

**BRISTOL CITY COUNCIL
AUDIT COMMITTEE
8th November 2013**

Report of: Chief Internal Auditor

Report Title: Internal Audit Charter, Strategy and Terms of Reference

Ward: Citywide

Officer presenting report: Melanie Henchy-McCarthy/ Alison Mullis, Chief Internal Auditor (J/S)

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RECOMMENDATION

The Audit Committee note the introduction of new mandatory standards for Public Sector Internal Audit and review and approve the revised Internal Audit Charter, Strategy and Terms of Reference.

SUMMARY

The significant issues in the report are:

- Mandatory Public Sector Internal Audit Standards (PSIAS) were introduced and effective from 1 April 2013.
- The Internal Audit Charter has been updated to reflect the PSIAS requirements (Paragraph 2 and Appendix A)

Policy

Public Sector Internal Audit Standards are mandatory from 1 April 2013 and Internal Audit is required to comply with them. This includes the requirement to have an Internal Audit Charter.

Consultation:

Internal: s151 Officer, Strategic Leadership Team

External: None necessary

1. Introduction

- 1.1 With effect from 1st April 2013, new Public Sector Internal Audit Standards (PSIAS) have been introduced as mandatory guidance that constitutes the principles of the fundamental requirements for the professional practice of internal auditing within the public sector and for the evaluation of the effectiveness of Internal Audit's performance. These standards have replaced CIPFA's

Code of Practice for Internal Audit in Local Government as the mandatory guidance for internal audit in the public sector.

- 1.2 The requirement for an Audit Charter is set out in the PSIAS. The charter is intended to define Internal Audit's purpose, authority and responsibility. It establishes Internal Audit's position within the organisation, including the nature of the Head of Internal Audit's functional reporting relationship with Audit Committee; rights of access to records, personnel and physical properties relevant to the performance of audits; and defines the scope of internal audit activities.

2. Internal Audit Charter, Strategy and Terms of Reference

- 2.1 The Audit Committee have previously approved the Internal Audit Charter and Terms of Reference and a separate Internal Audit Strategy in June 2006. These documents have been updated annually since then.
- 2.2 The new standards recommend inclusion of certain items in the Internal Audit Charter, some of which we had previously included in a separate strategy. Therefore, the two documents have now been combined into an Internal Audit Charter, Strategy and Terms of Reference, see Appendix A.
- 2.3 The PSIAS require the following to be included in the Audit Charter:
 - 2.3.1 Clarity around Internal Audit's consultancy role and arrangements to ensure avoidance of conflicts of interest
 - 2.3.2 Clarity around the nature of assurance provided to external clients
 - 2.3.3 Defining the responsibilities of the Board and Statutory Officers.
 - 2.3.4 Determining arrangements for self-assessment and external validation of compliance with the standards as part of the Quality Assurance and Improvement Programme
- 2.4 The PSIAS included a lengthy checklist for assessing compliance and Internal Audit is currently working through this checklist to ensure full compliance. The results of this review will be reported to the Committee. The standards also require an external assessment of compliance with the standards. It is envisaged this will be completed via a peer review programme with neighbouring Council Audit Teams which is being planned for early in 2014/15.
- 2.5 Training has been provided to all Internal Audit staff regarding the requirements of the standards.

Other Options Considered

None necessary. The requirements for an Audit Charter is mandatory under the Public Sector Internal Audit Standards.

Risk Assessment

Failure to comply with the Public Sector Internal Audit Standards would attract adverse comment from the Council's external auditors and weaken the effectiveness of Internal Audit.

Equalities Impact Assessment

None necessary for this report

Environmental Impact Assessment

None necessary for this report

Legal and Resource Implications

Legal - none sought.

Resources - none arising from this report

Appendices

Appendix A – Draft Internal Audit Charter, Strategy and Terms of Reference

LOCAL GOVERNMENT ACCESS TO INFORMATION

Background Papers - Public Sector Internal Audit Standards and Local Government Application Note.

