

External Review of Effectiveness 2017/18

Draft

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1. Introduction and background

- 1.1. Internal Audit in the public sector is governed by the Public Sector Internal Audit Standards (PSIAS). The PSIAS require organisations to have an external assessment of their internal audit functions every five years.

The external assessment provides assurance to the Audit Committee over the following key risks in relation to the Internal Audit function:

- The Council's assurance requirement is not satisfied and the Head of Business Assurance maybe unable to provide an opinion in the Annual Governance Statement (AGS);
- Gaps between what IA agrees to deliver and the expectation of the audit sponsor / management / auditee;
- Non-compliance with professional standards and Internal Audit's own policies and procedures;
- Control weaknesses are not identified accurately or fully, failing to fulfil the role of Internal Audit as the third line of defence;
- Work delivered does not fulfil the coverage defined in the terms of reference; and
- Budget over runs resulting in financial loss and audits not completed in a timely manner impacting on the remainder of the audit plan and potentially undermining the usefulness of audit recommendations.

- 1.2. The London Audit Group (LAG) has organised a system of peer reviews to perform external assessments. External assessments have taken the form of self-assessments which are then validated by suitably qualified individuals or teams from other members of the group across a 5 year cycle.

This review has been performed by the Interim Head of Internal Audit and Counter Fraud (HIACF) and internal Audit Manager at the London Borough of Lambeth. The Interim HIACF is a chartered accountant with the ICAEW and an affiliated member of the Institute of Internal Auditors (IIA). She is also a member of CIPFA's Internal Audit Special Interest Group.

- 1.3. The following criteria have been used when assessing conformance with each area.

DEFINITIONS	
Fully Conforms	The internal audit service fully complies with each of the statements of good practice in the assessment.
Generally Conforms	The relevant structures, policies, and procedures of the internal audit service, as well as the processes by which they are applied, at least comply with the requirements of the section in all material respects.
Partially Conforms	The internal audit service falls short of achieving some elements of good practice but is aware of the areas for development. These will usually represent significant opportunities for improvement in delivering effective internal audit.
Does Not Conform	The internal audit service is not aware of, is not making efforts to comply with, or is failing to achieve many/all of the objectives and good practice statements within the section or sub-section. These deficiencies will usually have a significant negative impact on the internal audit service's effectiveness and its potential to add value to the organisation. These will represent significant opportunities for improvement, potentially including actions by senior management or the audit committee.

2. Results

- 2.1 The results of the external assessment are summarised below; all areas assessed were determined as 'Fully Conforms' except for one area under Reporting Lines. Please see **Appendix A** for detail.

Purpose & positioning		Does not conform	Partially conforms	Generally conforms	Fully conforms	Comments
1.1	• Remit				X	
1.2	• Reporting lines			X		
1.3	• Independence				X	
1.4	• Other assurance providers				X	
1.5	• Risk based plan				X	
Structure & resources						
2.1	• Competencies				X	
2.2	• Technical training & development				X	
2.3	• Resourcing				X	
2.4	• Performance management				X	
2.5	• Knowledge management				X	
Audit execution						
3.1	• Management of the IA function				X	
3.2	• Engagement planning				X	
3.3	• Engagement delivery				X	
3.4	• Reporting				X	
Impact						
4.1	• Standing and reputation of internal audit				X	
4.2	• Impact on organisational delivery				X	
4.3	• Impact on Governance, Risk, and Control				X	

Core Principles		Do not agree	Partially agree	Generally agree	Fully agree	Comments
	• Demonstrates achievement of the Core Principles				X	

3. Follow up of 2016/17 Management Action Plan

3.1 The London Borough of Hillingdon also commissioned an independent assessment of their Internal Audit function in 2016/17.

Two medium risk recommendations were raised; the current implementation status is reported below.

