

PUBLIC SECTOR INTERNAL AUDIT STANDARDS

LEAD OFFICER: Darienne Law,
Head of Corporate Resources (and S.151 Officer)

AUTHOR: Niki Riley,
Group Audit Manager

1.0 EXECUTIVE SUMMARY

1.1 This report provides an overview of the requirements of the Public Sector Internal Audit Standards which became mandatory for all UK public sector internal auditors from 1st April 2013.

1.2 Key points are:

- A revised definition of internal auditing focusing on the role of internal audit in providing independent assurance over the Council's systems of Governance, Risk Management and Internal Control.
- A mandatory code of ethics which must be adopted by all internal auditors working in the UK public sector.
- The preparation of an Audit Charter setting out the role and purpose of internal audit, as well as the nature of the head of internal audit's functional reporting relationship with the Audit and Governance Committee and affirms internal audit's rights of access to all records, information, premises relevant to internal audit assignments.
- The requirement for a quality assurance and improvement programme for internal audit.
- The preparation of annual risk-based audit plans designed to allow an annual opinion to be given over the Council's arrangements for Governance, Risk Management and Internal Control.
- The duty placed on the Head of Internal Audit to escalate to senior management and Audit and Governance Committee any instances where he / she considers that management have accepted a level of risk that may be unacceptable to the Council.

1.3 A review of internal audit is currently being undertaken by the external auditors Grant Thornton to provide recommendations aimed at ensuring conformance with the Standards. In addition, a self-assessment against the checklist is being undertaken and the outcomes and an action plan will be reported to Audit and Governance Committee.

2.0 POLICY POSITION, BUDGETARY AND EQUALITY IMPLICATIONS, AND LINKS TO COUNCIL PLAN

2.1 The Accounts and Audit Regulations 2011 require the Council to 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. Proper practices as stated within the Regulations are now defined as the Public Sector Internal Audit Standards.

3.0 RECOMMENDATION

3.1 Members are asked to note:

- The requirements of the Public Sector Internal Audit Standards

4.0 BACKGROUND

4.1 Until 1st April 2013, internal audit was required to comply with the CIPFA Code of Practice for Internal Audit in Local Government and an annual self-assessment was undertaken and the outcomes reported to Audit and Assurance Committee.

4.2 The Public Sector Internal Audit Standards replace the CIPFA Code as the mandatory standards and the Head of Internal Audit is now required to report any instances of non-conformance with the Standards such that they impact the scope or operation of the internal audit activity.

October 2013

5.0 INTRODUCTION AND SCOPE

- 5.1 The Public Sector Internal Audit Standards became mandatory for all internal audit service providers within the public sector from 1st April 2013. The Standards replace the CIPFA Code of Practice for Internal Audit in Local Government (2006) as ‘proper audit practices’ as required by the Accounts and Audit Regulations 2011.
- 5.2 The primary role for Internal Audit in the public sector is the provision of assurance services. This role requires the chief audit executive (Group Audit Manager within the Shared Internal Audit service) to produce an annual internal audit opinion based on an objective assessment of the framework of governance, risk management and internal control. Internal audit may also provide discretionary consulting activities at the request of the organisation with the aim of improving governance, risk management and internal control and contributing to the overall opinion. However, the provision of consulting activities is subject to there being no impact on core assurance work.
- 5.3 The PSIAS refer to the head of internal audit as the ‘chief audit executive’ and require the organisation to define the terms ‘board’ and ‘senior management’ for the purposes of internal audit activity. Within the Cumbria Shared Audit Service, the chief audit executive is the Group Audit Manager or the responsible Audit Manager who acts with delegated authority of the Group Audit Manager in relation to the client organisations within the shared audit service. The ‘board’ is generally the committee charged with responsibility for governance, risk management and internal control and will most frequently be the Audit and Assurance/ Governance committee. This will be defined within an audit charter approved and owned by each organisation within the Shared Audit Service.

6.0 DEFINITION OF INTERNAL AUDITING

- 6.1 The Standards introduce a slightly amended definition of internal auditing from that of the former CIPFA Code of Practice for Internal Audit. The definition is:

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

- 6.2 This definition further emphasises the role of internal audit in reviewing all systems of risk, governance and internal control, moving away from the traditional role of internal audit in primarily reviewing systems of internal *financial* control. The definition also focuses on the role of Internal Audit in assisting the organisation to achieve its objectives.

