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Appendix – PSIAS Action Plan

Public Sector Internal Audit Standards Report – May 2014**1. Introduction**

- 1.1 This report deals with the outcome of the assessment of the Internal Audit Function against the New Public Sector Internal Audit Standards (PSIAS), which came into effect on 1 April 2013. The report identifies the degree of compliance by the Audit Function with the new mandatory standards and relevant actions required by the Shared Services Partnership to be fully compliant with the standards. Management is requested to consider and agree the proposals, or suggest amendments as appropriate. For the purposes of this report, the position referred to within the standards as Chief Audit Executive (CAE), which refers to the person with lead professional responsibility for the internal audit function, is currently performed by the Audit Risk and Anti-Fraud Manager (ARAFM). The exact title within the public sector for the lead audit officer is not prescribed within the standards, but is usually titled, Chief Internal Auditor, or Head of Internal Audit, in most public sector organisations, including local authorities.

2. Background

- 2.1 New mandatory Internal Audit Standards for the public sector came into effect from 1 April 2013. The standards provide a comprehensive and consistent framework for internal audit across the UK public sector. A summary report, for information purposes, on the new standards was sent to Management Team and the Audit Committee/Board in June 2013, ahead of this comprehensive assessment to determine the Function's compliance with the new standards.
- 2.2 The new standards were issued by the "Relevant Internal Audit Standards Setters" in the public sector; CIPFA, HM Treasury, the NHS, the Scottish, Welsh and Northern Ireland Governments. The PSAIS replaces the CIPFA Code of Practice for Internal Audit in Local Government 2006.
- 2.3 This ground breaking development (the PSIAS) encompasses the mandatory elements of the Institute of Internal Auditors (IIA) International Professional Practices Framework (IPPF) as set out below.
- 2.4 To facilitate implementation of the standard, current procedures and practices within the Audit Function have been assessed against the Practice Notes and Self-Assessment Toolkit issued by CIPFA. The results of this assessments and relevant actions to comply with the standards are also set out below.

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2.5 The Council's Internal Audit Service

Sevenoaks District Council and Dartford Borough Council entered into a shared services agreement in 2010 for the provision of an Internal Audit Service. The assessment and proposals in this report is intended to address the Audit Service as a single entity, but with relevant adjustments made to comply with individual Council's customs, traditions and policies, or procedures where appropriate.

Executive Summary:

The new PSIAS sets out mandatory requirements which all Public Sector Internal Audit Functions are required to comply with. This ground breaking development is intended to standardise the internal audit process across the UK Public Sector and improve the quality and effectiveness of the audit function in assisting the Council to deliver its objectives more effectively. The self-assessment of the Council's shared service internal audit service against the new standards indicates that there is substantial degree of compliance with the new standards. However, there are some key aspects which require further development or action. A summary of the key points are as follows:

- **Closer Working With Management** – whilst the independence of the internal audit function is re-emphasised, greater emphasis is placed on the effectiveness of the function. Hence internal audit must work closely with senior management to facilitate the achievement of the Council's objectives and delivering value for money.
- **Definition of Internal Audit** - The new definition of internal audit acknowledges that the internal audit service can also provide consultancy to management, in contributing towards the achievement organisation's goals and objectives. However, this work must be separated from statutory assurance requirement and must be defined.
- **Internal Audit Charter** - The Council's Internal Audit Charter would require updating to reflect the mandatory requirements of the PSIAS.
- **Responsibilities of the Chief Audit Executive (CAE)** - The PSIAS specify the responsibilities, qualifications and status of the CAE (see 1.1 above), as the professional head of the service; and that the CAE should not report at a level lower than the Corporate Management Team. Although most of the responsibilities of the CAE are included in the Audit, Risk and Anti-Fraud Manager's JD, there is a need to review the position of the ARAFM in order to determine fitness for purpose; including the position of the function within the organisation and its existing structure. (see para 7.2, 7.3 and point 3 of the action)
- **Quality Assessment and Improvement Planning** - There is a new requirement for an internal and an external quality assessment process. The external assessment should be conducted by a suitably qualified and independent external assessor. The external assessment would incur an additional cost to the Council.

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- **Proficiency, Capability and Performance** - some aspects of the team's performance will require further development to improve individual proficiency, capability and effectiveness. This is also address on the action plan.
- **Engagement Planning** - internal audit engagement brief should not only be risk based, but should also include value for money considerations as standard, where appropriate, and agreed with relevant stake holders.
- **Annual Governance Statement** – non-conformance with the PSIAS is required to be reported in the Council's AGS

3. Purpose of the PSIAS

3.1 There are four key objectives of the PSIAS

- 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.