BRISTOL CITY COUNCIL

INTERNAL AUDIT CHARTER, STRATEGY & TERMS OF REFERENCE

1. Purpose and Statutory Requirements

- 1.1 The purpose of the Internal Audit Charter, Strategy and terms of reference is to define the purpose, authority, scope and responsibility of Internal Audit. It complies with the mandatory requirements of the Public Sector Internal Audit Standards.
- 1.2 Internal Audit is an independent, objective assurance and consulting function that is designed to add value and improve an organisation's objectives. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes.
- 1.3 Internal Audit is a statutory service in the context of the **Accounts and Audit Regulations 2011**, which state in respect of Internal Audit that:
- "A relevant body must undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control."*
- 1.4 Internal Audit must comply with the Public Sector Internal Audit Standards (PSIAS) which became mandatory across the UK public sector from the 1 April 2013. The purpose of the PSIAS is to define the nature of internal auditing within the UK public sector, set basic principles for carrying out internal audit, establish a framework for providing internal audit services and establish the basis for the evaluation of internal audit performance and to drive improvement planning.
- 1.5 The work of Internal Audit forms an essential part of the assurance framework in place which informs management when considering and compiling the Annual Governance Statement. However, the existence of Internal Audit does not diminish the responsibility of management to establish systems of internal control to ensure that activities are conducted in a secure, efficient and well-ordered manner.

2. Scope

- 2.1 The scope for Internal Audit work includes the whole control environment comprising risk management, internal control and governance. This effectively means that Internal Audit independently reviews all of the Council's operations, resources, services and processes in place to:
- establish and monitor the achievement of Council objectives
 - identify, assess and manage the risks to achieving the Council's objectives
 - facilitate policy and decision making
 - ensure the economical, effective and efficient use of resources
 - ensure compliance with established policies, procedures, laws and regulations
 - safeguard assets and interests from losses of all kinds, including those arising from fraud, irregularity or corruption
 - ensure the integrity and reliability of information, accounts and data, including internal and external reporting.
- 2.2 Where the scope of the audit work extends to services provided through partnership arrangements. The Chief Internal Auditor will decide, in consultation with all parties, whether Internal Audit staff conduct the work to derive the required assurance themselves or rely on the assurances provided by other auditors. Where necessary the Chief Internal

Auditor will agree the appropriate access rights in order to obtain the necessary assurances.

3. Authority

3.1 Internal Audit, with strict accountability for confidentiality and safeguarding records and information, is authorised to have full, free and unrestricted access to any and all Council records (whether manual or computerised systems), personnel, cash, stores, other assets and premises, including those of partner organisations, where appropriate and have authority to obtain such information and explanations as considered necessary to fulfil Internal Audit responsibilities.

3.2 The **Accounts and Audit Regulations (England) 2011** provide that:

Any officer or member of that body must, if the body requires:

- (a) *make available such documents and records as appear to that body to be necessary for the purposes of the audit; and*
- (b) *supply the body with such information and explanation as that body considers necessary for that purpose.*

3.3 All Directorates of the City Council, or partners/agents contracted to provide services on its behalf, are required to give complete co-operation to Internal Audit staff for the expedient fulfilment of the audit process.

4. Definitions and Responsibilities of Officers and Members in relation to Internal Audit

4.1 For the purpose of this Charter, Strategy and Terms of Reference the following definitions shall apply:

- The Board = the Audit Committee - those charged with independent assurance on the adequacy of the Council's risk management framework, the internal control environment and the integrity of financial reporting arrangements.
- Head of Paid Service = The City Director - who has responsibility for the corporate and strategic management of the authority.
- Senior Management = the Strategic Leadership Team - those responsible for the leadership and the direction of the Council. Senior Management are also responsible for ensuring that internal control, risk management, and governance arrangements are sufficient to address the risks facing their Services including the risk of fraud and corruption.
- Section 151 Officer = undertaken by the Service Director: Finance. The officer is responsible for: ensuring lawfulness and financial prudence of decision making; providing financial advice; internal control; risk management; setting financial standards; and ensuring key financial controls are in place to secure sound financial management. One of the ways this duty is discharged is by maintaining an adequate and effective internal audit service.
- Monitoring Officer = The Head of Legal Services – with responsibility for maintaining the Constitution; ensuring lawfulness and fairness of decision making; providing legal advice; and conducting investigations.

