



EASTERN SHIRES
PURCHASING
ORGANISATION

A LOCAL AUTHORITY PURCHASING AND DISTRIBUTION CONSORTIUM

CONSORTIUM SECRETARY: JOHN SINNOTT, MA, Dipl. P.A.,
CHIEF EXECUTIVE, LEICESTERSHIRE COUNTY COUNCIL

Date: 13 February 2015
My Ref: BH/ESPO
Please ask for: Ben Holihead
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To: Members of the ESPO Finance and Audit Subcommittee

Dear Member,

ESPO FINANCE AND AUDIT SUBCOMMITTEE

A meeting of the Finance and Audit Subcommittee will be held at on Monday, 23 February 2015 at 10.30 am in the Goscote Committee Room, County Hall, Glenfield.

A buffet lunch will be provided after the meeting. Please telephone or email me (details above) to confirm that you require lunch and, if so, whether you have any special dietary requirements.

Yours faithfully,

Ben Holihead
for Consortium Secretary

AGENDA

<u>Item</u>		<u>Pages</u>
1.	Minutes of the meeting held on 17 November 2014.	(Pages 3 - 6)
2.	To advise of any other items which the Chairman has decided to take as urgent elsewhere on the agenda.	
3.	Declarations of interest in respect of items on the agenda.	
4.	Management Accounts to December 2014.	(Pages 7 - 14)

Democratic Services ◦ Chief Executive's Department ◦ Leicestershire County Council ◦ County Hall
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5. Progress against the Internal Audit Plan. (Pages 15 - 26)
6. Internal Audit Charter. (Pages 27 - 82)
7. Governance Over Managing the Risk of Fraud. (Pages 83 - 94)
8. Date of next meeting.

The next meeting will take place on the 9 June 2015 at 10.30am at County Hall, Glenfield.

9. Any other items which the Chairman has decided to take as urgent.

The public are likely to be excluded from the meeting during the consideration of the following items of business in accordance with the provisions of Section 100 (A) (4) of the Local Government Act 1972.

10. Forecast Outturn 2014/15 and draft MTFs 2015/16 - 2018/19. (Pages 95 - 114)

(Exempt under paragraphs 3 and 10 of Schedule 12(A))

11. Internal Audit Highlight Report - GEMS Replacement. (Pages 115 - 126)

(Exempt under paragraphs 3 and 10 of Schedule 12(A))

Members are asked to consider and note this exempt report.

Minutes of a meeting of the ESPO Finance and Audit Subcommittee held at County Hall, Glenfield, Leicestershire on Monday, 17 November 2014.

PRESENT

Mr. J. Clarke CC (in the Chair)

Mr. G. A. Hart CC

Ms. S. Rawlins CC

60. APOLOGIES.

Apologies were received from Dr Feltham CC (Leicestershire) and Mr Reynolds CC (Cambridgeshire). Mr Hart CC substituted for Dr Feltham CC.

61. MINUTES.

The minutes of the meeting held on 9 September 2014 were taken as read, confirmed and signed.

62. DECLARATIONS OF INTEREST.

The Chairman invited members who wished to do so to declare any interest in respect of items on the agenda for the meeting.

No declarations were made.

63. URGENT ITEMS.

There were no urgent items for consideration.

64. MTFS MONITORING FOR THE FIRST SIX MONTHS OF 2014-15

The Director presented a report outlining the financial performance against the MTFS for the first six months of the financial year. A copy of the report, marked 'Agenda Item 4', is filed with these minutes.

Arising from discussion the following points were noted:-

- (i). That at the time of writing the Growth Net worth of business was £2.2m, but this was now £2.0m due to a higher than forecast usage of agency staff. The RAG rating for this had been changed to red since the time of writing of the report. As a consequence of this it was advised that the return to Members had been reduced to £1.2m from £1.4m (as stated in the report);
- (ii). The end of the phonics scheme had resulted in a decrease in the Direct Sales but this had been offset by an increase in income from the implementation of that school meals for primary pupils;
- (iii). Catalogue advertising spend was lower than had been originally budgeted for;

- (iv). Whilst schools had not experienced the level of cuts as other local authority services it was anticipated that following the general election there would be a higher level of cuts to school budgets than hitherto. ESPO had a strong foothold in the schools market with 9000 schools as customers, of these 1275 were academies and 80% were primary schools. Work was in hand to develop this market further;
- (v). The delay in implementing new warehouse processes was taking longer than had been anticipated. Following implementation of the changes the pace of orders going through the warehouse would increase;
- (vi). With regard to the use of reserves to pay off debt, the conclusion of the Consortium Treasurer was that this was not desirable due to the penalties of early repayment and because the reserves would not be available for the purposes that they were set aside for, such as fleet and IT renewal.

RESOLVED:

That the contents of the report be noted.

65. PROGRESS AGAINST THE 2014-15 INTERNAL AUDIT PLAN

The Consortium Treasurer presented a report outlining progress made against the 2014-15 Internal Audit Plan, and to highlight any audits where high importance recommendations had been made. A copy of the report, marked 'Agenda Item 5', is filed with these minutes.

Arising from discussion the following points were noted:-

- (i). An outside project manager had been brought in for the GEMS replacement, with the biggest issue being in regards to data transfer from the Laser system. This change was being done slowly in order to identify any errors in data transfer and ensure the transfers were done effectively. As a result of this the GEMS replacement had been delayed until December;
- (ii). An Internal Audit Charter was due to be considered by Leicestershire County Council's Corporate Governance Committee at its meeting on 24 November 2014, and ESPO would be asked to adopt a similar charter. In addition a Quality Assurance and Improvement Programme (QAIP) was being developed and was scheduled to be approved by the County Council's Chief Financial Officer in December. The adapted Internal Audit Charter and progress on the QAIP would be reported to the Subcommittee in February 2015.

RESOLVED:

That the contents of the report be noted.

66. PROCUREMENT AND RISK MANAGEMENT UPDATE

The Director presented a report on the risk position of procurement activities at ESPO. A copy of the report, marked 'Agenda Item 6', is filed with these minutes.

Arising from discussion the following points were noted:-

- (i). The Chief Officer Group had considered the current approach to levels of risk undertaken and were satisfied with the approach and advised that there was no desire on their part to take on any more risk;
- (ii). As with risk generally, the Chief Officer Group would not recommend a change to energy trading practises. It was noted that although more energy trading could produce greater returns, it would expose ESPO to greater risk due to the volatility of the market;
- (iii). Procurement activities which were not compliant could be at greater risk of legal challenge and mechanisms had been put in place to ensure robust procurement governance arrangements, as a result of which ESPO had not been exposed to any legal risks during the last two years;
- (iv). That although 5% of the 200 framework agreements provide 43% of ESPOs £5m rebate, in the spirit of the ESPO ethos as a public sector provider it was necessary to provide some services that were not commercially viable but the service outcome/value was considered high especially to Consortium partners. An example of a necessary framework agreement was the provision of banking services following supplier changes;
- (v). With regard to the impact of a withdrawal by the UK from membership of the EU, officers advised that this would be unlikely to alter the approach to procurement significantly as the current rules were seen as good practice which ensured transparency in the process.

RESOLVED:

That the contents of the report be noted.

67. DATES OF FUTURE MEETINGS.

RESOLVED:

The Subcommittee noted the 2015 meeting dates.

68. ANY OTHER ITEMS.

There were no other items for consideration.

69. EXCLUSION OF THE PUBLIC.

RESOLVED:

That under Section 100(A)(iv) of the Local Government Act 1972 the public be excluded from the meeting on the grounds that it will involve the likely disclosure of exempt information during consideration of the following item of business entitled 'Strategic Discussion Document to Inform MTFs Assumptions for 2015-19' as defined in paragraphs 3 and 10 of Schedule 12A of the Act; and, in all circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information.'

70. STRATEGIC DISCUSSION DOCUMENT TO INFORM MTFS ASSUMPTIONS FOR 2015-19.

The Subcommittee received an exempt report of the Director and Consortium Treasurer setting out the assumptions being considered for the MTFS covering the period 2015-19. A copy of the exempt report, marked 'Agenda Item 9', is filed with these minutes.

RESOLVED:

That the report and the proposal therein for the refresh of the MTFS be approved for submission to the Management Committee.

(THE MEETING THEN RECONVENED INTO PUBLIC SESSION.)

10.32 am - 12.02 pm
17 November 2014

CHAIRMAN



ESPO FINANCE AND AUDIT SUB COMMITTEE – 23 February 2015

AGENDA ITEM NO.4

MTFS MONITORING FOR THE FIRST 9 MONTHS OF 2014-15

**REPORT OF THE DIRECTOR AND
CONSORTIUM TREASURER**

Purpose of Report

1. This report sets out the results for the first nine months of trading April to December 2014 as per the management accounts with explanations for the more significant variances to budget.

Background

2. The Finance and Audit Subcommittee are updated quarterly on the financial performance of ESPO compared to budget and the targets set out in the four year Medium Term Financial Strategy.

Financial Performance for the first 9 Months of 2014-15 compared to the MTFS.

Sales

	ACTUAL	BUDGET	PRIOR YEAR
	£000	£000	£000
<u>SALES</u>			
STORES	33,394.0	34,029.0	32,428.0
DIRECT	15,289.8	15,105.9	16,931.9
GAS	13,311.0	19,082.3	16,240.2
CATALOGUE ADVERTISING	740.3	879.4	870.3
REBATE INCOME	3,127.2	2,123.9	2,774.4
MISCELLANEOUS INCOME	85.2	138.5	158.9
<u>TOTAL SALES</u>	65,947.5	71,359.0	69,403.8

3. Total sales at £65.9m are behind budget of £71.4m principally down to lower gas sales which are showing an adverse variance of £5.8m. This is weather dependant and not a reflection of lost business.
4. Store sales are £635k behind budget but £966k ahead of last year.
5. Direct sales have held up strongly considering that the Phonics DofE initiative came to an end last October. They have largely been replaced by

the current school meals initiative.

6. Rebates are £1,004k ahead of budget and £353k ahead the prior year. Some rebates have been collected quarterly this year rather than at the end of the financial year in March. Current forecasts indicate that the year-end rebate number will be at least in line with the prior year at £5m
7. Catalogue advertising remains behind budget but discussions suggest that some catalogue advertising has been booked as rebate income from suppliers and this explains the bulk of the variance.

Margin

	ACTUAL	BUDGET	PRIOR YEAR
	£000	£000	£000
<u>Margin</u>			
STORES	8,421.6	8,260.8	7,921.2
DIRECT	1,808.8	1,632.9	1,571.6
GAS	155.6	223.0	339.3
CATALOGUE ADVERTISING	740.3	879.4	870.3
REBATE INCOME	3,127.2	2,123.9	2,774.4
MISCELLANEOUS INCOME	85.2	138.5	158.9
<u>TOTAL MARGIN</u>	<u>14,339.5</u>	<u>13,258.6</u>	<u>13,635.7</u>

8. Overall margin is £1,081k ahead of budget due to higher rebates and improved stores margin.
9. Stores mark-up is 33.7% compared to a budget of 32.4%. Overall the mix has been more favourable towards higher margin items than expected in the budget. Last year the comparable figure was 34.1% and we expected a fall as a result of the sub inflation pricing strategy.
10. The impact of the shortfall in gas sales of over £5.8m is the reduced margin of £67k.

Expenditure

	ACTUAL	BUDGET	PRIOR YEAR
	£000	£000	£000
<u>EXPENDITURE</u>			
EMPLOYEES			
Staff	7,333.0	7,141.8	6,889.0
Agency/Contract	1,122.6	701.9	803.9
Total	<u>8,455.7</u>	<u>7,843.7</u>	<u>7,693.0</u>
OVERHEAD EXPENSES			
Stores	3,088.6	2,978.9	2,949.2
CP	1,765.5	1,629.6	1,600.3
Total	<u>4,854.1</u>	<u>4,608.5</u>	<u>4,549.5</u>
TOTAL EXPENDITURE	<u>13,309.8</u>	<u>12,452.2</u>	<u>12,242.5</u>

11. Total expenditure is £857k ahead of budget principally driven by higher agency costs and staff costs. This is a result of the significant pressures experienced whilst servicing peak demand.

12. Staff costs have risen beyond budget levels as a result of vacancy levels throughout the organisation not being as high as budgeted.

FTE numbers as at December 2014 are as follows

	<u>YEAR TO DATE</u>		
	ACTUAL	BUDGET	PRIOR YEAR
	£000	£000	£000
EMPLOYEES NUMBERS (Full-time equivalents):			
Stores	169	181	161
Purchasing	92	105	95
Indirects	84	80	81
TOTAL EMPLOYEES	<u>346</u>	<u>366</u>	<u>338</u>

13. Warehouse agency costs are £405k over budget reflecting the challenges incurred during the peak period and the length of time taken recover from being behind on deliveries over that period.

14. In addition to this our 3rd party distribution costs are £190k over budget. This is also a cost associated with being behind as customers chase urgent delivery.

15. At the time of the budget for 2014-15 an overlay of £200k was applied to CP overhead expenses as an efficiency challenge. Though partly delivered in the period to December 2014 further efficiencies are required.

Surplus

	ACTUAL	BUDGET	PRIOR YEAR
	£000	£000	£000
TRADING SURPLUS	<u>1,029.8</u>	<u>806.4</u>	<u>1,393.2</u>

16. Trading surplus is £223k ahead of budget but £364k behind last year.
17. At the November 2014 Finance and Audit Sub Committee members were given guidance that the year-end surplus will fall in the range of £2.0-2.2m compared to a budget of £2.2m. This guidance still stands.

