

 Finance & Audit Scrutiny Committee - 10 December 2013		Agenda Item No. <div style="text-align: right; font-size: 2em;">6</div>
Title	Implications of the Public Sector Internal Audit Standards	
For further information about this report please contact	Richard Barr Tel: (01926) 456815 E Mail: richard.barr@warwickdc.gov.uk	
Service Area	Finance	
Wards of the District directly affected	Not applicable	
Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No	
Date and meeting when issue was last considered and relevant minute number	Not applicable.	
Background Papers	Public Sector Internal Audit Standards. Local Government Application Note	

Contrary to the policy framework:	No
Contrary to the budgetary framework:	No
Key Decision?	No
Included within the Forward Plan? (If yes include reference number)	No

Officer/Councillor Approval		
With regard to officer approval all reports <i>must</i> be approved by the report author's relevant director, Finance, Legal Services and the relevant Portfolio Holder(s).		
Officer Approval	Date	Name
Chief Executive/Deputy Chief Executive	26 Nov 2013	Chris Elliott
Head of Service	26 Nov 2013	Mike Snow
CMT		
Section 151 Officer	26 Nov 2013	Mike Snow
Monitoring Officer		
Finance	26 Nov 2013	As S151 Officer
Portfolio Holder	26 Nov 2013	Councillor Mobbs
Consultation Undertaken		
Not applicable.		
Final Decision?	Yes	
Suggested next steps (if not final decision please set out below)		

1 **SUMMARY**

- 1.1 Report advises on the implications to the Council's internal audit service of the Public Sector Internal Audit Standards.

2 **RECOMMENDATIONS**

- 2.1 That the new Public Sector Internal Audit Standards and the impact thereupon be noted.
- 2.2 That the Public Sector Internal Audit Standards be adopted as best practice for the delivery of a quality Internal Audit Service in Warwick District Council.

3 **REASON FOR THE RECOMMENDATIONS**

- 3.1 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.
- 3.2 The Accounts and Audit (England) Regulations 2011 require that Local Authorities "maintain an adequate and effective system of internal audit of their accounting records and systems of internal control in accordance with proper internal audit practices...."

4 **ALTERNATIVE OPTIONS CONSIDERED**

- 4.1 This report is not concerned with recommending a particular option in preference to others so this section is not applicable.

5 **BUDGETARY FRAMEWORK**

- 5.1 External assessments will be financed from within the Internal Audit Service budget.

6 **POLICY FRAMEWORK**

- 6.1 Although there are no direct policy implications, Internal Audit provides a view on all aspects of governance and will take into account the Council's policies.

7 **BACKGROUND**

- 7.1 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, a new set of Internal Audit Standards for the whole of the public sector have been produced. These are known as the Public Sector Internal Audit Standards (PSIAS).
- 7.2 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.

- 7.3 The Council will be required to comply fully or to provide a clear justification for any aspects of non-compliance. The Council's External Auditor will also be required to obtain assurance as to compliance and to report any material non-compliance.
- 7.4 Broadly speaking, the Standards will have the same status in respect of internal audit as the International Financial Reporting Standards have in respect of accounting and financial reporting.
- 7.5 This report provides an overview of the Standards, sets out the key requirements of the PSIAS and highlights areas where these differ from the CIPFA Code of Practice.

8 **OVERVIEW OF THE STANDARDS**

- 8.1 The objectives of the PSIAS are to:
- define the nature of internal auditing within the UK public sector
 - set basic principles for carrying out internal audit in the UK public sector
 - establish a framework for providing internal audit services, which add value to the organisation, leading to improved organisational processes and operations, and
 - establish the basis for the evaluation of internal audit performance and to drive improvement planning.
- 8.2 Note that, for the Standards, the term 'chief audit executive' (CAE) has replaced the term 'head of internal audit' that had been used in the CIPFA Code of Practice.
- 8.3 The key requirements in respect of the new Standards are outlined below.

8.2.1 Code of Ethics

The Standards contain a Code of Ethics that is mandatory for all Internal Auditors working in the UK public sector. The Standards also require internal auditors to have regard for the Committee on Standards of Public Life's Seven Principles of Public Life.

8.2.2 Internal Audit Charter

The Standards require the Council to have an Internal Audit Charter that must be approved by Senior Management and the Audit Committee. The Charter defines the purpose, authority and responsibility of Internal Audit. It also sets out the nature of the CAE's functional relationship with the board (in the Council's case this is deemed to be the Audit Committee) as well as the rights of access to records, personnel and physical properties relevant to internal audit engagements.

8.2.3 Reporting lines

The CAE must report functionally to the Audit Committee and must have free, unfettered access to the Chief Executive and Chair of the Audit Committee.

Examples of functional reporting to the Audit Committee include the committee:

- Approving the internal audit charter

- Approving the risk based internal audit plan
- Approving the internal audit budget and resource plan
- Receiving communications from the CAE on the Internal Audit activity's performance relative to its plan and other matters
- Approving decisions regarding the appointment and removal of the CAE
- Approving the remuneration of the CAE.

Governance requirements in the UK public sector would not generally involve the board (Audit Committee) approving the CAE's remuneration specifically. The underlying principle is that the independence of the CAE is safeguarded by ensuring that his or her remuneration or performance assessment is not inappropriately influenced by those subject to audit. In the UK public sector, this can be achieved by ensuring that the chief executive (or equivalent) undertakes, countersigns, contributes feedback to or reviews the performance appraisal of the CAE and that feedback is also sought from the chair of the Audit Committee.

