Stevenage Borough Council

Audit Committee

Public Sector Internal Audit Standards
(incorporating the SIAS Audit Charter)

29 May 2013

Recommendations

That Members give due consideration to this report and adopt the PSIAS with effect from 1 April 2013.

That Members accept the SIAS Audit Charter (shown at Appendix A) as part of compliance with the Public Sector Internal Audit Standards 2013

That assurance from management that there have been no inappropriate scope or resource limitations on internal audit activity is confirmed to the Committee when the Head of Assurance's annual report is considered.

Contents

1. INTRODUCTION AND BACKGROUND

1.1 In May 2011, the Chartered Institute of Public Finance & Accountancy (CIPFA) and the Chartered Institute of Internal Auditors (CIIA) agreed to collaborate in the development of the internal audit profession in the public sector. As a result, national Public Sector Internal Audit Standards (PSIAS), based upon the mandatory elements of the global CIIA's International Professional Performance Framework have been developed.

1.2 The PSIAS are effective from 1 April 2013 and consist of the following:
- Definition of Internal Auditing;
- Code of Ethics; and
- Standards for the Professional Practice of Internal Auditing.

1.3 The PSIAS replace the Code of Practice for Internal Audit in Local Government in the United Kingdom, last revised in 2006. In local government, the PSIAS are mandatory for all principal local authorities and other relevant bodies subject to the Accounts and Audit (England) Regulations 2011, the Accounts and Audit (Wales) (Amended) Regulations 2010, Section 95 of the Local Government (Scotland) Act 1973, and Section 54 of the Local Government Act (Northern Ireland) 1972. They are also mandatory for the Office of the Police and Crime Commissioner, constabularies, fire authorities, national park authorities, joint committees and joint boards in the United Kingdom.

2. REASON FOR RECOMMENDATION

2.1 The new Standards are intended to promote further improvement in the professionalism, quality and effectiveness of internal audit across the public sector. They reaffirm the importance of robust, independent and objective internal audit arrangements to provide Audit Committees and Senior Management with the key assurances they need to support them both in managing the organisation and in producing the annual governance statement.

2.2 Overall, most of the content within the Standards is a continuation and further development of existing best practice. Listed below are some key points of difference for the Audit Committee's consideration.

Existing requirements

- **The chief audit executive** – The chief audit executive (CAE) (referred to as the head of audit in the previous standards), must hold a professional qualification (CMIIA, CCAB or equivalent) and be suitably experienced.   The Head of Assurance (Chartered Public Finance Accountant) fulfils this role in respect of SIAS.

- **Annual report** – The requirement for the production of an internal audit annual report remains. The Annual Report to each Council will now need to include details of any non-conformance with PSIAS and the impact that non-conformance has had on the overall scope or operation of the internal audit

activity. More significant deviations must be considered for inclusion in the annual governance statement.

- **Risk-based audit plan** – There is still a requirement to produce a risk based audit plan. However, an audit strategy is no longer required and has been replaced with a risk based plan that incorporates or links to a strategic statement setting out how the internal audit service will be provided and how The Charter (see below) will link to the authority's objectives and priorities.

- **Ethical standards** - the internal audit manual already contains a set of ethical standards which are based upon those within the 2006 Cipfa Code. These are now replaced by those of the IIA. The IIA Code of Ethics has been further enhanced with the requirement that internal auditors in the public sector must also have regard to the Seven Principles of Public Life (the Nolan Principles).

New requirements

- **Internal Audit Charter (The Charter)** – The Charter must formally define the purpose, authority and responsibility of the internal audit activity. It will also cover arrangements for avoiding conflicts of interest if internal audit performs non-audit activities. A copy of the SIAS Audit Charter is included in this report at Appendix A.

- **Quality assurance** – The quality of service should be rigorously checked under a quality assurance and improvement programme which requires on-going internal assessments of all aspects of internal audit activity, as well as external assessment every five years. The programme is designed to assess the efficiency and effectiveness of internal audit as well as identify opportunities for improvement. There is a requirement for the CAE to include a section on the quality assurance and improvement programme in the internal audit annual report.

- **External assessment** – will be required every five years. The assessment will need to be performed by qualified and independent assessors or assessment teams that are external to the organisation.

- **Resource limitations** – it will be the role of the Audit Committee to seek assurance from the CAE and from management that there are no inappropriate limitations on the scope or resources of internal audit. The Head of Assurance will provide this assurance in the annual report and it is suggested that the Committee also seeks assurance from management in considering the annual report.

- **Effective communication** – The standards require 'effective communication' between the CAE and both the audit committee and the committee chair in discussions about: the authority's risk and assurance requirements; assurance opinions; issues of concern raised by audit work undertaken; and implementation of agreed recommendations and the enhanced assurance arising.

