

NORTH LINCOLNSHIRE COUNCIL

AUDIT COMMITTEE

INTERNAL AUDIT – EFFECTIVENESS REPORT 2008/09

1. OBJECT AND KEY POINTS IN THIS REPORT

1.1 To provide an opinion on the effectiveness of internal audit in accordance with the Accounts and Audit Regulations and CIPFA Code of Practice.

1.2 The assessment is based on the following:

- External Audit's assessment of Internal Audit's work
- Compliance with Best Practice as defined by The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Internal Audit
- Customer feedback and endorsement
- Achievement of performance targets.

2. BACKGROUND INFORMATION

2.1 The requirement for Internal Audit is supported by statute in the Accounts and Audit Regulations 2003 and the Local Government Act 1972. From 1 April 2006 The Accounts and Audit (Amendment) (England) Regulations 2006 require an annual review of the effectiveness of Internal Audit.

2.2 Regulation 6 of the Accounts and Audit Regulations requires the council to review the effectiveness of their system of internal audit annually as part of the consideration of the Governance Statement.

2.3 The Regulation requires that an adequate and effective system of internal audit of its accounting records and its system of internal control shall be maintained in accordance with proper internal audit practice.

2.4 The assessment is based on the following:

- External Audit's assessment of Internal Audit's work
- Compliance with Best Practice as defined by CIPFA's Code of Practice for Internal Audit
- Customer feedback and endorsement
- Achievement of performance targets

2.5 External Audit has undertaken the triennial review of the internal audit function. The report is attached in Appendix A. The review concluded that the internal audit function meets all 11 standards as set out within the CIPFA Code. Therefore the External Audit are able to place reliance on the work of Internal Audit to discharge their own audit responsibilities.

2.6 Whilst External Audit found no issues of non-compliance with the required standards, some areas of improvement were identified such as:

- ensuring that the impact and mitigation of control failures on financial statements and risks relating to fraud and error are clear on all reports and in audit files, and
- Audit files need to clearly document the reason for control failures in all cases.

Appendix B shows progress made in response to agreed actions.

2.7 It is important to receive feedback on our work. Questionnaires are issued with each system review and establishment audit. Service managers are asked to comment on their satisfaction and added value received from the audit work. All comments are appreciated and used to improve our service delivery. For 2008-2009, there was a return rate of 57%. One hundred percent of questionnaires returned considered the conduct, manner and attitude of the staff good or excellent. One hundred percent found audit recommendations to be realistic and helpful.

The section continues to provide an internal audit service for the Humberside Police Authority and Humber Connexions, won under contractual arrangements. Both of these contracts provide the opportunity for professional development and indicate good quality audit service.

2.8 The Internal Audit section constantly strives to improve the service they provide. There is a suite of performance measures and development issues set to monitor performance, set targets for improvements and provide comparison both internally and externally. The Section also participates in national and local benchmarking exercises. Performance targets were met for 2008/2009 details of which are below:

- 78% of the planned audit days were achieved, the shortfall being due to increased unforeseen audit work. This is an improvement on previous years.
- Follow up work confirmed acceptable progress on implementation of agreed audit recommendations (65%).
- All customers were surveyed and quality control questionnaires returned showed 100% satisfaction with the service provided.
- 67% of audits were completed within agreed allocations.
- 72% of audits were completed within agreed timescales.
- 91% of audits were reviewed by the supervisor within the target.

- 2.9 Based on the findings described in the above paragraphs Internal Audit is assessed as providing an effective service to the council.

3. OPTIONS FOR CONSIDERATION

- 3.1 Internal Audit provides an important source of assurance on the adequacy of internal control throughout the council. Members should seek clarification on its contents as necessary to ensure Internal Audit's work was carried out in such a way to provide sufficient assurance to fulfil their role as set out in the Committee's terms of reference.
- 3.2 The Audit Committee may conclude Internal Audit's work was not carried out in an effective way and therefore cannot be relied upon as a source of assurance to fulfil its terms of reference.