Service Line

18. The detailed service line analysis is included in Appendix 1 showing performance compared to budget for the Stores, Directs, Energy, Frameworks and Consultancy. All areas are making a net contribution apart from consultancy which is showing a small loss.

Balance Sheet and Cash Flow

19. A detailed balance sheet and cash flow is included in appendix 2.
20. Overall stock levels are £257k higher than at last year end reflecting stocking up in advance of the January mini peak.
21. Debtors are £3.0m lower than year-end but this is seasonal though debtor days at 26.17 were ahead of the prior year of 32.57. The cash collection teams are planning to achieve debtor days of below the March 2014 level of 36.69.
22. Creditors are lower as a result of paying winter gas charges to Total for our customers.
23. In December 2014 the dividend of £1.5m was paid to Members.

Resources Implications

24. None

Recommendation

25. The Subcommittee is asked to consider and comment on the contents of the report and the attached appendix's.

Equal Opportunities Implications

26. None

Risk Assessment

27. None identified

Officers to Contact

Mr J Doherty – Director (Tel: 0116 265 7931)

Mr C Tambini – Treasurer to the Consortium (Tel: 0116 305 7831)

Appendices

Appendix 1 Service Line Analysis

Appendix 2 Balance Sheet and Cash Flow

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ACTUAL	STORES	DIRECTS	ENERGY	FRAMEWORK	CONSULTING	MAJOR	TOTAL
	£000	£000	£000	£000	£000	£000	£000
			& FUELS	CONTRACTS		PROJECTS	
STORES	33,394	0	0	0	0	0	33,394
DIRECT	0	15,290	0	0	0	0	15,290
GAS	0	0	13,311	0	0	0	13,311
CATALOGUE ADVERTISING	370	222	0	148	0	0	740
REBATE INCOME	-133	0	493	2,577	190	0	3,127
MISCELLANEOUS INCOME	0	0	1	64	21	0	86
Total Sales	33,631	15,512	13,805	2,789	211	0	65,948
Less Cost of Sales	24,972	13,481	13,161	0	0	0	51,614
Surplus on Trading Account	8,659	2,031	644	2,789	211	0	14,334
Wages and Salaries	2,830	452	242	905	151	0	4,579
Agency Costs	1,012	2	0	4	1	0	1,018
Other Expenses	1,392	70	14	141	23	0	1,641
Transport	1,696	0	0	0	0	0	1,696
Operating Surplus	1,729	1,507	388	1,740	36	0	5,401
%	5.1%	9.7%	2.8%	62.4%	17.2%		8.2%
Contribution to Central Costs							
Finance and IT	413	413	80	413	13	0	1,333
Marketing	696	696	135	696	22	0	2,245
Directorate	248	248	48	248	8	0	798
Net Surplus	372	150	126	384	-7	0	1,024
	1.1%	1.0%	0.9%	13.8%	-3.5%		1.6%
Check Balance							-5

BUDGET	STORES	DIRECTS	ENERGY	FRAMEWORK	CONSULTING	MAJOR	TOTAL
	£000	£000	£000	£000	£000	£000	£000
			& FUELS	CONTRACTS		PROJECTS	
STORES	34,029	0	0	0	0	0	34,029
DIRECT	0	15,106	0	0	0	0	15,106
GAS	0	0	19,082	0	0	0	19,082
CATALOGUE ADVERTISING	440	264	0	176	0	0	879
REBATE INCOME	0	0	538	1,452	134	0	2,124
MISCELLANEOUS INCOME	0	0	0	105	34	0	139
Total Sales	34,469	15,370	19,621	1,732	168	0	71,359
Less Cost of Sales	25,768	13,473	18,859	0	0	0	58,100
Surplus on Trading Account	8,701	1,897	762	1,732	168	0	13,259
Wages and Salaries	2,907	501	278	1,002	167	0	4,855
Agency Costs	606	0	0	0	0	0	606
Other Expenses	1,355	59	22	117	20	0	1,573
Transport	1,623	0	0	0	0	0	1,623
Operating Surplus	2,209	1,337	461	613	-19	0	4,601
%	6.4%	8.7%	2.4%	35.4%	-11.2%		6.4%
Contribution to Central Costs							
Finance and IT	392	392	76	392	13	0	1,265
Marketing	722	722	140	722	23	0	2,331
Directorate	62	62	12	62	2	0	200
Net Surplus	1,033	161	234	-564	-57	0	806
	3.0%	1.0%	1.2%	-32.5%	-33.9%		1.1%
Check Balance							0

ACTUAL V BUDGET VARIANCE	STORES	DIRECTS	ENERGY	FRAMEWORK	CONSULTING	MAJOR	TOTAL
	£000	£000	£000	£000	£000	£000	£000
			& FUELS	CONTRACTS		PROJECTS	
STORES	-635	0	0	0	0	0	-635
DIRECT	0	184	0	0	0	0	184
GAS	0	0	-5,771	0	0	0	-5,771
CATALOGUE ADVERTISING	-70	-42	0	-28	0	0	-139
REBATE INCOME	-133	0	-46	1,126	57	0	1,003
MISCELLANEOUS INCOME	0	0	1	-41	-13	0	-52
Total Sales	-838	142	-5,816	1,057	43	0	-5,411
Less Cost of Sales	-796	8	-5,699	0	0	0	-6,486
Surplus on Trading Account	-42	134	-117	1,057	43	0	1,076
Wages and Salaries	77	49	36	98	16	0	276
Agency Costs	-406	-2	0	-4	-1	0	-412
Other Expenses	-37	-12	8	-23	-4	0	-68
Transport	-73	0	0	0	0	0	-73
Operating Surplus	-480	170	-73	1,128	55	0	799
%							
Contribution to Central Costs							
Finance and IT	-21	-21	-4	-21	-1	0	-68
Marketing	27	27	5	27	1	0	86
Directorate	-186	-186	-36	-186	-6	0	-599
Net Surplus	-661	-11	-108	948	49	0	218

EASTERN SHIRES PURCHASING ORGANISATION

Appendix 2

CONSOLIDATED MANAGEMENT BALANCE SHEET AS AT **Dec-14**

Cash Flow from 01/4/2014 to **Dec-14**

31st March 2014

£	£	£	£
	11,164,612		10,774,594
<u>FIXED ASSETS :</u>			
	Net tangible Fixed Assets		10,774,594
<u>CURRENT ASSETS :</u>			
5,166,626		5,423,981	
9,609,086		6,606,327	
639		2,157	
8,056,000		2,491,000	
	22,832,351		14,523,465
<u>CURRENT LIABILITIES :</u>			
646,842		500,000	
12,690,660		8,502,203	
231,381		845,338	
-440,633	13,128,250	-4,699,577	5,147,964
	<u>9,704,101</u>		<u>9,375,501</u>
<u>NET CURRENT ASSETS</u>			
<u>LONG TERM LIABILITIES</u>			
	8,500,000		8,000,000
	<u>12,368,713</u>		<u>12,150,095</u>
<u>NET ASSETS</u>			
<u>REPRESENTED BY:</u>			
10,303,588	Usable Reserves		10,028,054
2,065,125	Unusable Reserves		2,122,042
	<u>12,368,713</u>		<u>12,150,096</u>
1.35	Acid Ratio		1.77
36.7	Debtor Days		26.2
58.7	Stock Days		58.6
50.6	Creditor Days		50.1

Surplus	<u>810,721</u>
<u>AFINIMOFs</u>	
Allocations to Maintenance and Equipment Reserves	420,003
Movement in Fixed Assets	390,018
Movement in Unusable/Earmarked Reserves	56,916
Total	<u>1,677,658</u>
Movement in Long Term Borrowings	(500,000)
Payment of Dividend	(1,506,258)
Movement in Long Term Items	<u>(2,006,258)</u>
(Increase)/Decrease in Stock	(257,355)
(Increase)/Decrease in Debtors	3,002,759
Increase/(Decrease) in Creditors	(3,721,342)
Movement in Working Capital	<u>(975,938)</u>
Total	<u>(1,304,538)</u>
Movement in Cash Balances	<u>(1,304,538)</u>
	0



ESPO FINANCE AND AUDIT SUBCOMMITTEE – 23 FEBRUARY 2015

AGENDA ITEM NO.5

INTERNAL AUDIT SERVICE - PROGRESS AGAINST THE 2014-15 INTERNAL AUDIT PLAN

REPORT OF THE CONSORTIUM TREASURER

Purpose of the Report

1. To provide a summary of Leicestershire County Council's Internal Audit Service (LCCIAS) work to the Subcommittee and highlight any audits where high importance (HI) recommendations have been made and the position against implementing actions required.

Background

2. The Consortium Treasurer (the Treasurer) is responsible for the proper administration of ESPO's financial affairs. In accordance with ESPO's Financial Regulations Rule 15, specific responsibility for arranging a continuous internal audit is delegated to the Treasurer. Under its terms of reference the Finance and Audit Subcommittee (the Subcommittee) should receive and review audit and governance reports. The Subcommittee also monitors the adequacy and effectiveness of the internal audit service provided to ESPO. To achieve this, the Subcommittee is provided with periodic progress reports.
3. The audits undertaken are based on the annual internal audit plan. Variations to the plan can occur but need to be considered with and agreed by the Treasurer and the Director of ESPO.

Summary of Progress

4. Audits completed to final report stage between 1 November 2014 and 10 February 2015, are shown in **Appendix 1**. The 'opinion' is what level of assurance can be given that material risks are being managed.
5. There are four classifications of assurance: full; substantial; partial; and little. A report that has a high importance (HI) recommendation would not normally get a classification above partial. Exceptions would be where the controls are sound but there is a high importance efficiency recommendation.

6. An audit of the project management arrangements for the replacement for the GEMS energy system reported that at the end of November 2014 there were two high importance (HI) recommendations due to delays in migrating data and arranging user testing. These were known to, and accepted by the Project Board. Since the audit report was issued, the auditor has received verbal assurances on both progress made and updated plans for implementation. Nevertheless, the Director supports that these will need to be independently substantiated by the auditor in the very near future.
7. **Appendix 2** summarises for audits in progress as at 10 February 2015 the scope and current position, including in sequential order the planned completion (to final report) date. Whilst there remain a considerable number of audits in train at different stages of workflow, almost all are on schedule to be completed by the end of the financial year. Discussions will be held with the Director of ESPO to balance any impact on operations in the last quarter, with the need to provide assurance.
8. Members are advised that in relation to the GEMS energy system the audit rating is a partial assurance. Previously members requested that where this was the case, a detailed report should be submitted for consideration. That report, which contains exempt information, is set out elsewhere on the agenda.

Recommendation

9. That the contents of the report be noted.

Equal Opportunities Implications

10. There are no discernible equal opportunities implications resulting from the audits listed.

Background Papers

Report to ESPO Management Committee on 27 September 2012 – Finance and Audit Subcommittee – Proposed terms of reference and indicative work plan

Report to ESPO Finance and Audit Subcommittee 10 June 2014 – Annual Internal Audit Plan

Officer to Contact

Neil Jones, Head of Internal Audit Service

Tel: 0116 305 7629

Email: neil.jones@leics.gov.uk

Appendices

Appendix 1 – Summary of Internal Audit Service reports issued between 1 November 2014 and 10 February 2015

Appendix 2 – Audits in progress at 10 February 2015 and planned for the remainder of 2014-15

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Summary of Internal Audit Service reports issued 1st November 2014 to 10th February 2015

Appendix 1

<u>Sub-Function</u>	<u>Name</u>	<u>Final Issued</u>	<u>Audit Opinion</u>	<u>HI Rec'n</u>
Procurement & Compliance	GEMS Replacement	04-Dec-14	Partial Assurance (see detailed Internal Audit Highlight report on exempt part of the agenda).	Yes
Sales & Marketing	ESPO Services	10-Feb-15	Substantial Assurance	No

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Audits in progress at 10th February 2015 and planned for the remainder of 2014-15

Note: ToE (Terms of Engagement)

<u>Audit title</u>	<u>Scope</u>	<u>Stage @ 10/2/15</u>	<u>Finalise by</u>
Distribution of Surplus	There's a robust approved methodology which ensures an accurate calculation and distribution of surplus.	Draft report issued – substantial assurance	End of February
Supply Chain	ESPO identifies, evaluates and monitors its supply chains to ensure integrity and sustainability	Testing almost complete. one team left to audit	Issue draft by end of February
Fleet Management	The outcomes from the logistics review are embedded so that fleet is managed effectively and efficiently	Draft pending. Meeting client to discuss findings w/e 13/2	End of February
Risk management	The revised policy and framework is operating as intended. Lines of defence are understood and complied with.	Testing concluded. Report being drafted	End of February
General ledger reconciliation (*)	Reconciliations are undertaken to facilitate the accuracy and completeness of the general ledger. Usual coverage of cash & treasury; receivables; payables; payroll and stock	Testing complete. draft report pending	End of February

