

Government and Public Sector



London Borough of Harrow

Internal Audit Service Review- CONFIDENTIAL

March 2010



PRICEWATERHOUSECOOPERS 

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1. Background, Scope and Our Approach

Background and Scope

PricewaterhouseCoopers LLP was asked to assess the capacity, effectiveness and options for building future resilience into the Harrow Internal Audit Service. Our work included a review of the following:

- internal audit plans, procedures and practice.
- integration of internal audit into the Council's governance process.
- the tools and techniques employed by the service.
- and; the performance of the service against the expectations of Senior Management and Members.

We were also asked to review the effectiveness of non-audit activities, Principally:

- the Council's counter fraud arrangements, including resourcing and proactive counter-fraud activity,
- and; the effectiveness of the risk management process in identifying and assisting the authority in managing the threats to achieving its objectives.

Our Approach

Our approach to this review was to:

Gather views from key stakeholders across the organisation on how the Internal Audit, Anti-fraud and Risk Management function was perceived by end users:

- We met with 13 key stakeholders across the organisation including officers and Members.
- We reviewed key performance information for the service.

Assess the Service through high level review against its own procedures and practises:

- For non-compliance with procedures.
- For gaps in service delivery against its objectives.
- For adherence to good practice in service delivery.

Provide to management suggestions for improvement:

- To enhance the engagement with key stakeholders of the service.
- To improve performance and the added value to Harrow from the service.
- To build future resilience into the Harrow Internal Audit, Anti-fraud and Risk Management service.

2. Key Observations on Service Compliance with Standards

Compliance with Code of Practice for Internal Audit in Local Government 2006

The service appears to comply with the key requirements laid down in the Cipfa Code of Practice for Internal Audit in Local Government 2006. This includes having a terms of reference, a comprehensive audit manual and an independent and competent team delivering the audit work.

The internal audit function is managed by an experienced Service Manager reporting to a Divisional Director for Risk, Audit and Fraud and then to the Director of Finance.

The Internal Audit Service Manager has performed well in delivering the Internal Audit service with limited existing resources and has maintained excellent relationships with Departmental Stakeholders across the Council.

The resources of the service are focussed principally at obtaining independent assurance on compliance with procedures and the function carried out a self-assessment in 2008/09 on adherence to the “Code of Practice” where it assessed itself as fully compliant with 80% of the Code’s standards.

Compliance with Standards – key thoughts

Feedback from the interview process indicated that the Council has generally focussed internal audit on routine controls and compliance audit assurance. The audit plan has been reconfigured based on limited existing resources to allow delivery of 871 days in 2009/10, targeted mainly at “adherence to existing control” reviews.

Despite these input restrictions a generally compliant with standards service is being delivered to the Authority, and based on stakeholder feedback, the service is well engaged with stakeholders.

The work of the service is considered to be helpful to management, although timeliness of report turnaround was raised as an issue from some stakeholders as well as a need for the service to have scope over and above a compliance capability for some of its work.

“Audit is always willing to help...” Stakeholder Comment

3. Key Observations from the Consultation with Stakeholders

Service Engagement and Performance at meeting Stakeholders Needs

The Audit Service is perceived as effective at providing stakeholders with compliance based assurance on controls.

The annual audit planning process is seen as effective, but liaison and engagement post planning process is less identifiable and does prevent the service from rapid response to emerging risk and needs.

The service is seen as having a recognisable profile across the Council, most readily identifiable with the Service Manager, who is considered, from feedback received, to be a motivated and customer focused representative of the Internal Audit service.

Much of the work produced by the team is focussed on basic controls and is targeted, for resourcing reasons, at core processes only.

The service seeks to be responsive, but is not always as responsive as the Council would like, and there is a desire for more coverage of some areas over and above the existing rotational plan as well as a need for more specialist audit support in some areas.

Service Delivery – key thoughts

Potential improvements were identified in the ability of the service to turn around reports more speedily.