4. ANALYSIS OF OPTIONS

- 4.1 It is a statutory requirement for the council to maintain an internal audit function and for its effectiveness to be reviewed on an annual basis. The information contained within this report provides evidence of that review and sets out the reasons for determining that the service provided by Internal Audit has been effective during 2008/09. This year in addition to the internal review, the External Audit have undertaken their triennial review of Internal Audit, which indicated that all of the standards set out in the CIPFA Code of Internal Audit had been met. This means that Internal Audit's work can be relied upon to provide an important source of assurance on the adequacy of the council's internal control environment. This report together with the Annual Internal Audit Report this report provides important reassurance that the council's governance processes are sound.
- 4.2 If the Committee concludes Internal Audit's work cannot be relied upon then an important source of assurance to enable them to fulfill their role is no longer available.

5. RESOURCE IMPLICATIONS (FINANCIAL, STAFFING, PROPERTY, IT)

- 5.1 The work of the internal audit section enhances control over the use of the council's resources through the recommendations made in audit reports.
- 5.2 There are no additional staffing, property or IT implications

6. OTHER IMPLICATIONS (STATUTORY, ENVIRONMENTAL, DIVERSITY, SECTION 17 - CRIME AND DISORDER, RISK AND OTHER)

- 6.1 The requirement for an internal audit function is set out in the Accounts and Audit Regulations 2003. Internal audit will continue to assist the Chief Financial Officer discharge his statutory duty under the provisions of the Local Government Act 1972. The Accounts and Audit (Amendment) (England) Regulations 2006 require an annual review of the effectiveness of internal audit.
- 6.2 The effectiveness of internal audit's work is an important component of the Annual Governance Statement and promotes good corporate governance.

7. OUTCOMES OF CONSULTATION

- 7.1 The approach adopted to measure the effectiveness of internal audit has been agreed with external audit. Consultation takes place at all stages of audit work to ensure service provision is of a high standard. Customers are also invited to feedback on individual audit assignments to improve service delivery.

8. RECOMMENDATION

- 8.1 That the Audit Committee consider the effectiveness of Internal Audit in 2008/09, and the assurance provided on the adequacy as a key component of the council's internal review processes and internal control environment.

SERVICE DIRECTOR FINANCE

Pittwood House
Ashby Road
SCUNTHORPE
North Lincolnshire
DN16 1AB
Author: C Andrews
Date: 06/06/09

Background Papers used in the preparation of this report Nil

Audit Summary Report

November 2008



Review of Internal Audit

North Lincolnshire Council

Audit 2008/09

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.
- Auditors may report aspects of their work widely to the public and other key stakeholders.

The duties and powers of auditors appointed by the Audit Commission are set out in the Audit Commission Act 1998, the Local Government Act 1999 and the Commission's statutory Code of Audit Practice. Under the Code of Audit Practice, appointed auditors are also required to comply with the current professional standards issued by the independent Auditing Practices Board.

Appointed auditors act quite separately from the Commission and in meeting their statutory responsibilities are required to exercise their professional judgement independently of both the Commission and the audited body.

Status of our reports

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors/members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

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For further information on the work of the Commission please contact:

Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ

Tel: 020 7828 1212 Fax: 020 7976 6187 Textphone (minicom): 020 7630 0421

www.audit-commission.gov.uk

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Introduction

- 1 Under the requirements of International Standard on Auditing (ISA) 610 Consideration of the work of Internal Audit, we are required to review the Internal Audit function. Our review considers whether the Internal Audit function complies with the required standards and we conclude from this assessment whether we can place reliance on the work of Internal Audit for our own audit responsibilities.
- 2 This report summarises the main findings and recommendations arising from our recent review.

