive summary

Background

The Accounts Commission aims to ensure that all councils achieve the highest standards of financial stewardship, governance and public accountability. However, in recent years, there have been a number of instances where external auditors of councils have reported weaknesses in internal audit. The Commission requested Audit Scotland to carry out this national study to:

- establish a clear picture of the performance of internal audit services in all councils in Scotland
- provide benchmarking data to support continuous improvement.

Council performance was assessed against the standards set by the CIPFA Code of Practice for Internal Audit in Local Government.

Local authorities' investment in internal audit services

Every Scottish council has its own internal audit service resourced by in-house staff (with Comhairle nan Eilean Siar having a partnership agreement with a private sector firm to provide quality control). This contrasts with the NHS where consortia of in-house staff provide internal audit services to eight health board areas. The private sector provides internal audit services in the remaining seven health board areas.

The total amount invested in internal audit in all 32 Scottish councils is £9.3 million – about 0.1% of aggregate council expenditure. There are 300 full-time equivalent (FTE) established posts of which 265 were filled at the date of the study. Ten councils also provide internal audit services to other public bodies, for example, local police, fire and other joint boards. This work accounts for between 2-5% of total internal audit staff time in the councils concerned. There is considerable variation in the number of internal audit staff employed among councils of similar size.

What internal audit does

Internal audit is an 'independent appraisal function established by the management of an organisation for the review of the internal control system as a service to the organisation. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic efficient and effective use of resources'[1].

All internal audit sections undertake broadly similar types of work. This involves reviewing and testing the internal controls of key financial and non-financial systems, investigating any frauds or irregularities and, in some councils, specialist computer audit and contract audit work (Exhibit 1).

More than three-quarters of internal audit time is spent on internal control tasks.

Non-audit tasks 2%

Strategic and annual planning 5%

Non-internal control tasks 15%

Internal control tasks 78%

Breakdown of internal control tasks

Computer audit 7%

Fraud/corruption enquiries 17%

Contract audit 4%

Other internal control tasks 3%

Systems and regularity audit 69%
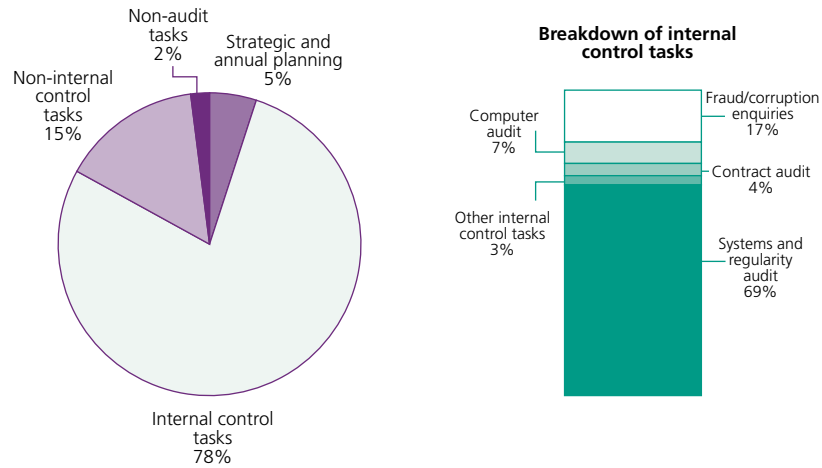
Source: Local audit returns

How we assessed councils

The approach and methodology was developed in consultation with the study advisory group, the Scottish Local Authorities Chief Internal Auditors' Group, and a panel of external auditors. It involved identifying critical success factors for internal audit and establishing a framework of issues to be used in assessing the level of council compliance with the CIPFA Code.

Six critical factors were identified (Exhibit 2), with these being supported by 15 statements of good practice and 97 tests on individual council processes and outcomes (Exhibit 3).

Exhibit 2: Critical success factors

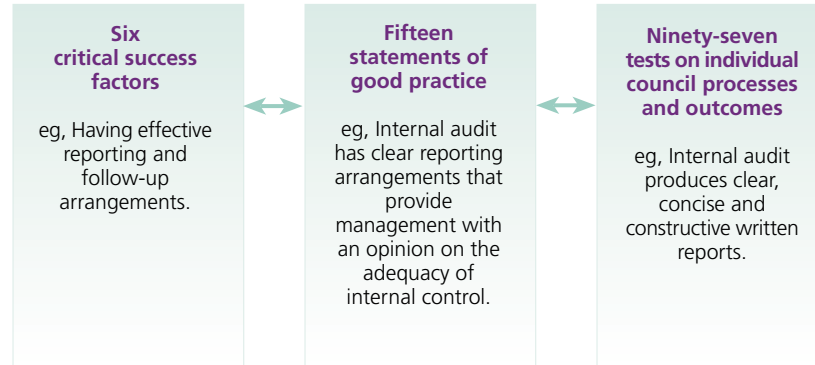The study identified six critical success factors for internal audit.

1. Setting clear and properly focused objectives for internal audit

2. Maintaining internal audit independence

3. Planning and controlling the work of internal audit

4. Resourcing the internal audit work programme

5. Having effective reporting and follow-up arrangements

6. Holding internal audit to account for its performance

Source: Audit Scotland

Exhibit 3: Structure of the assessment

Fifteen statements of good practice and 97 tests on council processes and outcomes support the six critical success factors.

Six critical success factors		**Fifteen statements of good practice**		**Ninety-seven tests on individual council processes and outcomes**
eg, Having effective reporting and follow-up arrangements.	⟷	eg, Internal audit has clear reporting arrangements that provide management with an opinion on the adequacy of internal control.	⟷	eg, Internal audit produces clear, concise and constructive written reports.

Source: Audit Scotland

External auditors conducted their independent assessments in February 2001, based on interviews and evidence gathered from each council's chief executive, director of finance and chief internal auditor. Client surveys of managers in education, housing, and social work services were also undertaken to obtain their assessment of internal audit performance in their service area.
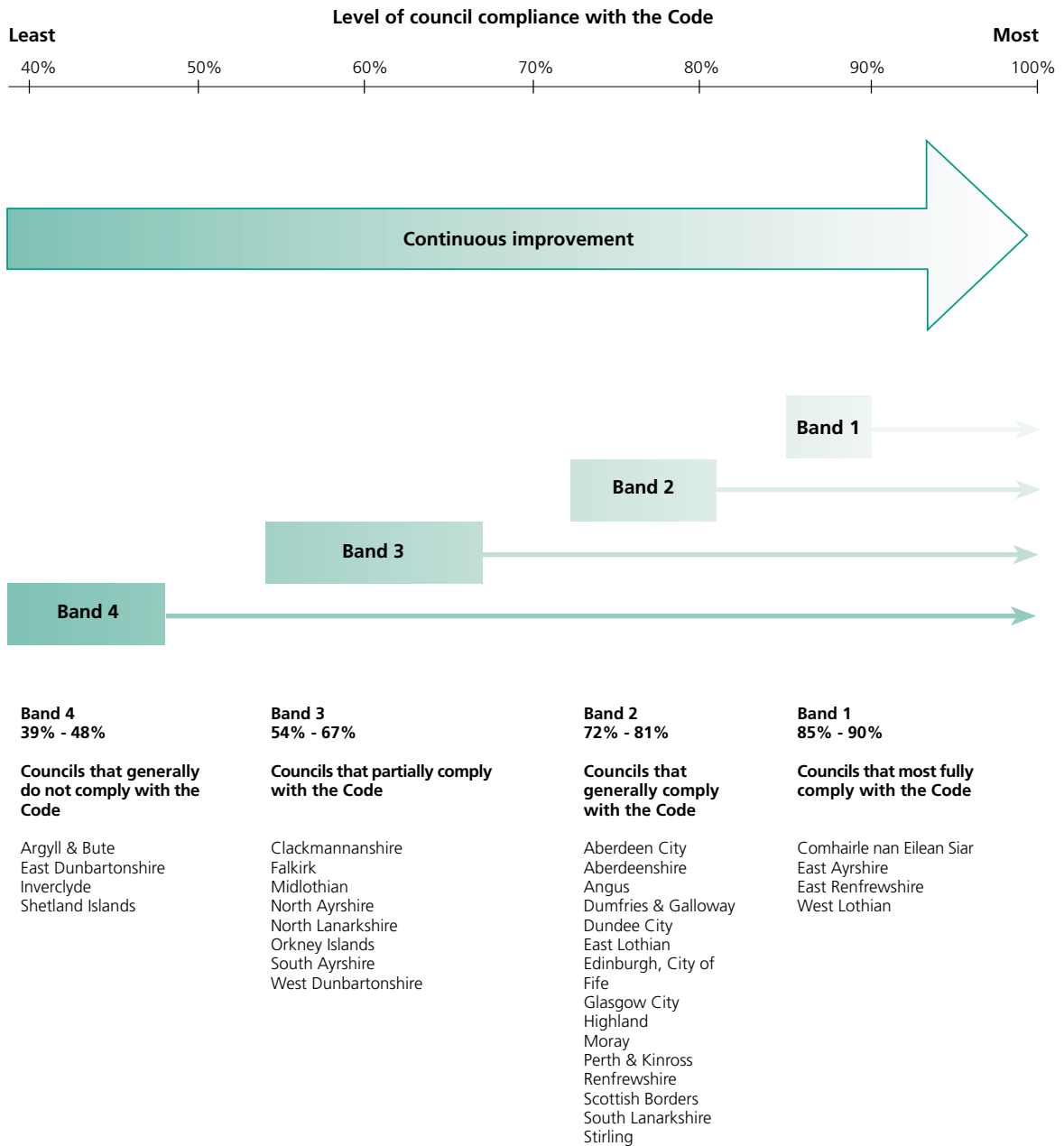
How councils performed

The study found that there is room for improvement in internal audit in all councils, but some councils perform significantly better than others (Exhibit 4). Councils are grouped according to their assessed level of compliance with the Code and listed in alphabetical order within the four performance bands. The better performing councils tend to perform well across the board, whereas councils in the lowest band of performance tend to perform poorly in most areas.

No council complied completely with the Code, but four councils – Comhairle nan Eilean Siar, East Ayrshire, East Renfrewshire and West Lothian were found to comply most fully (over 85% compliance). The councils with the lowest level of compliance with the Code were Argyll & Bute, East Dunbartonshire, Inverclyde and Shetland (below 50% compliance). Twenty councils complied with more than 70% of the standards in the Code.

Exhibit 4: Extent of council compliance with the CIPFA Code of Practice

All councils need to improve their compliance with the Code. Councils in bands 3 and 4 have the most to do.

Level of council compliance with the Code

Least   Most

40%   50%   60%   70%   80%   90%   100%

Continuous improvement

Band 1

Band 2

Band 3

Band 4

Band 4 **39% - 48%**	**Band 3** **54% - 67%**	**Band 2** **72% - 81%**	**Band 1** **85% - 90%**
Councils that generally do not comply with the Code	**Councils that partially comply with the Code**	**Councils that generally comply with the Code**	**Councils that most fully comply with the Code**
Argyll & Bute East Dunbartonshire Inverclyde Shetland Islands	Clackmannanshire Falkirk Midlothian North Ayrshire North Lanarkshire Orkney Islands South Ayrshire West Dunbartonshire	Aberdeen City Aberdeenshire Angus Dumfries & Galloway Dundee City East Lothian Edinburgh, City of Fife Glasgow City Highland Moray Perth & Kinross Renfrewshire Scottish Borders South Lanarkshire Stirling	Comhairle nan Eilean Siar East Ayrshire East Renfrewshire West Lothian

Note: Councils are listed in alphabetical order within each performance band.

Source: Audit Scotland

The support and commitment of councillors, senior management, particularly the director of finance and chief executive, are key factors in developing an effective internal audit service. Some features most commonly found in the better performing councils, which were usually absent in the poorer performing councils, included:

- The presence of an audit committee, or equivalent, to hold internal audit to account and to ensure agreed audit recommendations are implemented.
- The use of comprehensive risk assessment to determine the council's internal control priorities and the work of internal audit.
- A richer skill-mix, which may be reflected in above-average unit staff costs, but not necessarily higher total audit costs. There is a significant correlation between the assessment score and the cost per audit day ($r^2 = 0.49$).
- Annual reporting by the chief internal auditor giving an overall assessment of internal controls.

The assessments highlighted a number of areas where improvement actions are required in a significant number of councils. For example:

- In 15 councils, the line-management arrangements for chief internal auditors did not comply with the Code (ie, their line manager was at a lower organisational level than the responsible finance officer). In these councils, there is a risk that the status and independence of the chief internal auditor may be compromised.
- In ten councils, internal audit did not maintain open channels of communication with members.
- 16 councils did not have defined control objectives for all major systems.
- 11 councils did not have an adequate anti-fraud and corruption strategy.
- Internal audit time spent on systems and internal control was more than 10% under-budget in 14 councils.
- 18 internal audit services did not use the results of follow-up work to update their risk assessment.
- In ten councils, the chief internal auditor did not co-ordinate and review the training and development requirements of their staff. In 13 councils, there was no induction programme for new staff.
- In nine councils, there was scope for chief internal auditors to further develop their use of performance indicators to measure the performance of their service.

The assessments also highlighted a number of areas of good practice. For example:

- Over 90% of service managers surveyed felt that internal audit recommendations were concise, clear and constructive.
- Service managers were generally satisfied with the time taken by internal audit to submit its draft and final reports.
- Internal audit generally had good working relationships with their external auditors, inspectorates and other review agencies.
- Standards of professional and ethical behaviour of internal audit staff were high across all councils.
- Five councils had independent accreditation (eg, ISO 9000 or 9002), which can assist in ensuring that the appropriate standards are in place.

Opportunities for the future

All internal audit services need to embrace a culture of continuous improvement, adopting proven best practice from other public sector and private sector organisations. Best Value and other initiatives are fundamentally changing the way councils work and this presents

opportunities as well as challenges for internal audit services. These include:

- **The introduction of audit committees and revised council structures.** Sixteen councils now have audit committees (or equivalent).
- **The changing role of internal audit.** Internal audit is emerging from its traditional 'policing' role to developing a more proactive corporate role. This changing role demands broader competencies than those of traditional audit services.
- **Expansion in the use of ICT.** The growing use of e-commerce and electronic signatures is placing greater demands on councils for expert skills in computer audit.
- **Getting improved value from council resources.** There is an opportunity for internal audit to develop new and improved ways of working to enable it to manage its resources more effectively.
- **The likely introduction of internal (financial) control statements (ICS).** These have been successfully introduced in other parts of the public and private sectors as a means of providing assurance to shareholders or stakeholders on the adequacy of internal controls within the organisation. The CIPFA LASAAC Joint Committee is actively considering the introduction of ICS to local government accounts.

However, in order to be able and well placed to meet these challenges councils need to ensure that internal audit is undertaking its core work effectively.

Challenging councils to improve

All councils have individual reports from their external auditor, assessing their level of compliance with the CIPFA Code of Practice. These show that some have a lot to do in raising their standards to those reflected in the Code. Each council is expected to implement the agreed recommendations contained in their external auditor's report.

Where the room for improvement is significant (particularly those councils falling within performance band 4), substantial progress is needed in a short space of time. There is a strong case for these councils testing current provision against what the market might provide. This would involve looking at options that would provide a high-quality service that ensures that the council's control objectives are met, at acceptable cost. These options would include:

- buying in specialist skills, for example, computer audit expertise
- entering into consortia arrangements with other councils
- partnership arrangements with the private sector
- externalising service provision.

Irrespective of who provides the service, the critical factors that underpin a Best Value internal audit service remain the same. All councils should be looking to develop sound internal control arrangements where:

- **councillors** are demonstrably committed to supporting the need for a sound internal control environment, including internal audit
- **senior managers** are demonstrably committed to maintaining effective internal controls and implementing sound internal audit arrangements
- **chief internal auditors** demonstrably provide an excellent internal audit service.

Exhibit 5 provides a checklist that highlights the key messages for an effective internal audit service. It should help councillors, chief executives, senior managers and chief internal auditors to ensure that their council has these arrangements in place. External auditors will be monitoring progress.

Exhibit 5: Achieving a Best Value internal audit service – a checklist for councillors, chief executives, senior managers and chief internal auditors

Critical factors	Key enabling factors	
1. Setting clear and properly focused objectives for internal audit	■ Is the council committed to establishing an effective internal audit service?	☐
	■ Does internal audit have clear terms of reference agreed by senior management and communicated these across the council?	☐
	■ Does internal audit have a good understanding of the risks facing the council, developed in consultation with all service managers?	☐
2. Ensuring that internal audit is independent	■ Does internal audit have direct access to councillors, the chief executive and the director of finance?	☐
	■ Does internal audit have (and is it seen to have) independence from operational procedures?	☐
	■ Does internal audit have the right of final edit in submitting reports?	☐
3. Making sure the work of internal audit is properly planned	■ Does internal audit's planned work support the corporate objectives of the council?	☐
	■ Does internal audit ensure that all planned work reflects the results from its systematic assessment of the council's risks?	☐
	■ Does internal audit plan a sufficient contingency to accommodate unforeseen work, enabling it to complete its planned work within time-scale?	☐
4. Making sure internal audit is adequately resourced	■ Does senior management ensure that internal audit has the resources required to meet the internal control needs of the council?	☐
	■ Does the council recruit and train suitably skilled internal audit staff?	☐
	■ Has senior management given authority to the chief internal auditor to access specialist skills to tackle complex areas?	☐
5. Ensuring that internal audit findings are reported and followed up	■ Does internal audit report weaknesses in internal control for action by management?	☐
	■ Does senior management systematically encourage all managers to implement report recommendations within agreed time-scales?	☐
	■ Does internal audit report any failure by management to implement agreed recommendations?	☐
	■ Does internal audit provide an annual report, providing an overall view on the soundness of the council's internal control systems?	☐
6. Ensuring that internal audit is held to account for its performance	■ Does the council have an audit committee or equivalent to:	
	– approve internal audit work plans?	☐
	– review internal audit's output and performance and ensure that it completes its programme of work?	☐
	– act as a conduit for receiving audit reports and call service managers to account?	☐
	■ Does internal audit prepare annual performance plans, setting out its achievements and targets?	☐
	■ Does internal audit maintain an effective performance management framework to continuously review and improve its performance?	☐

1. Introduction

Why look at internal audit?