4. Summary of Key Elements within the Standards

4.1 The standards recognise that a professional, independent and objective audit service is one of the key elements of good governance in local government. To this effect, the standard emphasised the need for internal audit to be “effective” in delivering its engagement responsibilities. An effective internal audit service is required to understand the whole of the organisation and should possess the following key characteristics:

- Understand its position with respect to the organisation's other sources of assurance and plan its work accordingly
- Be seen as a catalyst for improvement at the heart of the organisation
- Add value and assist the organisation in achieving its objectives, and
- Be forward looking – knowing where the organisation wishes to be and aware of the national agenda and its impact

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5. Definition of Internal Audit.

5.1 A key aspect of the standard is the new definition of internal audit, as follows:

5.2 *Internal Audit 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.*

5.3 The above replaces the old definition within the previous CIPFA Code of Practice 2006 which is now no longer applicable:

5.4 *Internal Audit is an assurance function that provides an independent and objective opinion to the organisation on the control environment by evaluating its effectiveness in achieving the organisation's objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources.*

5.5 Comparative Analysis with Previous Definition - The key differences are:

- a. Greater emphasis is placed on “independence” of the audit activity or function. The previous requirement was on “independence” of the audit “opinion”. The new requirement is “independence” of the audit activity.
- b. Implications: There is a need to assess where internal audit sits within the organisation in order to determine whether it sufficiently meets the requirement for independence and whether it is of sufficient status and seniority to be effective in delivering an informed and objective assurance function. This is covered in more details below (**see 7.2 below**)
- c. There is greater emphasis on consultancy, in addition to the standard assurance requirements and also “adding value” in improving an organisation's operations. Consultancy was not mentioned in the previous definition of internal audit, but it is expected that this would be driven by management. This would involve training staff to a level of proficiency not previously required for the average internal audit staff. The level of proficiency required to deliver consultancy at an effective corporate level, would be at Chartered Internal Auditor Level; Full Accountancy Qualification, or equivalent.
- d. There is also greater emphasis for the internal audit service to work towards assisting management to deliver the organisation's objectives.

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Again this would require internal auditors to be more innovative than previously the case. Internal audit is in a unique position to affect the delivery of more effective organisational objectives, by utilising intelligence obtained of organisational risks, controls and activities in a co-ordinated and joined up way, to facilitate improvement proposals, or innovative solutions to identified problems or goals.

- e. There is also greater emphasis on utilisation of inherent skills to improve the organisation's risk management, control and governance processes. Although, these skills already exist at managerial level, the team as a whole would need some development to facilitate this across the board. In the short term, some key skills could be transferred to staff that are amenable to developing their expertise, via in-house training and development, for staff who would benefit from such opportunities and are prepared to engage in developing their skills further.
- f. The overall implication of the new definition of internal audit is that the service can no longer be viewed simply as a function which only delivers regulatory assurance; but that it can also legitimately engage in consultancy which can generate innovation and contribute more directly towards organisational improvement and achievement of organisational objectives. This was previously implicit in the old standards, but now carries a more explicit implication. However, in addition to developing staff, there would be a need to separate statutory assurance requirements (which should be separately budgeted for) from consultancy activities. Also a proposal and approval process would need to be specified.

5.6 Key attributes of independence:

5.6.1 The effectiveness of Internal Audit and the reliance which key stakeholders places on it (Audit Committee, External Audit etc.) hinges on its independence; or perceived independence. The key attributes contributing to real or perceived independence are cited as follows:

- Status of the Chief Audit Executive (CAE)/ARAFM.
- Position of the Audit Function within the organisation.
- Access to records and information for the Auditors in fulfilling their responsibilities.
- The proficiency, objectivity and diligence with which Auditors conduct their work.
- The existence of an independent Audit Committee.
- Adherence and degree of compliance to the PSIAS.

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The internal self-assessment to the Standards indicates that the Audit function is substantially compliant with the requirements for independence. However, the position of the CAE or equivalent and the position of IA function within the organisation require further review. For e.g. currently the role of CAE is performed by the Audit, Risk and Anti-Fraud Manager, whose status is not quite at the same level as implied in the Standards. Thus this is an area for further development and has been addressed in the action plan. (See action Plan 3)

6. Key Aspects of the PSIAS

There are two key aspects of the Standards:

- 6.1 **Attribute Standards** – these apply to the type of organisation, for example, local authorities, as well as to individual auditors who are providing the internal audit service in local authorities.
- 6.2 **Performance Standards** – these describe the nature of the internal audit service provided. It also set the criteria against which the performance of an internal audit function can be measured.