Background

- 3 The Accounts and Audit Regulations (2003) require that the Council '*Maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with the proper internal audit practices*'.
- 4 Proper internal audit practices are defined in the Code of Practice for Internal Audit in Local Government in the United Kingdom (the Code) which was re-issued by CIPFA in December 2006. Under the Accounts and Audit Regulations (2003), the Council's Internal Audit function is therefore required to comply with the Code's requirements.
- 5 Under the Audit Commission's Code of Audit Practice, we are required to give an opinion on the Council's financial statements, which include the Corporate Governance Statement (CGS).
- 6 The Internal Audit function provides officers and members with an assessment of the adequacy and effectiveness of the internal controls operating within the organisation. Therefore, some of the work that Internal Audit perform is directly relevant to the external auditor's statutory responsibilities.
- 7 Our review has assessed compliance with the proper practice as set out in the Code, and recommends where improvements can be made.
- 8 For the purpose of our Code of Practice audit, this review will:
 - establish whether we can rely on Internal Audit work as part of the 2007/08 audit; and
 - provide us with information that may be relevant in relation to the Use of Resources work.

Audit approach

- 9 Our audit approach included:
- interviewing key audit staff;
 - reviewing relevant council documents and policies; and
 - reviewing samples of recent Internal Audit work.

Main conclusions

- 10 We conclude that the Internal Audit function has met the requirements of all eleven standards set out within the Code. Consequently our review has provided assurance that we can rely on work carried out by the Council's Internal Audit function.
- 11 Whilst there was clear evidence that council internal audit section met the standards, although we did find a number of opportunities for improvement:
- ensuring that the impact and mitigation of control failures on your financial statements and risks relating to fraud and error are clear on all reports and in audit files, and
 - audit files need to clearly document the reason for control failures in all cases.
- 12 A summary of compliance against each of the standards within the Code is provided at Appendix 1.
- 13 Following this work an Action Plan has been produced and it is included at Appendix 2.

Detailed findings

- 14 Detailed findings and recommendations follow.

Standard 1 - Scope of Internal Audit

- 15 The standard has been met and we have identified no improvement areas. The recently revised terms of reference specifically cover partnerships and the training programme ensure staff have the necessary skills to cover all areas of the scope of internal audit.

Standard 2 - Independence

- 16 Compliance with Standard 2 has been achieved we found evidence of a system of declarations in force, to ensure that audit staff have suitable independence to carry out audit assignments. We found no evidence of any independence issues, although we noted, that whilst staff are considered for rotation between services, this is not documented.

Recommendation

R1 The Audit and Risk Manager should consider formally assessing independence risks relating to those staff with long term involvement in a particular department.

Standard 3 - Ethics for Internal Auditors

- 17 This standard requires all auditors must observe four main principles: integrity, objectivity, competence and confidentiality. This standard has been met we found a suitable monitoring and training regime and no reported ethical issues.

Standard 4 - Audit Committees

- 18 This standard has been achieved, an Audit Committee is in place within the Council and there is a close working relationship between that committee and the Internal Audit function. Follow up audit recommendations is now occurring on a systematic basis, strengthening controls and increasing audit impact.

Standard 5 - Relationships

- 19 This standard has been met. Relationships with management, other internal auditors, external audit, and elected members are managed appropriately. Whilst there was no evidence of any concerns in this area, apart from external audit there were no formal protocols for working with other auditors.

Recommendation

R2 The Head of Audit and Risk should consider developing more formal working relationships with other auditors if the need arises.

Standard 6 - Staffing, Training and Continuing Professional Development

- 20 Full compliance with Standard 6 has been achieved. One minor improvement already identified is the introduction of updated job descriptions for all staff. This has been completed apart from Group Auditors.

Standard 7 - Audit Strategy and Planning

- 21 The Head of Internal Audit and Risk produces and a risk-based audit plan in accordance with the requirements of Standard 7.