8.2.4 Qualifications and Experience

The CAE must hold a professional qualification (CMIIA, CCAB or equivalent) and be suitably experienced. The Audit and Risk Manager (Chartered Public Finance Accountant, MSc in Audit Management & Consultancy) fulfils this requirement.

8.2.5 Quality Assurance and Improvement Programme

This should incorporate:

- On-going monitoring of the performance of the internal audit function
- Periodic self-assessments or assessments by other persons within the Authority with sufficient knowledge of internal audit practices
- An external assessment of Internal Audit to be carried out at least every five years by a qualified, independent assessor or assessment team from outside the organisation.

8.2.6 Internal Audit Planning

The CAE is responsible for developing a risk based audit plan that must take into account the requirement to produce an annual internal audit opinion. In preparing the risk based audit plan, consideration should be taken of the Council's risk management framework, including using risk appetite levels set by management for the different activities or parts of the organisation. If a framework doesn't exist, the CAE uses his / her own judgement of risks after consideration of input from senior management and the Audit Committee.

The internal audit annual plan must explain how internal audit's resource requirements have been assessed. Where the CAE believes that the level of agreed resources will adversely impact on the provision of the annual internal audit opinion, the consequences must be brought to the attention of the Audit committee.

8.2.7 Nature of Audit Work

a. Governance

Internal audit must assess and make appropriate recommendations for improving the governance arrangements in its accomplishment of the following objectives:

- Promoting appropriate ethics and values within the Authority
- Ensuring effective organisational performance management and accountability
- Communicating risk and control information to appropriate areas of the Council; and
- Coordinating the activities of and communicating information among the Audit Committee, internal and external auditors and management

b. Risk Management

Internal audit must evaluate the effectiveness and contribute to the improvement of risk management processes. Internal audit must also evaluate the potential for the occurrence of fraud and how the organisation manages fraud. Internal auditors must refrain from assuming any management responsibility by actually managing risks.

c. Control

Internal audit must assist the organisation in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement.

d. Consultancy

The Standards recognise that internal audit can perform added value work in the form of consultancy assignments. These reviews may assist management in improving their management of risks and improve the achievement of organisational objectives. The relative costs and benefits should be assessed before the assignment is accepted. Approval must be sought from the Audit Committee for any significant consulting assignment that is not already included in the audit plan.

8.2.8 Annual Internal Audit Opinion

The CAE must deliver an annual internal audit opinion and report that can be used by the Council to inform its governance statement. The annual internal audit opinion must conclude on the overall adequacy and effectiveness of the Council's framework of governance, risk management and control. The annual report must incorporate:

- The opinion
- A summary of the work that supports the opinion; and
- A statement on conformance with the Public Sector Internal Audit Standards and the results of the quality assurance and improvement programme.

The first two items listed above are already contained in the Internal Audit Annual Report that is published each year.

8.2.9 Communicating the acceptance of risks

The CAE must establish a follow up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

Where the CAE concludes that management has accepted a level of risk that may be unacceptable to the Council, the CAE must discuss the matter with senior management. If the CAE determines that the matter has not been resolved, the CAE must communicate the matter to the Audit Committee.

- 8.3 The full Public Sector Internal Audit Standards can be viewed from the following link:

<http://www.cipfa.org/Policy-and-Guidance/Standards/Public-Sector-Internal-Audit-Standards>

9 NEW REQUIREMENTS

- 9.1 The following paragraphs highlights those areas where the PSIAS differ from the CIPFA Code of Practice.

9.1.1 Internal Audit Charter

An Internal Audit Charter must be produced that formally defines 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. Internal Audit has a terms of reference that is approved annually by the Finance and Audit Scrutiny Committee. An Audit Charter will need to be produced to replace this.

9.1.2 Quality assurance

The quality of service should be rigorously checked under a quality assurance and improvement programme that requires ongoing 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. Previously, External audit had evaluated internal audit against the CIPFA Code of Practice on a triennial basis. In addition, a peer review of internal audit's protocols and performance had been commissioned from time to time.

9.1.3 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 Audit and Risk Manager will provide this assurance in the annual report and it is suggested that the Committee should also seek assurance from management in considering the annual report.

9.1.4 Additional work

The Committee will be required to consider proposals for Internal Audit to undertake any significant consultancy work not already included in the Annual Audit Plan and to assure itself that the proposed work would not impair Internal

Audit's independence or objectivity. Any such proposal could be cleared on a quarterly basis at Committee meetings with urgent work being agreed by the Chair if necessary.

9.1.5 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.

The Chair of the Audit Committee (Finance & Audit Scrutiny Committee) must be formally consulted as part of the review of the Head of Internal Audit's performance and remuneration. In its local government interpretation, CIPFA recognises that "Governance requirements in the UK public sector would not generally involve the board approving the CAE's remuneration specifically. The underlying principle is that the independence of the CAE is safeguarded by ensuring that his or her remuneration or performance assessment is not influenced inappropriately by those subject to audit. In local government this can be achieved by ensuring that the Chief Executive (or equivalent) undertakes, countersigns and contributes feedback to or reviews the performance appraisal of the CAE and that feedback is sought from the Chair of the Audit Committee."

It has been agreed with the Chief Executive that he will provide feedback on the performance of the Audit and Risk Manager when the Head of Finance carries out the annual performance appraisal.

In terms of effective communication between the CAE and the Audit Committee, that is to be addressed by the Audit and Risk Manager attending, for the audit items, the regular 'chair's briefings' between the Head of Finance and the Chair of Finance & Audit Scrutiny Committee, together with the 'shadow chair'.

- 9.2 Amendments have been made to the Internal Audit Manual to reflect requirements of an operational nature and a revised Audit Charter will be presented to a future Finance & Audit Scrutiny Committee meeting.