Scotland's councils are required to have in place arrangements for ensuring propriety, regularity and value for money in their stewardship of public funds[2]. It is the responsibility of management to ensure that adequate internal controls[3] are in place to:

- ensure sound corporate governance
- ensure that their council's resources are applied in the manner and on the activities intended
- prevent, detect and deter fraud and impropriety
- ensure the most economic, efficient and effective use of resources.

Internal audit supports management in maintaining sound corporate governance and internal controls. It does this by independently examining and evaluating council systems, and reporting any inadequacies in internal control for action by management.

The Accounts Commission aims to ensure that all councils achieve the highest standards of financial stewardship, governance and public accountability. However, in recent years, there have been a number of instances where external auditors of councils have reported weaknesses in internal audit. The Commission requested Audit Scotland to carry out this national study to:

- establish a clear picture of the performance of internal audit services in all councils in Scotland
- provide benchmarking data to support continuous improvement.

There have been a number of developments in recent years to strengthen corporate governance and internal control in both public and private sectors. These developments have had a significant impact on the way an internal audit function should operate.

In the private sector[4], these include the Cadbury report, which set out a code of best practice for corporate governance in listed companies, including the role of audit committees and internal audit. More recently, the Turnbull report set out guidance for directors on internal control to meet the listing rules of the stock exchange, including the need for internal audit and the requirement for the board to produce a statement on internal control.

In the public sector, examples include the introduction of internal financial control assurance statements and audit committees in the NHS, and the adoption of audit committee principles by an increasing number of councils in Scotland.

There are a number of recent initiatives in local government that will also have an impact on councils' arrangements for internal audit including:

- The Leadership Advisory Panel (LAP)[5], which reported to Ministers in June 2001 making recommendations for councils' scrutiny arrangements and how they account for their performance. These will have implications for scrutiny and audit committees and the reporting arrangements for internal audit.

- The joint report by CIPFA and SOLACE published in June 2001[6], which sets out a framework for corporate governance in local authorities, including:
  - a systematic strategy for risk management and internal control
  - the publication of an annual report presenting an objective, understandable account and assessment of the council's:
    - activities and achievements
    - financial position and performance.

Other developments that present significant challenges for internal audit in the public sector include the modernising government agenda and electronic service delivery. The implications of these for audit have been considered in reports[7] published by the Public Audit Forum[8].

All of these factors will have an impact on councils' arrangements for internal audit and the skills that internal auditors will need to provide an effective audit service.

This report provides a national overview. It assesses current council performance and makes recommendations that will assist all councils to develop excellent internal audit services in the future. Details of the specific steps that need to be taken by individual councils are contained in their local external audit reports and action plans.

Study objectives and methodology

The aim of this study is to help councils to achieve Best Value from their internal audit arrangements. There are three main objectives:

1. to assess the extent to which councils' internal audit services meet the standards of good practice set out in the CIPFA Code of Practice for Internal Audit in Local Government[9]

2. to promote best practice in internal audit and encourage councils to fully comply with the Code

3. to make recommendations that will help all councils develop a Best Value internal audit service.

The approach and methodology was developed in consultation with the study advisory group (Appendix 1), the Scottish Local Authorities Chief Internal Auditors' Group, and a panel of external auditors. It involved identifying critical success factors for internal audit services and establishing a framework of issues to be used in assessing the level of council compliance with the CIPFA Code.

Six critical success factors were identified (Exhibit 1), supported by 15 statements of good practice and 97 tests on individual council processes and outcomes (Exhibit 2).

Exhibit 1: Critical success factors

The study identified six critical success factors for internal audit.

1. Setting clear and properly focused objectives for internal audit
2. Maintaining internal audit independence
3. Planning and controlling the work of internal audit
4. Resourcing the internal audit work programme
5. Having effective reporting and follow-up arrangements
6. Holding internal audit to account for its performance

Source: Audit Scotland

Exhibit 2: Structure of the assessment

Fifteen statements of good practice and 97 tests on council processes and outcomes support the six critical success factors.

Six critical success factors	**Fifteen statements of good practice**	**Ninety-seven tests on individual council processes and outcomes**
eg, Having effective reporting and follow-up arrangements.	eg, Internal audit has clear reporting arrangements that provide management with an opinion on the adequacy of internal control.	eg, Internal audit produces clear, concise and constructive written reports.
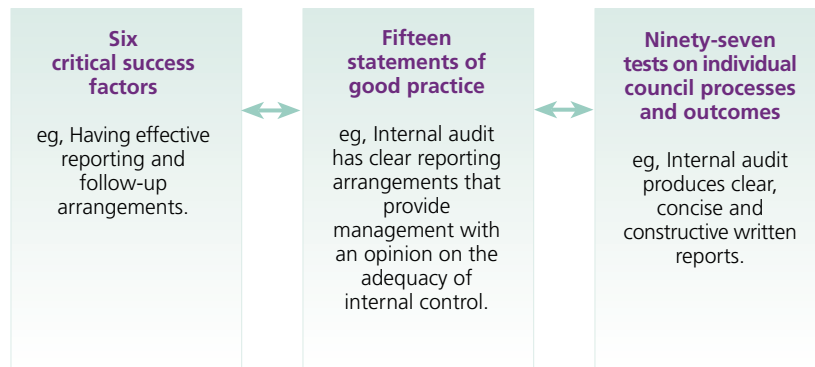
Source: Audit Scotland

Exhibit 3 sets out the relationship between the six critical success factors and the 15 statements of good practice.

Exhibit 3: The critical success factors and their linked statements of good practice

Councils' internal audit services were assessed against these statements of good practice.
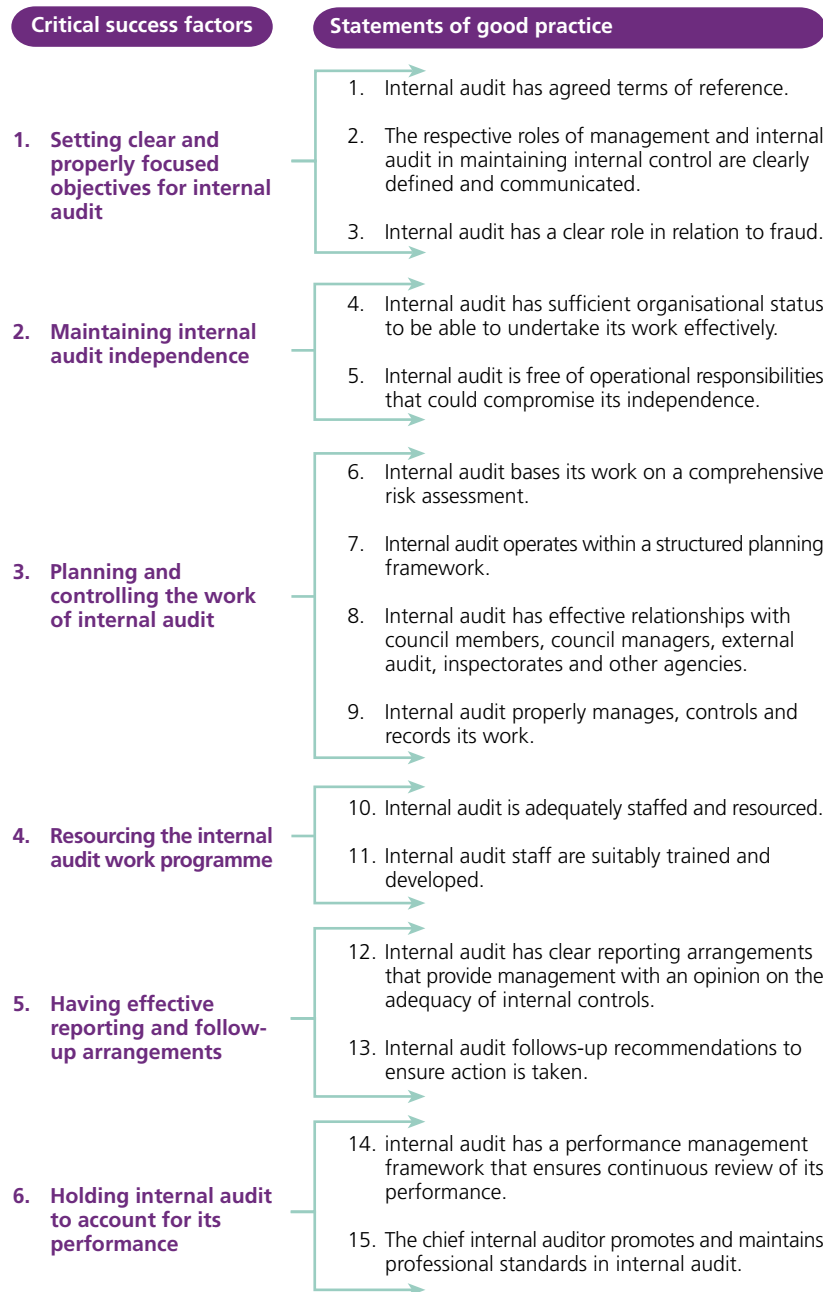
Critical success factors	Statements of good practice
1. Setting clear and properly focused objectives for internal audit	1. Internal audit has agreed terms of reference. 2. The respective roles of management and internal audit in maintaining internal control are clearly defined and communicated. 3. Internal audit has a clear role in relation to fraud.
2. Maintaining internal audit independence	4. Internal audit has sufficient organisational status to be able to undertake its work effectively. 5. Internal audit is free of operational responsibilities that could compromise its independence.
3. Planning and controlling the work of internal audit	6. Internal audit bases its work on a comprehensive risk assessment. 7. Internal audit operates within a structured planning framework. 8. Internal audit has effective relationships with council members, council managers, external audit, inspectorates and other agencies. 9. Internal audit properly manages, controls and records its work.
4. Resourcing the internal audit work programme	10. Internal audit is adequately staffed and resourced. 11. Internal audit staff are suitably trained and developed.
5. Having effective reporting and follow-up arrangements	12. Internal audit has clear reporting arrangements that provide management with an opinion on the adequacy of internal controls. 13. Internal audit follows-up recommendations to ensure action is taken.
6. Holding internal audit to account for its performance	14. internal audit has a performance management framework that ensures continuous review of its performance. 15. The chief internal auditor promotes and maintains professional standards in internal audit.

Source: Audit Scotland

External auditors used this performance framework to conduct their independent assessments. These were based on:

- interviews and evidence gathered from each council's chief executive, director of finance and chief internal auditor
- surveys of the heads of education, housing and social work services in all councils to obtain their assessment of internal audit performance in their service areas
- benchmarking information collected on each council's internal audit service, including an analysis of staffing numbers, expenditure and workload.

Details of the assessment and scoring methodology are given in Appendix 2, and the results are given in Appendices 3 and 4. In addition, the study team also visited a number of councils and interviewed councillors who were members of audit committees.

Structure of the report

The report is in four sections.

Section 2 – describes the role and the requirement for internal audit in councils. It also looks at the level of resources Scottish councils invest in internal audit.

Section 3 – summarises the results of the external audit assessments. It highlights specific areas where there is scope for councils to improve internal audit performance and makes recommendations for making the necessary improvements.

Section 4 – describes the main challenges facing councils in providing Best Value internal audit services. It summarises the key actions that councils need to take to ensure that their internal audit services are fit to meet the challenges facing them. An action checklist comprising the key messages is included for use by councillors, chief executives, senior managers and chief internal auditors.

Appendices:

- membership of the study advisory group (Appendix 1)
- assessment and scoring methodology (Appendix 2)
- results of external audit assessments for each council (Appendix 3)
- scores for each of the 97 tests (Appendix 4)
- client survey findings (Appendix 5)
- views of chief executives and directors of finance (Appendix 6)
- notes.

2. The internal audit service

Why have internal audit?

Internal audit provides a valuable service to councils by helping them to implement cost-effective and efficient systems of internal control, and by providing senior management and members with assurance that internal control systems are operating effectively.

Effective internal audit is not only essential for sound corporate governance, it can also add value, for example, by both assisting the council to obtain Best Value from its resources and by providing advice to service managers and staff.

In Scotland, as in England and Wales, legislation provides that authorities: "shall make arrangements for the proper administration of their financial affairs...". However, in respect of securing effective internal audit, the position is different. In England and Wales, specific provision is contained in legislation (The Accounts and Audit Regulations 1996 (SI 1996/590)), whereas in Scotland, effective internal audit is commended as good practice in a Scottish Office Circular (Exhibit 4). The combination of the Local Government (Scotland) Act and the Circular has the effect of ensuring that all councils in Scotland make appropriate arrangements for internal audit. The importance of internal audit would be reinforced by making it a statutory requirement.

Exhibit 4: The requirement for internal audit in councils in Scotland, and in England and Wales

The legislative requirements for internal audit differ north and south of the border.

	England and Wales	**Scotland**
Requirement for proper administration of financial affairs	Section 151 of the Local Government Act 1972, requires that authorities:	Section 95 of the Local Government (Scotland) Act 1973 specifies that every local authority:
	"shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs."	"shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer has responsibility for those affairs."
Requirement for internal audit in councils	The Accounts and Audit Regulations 1996 (SI1996/590) require that a:	Scottish Office Circular 5/85 states:
	"relevant body shall maintain an adequate and effective system of internal audit of their accounting records and control systems."	"effective internal audit cover is regarded as a matter of good practice."

Source: CIPFA Code of Practice for Internal Audit in Local Government

The complementary roles of internal and external audit

Internal audit and external audit have different but complementary roles.

Internal audit is 'an independent appraisal function established by the management of an organisation for the review of the internal control system as a service to the organisation. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources'[10].

The role of external audit is to undertake an independent appraisal of the discharge by management of its stewardship responsibilities, to enable the external auditor to assess and report on whether those responsibilities have been reasonably discharged. This involves:

- reviewing and testing the effectiveness of the internal controls in place
- reviewing the council's arrangements for securing economic, efficient and effective use of its resources
- providing an opinion on the council's financial statements.

External auditors review the work undertaken by internal audit as part of their review of the council's internal control framework. They look to rely on internal control reviews undertaken by internal audit, to make the most efficient use of the combined audit resource. It is therefore important that there are good channels of communication between external and internal audit.

An effective internal audit can contribute significantly to reducing the work of external audit. Audit Scotland provides a flexible arrangement for external auditors to agree appropriate audit fees with councils, taking into account the standard of corporate governance, including the quality and coverage of the work undertaken by internal audit. In future, public bodies with good internal control procedures will be expected to negotiate lower fees.

The role and organisational framework for internal audit

Within each council, there are a number of key stakeholders who have an important role in ensuring that their council benefits from an effective internal audit service:

- **the chief executive** who looks to internal audit to provide objective assurance on the effectiveness of the council's risk management and internal control framework, and to assist the council to achieve the highest standards of corporate governance and financial stewardship.
- **the Section 95 officer, normally the director of finance** who is responsible for ensuring that the council:
  - has arrangements for the proper administration of its financial affairs
  - has put in place effective arrangements for the internal audit of its systems of internal control.
- **the chief internal auditor** who is responsible for ensuring that internal audit makes a significant and positive contribution to the council by, for example:
  - providing advice on the management of risk, especially on issues surrounding the design, implementation and operation of systems of internal control
  - enhancing efficient and effective risk and control management by recommending controls to avoid operational losses
  - providing advice to all parts of the council on good risk identification and internal control procedures.

- **service managers** who are responsible for ensuring that effective internal controls are in place in their service, who contribute to the council's risk assessment processes and who, drawing on the advice of internal audit, design and operate systems to minimise the risks to which the council is exposed.
- **the chair of the audit committee** (or equivalent group) who is concerned to ensure that the council receives objective assurance as to the adequacy and effectiveness of its risk management and internal control framework. An increasing number of councils are introducing audit committees. This is looked at in detail in Section 3.

All chief internal auditors require operational independence in order to be seen to exercise their own professional judgement. Free access to each of these key stakeholders is therefore essential in enabling chief internal auditors to fulfil their role effectively. Auditing standards, for example, those of the Institute of Internal Auditors, reinforce the requirement of the chief internal auditor to have direct access to the chief executive and the chair of the audit committee (or equivalent).