Recommendation	Risk rating	Status
<p>A formal sign off document should be put in place for each Audit review. This will help to ensure that all necessary checks have been completed prior to the issue of the audit reports. This should include, but is not limited to:</p> <ul style="list-style-type: none"> • Confirmation that the audit working papers have been signed off as complete by the Auditor; • Confirmation that the audit file has been reviewed on Teammate; • Confirmation that review points have been addressed; and • Approval from the HoIA prior to the issue of the audit reports. 	Medium	Implemented
<p>A formal assurance mapping exercise should be undertaken across the Council to enable reliance to be placed on other forms of assurance and focus IA resource on assurance gaps across the Council.</p> <p>Until this exercise takes place, alternative sources of assurance should be included as part of the planning meeting agenda template to be discussed with management when setting the annual and quarterly audit plans.</p>	Medium	In progress. See 1.5 in Appendix 4.

Acknowledgement

We would like to formally thank all of the officers contacted during the course of this review for their co-operation and assistance including; the Head of Business Assurance, the Senior Internal Audit Manager and the Internal Audit Team, whose advice and help were gratefully appreciated. We would particularly like to extend our appreciation to the Chief Executive Officer and the Vice Chair of the Audit Committee for their time during the interview process.

Appendix A: External Quality Assessment – Detailed Results

1. Purpose and positioning

Statements of good practice	Level of Conformity		
1.1 Remit			
1.1.1 An internal audit Charter defines the purpose, authority and responsibility, within the organisation, consistent with the Definition of Internal Auditing, the Code of Ethics and the Standards, including a definition of the Board.	Category	Self-Assessment	Independent Review
	Fully	✓	✓
	Generally		
	Partially		
	Does not		
1.1.2 The internal audit Charter is approved by the Board and is regularly reviewed, and communicated to all senior management and other relevant people.			
1.1.3 The Charter defines the nature and scope of the assurance and consulting services provided to the organisation (including any assurances provided to parties outside of the organisation) and is such that it can provide independent and objective assurance and is not part of the direct control framework.			
1.1.4 The Charter includes the mission of Internal Audit and what it aspires to accomplish within the organisation.			
1.1.5 The Charter clearly defines internal audit's role in evaluating and contributing to the development of risk management, control and governance processes. Internal audit's role in relation to any fraud-related / investigations work is clearly defined within the Charter.			
	Comments		
	<ul style="list-style-type: none"> Agreed with self-assessment that the IA function fully confirms in this area. No further comments. 		
1.2 Reporting lines			
1.2.1 The Board reviews and approves the appointment of the Chief Audit Executive (CAE)	Category	Self-Assessment	Independent Review
	Fully		
	Generally	✓	✓
	Partially		
	Does not		
1.2.2 The CEO and the Chair of the Audit Committee contribute to the CAE's appraisal			
1.2.3 Reporting lines for the CAE support independence, with functional reporting to the Board			
1.2.4 The Board agrees the strategy/plans of the internal audit service			
1.2.5 The CAE or their representative attend all Board and/or senior management meetings, particularly where key issues are discussed relating to governance, risk management or control across the organisation			
1.2.6 The CAE meets regularly with the Section 151 Officer.			
1.2.7 The Board routinely see and considers the outputs of the internal audit service			
1.2.8 The Board is routinely updated with internal audit status and activity reports.			
	Comments		
	<ul style="list-style-type: none"> Agreed with self-assessment that the IA function generally confirms in this area. Areas for consideration: <ul style="list-style-type: none"> 1.2.1 - We noted that the Audit Committee does not currently perform this function, however this is not uncommon in local authorities and we understand there is limited political appetite for the Audit Committee to hold this responsibility. 		

Statements of good practice

Level of Conformity

1.3 Independence

- 1.3.1 Internal audit's position within the organisation is clearly established including authorisation for access to records, personnel and physical properties relevant to the performance of engagements
- 1.3.2 The internal audit service is free of executive responsibilities such that it can provide independent and objective assurance.
- 1.3.3 Conflict of interests are identified, appropriately managed and avoided including those transferring to internal audit from elsewhere in the organization.
- 1.3.4 Audit personnel are routinely rotated on assignments.
- 1.3.5 Audit personnel do not have any conflicting operating responsibilities or interests.
- 1.3.6 All internal audit staff are aware of and comply with the Code of Ethics and the Nolan principles.
- 1.3.7 Consultancy work that internal audit may undertake is clearly defined and agreed in advance by the Audit Committee when required by the PSIAS.
- 1.3.8 Areas which have been the recipient of internal audit 'consultancy' work are subject to audit review by personnel independent of the consultancy work
- 1.3.9 The CAE, at least annually, confirms to the Board the organisational independence of the internal audit activity.
- 1.3.10 The CAE, notifies the appropriate parties if independence or objectivity is impaired in fact or appearance

