

FALKIRK COUNCIL

Subject: INTERNAL AUDIT CHARTER AND EXTERNAL
QUALITY ASSESSMENT
Meeting: AUDIT COMMITTEE
Date: 24 March 2014
Author: INTERNAL AUDIT MANAGER

1. INTRODUCTION

- 1.1 The purpose of this paper is to seek Members' approval of a new Internal Audit Charter setting out the role, authority, and responsibility of the Council's Internal Audit Section.
- 1.2 It also seeks Members' approval of a proposal to participate in a national External Quality Assessment scheme being developed by the Scottish Local Authorities Chief Internal Auditors' Group.

2. BACKGROUND AND CONTEXT

- 2.1 Members will recall a previous paper to Audit Committee advising that the Public Sector Internal Audit Standards (PSIAS) came into force on 01 April 2013, replacing the CIPFA Code of Practice for Internal Audit in Local Government in the UK 2006.
- 2.2 The PSIAS Standards were developed jointly by CIPFA and the Chartered Institute of Internal Auditors (CIIA) and are the first set of truly pan-public sector Standards. The full text of the Standards is available via this link: <http://www.cipfa.org/policy-and-guidance/standards/public-sector-internal-audit-standards>.
- 2.3 Rather than fundamentally changing the way in which Internal Audit sections operate, the PSIAS Standards are an evolution of the previous CIPFA Code, while drawing on various other areas of best practice.
- 2.4 That said, it is worth summarising the key points / changes arising from the new Standards, and these are as follows:
 - the Standards stress the need for Internal Audit to be a value adding activity;
 - they are framed around Attribute Standards (characteristics of Internal Audit providers), Performance Standards (on the nature and quality of Internal Audit services), and Implementation Standards (on specific activities, eg assurance, consulting);
 - there is a requirement for an Internal Audit Charter;

- Internal Audit Sections are required to develop and maintain a quality assurance and improvement programme (through internal and external assessment); and
 - the need for Internal Audit to take account of other, alternative, sources of assurance is stressed.
- 2.5 The remainder of this paper focuses on two of the above, namely the requirement for an Internal Audit Charter, and the requirement for periodic External Quality Assessment.

3. INTERNAL AUDIT CHARTER

- 3.1 The PSIAS Standards require that all public sector Internal Audit providers establish an Internal Audit Charter. The Charter must set out the role, authority, and responsibility of the Internal Audit Section, and the Standards require that it is approved by 'the board' (in this case, Falkirk Council's Audit Committee).
- 3.2 The draft Charter set out at **Appendix 1** has been prepared in line with the requirements of the PSIAS Standards. It includes sections on:
- The Role of Internal Audit;
 - Professionalism;
 - Authority and Scope;
 - Organisation;
 - Independence and Objectivity;
 - Responsibility – Reporting Requirements;
 - Responsibility – Consultancy Work and Fraud / Corruption; and
 - Quality Assurance.
- 3.3 The Charter is largely based on the high level principles of the functioning of the Section. A separate Internal Audit Manual is in place that guides staff through the practical matters of planning, undertaking, and reporting on Internal Audit work.
- 3.4 Nevertheless, the Charter will be kept under review, with any changes presented to Audit Committee on a two yearly basis (or earlier if required).

4. EXTERNAL QUALITY ASSESSMENT

- 4.1 The PSIAS Standards also require that the Internal Audit Manager develops a quality assurance and improvement programme, designed to enable evaluation of compliance with the Standards. This must include an annual self assessment and, on a five yearly basis (commencing 01 April 2013), an independent external assessment.
- 4.2 The annual self assessment will be undertaken as a matter of course, with the results summarised in the Internal Audit Annual Assurance Report presented to the June meeting of the Audit Committee.