Resourcing the internal audit service

Every Scottish council has its own internal audit service resourced by in-house staff. (Comhairle nan Eilean Siar has a partnership arrangement with the private sector. It has three in-house staff, headed by a qualified accountant, with the quality assurance role being provided by a private firm.) This contrasts with the NHS where consortia of in-house staff provide internal audit services to eight health board areas. The private sector provides internal audit services in the remaining seven health board areas.
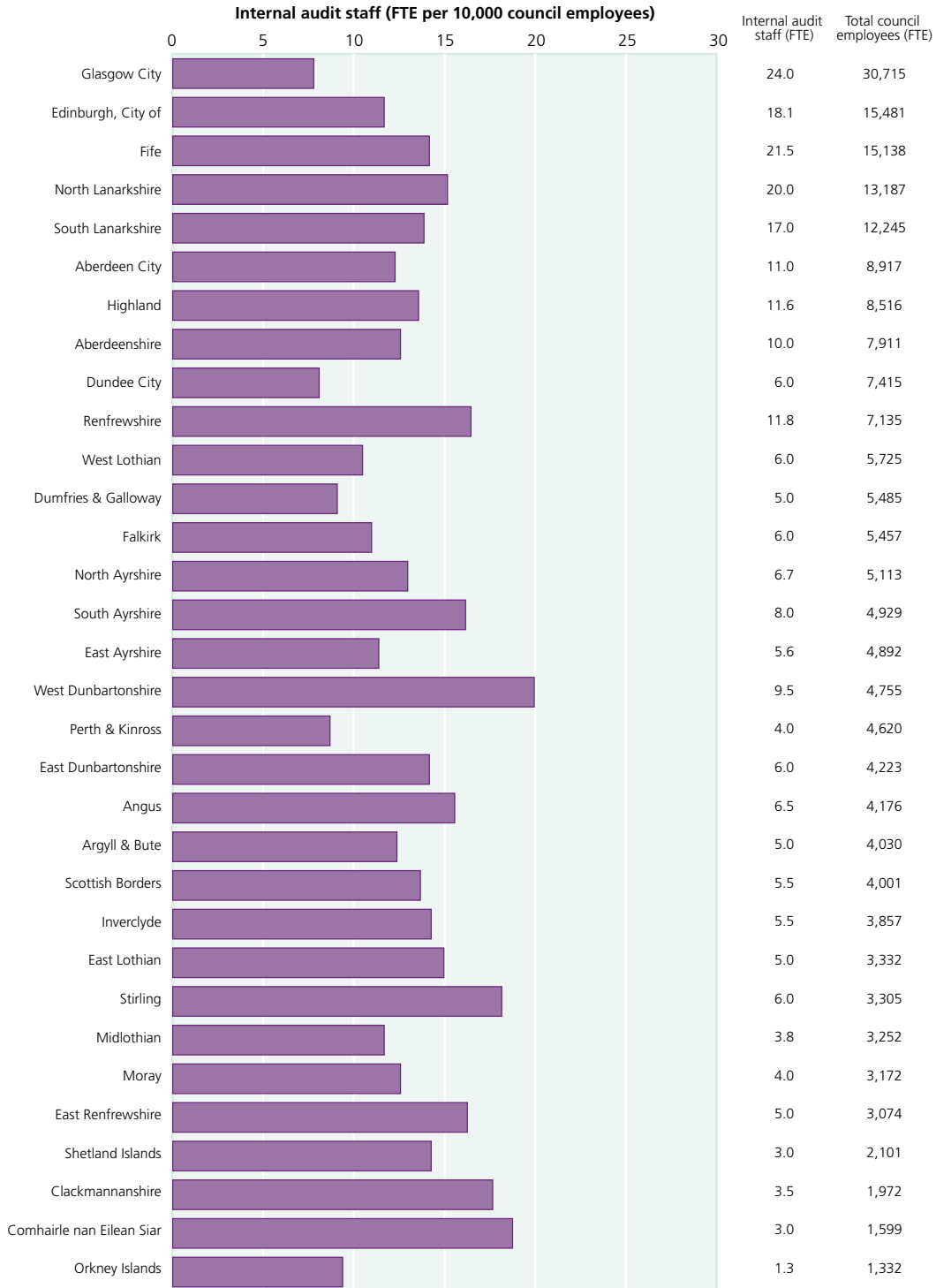
The total amount invested in internal audit in all 32 Scottish councils is £9.3 million – about 0.1% of aggregate council expenditure[11]. There are 300 full-time equivalent (FTE) established posts of which 265 were filled, at the date of the study. Ten councils also provide internal audit services to other public bodies, for example, local police, fire and other joint boards. This work accounts for between 2-5% of total internal audit staff time in the councils concerned.

The Institute of Public Finance (IPF) has recently benchmarked the level of investment in internal audit, north and south of the border (£ invested per £m council spend). It identified that, on average, unitary councils in England and Wales spend some 40% more on internal audit than councils in Scotland, with more days being invested at broadly comparable daily rates.

The size of internal audit services varies significantly between councils, ranging from 24 FTE in Glasgow to 1.3 FTE in Orkney (Exhibit 5). Economies of scale may apply in the larger councils, but there is wide variation in the proportion of internal audit staff employed by broadly comparable councils.

Exhibit 5: The number of internal audit staff (FTE per 10,000 council FTE employees)

There is wide variation in the proportion of internal audit staff employed by broadly comparable councils.

Internal audit staff (FTE per 10,000 council employees)

Council	Internal audit staff (FTE)	Total council employees (FTE)
Glasgow City	24.0	30,715
Edinburgh, City of	18.1	15,481
Fife	21.5	15,138
North Lanarkshire	20.0	13,187
South Lanarkshire	17.0	12,245
Aberdeen City	11.0	8,917
Highland	11.6	8,516
Aberdeenshire	10.0	7,911
Dundee City	6.0	7,415
Renfrewshire	11.8	7,135
West Lothian	6.0	5,725
Dumfries & Galloway	5.0	5,485
Falkirk	6.0	5,457
North Ayrshire	6.7	5,113
South Ayrshire	8.0	4,929
East Ayrshire	5.6	4,892
West Dunbartonshire	9.5	4,755
Perth & Kinross	4.0	4,620
East Dunbartonshire	6.0	4,223
Angus	6.5	4,176
Argyll & Bute	5.0	4,030
Scottish Borders	5.5	4,001
Inverclyde	5.5	3,857
East Lothian	5.0	3,332
Stirling	6.0	3,305
Midlothian	3.8	3,252
Moray	4.0	3,172
East Renfrewshire	5.0	3,074
Shetland Islands	3.0	2,101
Clackmannanshire	3.5	1,972
Comhairle nan Eilean Siar	3.0	1,599
Orkney Islands	1.3	1,332

Note: Councils are listed in order of the number of total council employees in post at the time of the study.
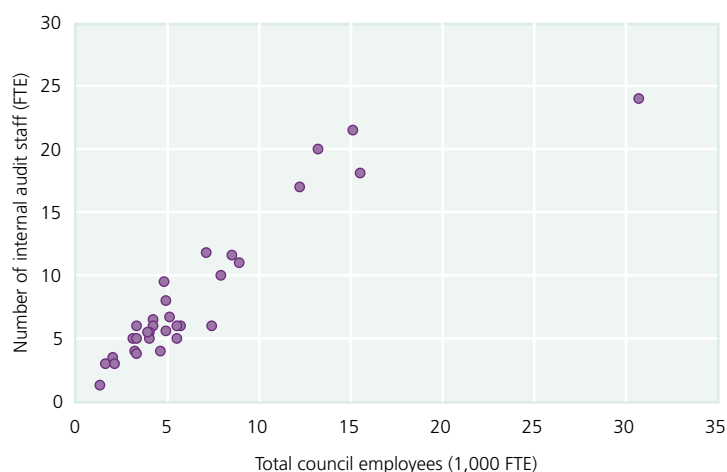
Source: Local audit returns and Joint Staffing Watch (March 2001)

Some of these variations are caused by differences in organisational arrangements between councils. For example, some internal audit services provide services in addition to mainstream audit (eg, in Angus Council the internal audit section employs dedicated value for money staff). Conversely, other councils (eg, East Ayrshire, Glasgow City and South Lanarkshire), have dedicated units outwith internal audit that review aspects of internal control in specialist areas such as contract audit. However, the overall number of such staff is low.

Exhibit 6 highlights the variation in the number of internal audit staff employed by councils having broadly similar circumstances.

Exhibit 6: The number of internal audit staff vs. the total number of council employees

There is a high degree of correlation (r^2=0.95) between the number of internal audit staff and the number of council employees, although there is considerable variation in the number of internal audit staff among councils of similar size.

Source: Local audit returns, Joint Staff Watch, (March 2001)

Exhibit 7 shows the qualifications held by internal audit staff across Scotland. Over 60% of internal audit staff either already hold a professional accountancy qualification or are studying towards one:
- 34% hold a Consultative Committee of Accountancy Bodies (CCAB) qualification
- 11% have a relevant auditing qualification, eg, membership of the Institute of Internal Auditors (IIA)
- 18% are actively pursuing an accountancy qualification.

In addition, a small proportion of staff (5%) have other relevant qualifications in areas such as management and information technology. The remaining one third comprises unqualified and clerical staff.

Exhibit 7: Qualifications among internal audit staff

A third of internal audit staff has a CCAB qualification.
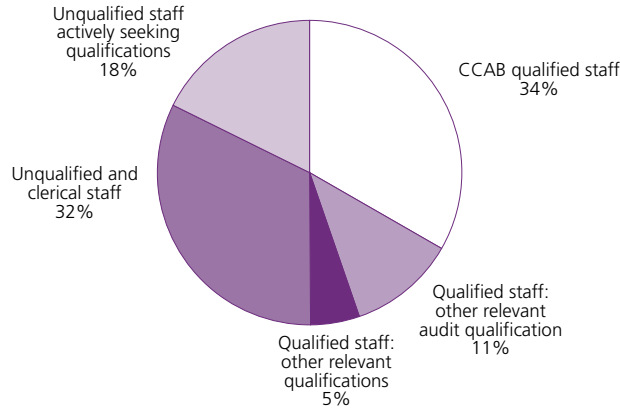
Source: Local audit returns

What internal audit does

Exhibit 8 summarises the types of work undertaken by internal audit services. They all undertake broadly similar types of internal control work. This involves testing and reviewing the internal controls of key financial and non-financial systems, investigating any frauds or irregularities and, in some councils, specific computer audit and contract audit work.

Exhibit 8: The types of work undertaken by internal audit

Internal audit can be involved in a wide variety of tasks.

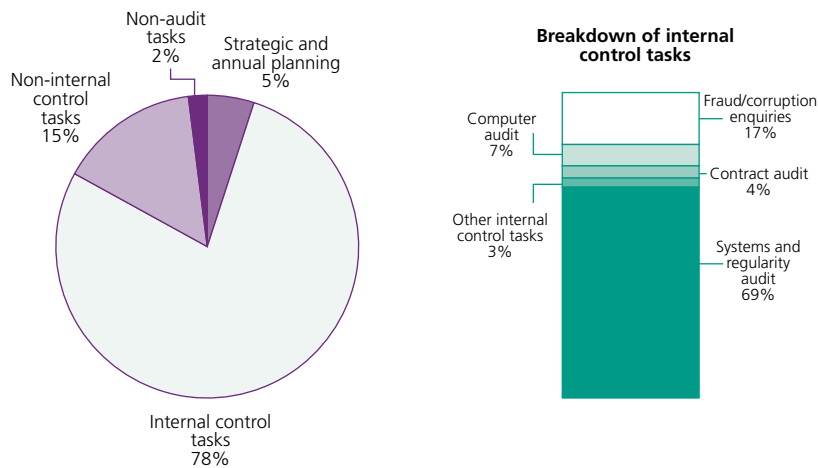| Core tasks		Non-internal control tasks	Non-audit tasks
Strategic and annual planning	**Internal control tasks**		
Risk assessment	Systems and regularity audit	Best Value reviews	Bank reconciliations
Strategic planning	Computer audit	Value for money work	Financial accounting duties
Annual planning	Contract audit	Consultancy /advice	Internal checks
	Fraud/corruption enquiries	Risk management services	

Source: Local audit returns

Exhibit 9 shows that internal control tasks account for 78% of total time. This is made up of systems and regularity audit[12] (69% of internal control tasks), fraud[13] and corruption[14] work (17%), computer audit (7%), contract audit (4%) and other internal control tasks (3%).

Overall, strategic and annual planning of internal audit work takes about 5% of total available time. About 15% of audit time is spent on non-internal control tasks (ie, value for money work, consultancy and advice) – areas of work where internal audit is able to make a valuable contribution, but which may also be undertaken by staff outside internal audit.

A small proportion (2%) of internal audit staff time is spent on non-audit tasks that may compromise the independence of internal audit (eg, preparation of bank reconciliations). This type of work is looked at in more detail in Section 3.

Exhibit 9: Internal audit workload

More than three-quarters of internal audit time is spent on internal control tasks.

Non-audit tasks 2%
Strategic and annual planning 5%
Non-internal control tasks 15%
Internal control tasks 78%

Breakdown of internal control tasks

Computer audit 7%
Fraud/corruption enquiries 17%
Contract audit 4%
Other internal control tasks 3%
Systems and regularity audit 69%

Source: Local audit returns

3. Assessment of internal audit performance

Introduction

The assessment framework was developed from the CIPFA Code of Practice. CIPFA updated its Code in October 2000 to reflect the following changes in accepted good practice in recent years:

- work and audit planning should be based on comprehensive risk assessment
- the head of internal audit should provide an overall assessment and produce an annual report containing a view of the internal control system.

External auditors finalised their assessments only three to four months after the publication of the revised Code, so councils may not have had time to put arrangements in place to comply fully with the revised Code in these areas.

Where improvement actions are identified, responsibility for implementing these does not rest solely with chief internal auditors. It will require political leadership from the council and the support of the chief executive, director of finance and service managers.

Councils have received feedback on their assessments and a number of councils have already introduced changes to improve their internal audit service.

Overall assessment of council performance

There is room for improvement in internal audit in all councils, but some perform significantly better than others (Exhibit 10). Councils are grouped according to their assessed level of compliance with the Code and listed in alphabetical order within the four performance bands. The methodology used to derive the performance bands is included at Appendix 2.
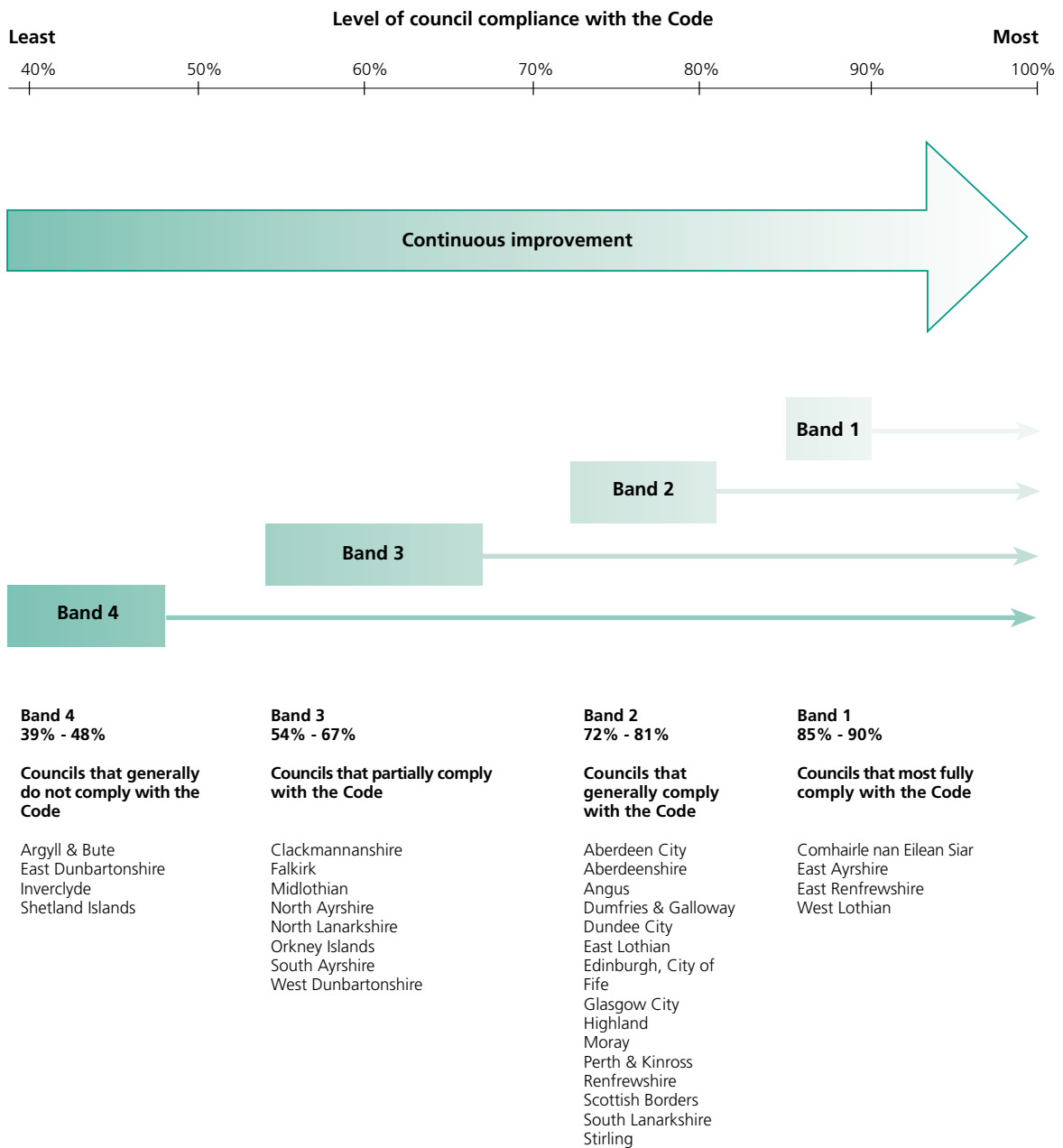
No council complied fully with the Code but four councils – Comhairle nan Eilean Siar, East Ayrshire, East Renfrewshire and West Lothian complied with over 85% of standards in the code.

The councils with the lowest level of compliance with the Code (less than 50%) were Argyll & Bute, East Dunbartonshire, Inverclyde and Shetland.

Twenty councils (those in bands 1 and 2) complied with more than 70% of the Code.

Exhibit 10: Extent of council compliance with the CIPFA Code of Practice

All councils need to improve their compliance with the Code. Councils in bands 3 and 4 have the most to do.