Category	Self-Assessment	Independent Review
Fully	✓	✓
Generally		
Partially		
Does not		

Comments

- Agreed with self-assessment that the IA function fully confirms in this area.
- No further comments.

1.4 Other assurance providers

- 1.4.1 A risk based internal audit plan has been developed which:
- considers the relative risk maturity of the organisation
 - considers the risk appetite as defined by management
 - includes an assessment of optimal resources and skills required to deliver both the audit assurance and consultancy work, including identification of specialist skills, which may be required
 - is clearly designed to enable the CAE to deliver an annual opinion on the effectiveness of Governance, risk management and the system of control
 - has been approved by the Board
 - has been promulgated to all relevant parties
 - is subject to regular review to ensure that it remains appropriate and current

Category	Self-Assessment	Independent Review
Fully	✓	✓
Generally		
Partially		
Does not		

Independent Review Comments

- Agreed with self-assessment that the IA function fully confirms in this area.
- No further comments.

Statements of good practice

Level of Conformity

1.4.2 Either the audit plan or a separate audit strategy document should:

- include an assessment of risks that the audit service itself faces in delivering the plan and plans for controlling and mitigating the risks identified
- include consideration of if, and how, internal audit will rely on the assurance provided by other assurance providers
- include an assessment of the range of audit techniques that have been selected as the most effective for delivering the audit objectives
- set out how the internal audit service will measure its performance, quality assure itself and seek continuous improvement

1. 5 Risk based plan

- 1.5.1 The internal audit service effectively co-ordinates with appropriate assurance providers to reduce the duplication and minimise gaps in the assurance framework
- 1.5.2 Internal audit promote co-operation between internal and external audit
- 1.5.3 When auditing shared service functions consideration is given to audit work being performed by other audit services such that duplication is minimized
- 1.5.4 When internal audit needs to work with other internal auditors from another organisation, the respective roles and responsibilities of the involved parties have been clearly defined and agreed in advance.

Category	Self-Assessment	Independent Review
Fully		✓
Generally	✓	
Partially		
Does not		

Independent Review Comments

- We have assessed that the IA function fully confirms in this area.
- We have noted the following advisory point:
 - 1.5.1 requires that the internal audit service effectively coordinates with assurance providers to minimize gaps in the assurance framework. IA have a good relationship with External Audit and the risk-based approach applied by IA demonstrates consideration of other forms of assurance. However, as noted in the self-assessment, the Council could further develop this by creating a form of assurance map to document what other sources of comfort are in place over key risks e.g. from central government bodies, partnerships and other arrangements. This was also raised in Mazar's 2016/17 external assessment.