- 4.3 The requirement for an external assessment is less straightforward. The Standards are clear that the assessment must be undertaken by a qualified, independent assessor. The indicative cost of procuring an independent external assessment from a third party provider (such as the Chartered Institute of Internal Auditors) is between £6,000 and £9,000. This is in addition to Officer time preparing for, and participating in, the assessment process.
- 4.4 As an alternative to this, the Scottish Local Authorities Chief Internal Auditors' Group (SLACIAG) has developed the proposal set out at **Appendix 2**.
- 4.5 Fundamentally, the approach set out in this proposal would allow Authorities to participate in a 'peer review' scheme, whereby each Authority would be allocated another Authority to act as assessor. Each Authority would be assessed once, and act as assessor once, over the initial five years of the scheme.¹
- 4.6 While there would be a cost to each participating Authority in relation to the training required to become an assessor, this will not be material within the context of the cost of purchasing the service from an external provider. In addition, an allocation of 'days' will have to be made to allow Falkirk Council's Internal Audit section to fulfil our obligations as an assessor but, again, this is likely to be minimal (with an assessment likely to take 5-7 days, and a requirement to undertake an assessment only once every five years).
- 4.7 The requirement for external assessment is mandatory and, at some point over the coming five years, the Internal Audit Section will require to source and undergo assessment. In my view, the SLACIAG proposal is a low cost / high quality option, which allows for the retention of an acceptable degree of independence.

5. RECOMMENDATIONS

5.1 Members are invited to:

- 5.1.1 Consider and approve the Internal Audit Charter attached at Appendix 1; and**
- 5.1.2 Consider and approve Falkirk Council Internal Audit's participation in the SLACIAG External Quality Assessment scheme.**

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Internal Audit Manager

Date: 10 March 2014

¹ This differs from the previous 'reciprocal peer review' process with West Lothian Council in that, under the SLACIAG proposal, one Authority could not assess an Authority which they have been assessed by.

INTERNAL AUDIT CHARTER



Falkirk Council

INTERNAL AUDIT CHARTER

Prepared By:	Gordon O'Connor, Internal Audit Manager
Distribution:	Audit Committee, Internal Audit Section
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1. Internal Audit Charter

1.1 This Internal Audit Charter sets out the role, authority, and responsibility of the Council's Internal Audit Section, in accordance with the UK Public Sector Internal Audit Standards (PSIAS). The Charter will be reviewed bi-ennially.

1.2 It is a requirement of PSIAS that the Charter is approved by the 'Board'. Within Falkirk Council, the Audit Committee is deemed to be the Board.

2. Role of Internal Audit

2.1 Internal Audit is an independent and objective assurance and consulting activity that aims to add value to, and improve the operations of, Falkirk Council.

2.2 The main objective of Internal Audit is to provide a high quality, independent, and innovative audit service, culminating in an Annual Assurance Report providing an opinion on the adequacy of the Council's arrangements for risk management, governance, and control.

2.3 In addition to this assurance role, Internal Audit will also:

- present periodic Progress Reports on the Section's work to Audit Committee;
- provide ad hoc consultancy and advice to Services;
- monitor and report on the implementation of Internal Audit recommendations;
and
- help promote an anti-fraud and corruption culture, and assist with investigations as appropriate.

2.4 The Internal Audit Manager acts as Key Contact for the bi-ennial National Fraud Initiative exercise and as the Council's Single Point Of Contact (SPOC) with Police Scotland in relation to Serious Organised Crime and Corruption.

3. Professionalism

3.1 Internal Audit will adhere to the PSIAS. These Standards set out the fundamental requirements for the professional practice of Internal Auditing, and are based on the Institute of Internal Auditors' mandatory guidance. They also set out requirements in relation to evaluating the effectiveness of the Internal Audit Section's performance.

3.2 Internal Audit will adhere to Council policies, procedures, and guidance, and will operate in line with its own Internal Audit Manual.

3.3 All Internal Audit staff participate in the Continuous Professional Development (CPD) requirements of the relevant Chartered Institute, and in the Council's Achievement and Personal Development Scheme (APDS). To assist with compliance with these CPD requirements, the Council's Finance Service is an accredited CIPFA and ACCA CPD employer, and the Internal Audit Section has been awarded the equivalent CIIA accreditation.

3.4 Internal Audit staff are also required to adhere to the Chartered Institute of Internal Auditors' Code of Ethics, and are reminded of this requirement on an annual basis.

3.5 Networking and sharing of good professional practice across Local Authorities is achieved through the Scottish Local Authorities Chief Internal Auditors' Group (SLACIAG) and its Computer Audit Sub-Group (CASG). Both of these Groups meet periodically throughout the year to discuss topical issues, emerging risks, and to progress specific initiatives.

4. Authority and Scope

4.1 The scope of Internal Audit allows for unrestricted coverage of the Council's activities. To allow the Section to provide a truly independent service, all Internal Audit staff will have authority to:

- enter any Council premises or land;
- access any records, documents, or correspondence (held in any format) relating to any matter which may have audit or assurance implications for the Council;

- require explanations relating to any matter under review from any employee, including Chief Officers; and
- require any employee (or agent) of the Council to produce cash, stores, assets, or any other property under their control or to which they have access.