The service is also short of specialisms, particularly in the area of contract management and IT audit.

There is a feeling that the service could be more challenging in terms of process re-engineering to streamline existing processes and help Harrow reduce bureaucracy.

However, in overall terms the service remains a supportive function of the Council and a valued provider of assurance.

4. Key Observations from Review of Audit Function Operation

Internal Audit Effectiveness

The service is delivered at present entirely in-house with estimated available resources, assuming around 182 days of productive time per FTE per annum and 50% Service Manager delivery availability, of 820 days.

The actual 2009/10 plan includes 871 days (150 of which are to be delivered by contracted in resources).

Of the 871 planned audit days nearly 350 days are allocated to advice, support and other, non-reportable activities. From review of the 2009/10 plan there is linkage to the Council's risk registers.

As at mid February 2010, the service has delivered 26 (46%) of its annual planned 57 reportable outputs, and of the 26 reports/outputs issued, 11 related to non-FMSIS reviews and of these only 5 have an assurance rating.

Moreover, key financials are afforded only 100 days or 11.5% of the annual plan, with some key controls orientated projects allocated significant relative resources in the context of assurance needs, for example, 25 days to complete the 2009/10 Housing Rents key controls audit.

Based on current resources the average days for the service per gross £m of turnover are 1.5 days compared with benchmarked* comparison of 2-4 days.

Implementation of recommendations rate for 2009/10 is unavailable but reported as 72% for the prior year.

How effective is the function? Key thoughts

Management perception is that the Council internal control environment is generally robust.

The service is currently behind its profiled delivery schedule which would, on a linear basis, anticipate having delivered 48 reports at this stage in the year. Additional resources may be called in to help backfill on delivery at the end of the current year.

In overall terms the service is orientated towards compliance reviews, with some 40% of the audit plan allocated to non-reportable advice and support activities which are designed to help engage the service with the Council's emerging issues.

The service is relatively low on reportable outputs in part due to maintenance of an advice and support capability. Feedback, however, indicates a need for more complex specialist support in some of these advisory areas.

*Cipfa IPF benchmark and comparison with other London Boroughs
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4. Key Observations from Review of Audit Function Operation (cont'd)

Internal Audit Focus and Efficiency

There is limited cross fertilization of risk and control issues between the Audit Service, the Anti-fraud function and Risk Management undermining the services' ability to develop a coherent and overarching view of the Council's control environment, although the merging of services under new organisational changes will help to "join-up" the service.

Management currently monitor productive v. unproductive time to support minimisation of administrative time and the service metrics show in excess of 180 productive days per auditor per year, which is good performance from the audit team.

The service has adopted a key controls based programme for the audit of the Council's identified Key Financial Systems (KFS). Average* days allocated to KFS reviews in similar sized Councils range between 200 and 300 days.

Good practice* indicates IT audit days should account for approximately 20% of the annual plan. At present the Council's 2009/10 plan allocates <5% of its resources to IT system assurance.

Limited resources are allocated to key risk areas such as contract management risk, despite identifiable control exposure in this area from our interviews and review of the Council's risk registers.

Moreover, a significant number of risks in the strategic and departmental risk registers relate to funding shortfalls, however, there are few projects within the plan underpinning budget monitoring and control arrangements for the Council as a whole.

*Cipfa IPF benchmark and comparison with other London Boroughs

Does Internal Audit focus on the right things?

The audit service currently has limited engagement with risk management and is reliant on the annual planning process for focus. Resource constraints have led to reduced coverage on key areas of assurance and audit team have needed to manage ad-hoc advice and delivery of quality audit reports with very limited resources. The Service Manager does well to manage the service in this environment and to shape a programme of work to meet multiple objectives.

However, sample projects reviewed demonstrated generous allocations for days on specific projects which could be reduced using a fully risk based audit approach to help free resources for other assurance activities. Some additional focus for the service may assist the Council to address key control risk as well as help mitigate the effects of the restricted audit days.

