

Review of Internal Audit

**West Yorkshire Passenger Transport Authority and
Executive**

Audit 2005/2006

External audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services.

Audit in the public sector is underpinned by three fundamental principles:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements but also value for money and the conduct of public business; and
- auditors may report aspects of their work widely to the public and other key stakeholders.

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Introduction

- 1 International Standards on Auditing (UK & Ireland) (ISA+s) came into effect from 2005/06 and ISA+ 610 requires External Auditors to consider the activities of Internal Audit and perform an assessment of the Internal Audit function where they intend to rely on Internal Audit work on specific audit areas.
- 2 This document sets out our assessment of the Internal Audit function for both West Yorkshire Passenger Transport Executive (WYPTE) and Authority (WYPTA) and the extent of our reliance on 2005/06 Internal Audit work.

Background

- 3 Metro's (WYPTE & WYPTA) Internal Audit (IA) department co-operates fully with External Audit and, at previous audits, we have been able to place reliance over specific areas covered by Internal Audit in 2004/05 this included IA work on WYPTE payroll, creditors and main accounting systems.
- 4 Our last full review of IA was carried out in 2002/03. This review concluded that IA met the standards of the CIPFA code of practice for Internal Audit, with scope for improvements in the following areas, 'Planning', 'Controlling and Recording' and 'Evaluation of the Internal Control system'.

Audit approach

- 5 In 2003, CIPFA issued a Code of Practice for IA in local government (the Code). This represents proper IA practice, for IA in principal local authorities, as specified in the Accounts and Audit Regulations 2003 (recently replaced by the Accounts and Audit Regulations (amendment) (England) Regulations 2006). We have, therefore, decided to use this as the most appropriate means of assessing the work of IA at Metro.
- 6 In 2006, CIPFA's audit panel reviewed the Code and it has issued a revised draft Code of Practice. This updates the Code to reflect the Accounts and Audit (amendment) (England) Regulations 2006. The main influences and changes to the Code are set out in the main conclusion section (12) below.
- 7 Our approach to the review has included the following stages:
 - initially the Internal Audit Manager (IAM) carried out a self-assessment of IA, against the CIPFA Code, by completing our IA self-assessment tool;
 - we then evaluated the results of the self-assessment together with supporting evidence provided and undertook further work, as necessary, to enable us to decide whether we can place reliance on IA's work as intended; and
 - we agreed our evaluation of the self-assessment with the IAM.

- 8 Further work included the review of a sample of recently reported IA assignments, to assess whether quality assurance arrangements have ensured that audit conclusions are supported by work completed to professional standards.

Main conclusions

- 9 We received full co-operation from IA during this year's audits, and we found that we are able to continue to place reliance on its work. However, there are a number of improvements that can be made to meet the changed requirements caused by the introduction of ISA+s, the CIPFA Code of Practice for IA 2003, and revised 2006 draft Code.

Impact on new ISA+ external audit approach

- 10 Limited reliance on IA compliance work was possible in 2005/06 due to timing of the roll out of our new ISA+ audit approach, although significant reliance was placed on IA systems documentation. In summary:
- IA systems documentation was assessed as good with reliance placed on all WYPTE key systems except fixed assets and grants (completed by us instead);
 - reliance was also placed on IA WYPTA documentation, although LCC outsourced systems were not covered by IA (completed by us instead);
 - from 2006/07, audit sample sizes need to be increased and clearer coverage of whole sample population evidenced to meet ISA+ requirements;
 - generally, IA working papers are sufficient for AC to place reliance on IA work but some isolated instances were noted where supporting evidence needs to be improved;
 - IA manager supervision and review of audits needs to be extended. One instance (main accounting system) was noted in 2005/06 where audit manager sign off of files was not done prior to the IA report being issued to the audit committee;
 - external audit interim work needs to be brought forward to January/February to ensure it does not conflict with close down period and IA completion of Statement of Internal Control (SIC) assurance work; and
 - completion of IA work on which AC place reliance will also need to be brought forward, to cover the nine months to 31 December 2006. Henceforth, AC will place reliance on controls testing over a 3 year cycle and so will only need to review detailed testing of a third of all material systems each year. However, IA will still need to perform testing of all key controls throughout 2006/07 to provide internal assurance regarding the SIC.
- 11 IA and Audit Commission have agreed to hold a joint workshop to address the issues above and maximise use of IA work during 2006/07 external audit.