2. Structure and resources

Statements of good practice	Level of Conformity		
2.1 Competencies			
2.1.1 The CAE holds a professional qualification (i.e. CMIIA, CCAB or equivalent professional membership) and is suitably experienced	Category	Self-Assessment	Independent Review
	Fully	✓	✓
	Generally		
	Partially		
	Does not		
2.1.2 The audit function has access to the appropriate skills (technical expertise, qualifications, experience) required to ensure assurance can be provided in all areas of the business, for example in relation to fraud and knowledge of IT risks and controls.			
2.1.3 Where there is a contracted out or partnership arrangement there is ongoing monitoring to ensure that contractors have the skills required for designated audit assignments			
Independent Review Comments			
<ul style="list-style-type: none"> Agreed with self-assessment that the IA function fully confirms in this area. No further comments. 			
2.2 Technical training & development			
2.2.1 All new staff receive induction training including both into the internal audit service and induction into the organisation	Category	Self-Assessment	Independent Review
	Fully	✓	✓
	Generally		
	Partially		
	Does not		
2.2.2 Arrangements are in place to ensure that new staff receive an early assessment of their development needs and appropriate guidance, and training to address these needs.			
2.2.3 All internal auditors undertake Continuing Professional Development (CPD) and have a training and development plan approved by their line manager.			
2.2.4 Audit planning includes a sufficient time provision for training (including CPD) for all staff			
Independent Review Comments			
<ul style="list-style-type: none"> Agreed with self-assessment that the IA function fully confirms in this area. No further comments. 			
2.3 Resourcing			
2.3.1 Internal audit is sufficiently resourced (in terms of staff and budget available) and deployed effectively to deliver the approved plan	Category	Self-Assessment	Independent Review
	Fully	✓	✓
	Generally		
	Partially		
	Does not		
2.3.2 There is a recruitment strategy that sets out the recruitment standard to ensure that all staff have the appropriate intellectual qualities, personal attributes, skills, knowledge and qualifications			
2.3.3 A succession plan exists to ensure that senior vacancies are filled promptly by appropriately qualified staff			

Statements of good practice**Level of Conformity****Independent Review Comments**

- Agreed with self-assessment that the IA function fully confirms in this area. No further comments.

2.4 Performance management

2.4.1 Appropriate personnel management and development procedures are in place within internal audit including:

- Written job descriptions
- Required competency frameworks
- Recruitment procedures
- Training and continuing education arrangements
- Personal objectives setting and performance appraisal

Category	Self-Assessment	Independent Review
Fully	✓	✓
Generally		
Partially		
Does not		

Independent Review Comments

- Agreed with self-assessment that the IA function fully confirms in this area. No further comments.

2.5 Knowledge management

2.5.1 The internal audit service has systems in place to facilitate knowledge and sharing of best practice / organisational learning

2.5.2 All staff attend regular team meetings to ensure that they remain up to date on knowledge of the organisation, the internal audit service and audit practices.

Category	Self-Assessment	Independent Review
Fully	✓	✓
Generally		
Partially		
Does not		

Independent Review Comments

- Agreed with self-assessment that the IA function fully confirms in this area. No further comments.