Standard 8 - Undertaking audit work

- 22 We have reviewed a sample of audit files to test compliance with the audit standards. Our overall assessment was that files met the required standard. Documentation was clear, work was appropriately planned, controlled and executed. Most files met the standard requirements although there were isolated examples of insufficient information to support audit conclusions. The rationale for sample testing was also not documented in a small number of the controls testing in 3 of the audit reviews examined.
- 23 Audit files did not consistently document in all cases the impact of a control failure on the Council's overall control environment particularly the reliability of the financial statements and the potential for fraud and error. For example the Budgetary Control Report evaluated the system as sound, although had 15 high risk recommendations (accepted by client). A possible approach is to use high risk recommendations for systems not working adequately, and given a lower level of assurance by internal audit. This may help management and the audit committee identify the most important recommendations to be given the highest priority.
- 24 Highlighting the consequences of not addressing control weaknesses in reports should also increase the potential impact of audit reports. If the consequences of control failures are clear to all, readers of the report and those responsible for taking action can make more accurate judgements on their priorities and resources required.
- 25 There was also scope to improve standard audit documentation to ensure a consistent approach is more likely. For example, a job sheet proforma could remind auditors to bring key issues to the attention of managers as soon as they arose within the audit, rather than awaiting conclusion of the work.

- 26 We reviewed the council's Audit Manual which is fit for purpose although there is no specific reference to document retention and access policy (covering FoI and Data Protection). There is however an awareness of what's needed and IA follow the Finance manual.

Recommendations
<i>R3 The Head of Audit and Risk should look at the specific issues identified in our file reviews and address any procedural, training or development needs.</i>
<i>R4 All audit files should contain clear evaluation of the impact of any control failures on the Council's control environment particularly the reliability of the financial statements and the risk of fraud and error.</i>
<i>R5 All audit files should contain sufficient evidence and evaluation of the reason for control failures (systematic or one-off) and document the reason for picking a particular sample size.</i>
<i>R6 The Internal audit manual should be updated to take into account the council's documentation retention and access policies.</i>

Standard 9 - Due professional Care

- 27 This standard which was met by the council specifies that individual auditors are personally responsible for applying due professional care to their own work and conducting themselves appropriately. On an audit by audit basis group auditors review files to ensure that due professional care has been exercised and is maintained. Whilst we found evidence in the audit files reviewed of an appropriate approach to the work, there is no formal programme showing how the Head of Audit and Risk ensures that due professional care is maintained. For example there is no documented review of a sample of files by the Head of Audit and Risk.

Recommendation
<i>R7 The Head of Audit and Risk should develop a formal monitoring and review programme to ensure that due professional care has been exercised and is maintained.</i>

Standard 10 - Reporting

- 28 Standard 10 of the Code requires that the Head of Audit and Risk's annual report to the organisation must set out the overall adequacy and effectiveness of the organisation's control environment and summarise key issues from work to those charged with governance. Our review found audit work met the relevant standards, the report followed the model set out in your standards and appropriate information is reported to the audit committee.
- 29 The Council's self assessment has identified improvements areas to ensure in future action plans are compiled in priority order and the 'updating of risk registers' is included in written arrangements.

<i>Recommendation</i>
<i>R8 Consideration should be given to compiling future action plans in priority order</i>

Standard 11 - Performance, Quality and Effectiveness

- 30 The Head of Internal Audit and Risk has set up satisfactory performance managements arrangements there are no issues to report

Appendix 1 – Requirements of the Code of Practice for Internal Audit in Local Government in the United Kingdom 2006

Standard	Summary of requirements within the Code	Standard met	Areas for improvement
Standard 1 - Scope of Internal Audit	Formally defined terms of reference for Internal Audit should be in place. The scope of Internal Audit should be defined and should extend to reviewing services provided through partnership arrangements if required, and to the investigation of suspected fraud and corruption.	Yes	No
Standard 2 - Independence	Internal Audit should be independent of the activities that it audits. The Head of Internal Audit and Risk should have the ability to report to Management and those charged with governance, in her own name, about any matter that she sees fit. The status of Internal Audit within the Council should be sufficient to facilitate the effective discussion of audit strategies, audit plans, audit reports and action plans with senior management. Individual auditors should be impartial and unbiased.	Yes	Yes
Standard 3 - Ethics for Internal Auditors	All auditors must observe four main principles: integrity, objectivity, competence and confidentiality. The Head of Internal Audit and Risk must regularly remind staff of these responsibilities.	Yes	No
Standard 4 - Audit Committees	An Audit Committee should be in place within the Council and there should be a close working relationship between that committee and the Internal Audit function, with the Head of Internal Audit and Risk attending all Audit Committee meetings.	Yes	No