4.2 Internal Audit responsibilities include:

- formulation and delivery of an internal audit strategy which will enable the Chief Internal Auditor to provide management and the Audit Committee with the required objective opinion on the internal control, governance and risk management arrangements in place across the City Council to inform the Annual Governance Statement.

- reporting significant risk exposures and control issues identified to management and the Audit Committee, including fraud risks, governance issues, and other matters and making recommendations for improvement.
- ensuring the Council has a robust and proactive approach to fraud identification and investigation, investigating alleged frauds and other irregularities
- the review and certification of grant/funding claims as required.
- driving, embedding and supporting effective risk management arrangements across the City Council on behalf of the Member and Officer Champions for risk management.
- providing reports to the Audit Committee to enable it to discharge its duties.
- co-ordinating, on behalf of management, an annual review of the internal control environment in support of the Annual Governance Statement.
- raising awareness of internal control, risk management and governance across the City Council.

4.3 The Chief Internal Auditor is also managerially responsible for the Housing Benefit Fraud Investigation Team. Synergies arise from the two sections working closely, particularly around National Fraud Initiative work.

5. Accountability

5.1 Internal Audit is located within the Organisational Development Directorate. The Chief Internal Auditor's line manager is the Service Director Finance who monitors the performance of the Chief Internal Auditor and the audit function.

5.2 The Chief Internal Auditor reports functionally to the Audit Committee in terms of approving the Audit Charter and risk based plan, reviewing the section's performance and effectiveness, receiving the Chief Internal Auditors Annual Report and other reports.

5.3 The Chief Internal Auditor has direct access to the Chair of Audit Committee and has the opportunity to meet with the Audit Committee in private.

6 Independence and Objectivity

6.1 Internal Audit is independent of the activities that it audits to ensure the unbiased judgements essential to its proper conduct and impartial advice to management. The Chief Internal Auditor will confirm to the Audit Committee, at least annually, the organisational independence of Internal Audit Activity.

6.2 Internal Audit operates within a framework that allows unrestricted access to senior management and Members, particularly the Mayor, the Chair of the Audit Committee, the Strategic Leadership Team and the City Director. The Chief Internal Auditor reports in their own name to the Strategic Leadership Team and the Audit Committee.

6.3 As far as practicable, Internal Audit will not participate in the day to day operation of any systems without agreement of the Audit Committee. However, in strict emergency situations only, Audit personnel may be called upon to carry out operational work.

6.4 Where non audit work, or consultancy work is requested/required, the Chief Internal Auditor will ensure that there are no conflicts of interest arising from undertaking the consultancy work and if necessary make alternative arrangements for internal audit review of any area where such a conflict exists.

6.5 Where staff move into Internal Audit from a different part of the organisation, they will not complete audit work in that area for a period of at least 1 year.

7. Ethics

7.1 To enhance an environment of trust between auditors and management, all staff involved in the delivery of the Internal Audit service comply with the code of ethics laid down in the

Public Sector Internal Audit Standard (PSIAS). Staff induction and training ensures all staff are aware of this requirement. Additionally, many Internal Audit staff are bound by the ethical codes of the professional bodies they have qualified with and all are bound by the Council's own Code of Conduct for employees. Fundamentally, the following ethical standards will be observed:

- Integrity
- Professional objectivity and independence when providing opinions, assessment and recommendations.
- Competence and due professional care
- Confidentiality - Internal Audit staff will ensure that the information they receive is safeguarded from unauthorised release or disclosure unless there is a legal or professional obligation to do so.
- Ensuring information is not used 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 Council.

7.2 Internal Auditors are required to complete a Declaration of Interest every two years to ensure that any interests are known by management and safeguards can be put in place as required. Additionally, they are required to declare any potential conflicts of interest at the start of an audit assignment.

8 Internal Audit Activities

8.1 The primary task of Internal Audit is to review the systems of governance, risk management and internal control operating throughout the Council and in this a predominantly risk based approach to assessing controls will be adopted.