<u>Audit title</u>	<u>Scope</u>	<u>Stage @ 10/2/15</u>	<u>Finalise by</u>
Anti-Fraud & Corruption	Evaluate progress against adopting Leicestershire County Council's (the Servicing Authority) revised policies, procedures and training.	<p>Finance and Audit Subcommittee is being asked on 23rd February to adopt the CIPFA Code of Practice on Managing the Risk of Fraud and Corruption (2014).</p> <p>The Council's revised employee's Code of Conduct including cross references to policies on gifts and hospitality and whistleblowing, were presented on 11th February to ESPO Management Team.</p> <p>Revised Council policies and strategies for Anti-Fraud & Corruption, Anti-Bribery and Money Laundering are to be approved by its Corporate Governance Committee on 20th February and will be adopted by ESPO thereafter.</p>	<p>Confirm the code and respective policies have been shared with employees (end of March)</p> <p>Confirm adoption and roll out (end of March)</p>
Business Strategy	Attainment of the objectives of the Strategy is well governed	Meeting scheduled 12/2 with Director of ESPO to further discuss audit suggestions on governance	End of March

Audit title	Scope	Stage @ 10/2/15	Finalise by
Electronic Transactions	Adequate arrangements are in place with the host supplier 'Interactive Transaction Solutions' (ITS) for the processing of transactions made to ESPO through the Purchasing Card process. P-card and other electronic transaction methods are PCI compliant	Draft imminent Following a complaint, an audit of the staff purchase scheme was undertaken and a draft report issued. Further work audit work required to confirm PCI compliance.	End of February End of March
IT General Controls (*)	The range of controls expected by the External Auditor are well designed and consistently applied.	Work completed other than awaiting the results of penetration testing in order to finalise draft report	End of March
Rebates Income	Annual audit to evaluate whether rebates received conform to estimates of supplier business generated	Testing almost concluded.	End of March
E-tendering	ESPO complies with its role in e-tendering arrangements	ToE agreed and testing underway	End of March
Procurement & Compliance Risk Management	The framework is sufficiently robust to prove effectiveness and avoid liability	Scope being determined but will reflect that some testing of the framework occurred in the ESPO Services audit.	End of March

Audit title	Scope	Stage @ 10/2/15	Finalise by
Annual governance statement	There are adequate arrangements to demonstrate compliance to the principles of good governance outlined in the CIPFA/SOLACE Framework.	Planned to start Phase one (approach, plans etc) in March and potentially some employee interviews	End of March
Trading performance & distribution of surplus (*)	The trading results provided by ESPO, both for internal use and reported to the Management Committee, are well founded in the general ledger and the distribution of surpluses process is robust.	Planned to start w/c 9/2	End of March
Servicing Authority	The servicing authority is providing service in line with the agreement	ToE currently being produced	End of March
Counter Fraud	There is no pattern of fraud in large data sets - use of LCCIAS data analysis and matching tool Volunteered submission of data sets to the biennial Audit Commission National Fraud Initiative (NFI)	Still hopeful of undertaking some data analysis outside of NFI Relevant NFI reports have been received and will be passed on to ESPO for investigation where required	End of March Will continue into 2015-16
Business Strategy - Projects -	Control design (of specific project(s)) is adequate to mitigate risk	This was going to be 'part 2' of the audit above and is postponed until there is a control framework to measure against	Likely postpone into 2015-16
Governance framework	The requirements of the Consortium Agreement, Constitution and appropriate schedules are embedded - to include role of Servicing Authority	Not yet planned	

Audit title	Scope	Stage @ 10/2/15	Finalise by
Information management	Information is secure both on and off site and in transit and breaches are identified and investigated	Not yet planned	
Applications management	Risks (e.g. continuity and resilience) to the successful operation of key business management systems within ESPO have been identified and appropriately mitigated.	Not yet planned	

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ESPO FINANCE AND AUDIT SUBCOMMITTEE – 23 FEBRUARY 2015

AGENDA ITEM NO.8

REPORT OF THE CONSORTIUM TREASURER

THE INTERNAL AUDIT CHARTER FOR ESPO

Purpose of Report

1. The purpose of this report is for the Subcommittee to review and note:-
 - a. the Internal Audit Charter for ESPO and recommend its formal approval by the Management Committee
 - b. progress against a Quality Assurance and Improvement Programme (QAIP).

Background

2. A professional, independent and objective internal audit service is recognised throughout the UK public sector as a key element of good governance. The foundation of an effective internal audit service is compliance with standards and proper practices.
3. The 'Relevant Internal Audit Standard Setters' in the UK (for which CIPFA represents local government), have adopted a common set of Public Sector Internal Audit Standards (PSIAS) from 1 April 2013. The PSIAS encompass the mandatory elements of the Global Institute of Internal Auditors (IIA Global) International Professional Practices Framework (IPPF) as follows: -
 - a. Definition of Internal Auditing
 - b. Code of Ethics
 - c. International Standards for the Professional Practice of Internal Auditing
4. Additional requirements and interpretations for the UK public sector have been inserted into the PSIAS. All principal local authorities (Joint Committees included) must make provision for internal audit in accordance with the PSIAS.
5. The objectives of the PSIAS are to: -
 - a. define the nature of internal auditing within the UK public sector
 - b. set principles for carrying out internal audit in the UK public sector
 - c. establish a framework for providing internal audit services, which add value to the organisation, leading to improved organisational processes and operations

- d. establish the basis for the evaluation of internal audit performance and to drive improvement planning

The Internal Audit Charter for ESPO

6. The PSIAS mandate that the purpose, authority and responsibility of the internal audit activity must be formally defined in an internal audit charter (the Charter). Leicestershire County Council is the appointed Servicing Authority for ESPO, and is responsible for performing the functions set out in Schedule 3 of the Consortium Agreement, including under 'Support Services' the provision of internal audit service. The Charter establishes Leicestershire County Council's Internal Audit Service (LCCIAS) position with ESPO and the associated governance arrangements, including the nature of the HoIAS' functional reporting relationship with the Subcommittee and Management Committee; authorises access to records, personnel and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities.
7. Common terms found throughout the PSIAS need to be interpreted in the context of differing governance arrangements at each organisation. For ESPO, consultations with the Director of ESPO, the Consortium Secretary and the Consortium Treasurer i.e. the three Officers with delegated functions within the Consortium Agreement, interpreted the terms 'Board' as the Finance and Audit Subcommittee (the Subcommittee); 'Senior Management' as the three Officers i.e., collectively known as (the Officers), and the 'Chief Audit Executive' as Leicestershire County Council's Head of Internal Audit Service (HoIAS).
8. Providing a formal, written Charter is important to managing the provision of internal audit activity by LCCIAS. The Charter provides a recognised statement for review and acceptance by the Officers and for the Subcommittee to recommend as documented in formal minutes, final approval by the Management Committee.
9. A Charter also facilitates a periodic assessment by the HoIAS of the adequacy of the internal audit activity's purpose, authority, and responsibility, which establishes the role of LCCIAS and whether it continues to be adequate to enable it to accomplish its objectives. If a question should arise, the Charter provides a formal, written protocol agreed with the Officers and the Subcommittee and Management Committee, about ESPO's internal audit activity.
10. The PSIAS mandate that the Internal Audit Charter for ESPO should:-
 - a. recognise the mandatory nature of the PSIAS
 - b. define the scope of internal audit activities recognising that internal audit's remit extends to the organisation's entire control environment not just financial controls
 - c. establish internal audit's responsibilities, objectives & organisational independence

- d. establish accountability, reporting lines and relationships between the leader of the internal audit activity and those to whom they report functionally and administratively
- e. set out the arrangements that exist within the organisation's anti-fraud and anti-corruption policies
- f. establish internal audit's right of access to all records, assets, personnel and premises and its authority to obtain such information and explanations as it considers necessary to fulfil its responsibilities

Additional public sector requirements also specify that the Charter must:-

- g. define the terms 'board' & 'senior management' in relation to internal audit activity
- h. cover the arrangements for appropriate resourcing
- i. define the role of internal audit in any fraud-related work
- j. include arrangements for avoiding conflicts of interest if non audit activities are undertaken

11. In developing the Charter, the HoIAS has taken full account of the detailed requirements of the PSIAS and also a Local Government Application Note (LGAN) developed by CIPFA, which provides further explanation for the PSIAS and practical guidance on how to apply them. The Charter has 6 distinct sections:-

<u>Section</u>	<u>Content</u>
1	Introduction
2	Purpose (PSIAS definition of the internal audit activity)
3	Definitions (including the Board and Senior Management)
4	Authority (afforded to the internal audit activity)
5	Responsibility (of the Subcommittee, the Officers and the HoIAS)
6	The scope of the internal audit activity (including its roles in fraud and corruption)

12. The HoIAS has interpreted that many of the detailed PSIAS requirements merely reinforce practices and procedures that are already firmly embedded in LCCIAS' approaches to internal audit activity. Those intricate details are not repeated in the Charter but new requirements, extensions and variations are explained.
13. The Internal Audit Charter for ESPO, as reviewed by the Officers is included as Appendix 1. The full PSIAS are included as Appendix 2.
14. The Charter replaces two documents that previously explained the internal audit activity at Leicestershire County Council, 'The Statement of Aims and Objectives' and 'The Strategy of Leicestershire County Council Internal Audit.

Brief update on the development of the Quality Assurance and Improvement Programme

15. A Quality Assurance and Improvement Programme (QAIP) is being developed by the HoIAS. The QAIP is designed to enable an evaluation of LCCIAS' conformance with the PSIAS, assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement. The QAIP is scheduled to be approved by the Council's Chief Financial Officer by the end of February. There is not a requirement for an organisation's Board to formally approve the QAIP, only to receive results of future assessments against it. Nevertheless, progress against the development of the QAIP and its approval will be reported to ESPO's Finance and Audit Subcommittee and its Management Committee.

Resource Implications

16. The determination of resource to undertake internal audit activity is referred to at various points throughout the Charter

Equal Opportunities Implications

17. There are no discernible equal opportunities implications resulting from the audits listed.

Recommendations

18. That the Subcommittee: -
- a. reviews the Charter and notes the report
 - b. recommends to Management Committee final approval of the Charter.

Background Papers

Report to ESPO Finance and Audit Subcommittee 10 June 2014 – Annual Internal Audit Plan

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Appendices

Appendix 1 – The Internal Audit Charter for ESPO

Appendix 2 – The Public Sector Internal Audit Standards (2013)

The Internal Audit Charter for ESPO : Contents

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Introduction

- 1.1. The Eastern Shires Purchasing Organisation (ESPO) is a Joint Committee set up under section 102 of the 1972 Local Government Act. Leicestershire County Council (the Council) is the appointed Servicing Authority, and is responsible for performing the functions set out in Schedule 3 of the ESPO Consortium Agreement, including under 'Support Services' the function of internal audit.
- 1.2. The Public Sector Internal Audit Standards 2013 (the PSIAS), provide a consolidated approach to the function of internal auditing across the whole of the public sector enabling continuity, sound corporate governance and transparency. The PSIAS encompass both the mandatory elements of the Global Institute of Internal Auditors (IIA) standards, and also additional requirements and interpretations for the UK public sector. A Local Government Application Note (LGAN) developed by CIPFA provides further explanation for the PSIAS and practical guidance on how to apply them.
- 1.3. The PSIAS mandate that the purpose, authority and responsibility of the internal audit activity must be formally defined in an internal audit charter (the Charter), that is consistent with the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards*. Responsibility for, and ownership of, the Charter remains with the organisation and final approval of the Charter resides with the Board (the definition is explained in paragraphs 3.12 to 3.14 below).
- 1.4. This Charter replaces two documents that previously explained the internal audit activity at the Council, 'The Statement of Aims and Objectives' and 'The Strategy of Leicestershire County Council Internal Audit'.

2. Purpose

- 2.1. The purpose of the internal audit activity is explained by the PSIAS Definition of Internal Auditing: -

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.

- 2.2. The LGAN further explains that '*the organisation (ESPO's management) is responsible for establishing and maintaining appropriate risk management processes, control systems, accounting records and governance arrangements (known as the control environment). Internal audit plays a vital part in advising the organisation that these arrangements are in place and operating properly. The annual internal audit opinion, which informs the governance statement, both emphasises and reflects the importance of this aspect of internal audit work. The organisation's response to internal audit activity should lead to the strengthening of the control environment and, therefore, contribute to the achievement of the organisation's objectives.*

2.3. Leicestershire County Council Internal Audit Service (LCCIAS) has adopted the PSIAS definition of internal auditing.

3. Definitions

Independence

3.1. The PSIAS define independence as *'the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity requires the head of the activity to have direct and unrestricted access to senior management and the board. This can be achieved through a dual-reporting relationship. Threats to independence must be managed at the individual auditor, engagement, functional and organisational levels'*.

Objectivity

3.2. The PSIAS define objectivity as *'an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others. Threats to objectivity must be managed at the individual auditor, engagement, functional and organisational levels'*.

Assurance activity

3.3. This is defined in the PSIAS as *'An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management and control processes for the organisation. Examples may include financial, performance, compliance, system security and due diligence engagements'*.

3.4. LCCIAS conducts a wide range of engagements (assignments) designed to evaluate the quality of risk management processes, systems of internal control and corporate governance processes, across all aspects of ESPO's control environment (including where it works in partnership with, and leads on behalf of others).

3.5. LCCIAS aims to co-ordinate its assurance activity with any other identified internal and external providers of assurance services to ensure sufficient and proper coverage over the control environment and minimise duplication of efforts.