Review of Internal Audit | Appendix 1 – Requirements of the Code of Practice for Internal Audit in Local Government in the United Kingdom 2006 11

Standard	Summary of requirements within the Code	Standard Met	Areas for improvement
Standard 5 - Relationships	Internal Audit must ensure that it manages its relationships with Management, other internal auditors, external audit, other regulators and inspectors and elected members.	Yes	Yes
Standard 6 - Staffing, Training and Continuing Professional Development	Internal Audit should be appropriately resourced to meet its objectives. It should have appropriate numbers of staff in terms of grades, qualifications, personal attributes and experience or have access to appropriate resources in order to meet its objectives. Training needs and continuing development should be regularly reviewed.	Yes	No
Standard 7 - Audit Strategy and Planning	An Internal Audit strategy should be in place which communicates how the internal audit service will be delivered and developed in accordance with the terms of reference and how it links to the organisational objectives and priorities. The Head of Internal Audit and Risk should produce a risk-based audit plan which spans a period of no more than a year and which outlines the work to be undertaken.	Yes	No
Standard 8 - Undertaking Audit Work	The Head of Internal Audit and Risk should set out in the Internal Audit Manual the requirements for undertaking audit work in terms of: planning, audit approach and recording audit assignments. The Head of Internal Audit and Risk should put in place arrangements to ensure that these standards are met.	Yes	Yes
Standard 9 - Due Professional Care	Individual auditors are personally responsible for applying due professional care to their own work and conducting themselves appropriately. The Head of Internal Audit and Risk should develop a monitoring and review programme to ensure that due professional care has been exercised and is maintained. Arrangements must be in place to ensure that auditors are able to report any suspicions of fraud, corruption or improper conduct.	Yes	Yes

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Standard	Summary of requirements within the Code	Standard Met	Areas for improvement
Standard 10 - Reporting	<p>The Head of Internal Audit and Risk should set reporting standards to be upheld within all reports issued by Internal Audit.</p> <p>Appropriate arrangements for following up on recommendations should be in place including an escalation procedure where agreed actions have not been effectively implemented by the date agreed.</p> <p>The Head of Internal Audit and Risk must provide a written report to those charged with governance timed to support the Annual Governance statement. In addition to the annual report, the Head of Audit and Risk should make arrangements for interim reporting to the council in the course of the year.</p>	Yes	Yes
Standard 11 - Performance, Quality and Effectiveness	<p>The Head of Internal Audit and Risk should establish policies and procedures in an audit manual to guide staff in performing their duties and complying with the Code.</p> <p>The manual should be regularly reviewed and updated to reflect changes in working practices and standards.</p> <p>The Head of Internal Audit and Risk should ensure that internal audit staff at all levels are appropriately supervised and work is reviewed throughout all audits to monitor progress, assess quality and coach staff.</p>	Yes	No

Appendix 2 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
6	R1 The Head of Audit and Risk should consider formally assessing independence risks relating to those staff with long term involvement in a particular department.	2	Head of Audit and Risk	Yes	This is done as part of audit planning each year but will be formally recorded within Internal Audit's terms of reference and strategy, which are approved by the Audit Committee.	February each year
7	R2 The Head of Audit and Risk should consider developing more formal working relationships with other internal auditors, regulators and inspectors.	1	Head of Audit and Risk	Yes	The Internal Audit / External Audit protocol is in place and will be developed through the audit cycle. Working relations with other auditors will be developed as appropriate.	As need arises
8	R3 The Head of Audit and Risk should look at the specific issues identified in our file reviews and address any procedural, training or development needs.	3	Head of Audit and Risk	Yes	This will be addressed in a number of ways: <ul style="list-style-type: none"> external Audit review of Internal Audit feedback will be given at the next audit development day (planned for early December); uniformity of working papers will be driven through the development and roll out of the new audit management system which includes electronic working papers; and specific issues will be raised with individuals through EDRs and staff development meetings. 	December 2008
8	R4 All audit files should contain clear evaluation of the impact of any control failures on the Council's control environment particularly the reliability of the financial statements and the risk of fraud and error.	3	Head of Audit and Risk	Yes	This will be introduced formally as part of External Audit review of Internal Audit feedback will be given at the next audit development day (planned for early December).	December 2008