3. COMPLIANCE WITH PSIAS

3.1 The Head of Assurance has reviewed in detail the compliance of the Shared Internal Audit Service with the PSIAS standards. The document detailing this exercise is lengthy and has not been provided with agenda papers but is available on request.

3.2 Areas of non-conformance with PSIAS and arrangements for addressing these are detailed in the Annual Report of the Head of Assurance, also on this agenda.

Internal Audit Charter

Introduction and Purpose

Internal auditing is an independent and objective assurance and consulting activity that is guided by a philosophy of adding value to improve the operations of the Council. It assists the Council in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the Council's risk management, control, and governance processes.

Statutory Basis of Internal Audit

Within local government there is a statutory requirement for an internal audit function. The 2003 Accounts and Audit Regulations (as amended by the 2006, 2009 and 2011 Regulations) require that a local authority 'must undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control'.

In addition, the Council's Chief Finance Officer has a statutory duty under Section 151 of the Local Government Act 1972 to establish a clear framework for the proper administration of the authority's financial affairs. The S151 officer relies, amongst other sources, upon the work of internal audit in reviewing the operation of systems of internal control and financial management.

Role

The internal audit activity is established by the Audit Committee. The internal audit activity's responsibilities are defined by the Audit Committee, via this Charter, as part of their oversight role.

SIAS may undertake consultancy activity (additional activity requested by management) where it has the necessary skills and resources to do this, and this will be determined by the Head of Assurance on a case by case basis.

Professionalism

SIAS governs itself by adherence to The Chartered Institute of Internal Auditors' (CIIA) mandatory guidance including the Definition of Internal Auditing, the Code of Ethics, and the International Standards for the Professional Practice of Internal Auditing ('the Standards'). This mandatory guidance constitutes principles of the fundamental requirements for the professional practice of internal auditing and for evaluating the effectiveness of the internal audit activity's performance.

The Institute of Internal Auditors' Practice Advisories, Practice Guides, and Position Papers will also be adhered to as applicable to guide operations. In addition, the internal audit activity will adhere to the Council's relevant policies and procedures and the internal audit activity's standard operating procedures manual.

Mandatory public sector specific standards were introduced on 1 April 2013, through a joint venture between the Chartered Institute of Public Finance and Accountancy (CIPFA) and the CIIA. These new Public Sector Internal Audit Standards (PSIAS) are based on the mandatory elements of the CIIA existing standards, with additional public sector requirements.

Authority

The internal audit activity, with strict accountability for confidentiality and safeguarding records and information, is authorised full, free, and unrestricted access to any and all of the organisation's records, physical properties, and personnel pertinent to carrying out any engagement. All employees are
requested to assist the internal audit activity in fulfilling its roles and responsibilities. The internal audit activity will also have free and unrestricted access to the Audit Committee and senior management.

Organisation

SIAS has direct access to senior management, the Audit Committee, the Chief Executive and the Chair of the Audit Committee. The Section 151 Officer and the Audit Committee will jointly agree the level of internal audit resource to be deployed at the Council.   The Head of Assurance Services will communicate and interact directly with the senior management and the Audit Committee, including in executive sessions and between meetings as appropriate. Outside of formal senior management meetings and meetings of the Audit Committee, the Head of Assurance Services will have unrestricted access to the Chief Executive and to the Chair of the Audit Committee.

For line management purposes, the Head of Assurance Services will report to the post of Deputy Chief Executive and Chief Financial Officer at Hertfordshire County Council (HCC).   The Deputy Chief Executive of HCC will approve all decisions regarding the performance evaluation, appointment, or removal of the Head of Assurance Services, in consultation with the SIAS Board.

For the purposes of the internal audit activity, the following groups are defined:

<u>Audit Committee</u>

Audit Committee is responsible for overseeing the effectiveness of the internal audit function, and holding the Head of Assurance Services to account for delivery, through the receipt of regular updates and reports. The Audit Committee is responsible for the effectiveness of the governance, risk and control environment within the Council, holding managers to account for delivery.

<u>Senior Management</u>

Responsible for helping shape the programme of assurance work through an analysis and review of key risks to the achieving the Council's objectives and priorities. Senior management provide leadership and direction for the Council.

<u>SIAS Board</u>

The governance group charged with monitoring and reviewing the overall operation of SIAS, including:
- Resourcing and financial performance
- Performance indicators measuring operational effectiveness
- The overall strategic direction of the shared service.

Independence and Objectivity

The internal audit activity will remain free from interference by any element in the organisation, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of a necessary independent and objective mental attitude.

Internal auditors will have no direct operational responsibility or authority over any of the activities audited. Accordingly, they will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair internal auditor's judgment.

The Head of Assurance Services will confirm to the Audit Committee, at least annually, the organisational independence of the internal audit activity.