7. Details of Attribute Standards

There are four key attribute standards as follows:

7.1 Purpose, Authority and Responsibility – Standard 1000

- 7.1.1 The standard requires the purpose, authority, scope and responsibilities of the internal audit service to be set out in an Internal Audit Charter, which should recognise the mandatory nature of the new standards, including the independence of internal audit. The Chief Audit Executive (Head of Internal Audit) must review the Charter annually and present it to senior management and the Board (The Audit Committee/Audit Board) for approval.
- 7.1.2 Following the initial review, a new Charter has been drafted for both Councils within the partnership, which takes account of the bespoke needs of each Council. The SDC Charter has already received MT and Committee approval. The DBC Charter is now ready for SMT approval and accompanies this report. Once approved, it will be presented to the Audit Board in June for their consideration.

7.2 Independence and Objectivity – Standard 1100

- 7.2.1 The Standard require Internal Audit to be independent and for internal auditors to be objective in the approach and conduct of their work. The

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requirement for independence necessitates organisational and operational independence. It covers both real and perceived. The requirement is that the CAE must report to a level no lower than the corporate management team; and that the CAE should be of sufficient status within the organisation to be effective in meeting the criteria for independence and objectivity. Organisations are required to ensure that the CAE's independence is protected so that conflicts of interest, real or perceived are avoided. To facilitate this the public sector application note states that the Chief Executive (or equivalent) and the Chair of the Audit Committee should be involved in the appraisal of the lead officer for internal audit (See Action Plan 4)

- 7.2.2 Some of the criteria for independence and objectivity are met within existing arrangements. However, the role of the CAE requires review and greater clarity, as indicated above, as the most senior personnel within the audit service is the "Audit Risk and Anti-Fraud Manager", rather than a Head of Service (or equivalent) as required by the new standards. Although most of the key requirements of the CAE are within the scope of the Job Description of the Audit Manager, organisationally, the role is not consistent with that of a Head of Service, or Chief Audit Executive. The ARAFM currently performs the role of CAE as well as that of an audit manager (these roles are required to be separate and distinct) as their responsibilities are professionally separate. The role of the lead audit officer is required to be responsible for the strategic direction of the function, whilst that of an audit manager is to facilitate the operational aspects of the function. Thus there is a need to review the structure in order to determine fitness for purpose; and to ensure that the function sits at the appropriate level organisationally. The CIPFA Statement on the Role of the Head of Internal Audit 2010, states that the Head of Internal Audit must be:

"Sufficiently senior and independent within the organisation's structure to allow them to carry out their role effectively and to be able to provide credible constructive challenge to Management Team"

- 7.2.3 Also some direct reporting is done by lower grade staff to senior management at SDC (though not at DBC) which may impact on the perception of independence. This would need to be reviewed in the light of the standards to determine its appropriateness, or to transparently define the basis and scope of such reporting.

Public Sector Internal Audit Standards Report – May 2014**7.3 Proficiency and Due Professional Care – Standard 1200**

- 7.3.1 Much of the attributes of this standard were within the 2006 Code and the CIPFA Statement of the Role of the Head of Internal Audit 2010. A key requirement is that the CAE must be professionally qualified and suitably experienced in internal auditing. The CAE is also required to ensure that the team periodically assess individual auditors against the skills and competencies set out in the relevant job descriptions and person specifications. Internal auditors are required to conduct their work with diligence and proficiency, including compliance with professional code of ethics. All auditors also have a professional responsibility to undertake a programme of continuing professional development (CPD) to maintain and develop their professional competencies.
- 7.3.2 The standard also requires the internal audit function to have appropriate resource to meet its objectives. It should have appropriate numbers of staff, grade, qualifications, personal attributes and experience, in order to meet its objectives and to comply with the PSIAS standards. The current structure of the function is not consistent with the standards (see 7.2.2 above). The CAE role straddles that of a head of service and an audit manager, thus imposing a significant degree of expectations on one individual, as well as a disproportionate amount of the responsibilities and burden of delivering an effective service. It is therefore not the most effective arrangement and is not consistent with professional standards. There is therefore a need to review the structure to ensure to ensure fitness for purpose. (See Action Plan 3)
- 7.3.3 In regards to qualifications, the current internal audit manager has the relevant qualifications, experience and attributes. Two members of the team have relevant professional qualifications. Also opportunities for professional qualification and CPD training are available. But further development would be required for some team members in meeting the requirements, both in relevant competencies and qualifications.
- 7.3.4 There is existing arrangements in place to ensure that all audit work is carried out with due professional care, including guidance and supervision arrangements. The team also has periodic technical meetings, in addition to monthly team meetings, to update staff on technical developments and service improvements. However, the degree of compliance by individual auditors with these arrangements is variable, hence indicating that there is room for further development by individual auditors.