Consulting activity

- 3.6. This is defined in the PSIAS as *'Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organisation's governance, risk management and control processes without the internal auditor assuming management responsibility'*.
- 3.7. LCCIAS often acts in a consulting role and provides support for improvement in ESPO's systems, procedures and control processes without assuming management responsibility. Examples include advice, commentary on management's intended control design and framework and potential implications of changes to systems, processes and policies. The provision of such advice does not prejudice LCCIAS' right to evaluate the established systems and controls at a later date. Other consulting could include counsel, facilitation and training.
- 3.8. There is a specific public sector requirement that *'Approval must be sought from the Board (see paragraphs 3.12 to 3.14 below) for any significant additional consulting services not already included in the audit plan, prior to accepting the engagement'*. This is to ensure an appropriate balance of assurance (the primary internal audit function) and consulting activity.
- 3.9. The combined results and outcomes of assurance and consulting activities are fundamental to determining the annual internal audit opinion on the overall adequacy and effectiveness of ESPO's control environment.

The Chief Audit Executive

- 3.10. Although the PSIAS and LGAN have both adopted the original IIA Standards term 'Chief Audit Executive', it is recognised that this only describes a role, which at the Council (the Servicing Authority for ESPO) is performed by the Head of Internal Audit Service (HoIAS). Within this Charter, all references from hereon are to the HoIAS.

The Board and Senior Management

- 3.11. A public sector requirement of the PSIAS is for the Charter to define the terms 'Board' and 'Senior Management' for the purposes of internal audit activity. The LGAN advises the terms must be interpreted in the context of the governance arrangements within each individual organisation.

The Board

- 3.12. The PSIAS define the Board as *'The highest level of governing body charged with the responsibility to direct and/or oversee the activities and management of the organisation. This includes a supervisory board or a board of governors or trustees... 'Board' may refer to an audit committee to which the governing body has delegated certain functions'*.

- 3.13. For ESPO, the Terms of Reference for the Finance and Audit Subcommittee (the Subcommittee) include a delegated function to, *'Receive and review audit and governance reports'*.
- 3.14. Consequently, at ESPO the Finance and Audit Subcommittee (the Subcommittee) will perform the function of the Board. Within this Charter, all references from hereon are to the Subcommittee.

Senior Management

- 3.15. There is not a specific definition of 'senior management' in either the PSIAS or the LGAN. However, the PSIAS require *'the HoIAS to establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organisation's goals'*, and the LGAN advises that *'an effective internal audit service should understand the whole organisation, its needs and objectives'*.
- 3.16. In order to fully understand and be able to fulfill its responsibilities, the HoIAS and his/her team requires unfettered access to not only the Director of ESPO (the Director) but also, given the role of the Servicing Authority, to both the Consortium Secretary (the Secretary) and Consortium Treasurer (the Treasurer).
- 3.17. Consequently, at ESPO, the three roles of Director, Secretary and Treasurer (collectively referred to as the Delegated Officers (the Officers)) will perform the functions of Senior Management. Within this Charter, all references from hereon are to the Officers.

4. Authority

Statutory and Professional Requirements for internal audit activity

- 4.1. ESPO is a local authority purchasing consortium made up of six local authorities for which the Council is the Servicing Authority. The Accounts and Audit Regulations 2011 (the Regulations), requires any local authority to *'undertake an adequate and effective system of internal audit of its accounting records and of its system of internal control, (comprising risk management, control and governance), in accordance with the 'proper practices' in relation to internal control'*. Guidance to the Regulations recognises the PSIAS as representing *'proper internal audit practices'*.
- 4.2. Section 151 of the Local Government Act 1972, states that every local authority should *'make arrangements for the proper administration of their financial affairs, and shall secure that one of their officers has responsibility for the administration of those affairs'*. CIPFA defines that *'proper administration'* should include *'compliance with the statutory requirements for accounting and internal audit'*. ESPO's Constitution (Financial Regulation Rule 15(a)) determines that *'Responsibility for arranging a continuous internal audit of the ESPO's financial management arrangements will be delegated by the Management Committee to the Consortium Treasurer'*.

- 4.3. The relationship between the head of the internal audit activity, namely the HoIAS, and the Treasurer (the Chief Financial Officer (CFO) of the Council) is of particular importance in local government. The CIPFA Statement on the Role of the CFO in Local Government states that the CFO must: -
- a. *ensure an effective internal audit function is resourced and maintained*
 - b. *ensure that the authority has put in place effective arrangements for internal audit of the control environment*
 - c. *support the authority's internal audit arrangements*
 - d. *ensure that the audit committee receives the necessary advice and information, so that both functions can operate effectively*
- 4.4. At ESPO, the Treasurer: -
- a. In conjunction with the Director and the Secretary contributes to and agrees the overall annual internal audit plan
 - b. In conjunction with the Director receives periodic updates on progress and performance against the plan and approves major variations before they are reported to the Committee
 - c. commissions (or approves) unplanned audits
 - d. is the HoIAS' line manager and conducts his/her annual performance and development review;
 - e. In conjunction with the Director determines LCCIAS resources required for ESPO;

Access

- 4.5. PSIAS 1000 requires the Charter to, *'establish internal audit's right of access to all records, assets, personnel and premises, including those of partner organisations where appropriate, and its authority to obtain such information and explanations as it considers necessary to fulfil its responsibilities'*.
- 4.6. ESPO's Constitution Financial Regulations Rule 15(b) states that the Treasurer or an authorised representative (interpreted to be any LCCIAS internal auditors) has authority to:-
- a. enter any ESPO building or land at all reasonable times;
 - b. have access to all records, documents and correspondence relating to any transactions of ESPO;
 - c. receive such explanations as he or she considers necessary on any matter under examination;
 - d. require any employee of ESPO to produce cash, stores or any other ESPO property under his/her her control.
- 4.7. Whilst not explicit, Rule 15(b) is a conduit to seeking agreement to access any relevant partner organisations' records.

Organisational independence

- 4.8. The PSIAS require that *'reporting and management arrangements must be put in place that preserves the HoIAS (and LCCIAS') independence and objectivity, in particular with regard to the principle that they must remain independent of the audited activities'*.

This requirement aligns to CIPFA's Statement on the Role of the Head of Internal Audit (2010) that '*organisations need to ensure that where the HoIAS is an employee, he or she is sufficiently senior and independent within the organisation's structure to allow them to carry out their role effectively and be able to provide credibly constructive challenge to the Management Team*'.

4.9. PSIAS 1110 on Organisational Independence states that '*the HoIAS (HoIAS) must report to a level within the organisation that allows the internal audit activity to fulfil its responsibilities. The HoIAS must confirm to the Subcommittee, at least annually, the organisational independence of the internal audit activity*'. An additional public sector requirement of PSIAS 1110 is that '*The HoIAS must also establish effective communication with, and have free and unfettered access to, the chief executive (or equivalent) and the chair of the audit committee*'.

4.10. The HoIAS reports to the Treasurer and to the Subcommittee (reports are agreed with the Director beforehand). The HoIAS has direct access to ESPO's organisational management team, the Secretary and, if required, to the Chair of the Subcommittee. In accordance with PSIAS 1110A.1, there is acknowledgement amongst these parties that the internal audit activity must be free from interference in determining the scope of internal auditing, performing work and communicating results.

5. Responsibility

This section of the Charter summarises the key responsibilities of the Subcommittee, the Officers and the HoIAS and LCCIAS internal auditors

The Subcommittee's responsibilities

5.1. The Subcommittee does not have any decision making authority. Instead, the Management Committee has overall strategic responsibility for the management oversight and direction of ESPO, and it is the sole decision maker. As such, the Subcommittee will undertake the following key duties within the PSIAS which will then have to be formally approved by the Management Committee, namely review and note: -

- a. the internal audit charter
- b. the risk based internal audit plan
- c. communications from the HoIAS on internal audit performance relative to its plan and other matters
- d. an annual confirmation from the HoIAS with regard to the organisational independence of the internal audit activity

- e. the HoIAS' annual report, including the opinion on the control environment, a statement on conformance to the PSIAS and the results of the Quality Assurance and Improvement Programme – QAIP (see 5.4a)
- f. whether there are inappropriate scope or resource limitations, determined by making appropriate enquiries of the Officers and the HoIAS.

The Officers' responsibilities

5.2. The effectiveness of the internal audit activity relies upon the full co-operation of Senior Management. Under this Charter, the Officers will co-operate with the HOIAS in the following: -

- a. providing input to the annual risk based internal audit plan
- b. agreeing Terms of Engagement within agreed timescales
- c. sponsoring each audit at Assistant Director level
- d. providing LCCIAS with full support and co-operation including access to relevant records and personnel
- e. responding to LCCIAS reports within agreed timescales;
- f. ensuring that agreed recommendations are implemented within timescales;
- g. providing assurance that management actions have been implemented
- h. notifying the Treasurer of any significant changes in the control environment and proposed changes and developments in systems;
- i. notifying the Treasurer and Secretary of all suspected or detected fraud, corruption or impropriety.

The HoIAS' responsibilities

Code of Ethics

5.3. The HoIAS must ensure that LCCIAS internal auditors conform to the Code of Ethics (the Code), which promotes an ethical and professional culture and comprises both principles that are relevant to the profession and practice of internal auditing, and rules of conduct that describe behaviour norms and guide the ethical conduct expected of internal auditors. The Code does not supersede or replace either individuals' own professional bodies' codes of ethics or those of the Council (LCCIAS' employer). A PSIAS public sector requirement is that LCCIAS internal auditors must have regard to the Committee on Standards in Public Life's 'Seven Principles of Public Life'.

International Standards for the Professional Practice of Internal Auditing

5.4. The HoIAS must ensure that there is a robust framework supporting the activity of internal audit and that LCCIAS' internal auditors are trained and guided, and their performance monitored, to ensure they conform to the detailed attribute and performance standards within the PSIAS.

5.5. LCCIAS will conform to the full range of the standards. Nevertheless, the HoIAS has interpreted that many of the detailed PSIAS requirements for planning, performing, communicating results and monitoring progress merely reinforce practices and procedures that are already firmly embedded in LCCIAS' approach to internal audit activity and so those details are not repeated in this Charter. Only new requirements, extensions and variations are explained in more detail below: -

Attribute standards

- a. 1300 - The HoIAS must develop and maintain a quality assurance and improvement programme (QAIP) that covers all aspects of the internal audit activity. This is a new requirement for LCCIAS.

The QAIP should enable: -

- evaluations of LCCIAS' conformance with the Definition of Internal Auditing and the Standards
- internal auditors' compliance with the Code of Ethics
- assessment of the efficiency and effectiveness of the internal audit activity
- the identification of opportunities for improvement.

The QAIP must plan for both internal and external assessments and the latter must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organisation.

To avoid any duplication and unnecessary cost, the HoIAS would discuss with and gain agreement from the Council's 'Board' (Corporate Governance Committee) to both the form of external assessments and the qualifications and independence of the external assessor or assessment team, including any potential conflict of interest. There are two additional public sector requirements: -

- the HoIAS must agree the scope of external assessments with an appropriate sponsor, e.g. the Council's CFO (the Consortium Treasurer) as well as with the external assessor or assessment team
- The HoIAS must communicate the results of the QAIP and progress against any improvement plans, firstly to the Council's Senior Management Team and Board, and then to ESPO's equivalents. The results must be reported in the HoIAS' annual report (usually on the agenda for the June Committee). The HoIAS may state that LCCIAS conforms with the International Standards for the Professional Practice of Internal Auditing only if the results of the QAIP support this statement. When non-conformance with the Definition of Internal Auditing, the Code of Ethics or the Standards impacts the overall scope or operation of the internal audit activity, the HoIAS must disclose the non-conformance and the impact to the respective Senior Management Teams and Boards.

- An additional public sector requirement is that more significant deviations must be considered for inclusion in the governance statement.

Performance standards

- b. 2000 - The HoIAS must effectively manage the internal audit activity to ensure it adds value to the organisation. This sub-set of requirements includes the HoIAS' responsibility to establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organisation's goals.

There is a revised requirement for the risk based plan to incorporate or be linked to a strategic or high-level statement of how the internal audit activity will be delivered and developed in accordance with the Charter and how it links to ESPO's objectives and priorities.

There are two additional public sector requirements: -

- the risk-based plan must explain how LCCIAS' resource requirements have been assessed. Where the HoIAS believes that the level of agreed resources will impact adversely on the provision of the annual internal audit opinion, the consequences must be brought to the attention of the Subcommittee
- the HoIAS must include in the risk-based plan the approach to using other sources of assurance (e.g. the External Auditor or where ESPO is in partnership with another organisation) and any work required to place reliance upon those other sources.

Reporting to the Subcommittee on performance relative to the plan is well established. However PSIAS also requires periodically reporting to the Treasurer and the other two Officers and the Subcommittee on the internal audit activity's purpose, authority and responsibility.

- c. 2100 - The internal audit activity must evaluate and contribute to the improvement of governance, risk management and control processes using a systematic and disciplined approach. This sub-set formalises some of the work already undertaken by LCCIAS to assess and make appropriate recommendations for improving the governance process, but then requires specific coverage to ensure accomplishment of the following objectives: -
- Promoting appropriate ethics and values within ESPO;
 - Ensuring effective organisational performance management and accountability;
 - Communicating risk and control information to appropriate areas of ESPO;
 - Coordinating the activities of and communicating information among the Subcommittee, external and internal auditors and management.

For risk management processes, there are requirements to evaluate risk exposures relating to ESPO's governance, operations and information systems and the potential for the occurrence of fraud and how ESPO manages fraud risk.

- d. 2400 – LCCIAS must communicate the results of engagements, including the engagement's objectives and scope as well as applicable conclusions, recommendations and action plans. The PSIAS is explicit that LCCIAS auditors may report that their engagements are "conducted in conformance with the International Standards for the Professional Practice of Internal Auditing", only if the results of the QAIP support the statement.