4.2 This access is on demand and need not be subject to prior notice.

4.3 In addition, the Internal Audit Manager will have unrestricted access to:

- the Chief Executive;
- the Convener and Members of the Audit Committee;
- Chief Officers; and
- all Council employees.

4.4 The Internal Audit Manager has the right to report directly to the Council in any instance where he / she deems it inappropriate to report to the Chief Finance Officer, Chief Executive, or Audit Committee.

4.5 Right of access to other bodies funded by the Council should be set out in the conditions of funding or relevant contractual arrangement.

5. Organisation

5.1 The Internal Audit Manager reports functionally to the Audit Committee and administratively to the Chief Finance Officer, who is a member of the Council's Corporate Management Team. The Internal Audit Manager meets with the Convener of the Audit Committee prior to each meeting of the Committee to discuss matters relating to the Agenda.

5.2 Functional reporting means that the Audit Committee will:

- approve the Internal Audit Charter;
- approve the annual risk based Internal Audit Plan;
- consider reports on Internal Audit activity, including an Annual Assurance Report;

- seek assurances from Chief Officers that appropriate action has been taken to address Internal Audit recommendations; and
- make enquiries of management and the Internal Audit Manager to identify any inappropriate scope or resource limitations.

5.3 The Internal Audit Manager, Senior Internal Auditors, and Internal Auditors are required to hold a relevant professional qualification and to be suitably experienced.

6. Independence and Objectivity

6.1 Internal Audit staff will act independently and objectively at all times. In addition, it should be noted that Internal Audit is not an extension of, or substitute for, the functions of line management and will remain free from any undue influence or other pressure affecting its actions and reporting.

6.2 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 their judgment. They may, however, be consulted on the implementation of new systems or processes to ensure that, as far as possible, sound and proportionate arrangements for risk management, governance, and control are built in.

6.3 It is Service management's (not Internal Audit's) responsibility, to:

- maintain a robust framework of internal control within their area of responsibility;
- put in place arrangements to prevent, detect, and resolve instances of fraud or corruption;
- consider and act upon Internal Audit findings and recommendations, or accept the risk of not acting on these; and
- inform Internal Audit of any material proposed changes to systems or processes.

6.4 Internal Auditors must exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being reviewed.

They must make a balanced assessment of all the relevant circumstances, and not be unduly influenced in forming judgments.

6.5 The Internal Audit Manager will report to Audit Committee in his / her own name, and will confirm, in his / her Annual Assurance Report, the organisational independence of the Internal Audit Section.

7. Responsibility - Reporting Requirements

7.1 The scope of Internal Auditing encompasses, but is not limited to, the examination and evaluation of the adequacy and effectiveness of the Council's risk management, governance, and control arrangements.

7.2 It is the responsibility of Internal Audit to complete sufficient work to allow an Annual Assurance Report to be presented to the Audit Committee. This report provides an annual, overall, opinion on the adequacy of arrangements for risk management, governance, and control, and informs the Council's Annual Governance Statement.

7.3 The Annual Assurance Report will be based on the range of risk based reviews set out in the Annual Internal Audit Plan, and will encompass:

- systems and processes for establishing and embedding effective risk management across Falkirk Council;
- corporate governance arrangements;
- routine business processes and central systems; and
- non-key processes.

7.4 In preparing the Annual Internal Audit Plan, cognisance will also be taken of information obtained from Internal Audit's own Audit Needs Assessment model, previous audit reviews, and from consultancy / advice work. In addition, consideration will be given to information obtained through regular contact with Service managers, and from other independent review activities, eg external audit, REFLECT, and the work of external inspection agencies.

7.5 For each individual audit review, Internal Audit will develop a Terms of Reference and agree this with the relevant Service managers. Reviews are carried out using a risk based approach, taking account of the objectives of the activity being reviewed, risks to that activity, and the adequacy of existing risk management, governance, and control arrangements.

7.6 Internal Audit will develop and document work programs for each review, setting out the approach to be taken for identifying, analysing, evaluating, and documenting information during the review. A detailed file will be kept as a record of work undertaken. This will be done in line with the standards set out in Falkirk Council's Internal Audit Manual.