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One of the issues identified during the self-assessment process for the shared service internal audit team, is the impact of isolation on moral and performance for some audit staff who work mainly away from the rest of the team. This is an issue which requires addressing as part of the review process, (although it may not necessarily have a direct impact on compliance with the new standards), in view of its impact on morale, quality and performance. (See Action Plan 8)

7.4 Quality Assurance and Improvement Programme – Standard 1300

- 7.4.1 The standards require the CAE to develop and maintain a quality assurance and improvement programme (QAIP). This is a new requirement for local authorities. The key objective of this requirement in applying it within the public sector, is aimed at raising standards and consistency in the quality of the internal audit activity across the board. Part of the requirement is that the CAE should ensure that the design of the QAIP could be used to assess conformance with the relevant aspects of the PSIAS.
- 7.4.2 A key requirement is that the CAE should establish policies and procedures which would enable internal audit staff to comply with the standards in providing a high quality and effective internal audit service. The quality assurance requirement stipulates both internal and external assessments.
- 7.4.3 **Internal Assessments** – the CAE should ensure that audit work is allocated to staff with the appropriate level of skills and experience; and that audit staff at all levels are appropriately supervised. The audit function has policies and procedures in place, including performance targets, which conforms with good professional practice. The audit team also currently complies with ISO9001 in its working practices. The requirement for internal assessments necessitates an annual review of the team's performance, which is overseen by senior management with an appropriate understanding of the requirement of internal audit objectives. The outcome of this assessment could also form part of the CAE's annual appraisal. (See Action Plan 8)
- 7.4.4 **External Assessments** – the requirement stipulate an external assessment should be carried out by a suitably qualified independent external assessor, in compliance with the requirements of the standards, every five years. However, it is expected that this would commence following the first full year of implementation of the standards. To this effect, the first assessment could be undertaken after April 1 2014 and every five years thereafter. The work would require an

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external provider, suitably qualified, to be employed to carry out this task at an additional cost to the service. (See action Plan 9)

- 7.4.5 To facilitate the external assessment, at minimum costs, the self-assessment toolkit could be used to carry out an initial assessment, which would then be validated by the external assessor, in line with available supporting evidence. It is suggested that the Institute of Internal Auditors be employed to perform this role in the first year, as the standards are derived from the International IIA Standards.

8. Details of Performance Standards

There are six key Performance Standards as follows:

8.1 Managing the Internal Audit Activity – Standard 2000

- 8.1.1 The standard requires the CAE to effectively manage the Internal Audit Activity to ensure that it delivers its objectives and adds value to the organisation in meeting the Council's key priorities and objectives.
- 8.1.2 In particular, the CAE is required to develop a risk based internal audit plan which has clear links to the audit Charter and the key priorities of the Council. The plan should address the minimum level of coverage required to provide satisfactory assurance and be flexible enough to reflect the changing risks and priorities of the organisation. The plan must distinguish between work required for assurance, consultancy and other work.
- 8.1.3 Current practice within the Partnership internal audit arrangements regarding audit planning and the management of the audit activity is substantially compliant with the new code. The audit plan is risk based and reflects the organisation's key priorities as agreed with senior management, during the planning stage. Account is also taken of other sources of assurance, including external audit arrangements and their work plan. The plan is also endorsed by the relevant Audit Committee/Board and fully reflects available resources. Progress reports are periodically sent to the Audit Committee/Board, via senior management team.
- 8.1.4 An additional benefit within current arrangement is that the CAE is also responsible for co-ordinating risk management across both Councils in the Partnership and therefore is well placed to align audit planning and risk, in developing a risk based internal audit plan.
- 8.1.5 However, the issues raised above would be more effectively strengthened by addressing the position of the CAE, as cited above.

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8.2 Nature of Work – Standard 2100

- 8.2.1 The standard sets out the main areas of the Council, where Internal Audit Activity should focus in order to contribute towards improvements. These include governance, risk management and internal control. Current arrangements meet this requirement and in some cases surpass the requirement as risk management is co-ordinated by the ARAFM.