8.2 A risk based plan of audit work is prepared annually, and reviewed quarterly, informed by risk registers prepared by management, performance management and other assurance processes where these are sufficiently robust to be relied upon. Where the outputs from these processes are not judged to be sufficiently reliable, Internal Audit will undertake its own risk assessment.

8.3 Audit plans will be agreed with Senior Management and the Section 151 Officer, to ensure key risk areas receive appropriate attention and will then be reviewed and approved by the Audit Committee. The City Director will be provided with details of the annual plan for information. The audit plan is reviewed quarterly to ensure that it reflects current risks. Any significant changes to the agreed plan will be reported through the periodic activity reporting process.

Audit and Assurance Reviews

8.4 For each audit assignment within the annual audit plan, a terms of reference will be drawn up and shared with the relevant managers. The terms of reference will identify the key risks to the achievement of objectives and identify the scope of the work being carried out.

8.5 During the course of the audit, key issues will be brought to the attention of the relevant manager to enable them to take corrective action. On completion of the audit, Internal Auditors will communicate the results of the audit to the relevant Manager.

8.6 The completion of each planned assignment will lead to individual reports to Service Directors and Strategic Directors and these will include an opinion on the control framework in place to manage the risks in the area reviewed. These opinions, together with other knowledge of issues identified in other audit work, will assist the Chief Internal Auditor in providing his overall opinion on the control environment to management for the Annual Governance Statement.

Fraud and Irregularity work

- 8.7 Internal Auditors will plan and evaluate their work to have a reasonable chance of detecting fraud however the managing the risk of fraud and corruption is the responsibility of management.
- 8.8 The Anti-Fraud, Bribery and Corruption Policy requires the Chief Internal Auditor is informed of all suspected or detected fraud. A fraud risk assessment will be performed on all suspected/detected fraud which will determine whether the irregularity will be investigated by Internal Audit or by the relevant directorate with support from Internal Audit where required.
- 8.9 Investigation of fraud and corruption will be carried out in compliance with statutory requirements and the fraud investigation protocol, by staff with the necessary skills to do so.
- 8.10 In addition to determining the extent of the fraud, attention will be given to correction of any control failures to prevent recurrence of the fraud.
- 8.11 As well as responding to incidents of fraud and corruption, Internal Audit staff will maintain and deliver a programme of pro-active fraud prevention and detection work including national initiatives to prevent and detect fraud and testing of priority fraud risk areas.
- 8.12 The Chief Internal Auditor has also been nominated as the Council's 'reporting officer' under the Money Laundering Act 2007.

Risk Management and Governance work

- 8.13 A programme of work will be undertaken to enhance understanding of effective risk management across the council and embed a culture of appropriate risk taking.
- 8.14 As well as reviews of governance processes included in the risk based plan, Internal Audit will lead on the Annual Governance Review required in across the Council including the preparation of the Annual Governance Statement (AGS).

Consultancy reviews as requested/required

- 8.15 Internal Audit provide both statutory and discretionary services. Discretionary services provided by audit are a form of consultancy. These services may be on request by the City Council or recommended by Internal Audit. Each of these reviews will have a clearly defined and agreed Terms of Reference with agreed timescales for completion of the work and agreed reporting format.
- 8.16 In addition to planned audit reviews, Internal Audit will advise on internal control implications of new systems being implemented across the City Council. Internal Audit plan to be involved in change programmes from the outset and consult as required.
- 8.17 The Chief Internal Auditor will ensure that there are no conflicts of interest arise from undertaking any consultancy work.

External Clients

- 8.18 Internal Audit provides internal audit services to a number of public sector clients including the Avon Fire & Rescue Services and Academies. Further assurance and consultancy work has also arisen from the newly created Trading with Schools function.

9. Resources and Skills

- 9.1 In order to ensure an adequate and effective internal audit service is maintained, Internal Audit must have adequate budgetary resources to maintain organisational independence and be appropriately staffed in terms of numbers and skills. The Chief Internal Auditor is responsible for ensuring that resources and skills in the audit team are in place. Where resources available are felt to be insufficient to deliver the annual audit plan, the s151 Officer and the Audit Committee will be advised of this.
- 9.2 The staffing structure of Internal Audit is divided into three key areas:

- Assurance – dedicated to delivering the planned and unplanned assurance work
- Fraud and Value for Money – dedicated to both pro-active anti-fraud risk work and responding to fraud and irregularity reported to the Service
- Risk Governance and Service Development – leading on risk management, the governance agenda including the preparation of the Annual Governance Statement and driving the Internal Audit service development.