A specific public sector requirement formalises the HoIAS responsibility to deliver an annual internal audit opinion on the overall adequacy and effectiveness of ESPO's control environment contained within a report that can be used to inform the governance statement. A new requirement is for the HoIAS annual report to include a statement on conformance with the PSIAS and the results of the QAIP.

- e. 2600 - When the HoIAS concludes that ESPO's organisational management has accepted a level of risk that may be unacceptable and there is a danger that ESPO's objectives may not be achieved, the matter should be discussed with the Treasurer and/or the other two Officers. If the HoIAS determines that the matter has not been resolved, the HoIAS must communicate the matter to the Subcommittee.

6. The Scope of Internal Audit Activity

6.1. The Officers are responsible for establishing and maintaining appropriate governance, risk management and control arrangements (i.e. the control environment), for not only ESPO activities, but also for those provided in conjunction with, and/or on behalf of its partners. LCCIAS' remit extends to ESPO's entire control environment. However, limitations on internal audit resource requires the HoIAS to understand and take account of the position with respect to ESPO's other sources of assurance (internal and external) and plan internal audit work accordingly so that activity can be co-ordinated, ensuring proper coverage and minimising duplication of effort.

6.2. Internal audit activity for ESPO (and, where appropriate its partners) includes:

-
- providing assurance services i.e. reviewing, appraising and reporting on: -
 - the soundness, adequacy and application of governance processes, risk management frameworks and internal controls;
 - the extent to which assets are accounted for and safeguarded from losses of all kinds
 - the suitability and reliability of financial and other data developed;
 - reviewing compliance and conformance to rules, regulations, laws, codes of practice, guidelines and principles
 - the accuracy and completeness of grant claims

- providing consulting services;
- undertaking investigations, studies, reviews or assignments as directed (or approved) by the Officers;

The role of internal audit in fraud and corruption

6.3. The Officers are responsible for developing and maintaining a control environment that mitigates the risk of fraud and corruption

6.4. The HoIAS is responsible for reviewing and evaluating ESPO's approach to managing the risks of fraud, bribery and corruption. This includes: -

- Ensuring that strategies, policies and procedures are kept up to date and align with relevant codes of conduct
- Ensuring adherence to the CIPFA Code of Practice on Managing the Risk of Fraud and Corruption
- Assisting with developing training and guidance on fraud awareness
- Coordination of ESPO's involvement in national anti-fraud projects

6.5. LCCIAS does not have responsibility for the detection or prevention of fraud and corruption, but it considers those risks when undertaking its activities. The independence of the internal audit activity leaves it well placed to undertake (or guide) any investigations that are required. The HoIAS will determine the level and scope of LCCIAS' involvement including delegating the investigation of specific allegations to ESPO itself following an assessment of risk and financial impact.

Public Sector Internal Audit Standards

Applying the IIA International Standards to
the UK Public Sector

Issued by the Relevant Internal Audit Standard Setters:



Llywodraeth Cymru
Welsh Government



HM TREASURY



**The Scottish
Government**
Riaghaltas na h-Alba

In collaboration with:



Chartered Institute of
Internal Auditors

Public Sector Internal Audit Standards

Applying the IIA International Standards to
the UK Public Sector

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SECTION 1

Introduction

A professional, independent and objective internal audit service is one of the key elements of good governance, as recognised throughout the UK public sector.

This document is therefore addressed to Accounting Officers, Accountable Officers, board and audit committee members, heads of internal audit, internal auditors, external auditors and other stakeholders such as chief financial officers and chief executives.

Framework overview

The Relevant Internal Audit Standard Setters (RIASS)¹ have adopted this common set of Public Sector Internal Audit Standards (PSIAS) from 1 April 2013. The PSIAS encompass the mandatory elements of the Institute of Internal Auditors (IIA) International Professional Practices Framework (IPPF) as follows:

- Definition of Internal Auditing
- Code of Ethics, and
- International Standards for the Professional Practice of Internal Auditing (including interpretations and glossary).

Additional requirements and interpretations for the UK public sector have been inserted in such a way as to preserve the integrity of the text of the mandatory elements of the IPPF.

The overarching principle borne in mind when all potential public sector interpretations and/or specific requirements were considered was that only the minimum number of additions should be made to the existing IIA Standards. The criteria against which potential public sector requirements were judged for inclusion were:

- where interpretation is required in order to achieve consistent application in the UK public sector
- where the issue is not addressed or not addressed adequately by the current IIA Standards, or
- where the IIA standard would be inappropriate or impractical in the context of public sector governance (taking into account, for example, any funding mechanisms, specific legislation etc).

At the same time, the following concepts were also considered of each requirement or interpretation being proposed:

- materiality
- relevance
- necessity, and
- integrity (the additional commentary does not cause inconsistency elsewhere).

¹ The Relevant Internal Audit Standard Setters are: HM Treasury in respect of central government; the Scottish Government, the Department of Finance and Personnel Northern Ireland and the Welsh Government in respect of central government and the health sector in their administrations; the Department of Health in respect of the health sector in England (excluding Foundation Trusts); and the Chartered Institute of Public Finance and Accountancy in respect of local government across the UK.

Wherever reference is made to the International Standards for the Professional Practice of Internal Auditing, this is replaced by the PSIAS. Chief audit executives are expected to report conformance on the PSIAS in their annual report.

Purpose of the PSIAS

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.

Additional guidance is a matter for the RIASS.

Scope

The PSIAS apply to all internal audit service providers, whether in-house, shared services or outsourced.

All internal audit assurance and consulting services fall within the scope of the Definition of Internal Auditing (see section 3). The provision of assurance services is the primary role for internal audit in the UK public sector. This role requires the chief audit executive to provide an annual internal audit opinion based on an objective assessment of the framework of governance, risk management and control. Consulting services are advisory in nature and are generally performed at the specific request of the organisation, with the aim of improving governance, risk management and control and contributing to the overall opinion.

The Code of Ethics promotes an ethical, professional culture (see section 4). It does not supersede or replace internal auditors' own professional bodies' Codes of Ethics or those of employing organisations. Internal auditors must also have regard to the Committee on Standards of Public Life's *Seven Principles of Public Life*.

In common with the IIA IPPF on which they are based, the PSIAS comprise Attribute and Performance Standards. The Attribute Standards address the characteristics of organisations and parties performing internal audit activities. The Performance Standards describe the nature of internal audit activities and provide quality criteria against which the performance of these services can be evaluated. While the Attribute and Performance Standards apply to all aspects of the internal audit service, the Implementation Standards apply to specific types of engagements and are classified accordingly:

- Assurance (A) and
- Consulting (C) activities.

The Standards employ terms that have been given specific meanings that are included in the Glossary.

Key governance elements

Within the PSIAS, the terms 'board' and 'senior management' need to be interpreted in the context of the governance arrangements within each UK public sector organisation, as these arrangements vary in structure and terminology between sectors and from one organisation and the next within in the same sector.

It is also necessary for the chief audit executive to understand the role of the Accounting or Accountable Officer, Chief Financial Officer, chief executive, the audit committee and other key officers or relevant decision-making groups as well as how they relate to each other. Key relationships with these individuals and groups are defined for each internal audit service within its charter.

Applicability

The Relevant Internal Audit Standard Setters for the various parts of the UK public sector are shown below, along with the types of organisations in which the PSIAS should be applied.

SECTOR / RELEVANT INTERNAL AUDIT STANDARD SETTER	Central Government	NHS	Local Government
CIPFA			<p>UK Local authorities.</p> <p>England & Wales only The Office of the Police & Crime Commissioner, constabularies, fire authorities, National Park authorities, joint committees and joint boards in the UK.</p> <p>Scotland only Strathclyde Partnership for Transport.</p>
HM Treasury	<p>UK* Government departments and their executive agencies and non-departmental public bodies.</p>		
Department of Health		<p>England Clinical Commissioning Groups. NHS Trusts.</p>	

SECTOR / RELEVANT INTERNAL AUDIT STANDARD SETTER	Central Government	NHS	Local Government
Scottish Government	Scotland The Scottish Government, the Crown Office and Procurator Fiscal Service, Executive Agencies and non-ministerial departments, non-departmental public bodies, the Scottish Parliament Corporate Body and bodies sponsored / supported by the Scottish Parliament Corporate Body.	Scotland NHS Boards, Special NHS Boards, NHS Board partnership bodies in the public sector (eg joint ventures, Community Health Partnerships etc), NHS Board subsidiaries.	
Welsh Government	Wales The Welsh Government, National Assembly for Wales and Welsh Government sponsored bodies including commissioners.	Wales Health Boards and Trusts.	
Northern Ireland Assembly: Department of Finance and Personnel (NI)	Government departments, executive agencies, non-ministerial departments, non-departmental public bodies, NI health and social care bodies and other relevant sponsored bodies.		

* Unless the body falls under the jurisdiction of the devolved governments.

Definition of Internal Auditing

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.

SECTION 4

Code of Ethics

Public sector requirement

Internal auditors in UK public sector organisations (as set out in the Applicability section) must conform to the Code of Ethics as set out below. If individual internal auditors have membership of another professional body then he or she must also comply with the relevant requirements of that organisation.

The purpose of The Institute's Code of Ethics is to promote an ethical culture in the profession of internal auditing. A code of ethics is necessary and appropriate for the profession of internal auditing, founded as it is on the trust placed in its objective assurance about risk management, control and governance.

The Institute's Code of Ethics extends beyond the definition of internal auditing to include two essential components:

Components

- 1 Principles that are relevant to the profession and practice of internal auditing;
- 2 Rules of Conduct that describe behaviour norms expected of internal auditors. These rules are an aid to interpreting the Principles into practical applications and are intended to guide the ethical conduct of internal auditors.

The Code of Ethics provides guidance to internal auditors serving others. 'Internal auditors' refers to Institute members and those who provide internal auditing services within the definition of internal auditing.

Applicability and Enforcement

This Code of Ethics applies to both individuals and entities that provide internal auditing services. For Institute members, breaches of the Code of Ethics will be evaluated and administered according to The Institute's Disciplinary Procedures. The fact that a particular conduct is not mentioned in the Rules of Conduct does not prevent it from being unacceptable or discreditable and therefore, the member liable to disciplinary action.

Public sector interpretation

The 'Institute' here refers to the IIA. Disciplinary procedures of other professional bodies and employing organisations may apply to breaches of this Code of Ethics.

1 Integrity

Principle

The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgement.

Rules of Conduct

Internal auditors:

- 1.1 Shall perform their work with honesty, diligence and responsibility.
- 1.2 Shall observe the law and make disclosures expected by the law and the profession.
- 1.3 Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organisation.
- 1.4 Shall respect and contribute to the legitimate and ethical objectives of the organisation.

2 Objectivity

Principle

Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating and communicating information about the activity or process being examined.

Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgements.

Rules of Conduct

Internal auditors:

- 2.1 Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organisation.
- 2.2 Shall not accept anything that may impair or be presumed to impair their professional judgement.
- 2.3 Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

3 Confidentiality

Principle

Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

Rules of Conduct

Internal auditors:

- 3.1 Shall be prudent in the use and protection of information acquired in the course of their duties.
- 3.2 Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organisation.

4 Competency

Principle

Internal auditors apply the knowledge, skills and experience needed in the performance of internal auditing services.

Rules of Conduct

Internal auditors:

- 4.1 Shall engage only in those services for which they have the necessary knowledge, skills and experience.
- 4.2 Shall perform internal auditing services in accordance with the International Standards for the Professional Practice of Internal Auditing.
- 4.3 Shall continually improve their proficiency and effectiveness and quality of their services.

Public sector requirement

Internal auditors who work in the public sector must also have regard to the Committee on Standards of Public Life's *Seven Principles of Public Life*, information on which can be found at www.public-standards.gov.uk

Standards

Attribute Standards

1000 Purpose, Authority and Responsibility

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 chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.

Interpretation:

The internal audit charter is a formal document that defines the internal audit activity's purpose, authority and responsibility. The internal audit charter establishes the internal audit activity's position within the organisation, including the nature of the chief audit executive's functional reporting relationship with the board; authorises access to records, personnel and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. Final approval of the internal audit charter resides with the board.

Public sector requirement

The internal audit charter must also:

- define the terms 'board' and 'senior management' for the purposes of internal audit activity;
- cover the arrangements for appropriate resourcing;
- define the role of internal audit in any fraud-related work; and
- include arrangements for avoiding conflicts of interest if internal audit undertakes non-audit activities.

1000.A1

The nature of assurance services provided to the organisation must be defined in the internal audit charter. If assurances are to be provided to parties outside the organisation, the nature of these assurances must also be defined in the internal audit charter.

1000.C1

The nature of consulting services must be defined in the internal audit charter.

1010 Recognition of the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards* in the Internal Audit Charter

The mandatory nature of the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards* must be recognised in the internal audit charter. The chief audit executive should discuss the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards* with senior management and the board.

1100 Independence and Objectivity

The internal audit activity must be independent and internal auditors must be objective in performing their work.

Interpretation:

Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the chief audit executive has direct and unrestricted access to senior management and the board. This can be achieved through a dual-reporting relationship. Threats to independence must be managed at the individual auditor, engagement, functional and organisational levels.

Objectivity is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others. Threats to objectivity must be managed at the individual auditor, engagement, functional and organisational levels.

1110 Organisational Independence

The chief audit executive must report to a level within the organisation that allows the internal audit activity to fulfil its responsibilities. The chief audit executive must confirm to the board, at least annually, the organisational independence of the internal audit activity.

