

Internal Audit Charter (November 2016) : Contents

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1. Introduction

- 1.1. The Public Sector Internal Audit Standards (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 the mandatory elements of the Global Institute of Internal Auditors (IIA) standards, and also additional requirements and interpretations for the UK public sector. The PSIAS were revised from 1st April 2016. A Local Government Application Note (LGAN) developed by CIPFA provides practical guidance on how to apply the PSIAS.
- 1.2. 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), consistent with the Mission of Internal Audit and the mandatory elements of the International Professional Practices Framework (the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the Standards, and the Definition of Internal Auditing). The chief audit executive (the term is explained at 5.10 below) must periodically review the Charter and present it to senior management and the board for approval. Responsibility for, and ownership of, the Charter remains with the organisation and final approval of the Charter resides with the Board (the term is explained in 5.12 and 5.13 below).

2. The Mission of Internal Audit

- 2.1. *To enhance and protect organisational value by providing risk-based and objective assurance, advice and insight.*

3. Purpose

- 3.1. Leicestershire County Council Internal Audit Service (LCCIAS) has adopted the Definition of Internal Auditing from the PSIAS. The definition explains the purpose of the internal audit activity: -

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.

- 3.2. The LGAN further explains that '*the organisation (Leicestershire County Council'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.*

4. Core Principles for the Professional Practice of Internal Auditing

4.1. The Core Principles, taken as whole, articulate internal audit effectiveness.

4.2. For an internal audit function to be considered effective, all Principles should be present and operating effectively. The Head of Assurance Services acting in the role of the role of Head of Internal Audit Service (HoIAS) is responsible for ensuring that internal auditors, as well as the internal audit activity, demonstrate achievement of the Core Principles.

4.3. The Core Principles are: -

- a. Demonstrates integrity.
- b. Demonstrates competence and due professional care.
- c. Is objective and free from undue influence (independent).
- d. Aligns with the strategies, objectives, and risks of the organisation.
- e. Is appropriately positioned and adequately resourced.
- f. Demonstrates quality and continuous improvement.
- g. Communicates effectively.
- h. Provides risk-based assurance.
- i. Is insightful, proactive, and future-focused.
- j. Promotes organisational improvement.

5. Definitions

Independence

5.1. 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

5.2. 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

- 5.3. 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'*.
- 5.4. 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 the Council's control environment (including where it works in partnership with, and leads on behalf of others).
- 5.5. LCCIAS aims to co-ordinate its assurance activity with other internal and external providers of assurance services to ensure sufficient and proper coverage over the control environment and minimise duplication of efforts.

Consulting activity

- 5.6. 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'*.
- 5.7. LCCIAS often acts in a consulting role and provides support for improvement in the Council'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 includes counsel, facilitation and training.
- 5.8. There is a specific public sector requirement that *'Approval must be sought from the board (see 5.12 below) for any significant additional consulting services not already included in the audit plan, prior to accepting the engagement. The HoIAS' determination of 'significant' is 5% of total available planned days.*
- 5.9. 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 the Council's control environment.

The Chief Audit Executive

- 5.10. 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 Leicestershire County Council (the Council) is performed by the Head of Assurance Services when undertaking the role of Head of Internal Audit Service (HoIAS). Within this Charter, all references from hereon are to the HoIAS.

The Board and Senior Management

- 5.11. 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

- 5.12. The PSIAS definition of the Board informs that it, '*...may refer to an audit committee to which the governing body has delegated certain functions*'. For the Council, responsibility for, '*...the promotion and maintenance within the Authority of high standards in relation to the operation of the Council's Code of Corporate Governance*' is delegated to the Corporate Governance Committee (the Committee). Other responsibilities of the Committee that align to requirements of PSIAS include monitoring: -
- a. the adequacy and effectiveness of the Internal Audit Service
 - b. the effectiveness of officer arrangements for ensuring an adequate internal control environment and combating fraud and corruption
 - c. the arrangements for the identification monitoring and management of strategic and operational risk within the Council.
- 5.13. Consequently, at the Council the Committee will perform the function of the Board. Within this Charter, all references from hereon are to the Committee.

The Senior Management Team

- 5.14. 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*'. In order to fully understand and be able to fulfill its responsibilities, the HoIAS and his/her team requires unfettered access to Directors and especially the statutory officers i.e. the Chief Financial Officer and Monitoring Officer.
- 5.15. Consequently, at the Council, Corporate Management Team (CMT) will perform the functions of the Senior Management Team. Within this Charter, all references from hereon are to the CMT.

6. Authority

Statutory and Professional Requirements for internal audit activity

- 6.1. The Accounts and Audit Regulations 2015 (the Regulations), require that *'A relevant authority must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance'*.
- 6.2. 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'*. The Council's Constitution (Financial Procedure Rule 15(a)) determines that responsibility for arranging a continuous internal audit of the County Council's financial management arrangements will be delegated by members of the County Council to the Chief Finance Officer (CFO).
- 6.3. The relationship between the head of the internal audit activity, namely the HoIAS, and the CFO 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*
- 6.4. At the Council, the CFO: -
- a. contributes to and agrees the overall annual internal audit plan
 - b. 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. determines LCCIAS resources and approves the boundaries and limits for any external trading;

Access

- 6.5. 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'*.