"Internal Audit does well with what it has as resources".

5. Key Observations from Review of the Investigations Function Operation

Investigations Effectiveness and Efficiency

- The investigations team can muster the resources of 7 staff and assuming average productive input days of 180 days per annum and 50% productive time for manager grade staff, this gives the team available resources of 1,170 days per annum to cover a mixed portfolio of Housing Benefit and Corporate fraud investigations.
- The team has motivated and experienced Manager and has a clear work flow management process with good case file management systems, but does not separate the delivery teams in terms of Corporate versus Benefit fraud and there are no established performance metrics by which to measure the service's overall performance and effectiveness.
- Staff inputs for the service are not measured.
- There is presently a proactive fraud plan for the team to deliver against but this is not clearly aligned to the internal audit assurance plan.
- Based on statistics provided by the service lead manager, as at 15th February 2010, of 139 corporate fraud cases closed in the period 1 Jan 2009 to 31 Dec 2009, 57 were proved resulting in prosecution, recovery of assets or disciplinary action. At 41% positive outcomes from investigatory work, there would appear to be a need to strengthen the risk assessment referral process in order to achieve a positive outcome ratio of at least 50% or, if possible, more.
- There is no formal reporting and follow-up link to internal audit on control findings to prevent re-occurrence of anti-fraud identified control issues.

Is the investigations team focussed appropriately?

The investigations team uses a basic risk assessment on referrals and does not measure with clear milestones, individual case progress against inputs.

Measurable outputs are limited and inefficiencies in the use of resources cannot currently be clearly identified, although in comparison with other Councils the service does appear to have limited resources.

Minor issues were identified in terms of consistency of conclusion documentation for the one case reviewed during our testing.

Management may consider improved productivity monitoring of this resource pool in order to clearly identify the benefits the service is providing to the Council and where proven, consider the scope for increased resources where recovery benefits justify further investment.

6. Key Observations from Review of the Risk Management Functions Operation

Risk Management Effectiveness and Efficiency

- The risk management function has undergone significant change over the recent past with the departure from the team of the Strategic Risk Manager and change of staff at the Operational Risk Officer level.
- The service is currently staffed by an interim officer.
- The service is seen as having only partial traction and there is a feeling amongst senior management that the Council is currently only really going through the motions of risk management, rather than actively participating in the risk management process at a strategic and tactical level.
- Those risks that are articulated into the Council's strategic risk registers are framed in extremely broad terms which do not readily map against the Council's Corporate objectives. They are therefore difficult to translate into clear mitigation actions or to use as an additional source for the targeting of internal audit work.

**We have included in section 7 some suggestions for service improvement .
Our detailed findings are included in Appendix A**

Is the investigations team focussed appropriately?

The Risk Management service has recognised a need to reframe its position in supporting the Council and is seeking to take on a more challenging role in developing Senior Managers' perceptions of risk and response.

There is a clear need to align risk management with internal audit and for each function to better cross support each other.

We have made some suggestions as part of our review on how this could be achieved, using for example, a different reporting format and the Internal Audit Service Manager is already looking at ways to better align the risk management service with the audit function.

7. Suggestions for Audit, Investigations and Risk Management Improvement *

* *The following section should be read in conjunction with Appendix A and does not contain all of our suggestions, but those key actions likely to be of immediate benefit to the service.*

Productivity

- Application of a **full risk based internal audit methodology** could help the service isolate key assurance risks more efficiently and an improved interface with Risk Management and counter fraud would help the service obtain a better understanding of the overall assurance universe for the Authority.
- An **enhanced risk assessment** process before acceptance of counter fraud referrals should help reduce time wasted on weak cases, and a staged review of all on-going cases at 5 – 10 – 20 day inputs may reduce time spent on ongoing cases with little prospect of success.
- All staff in the investigations team should utilise a code-able time sheet system linked to weekly monitoring for inputs. **Productive (case load) orientated inputs should be monitored against non-productive time spent** and a target productivity ratio of 90% productive 10% on-productive should be applied.