Level of council compliance with the Code

Least   Most

40%   50%   60%   70%   80%   90%   100%

Continuous improvement

Band 1

Band 2

Band 3

Band 4

Band 4	Band 3	Band 2	Band 1
39% - 48%	**54% - 67%**	**72% - 81%**	**85% - 90%**
Councils that generally do not comply with the Code	**Councils that partially comply with the Code**	**Councils that generally comply with the Code**	**Councils that most fully comply with the Code**
Argyll & Bute	Clackmannanshire	Aberdeen City	Comhairle nan Eilean Siar
East Dunbartonshire	Falkirk	Aberdeenshire	East Ayrshire
Inverclyde	Midlothian	Angus	East Renfrewshire
Shetland Islands	North Ayrshire	Dumfries & Galloway	West Lothian
	North Lanarkshire	Dundee City	
	Orkney Islands	East Lothian	
	South Ayrshire	Edinburgh, City of	
	West Dunbartonshire	Fife	
		Glasgow City	
		Highland	
		Moray	
		Perth & Kinross	
		Renfrewshire	
		Scottish Borders	
		South Lanarkshire	
		Stirling	

Note: Councils are listed in alphabetical order within each performance band.

Source: Audit Scotland

Exhibit 11 shows the average council scores for each of the 15 statements, within each performance band. These results show that councils in:

- **band 1** perform well across the board (averaging over three out of four for each statement)
- **band 2** perform reasonably well for most statements
- **band 3** have substantial room for improvement for most statements
- **band 4** have substantial room for improvement across all statements (averaging less than three for each statement).

The support and commitment of councillors, senior management, particularly the director of finance and chief executive, are key factors in developing an effective internal audit service. Some features most commonly found in the better performing councils, which were usually absent in the poorer performing councils, included:

- the presence of an audit committee, or equivalent, to hold internal audit to account and to ensure agreed recommendations are implemented
- the use of comprehensive risk assessment to determine the council's internal control priorities and the work of internal audit
- a richer skill-mix, which may be reflected in above-average unit staff costs, but not necessarily higher total audit costs. There is a significant correlation between the assessment score and the cost per audit day ($r^2 = 0.49$)
- annual reporting by the chief internal auditor giving an overall assessment of internal controls.

The remainder of this section is structured around the six critical success factors. It explores the main strengths found, identifies areas for further improvement and makes recommendations that, in most cases, apply to a number of councils. Specific details of the improvement actions needing to be taken by individual councils can be found in their external auditor's local report and action plans.

Appendix 3 contains a summary of each council's performance for each of the 15 statements. Appendix 4 contains a summary of the assessment scores for each of the 97 tests.

Exhibit 11: Average assessment scores for each statement of good practice for councils in each performance band

The better performing councils tend to perform well across the board, whereas councils in the lowest band of performance tend to perform poorly in most areas.

Key

1. Internal audit has agreed terms of reference.
2. The respective roles of management and internal audit in maintaining internal control are clearly defined and communicated.
3. Internal audit has a clear role in relation to fraud.
4. Internal audit has sufficient organisational status to be able to undertake its work effectively.
5. Internal audit is free of operational responsibilities that could compromise its independence.
6. Internal audit bases its work on a comprehensive risk assessment.
7. Internal audit operates within a structured planning framework.
8. Internal audit has effective relationships with council members, council managers, external audit, inspectorates and other agencies.
9. Internal audit properly manages, controls and records its work.
10. Internal audit is adequately staffed and resourced.
11. Internal audit staff are suitably trained and developed.
12. Internal audit has clear reporting arrangements that provide management with an opinion on the adequacy of internal controls.
13. Internal audit follow-up their recommendations to ensure action is taken.
14. Internal audit has a performance management framework that ensures continuous review of its performance.
15. The chief internal auditor promotes and maintains professional standards in internal audit.

Critical factor 1 – Setting clear and properly focused objectives

Agreed terms of reference, that are widely communicated across the council, help to ensure that the role and objectives of internal audit are made clear to both internal audit and its clients.

Where properly designed terms of reference are not in place there is a risk that staff may not be clear about their roles and responsibilities and management may not be clear about their role in maintaining effective internal controls.

Communicating internal audit roles and responsibilities

Terms of reference cover areas such as the aims and objectives of internal audit, the scope and remit of their work, and rights of access. Senior management and members should formally agree terms of reference. It is important that the role and objectives of internal audit are understood across the council, and the Code recommends that a charter or mission statement is a good way of achieving this.

In many councils, internal audit terms of reference are set out briefly in council Standing Orders and Financial Regulations rather than as a separate, formally approved, document, as recommended by the Code. Overall, nine councils do not have separate written terms of reference.

The Code sets out the key areas that should be covered by internal audit's terms of reference. However:
- in 13 councils, the terms of reference do not take account of the council's corporate aims and objectives
- in 15 councils, the terms of reference do not make it clear that internal audit should not be seen as a substitute for internal control.

In addition, fourteen internal audit services do not have a charter or mission statement to communicate their roles and responsibilities across the council.
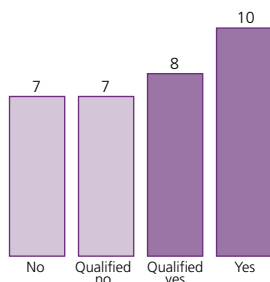
The client manager survey revealed an example of the consequences of this – whilst over 90% of service managers feel they have adequate information on the role of internal audit, over half of them see its main role as detecting fraud, revealing a misconception of the role of internal audit.
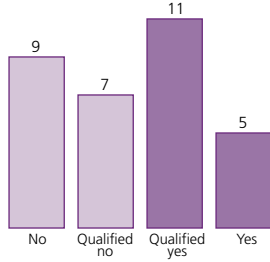
Recommendations

Internal audit should have terms of reference, which comply with the CIPFA Code of Practice for internal audit. They should be formally agreed between senior management, the chief internal auditor and the relevant committee of the council.

The terms of reference should be communicated throughout the council via a mission statement or audit charter.

Fourteen internal audit services do not have a charter or mission statement to communicate their roles and responsibilities across the council.

Clarifying the respective roles of management and internal audit in maintaining internal control

It is management's responsibility to:

- set control objectives (eg, creditors system controls should exist to ensure that valid and timely payments are made)
- establish and maintain an adequate system of internal control (eg, by division of responsibilities) for all major systems.

The role of internal audit is to assess the extent to which individual controls contribute to the overall control system and to advise management on setting up, or changing, systems of internal control. However:

- 16 councils did not have defined control objectives for all major systems
- in nine councils, internal audit was not adequately consulted about changes to internal control systems.

Overall, only two councils almost fully complied with the Code. There is significant scope for improvement in 24 councils.

Good practice example: East Ayrshire Council
The council's internal audit section has service level agreements with all departments. These include agreed terms of reference and set out the respective roles of management and internal audit in maintaining internal control.

Recommendations

Managers should establish and maintain an adequate system of internal control and should define control objectives for all major systems.

Internal audit should be consulted when systems, and their controls, are being designed or reviewed.

Procedures in relation to fraud

It is important that the council has a strategy for dealing with fraud and corruption together with a fraud response plan, which sets out the procedures to be followed in the event of a suspected fraud. These procedures should be clearly communicated to all staff. Failure to do this can result in fraud remaining undetected or being inadequately investigated.
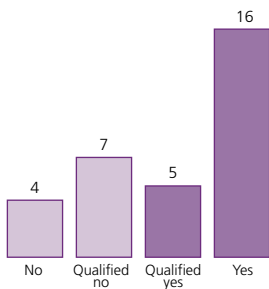
Eleven councils did not have an adequate anti-fraud and corruption strategy, and ten did not have a fraud response plan. Ten councils had not updated their fraud strategy since council reorganisation in 1996.

Following the Public Interest Disclosure Act 1998, councils should have a whistle-blowing policy, or confidential reporting procedure for staff. However, 11 councils either did not have a policy in place or had not communicated their policy to staff.

Good practice example: Angus Council
The council has a fraud and corruption strategy, including whistle-blowing policies for officers and for third parties. These, together with fraud and defalcation guidelines included within the financial regulations, clearly state how the council will deal with any disclosures. The policy has been disseminated to all council staff.

Sixteen councils did not have defined control objectives for all major systems.

Eleven councils did not have an adequate anti-fraud and corruption strategy.

Recommendations

All councils should have:

- *an anti-fraud and corruption strategy, which sets out management's responsibilities for the prevention and detection of fraud and other illegal acts and includes a framework for involving internal audit in fraud investigation and prosecution*

- *a fraud response plan, setting out the roles and responsibilities of staff, management and internal audit in relation to fraud.*

The roles of staff, management and internal audit in dealing with fraud should be clearly defined and communicated.

Following the Public Interest Disclosure Act 1998, councils should have a whistle-blowing policy, or confidential reporting procedure for staff.

Critical factor 2 – Maintaining internal audit independence

Internal audit should be seen to be independent in exercising judgement, reporting opinion and presenting recommendations. To achieve this, internal audit needs to be free of operational tasks and to have sufficient organisational status to enable it to properly perform its duties. In CIPFA's view the chief internal auditor should not report at a lower organisational level than the responsible finance officer.

A lack of independence will compromise the work of internal audit and may lead to audit findings not being fully reported or implemented. The position of internal audit within the council's structure can affect its authority and independence.
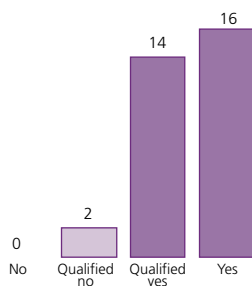
Line-management arrangements for chief internal auditors

Chief internal auditors must be able to report their findings in their own name without fear or favour, and their line managers should not influence their reports. Although it is for each council to decide where the chief internal auditor fits into its management structure, the associated status must ensure that internal audit can function independently. The CIPFA statement on the role of the finance director in local government states:

"the responsibility for ensuring effective internal audit should be that of a senior director who is at the heart of the corporate management of the authority. This widely held professional view means, in practice, that internal audit should report on a line or contract management basis to either the head of the paid service (the chief executive) or finance director."

This statement is also reflected in the CIPFA Code of Practice for Internal Audit in Local Government.

One way of measuring a chief internal auditor's status is to examine the number of managers between the chief internal auditor and the council's chief executive (ie, the number of management tiers). Exhibit 12 shows that 15 chief internal auditors report to a level below the director of finance (or equivalent) – arrangements that do not comply with the Code.

Where the chief internal auditor's line manager is lower than the director of finance (or equivalent), there is a risk that the status and independence of the chief internal auditor may be compromised.

These problems can be alleviated if chief internal auditors have direct access to council Members, the chief executive and the director of finance. Importantly, almost all chief internal auditors consider that they have such rights of access.

Almost all chief internal auditors consider that they have direct access to Members, the chief executive and the director of finance.

Exhibit 12: Line-management arrangements for chief internal auditors

Fifteen councils do not comply with the CIPFA Code.

Chief internal auditor's line manager	Management tier	Number of councils
Chief executive	0	2
Director of finance	1	12
Director of corporate services (or equivalent)	1	3
Head of accounting (or equivalent)	2	13
Finance manager (or equivalent)	3	2

Source: Local audit returns

Recommendations

Councils should review:

- *the line-management arrangements of the chief internal auditor to ensure that they reinforce his/her independence and status within the council*

- *the reporting lines of internal audit to ensure they reinforce the independence of internal audit within the council. For example, the reporting lines to the chief executive and relevant member committees, should be both visible and active.*

Operational independence
Internal auditors should not have operational responsibilities outside audit. This means that, if internal audit were not involved, the operational process would continue unaffected. Overall, the time spent on such tasks represents only 2% of internal audit work across all councils, varying among councils from 0-5% of audit time. Five internal audit services were assessed to be involved in tasks that could affect their independence.

Recommendation

Internal audit involvement in non-audit work should be kept to an absolute minimum. Where it is unavoidable, the chief internal auditor should take steps to ensure internal audit's independence is not compromised.

Critical factor 3 – Planning and controlling the work of internal audit

A structured framework of strategic, annual and individual project plans helps internal audit to consult with members and senior managers and ensure that the work programme is properly focused on the council's needs. Internal audit resources need to be prioritised to areas of greatest risk to ensure that its resources are used effectively.

Good working relationships with external auditors and inspectorates help develop an integrated approach to audit, enabling the overall burden of audit and inspection to be minimised.

Internal audit needs good working papers to be able to present findings and make recommendations that can be supported by robust evidence.

Risk assessment
A structured risk management methodology is required to properly prioritise and plan internal audit work. It should cover both financial and operational systems and should be regularly reviewed, particularly in periods of rapid organisational change.

However, the study found that:
- 14 internal audit services did not use a formal process to assess risks
- 12 did not regularly review their risk assessments
- a quarter of the service managers who responded to the client survey were not consulted on the key risks in their area
- over 20% of chief executives felt that internal audit plans were not based on an analysis of the risks facing the council
- overall, 12 councils almost fully complied with the Code. However, there is significant scope for improvement in 16 councils.
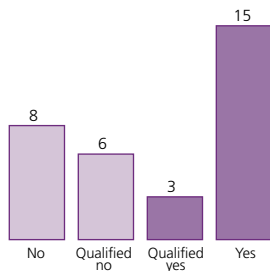

Fourteen internal audit services did not use a formal process to assess risks.

Exhibit 13 shows the planned budgets for systems and regularity audit. The data suggests economies of scale in the larger councils. However, the variation in the time spent by internal audit in some comparable councils may be a consequence of them not properly identifying the level of input required.

Exhibit 13: Days planned for systems and regularity audit, per £m of total council revenue expenditure

There are significant variations between broadly comparable councils.

Days planned per £m of council revenue expenditure
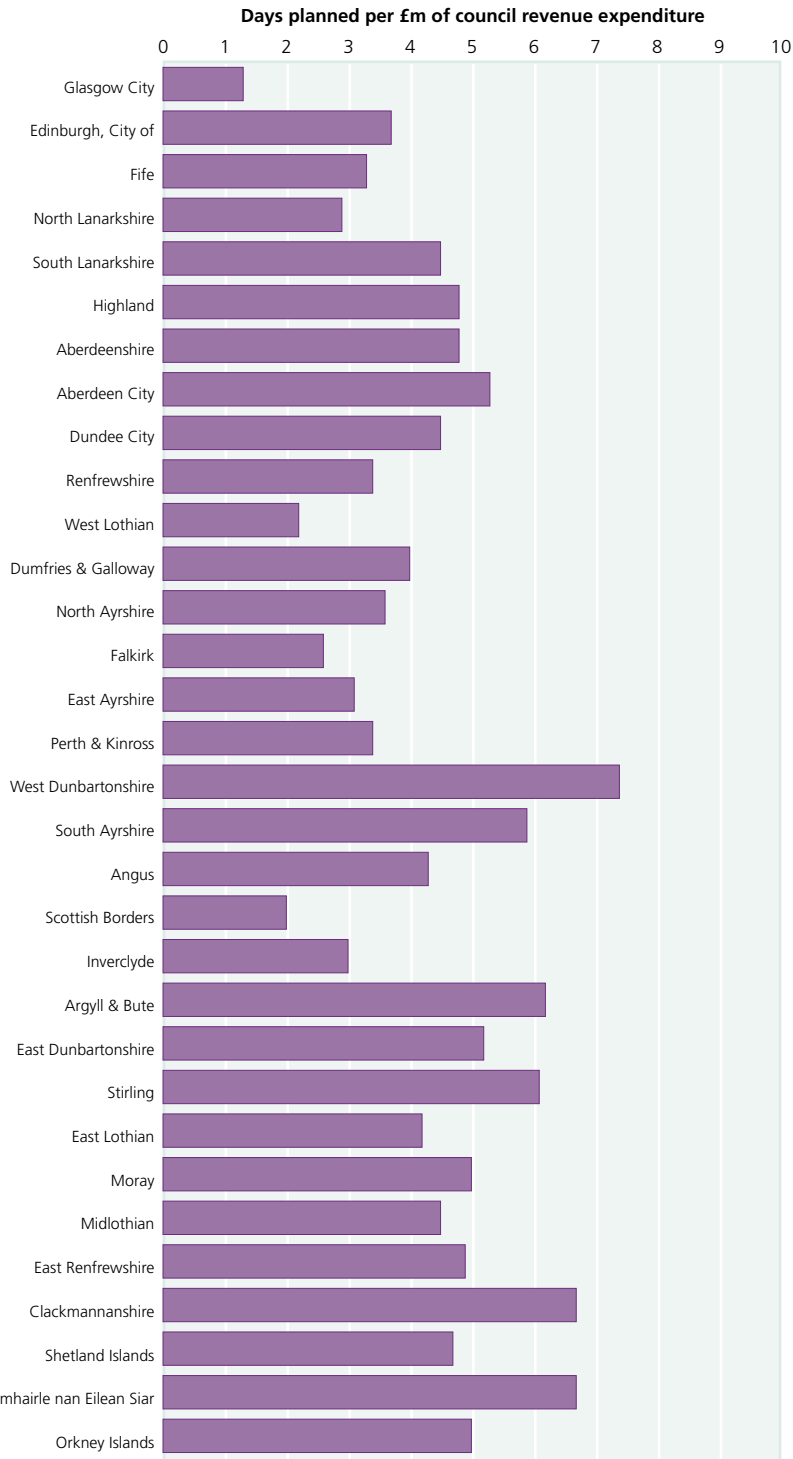
Note: Councils are listed in order of total council revenue expenditure.

Good practice example: Perth and Kinross Council
Internal audit has carried out a formal risk assessment of all of the council's services. It is based on income, expenditure and value of stores, weighted by three risk factors (financial, business, and political).