Interpretation:

Organisational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:

- approving the internal audit charter;
- approving the risk based internal 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;
- approving the remuneration of the chief audit executive; and
- making appropriate enquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.

Public sector requirement

The chief audit executive must report functionally to the board. The chief audit executive must also establish effective communication with, and have free and unfettered access to, the chief executive (or equivalent) and the chair of the audit committee.

Public sector interpretation

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 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.

1110.A1

The internal audit activity must be free from interference in determining the scope of internal auditing, performing work and communicating results.

1111 Direct Interaction with the Board

The chief audit executive must communicate and interact directly with the board.

1120 Individual Objectivity

Internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest.

Interpretation:

Conflict of interest is a situation in which an internal auditor, who is in a position of trust, has a competing professional or personal interest. Such competing interests can make it difficult to fulfil his or her duties impartially. A conflict of interest exists even if no unethical or improper act results. A conflict of interest can create an appearance of impropriety that can undermine confidence in the internal auditor, the internal audit activity and the profession. A conflict of interest could impair an individual's ability to perform his or her duties and responsibilities objectively.

1130 Impairment to Independence or Objectivity

If independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment.

Interpretation:

Impairment to organisational independence and individual objectivity may include, but is not limited to, personal conflict of interest, scope limitations, restrictions on access to records, personnel and properties and resource limitations, such as funding.

The determination of appropriate parties to which the details of an impairment to independence or objectivity must be disclosed is dependent upon the expectations of the internal audit activity's and the chief audit executive's responsibilities to senior management and the board as described in the internal audit charter, as well as the nature of the impairment.

1130.A1

Internal auditors must refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an internal auditor provides assurance services for an activity for which the internal auditor had responsibility within the previous year.

1130.A2

Assurance engagements for functions over which the chief audit executive has responsibility must be overseen by a party outside the internal audit activity.

1130.C1

Internal auditors may provide consulting services relating to operations for which they had previous responsibilities.

1130.C2

If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure must be made to the engagement client prior to accepting the engagement.

Public sector requirement

Approval must be sought from the board for any significant additional consulting services not already included in the audit plan, prior to accepting the engagement.

1200 Proficiency and Due Professional Care

Engagements must be performed with proficiency and due professional care.

1210 Proficiency

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.

Interpretation:

Knowledge, skills and other competencies is a collective term that refers to the professional proficiency required of internal auditors to effectively carry out their professional responsibilities. Internal auditors are encouraged to demonstrate their proficiency by obtaining appropriate professional certifications and qualifications, such as the Certified Internal Auditor designation and other designations offered by The Institute of Internal Auditors and other appropriate professional organisations.

Public sector requirement

The chief audit executive must hold a professional qualification (CMIIA, CCAB or equivalent) and be suitably experienced.

1210.A1

The chief audit executive must obtain competent advice and assistance if the internal auditors lack the knowledge, skills, or other competencies needed to perform all or part of the engagement.

1210.A2

Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organisation, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.

1210.A3

Internal auditors must have sufficient knowledge of key information technology risks and controls and available technology-based audit techniques to perform their assigned work. However, not all internal auditors are expected to have the expertise of an internal auditor whose primary responsibility is information technology auditing.

1210.C1

The chief audit executive must decline the consulting engagement or obtain competent advice and assistance if the internal auditors lack the knowledge, skills, or other competencies needed to perform all or part of the engagement.

1220 Due Professional Care

Internal auditors must apply the care and skill expected of a reasonably prudent and competent internal auditor. Due professional care does not imply infallibility.

1220.A1

Internal auditors must exercise due professional care by considering the:

- Extent of work needed to achieve the engagement's objectives;
- Relative complexity, materiality or significance of matters to which assurance procedures are applied;
- Adequacy and effectiveness of governance, risk management and control processes;
- Probability of significant errors, fraud, or non-compliance; and
- Cost of assurance in relation to potential benefits.

1220.A2

In exercising due professional care internal auditors must consider the use of technology-based audit and other data analysis techniques.

1220.A3

Internal auditors must be alert to the significant risks that might affect objectives, operations or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified.

1220.C1

Internal auditors must exercise due professional care during a consulting engagement by considering the:

- Needs and expectations of clients, including the nature, timing and communication of engagement results;
- Relative complexity and extent of work needed to achieve the engagement's objectives; and
- Cost of the consulting engagement in relation to potential benefits.

1230 Continuing Professional Development

Internal auditors must enhance their knowledge, skills and other competencies through continuing professional development.

1300 Quality Assurance and Improvement Programme

The chief audit executive must develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit activity.

Interpretation:

A quality assurance and improvement programme is designed to enable an evaluation of the internal audit activity's conformance with the *Definition of Internal Auditing* and the *Standards* and an evaluation of whether internal auditors apply the *Code of Ethics*. The programme also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement.

1310 Requirements of the Quality Assurance and Improvement Programme

The quality assurance and improvement programme must include both internal and external assessments.

1311 Internal Assessments

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 internal audit practices.

Interpretation:

Ongoing monitoring is an integral part of the day-to-day supervision, review and measurement of the internal audit activity. Ongoing monitoring is incorporated into the routine policies and practices used to manage the internal audit activity and uses processes, tools and information considered necessary to evaluate conformance with the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards*.

Periodic assessments are conducted to evaluate conformance with the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards*.

Sufficient knowledge of internal audit practices requires at least an understanding of all elements of the International Professional Practices Framework.

1312 External Assessments

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.

Interpretation:

External assessments can be in the form of a full external assessment, or a self-assessment with independent external validation.

A qualified assessor or assessment team demonstrates competence in two areas: the professional practice of internal auditing and the external assessment process. Competence can be demonstrated through a mixture of experience and theoretical learning. Experience gained in organisations of similar size, complexity, sector or industry and technical issues is more valuable than less relevant experience. In the case of an assessment team, not all members of the team need to have all the competencies; it is the team as a whole that is qualified. The chief audit executive uses professional judgment when assessing whether an assessor or assessment team demonstrates sufficient competence to be qualified.

An independent assessor or assessment team means not having either a real or an apparent conflict of interest and not being a part of, or under the control of, the organisation to which the internal audit activity belongs.

Public sector requirement

The chief audit executive must agree the scope of external assessments with an appropriate sponsor, eg the Accounting/Accountable Officer or chair of the audit committee as well as with the external assessor or assessment team.

1320 Reporting on the Quality Assurance and Improvement Programme

The chief audit executive must communicate the results of the quality assurance and improvement programme to senior management and the board.

Interpretation:

The form, content and frequency of communicating the results of the quality assurance and improvement programme is established through discussions with senior management and the board and considers the responsibilities of the internal audit activity and chief audit executive as contained in the internal audit charter. To demonstrate conformance with the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards*, the results of external and periodic internal assessments are communicated upon completion of such assessments and the results of ongoing monitoring are communicated at least annually. The results include the assessor's or assessment team's evaluation with respect to the degree of conformance.

Public sector requirement

The results of the quality and assurance programme and progress against any improvement plans must be reported in the annual report.

1321 Use of "Conforms with the International Standards for the Professional Practice of Internal Auditing"

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.

Interpretation:

The internal audit activity conforms with the Standards when it achieves the outcomes described in the *Definition of Internal Auditing*, *Code of Ethics* and *Standards*.

The results of the quality assurance and improvement programme include the results of both internal and external assessments. All internal audit activities will have the results of internal assessments. Internal audit activities in existence for at least five years will also have the results of external assessments.

1322 Disclosure of Non-conformance

When non-conformance with the *Definition of Internal Auditing*, the *Code of Ethics* or the *Standards* impacts the overall scope or operation of the internal audit activity, the chief audit executive must disclose the non-conformance and the impact to senior management and the board.

Public sector requirement

Instances of non-conformance must be reported to the board. More significant deviations must be considered for inclusion in the governance statement.

Performance Standards

2000 Managing the Internal Audit Activity

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

Interpretation:

The internal audit activity is effectively managed when:

- The results of the internal audit activity's work achieve the purpose and responsibility included in the internal audit charter;
- The internal audit activity conforms with the *Definition of Internal Auditing* and the *Standards*; and
- The individuals who are part of the internal audit activity demonstrate conformance with the *Code of Ethics* and the *Standards*.

The internal audit activity adds value to the organisation (and its stakeholders) when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management and control processes.

2010 Planning

The chief audit executive must establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organisation's goals.

Interpretation:

The chief audit executive is responsible for developing a risk-based plan. The chief audit executive takes into account the organisation's risk management framework, including using risk appetite levels set by management for the different activities or parts of the organisation. If a framework does not exist, the chief audit executive uses his/her own judgment of risks after consideration of input from senior management and the board. The chief audit executive must review and adjust the plan, as necessary, in response to changes in the organisation's business, risks, operations, programs, systems, and controls.

Public sector requirement

The risk-based plan must take into account the requirement to produce an annual internal audit opinion and the assurance framework. It must incorporate or be linked to a strategic or 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 organisational objectives and priorities.

2010.A1

The internal audit activity's plan of engagements must be based on a documented risk assessment, undertaken at least annually. The input of senior management and the board must be considered in this process.

2010.A2

The chief audit executive must identify and consider the expectations of senior management, the board and other stakeholders for internal audit opinions and other conclusions.

2010.C1

The chief audit executive should consider accepting proposed consulting engagements based on the engagement's potential to improve management of risks, add value and improve the organisation's operations. Accepted engagements must be included in the plan.

2020 Communication and Approval

The chief audit executive must communicate the internal audit activity's plans and resource requirements, including significant interim changes, to senior management and the board for review and approval. The chief audit executive must also communicate the impact of resource limitations.

2030 Resource Management

The chief audit executive must ensure that internal audit resources are appropriate, sufficient and effectively deployed to achieve the approved plan.

Interpretation:

Appropriate refers to the mix of knowledge, skills and other competencies needed to perform the plan. Sufficient refers to the quantity of resources needed to accomplish the plan. Resources are effectively deployed when they are used in a way that optimises the achievement of the approved plan.

Public sector requirement

The risk-based plan must explain how internal audit's resource requirements have been assessed.

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

2040 Policies and Procedures

The chief audit executive must establish policies and procedures to guide the internal audit activity.

Interpretation:

The form and content of policies and procedures are dependent upon the size and structure of the internal audit activity and the complexity of its work.

2050 Coordination

The chief audit executive should share information and coordinate activities with other internal and external providers of assurance and consulting services to ensure proper coverage and minimise duplication of efforts.

Public sector requirement

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

2060 Reporting to Senior Management and the Board

The chief audit executive must report periodically to senior management and the board on the internal audit activity's purpose, authority, responsibility and performance relative to its 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.

Interpretation:

The frequency and content of reporting are determined in discussion with senior management and the board and depend on the importance of the information to be communicated and the urgency of the related actions to be taken by senior management or the board.

2070 External Service Provider and Organisational Responsibility for Internal Auditing

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.

Interpretation:

This responsibility is demonstrated through the quality assurance and improvement programme which assesses conformance with the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards*.

2100 Nature of Work

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

2110 Governance

The internal audit activity must assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:

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

2110.A1

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

2110.A2

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

2120 Risk Management

The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes.

Interpretation:

Determining whether risk management processes are effective is a judgment 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.

The internal audit activity may gather the information to support this assessment during multiple engagements. The results of these engagements, when viewed together, provide an understanding of the organisation's risk management processes and their effectiveness.

Risk management processes are monitored through ongoing management activities, separate evaluations, or both.

2120.A1

The internal audit activity must evaluate risk exposures relating to 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.

2120.A2

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

2120.C1

During consulting engagements, internal auditors must address risk consistent with the engagement's objectives and be alert to the existence of other significant risks.

2120.C2

Internal auditors must incorporate knowledge of risks gained from consulting engagements into their evaluation of the organisation's risk management processes.

2120.C3

When assisting management in establishing or improving risk management processes, internal auditors must refrain from assuming any management responsibility by actually managing risks.

2130 Control

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

2130.A1

The internal audit activity 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.

2130.C1

Internal auditors must incorporate knowledge of controls gained from consulting engagements into evaluation of the organisation's control processes.

2200 Engagement Planning

Internal auditors must develop and document a plan for each engagement, including the engagement's objectives, scope, timing and resource allocations.

2201 Planning Considerations

In planning the engagement, internal auditors must consider:

- The objectives of the activity being reviewed and the means by which the activity controls its performance;
- The significant risks to the activity, its objectives, resources and operations and the means by which the potential impact of risk is kept to an acceptable level;
- The adequacy and effectiveness of the activity's governance, risk management and control processes compared to a relevant framework or model; and
- The opportunities for making significant improvements to the activity's governance, risk management and control processes.

2201.A1

When planning an engagement 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 the results of the engagement and access to engagement records.

2201.C1

Internal auditors must establish an understanding with consulting engagement clients about objectives, scope, respective responsibilities and other client expectations. For significant engagements, this understanding must be documented.

2210 Engagement Objectives

Objectives must be established for each engagement.

2210.A1

Internal auditors must conduct a preliminary assessment of the risks relevant to the activity under review. Engagement objectives must reflect the results of this assessment.

2210.A2

Internal auditors must consider the probability of significant errors, fraud, non-compliance and other exposures when developing the engagement objectives.

2210.A3

Adequate criteria are needed to evaluate governance, risk management and controls. Internal auditors must ascertain the extent to which management and/or the board has established adequate criteria to determine whether objectives and goals have been accomplished. If adequate, internal auditors must use such criteria in their evaluation. If inadequate, internal auditors must work with management and/or the board to develop appropriate evaluation criteria.