Resources

- Based on empirical evidence, **the Harrow Internal Audit service is under resourced** in terms of audit days and should consider options for development of an assurance programme of work at levels of between 1,150 – 1,250 days per annum. Furthermore, options to resource the existing gap of around 300 – 400 days and to obtain access to flexible specialist resources, include recruitment or co-sourcing. Management should consider the best way to meet this need in developing the resourcing plan and, if decided to co-source, the most appropriate route from which to gain external support using the Councils procurement framework.

Suggestions for Audit and Investigations Improvement (cont'd)

Service Effectiveness



- The service demonstrates a number of laudable attributes in terms of customer focus, and a desire to be flexible and supportive and the service has developed a comprehensive audit manual and approach to delivery of services. However, the service could realise yet further potential with a more risk focused approach and with **greater challenge on traditional methods of delivery**, for example in agreeing with the external auditors on where key financial systems assurance will be obtained in an audit cycle.
- It is critical that **all high priority internal audit findings are physically verified** at follow-up and implemented in agreed timescales. Failure to do so may indicate mis-classification of the high prioritisation or disengagement of the auditee.
- We have included a model at Appendix B which identifies the options for assurance positioning for the service based on maturity and management control. We would recommend that the Service Manager review the Harrow Internal Audit function's current and potential position on this spectrum with a view to updating the service vision for 2010 onwards to address some of the findings in this report.

Key Performance Indicators


- See Appendix C.

Appendix A - Detailed Findings



We have identified the following key findings and recommendations from our review of the Service

Objective	Priority	Findings and Recommendations
1. Adequacy and effectiveness of internal audit activity's charter, plans, policies, procedures, practices, and applicable legislative and regulatory requirements.		From our high level review of the Harrow Internal Audit Service's compliance with the headline requirements of the Cipfa Code of Practice for Internal Audit in Local Government 2006, no issues have been identified.
2. Integration of internal audit into the Council's governance process and its relationship with the key groups involved in that process.		<p>The Service demonstrates connections with both the Audit Committee, the S.151 Officer and Service Managers in terms of reporting internal control issues to the Authority.</p> <p>Feedback from stakeholders was generally very positive in terms of service engagement, but there was suggestion that the positive profile of the service was overly reliant on the Service Manager.</p> <p>The service is intentionally targeted at compliance review and is seen as competent, but the absence of consultancy or specialist capabilities within the function may limit the influence of the service in terms of re-engineering of processes, especially regarding efficiency.</p> <p>Moreover, the size of the audit plan (due mainly to resource constraints), particularly regarding IT and Key Financial Systems, and the scope for refinement of the planned audit work with greater emphasis on risk currently limits the effectiveness of the service to provide assurance on all key threats to the Council.</p>

Appendix A - Detailed Findings (cont'd)

Objective	Priority	Findings and Recommendations
<p>3. Adequacy and effectiveness of the tools and techniques employed by the service.</p>		<p>The service is delivered entirely in-house and no significant issues were identified in the services adherence to its tools and techniques for completion of audit work. A 'Quality Control Review' process exists to ensure outputs are checked before release.</p> <p>Relative days allocated to specific projects do appear to be high in the context of available resources and some concerns were also identified in terms of the function's limited focus on higher impact risks, such as assurance on contract risk.</p> <p>Of more importance is the delivery profile of work for the year to date, which currently demonstrates shortfall in outputs delivered as at the middle of February 2010 against a linear profiled work plan for the year.</p> <p>Of equal importance is the implementation rate reported for recommendations which as at the time of our review was not readily available, albeit the prior year implementation rate was some 72%. It is important that the audit function monitors this performance statistic as a key measure of the success, practicality and benefit of the service.</p>