Conflicts of Interest

Internal auditors must exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors must make a balanced assessment of all the relevant circumstances and not be unduly influenced by their own interests or by others in forming judgments.

In addition to the ethical requirements of the various professional bodies, each auditor is required to proactively declare any potential 'conflict of interest' prior to the commencement of each audit assignment.

All auditors are required to sign an annual declaration of interest to ensure that the allocation of audit work avoids conflict of interest. Auditors who undertake any consultancy work will be prohibited from auditing those areas. Audits are rotated within the team to avoid over-familiarity and complacency. SIAS has procured an arrangement with an external firm to provide additional internal audit days on request; this arrangement will be used for the internal audit of any functions also directly managed by the Head of Assurance.

Responsibility and Scope

The scope of internal auditing encompasses, but is not limited to, the examination and evaluation of the adequacy and effectiveness of the organisation's governance, risk management, and internal control processes in relation to the organisation's defined goals and objectives. Internal control objectives considered by internal audit extend to the entire control environment of the organisation and include:

- Consistency of operations or programs with established objectives and goals, and effective performance
- Effectiveness and efficiency of operations and employment of resources
- Compliance with significant policies, plans, procedures, laws, and regulations
- Reliability and integrity of management and financial information processes, including the means to identify, measure, classify, and report such information
- Safeguarding of assets

Internal audit is responsible for evaluating all processes ('audit universe') of the organisation including governance processes and risk management processes. It also assists the Audit Committee in evaluating the quality of performance of external auditors and ensuring a proper degree of coordination with internal audit is maintained.

Due to its detailed knowledge and understanding of risks and controls, internal audit is well placed to provide advice and support on emerging risks and issues. As a result, internal audit may perform consulting and advisory services as appropriate for the organisation. It may also evaluate specific operations at the request of the Audit Committee and senior management, as appropriate.

Based on its activity, internal audit is responsible for reporting significant risk exposures and control issues identified to the Audit Committee and to senior management, including fraud risks, governance issues, and other matters needed or requested by these bodies. This ensures Internal audit plays a key role in providing assurance to the Audit Committee and senior management on the effectiveness of the entire control environment.

Role in Anti-Fraud

The work programme of SIAS is designed, in part, to help deter fraud and corruption. With this in view, SIAS bases its planning on regular risk assessment, and works with Chief Financial Officers, other senior managers, and the Audit Committee in determining its programme of work.

SIAS also shares information with relevant partners, including with government via the National Fraud Initiative, to increase the likelihood of detecting fraudulent activity, and of reducing the risk of fraud to all.

SIAS offers a fraud investigation services and can support organisations in ensuring their fraud prevention arrangements are robust. The Head of Assurance should be notified of all suspected or detected fraud, corruption or impropriety so that the impact upon control arrangements can be evaluated.

Internal Audit Plan

At least annually, the Head of Assurance Services will submit to the Audit Committee an internal audit plan for review and approval, including risk assessment criteria. The internal audit plan will include timing as well as budget and resource requirements for the next financial year. The Head of Assurance Services will communicate the impact of resource limitations and significant interim changes to senior management and the Audit Committee.

The internal audit plan will be developed based on a prioritisation of the audit universe using a risk-based methodology, including input of senior management. Prior to submission to the Audit Committee for approval, the plan will be discussed with appropriate senior management. Any significant deviation from the approved internal audit plan will be communicated through the periodic activity reporting process.

Reporting and Monitoring

The Head of Assurance will arrange for a written report to be prepared and issued following the conclusion of each internal audit engagement; this will be distributed as appropriate.

The internal audit report will include management's response and corrective action taken or to be taken in regard to the specific findings and recommendations. Management's response will include a timetable for anticipated completion of action to be taken and an explanation for any corrective action that will not be implemented.

The internal audit activity will be responsible for appropriate follow-up on engagement findings and recommendations and will report to the Audit Committee on the results of this activity.

The Head of Assurance will consider any request from external stakeholders for reports on the results of internal audit activity, in consultation with senior management.

The Head of Assurance will arrange for quarterly update reports to the Audit Committee to advise on the results of each internal audit engagement, and provide an annual report to the Audit Committee giving an opinion on the internal control environment.

Periodic Assessment

In accordance with section 6 of the Accounts and Audit (England) Regulations 2011, the SIAS Board will make arrangements for the conduct of a review of the effectiveness of internal audit.

The review is designed to ensure that the opinion given in the Annual Report of the Head of Assurance Services may be relied upon as a key source of evidence in the Annual Governance Statement.

The work will be conducted on the basis of one review of SIAS providing assurance for all SIAS partner members.

Review of the Audit Charter

This charter will be subject to annual review by the Head of Assurance Services and any changes presented to Audit Committee for approval at the first audit committee meeting in each financial year.

Helen Maneuf - Head of Assurance Services
May 2013

(Date of next review: May 2014)