3. Audit execution

Statements of good practice	Level of Conformity															
3.1 Management of the internal audit service																
<p>3.1.1 The CAE has established policies and procedures (typically in the form of a manual) to guide the internal audit activity.</p> <p>3.1.2 Audit methodologies have been developed and are regularly reviewed and updated to ensure they are in line with current practice</p> <p>3.1.3 Policies in respect of document confidentiality, retention requirements and the release to internal and external parties have been developed and are consistent with the organisation's guidelines and any pertinent regulatory or other requirements</p> <p>3.1.4 Quality assurance procedures are defined and cover all aspects of the internal audit activity including: Supervision and review</p> <p>3.1.5 QA procedures and checklists including periodic internal quality reviews</p> <p>3.1.6 Compliance with applicable laws, regulations and government or industry standards</p> <p>3.1.7 Auditee / customer satisfaction surveys</p> <p>3.1.8 Periodic self-assessments against the PSIA's are performed and actions taken to address weaknesses</p>	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="background-color: #0070C0; color: white;">Category</th> <th style="background-color: #0070C0; color: white;">Self-Assessment</th> <th style="background-color: #0070C0; color: white;">Independent Review</th> </tr> </thead> <tbody> <tr> <td style="background-color: #008000; color: white;">Fully</td> <td style="text-align: center;">✓</td> <td style="text-align: center;">✓</td> </tr> <tr> <td style="background-color: #90EE90;">Generally</td> <td></td> <td></td> </tr> <tr> <td style="background-color: #FFD700;">Partially</td> <td></td> <td></td> </tr> <tr> <td style="background-color: #FF0000; color: white;">Does not</td> <td></td> <td></td> </tr> </tbody> </table> <p>Independent Review Comments</p> <ul style="list-style-type: none"> • Agreed with self-assessment that the IA function fully confirms in this area. No further comments. 	Category	Self-Assessment	Independent Review	Fully	✓	✓	Generally			Partially			Does not		
Category	Self-Assessment	Independent Review														
Fully	✓	✓														
Generally																
Partially																
Does not																
3.2 Engagement planning																
<p>3.2.1 Detailed plans are developed and documented setting out the scope, limitations, objectives, resources, timing and reporting lines for each engagement.</p> <p>3.2.2 Engagement plans are agreed with relevant management prior to the start of the fieldwork.</p> <p>3.2.3 Engagement plans include consideration of the relevant systems, records, personnel, and physical properties including those under the control of third parties.</p> <p>3.2.4 Plans include consideration of the risks to the area under review and the organisation's risk management and controls processes.</p> <p>3.2.5 Time budgets are developed for each engagement plan and are appropriate to the review scope and degree of associated risk</p> <p>3.2.6 Where areas require, particular specialist knowledge subject matter experts are identified and included as part of the audit team</p>	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="background-color: #0070C0; color: white;">Category</th> <th style="background-color: #0070C0; color: white;">Self-Assessment</th> <th style="background-color: #0070C0; color: white;">Independent Review</th> </tr> </thead> <tbody> <tr> <td style="background-color: #008000; color: white;">Fully</td> <td style="text-align: center;">✓</td> <td style="text-align: center;">✓</td> </tr> <tr> <td style="background-color: #90EE90;">Generally</td> <td></td> <td></td> </tr> <tr> <td style="background-color: #FFD700;">Partially</td> <td></td> <td></td> </tr> <tr> <td style="background-color: #FF0000; color: white;">Does not</td> <td></td> <td></td> </tr> </tbody> </table> <p>Independent Review Comments</p> <ul style="list-style-type: none"> ▪ Agreed with self-assessment that the IA function fully confirms in this area. No further comments. 	Category	Self-Assessment	Independent Review	Fully	✓	✓	Generally			Partially			Does not		
Category	Self-Assessment	Independent Review														
Fully	✓	✓														
Generally																
Partially																
Does not																

3.3 Performance of Audit work / audit delivery

- 3.3.1 Work programmes that will achieve the engagement objectives are developed and approved prior to use and include procedures for identifying, analysing, evaluating and documenting information during the engagement.
- 3.3.2 Internal auditors use standard documentation to ensure that evidence and findings are adequately documented.
- 3.3.3 Work papers are clear, concise, and appropriately cross-referenced to work programmes so as to enable independent review and comprehension.
- 3.3.4 There is evidence that internal auditors are identifying, analysing, evaluating and documenting sufficient information to support the audit conclusions and opinions.
- 3.3.5 There is evidence that internal auditors are identifying, analysing, evaluating and documenting sufficient information to support the audit conclusions and opinions
- 3.3.6 There is evidence to confirm that all engagements are led or supervised by suitably competent individuals.
- 3.3.7 Audit findings are discussed and confirmed with auditees prior to report drafting
- 3.3.8 Automated tools (e.g. data interrogation) are used appropriately to undertake testing as efficiently as possible

Category	Self-Assessment	Independent Review
Fully	✓	✓
Generally		
Partially		
Does not		

Independent Review Comments

- Agreed with self-assessment that the IA function fully confirms in this area.
- No further comments.