Risk scores are allocated and audit areas are prioritised as very high, high, medium, and low risk. Internal audit work is prioritised according to the scores obtained. The risk assessment drives a three-year strategic plan, which in turn drives the annual audit plan. All very high- and high-risk areas are covered each year.
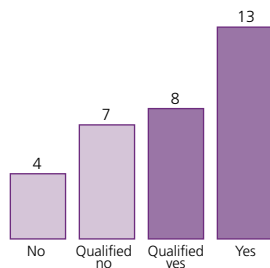
Recommendations
The chief internal auditor should adopt a formal risk assessment methodology to identify all the systems that require priority review by internal audit. The council's corporate risk assessment process and the knowledge and awareness of service managers, external audit and internal audit should inform the process.

Internal audit resources should be allocated to priority internal control areas, based on robust risk assessment.
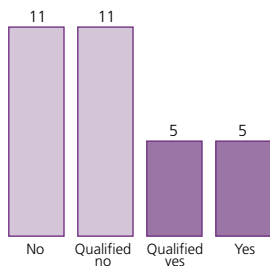
Audit planning
Internal audit requires a structured planning framework of strategic, annual and project plans to ensure that all council systems are kept under review.

- **The strategic plan,** based on the risk assessment, should link to the council's corporate aims and objectives and determine a schedule of systems to be reviewed (with the frequency of review having regard to their assessed risk) and identify the resources required to undertake this work.

- **The annual plan** should be derived from the strategic plan and should detail the work to be undertaken in any year. To ensure risks are properly managed, annual plans should be sufficiently flexible (and include a contingency) to ensure that all priority work is completed within the scheduled time.

- **Operational plans** should be prepared for each project in consultation with client managers, and set out the scope and objectives of the work, time-scales and reporting arrangements.

Eleven internal audit strategic plans were not informed by comprehensive risk assessment.

External auditors' assessments of internal audit planning frameworks showed that:
- strategic plans were not informed by comprehensive risk assessment (11 internal audit services)
- strategic plans did not set out the resources needed to meet the internal audit needs of the council, resulting in a failure to identify any mismatch between the resources required and the resources available (22)
- strategic plans did not link back to the council's corporate aims and objectives (16)
- annual plans did not have sufficient contingency provision to accommodate work arising during the audit year (10)
- project plans were not prepared for each audit assignment (11)
- over a quarter of service managers surveyed felt that they did not have sufficient input into the planning of internal audit work

Twenty-two strategic plans did not set out the resources needed to meet the internal audit needs of the council.

- 19% of chief executives and 22% of directors of finance felt that internal audit did not always complete their priority work within planned timescales
- overall, six councils almost fully complied with the Code. However, there is significant scope for improvement in 17 councils.

Comparison of internal audit's planned and actual work revealed significant under/overspends on particular categories of work. Across all councils, a 14% under-provision in the contingency for investigating fraud and corruption contributed to an 11% shortfall in systems audit work. Exhibit 14 shows the areas where actual time spent was more than 10% outwith internal audit's planned budget estimates. Significantly, internal audit time on systems and internal control was more than 10% under-budget in 14 councils, and 20% of councils were more than 10% under-budget overall.

Exhibit 14: Comparison of planned and actual work 2000/2001

Planned systems and internal control work are not always completed within the period of the plan.
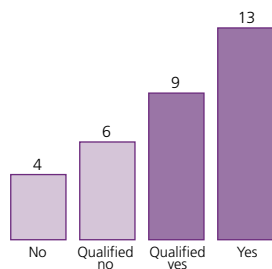
Types of work	Number of councils more than 10% over budget	Number of councils more than 10% under budget
Strategic and annual planning	8	5
Systems and internal control (excluding fraud and corruption)	3	14
Fraud and corruption	14	10
VFM/Best Value etc	7	12
Client non-audit work	6	9
Total	2	6

Source: Local audit returns

Working relationships

To undertake its work effectively, internal audit should foster constructive working relationships with management, external auditors, inspectorates, any other review agencies, and where one exists, with the audit committee or equivalent mechanism.

Overall, internal audit performed well in this area. However, in ten councils, internal audit did not maintain open channels of communication with Members.

Managing, controlling and recording work

Sound management of the internal audit section and of individual assignments ensures that internal audit objectives are achieved and work is performed effectively. Twenty-eight councils performed well in this area.

Audit guides are a useful tool in assisting staff to follow standardised procedures to consistent quality standards. The Scottish Local Government Chief Internal Auditors' Group has produced a standard audit guide available for use by all councils in Scotland. The internal audit section in Angus Council has further developed this guide.

Good practice example: Angus Council
All the procedures for the conduct of the internal audit section are set out in the audit manual, which is part of the Audit, VFM & Risk Services intranet as an HTML document. All standard forms, memoranda and programmes are embedded in the document. Staff access the relevant section in the manual to obtain the required information.

Ten internal audit services did not maintain open channels of communication with Members.

Critical factor 4 – Resourcing the internal audit work programme

Internal audit services need to be properly resourced to complete their agreed work programme, efficiently, effectively and on time. The internal control needs of the council should drive the need for audit resources. Otherwise, there is a risk that the internal control needs of the council will not be met (eg, there may be a skills deficit in a high-risk area, eg, IT, which may not be adequately reviewed).

Internal audit work requires a balance of skills, experience and qualifications. Staff should be supported with needs-based training to enable them to develop the skills required to meet both current and future work challenges.

An absence of needs-based training and personal development programmes can lead to limited staff development, difficulties in recruiting and retaining good staff, and a lack of skills in the use of modern audit techniques.

Staffing resources

Internal audit needs to have the appropriate number and quality of staff to do the required work, and manage these resources efficiently and effectively. IPF data suggests that unitary councils in England and Wales spend 40% more on internal audit than councils in Scotland. However, it is difficult to draw a firm conclusion from this comparison as the variation may be due to differences in the types of work undertaken by internal audit both north and south of the border. Importantly, it is for each council to decide the level of internal audit resources to meet its internal control needs, based on a comprehensive assessment of the risks facing the council.

External auditors assessed 12 internal audit services as having inadequate resources to enable them to meet their work objectives efficiently and effectively, based on interviews with chief internal auditors, and the views of chief executives and directors of finance. The main shortfalls were insufficient qualified staff and a lack of computer audit specialists. Four councils had not reviewed their internal audit staffing requirements since council reorganisation.

Recruitment of internal audit staff is a problem for many councils. At the time of the study, there were 35 vacant internal audit posts across Scottish councils, representing 12% of internal audit's overall establishment. Eight of the 13 chief internal auditors who had recently advertised posts reported particular difficulties in filling vacancies for qualified auditors and IT audit staff. Here, councils have to compete with the private sector and other public sector organisations in a market where qualified auditors, particularly IT auditors, are in short supply.

Where particular skills gaps arise (eg, for computer and contract audit staff), it should be possible to access these skills, on a temporary basis, by 'buying in' specialist staff. However, this option is only available to chief internal auditors in 16 councils.

Where councils are unable to attract suitably experienced staff, more fundamental longer-term options should be considered, for example:

- entering into consortia arrangements with other councils or other public sector organisations (eg, the NHS)
- entering into partnership arrangements with the private sector
- contracting out an element, or all, of the service to the private sector.
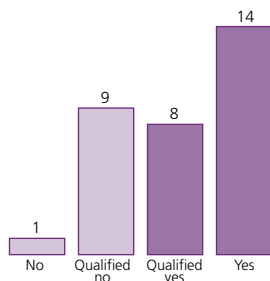
Recommendations

Councils should determine the staffing and skill mix required by internal audit based on a comprehensive risk assessment. The strategic plan should identify the council's internal audit requirements.

Councils should conduct an option appraisal for procuring internal audit services and challenge whether:

- *the council's internal audit needs are being met*

- *internal audit has the relevant skills and experience to meet the current and changing needs of the organisation*

- *the resources being spent on internal audit are providing a Best Value service*

- *the service could be improved by entering into consortia arrangements with other councils, entering into partnership arrangements with the private sector or contracting all, or elements, of the service to the private sector.*

Where additional specialist skills such as IT are required, the chief internal auditor should consider consortium arrangements, partnerships or 'buying in' contract staff to fulfil short-term IT audit requirements.

Staff training and development

Training should be tailored to the needs of individual auditors to help them meet their current responsibilities and the challenges they are likely to face, for example, the need for improved IT skills.

However, in ten councils, the chief internal auditor did not co-ordinate and review the training and development requirements of their staff. In 13 councils, there was no induction programme for new staff.

Good practice example: Glasgow City Council
The council's internal audit section has two experienced computer auditors, trained in data protection legislation and other computer-aided audit techniques (CAAT). These skills have enabled the council to use data matching techniques to combat fraud.

Recommendations

The chief internal auditor should co-ordinate, and keep under review, the training requirements of internal auditors and arrange for personal training records to be maintained for each member of his/her staff.

Induction programmes should be arranged for all new internal audit staff.

Ten chief internal auditors did not co-ordinate and review the training and development requirements of their staff.

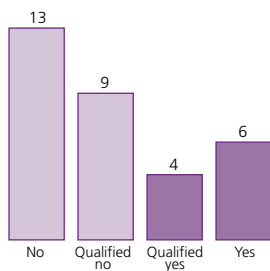## Critical factor 5 – Reporting and follow-up arrangements

It is internal audit's responsibility to submit timely reports to management, identifying the findings from its work and making recommendations for improvement.

Systematic follow-up procedures ensure that management has implemented internal audit recommendations within agreed time-scales, or has understood and assumed the risk resulting from not taking action.

Low priority given to follow-up work is counter-productive in the long term, as the effect of implementation of recommendations cannot be assured. This can undermine the whole audit process.

Reporting arrangements

Over three-quarters of councils had clear procedures for producing and clearing internal audit reports. In addition, over 90% of service managers surveyed felt that internal audit recommendations were concise, clear and constructive. Almost all agreed with internal audit recommendations. Service managers were generally satisfied with the time taken by internal audit to submit its draft and final reports.

It important that the council has a clear understanding of the issues raised by internal audit during the year. However, in more than two-thirds of councils, the chief internal auditor did not produce an annual report providing an overall view on the soundness of the council's internal control systems.

The CIPFA/SOLACE report on corporate governance calls upon councils to: *"publish on a timely basis, within an annual report, an objective, balanced and understandable statement and assessment of the authority's risk management and internal control mechanisms and their effectiveness in practice."*

This development, taken together with the move by other parts of the public sector towards introducing internal (financial) control statements, makes it likely that, in due course, there will be a requirement on councils to produce an annual report, and include in their accounts a statement on the adequacy of their internal control arrangements.

Good practice example: East Renfrewshire Council
Each year, since 1998/99, the chief auditor has produced an annual assurance statement on internal control. This statement is approved by the audit committee and ratified by the council.

Recommendation
Internal audit should produce an annual report, which sets out its opinion on the adequacy of the council's internal control arrangements, based on the work undertaken that year.

Twenty-two chief internal auditors did not produce an annual report providing an overall view on the soundness of the council's internal control systems.

Follow-up arrangements

It is the responsibility of management to implement agreed recommendations or accept the risk resulting from not taking action. Internal audit should have systematic follow-up procedures in place to monitor the implementation of its recommendations. The results of follow-up work should be used by internal audit to update its risk assessment and plan its future work.

Auditors assessed that many councils could improve their follow-up arrangements:

- 18 internal audit services did not use the results of follow-up work to update their risk assessment
- 14 did not report to the corporate management team instances where service managers failed to implement remedial action plans, as agreed
- ten did not use the results of follow-up work to update their audit plans
- overall, only two councils almost fully complied with the Code. There is significant scope for improvement in 19 councils.

Recommendations

The chief internal auditor should ensure that appropriate arrangements are made to determine whether action has been taken on internal audit recommendations, and that management has understood and accepted the risk of not taking action.

The chief internal auditor should report failure to implement agreed action plans to the corporate management team and audit committee.

Internal audit should use the results of follow-up work to update its risk assessment and its planning of future internal audit work.

Fourteen services did not report to the corporate management team instances where service managers failed to implement remedial action plans, as agreed.

Critical factor 6 – Holding internal audit to account for its performance and the role of audit committees

The effectiveness of internal audit is enhanced if it operates within a performance management framework that embraces professional standards, performance review and continuous improvement.

The adoption of audit committee principles helps to raise the profile and effectiveness of audit by establishing scrutiny arrangements that hold both internal audit and service managers to account.

Where effective performance review processes are not in place, there is a risk that the council may not be getting appropriate assurance on the level of internal controls in operation.

Performance management

The chief internal auditor should promote and maintain quality standards within the section. Performance measures and indicators can be used to demonstrate whether internal audit is achieving its planned objectives and delivering Best Value. Independent accreditation (eg, ISO 9000 or 9002) can assist in ensuring that the appropriate standards are in place. Five councils have such accreditation.
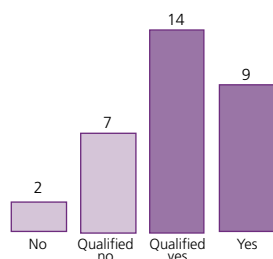
The standards of professional and ethical behaviour of internal audit staff are high across all councils. Many chief internal auditors continuously maintain and develop the performance of their services. However, there was scope for nine chief internal auditors to further develop their use of performance indicators to measure the performance of their service.

There was scope for nine chief internal auditors to further develop their use of performance indicators.

Recommendation

The chief internal auditor should establish a set of performance measures and local indicators, relevant to the achievement of audit objectives within a Best Value context.

Audit committees

The Accounts Commission regards the adoption and implementation of audit committee principles as an important step in raising the standards of corporate governance in local government. To be fully effective, an audit committee or equivalent should:

- be established at a high level, constituted as a separate committee or included within the remit of a relevant committee with other functions
- ensure broad terms of reference, permitting it to investigate matters of financial management and economy, efficiency and effectiveness, with the necessary resources to do so and with full access to information
- have direct (two-way) access between the chief internal auditor and the external auditor.

The number of councils having an audit committee, or equivalent, is increasing. Sixteen councils currently have these arrangements in place. Of the 16 councils currently without audit committees (or equivalent), eight chief internal auditors felt that an audit committee would encourage greater accountability and scrutiny of council performance. The client survey indicated that a majority of service managers would prefer internal audit to be accountable to an independent joint group of officers and members.

The study team discussed the role of audit committees with committee members in three councils that have long-established audit/scrutiny committees (Aberdeen, Dundee, and Fife). All members spoke very positively about the impact that their audit committees were having and, in particular, they felt the adoption of audit committee principles continued to help improve corporate governance.

The main impact of the audit committee in these councils is felt to be:
■ a sharper focus on corporate strategic risks
■ raised officer and member awareness of the importance of internal controls
■ better prioritisation and use of internal audit resources
■ corporate support for internal audit recommendations
■ a faster response by service departments to internal audit reports and recommendations.

However, they highlighted a number of problems and potential solutions (Exhibit 15).

Exhibit 15: Common issues experienced by audit committee members

There are a number of issues that could usefully be tackled by local government.

Issues	Potential solutions
Concerns about not wanting to 'stand on the toes' of other committees.	Ensure that the audit committee (or equivalent) has clear terms of reference.
Not feeling competent to challenge the content and balance of internal audit work, including work plans and reports submitted – leading to a lack of effective challenge.	Improved training for audit committee members and being able to call on specialist advice.
Not receiving an annual report on the work programme and the audit recommendations implemented.	Require internal audit to produce an annual overview report.
A lack of training for audit committee members – it took new members a long time to 'find their feet'.	Development of a handbook and training programme for members, giving guidance on the role and operation of audit committees.
	Potential exists to develop a forum, similar to the Health Service, enabling members to share experiences and learn from best practice in tackling common issues.

Source: Interviews with audit committee members

Recommendations

Councils should make arrangements to introduce an audit committee or equivalent mechanism where they have not already done so.

Councils should arrange for comprehensive training for all new audit committee members.

Local government should develop a handbook for audit committee members, and explore the potential to develop a forum for audit committee members to share best practice.

4. Securing Best Value internal audit services

Opportunities for the future

This study has identified a range of opportunities that exist to raise the standard of internal audit, by aiming for full compliance with the Code.

All internal audit services need to embrace a culture of continuous improvement, adopting proven best practice from other public and private sector organisations. Three case studies reflecting these aims are included at the end of this section. Through improving performance and delivering added value, internal audit services will be able to demonstrate their capacity to take on new responsibilities.

Best Value and other initiatives are fundamentally changing the way councils work and this presents opportunities as well as challenges for internal audit services. These include:

- **Introduction of audit committees and revised council structures.** In response to the McIntosh report, all councils are expected to review their corporate governance and management arrangements. This is having an impact on the line management of internal audit and its reporting lines to senior managers and councillors. Sixteen councils now have audit (or scrutiny) committees and this provides the opportunity for these councils to support and challenge both internal and external audit's contribution to achieving sound internal controls and performance stewardship. Under these new arrangements, internal audit has the opportunity to demonstrate excellent performance and to be held accountable for its work.

- **The changing role of internal audit.** Internal audit is emerging from its traditional 'policing' role to developing a more proactive corporate role (Exhibit 16). In a growing number of councils, internal audit is being given an increasingly important role in supporting corporate governance and performance. The client survey identified that many chief executives would like to see the role of internal audit being further developed and providing added value by:
  - identifying performance improvements through Best Value, value for money, and performance management and planning audits
  - undertaking more 'cross-cutting' type work
  - challenging the status quo and supporting continuous improvement in the council.

The changing role of internal audit demands broader competencies than those of traditional audit services. The former emphasis on accounting and auditing qualifications now needs to be balanced by a consideration of other skills that may be required to meet the wider demands on audit.

Exhibit 16: The changing role of internal audit

The role of internal audit is changing from a mostly financial to a more corporate role.

Traditional role	Emerging role
Finance based	Corporate role
Policing role	Pro-active partnership role
Self-sufficient	Use of specialists
Functional focus	Risk and process focus
Tangible asset focus	Intangible asset awareness eg, reputation, accountability

Source: Audit Scotland

- **Expansion in the use of ICT.** The growing use of electronic commerce and electronic signatures is placing greater demands on councils for expert skills in computer audit. Council chief executives recognised this in their survey responses.