- 6.6. The Council's Constitution Financial Procedure Rule 15(b) states that the CFO or an authorised representative (interpreted to be any LCCIAS internal auditors) has authority to:-
- a. enter any Council building or land at all reasonable times;
 - b. have access to all records, documents and correspondence relating to any transactions of the Council;
 - c. receive such explanations as he or she considers necessary on any matter under examination;
 - d. require any employee of the Council to produce cash, stores or any other Council property under his/her her control.
- 6.7. Whilst not explicit, Rule 15(b) is a conduit to seeking agreement to access partner organisations' records.

Organisational independence

- 6.8. 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'*.
- 6.9. PSIAS 1110 on Organisational Independence states that *'the 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 Committee, 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'*.
- 6.10. The HoIAS reports to both the CFO and to the Committee (occasionally reports are approved with CMT beforehand). The HoIAS has direct access to all of the Council's Directors and their management teams, the Chief Executive, the Monitoring Officer (MO) and CFO, and, if required, to the Chair of the Committee. 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.
- 6.11. PSIAS 1130 requires that *'if independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties'* and specifically at 1130.A2 that, *'Assurance engagements for functions over which the chief audit executive (HoIAS) has responsibility must be overseen by a party outside the internal audit activity'*.

6.12. The HoIAS is responsible for the administration and development of, and reporting on, the Council's risk management framework. Whilst the HoIAS doesn't identify, evaluate and manage the risks, since that is a management function, it is considered prudent that any internal audit engagement covering the risk management framework, especially for the formation of the annual opinion on the effectiveness of the control environment, would be overseen by a party outside of the internal audit activity.

7. Responsibility

This section of the Charter summarises the key responsibilities of the Committee, CMT and the HoIAS and LCCIAS internal auditors

The Committee's responsibilities

7.1. Examples of key duties within the PSIAS which align to the Committee's Terms of Reference (ToR) are as follows: -

- a. approve the internal audit charter
- b. approve the risk based internal audit plan
- c. receive communications from the HoIAS on internal audit performance relative to its plan and other matters
- d. receive an annual confirmation from the HoIAS with regard to the organisational independence of the internal audit activity
- e. receive 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 7.5a)
- f. make appropriate enquiries of management and the HoIAS to determine whether there are inappropriate scope or resource limitations.

CMT's responsibilities

7.2. The effectiveness of the internal audit activity relies upon the full co-operation of management. Under this Charter, CMT 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 recommendations are implemented within agreed timescales;
- g. providing assurance that management actions have been implemented
- h. notifying the CFO of any significant changes in the control environment and proposed changes and developments in systems;

- i. notifying the CFO and MO of all suspected or detected fraud, corruption or impropriety.

The HoIAS' responsibilities

Code of Ethics

7.3. 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. 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

7.4. 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.

7.5. 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 Mission, Definition and Core Principles of Internal Auditing; Code of Ethics and the Standards
- 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.

The HoIAS must discuss with the Committee 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 CFO as well as with the external assessor or assessment team. The HoIAS must communicate the results of the QAIP to CMT and the Committee
- the results of the QAIP and progress against any improvement plans must be reported in the HoIAS annual report (usually the May 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 Mission, Definition and Core Principles of Internal Auditing; Code of Ethics and the Standards impacts the overall scope or operation of the internal audit activity, the HoIAS must disclose the non-conformance and the impact to CMT and the Committee. 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 the Council'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 Committee
- the HoIAS must include in the risk-based plan the approach to using other sources of assurance (e.g. the External Auditor or where the Council is in partnership with another organisation) and any work required to place reliance upon those other sources.

Reporting to the Committee on performance relative to the plan is well established. However PSIAS also requires periodically reporting to the CFO, CMT and the Committee 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 the Council;
 - Ensuring effective organisational performance management and accountability;
 - Communicating risk and control information to appropriate areas of the Council;
 - Coordinating the activities of and communicating information among the Committee, external and internal auditors and management.

For risk management processes, there are requirements to evaluate risk exposures relating to the Council's governance, operations and information systems and the potential for the occurrence of fraud and how the Council 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 (see 5.4b) 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 the Council'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 management has accepted a level of risk that may be unacceptable and there is a danger that Council objectives may not be achieved, the matter should be discussed with the CFO and/or CMT. If the HoIAS determines that the matter has not been resolved, the HoIAS must communicate the matter to the Committee.

8. The Scope of Internal Audit Activity

- 8.1. CMT is responsible for establishing and maintaining appropriate governance, risk management and control arrangements (i.e. the control environment), for not only County Council activities, but also for those provided in conjunction with, and/or on behalf of its partners. LCCIAS' remit extends to the Council's entire control environment.

8.2. However, limitations on internal audit resource requires the HoIAS to understand and take account of the position with respect to the Council'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.

8.3. Internal audit activity for the Council (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 studies, reviews or assignments as directed (or approved) by the Chief Financial Officer;

The role of internal audit in compiling the annual governance statement

8.4. The planning and undertaking of assurance engagements, knowledge of, and co-ordination with, other assurance providers and specific requirements under PSAIS 2100, leaves the HoIAS well placed to compile the annual governance statement (AGS). The process of preparing the AGS should itself add value to the corporate governance and internal control framework. The AGS remains a corporately owned document.

The role of internal audit in fraud and corruption

8.5. CMT is responsible for developing and maintaining a control environment that mitigates risk of fraud and corruption

8.6. The HoIAS is responsible for developing and maintaining advice and guidance the Council'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
- Developing training and guidance on fraud awareness
- Compiling a fraud risk assessment that is the basis for planning anti-fraud audits
- Coordination of the Council's involvement in national anti-fraud projects
- Informing Committee of initiatives, progress and outcomes

8.7. 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 the service itself following an assessment of risk and financial impact.

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