3.4 Reporting

- 3.4.1 Communications are accurate, objective, clear, concise, constructive and timely.
- 3.4.2 Audit reports convey appropriate audit scopes, limitations of scope, results, recommendations and an opinion on the adequacy of controls
- 3.4.3 Audit evidence is reviewed by a senior member of the audit function to ensure that the audit has been carried out in sufficient depth and to the function's quality standards prior to the audit findings being distributed to the auditee
- 3.4.4 Internal audit recommendations help the organization address the risk in a way that does not create unnecessary control and the recommendations are practical
- 3.4.5 Draft audit reports are issued for consideration by the auditee within a reasonable, pre-agreed, timescale before they are finalised
- 3.4.6 Audit issues are reported to appropriate levels of management and to the Audit Committee
- 3.4.7 The CAE informs the Audit Committee if he/she believes that senior management has accepted a level of residual risk that may be unacceptable to the organization.
- 3.4.8 There is a procedure for follow-up that ensures agreed recommendations are implemented effectively or that senior management has accepted the risk of not taking action
- 3.4.9 Unresolved or outstanding audit issues are reported to senior management in accordance with pre-agreed timescales and escalation procedures
- 3.4.10 The CAE presents to the Board at least annually, a report of internal audit activity containing an opinion of the overall adequacy and effectiveness of the organisation's governance, risk management and control processes.
- 3.4.11 The annual report also states if the function conforms to the PSIA's and report any results of the QAIP

Category	Self-Assessment	Independent Review
Fully	✓	✓
Generally		
Partially		
Does not		

Independent Review Comments

- Agreed with self-assessment that the IA function fully confirms in this area.
- No further comments.

4. Impact

Has the internal audit service had a positive impact on the governance, risk and control environment within the organisation?

The impact of the internal audit service is best assessed by obtaining the views of a wide range of 'customers', combined with tangible evidence of impact and comparing this to the internal audit management's corporate view of the internal audit service they provide.

We interviewed a sample of customers directly involved in the areas subject to internal audit review. The table below aggregates the responses from both the customers and to capture the internal audit management's corporate view.

Ref	Aggregated Questionnaire Responses	Customers				Internal audit			
		Do not agree	Partially agree	Generally agree	Fully agree	Do not agree	Partially agree	Generally agree	Fully agree
Standing and reputation of Internal Audit									
1.	The internal audit service is seen as a key strategic partner throughout the organisation								
2.	Senior managers understand and fully support the work of internal audit								
3.	Internal audit is valued throughout the organisation								
4.	The internal audit service is delivered with professionalism at all times								
5.	The internal audit service demonstrates integrity in the way that it operates								
Impact on organisational delivery									
6.	The internal audit service responds quickly to changes within the organisation								
7.	The internal audit service has the necessary resources and access to information to enable it to fulfil its mandate								
8.	The internal audit service is adept at communicating the results of its findings, building support and securing agreed outcomes								
9.	The internal audit service ensures that recommendations made are commercial and practicable in relation to the risks identified								
10.	There have not been any significant control breakdowns or surprises in areas that have been positively assured by the internal audit service								
Has internal audit had a positive impact on Governance, Risk, and Control?									
11.	The internal audit service includes consideration of all risk areas in its work programme								
12.	Internal audit advice has a positive impact on the governance, risk, and the system of control of the organisation								
13.	Internal audit activity has enhanced organisation-wide understanding of governance, risk, and control								

Ref	Aggregated Questionnaire Responses	Customers				Internal audit			
		Do not agree	Partially agree	Generally agree	Fully agree	Do not agree	Partially agree	Generally agree	Fully agree
14.	The internal audit service asks challenging and incisive questions that stimulate debate and improvements in key risk areas								
15.	The internal audit service raises significant control issues at an appropriate level in the organisation								
16.	Internal audit advice is insightful, proactive and future-focused								
17.	The organisation accepts and uses the business knowledge of internal auditors to help improve business processes and meet strategic objectives								
18.	Internal audit activity influences positive change and continuous improvement to business processes, bottom line results and accountability within the organisation								
19.	Internal audit activity promotes appropriate ethics and values within the organisation								

5. Core Principles

The Core Principles, taken as a whole, articulate internal audit effectiveness. For an internal audit function to be considered effective, all Principles should be present and operating effectively. How an internal auditor, as well as an internal audit activity, demonstrates achievement of the Core Principles may be quite different from organisation to organisation, but failure to achieve any of the Principles would imply that an internal audit activity was not as effective as it could be in achieving internal audit's mission

Having completed sections 1 to 4 of this assessment we have collated enough information to be able to form a view on the extent to which the Core Principles are demonstrated. Please see our assessment below.