- **Getting improved value from council resources.** Internal audit is not immune from the drive to obtain Best Value from council resources. There is an opportunity for internal audit to develop new and improved ways of working to enable it to manage its resources more effectively, for example by:

  – adopting a risk management strategy, ensuring that its work programme is focused on the council's priority risk areas

  – introducing smarter ways of working, by training and developing staff in the use of modern audit techniques (eg, the use of internal control self-assessment methodologies[14], moves to 'paperless audit', increased use of computer aided audit techniques)

  – developing a stronger, effective partnership with external auditors and other review agencies, which will help to reduce the overall burden (both time and cost) of the audit and inspection processes on councils.

- **The likely introduction of internal (financial) control statements (ICS).** In the private sector and other parts of the public sector (eg, government departments, further education and health), ICS have been successfully introduced as a means of providing assurance to shareholders or stakeholders on the adequacy of internal controls within the organisation.

  The requirement to have the senior manager of the organisation certify the adequacy of internal controls provides a sharp focus on management's need to establish effective arrangements for internal control, and internal audit.

CIPFA and the Local Authority (Scotland) Accounts Advisory Committee (the CIPFA LASAAC Joint Committee) are actively considering the introduction of ICS to local government accounts. This development will be a key driver in encouraging councils to establish effective internal audit service provision. This is only the first step towards full Turnbull compliance, which is seeking to extend the statement in respect of financial control to all controls within the organisation, including financial, operational, compliance and the management of risk.

Conclusion – challenging councils to improve

All councils need sound internal control systems and strong corporate governance arrangements. An effective Best Value internal audit service can be a major contributor in achieving this. However, this study has identified that many councils need to improve their internal audit arrangements.

Understanding current performance is a key factor in driving continuous improvement. This report, along with the local external audit reports, provides each council with a robust assessment of their levels of compliance with the CIPFA Code. A sound baseline now exists to measure improvements made by individual councils over time.

All councils have individual reports from their external auditor, assessing their level of compliance with the CIPFA Code of Practice. These show that some have a lot to do in raising their standards to those reflected in the Code. Each council is expected to implement the agreed recommendations contained in their external auditor's report.

Where the room for improvement is significant (particularly those councils falling within performance band 4), substantial progress is needed in a short space of time. There is a strong case for these councils testing current provision against what the market might provide. This would involve looking at options that would provide a high-quality service that ensures that the councils' control objectives are met, at acceptable cost. These options would include:

- buying in specialist skills, for example, computer audit expertise
- entering into consortia arrangements with other councils
- partnership arrangements with the private sector
- externalising service provision.

Irrespective of who provides the service, the critical factors that underpin a Best Value internal audit service remain the same. All councils should be looking to develop sound internal control arrangements where:

- **councillors** are demonstrably committed to supporting the need for a sound internal control environment, including internal audit
- **senior managers** are demonstrably committed to maintaining effective internal controls and implementing sound internal audit arrangements
- **chief internal auditors** demonstrably provide an excellent internal audit service.

Exhibit 17 provides a checklist that highlights the key messages for an effective internal audit service. It should help councillors, chief executives, senior managers and chief internal auditors to ensure that their council has these arrangements in place. External auditors will be monitoring progress.

Exhibit 17: Achieving a Best Value internal audit service – a checklist for councillors, chief executives, senior managers and chief internal auditors

Critical factors	Key enabling factors	
1. Setting clear and properly focused objectives for internal audit	■ Is the council committed to establishing an effective internal audit service?	☐
	■ Does internal audit have clear terms of reference agreed by senior management and communicated these across the council?	☐
	■ Does internal audit have a good understanding of the risks facing the council, developed in consultation with all service managers?	☐
2. Ensuring that internal audit is independent	■ Does internal audit have direct access to councillors, the chief executive and the director of finance?	☐
	■ Does internal audit have (and is it seen to have) independence from operational procedures?	☐
	■ Does internal audit have the right of final edit in submitting reports?	☐
3. Making sure the work of internal audit is properly planned	■ Does internal audit's planned work support the corporate objectives of the council?	☐
	■ Does internal audit ensure that all planned work reflects the results from its systematic assessment of the council's risks?	☐
	■ Does internal audit plan a sufficient contingency to accommodate unforeseen work, enabling it to complete its planned work within time-scale?	☐
4. Making sure internal audit is adequately resourced	■ Does senior management ensure that internal audit has the resources required to meet the internal control needs of the council?	☐
	■ Does the council recruit and train suitably skilled internal audit staff?	☐
	■ Has senior management given authority to the chief internal auditor to access specialist skills to tackle complex areas?	☐
5. Ensuring that internal audit findings are reported and followed up	■ Does internal audit report weaknesses in internal control for action by management?	☐
	■ Does senior management systematically encourage all managers to implement report recommendations within agreed time-scales?	☐
	■ Does internal audit report any failure by management to implement agreed recommendations?	☐
	■ Does internal audit provide an annual report, providing an overall view on the soundness of the council's internal control systems?	☐
6. Ensuring that internal audit is held to account for its performance	■ Does the council have an audit committee or equivalent to: – approve internal audit work plans? – review internal audit's output and performance and ensure that it completes its programme of work? – act as a conduit for receiving audit reports and call service managers to account?	☐ ☐ ☐
	■ Does internal audit prepare annual performance plans, setting out its achievements and targets?	☐
	■ Does internal audit maintain an effective performance management framework to continuously review and improve its performance?	☐

Case study 1: East Renfrewshire Council

Contact: Asif Abdul Haseeb, Chief Auditor (CA), East Renfrewshire Council, (T. 0141 577 3000).

East Renfrewshire Council has been assessed as having one of the best internal audit services in Scotland. This case study provides an insight as to how the in-house service achieves this.

The council identified the following main characteristics that underpin their valued service:
- a clear long-term vision for internal audit
- strong leadership by the chief auditor, having effective management and interpersonal skills to turn the vision into reality
- effective support from elected members, the director of finance and chief executive
- a strong and effective audit committee
- appointing the right people and giving them support and the tools to do the job.

Good practice is present in all of the areas assessed and the following provides a flavour of these:

- **Setting clear and properly focused objectives.** The service has clear terms of reference approved by the audit committee and ratified by the council. Service level agreements apply with each department. The council has a fraud and corruption strategy, incorporating 'whistle-blowing' procedures.

- **Maintaining independence.** The CA reports directly to the director of finance and has regular access to elected members through the audit committee. The CA issues reports in his own name without editing. The section does not carry out any non-audit work.

- **Planning and control.** A rolling four-year strategic plan has been in place since 1996, covering all council activities – financial and non-financial systems. A 10% contingency is included in the annual plan for unplanned reactive work. All work in the annual plan is completed each year. An excellent working relationship exists between internal and external audit. This has resulted in a joint approach to audit planning with minimal duplication of work. An audit manual has been in place since February 1998.

- **Resourcing the work programme.** The section has five staff. Four are financially qualified and the fifth is studying for an audit qualification. One member of staff has a computer audit qualification. Each staff member reports to the CA and completes audits working to his/her own initiative. Secondments to other organisations are encouraged to help develop staff and maintain their current high level of morale. This has included a two-way secondment with Audit Scotland and secondments to the private sector and the NHS.

- **Reporting and follow-up.** Over 90% of reports are issued within five working days of staff completing the work. Client surveys indicate that reports are comprehensive and very well received. Each year, since 1998/99, the CA has produced an annual assurance statement on internal

control, which is approved by the audit committee and ratified by the council. Each annual audit plan makes provision to follow-up previous years' action plans for satisfactory implementation, as appropriate.

- **Holding internal audit to account.** The audit committee is chaired by the Leader of the Opposition, and reports to full council. The Committee approves the annual audit plan. The CA attends all meetings and provides the committee with quarterly progress reports and an annual overview report.

Case study 2: North Yorkshire Audit Partnership

Contact: James Ingham, Audit Manager, North Yorkshire Audit Partnership, Ryedale DC, Ryedale House, Malton, North Yorkshire (T. 01723 232364).

The North Yorkshire Audit Partnership was established on 1 February 1999 to provide internal audit services to three local authority partners: Ryedale District Council, Scarborough Borough Council, and Selby District Council.

The main objectives for setting up the Partnership were to provide economies of scale, with an increase in the quality of services through greater specialisation and sharing of skills across the different local authority boundaries. Partners also had specific requirements for the Partnership including:
- reducing recruitment difficulties
- improved access to specialist staff
- to explore partnerships in other service areas.

The Partnership was created using a joint committee whose responsibility is the overall strategy and management of the Partnership. There are two members from each authority on the Management Board with equal voting rights. The Partnership prepares annual trading accounts that are approved by the Board, and any balances are also shared equally.

Scarborough Council's chief internal auditor was appointed audit manager with responsibility for delivering an effective internal audit service. He reports on that to the client officer in each of the partner councils, and to the Board in respect of the Partnership itself.

Separate audit plans are prepared for each council, with each council being provided an agreed number of days to meet their audit needs. There is sufficient flexibility in the arrangements to allow for changes in the plans and therefore the number of audit days being provided to each council, if required.

The performance of the Partnership is being evaluated. The measures being employed include:
- feedback from audit clients
- completion of audit plans, by both number of audits and time
- feedback from the external auditor
- internal performance monitoring, including:
  - individual and group charged time percentages against targets
  - time taken for audits against planned time.

Overall the Partnership is performing well. The main successes achieved to date include:
- an increase in the number and range of audits undertaken
- a reduction in planned times for some of the audits without compromising the content of the audit through improved efficiency
- an increase in the percentage of the audit plan completed
- increased and extensive use of data manipulation software
- development of individual's skills and specialisms
- cross-fertilisation of ideas and audit experience, and not least
- a financial saving to the partner councils.

Case study 3: Comhairle nan Eilean Siar

Contact: Paul Macaskill, Senior Auditor, Comhairle nan Eilean Siar, (T. 01851 703773).

In 1992, Comhairle nan Eilean Siar was severely criticised by the Controller of Audit for having poor financial controls and treasury management practices. Following his appointment, the director of finance gave priority to establishing effective internal audit. To achieve rapid improvement in internal audit, it was decided to put the professional, technical and managerial aspects of internal audit to open tender, and the contract was awarded to a private firm of accountants.

Internal audit now consists of three in-house members of staff, headed by a qualified accountant. The contracted firm provides quality assurance support.

Features of the improved service include:
- **Independent audit arrangements.** The senior auditor reports to the director of finance with simultaneous reporting to the chief executive. Independent reporting by the senior auditor to the chief executive is considered to be essential.
- **Members actively consider audit reports**. A Member working party receives all audit reports and approves audit recommendations.
- **Greater reassurance on internal controls.** Effective internal audit gives Members and officers considerable reassurance on the reliability and integrity of the council's financial affairs.
- **Greater compliance with Auditing Standards.** This has provided more robust compliance and follow-up mechanisms.
- **More effective use of audit resources.** Audit resources are dedicated to audit and are applied based on risk, materiality and effectiveness of internal controls.
- **Improved training and skills for in-house staff.** The Partnership supports the development of in-house staff.

A recent Best Value review of the audit service identified other pointers to good practice:
- involve all senior managers in risk identification and analysis so that corporate ownership of the strategic and operational audit plans takes place
- train managers in making use of internal audit services and explain the benefits that can be achieved for the organisation
- continuously and effectively develop internal audit staff
- improve audit's positive perception by the rest of the council by identifying good practice to support improvement action recommendations
- minimise duplication of effort between internal audit, external audit and inspectorate functions, to allow resources to be deployed efficiently and effectively.

Comhairle nan Eilean Siar's experience has shown that a fully resourced and supported internal audit service can promote performance, stewardship and accountability within the council and shape how the council operates and delivers its services.

Appendix 1. Membership of the study advisory group

Robin Bennie, Director of Finance, Comhairle nan Eilean Siar

George Black, Director of Finance, Glasgow City Council

Valerie Davidson, Head of Finance, Strathclyde Passenger Transport, formerly Depute Director, CIPFA Scotland

David Dorward, Director of Finance, Dundee City Council

Brian Duncan, Chief Internal Auditor, Renfrewshire Council

Ian Fifield, Policy and Technical Manager (Audit), CIPFA

Robert Mackenzie, Partner, Scott-Moncrieff CA

Alex Mackie, Internal Audit Manager, East Lothian Council

Hamish McKay, Chief Internal Auditor, University of Edinburgh

David McLaren, Manager, PricewaterhouseCoopers

David Montgomery, Chief Executive, East Ayrshire Council

Marie Moy, Senior Finance Manager, Social Work Resources, South Lanarkshire Council, formerly Chief Internal Auditor, South Lanarkshire Council

Gavin Stevenson, Chief Auditor, Audit Scotland, formerly Chief Auditor, Fife & Forth Valley Internal Audit Consortium

Norie Williamson, Head of Finance, COSLA

Janine Wilson, Audit, VFM and Risk Manager, Angus Council

Appendix 2. Assessment and scoring methodology

Undertaking the assessment

External auditors assessed each council's arrangements for internal audit against accepted good practice as set out in the CIPFA Code of Practice for Internal Audit in Local Government. The assessments were completed during February 2001 and reflect councils' arrangements at that time.

The performance assessment framework used by external auditors is based on six critical success factors. Auditors scored council performance by testing almost 100 processes within 15 areas of good practice (Exhibit 18). These reflect the issues that the study advisory group and other consultees (including council internal auditors, and the Commission's appointed external auditors), felt were essential for delivering a Best Value internal audit service.

Exhibit 18: Structure of the assessment

Fifteen statements of good practice and 97 tests on council processes and outcomes support the six critical success factors.

Six critical success factors	**Fifteen statements of good practice**	**Ninety-seven tests on individual council processes and outcomes**
eg, having effective reporting and follow-up arrangements	eg, internal audit has clear reporting arrangements that provide management with an opinion on the adequacy of internal control	eg, internal audit produces clear, concise and constructive written reports
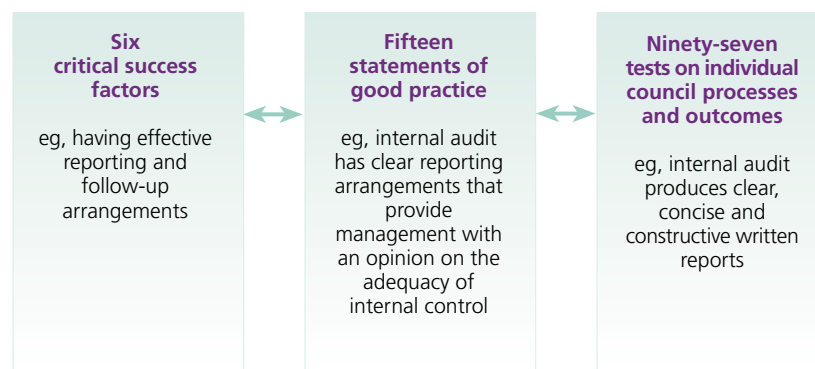
Source: Audit Scotland

External auditors tested documentary evidence, processes and outcomes to assess the degree of compliance with good practice. The following example shows how the scoring system was applied to documentary evidence.

1 = 'no' – ie, performance does not comply with good practice (eg, document does not exist or very early draft)
2 = 'qualified no' – ie, performance on the whole does not comply with good practice (eg, terms of reference are available in draft but have yet to be approved and are not in use operationally, or a formally approved document which misses out most of the important issues)
3 = 'qualified yes' – ie, performance on the whole complies with good practice, (eg, formally approved document but which misses some important issues or a draft document that, although yet to be formally approved, is in use operationally)
4 = 'yes' – ie, performance complies with good practice (eg, formally approved document covering all of the important issues).

Consistency and validation checks

To ensure auditors' assessments were consistently scored, the study team provided training and undertook robust validation procedures including:

- holding training workshops for auditors to familiarise them with the methodology and assessment process
- holding further workshops to ensure that auditors' assessments were undertaken consistently
- conducting extensive consistency checks on auditors' assessments and council data returns
- having a sample of 50% of assessments subjected to independent peer review by other external auditors.

Although the study team has made every effort to ensure that the assessments have been scored on a consistent basis, there always remains an element of subjectivity in scoring performance. For this reason, we are neither ranking overall council performance, nor giving individual scores.

Assessing overall performance

The scores for each test were used to calculate the average score for each statement. These were then used to calculate a council score for each of the six critical factors.

Exhibit 19 shows a scatterplot of the scores for the six critical factors and the 15 statements, for each council.

Exhibit 19: Bands of internal audit performance

Council performance falls into four distinct bands.
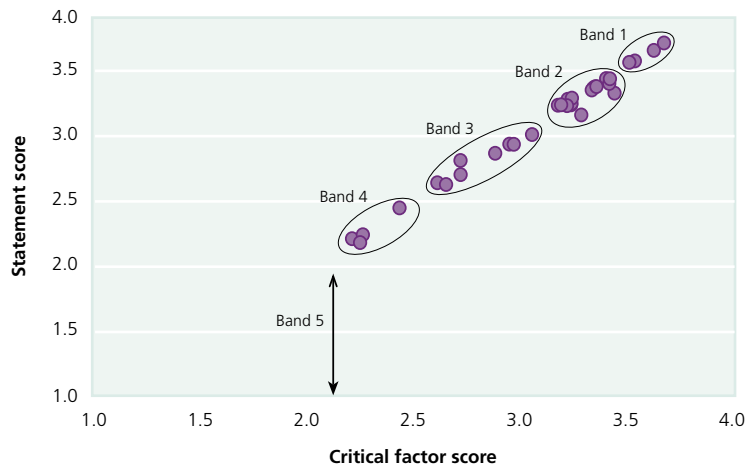
Source: Local audit returns

Four robust ranges of overall council performance emerged. The ranges in the overall scores were then used to create bands of performance (Exhibit 20).