7.7 Matters arising from each Internal Audit review will be reported to management in the form of a draft audit report. Each report will be reviewed by the Internal Audit Manager and will include a statement on the level of assurance that can be provided, as well as an action plan setting out any recommendations. The overall assurance will be provided in line with the definitions set out below.

Level of Assurance	Definition
Substantial assurance	Largely satisfactory risk, control, and governance systems are in place. There may be some scope for improvement as current arrangements may undermine the achievement of objectives or leave them vulnerable to error or abuse.
Limited assurance	Risk, control, and governance systems have some satisfactory aspects. There are, however, some significant weaknesses likely to undermine the achievement of objectives and leave them vulnerable to an unacceptable risk of error or abuse.
No assurance	The systems for risk, control, and governance are ineffectively designed and operated. Objectives are not being achieved and the risk of serious error or abuse is unacceptable. Significant improvements are required.

7.8 The report and completed Action Plan will form the final record of each audit.

7.9 Reports will be provided to the Audit Committee at its March and November / December meetings detailing progress in completing each Annual Internal Audit Plan and highlighting any key matters arising. These progress reports will also provide information on

any ad hoc / consultancy work undertaken by Internal Audit as well as any significant instances of theft, fraud, or irregularity considered by Internal Audit.

7.10 The Progress Reports to Audit Committee in March and November / December will also provide information in relation to Internal Audit Recommendations that remain outstanding.

7.11 Internal Audit maintain a spreadsheet logging all recommendations made along with management responses provided. This spreadsheet is periodically circulated to Service Directors / Chief Officers with a request that they provide an update on those recommendations falling within their area of responsibility. Any recommendations that have been fully implemented are removed from the spreadsheet with updates added where corrective action has commenced but not yet been completed.

7.12 The reporting to Audit Committee of recommendations that remain outstanding will focus on:

- recommendations where the agreed Action Date has lapsed; **and**
- where no revised (and reasonable) Action date has been agreed with Managers; **and**
- where there is a clear and material link to one of the Council's seven agreed risk categories.

7.13 This approach allows any particular areas of risk / concern to be highlighted, and positive assurance to be provided where appropriate.

8. Responsibility – Consultancy Work and Fraud / Corruption

8.1 Internal Audit will include an allocation of 'days' in the annual Internal Audit Plan for Consultancy Work and Fraud / Corruption.

8.2 Consultancy work includes commenting on draft procedural guidance and responding to management requests for advice on risk and control issues. Approval will be sought from

the Audit Committee if there is to be a significant variation in consultancy work above the allocation within the Internal Audit Plan.

8.3 As per Section 24.6 of Financial Regulations, Chief Officers are responsible for identifying and managing the risk of fraud. Chief Officers are, however, required to notify the Chief Finance Officer of all financial irregularities or of any circumstances that may suggest the possibility of irregularities. The Chief Finance Officer will form an opinion on the process to be followed on notification of an irregularity, and this may involve requesting that Internal Audit assist with, or take a lead on, any investigation. Ultimately, this decision will be taken with due regard to the Council's Anti Fraud and Corruption Strategy.

9. Quality Assurance

9.1 Internal Audit is subject to a Quality Assurance and Improvement Programme that covers all aspects of the Section's activity (and its compliance with PSIAS). This consists of an annual self assessment, ongoing performance monitoring, and a periodic external assessment.

9.2 The Internal Audit Manager is responsible for undertaking an annual self assessment and for reporting the results of this self assessment to the Audit Committee (within the Internal Audit Annual Assurance Report).

9.3 External assessments will be conducted at least once every five years by a suitably qualified, independent, assessor. The Internal Audit Manager will discuss and agree options for these assessments with the Chief Finance Officer and Convener of the Audit Committee.

COMPLIANCE WITH PUBLIC SECTOR INTERNAL AUDIT STANDARDS - REQUIREMENT FOR EXTERNAL QUALITY ASSESSMENT

Background and Context

1. The mandatory Public Sector Internal Audit Standards (PSIAS) require that the Chief Audit Executive develops a Quality Assurance and Improvement Plan (QAIP). The QAIP is designed to enable evaluation of Internal Audit's conformance with the Definition of Internal Auditing and the Standards, along with an evaluation of whether Internal Auditors apply the Code of Ethics. The QAIP must include both internal and external assessments. This document outlines options for Local Authorities in Scotland to comply with the requirement for the External Quality Assessment (EQA).