8.3 Engagement Planning – Standard 2200

- 8.3.1 The standard requires an internal audit brief to be prepared, discussed and agreed with relevant managers. The brief should establish the objectives, scope and timing for the assignment and its resource and reporting requirements. The work should be risk based and includes value for money considerations where applicable.
- 8.3.2 Current arrangements substantially meet the standard. However, to fully comply with the standard, greater emphasis will be placed on value for money considerations going forward. (See Action Plan 11)

8.4 Performing the Engagement – Standard 2300

- 8.4.1 The standard requires the CAE to have systems in place to enable auditors to obtain and record sufficient evidence to support their conclusions, professional judgements and recommendations. Working papers should always be sufficiently complete and detailed to enable an experienced internal auditor with no previous connection with the audit to ascertain what work was performed, to re-perform if necessary and to support the conclusions and judgements reached. All internal audit work should also be subjected to an internal quality control process.
- 8.4.2 Current arrangements substantially meet the standard, in terms of the framework arrangements in place, which also form part of the team's ISO9001 accreditation.
- 8.4.3 However, to fully meet the standard there is a need for further development regarding the competencies of individual auditors to improve their compliance with aspects impacting on sampling, testing and how conclusions are drawn, based on the evidence. Further development would also be required in enabling individual auditors to propose more insightful and practical recommendations which clearly align with Council objectives, rather than with an unattainable perception of best practice. Implementing this standard and the next

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two standards set out below, presents an opportunity to revisit the team's "ways of working" and to consider whether increased use of technology could improve overall performance, by streamlining and automation of some key activities, which could contribute towards quality of service provision, improved performance and value for money. The audit manual will also need to be revised and updated to reflect the new standard. (See action Plan 10)

8.5 Communicating Results – Standard 2400

- 8.5.1 The standard requires the internal audit activity to be communicated to relevant stake holders timely, for the results to be effective. It also requires internal auditors to ensure that all material facts known to them are disclosed in their audit reports which, if not disclosed, could distort their reports or conceal unlawful practice, subject to confidentiality requirements. In addition, the standard also requires that recommendations with a wider impact are reported to the appropriate forum; and also that where relevant, appropriate measures are taken to update risk registers.
- 8.5.2 Further, the CAE is required to provide an annual audit report to the Audit Committee/Board to support the Council's Annual Governance Statement, which must contain an overall assurance opinion, as well as a summary of the work done during the year to support the assurance opinion and any non-conformances with the PSIAS, including disclosure to any impairment of objectivity, real or perceived; and progress of action against improvement plans required by the QAIP
- 8.5.3 Current arrangements substantially meet the standard. However, to fully meet the standard, improvements would need to be made to the annual report to include those aspects set out above (see para 8.5.2) which are currently not reflected within the annual report. This would form part of the revised internal audit manual. (See Action Plan 11)

8.6 Monitoring Progress – Standard 2500

- 8.6.1 The standard requires the CAE to ensure that management actions have been effectively implemented or, if not, that senior management have accepted the risk of not taking action. The CAE must implement a follow-up process for ensuring the effective implementation of audit results, or ensuring that senior management are aware of the consequences of not implementing agreed action points and prepared to accept the risk of such consequences occurring. The CAE is also required to develop escalation procedures, for cases where agreed recommendation have not been implemented by the agreed date; and

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also cases where management accepts risk identified as part of the audit process. The relevant procedures should ensure that the risk of not taking action is understood at a sufficiently senior level within the Council. This would of necessity be executive level, sec 151, SMT and the Audit Committee/Board.

- 8.6.2 Current arrangements substantially meet the above requirements. However, to be fully compliant with the standards some minor adjustments would need to be made to escalating procedures for communicating risk acceptance by service managers, to senior management, and the Audit Committee/Board. This would form part of the updated audit manual. (See 8.6)

9. Conclusion

- 9.1 The new mandatory Public Sector Internal Audit Standards is designed to standardise and improve internal auditing in the public sector. This ground breaking development has been warmly welcomed by the profession across the board, as it is intended to Internal Audit as a Function more dynamic, as well as more effective in assisting organisations within the Public Sector to achieve their objectives and to gain improvements in value for money.
- 9.2 Implementing the standards present a valuable opportunity for the Councils within the Partnership to strengthen their internal audit function and its effectiveness. Thus delivering greater value for money.
- 9.3 The self -assessment of the Council Audit Function against the standards indicate that the current Partnership Internal Audit Service substantially complies with the standards. However, there are some areas for further development which have been addressed in the action plan attached as an Appendix to this report.

10. Recommendation

It is recommended that management consider and support the proposals set out in the attached action plan prior to the report being sent to the Audit Committee/Board for consideration

Appendix A – PSIAS Action Plan