Councils' actual scores were used to assess overall compliance and to create performance bands.

Actual overall scores	Overall compliance with Code (Note 1) %	Performance bands created from analysis of actual results Performance band	Range
3.56 - 3.71	85 - 90	1	3.50 - 4.00
3.24 - 3.44	72 - 81	2	3.10 - 3.50
2.64 - 3.01	54 - 67	3	2.50 - 3.10
2.21 - 2.45	39 - 48	4	1.75 - 2.50
Note 2	Note 2	5	1.00 - 1.75

Source: Audit Scotland

Notes:

1. The percentage compliance was calculated for each score thus:

   Percentage compliance = (score - 1)/3 x 100

   Because the lowest score that a council could achieve is 1 and the highest is 4, a score of 2.5 represents a percentage compliance score of 50%.

2. Although, overall, no council scored below 2.2, a fifth band was created only for the purposes of Appendix 4, to allow poor performance for a particular statement to be identified. 'Hotel star' ratings were awarded to each performance band.

Exhibit 21 shows how the average scores convert to 'hotel star' ratings. The star ratings indicate each council's performance – overall, and for each area. Because the ratings for each statement have been rounded, adding them together may not produce the council's overall score.

The 'hotel stars' reflect the performance bands.

Average scores for each statement Equal to or more than	But less than	'Hotel stars' symbol
3.50	4.00	★★★★★
3.10	3.50	★★★★
2.50	3.10	★★★
1.75	2.50	★★
1.00	1.75	★

Source: Audit Scotland

Appendix 3. Results of external audit assessments

		Overall	1. Internal audit has an agreed terms of reference	2. The respective roles of management and internal audit in maintaining internal control are clearly defined and communicated	3. Internal audit has a clear role in relation to fraud	4. Internal audit has sufficient organisational status to be able to undertake its work effectively	5. Internal audit is free of operational responsibilities that could compromise its independence	6. Internal audit bases its work on a comprehensive risk assessment	7. Internal audit operates within a structured planning framework	8. Internal audit has effective relationships with council members, council managers, external audit, inspectorates and other agencies
Band 1	Comhairle nan Eilean Siar	★★★★★	★★★★	★★★★	★★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★
	East Ayrshire	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★
	East Renfrewshire	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★
	West Lothian	★★★★★	★★★★	★★★★	★★★★★	★★★★★	★★★★	★★★★	★★★★★	★★★★★
Band 2	Aberdeen City	★★★★	★★★★★	★★	★★★★	★★★★★	★★★★★	★★★★	★★★	★★★★★
	Aberdeenshire	★★★★	★★★★★	★★	★	★★★★★	★★★★★	★★★	★★★	★★★
	Angus	★★★★	★★★★★	★★★	★★★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★★
	Dumfries & Galloway	★★★★	★★★★★	★★★	★★★	★★★★★	★★★★★	★★	★★★★	★★★★★
	Dundee City	★★★★	★★★	★★★	★★★★★	★★★★	★★★★★	★★★★★	★★★★	★★★★★
	East Lothian	★★★★	★★	★★★★	★★★★★	★★★★★	★★★★★	★★★	★★★★	★★★★★
	Edinburgh, City of	★★★★	★★★★	★★	★★★★	★★★★★	★★★★★	★★★★	★★★	★★★★★
	Fife	★★★★	★★★★★	★★★	★★★★	★★★★★	★★★★★	★★★	★★★★	★★★★★
	Glasgow City	★★★★	★★★★★	★★★★	★★★★★	★★★★★	★★★★	★★★★★	★★★	★★★
	Highland	★★★★	★★★★★	★★★	★★★	★★★★★	★★★★★	★★★★★	★★★	★★★★★
	Moray	★★★★	★★★	★★★	★★★★★	★★★★	★★★★★	★★★	★★★★	★★★★★
	Perth & Kinross	★★★★	★★★	★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★	★★★★
	Renfrewshire	★★★★	★★★★★	★★	★★★★★	★★★★	★★★★	★★★★★	★★★★★	★★★★★
	Scottish Borders	★★★★	★★★★	★★★	★★★★★	★★★★	★★★	★★★★★	★★★★	★★★★★
	South Lanarkshire	★★★★	★★★★	★★	★★★★★	★★★★★	★★★★★	★★★	★★	★★★★★
	Stirling	★★★★	★★★	★★★★	★★★★	★★★★★	★★★	★★★★★	★★★★	★★★
Band 3	Clackmannanshire	★★★	★★★	★★	★★★★	★★★	★★★	★	★★	★★★★
	Falkirk	★★★	★★★★	★★	★★★	★★★★	★★★★	★★★	★★★	★★★★
	Midlothian	★★★	★	★★	★★	★★★★★	★★★★	★★★★	★★★★	★★★★★
	North Ayrshire	★★★	★★	★★★	★★★	★★★	★★★	★★	★★★	★★
	North Lanarkshire	★★★	★★★	★★★	★★★★	★★★	★★★★★	★★	★★	★★★
	Orkney Islands	★★★	★★	★★★	★★★	★★★★	★★	★★★★★	★★	★★★
	South Ayrshire	★★★	★★	★★★★	★★★★★	★★★★	★★★★	★★	★★★	★★★★
	West Dunbartonshire	★★★	★★★★★	★★★	★★★★★	★★★★	★★★★★	★★	★	★★
Band 4	Argyll & Bute	★★	★★	★★	★	★★★	★★★	★★	★★	★★
	East Dunbartonshire	★★	★★	★★	★★	★★	★★★★★	★	★	★★★
	Inverclyde	★★	★★	★	★★	★★★★★	★★	★★	★	★★★
	Shetland Islands	★★	★★★	★★	★	★★★	★★★	★	★★	★★★★
	Scotland	★★★	★★★	★★★	★★★★	★★★★	★★★★	★★★	★★★	★★★★

Number of councils by assessment band, for each statement

Band	Assessment	Overall	1	2	3	4	5	6	7	8
1	★★★★★	4	11	2	13	16	18	12	6	16
2	★★★★	16	6	6	8	10	6	4	9	6
3	★★★	8	7	12	5	5	6	6	8	7
4	★★	4	7	11	3	1	2	7	6	3
5	★	0	1	1	3	0	0	3	3	0
	Total number of councils	32	32	32	32	32	32	32	32	32

		Internal audit properly manages, controls and records its work	Internal audit is adequately staffed and resourced	Internal audit staff are suitably trained and developed	Internal audit has clear reporting arrangements that provide management with an opinion on the adequacy of internal controls	Internal audit follow up their recommendations to ensure action is taken	Internal audit has a performance management framework that ensures continuous review of its performance	The chief internal auditor promotes and maintains professional standards in internal audit
		9	**10**	**11**	**12**	**13**	**14**	**15**
Band 1	Comhairle nan Eilean Siar	★★★★★	★★★★	★★★★★	★★★★	★★★★★	★★★★	★★★★★
	East Ayrshire	★★★★★	★★★★	★★★★★	★★★★★	★★★★	★★★★	★★★★★
	East Renfrewshire	★★★★★	★★★★★	★★★★	★★★★★	★★★★	★★★★	★★★★★
	West Lothian	★★★★★	★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★★
Band 2	Aberdeen City	★★★★★	★★★★	★★★	★★★★★	★★	★★★★★	★★★
	Aberdeenshire	★★★★	★★★★	★★★	★★★★	★★★★	★★★★★	★★★★★
	Angus	★★★★★	★★★★	★★★★★	★★★★	★★★	★★★	★★★★★
	Dumfries & Galloway	★★★	★★★★★	★★★★	★★★★★	★★★★	★★★	★★★★★
	Dundee City	★★★★	★★★★	★★★★★	★★★	★★	★★★★	★★★★
	East Lothian	★★★★★	★★★★★	★★★	★★★★★	★★	★★★	★★★★★
	Edinburgh, City of	★★★★★	★★★★	★★★★★	★★★★★	★★★	★★★★	★★★★★
	Fife	★★★★★	★★★★	★★★★★	★★★	★★★★	★★★★	★★★★★
	Glasgow City	★★★★	★★★★	★★★	★★★★	★★★	★★★★★	★★★★
	Highland	★★★★★	★★★★	★★★★★	★★★★	★★★★	★★★	★★★★
	Moray	★★★★★	★★★	★★★	★★★★★	★★	★★★★★	★★★★★
	Perth & Kinross	★★★★★	★★★★	★★★★★	★★★★	★★★★	★★★★	★★★★★
	Renfrewshire	★★★★★	★★★	★★★★★	★★★★★	★★★★	★★★	★★★★★
	Scottish Borders	★★★★★	★★★★	★★★★★	★★★★	★★	★★★	★★★
	South Lanarkshire	★★★★★	★★★★	★★★★★	★★★	★★★	★★★	★★★★★
	Stirling	★★★★	★★★	★★★★★	★★★★★	★★★★	★★	★★★
Band 3	Clackmannanshire	★★★★	★★	★★★★	★★★	★	★★	★★★
	Falkirk	★★★★	★★★	★★★	★★★★	★★★★	★★★	★★★★★
	Midlothian	★★★★★	★★★	★★★	★★★★	★★	★★★	★★★★★
	North Ayrshire	★★★	★★★	★★	★★★★	★★	★★	★★★
	North Lanarkshire	★★	★★★	★★	★★	★★	★★★★	★★★★
	Orkney Islands	★★★★★	★★	★★★	★★★	★★★★	★★	★★★★
	South Ayrshire	★★★	★★★	★★	★★★★★	★★★	★★★	★★★★★
	West Dunbartonshire	★★★★	★★★★	★★	★★★	★★★	★★	★★★★
Band 4	Argyll & Bute	★★	★★	★★	★★★	★★	★	★★★
	East Dunbartonshire	★★	★★	★★	★★★	★★	★	★★★★
	Inverclyde	★★	★	★	★★★	★	★★	★★★
	Shetland Islands	★★★★	★★★	★★	★★★	★★★	★	★★★
	Scotland	★★★★	★★★	★★★	★★★★	★★★	★★★	★★★★

Number of councils by assessment band, for each statement

Band	Assessment	9	10	11	12	13	14	15
1	★★★★★	17	3	12	11	2	5	17
2	★★★★	8	14	4	10	11	8	7
3	★★★	3	10	8	10	7	10	8
4	★★	4	4	7	1	10	6	0
5	★	0	1	1	0	2	3	0
Total number of councils		32	32	32	32	32	32	32

Appendix 4. Council scores for each of the 97 tests

The table shows, for each test, the number of councils scoring 1, 2, 3 or 4, and the average compliance score across all 32 councils. Each test is numbered according to its relevant statement number.

Statement reference	Issues tested	Number of councils scoring				Average council compliance %
		N	QN	QY	Y	
	Setting clear and properly focused objectives					
	Internal audit has agreed terms of reference.					
1.1	The internal audit section has written terms of reference.	2	7	5	18	74
1.2	The TOR have been agreed between the chief internal auditor, senior management and councillors.	2	7	8	15	71
1.3	The TOR have regard to the CIPFA Code of Practice and guidance published by relevant accountancy bodies.	4	2	13	13	70
1.4	The TOR frame objectives for internal audit that take account of the council's corporate aims and objectives.	7	6	10	9	55
1.5	The TOR make clear that internal audit should not be a substitute for effective control.	12	3	7	10	49
1.6	The TOR authorise internal audit's free access to all operations, information, records, assets and personnel across the council.	1	1	5	25	90
1.7	The TOR are reflected in the council's standing orders and financial regulations.	2	5	7	18	76
1.8	The communication arrangements between Members and the chief internal auditor are set out in the TOR or standing orders.	12	4	8	8	46
1.9	The TOR are communicated across the council in the form of a mission statement or charter.	7	7	8	10	55
1.10	The TOR have been reviewed since April 1996, ie since local government reorganisation.	4	3	5	20	76
	The respective roles of management and internal audit in maintaining internal controls are clearly defined and communicated.					
2.1	Management has defined control objectives for all major systems (financial and non-financial).	9	7	11	5	46
2.2	Internal audit is consulted about significant proposed changes to internal control systems.	1	8	15	8	65
2.3	The chief internal auditor provides an overall assessment for management of the robustness of internal control for the council's main systems, based on the work done that year.	15	9	4	4	30
2.4	Internal audit reviews demonstrate to managers the strength of internal controls and the levels of risk within their systems.	1	3	18	10	72
2.5	The chief internal auditor reports to the responsible finance officer the basis for demonstrating compliance with Section 95 of the Local Government (Scotland) Act 1973.	6	3	7	16	68

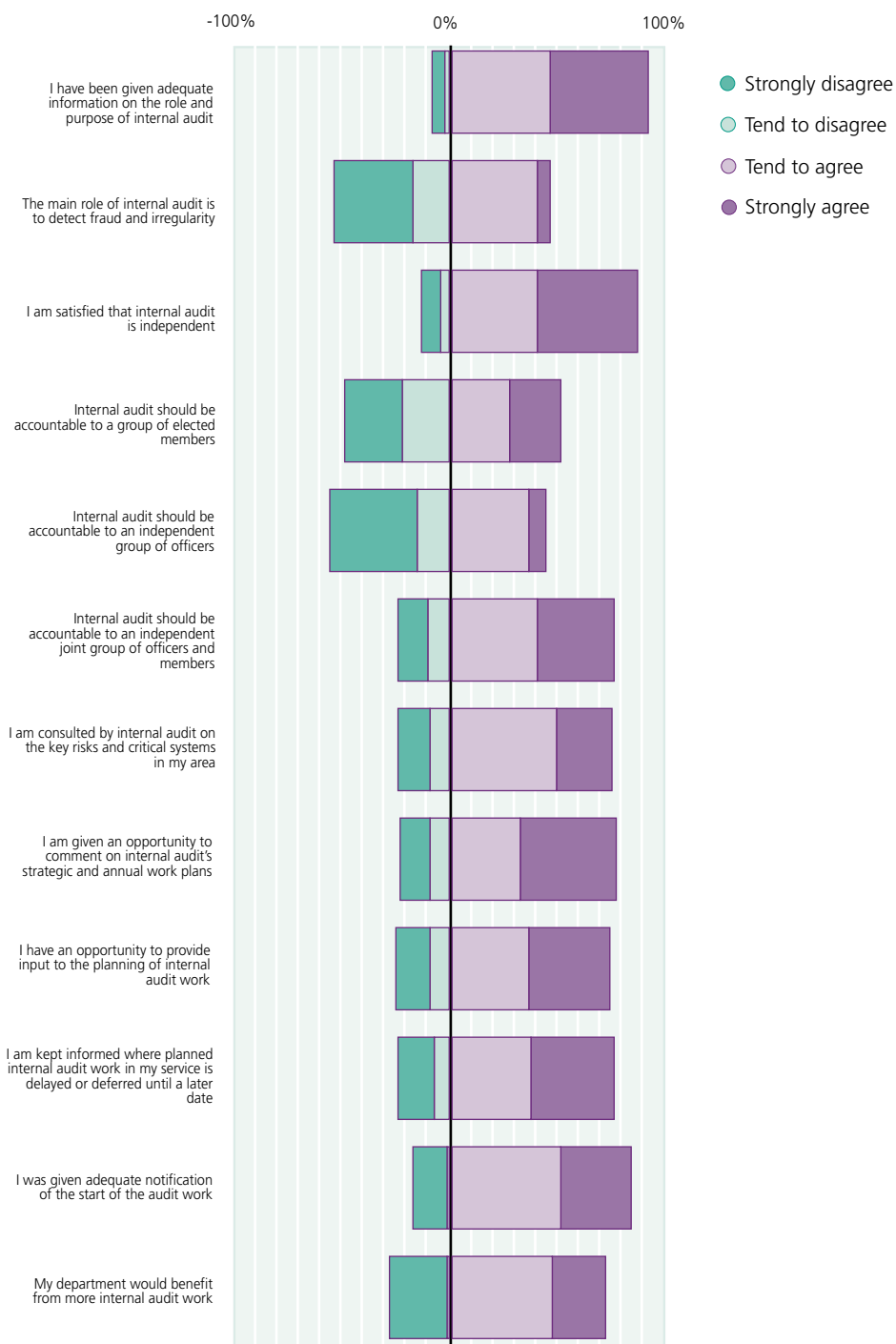| Statement reference	Issues tested	Number of councils scoring				Average council compliance %
		N	QN	QY	Y	
	Internal audit has a clear role in relation to fraud.					
3.1.	The council has an anti-fraud and corruption strategy.	4	7	5	16	68
3.2.	A framework for internal audit involvement in fraud investigation and prosecution is set down in the anti-fraud and corruption strategy.	5	3	6	18	72
3.3.	The council has a fraud response plan.	4	6	7	15	68
3.4.	The fraud response plan clearly sets out the roles and responsibilities of internal audit and management and includes a protocol for informing the police.	3	6	7	16	71
3.5.	The council has a 'whistleblowing' policy or confidential reporting procedure that has been communicated to all staff.	6	5	4	17	67
3.6.	Where appropriate, fraud investigations lead to recommendations to help disclose similar frauds and improve internal control.	0	2	8	22	88
3.7.	The anti-fraud and corruption strategy and fraud response plan have been reviewed since April 1996.	6	4	3	19	70
	Maintaining internal audit independence					
	Internal audit has sufficient organisational status to be able to undertake its work effectively					
4.1	The chief internal auditor has direct access to Members, the chief executive and senior managers.	0	2	14	16	81
4.2	The chief internal auditor formally discusses the work and performance of internal audit with the chief executive/audit committee or equivalent at least annually.	3	3	5	21	79
4.3	Internal audit determines its own priorities, based on risk assessment, in consultation with management.	1	5	9	17	77
4.4	The chief internal auditor submits reports to the responsible finance officer under S95 or to a more senior manager in the council.	2	6	3	21	78
4.5	The level of seniority (management tier) of the chief internal auditor within the management structure helps it to function effectively and independently.	0	7	10	15	75
4.6	Internal audit has unrestricted access to people, systems, documents and property as it considers necessary for the proper fulfilment of its responsibilities.	0	0	3	29	97
4.7	The chief internal auditor is free to report, without fear or favour, eg, the chief internal auditor has the right of final edit and issues reports in his or her own name.	0	2	10	20	85
	Internal audit is free of operational responsibilities that could compromise its independence.					
5.1	Internal audit is independent of any line-management task and is seen to be independent.	1	4	10	17	78
5.2	Where internal audit provides advice and consultancy work, staff are clear when they are operating as auditors and when they are not.	0	2	10	20	85
5.3	The chief internal auditor plans assignments to minimise the possibility of staff conflicts of interest.	1	4	9	18	79
5.4	Whilst reporting to the responsible finance officer, the chief internal auditor has freedom of access to all members and officers, especially the chief executive.	0	0	13	19	86
5.5	Staff with family or close friends within the council do not audit activities within their area of work.	0	6	10	16	77

Statement reference	Issues tested	Number of councils scoring				Average council compliance %
		N	QN	QY	Y	

Planning and controlling the work of internal audit

Internal audit bases its work on a comprehensive risk assessment.