Impact of 2006 CIPFA draft IA code of practice

- 12 Main areas covered by the revised Code include:
- Statement of Internal Control – IA assurance role;
 - role of audit committees (excluded from this review as it will be covered in our Overall Review of Governance Arrangements);
 - Accounts and Audit (amendment) (England) Regulations 2006;
 - ethical standards;
 - risk management;
 - corporate governance; and
 - risk based planning and IA.
- 13 The work of IA department needs to be reviewed to ensure all above areas are covered and work plans allocated accordingly. In particular, this should include a review of:
- the link between risk management and IA work (already addressed at audit file level, but the link with IA strategic plan should be made clearer);
 - IA corporate governance role;
 - IA's documents (audit charter, mission statement and audit manual) and the Financial Regulations, to ensure all of the above are adequately covered; and
 - Terms of Reference (TOR): IA documents need to be consolidated to ensure all TOR requirements per the 2006 draft Code are covered.

WYPTA coverage

- 14 IA coverage of WYPTA has improved significantly since our 2002/03 review of IA.
- 15 WYPTA IA audit for 2005/06 was completed, albeit not until after the year end. The audit coverage was assessed as satisfactory, given significant additional IA work performed in the year relating to the alleged fraud investigation, but additional coverage of WYPTA systems, for example, LCC outsourced systems, is recommended in 2006/07.
- 16 WYPTA Audit & Governance Committee is currently being set up. Specific IA TOR for its WYPTA responsibilities and TOR for the new WYPTA Audit and Governance Committee need to be agreed.

Staff Resourcing

- 17 Additional investigation work on the alleged fraud and IA involvement in Risk Management Group has reduced available time for routine IA work, particularly by the IA manager. From IA's time control analysis it was difficult to assess whether IA resources were sufficient.
- 18 Staff resourcing requirements should be reassessed in light of the new ISA+ approach requirements, 2006 CIPFA draft Code and additional WYPTA requirements.

Progress since previous IA review

- 19 Our last detailed review of IA was in 2002/03. Timely action was taken to address all recommendations arising from this review (WYPTA & WYPTE).
- 20 The current review includes further recommendations relating to three issues raised in 2002/03:
- improved linking of the IA planning process to the Risk Management Group output (R3);
 - improvements to standard working papers and documentary evidence (R8); and
 - improving overall work of IA relating to PTA, through PTA IA terms of reference and specific inclusion of PTA requirements in all key IA documentation (R1).

The way forward

- 21 Our detailed recommendations are set below and also in the Action Plan at Appendix 1. Recommendations have been made where we believe that compliance with Code standards could be improved, or where changes are desirable, to facilitate continued good working with External Audit.

Recommendations
<i>R1 All IA documents covering TOR requirements should be reviewed and updated to include IA responsibilities to WYPTA and cover current regulations and CIPFA Code.</i>
<i>R2 Separate TOR should be agreed for WYPTA & WYPTE, in accordance with Accounts and Audit Regulations (Amendment) (England) 2006. WYPTA TOR should set out the scope of IA as defined in the current CIPFA Code. IA TOR should be approved by the Audit Committee and Audit and Governance Committee of WYPTE and WYPTA respectively.</i>
<i>R3 IA plans should be reviewed to ensure they are clearly mapped to the results of the Risk Management process.</i>
<i>R4 IA manual should be updated to outline IA's specific role in cash/stock counts & the need for IA to check, rather than perform counts, in order to maintain its independence.</i>
<i>R5 Annual conflict of interest returns should be completed by all IA staff to confirm that there are none or, if any arise, they have been followed up appropriately.</i>