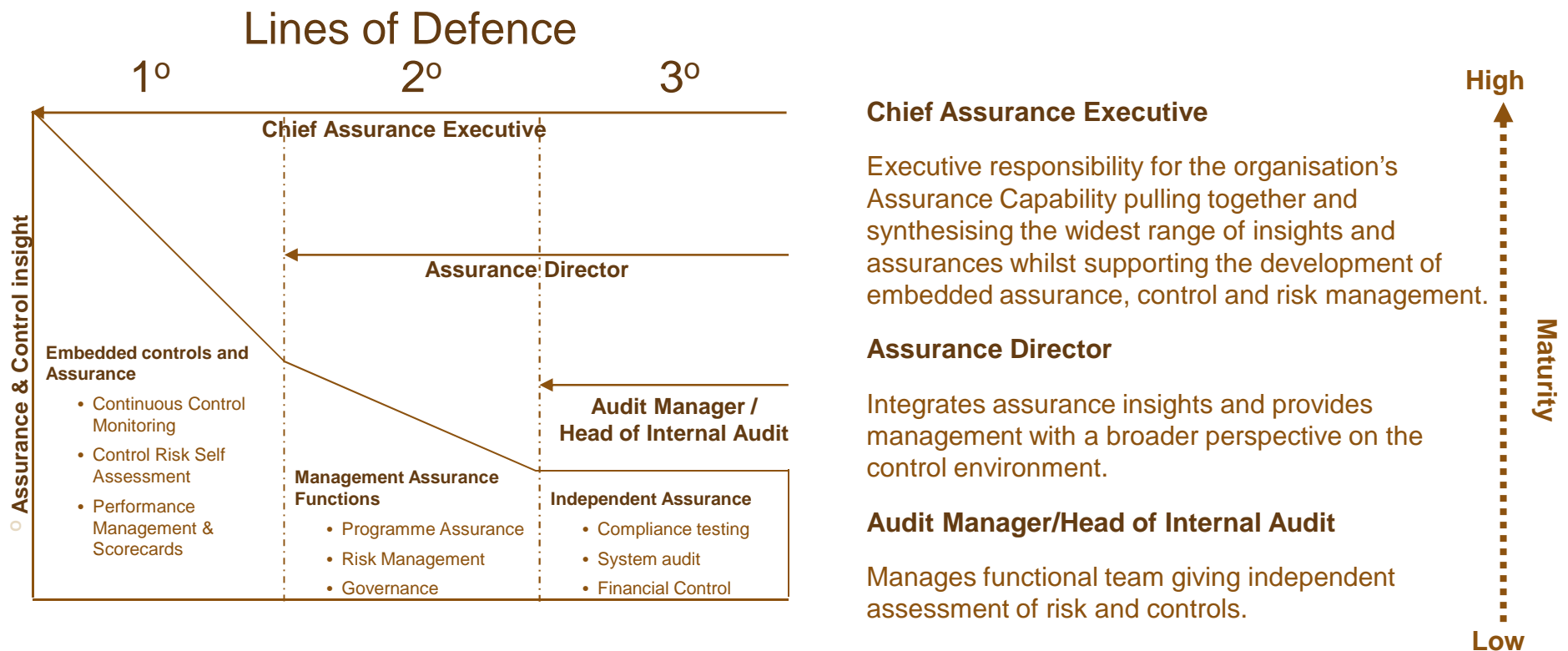
Appendix A - Detailed Findings (cont'd)