7.0 CODE OF ETHICS

- 7.1 The PSIAS contain a code of Ethics which is attached as an appendix to this paper. All internal auditors in UK public sector organisations must conform to this Code. The Code does not replace those of any professional body that auditors belong to or those of the employing organisation; internal auditors are required to comply with all relevant Codes of Ethics.
- 7.2 Internal auditors are also expected to have regard for the Committee for Standards of Public Life's *Seven Principles of Public Life*.

8.0 KEY REQUIREMENTS OF THE STANDARDS

8.1 Internal Audit Charter

- 8.1.1 The purpose, authority and responsibility of the internal audit activity must be formally defined in an internal audit charter consistent with the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards*. The internal audit charter establishes internal audit's position within the organisation, including the nature of the chief audit executive's functional reporting relationship with the board, it authorises access to records, personal and physical properties relevant to the performance of audit engagements and it defines the scope of internal audit activities. Final approval of the charter rests with the board (Audit & Governance Committee). The Charter is approved and owned by the organisation.

8.2 Independence and Objectivity

- 8.2.1 The internal audit activity must be independent and internal auditors must be objective in performing their work. This means that the chief audit executive must have direct and unrestricted access to senior management and the board (Audit Governance Committee). This can be achieved through a dual reporting relationship. The chief audit executive must confirm to the board, at least annually, the organisational independence of the internal audit activity.
- 8.2.2 Examples of functional reporting to the board include:
- approving the internal audit charter;
 - approving the risk based audit plan;
 - approving the internal audit budget and resource plan;
 - receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters;
 - approving decisions regarding the appointment and removal of the chief audit executive (for clients within the shared audit service this may mean approving the procurement of the internal audit service);

- making appropriate enquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.

8.3 Proficiency and Due Professional Care

8.3.1 Audit engagements must be carried out with proficiency and due professional care. The chief audit executive must hold a professional qualification (CMIIA, CCAB or equivalent) and be suitably experienced. The Group Audit Manager and Audit Managers within the Shared Internal Audit Service are all professionally qualified.

8.3.2 Internal auditors must possess the knowledge, skills and other competencies needed to perform their individual responsibilities. The internal audit activity collectively must possess or obtain the knowledge, skills and other competencies needed to perform its responsibilities. Internal auditors are encouraged to demonstrate their proficiency by obtaining appropriate professional qualifications.

8.4 Quality Assurance and Improvement programme

8.4.1 The chief audit executive must develop and maintain a quality assurance and development programme that covers all aspects of the internal audit activity. A quality assurance programme will enable an evaluation of the internal audit activity's conformance with the definition of internal auditing and the Standards. The quality assurance and improvement programme must include both internal and external assessments.

8.4.2 Internal assessments must include:

- Ongoing monitoring of the performance of the internal audit activity; and
- Periodic self-assessments or assessments by other persons within the organisation with sufficient knowledge of the internal audit profession

8.4.3 External assessments must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organisation. The chief audit executive must discuss with the board:

- The form of external assessments;
- The qualifications and independence of the external assessor or assessment team, including any potential conflict of interest.

8.4.4 The chief audit executive must communicate the results of the quality assurance and improvement programme to senior management and the board (Audit & Governance Committee).

8.4.5 The chief audit executive may state that the internal audit activity conforms with the International Standards for the Professional Practice of Internal Auditing only if the results of the quality assurance and improvement programme support this statement. Any instances of non-conformance which impact the overall scope or

operation of the internal audit activity must be reported together with the impact of these to senior management and the board.

8.5 Performance Standards

8.5.1 The chief audit executive must effectively manage the internal audit activity to ensure it adds value to the organisation.

Planning

8.5.2 The chief audit executive is responsible for developing a risk-based plan to determine the priorities of the internal audit activity consistent with the organisation's goals. The audit plan must take into account the organisation's risk management framework including risk appetite levels set. In the absence of a risk management framework, the chief audit executive must use her own judgement of risks after consideration of input from senior management and the board (Audit Committee).

8.5.3 The audit plan must be based on a documented risk assessment undertaken at least annually. The input of senior management and the board must be considered in the process.