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Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
8	R5 All audit files should contain sufficient evidence and evaluation of the reason for control failures (systematic or one-off) and document the reason for picking a particular sample size.	3	Head of Audit and Risk	Yes	This will be reinforced immediately through the review of audit work and at the audit development day (planned for early December).	Immediately
8	R6 The Internal audit manual should be updated to take into account the council's documentation retention and access policies.	1	Head of Audit and Risk	Yes	The audit manual will be updated to reflect document retention periods adhered to.	November 2008
8	R7 The Head of Audit and Risk should develop a formal monitoring and review programme to ensure that due professional care has been exercised and is maintained.	3	Head of Audit and Risk	Yes	Some review work is already carried out but more formal monitoring and review programme will be introduced.	March 2009
9	R8 Consideration should be given to compiling future action plans in priority order.	2	Head of Audit and Risk	Yes	This should already take place but will be reinforced immediately through the review of audit work and at the audit development day (planned for early December).	Immediately

Appendix B – Review of Internal Audit Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
	<Recommendation Title>					
6	R1 The Audit and Risk Manager should consider formally assessing independence risks relating to those staff with long term involvement in a particular department.	2	Audit and Risk manager	Yes	This is done as part of audit planning each year but will be formally recorded within Internal Audit's terms of reference and strategy, which are approved by the Audit Committee.	Completed March 2009
7	R2 The Audit and Risk Manager should consider developing more formal working relationships with other internal auditors, regulators and inspectors.	1	Audit and Risk manager	Yes	The Internal Audit / External Audit protocol is in place and will be developed through the audit cycle. Working relations with other auditors will be developed as appropriate.	As need arises
8	R3 The Audit and Risk Manager should look at the specific issues identified in our file reviews and address any procedural, training or development needs.	3	Audit and Risk manager	Yes	This will be addressed in a number of ways: <ul style="list-style-type: none"> - External Audit review of Internal Audit feedback will be given at the next audit development day (planned for early Dec) - Uniformity of working papers will be driven through the development and roll out of the new audit management system which includes electronic working papers - Specific issues will be raised with individuals through EDRs and staff development meetings 	Completed – development day took place on 16 th January 2009 Ongoing as Audit Management System is developed Completed through EDRs and development meetings
8	R4 All audit files should contain clear evaluation of the impact of any control failures	3	Audit and Risk manager	Yes	This will be introduced formally as part of External Audit review of Internal Audit feedback	Development day took place on 16 th

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
	on the Council's control environment particularly the reliability of the financial statements and the risk of fraud and error.				will be given at the next audit development day (planned for early Dec)	January 2009
8	R5 All audit files should contain sufficient evidence and evaluation of the reason for control failures (systematic or one-off) and document the reason for picking a particular sample size.	3	Audit and Risk manager	Yes	This will be reinforced immediately through the review of audit work and at the audit development day (planned for early Dec)	Raised at section meeting and development day on 16 th January 2009
8	R6 The Internal audit manual should be updated to take into account the council's documentation retention and access policies	1	Audit and Risk manager	Yes	The audit manual will be updated to reflect document retention periods adhered to.	Completed
9	R7 The Audit and Risk Manager should develop a formal monitoring and review programme to ensure that due professional care has been exercised and is maintained.	3	Audit and Risk manager	Yes	Some review work is already carried out but more formal monitoring and review programme will be introduced	Formal review system introduced March 2009
9	R8 Consideration should be given to compiling future action plans in priority order	2	Audit and Risk manager	Yes	This should already take place but will be reinforced immediately through the review of audit work and at the audit development day (planned for early Dec)	Immediately informed at section meeting and development day (16 th January 2009)