Objective	Priority	Findings and Recommendations
<p>4. Performance of the service against the expectations of Senior Management and Members.</p>		<p>The service is performing adequately against the expectations of most stakeholders.</p> <p>The Council is generally clear on the desire for a compliance orientated service although some interviewees felt the service needed to turn around deliverables more promptly and that scope to provide specialist audit within the existing team was limited.</p>
<p>5. The effectiveness of the Council's Counter fraud arrangements, including Resourcing and proactive counter fraud activity.</p>		<p>Concerns were identified regarding the absence of productivity management within the investigations service and the absence of communication channels between risk, counter-fraud and internal control generally.</p> <p>In order to properly determine whether additional resources are required for the team, more detailed performance management information is required from the service manager.</p>
<p>6. The effectiveness of the risk Management process in identifying and managing the threats to the Council achieving its objectives.</p>		<p>The service is seen as having only partial traction and there is a feeling amongst senior management that the Council is currently only really going through the motions of risk management, rather than actively participating in the risk management process at a strategic and tactical level.</p> <p>Closer working with Internal Audit and enhanced focus on risk as a tool for management decision-making is required to re-engage the function.</p>

Appendix B – 3 Lines of Defence Model - Options available to provide assurance to Harrow – Internal Audit Service positioning

The nature and capability of the function will be influenced by many things including the assurance maturity of the organisation, the level of inherent risk and the need for Audit Support.

The model below may assist management in determining the correct placement of the service



Chief Assurance Executive

Executive responsibility for the organisation's Assurance Capability pulling together and synthesising the widest range of insights and assurances whilst supporting the development of embedded assurance, control and risk management.

Assurance Director

Integrates assurance insights and provides management with a broader perspective on the control environment.

Audit Manager/Head of Internal Audit

Manages functional team giving independent assessment of risk and controls.

Appendix B (cont'd) - 3 Lines of Defence Model - Detail

High performing organisations will have all 3 lines of defence operating effectively and will gain real time assurance that controls and control monitoring procedures are operating as designed. Organisations that typically rely on the 3rd line of defence will only be aware of control failing retrospectively and should the 3rd line be deficient, may not be aware of control breakdowns at all. Harrow largely relies on the 3rd line only due to an ineffective risk management process and no embedded control assurance across the organisation. Existing weaknesses in the focus of the Harrow internal audit service mean the 3rd line could be breached at any time.

1st Line

Embed Controls and Assurance

Management self assurance on controls compliance. This can be from either regular management self testing – e.g. monthly of controls or self assessment of risk and impregnating systems with key controls, such as segregation of duties.

Internal audit can be used to provide independent assurance on the effectiveness of management's controls self assurance, "auditing the audit".

Internal audit can assist in establishing the self assurance framework through embedding continuous audit for the organisation.

2nd Line

Management Assurance Function

Reliance by management on "other" assurance streams, for example programme office assurance on large capital projects, or effective use of the organisation's risk management function.

The governance structures of the organisation are an effective tool for management to place reliance on where they are known to work and have been regularly tested, for example by internal audit.

3rd Line

Independent Assurance

Internal audit, external audit and other independent assurance providers give management comfort over the effectiveness of controls on a regular basis.

Underpinning both the first and second lines, this final barrier to control failure, if targeted effectively through a competent risk framework, is the ultimate protection for management against control breakdown.

The audit service must provide a timely and reliable dialogue to management on controls effectiveness and controls improvement.

Appendix C – Potential Service Key Performance Indicators

- Average number of days between the exit meeting and issue of draft report - Maximum of 10 working days
- Average number of days between receipt of management responses and issue of final report - Maximum of 10 working days
- Percentage of Assignments completed to budgeted number of days in the Audit Plan – 90% target
- Percentage of high, medium and low risk recommendations implemented within 3 months of target date - 90% target for High Priority recommendations
- Percentage of planned audits completed:

Targets:

Quarter 1: 20%
Quarter 2: 50%
Quarter 3: 80%
Quarter 4: 100%

- Utilisation Rates for staff (productive v. non-productive) 80 – 90% Target
- Customer Satisfaction results. Target - 90% of criteria rated as very good or good
- Audit Complaints – Target – No Complaints
- Staff sickness levels – Target - Below national average

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