6.1	Internal audit bases its risk assessment on information from the authority's risk management process and an agreed audit risk methodology.	9	11	5	7	44
6.2	Internal audit consults widely with management to identify critical systems and risks.	1	6	14	11	70
6.3	Internal audit has a comprehensive understanding of the authority's systems, structures and operations.	0	2	12	18	83
6.4	Internal audit uses a formal framework to assess risks.	8	6	3	15	59
6.5	Internal audit uses the risk assessment to prepare audit plans and prioritise its work.	4	4	9	15	70
6.6	Internal audit reviews its risk assessment periodically, depending on the extent of change within the organisation.	6	6	12	8	56

Internal audit operates within a structured planning framework.

7.1	Internal audit plans link back to the council's corporate aims and objectives and are co-ordinated with other review programmes (eg, Best Value reviews).	4	12	12	4	50
7.2	Audit plans are produced in consultation with senior managers across the organisation.	0	5	7	20	82
7.3	Internal audit has a strategic plan based on risk assessment, which sets out the audit scope and objectives.	4	7	8	13	65
7.4	The strategic plan sets out the resources required to meet the audit needs of the council and identifies any mismatch between resource needs and resource availability.	11	11	5	5	38
7.5	An annual audit plan is produced which translates the strategic plan into audit assignments to be undertaken during the year.	1	5	7	19	79
7.6	Project plans are set out for each audit assignment, which allocate resources, set out the scope and objectives of the assignment and establish target completion dates.	3	8	10	11	64
7.7	Audit plans are flexible enough to accommodate work that has arisen during the course of the plan without resulting in core risk areas not being reviewed.	6	4	10	12	63
7.8	Significant changes to audit plans are approved by senior management and the audit committee (or equivalent).	5	4	9	14	67
7.9	The planning process takes account of the work undertaken by external audit and other review agencies and inspectorates.	2	2	16	12	73
7.10	Internal audit strategic plans are reviewed to reflect the changed priorities of the council.	3	7	12	10	64
7.11	The agreed annual audit plan is only revised in exceptional circumstances.	2	2	12	16	77

Internal audit has effective relationships with council members, council managers, external audit, inspectorates and other agencies.

8.1	The timing of internal audit assignments is normally arranged with the management concerned to minimise disruption.	0	2	11	19	84
8.2	There is an ongoing dialogue between the internal auditor and client service throughout the audit assignment.	0	1	10	21	88
8.3	External audit place reliance on the work of internal audit.	2	0	12	18	81
8.4	Internal audit and external audit regularly exchange audit information.	1	8	13	10	67
8.5	Internal audit effectively co-ordinates its work with external audit and other review agencies.	1	4	17	10	71
8.6.	Internal audit maintains good working relationships and channels of communication with elected members.	4	6	9	13	66

Statement reference	Issues tested	Number of councils scoring				Average council compliance %
		N	QN	QY	Y	
	Internal audit properly manages, controls and records its work.					
9.1.	Internal audit has documented policies and procedures contained in an audit manual.	3	5	7	17	73
9.2.	The chief internal auditor allocates staff to assignments according to their skills and experience.	0	1	9	22	89
9.3.	Internal audit staff understand the objectives of their assignments and their responsibilities.	0	2	13	17	82
9.4.	Internal audit has a rigorous approach to collecting and managing evidence.	0	3	11	18	82
9.5.	Adequate working papers are prepared to support internal audit findings, conclusions and recommendations.	0	5	12	15	77
9.6.	Internal audit work is documented at all levels from audit planning to reporting.	1	4	11	16	77
9.7.	Internal audit assignments are adequately supervised and reviewed.	0	5	12	15	77
	Resourcing the internal audit work programme					
	Internal audit is adequately staffed and resourced.					
10.1.	The chief internal auditor is professionally qualified and has wide experience of internal audit and its management.	1	1	4	26	91
10.2.	The chief internal auditor has identified a staffing structure that enables internal audit to meet its objectives and the changing needs of the organisation.	4	5	18	5	58
10.3.	Internal audit has adequate resources to enable it to meet its work objectives efficiently and effectively.	4	8	20	0	50
10.4.	Internal audit employs or has access to people with relevant skills and experience in order to undertake the required tasks.	2	6	21	3	59
10.5.	Where required the chief internal auditor can 'buy in' people for specialist work who are suitably experienced and qualified.	6	10	7	9	53
10.6.	Internal audit uses the latest technology for planning, audit work and reporting.	1	4	19	8	69
10.7.	All audit staff have job descriptions and personnel specifications that reflect their current post.	2	2	6	22	83
	Internal audit staff are suitably trained and developed.					
11.1.	An induction programme has been prepared for all new audit staff.	4	9	10	9	58
11.2.	Training is tailored to the needs of individual auditors and includes both theoretical knowledge and its practical application.	3	6	10	13	68
11.3.	Internal auditors keep up-to-date with current developments in auditing and the issues facing the audited body.	0	4	12	16	79
11.4.	All staff maintain competence through professional development.	1	6	11	14	73
11.5.	The chief internal auditor co-ordinates and keeps under review the training and development requirements of internal audit staff.	1	9	8	14	70
	Reporting and follow-up arrangements					
	Internal audit has clear reporting arrangements that provide management with an opinion on the adequacy of internal controls.					
12.1.	The chief internal auditor produces an annual report, which contains a view on the soundness of the council's internal control system.	13	9	4	6	36
12.2.	Internal audit has documented, systematic, procedures in place for producing and clearing reports.	1	6	6	19	78
12.3.	Reporting arrangements, including timescales for drafting, finalisation and management action have been agreed with management.	4	8	13	7	57

Statement reference	Issues tested	Number of councils scoring				Average council compliance %
		N	QN	QY	Y	
12.4.	Internal audit produces clear, concise, constructive written reports.	0	1	16	15	81
12.5.	Before issuing final reports, internal audit discusses the contents with management, and may submit a draft to confirm factual accuracy.	0	0	5	27	95
12.6.	Where internal audit and management disagree the relevance of the factual content, the chief internal auditor has the opportunity to refer to this in his/her report.	0	0	5	27	95
	Internal audit follows-up recommendations to ensure action is taken.					
13.1.	Internal audit, agrees 'SMART' action plans, which identify persons responsible for implementation, with management to review progress of implementation by both parties.	3	2	9	18	77
13.2.	Internal audit reports instances of failure to comply with action plans to the corporate management team.	6	8	12	6	52
13.3.	Where management do not implement internal audit findings, it is clear that they accept the risk resulting from not taking action.	4	8	15	5	55
13.4.	The results of follow-up work by internal audit are used to update the comprehensive risk assessment.	6	12	10	4	46
13.5.	The results of follow-up work by internal audit are used to inform updated audit plans.	4	6	13	9	61
	Holding internal audit to account for its performance					
	Internal audit has a performance management framework that ensures continuous review of its performance.					
14.1.	Internal audit is accountable to an audit committee or equivalent body.	9	5	5	13	56
14.2.	The chief internal auditor prepares an annual plan that is presented to senior management and the audit committee (or its equivalent).	3	4	9	16	73
14.3.	Internal audit has a documented system for evaluating the performance of the unit as a whole.	3	7	15	7	60
14.4.	The chief internal auditor uses a set of indicators to measure the performance of internal audit.	2	7	14	9	65
14.5.	The chief internal auditor continuously maintains and develops the performance of internal audit.	1	3	13	15	77
14.6.	Internal audit is accredited under a national or international quality standard (eg, IIP, EFQM, etc).	16	4	7	5	34
	The chief internal auditor promotes and maintains professional standards in internal audit.					
15.1.	Internal auditors possess knowledge of the council and its systems to a level commensurate with their role in the unit.	0	1	12	19	85
15.2.	Internal auditors are impartial in discharging their responsibilities.	0	1	9	22	89
15.3.	Disciplinary procedures are invoked where a staff member contravenes the ethical standards required by the accountancy bodies.	0	2	13	17	82
15.4.	Internal audit maintains a current register of declarations of interest, and acceptance of hospitality.	5	6	12	9	59

Appendix 5. Client survey findings

Questionnaires were provided to each council's head of service for education, housing and social work. For each question, the table shows the percentage of respondents who agreed or disagreed, and the average score. A total of 86 responses were received from a potential maximum of 96 questionnaires (90% response rate).

Client survey findings, continued.

Legend:
- Strongly disagree
- Tend to disagree
- Tend to agree
- Strongly agree

Categories (top to bottom):
- The audit addressed key management controls, systems and risks
- Internal audit staff on the assignment were knowledgeable about my operations
- There was no disruption to my workplace during the audit
- Internal audit staff operated in a professional manner
- The audit findings were adequately supported by evidence
- Recommendations made in the audit were clear, constructive and relevant
- I usually agree with audit recommendations
- Internal audit follow up their recommendations to ensure agreed action taken
- Internal audit staff communicated key issues and audit findings to me as they arose during their work - there were no major surprises in their draft reports
- The elapsed time from initial drafting to issuing the final report was appropriate for the audit work done
- The final audit report was timely in comparison to the end of the fieldwork
- The audit work was worthwhile and added value to the work of my department

Appendix 6. The views of chief executives and directors of finance

There were 30 responses from chief executives (94% response) and 31 responses from directors of finance (97% response).

C = Chief executive   D = Director of finance
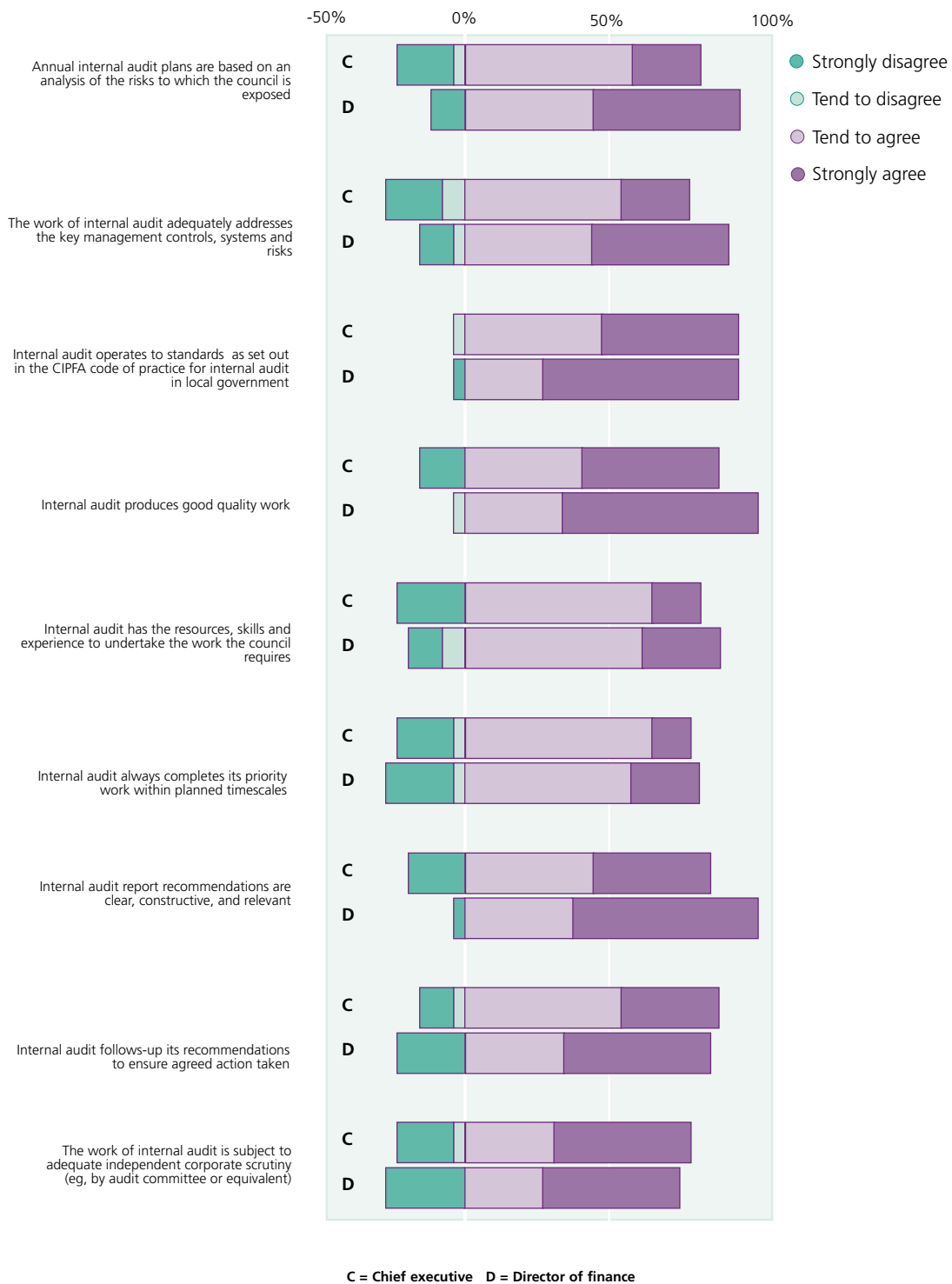
Notes

1   *'Auditing Practices Board Auditing Guidelines'*.

2   Section 95 of the Local Government (Scotland) Act 1973.

3   *Internal control* – The whole system of controls, financial and otherwise, established to provide reasonable assurance of effective and efficient operations, reliable financial information and reporting and compliance with laws and regulations.

4   Developments in the private sector that have had a significant impact on how an internal audit function should operate include:

       1992 – '*The report on the Committee of Financial Aspects of Corporate Governance*' (the Cadbury report) defines corporate governance as "the system by which organisations are directed and controlled". Cadbury suggested three important principles: openness, integrity, and accountability.

       1994 – The Rutterman working group published its guidance: *'Internal Control and Financial Reporting: Guidance for Directors of Listed Companies Registered in the UK'*.

       1995 – The Greenbury Committee provided recommendations on good practice in determining directors' pay.

       1995 – The Hampel Committee produced a *'Combined Code'* for stock exchange listed companies embracing the Cadbury Committee guidance, the Greenbury Committee, and its own work.

       1999 – The Turnbull Committee report *'Internal Control: Guidance for Directors on the Combined Code'* has provided guidance on how the Combined Code should be implemented.

5   *The Leadership Advisory Panel (LAP),* chaired by Alastair McNish was set up as a result of the recommendations contained in the McIntosh report, which required all councils to consider whether their policy development and decision-making processes were fit for the 21st century in terms of openness, transparency and accountability. The LAP reported to Ministers in June 2001 on the outcome of the self-reviews of policy development and decision-making processes carried out by the 32 councils. It provides assessments on the approach taken by each council in conducting its review and how well the new arrangements meet the McIntosh recommendations.

6   *'Corporate Governance in the Public Sector',* published jointly by the Chartered Institute of Public Finance and Accountancy(CIPFA) and the Society of Local Authority Chief Executives(SOLACE), June 2001.

[7]   *'Implications for Audit of the Modernising Government Agenda',* Public Audit Forum, April 1999. *'Audit Implications of Electronic Service Delivery in the Public Sector',* Public Audit Forum, April 2001.

[8]   *Public Audit Forum* – Forum established by the four national audit agencies.

[9]   *'Code of Practice for Internal Audit in Local Government in the United Kingdom',* CIPFA, October 2000.

[10] See note 1.

[11] *Aggregate council revenue expenditure* – estimated total net revenue expenditure plus housing revenue account income, CIPFA Rating Review, 1999/2000.

[12] *Systems-based audit* involves the auditor documenting the systems being examined, and identifying the controls within that system. Once this has been done, the controls are then evaluated to decide whether they are adequate and sufficient. The auditor, as well as confirming the existence of suitable controls, may also highlight expected controls (ie, controls that normally would be present in such a system, but are missing). The controls are then tested to ensure that they are working properly. *Regularity* relates to the consistent application of proper and appropriate public sector regulations and practice.

[13] *Fraud* – the intentional distortion of financial statements and accounting records and/or misappropriation of assets involving deception.

[14] *Corruption* – the offering, giving, soliciting or acceptance of an inducement or reward that may influence the actions taken by the audited body, its members or officers.

[15] *Control self-assessment (CSA)* – places the onus on managers to assess how the controls for which they are responsible address relevant business risks. CSA uses a questionnaire or workshop approach.