Public sector interpretation

In the public sector, criteria are likely to include value for money.

2210.C1

Consulting engagement objectives must address governance, risk management and control processes to the extent agreed upon with the client.

2210.C2

Consulting engagement objectives must be consistent with the organisation's values, strategies and objectives.

2220 Engagement Scope

The established scope must be sufficient to satisfy the objectives of the engagement.

2220.A1

The scope of the engagement must include consideration of relevant systems, records, personnel and physical properties, including those under the control of third parties.

2220.A2

If significant consulting opportunities arise during an assurance engagement, a specific written understanding as to the objectives, scope, respective responsibilities and other expectations should be reached and the results of the consulting engagement communicated in accordance with consulting standards.

2220.C1

In performing consulting engagements, internal auditors must ensure that the scope of the engagement is sufficient to address the agreed-upon objectives. If internal auditors develop reservations about the scope during the engagement, these reservations must be discussed with the client to determine whether to continue with the engagement.

2220.C2

During consulting engagements, internal auditors must address controls consistent with the engagement's objectives and be alert to significant control issues.

2230 Engagement Resource Allocation

Internal auditors must determine appropriate and sufficient resources to achieve engagement objectives based on an evaluation of the nature and complexity of each engagement, time constraints and available resources.

2240 Engagement Work Programme

Internal auditors must develop and document work programmes that achieve the engagement objectives.

2240.A1

Work programmes must include the procedures for identifying, analysing, evaluating and documenting information during the engagement. The work programme must be approved prior to its implementation and any adjustments approved promptly.

2240.C1

Work programmes for consulting engagements may vary in form and content depending upon the nature of the engagement.

2300 Performing the Engagement

Internal auditors must identify, analyse, evaluate and document sufficient information to achieve the engagement's objectives.

2310 Identifying Information

Internal auditors must identify sufficient, reliable, relevant and useful information to achieve the engagement's objectives.

Interpretation:

Sufficient information is factual, adequate and convincing so that a prudent, informed person would reach the same conclusions as the auditor. Reliable information is the best attainable information through the use of appropriate engagement techniques. Relevant information supports engagement observations and recommendations and is consistent with the objectives for the engagement. Useful information helps the organisation meet its goals.

2320 Analysis and Evaluation

Internal auditors must base conclusions and engagement results on appropriate analyses and evaluations.

2330 Documenting Information

Internal auditors must document relevant information to support the conclusions and engagement results.

2330.A1

The chief audit executive must control access to engagement records. The chief audit executive must obtain the approval of senior management and/or legal counsel prior to releasing such records to external parties, as appropriate.

2330.A2

The chief audit executive must develop retention requirements for engagement records, regardless of the medium in which each record is stored. These retention requirements must be consistent with the organisation's guidelines and any pertinent regulatory or other requirements.

2330.C1

The chief audit executive must develop policies governing the custody and retention of consulting engagement records, as well as their release to internal and external parties. These policies must be consistent with the organisation's guidelines and any pertinent regulatory or other requirements.

2340 Engagement Supervision

Engagements must be properly supervised to ensure objectives are achieved, quality is assured and staff is developed.

Interpretation:

The extent of supervision required will depend on the proficiency and experience of internal auditors and the complexity of the engagement. The chief audit executive has overall responsibility for supervising the engagement, whether performed by or for the internal audit activity, but may designate appropriately experienced members of the internal audit activity to perform the review. Appropriate evidence of supervision is documented and retained.

2400 Communicating Results

Internal auditors must communicate the results of engagements.

2410 Criteria for Communicating

Communications must include the engagement's objectives and scope as well as applicable conclusions, recommendations and action plans.

2410.A1

Final communication of engagement results must, where appropriate, contain internal auditors' opinion and/or conclusions. When issued, an opinion or conclusion 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.

Interpretation:

Opinions at the engagement level may be ratings, conclusions or other descriptions of the results. Such an engagement may be in relation to controls around a specific process, risk or business unit. The formulation of such opinions requires consideration of the engagement results and their significance.

2410.A2

Internal auditors are encouraged to acknowledge satisfactory performance in engagement communications.

2410.A3

When releasing engagement results to parties outside the organisation, the communication must include limitations on distribution and use of the results.

2410.C1

Communication of the progress and results of consulting engagements will vary in form and content depending upon the nature of the engagement and the needs of the client.

2420 Quality of Communications

Communications must be accurate, objective, clear, concise, constructive, complete and timely.

Interpretation:

Accurate communications are free from errors and distortions and are faithful to the underlying facts. Objective communications are fair, impartial and unbiased and are the result of a fair-minded and balanced assessment of all relevant facts and circumstances. Clear communications are easily understood and logical, avoiding unnecessary technical language and providing all significant and relevant information. Concise communications are to the point and avoid unnecessary elaboration, superfluous detail, redundancy and wordiness. Constructive communications are helpful to the engagement client and the organisation and lead to improvements where needed. Complete communications lack nothing that is essential to the target audience and include all significant and relevant information and observations to support recommendations and conclusions. Timely communications are opportune and expedient, depending on the significance of the issue, allowing management to take appropriate corrective action.

2421 Errors and Omissions

If a final communication contains a significant error or omission, the chief audit executive must communicate corrected information to all parties who received the original communication.

2430 Use of “Conducted in Conformance with the International Standards for the Professional Practice of Internal Auditing”

Internal auditors may report that their engagements are “conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*”, only if the results of the quality assurance and improvement programme support the statement.

2431 Engagement Disclosure of Nonconformance

When nonconformance with the *Definition of Internal Auditing*, the *Code of Ethics* or the *Standards* impacts a specific engagement, communication of the results must disclose the:

- Principle or rule of conduct of the *Code of Ethics* or Standard(s) with which full conformance was not achieved;
- Reason(s) for nonconformance; and
- Impact of nonconformance on the engagement and the communicated engagement results.

2440 Disseminating Results

The chief audit executive must communicate results to the appropriate parties.

Interpretation:

The chief audit executive is responsible for reviewing and approving the final engagement communication before issuance and deciding to whom and how it will be disseminated. When the chief audit executive delegates these duties, he or she retains overall responsibility.

2440.A1

The chief audit executive is responsible for communicating the final results to parties who can ensure that the results are given due consideration.

2440.A2

If not otherwise mandated by legal, statutory, or regulatory requirements, prior to releasing results to parties outside the organisation the chief audit executive must:

- Assess the potential risk to the organisation;
- Consult with senior management and/ or legal counsel as appropriate; and
- Control dissemination by restricting the use of the results.

2440.C1

The chief audit executive is responsible for communicating the final results of consulting engagements to clients.

2440.C2

During consulting engagements, governance, risk management and control issues may be identified. Whenever these issues are significant to the organisation, they must be communicated to senior management and the board.

2450 Overall Opinions

When an overall opinion is issued, it must take into account the expectations of senior management, the board and other stakeholders and must be supported by sufficient, reliable, relevant and useful information.

Interpretation:

The communication will identify:

- The scope including the time period to which the opinion pertains;
- Scope limitations;
- Consideration of all related projects including the reliance on other assurance providers;
- The risk or control framework or other criteria used as a basis for the overall opinion; and
- The overall opinion, judgment or conclusion reached.

The reasons for an unfavourable overall opinion must be stated.

Public sector requirement

The chief audit executive must deliver an annual internal audit opinion and report that can be used by the organisation to inform its governance statement.

The annual internal audit opinion must conclude on the overall adequacy and effectiveness of the organisation'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.

2500 Monitoring Progress

The chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.

2500.A1

The chief audit executive 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.

2500.C1

The internal audit activity must monitor the disposition of results of consulting engagements to the extent agreed upon with the client.

2600 Communicating the Acceptance of Risks

When the chief audit executive concludes that management has 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 that the matter has not been resolved, the chief audit executive must communicate the matter to the board.

Interpretation:

The identification of risk accepted by management may be observed through an assurance or consulting engagement, monitoring progress on actions taken by management as a result of prior engagements, or other means. It is not the responsibility of the chief audit executive to resolve the risk.

Glossary

Add Value

The internal audit activity adds value to the organisation (and its stakeholders) when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management and control processes.

Adequate Control

Present if management has planned and organised (designed) in a manner that provides reasonable assurance that the organisation's risks have been managed effectively and that the organisation's goals and objectives will be achieved efficiently and economically.

Public sector definition: Assurance Framework

This is the primary tool used by a board to ensure that it is properly informed on the risks of not meeting its objectives or delivering appropriate outcomes and that it has adequate assurances on the design and operation of the systems in place to mitigate those risks.

Assurance Services

An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management and control processes for the organisation. Examples may include financial, performance, compliance, system security and due diligence engagements.

Public sector definition: Audit Committee

The governance group charged with independent assurance of the adequacy of the risk management framework, the internal control environment and the integrity of financial reporting.

Board

The highest level of governing body charged with the responsibility to direct and/or oversee the activities and management of the organisation. Typically, this includes an independent group of directors (eg a board of directors, a supervisory board or a board of governors or trustees). If such a group does not exist, the 'board' may refer to the head of the organisation. 'Board' may refer to an audit committee to which the governing body has delegated certain functions.

Charter

The internal audit charter is a formal document that defines the internal audit activity's purpose, authority and responsibility. The internal audit charter establishes the internal audit activity's position within the organisation; authorises access to records, personnel and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities.

Chief Audit Executive

Chief audit executive describes a person in a senior position responsible for effectively managing the internal audit activity in accordance with the internal audit charter and the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards*. The chief audit executive or others reporting to the chief audit executive will have appropriate professional certifications and qualifications. The specific job title of the chief audit executive may vary across organisations.

Code of Ethics

The *Code of Ethics* of The Institute of Internal Auditors (IIA) are Principles relevant to the profession and practice of internal auditing and Rules of Conduct that describe behaviour expected of internal auditors. The *Code of Ethics* applies to both parties and entities that provide internal audit services.

The purpose of the *Code of Ethics* is to promote an ethical culture in the global profession of internal auditing.

Compliance

Adherence to policies, plans, procedures, laws, regulations, contracts, or other requirements.

Conflict of Interest

Any relationship that is, or appears to be, not in the best interest of the organisation. A conflict of interest would prejudice an individual's ability to perform his or her duties and responsibilities objectively.

Consulting Services

Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organisation's governance, risk management and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation and training.

Control

Any action taken by management, the board and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Management plans, organises and directs the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved.

Control Environment

The attitude and actions of the board and management regarding the importance of control within the organisation. The control environment provides the discipline and structure for the achievement of the primary objectives of the system of internal control. The control environment includes the following elements:

- Integrity and ethical values.
- Management's philosophy and operating style.
- Organisational structure.
- Assignment of authority and responsibility.
- Human resource policies and practices.
- Competence of personnel.

Control Processes

The policies, procedures (both manual and automated), and activities that are part of a control framework, designed and operated to ensure that risks are contained within the level that an organisation is willing to accept.

Engagement

A specific internal audit assignment, task, or review activity, such as an internal audit, control self-assessment review, fraud examination, or consultancy. An engagement may include multiple tasks or activities designed to accomplish a specific set of related objectives.

Engagement Objectives

Broad statements developed by internal auditors that define intended engagement accomplishments.

Engagement Opinion

The rating, conclusion and/or other description of results of an individual internal audit engagement, relating to those aspects within the objectives and scope of the engagement.

Engagement Work Programme

A document that lists the procedures to be followed during an engagement, designed to achieve the engagement plan.

External Service Provider

A person or firm outside of the organisation that has special knowledge, skill and experience in a particular discipline.

Fraud

Any illegal act characterised by deceit, concealment or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organisations to obtain money, property or services; to avoid payment or loss of services; or to secure personal or business advantage.

Governance

The combination of processes and structures implemented by the board to inform, direct, manage and monitor the activities of the organisation toward the achievement of its objectives.

Public sector definition: Governance Statement

The mechanism by which an organisation publicly reports on its governance arrangements each year.

Impairment

Impairment to organisational independence and individual objectivity may include personal conflict of interest, scope limitations, restrictions on access to records, personnel and properties and resource limitations (funding).

Independence

The freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.

Information Technology Controls

Controls that support business management and governance as well as provide general and technical controls over information technology infrastructures such as applications, information, infrastructure and people.

Information Technology Governance

Consists of the leadership, organisational structures and processes that ensure that the enterprise's information technology supports the organisation's strategies and objectives.

Internal Audit Activity

A department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve an organisation's operations. The internal audit activity helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management and control processes.

International Professional Practices Framework

The conceptual framework that organises the authoritative guidance promulgated by The IIA. Authoritative Guidance is comprised of two categories (1) mandatory and (2) strongly recommended.

Public sector interpretation

Only the mandatory elements apply for the purposes of the Public Sector Internal Audit Standards.

Public sector interpretation: International Standards for the Professional Practice of Internal Auditing

The Public Sector Internal Audit Standards take the place of the International Standards where applicable.

Must

The *Standards* use the word “must” to specify an unconditional requirement.

Objectivity

An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others.

Overall Opinion

The rating, conclusion and/or other description of results provided by the chief audit executive addressing, at a broad level, governance, risk management and/or control processes of the organisation. An overall opinion is the professional judgement of the chief audit executive based on the results of a number of individual engagements and other activities for a specific time interval.

Risk

The possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood.

Risk Appetite

The level of risk that an organisation is willing to accept.

Risk Management

A process to identify, assess, manage and control potential events or situations to provide reasonable assurance regarding the achievement of the organisation’s objectives.