2. Standard 1312 of the PSIAS requires that an *'external assessment must be carried out at least once every 5 years by a qualified independent assessor or assessment team from **outside** the organisation'*.

3. The Scottish Local Authorities Chief Internal Auditors' Group (SLACIAG) has considered compliance with this aspect of the PSIAS in one of two ways:

- the individual procurement of an external team to undertake the review; or
- the development of a framework for external assessments to be undertaken by member authorities of SLACIAG on a broadly reciprocal arrangement utilising a peer review pool.

Option 1

4. Each individual Authority would undertake procurement activity at the appropriate time within their own organisation to secure an external organisation to undertake the EQA. The Institute of Internal Auditors conduct EQAs and their fees for the basic service, a validated self assessment, range from £6k to £9k. In addition, there would be the time of appropriate Officers to take part in the assessment.

Option 2

5. The second option would be for SLACIAG to develop a framework for undertaking the EQA of member Authorities with costs being contained within individual member Authorities' own budgets. The remainder of this document outlines the proposal for this peer review option.

SLACIAG Proposal

6. The Committee of SLACIAG, with support from its members, would undertake to oversee the development of a framework which would satisfy the requirements of the PSIAS. The PSIAS states that external assessments can be in the form of a full external assessment, a facilitated self assessment, or a self assessment with independent validation. SLACIAG's proposal would take the form of a validated self-assessment for each of the Authorities and would be undertaken within the required timetable for compliance (ie within the first 5 years of the PSIAS being in place, but subject to the principle that each authority has an EQA to provide assurance to current Council members). The validated self assessment will include reviewing the self assessment checklist completed by the Chief Audit Executive, examining relevant evidence, and interviewing key stakeholders, including the Convener of the Audit Committee or equivalent.

7. Following the development of the framework, the Committee will oversee its implementation and will also provide a level of scrutiny and quality assurance to ensure the adequacy of the process and to arbitrate over any disputed outcomes as required.

8. Each Authority which signs up to the scheme will be allocated another authority to assess as an EQ Assessor. Such allocations will take cognisance of the existing closeness of relationships which already exist between Authorities, and also of geographical and logistical issues which may be relevant. The arrangements which will be developed will ensure that there is sufficient transparent independence in place to ensure that the assessment is truly an external assessment of conformance.

9. Each Authority may appoint either the Chief Audit Executive, or a team which would be headed by the Chief Audit Executive, to undertake the assessment of the body to whom it has been appointed. All members of any EQA team will be employed directly by the Authority in question. A qualified assessor, or assessment team, would need to demonstrate competence in two areas: the professional practice of Internal Auditing; and the external assessment process, and it is for the Chief Audit Executive of the body being assessed to determine whether the assessor or team is sufficiently competent. Where a team is undertaking the inspection, these competencies must be held by the team collectively and not necessarily by all individuals within the team.

10. Whilst the requirement for EQA is for at least every 5 years, SLACIAG would propose that an EQA be undertaken in line with each electoral cycle to ensure that each administration receives at least one EQA report. This will mean that an EQA would be undertaken at an appropriate time within each electoral cycle.

Benefits

11. The implementation of the proposed framework would minimise the costs to each constituent Authority, as there would be no direct fee paid for the EQA. Each Authority would absorb the time for the EQA, anticipated to be in the region of 5 – 7 days, within their Internal Audit Planning process. Any travel / accommodation costs would be kept to a minimum and charged to the Authority being assessed.

12. There is scope for developing Internal Auditors within teams undertaking the EQA in terms of their CPD requirements, and of gaining an increased level of understanding of Internal Audit within the Local Government sector outwith their own organisation.

Next Steps

13. The PSIAS requires the Chief Audit Executive to discuss with the Board (ie, the Audit Committee):

- the form of external assessments;

APPENDIX 2

- the qualifications and independence of the external assessor or assessment team, including any potential conflict of interest; and
- the need, if any, for more frequent external assessments.

14. SLACIAG requests that the Chief Audit Executive discuss this proposal with line management and also with their Audit Committee. A response will be required from each Chief Audit Executive as to whether their Authority would be involved in such a scheme were it to be established. In the event that this proposal has sufficient backing (a minimum of 20 authorities), a detailed framework will be developed for use across the Group.

15. To allow for the development of a scheme, a decision on whether each Authority wishes to participate will be required by 31 March 2014.