Recommendations
<p><i>R6 The IA manager should perform an overall review of IA resourcing procedures, to include review of resourcing needs, time control analysis, by audit and IA dept, including IA manager and reporting to WYPTA and WYPTE audit committees. The review should be based on updated TOR (covering 2006 Code) as outlined in R1 above.</i></p>
<p><i>R7 AC and IA should determine a joint approach to maximise AC reliance on IA work under ISA+ audit approach and sharing of audit expertise and understanding of WYPTE and WYPTA systems. IA and AC to hold joint workshop to provide training in new approach. Revised IA and external audit protocol should be agreed to reflect changes under ISA+ audit approach.</i></p>
<p><i>R8 IA manual to be updated to bring in line with CIPFA Code of audit practice 2006 and ISA + requirements. The review should include standard audit working papers, format of audit reports, reporting protocol and review and supervision of audits.</i></p>

Appendix 1 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
7	R1 All IA documents covering TOR requirements should be reviewed and updated to include IA responsibilities to WYPTA and cover current regulations and CIPFA Code.	2	IA Manager	Yes	Draft terms of reference are being finalised for the Executive. TOR for the Authority will be provided to the Audit and Governance Committee for consideration.	March 2007
7	R2 Separate TOR should be agreed for WYPTA and WYPTE, in accordance with Accounts and Audit Regulations (Amendment) (England) 2006. WYPTA TOR should set out the scope of IA as defined in the current CIPFA Code. IA TOR should be approved by the Audit Committee and Audit & Governance Committee of WYPTE and WYPTA respectively.	2	IA Manager	Yes	Agreed	March 2007
7	R3 IA plans should be reviewed to ensure they are clearly mapped to the results of the Risk Management process.	3	IA Manager	Yes	Operational risks are considered when producing the Strategic Audit Plan. These are then further reviewed, latest updated version available, at the commencement of each individual audit assignment. The Internal Audit Manager will ensure that these risk registers are cross-referenced to the control risk matrix provided on the audit workings file.	December 2006
7	R4 IA manual should be updated to outline IA's specific role in cash/stock counts and the need for IA to check, rather than perform counts, in order to maintain its independence.	1	IA Manager	Yes	Agreed	March 2007

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Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
7	R5 Annual conflict of interest returns should be completed by all IA staff to confirm that there are none or, if any arise, they have been followed up appropriately.	2	IA Manager	Yes	It is not required under the current code of conduct for Executive employees to provide written confirmation that there are no conflicts of interest. However, the Internal Audit Manager will implement and provide documentation for the Internal Audit section only.	March 2007
8	R6 The IA manager should perform an overall review of IA resourcing procedures, to include review of resourcing needs, time control analysis, by audit and IA dept, including IA manager and reporting to WYPTA and WYPTE audit committees. The review should be based on updated TOR (covering 2006 Code) as outlined in R1 above.	3	IA Manager	Yes	Agreed, Internal Audit Manager review resources in light of increased audit needs requirements.	March 2007
8	R7 AC and IA should determine a joint approach to maximise AC reliance on IA work under ISA+ audit approach and sharing of audit expertise and understanding of WYPTE and WYPTA systems. IA and AC to hold joint workshop to provide training in new approach. Revised IA and external audit protocol should be agreed to reflect changes under ISA+ audit approach.	3	AC and IA Manager	Yes	Agreed	March 2007

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
8	R8 IA manual to be updated to bring in line with CIPFA Code of audit practice 2006 and ISA + requirements. The review should include standard audit working papers, format of audit reports, reporting protocol and review and supervision of audits.	2	IA Manager	Yes	Agreed. To be updated to bring in line with CIPFA code of audit practice 2006 when this is finalised and published.	March 2007