	<i>Not Demonstrated</i>	<i>Partially Demonstrated</i>	<i>Generally Demonstrated</i>	<i>Fully Demonstrated</i>
Demonstrates Integrity				
Demonstrates competence and due professional care				
Is objective and free from undue influence (Independent)				
Aligns with the strategies, objectives and risks of the organisation				
Is appropriately positioned and adequately resourced				
Demonstrates quality and continuous improvement				
Communicates effectively				
Provides risk based assurance				
Is insightful, proactive and future focused				
Promotes organisational improvement				

Appendix B: Internal audit assurance levels and definitions

ASSURANCE LEVEL	DEFINITION
SUBSTANTIAL	There is a good level of assurance over the management of the key risks to the Council objectives. The control environment is robust with no major weaknesses in design or operation. There is positive assurance that objectives will be achieved.
REASONABLE	There is a reasonable level of assurance over the management of the key risks to the Council objectives. The control environment is in need of some improvement in either design or operation. There is a misalignment of the level of residual risk to the objectives and the designated risk appetite. There remains some risk that objectives will not be achieved.
LIMITED	There is a limited level of assurance over the management of the key risks to the Council objectives. The control environment has significant weaknesses in either design and/or operation. The level of residual risk to the objectives is not aligned to the relevant risk appetite. There is a significant risk that objectives will not be achieved.
NO	There is no assurance to be derived from the management of key risks to the Council objectives. There is an absence of several key elements of the control environment in design and/or operation. There are extensive improvements to be made. There is a substantial variance between the risk appetite and the residual risk to objectives. There is a high risk that objectives will not be achieved.

1. **Control Environment:** The control environment comprises the systems of governance, risk management and internal control. The key elements of the control environment include:
 - establishing and monitoring the achievement of the authority's objectives;
 - the facilitation of policy and decision-making;
 - ensuring compliance with established policies, procedures, laws and regulations – including how risk management is embedded in the activity of the authority, how leadership is given to the risk management process, and how staff are trained or equipped to manage risk in a way appropriate to their authority and duties;
 - ensuring the economical, effective and efficient use of resources, and for securing continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness;
 - the financial management of the authority and the reporting of financial management; and
 - the performance management of the authority and the reporting of performance management.

2. **Risk Appetite:** The amount of risk that the Council is prepared to accept, tolerate, or be exposed to at any point in time.

3. **Residual Risk:** The risk remaining after management takes action to reduce the impact and likelihood of an adverse event, including control activities in responding to a risk.

Appendix C: Risk response and risk rating definitions

RISK RESPONSE DEFINITIONS

Risk Response	Definition
TREAT	The probability and / or impact of the risk are reduced to an acceptable level through the proposal of positive management action.
TOLERATE	The risk is accepted by management and no further action is proposed.
TRANSFER	Moving the impact and responsibility (but not the accountability) of the risk to a third party.
TERMINATE	The activity / project from which the risk originates from are no longer undertaken.

INTERNAL AUDIT RECOMMENDATION RISK RATING AND DEFINITIONS

Risk	Definition
HIGH	The recommendation relates to a significant threat or opportunity that impacts the Council's corporate objectives. The action required is to mitigate a substantial risk to the Council. In particular it has an impact on the Council's reputation, statutory compliance, finances or key corporate objectives. The risk requires senior management attention.
MEDIUM	The recommendation relates to a potentially significant threat or opportunity that impacts on either corporate or operational objectives. The action required is to mitigate a moderate level of risk to the Council. In particular an adverse impact on the Department's reputation, adherence to Council policy, the departmental budget or service plan objectives. The risk requires management attention.
LOW	The recommendation relates to a minor threat or opportunity that impacts on operational objectives. The action required is to mitigate a minor risk to the Council as a whole. This may be compliance with best practice or minimal impacts on the Service's reputation, adherence to local procedures, local budget or Section objectives. The risk may be tolerable in the medium term.
NOTABLE PRACTICE	The activity reflects current best management practice or is an innovative response to the management of risk within the Council. The practice should be shared with others.