8.5.4 The risk based audit plan must explain how internal audit's resource levels have been assessed. The plan must link to a high level statement of how the internal audit service will be delivered and developed in accordance with the internal audit charter and how it links to the organisation's objectives and priorities.

8.5.5 Where the chief audit executive believes that the level of agreed resources will impact adversely on the provision of an annual audit opinion, the consequences must be brought to the attention of the board.

8.5.6 The internal audit activity's plans must be communicated to senior management and the board for review and approval.

8.5.7 The chief audit executive must include in the plan the approach to using other sources of assurance and any work required to place reliance upon these other sources.

Reporting to Senior Management and the Board

8.5.8 The chief audit executive must report periodically to senior management and the board on the internal audit's purpose, authority, responsibility and performance relative to the plan. Reporting must also include significant risk exposures and control issues, including fraud risks, governance issues and other matters needed or requested by senior management and the board. The frequency of such reporting to be agreed with senior management and the board.

External Service Provider and organisational responsibility for Internal Auditing

8.5.9 When an external service provider serves as the internal audit activity, the provider must make the organisation aware that the organisation has the responsibility for maintaining an effective internal audit activity. This is demonstrated through the quality assurance and improvement programme which assesses conformance with the Standards.

8.6 Nature of Work

8.6.1 The internal audit activity must evaluate and contribute to the improvement of governance, risk management and control processes using a systematic and disciplined approach.

Governance

8.6.2 Internal audit must assess and make appropriate recommendations for improving the governance process in its accomplishment of the following object

- Promoting appropriate ethics and values within the organisation
- Ensuring effective organisational performance management and accountability
- Communicating risk and controls information to appropriate areas of the organisation
- Coordinating the activities of and communicating information among the board, external and internal auditors and management.

8.6.3 The internal audit activity must evaluate the design, implementation and effectiveness of the organisation's ethics-related objectives, programmes and activities.

8.6.4 The internal audit activity must assess whether the information technology governance of the organisation supports the organisation's strategies and objectives.

Risk Management

8.6.5 The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes. Determining whether the risk management processes are effective is a judgement resulting from the internal auditor's assessment that:

- Organisational objectives support and align with the organisation's mission;
- Significant risks are identified and assessed;
- Appropriate risk responses are selected that align risks with the organisation's risk appetite; and

- Relevant risk information is captured and communicated in a timely manner across the organisation, enabling staff, management and the board to carry out their responsibilities.

8.6.6 The internal audit activity must evaluate the potential for occurrence of fraud and how the organisation manages fraud risk.

Internal Control

8.6.7 Internal audit must evaluate the adequacy and effectiveness of controls in responding to risks within the organisation's governance, operations and information systems regarding the:

- Achievement of the organisation's strategic objectives;
- Reliability and integrity of financial and operational information
- Effectiveness and efficiency of operations and programmes;
- Safeguarding of assets; and
- Compliance with laws, regulations, policies, procedures and contracts.

8.7 Engagement Planning

8.7.1 Where internal audit provides services for parties outside the organisation, internal auditors must establish a written understanding with them about objectives, scope, respective responsibilities and other expectations, including restrictions on distribution of results and access to engagement records.

8.8 Communication of Outcomes

8.8.1 Final communication of engagement results must contain internal audit's opinion and / or conclusions. The opinion must take account of the expectations of senior management, the board and other stakeholders and must be supported by sufficient, reliable, relevant and useful information.

8.8.2 The head of Internal Audit must also deliver an annual internal audit opinion and report that can be used by the organisation to inform its Annual 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.

8.9 Monitoring progress

- 8.9.1 The chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.
- 8.9.2 The chief audit executive must establish a follow up process and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.
- 8.9.3 Where the chief audit executive concludes that management have accepted a level of risk that may be unacceptable to the organisation, the chief audit executive must discuss the matter with senior management. If the chief audit executive determines the matter has not been resolved, the chief audit executive must communicate the matter to the board.

9.0 SUMMARY AND NEXT STEPS

- 9.1 A self-assessment is currently being undertaken to ensure that internal audit is compliant with the Standards. The outcome of the self-assessment will be reported to Audit and Governance Committee together with a Service Development Plan incorporating any actions arising from the self-assessment.

Consultees: Corporate Leadership Team