Should

The *Standards* use the word should where conformance is expected unless, when applying professional judgment, circumstances justify deviation.

Significance

The relative importance of a matter within the context in which it is being considered, including quantitative and qualitative factors, such as magnitude, nature, effect, relevance and impact. Professional judgment assists internal auditors when evaluating the significance of matters within the context of the relevant objectives.

Standard

A professional pronouncement promulgated by the Internal Audit Standards Board that delineates the requirements for performing a broad range of internal audit activities and for evaluating internal audit performance.

Technology-based Audit Techniques

Any automated audit tool, such as generalised audit software, test data generators, computerised audit programmes, specialised audit utilities and computer-assisted audit techniques (CAATs).



ESPO FINANCE AND AUDIT SUBCOMMITTEE – 23 FEBRUARY 2015

AGENDA ITEM NO. 7

REPORT OF THE CONSORTIUM TREASURER

GOVERNANCE OVER MANAGING THE RISK OF FRAUD

Purpose of the Report

1. To ask Members to:
 - a. Review the principles within the CIPFA Code of Practice on Managing the Risk of Fraud and Corruption (2014) and recommend its adoption to Management Committee
 - b. Note progress against adopting the Servicing Authority's policies, strategies and procedures designed to both guide on standards of conduct and to mitigate the risk of fraud and corruption

Background

2. The risk of fraud, corruption and bribery is inherent in all businesses, particularly where there are extensive procurement and supplier and customer relationships, such as exist at ESPO. The risk of fraud and corruption by employees is included on ESPO's Corporate Risk Register
3. ESPO's Constitution contains explicit references to requirements to manage the risk of fraud, for example within the Consortium Agreement Section 23 'Prevention of Corruption and Bribery'; Financial Regulation 17 'Financial Irregularities' and Contract Procedure Rule 7 'Prevention of Corruption / Conflict of Interest'.
4. There are also implied responsibilities for mitigating fraud risk contained in the 'Functions of the Management Committee' for ensuring, amongst other things, the successful operation of ESPO as a comprehensive professional purchasing service; the overall management of risk of the ESPO and that there is proper administration of ESPO's financial affairs. The Consortium Treasurer also has an implied responsibility for mitigating fraud risk through his delegated function to ensure proper administration of the financial affairs of ESPO.
5. ESPO adopts the Servicing Authority's (Leicestershire County Council) Employee Code of Conduct, whistleblowing and gifts and hospitality policies and procedures as well as its anti-fraud and corruption policies, strategies and procedures.

The CIPFA Code of Practice on Managing the Risk of Fraud and Corruption (2014)

6. The decommissioning of the Audit Commission has led to its counter fraud functions being transferred to the public sector accountancy institute, CIPFA. The CIPFA Code of Practice on Counter Fraud 2014 (the Fraud Code) was published on 16 October 2014. The Fraud Code supports organisations seeking to ensure they have the right governance and operational arrangements in place to counter fraud and corruption. It is a voluntary code that can be applied in any public service organisation. It is brief and clearly sets out the importance of top level support from the governing body and leadership team. Where an organisation chooses to make a statement in its annual governance report about its adherence to the Fraud Code, one of two statements should be approved according to whether the organisation either conforms to the Fraud Code or needs to take further action. Whilst it is to cease to exist from April 2015, the Audit Commission has recognised that the six key components of effective stewardship of public funds are incorporated within the Fraud Code and recommends that all public bodies, including local authorities, assess themselves against it.
7. The Fraud Code (as shown in Appendix 1) is organised around five key principles:
 - a. Acknowledge the responsibility of the governing body for countering fraud and corruption;
 - b. Identify the fraud and corruption risks;
 - c. Develop an appropriate counter fraud and corruption strategy;
 - d. Provide resources to implement the strategy;
 - e. Take action in response to fraud and corruption.
8. The starting point of a strategic approach to mitigating the risk of fraud is to acknowledge the first principle of the Fraud Code i.e. that fraud does exist within organisations, and that the governing body (elected members and senior management) has a responsibility for countering fraud and corruption. The three officers with delegated functions i.e. the Director of ESPO and the Consortium Treasurer and Consortium Secretary (the Officers) have agreed to adopt the principles of the Fraud Code and to include a statement of either conformance or further action required in ESPO's Annual Governance Statement. This report asks the Subcommittee to add its support to the Officers, by recommending that Management Committee approves adoption of both the principles and the inclusion of a statement of conformance.
9. Adoption of the principles of the Fraud Code and reporting conformance (or otherwise) to it would strengthen the response to the External Auditor's annual questions on fraud to those charged with governance, when they present their annual audit plan.
10. The second principle of the Fraud Code i.e. to identify fraud and corruption risks by performing a fraud risk assessment and using the results to direct anti-fraud resources and strategies accordingly, will form part of the 2015-16 annual internal

audit planning process in conjunction with the ESPO Director and the Consortium Treasurer and Secretary.

Update on the adoption of Servicing Authority policies, strategies and procedures designed to guide on standards of conduct and to mitigate the risk of fraud and corruption

11. Under the terms and conditions of their employment with Leicestershire County Council, ESPO employees should comply with the standards of conduct expected from all County Council employees which are set out in the recently revised and Member approved Employee Code of Conduct. The Employee Code is supported by more detailed policies and guidance including guidance on avoiding bribery, fraud and corruption; the requirements to disclose interests and rules on gifts and hospitality, and the revised whistleblowing procedure.
12. The Consortium Secretary presented the revised Employee Code to the ESPO Leadership Team on 11 February 2015. It was accepted that a short period of review and evaluation was required to ascertain whether there might need to be some minor adjustments to the County Council version, to ensure 'best fit' to ESPO's environment. The Director would consult with the Consortium Secretary on any changes and the arrangements for locally managing compliance to the requirements, then the approved ESPO version would be communicated to the ESPO workforce. Once the Employee Code was embedded, the HoIAS would undertake independent testing as part of the annual audit of the compilation of the Annual Governance Statement, designed to determine the knowledge and application of the Employee Code.
13. At the same meeting, the Head of Internal Audit Service (HoIAS) briefly introduced to the Leadership Team revised County Council policies, strategies and guidance for anti-fraud and corruption, anti-bribery and money laundering. These three documents are due to be presented to the County Council's Corporate Governance Committee on 20 February. Once they are approved, the HoIAS will consult with the Officers to once again adapt them if necessary to ESPO 'best fit' and then present them to the June Subcommittee for review and recommendation that Management Committee adopts them, before communicating them to the wider ESPO workforce.
14. The Employee Code and its associated policies and guidance and the policies, strategies and procedures for anti-fraud and corruption, anti-bribery and money laundering will form a suite of good conduct and counter fraud documents for ESPO, which will mitigate the risk of fraud.

Recommendations

15. That the Subcommittee: -

- a. recommends that the Management Committee adopts the principles of the CIPFA Code of Practice on Managing the Risk of Fraud and Corruption (2014) and makes a statement in its annual governance report on whether ESPO conforms to the Code or needs to take further action
- b. Notes the progress made with adopting Leicestershire County Council's (the Servicing Authority) Employee Code of Conduct, and the suite of anti-fraud and corruption documents.

Equal Opportunities Implications

16. There are no discernible equal opportunities implications resulting from the audits listed.

Background Papers

None

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Appendices

Appendix 1 – The CIPFA Code of Practice on Managing the Risk of Fraud and Corruption (2014)

Code of practice on

managing the risk of fraud and corruption

**CIPFA COUNTER
FRAUD CENTRE**

Code of practice on managing the risk of fraud and corruption

Published by:

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From 1 January 2015, CIPFA will be at 77 Mansell St, London E1 8AN. There will be no change to CIPFA phone numbers, email and web addresses.

Code of practice principles

Leaders of public sector organisations have a responsibility to embed effective standards for countering fraud and corruption in their organisations. This supports good governance and demonstrates effective financial stewardship and strong public financial management.

The five key principles of the code are to:

- acknowledge the responsibility of the governing body for countering fraud and corruption
- identify the fraud and corruption risks
- develop an appropriate counter fraud and corruption strategy
- provide resources to implement the strategy
- take action in response to fraud and corruption.

A Acknowledge responsibility

The governing body should acknowledge its responsibility for ensuring that the risks associated with fraud and corruption are managed effectively across all parts of the organisation.

Specific steps should include:

- A1 The organisation's leadership team acknowledge the threats of fraud and corruption and the harm they can cause to the organisation, its aims and objectives and to its service users.
- A2 The organisation's leadership team acknowledge the importance of a culture that is resilient to the threats of fraud and corruption and aligns to the principles of good governance.
- A3 The governing body acknowledges its responsibility for ensuring the management of its fraud and corruption risks and will be accountable for the actions it takes through its governance reports.
- A4 The governing body sets a specific goal of ensuring and maintaining its resilience to fraud and corruption and explores opportunities for financial savings from enhanced fraud detection and prevention.

B Identify risks

Fraud risk identification is essential to understand specific exposures to risk, changing patterns in fraud and corruption threats and the potential consequences to the organisation and its service users.

Specific steps should include:

- B1 Fraud risks are routinely considered as part of the organisation's risk management arrangements.
- B2 The organisation identifies the risks of corruption and the importance of behaving with integrity in its governance framework.
- B3 The organisation uses published estimates of fraud loss, and where appropriate its own measurement exercises, to aid its evaluation of fraud risk exposures.
- B4 The organisation evaluates the harm to its aims and objectives and service users that different fraud risks can cause.

C Develop a strategy

An organisation needs a counter fraud strategy setting out its approach to managing its risks and defining responsibilities for action.

Specific steps should include:

- C1 The governing body formally adopts a counter fraud and corruption strategy to address the identified risks and align with the organisation's acknowledged responsibilities and goals.
- C2 The strategy includes the organisation's use of joint working or partnership approaches to managing its risks, where appropriate.
- C3 The strategy includes both proactive and responsive approaches that are best suited to the organisation's fraud and corruption risks. Proactive and responsive components of a good practice response to fraud risk management are set out below.

Proactive

- Developing a counter-fraud culture to increase resilience to fraud.
- Preventing fraud through the implementation of appropriate and robust internal controls and security measures.
- Using techniques such as data matching to validate data.
- Deterring fraud attempts by publicising the organisation's anti-fraud and corruption stance and the actions it takes against fraudsters.

Responsive

- Detecting fraud through data and intelligence analysis.
 - Implementing effective whistleblowing arrangements.
 - Investigating fraud referrals.
 - Applying sanctions, including internal disciplinary, regulatory and criminal.
 - Seeking redress, including the recovery of assets and money where possible.
- C4 The strategy includes clear identification of responsibility and accountability for delivery of the strategy and for providing oversight.

D Provide resources

The organisation should make arrangements for appropriate resources to support the counter fraud strategy.

Specific steps should include:

- D1 An annual assessment of whether the level of resource invested to counter fraud and corruption is proportionate for the level of risk.
- D2 The organisation utilises an appropriate mix of experienced and skilled staff, including access to counter fraud staff with professional accreditation.
- D3 The organisation grants counter fraud staff unhindered access to its employees, information and other resources as required for investigation purposes.
- D4 The organisation has protocols in place to facilitate joint working and data and intelligence sharing to support counter fraud activity.

E Take action

The organisation should put in place the policies and procedures to support the counter fraud and corruption strategy and take action to prevent, detect and investigate fraud.

Specific steps should include:

- E1 The organisation has put in place a policy framework which supports the implementation of the counter fraud strategy. As a minimum the framework includes:
 - Counter fraud policy
 - Whistleblowing policy
 - Anti-money laundering policy
 - Anti-bribery policy
 - Anti-corruption policy
 - Gifts and hospitality policy and register
 - Pecuniary interest and conflicts of interest policies and register
 - Codes of conduct and ethics
 - Information security policy
 - Cyber security policy.
- E2 Plans and operations are aligned to the strategy and contribute to the achievement of the organisation's overall goal of maintaining resilience to fraud and corruption.
- E3 Making effective use of national or sectoral initiatives to detect fraud or prevent fraud, such as data matching or intelligence sharing.
- E4 Providing for independent assurance over fraud risk management, strategy and activities.
- E5 There is a report to the governing body at least annually on performance against the counter fraud strategy and the effectiveness of the strategy from the lead person(s) designated in the strategy. Conclusions are featured in the annual governance report.

Applying the code in practice

Where organisations are making a statement in an annual governance report about their adherence to this code, one of the following statements should be approved according to whether the organisation conforms with the code or needs to take further action.

The statement should be approved by the governing body and signed by the person responsible for signing the annual governance report¹.

Statement 1

Having considered all the principles, I am satisfied that the organisation has adopted a response that is appropriate for its fraud and corruption risks and commits to maintain its vigilance to tackle fraud.

Or

Statement 2

Having considered all the principles, I am satisfied that, subject to the actions identified below, the organisation has adopted a response that is appropriate for its fraud and corruption risks and commits to maintain its vigilance to tackle fraud.

Actions to be taken to manage the risk of fraud:

Action:	Responsibility:	Target date:

¹ Guidance notes on the implementation of the code to support evaluation are available at www.cipfa.org.

Glossary

As the code can apply to a wide range of organisations generic terms are used to describe governance and leadership responsibilities.

Governing body:

The person(s) or group with primary responsibility for overseeing the strategic direction, operations and accountability of the organisation. Examples include, the Board, Council.

The organisation's leadership team:

Leadership team: comprises the governing body and management team.

Examples or relevant roles include, cabinet members, chair of board, accounting officer, chief executive, executive directors, vice-chancellor, principal, headteacher.



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