9.3 Internal Audit staff comprise a mixture of qualified accountants, auditors and fraud investigators as well as a number of trainees. These include general audit skills in respect of reviews of internal control, risk and governance and appropriate specialism in areas such as computer audit, contract audit and investigation of fraud.

9.4 Where audits require access to specialist expertise and knowledge that is not available within the audit team, the advice of specialist experts from within the City Council, or occasionally externally, will be sought.

9.5 A continuous review of training and development required for all Internal Audit staff will be undertaken as part of the Corporate PMDS framework. These requirements are developed into a Training Strategy with a specific resource for training and development earmarked in the annual audit plan.

10. Reporting, Follow Up and Escalation Procedures

10.1 Following the completion of all audit assignments an internal audit report will be issued containing an opinion on the control environment. The report will identify concerns and prioritise recommended improvement actions based on the level of risk resulting from the control weakness. The appropriate Service Manager, Service Director and/or Strategic Director will be asked to respond to the report agreeing, or otherwise, to implement the recommendations and assigning responsibility and time-scales for doing so.

10.2 Where the overall level of risk to the Council is significant or of concern the implementation of recommendations will be followed up in line with the follow up and escalation procedure which has been established by the Chief Internal Auditor.

10.3 Under the escalation element of this procedure, any significant recommendations which are either not accepted or not implemented may be reported to Senior Management and the Audit Committee, who may call the appropriate manager to account for failure to correct the control environment.

10.4 The Chief Internal Auditor will routinely report to the Audit Committee providing periodic reports and an annual report of Internal Audit activity and details of significant control issues identified by audit work. The annual report provided by the Chief Internal Auditor will include the required opinion on the risk management and control arrangements in place and as such is an essential assurance to management in making their Annual Governance Statement.

11. Performance

11.1 The Public Sector Internal Audit Standards (PSIAS) require the Chief Internal Auditor to have a performance management and quality assurance framework in place to demonstrate that the Internal Audit Service;

- meets its aims and objectives
- meets internal quality standards
- is effective, efficient and continuously improving
- is adding value and assisting the organisation in achieving its objectives

11.2 Performance, quality and effectiveness of the Internal Audit Service as a whole is measured in a suite of performance indicators which are maintained locally and reported to the Audit Committee. These include qualitative targets concerning auditee feed back in

the form of Quality Assurance Questionnaire scores which are issued to auditees following the completion of each audit.

- 11.3 Additionally, a system of close supervision of audit work and review of audit files by Audit Managers is completed to ensure each audit has been completed to standard.
- 11.4 The Accounts and Audit Regulations 2011 require the City Council to complete an annual review of the effectiveness of its system of Internal Audit. This is completed by the Audit Committee and s151 Officer and referred to in the Annual Governance Statement.
- 11.5 Internal Audit continually self assesses its performance against the strategy and achievement of its aims and objectives. It also benchmarks key elements of its service. This will include an annual review against the PSIAS.
- 11.6 An external assessment of Internal Audit against PSIAS will be undertaken through a peer review programme with neighbouring Local Authorities.

12. Collaboration and Liaison with Other Auditors

- 12.1 The City Council's External Audit service is currently provided by Grant Thornton. The External Auditor has a statutory duty to express an opinion on the City Council's financial statements and a Value for Money opinion on its arrangements for securing economy, efficiency and effectiveness. In doing so, there is potential for duplication of work completed by Internal Audit particularly now that International Standards for Auditing (which apply to External Auditors) require a more detailed understanding of systems. Wherever possible, the Chief Internal Auditor will seek to co-ordinate the work of Internal Audit with that of the External Auditor by sharing of plans and monthly liaison meetings. A joint working protocol has been agreed between the External Auditor, the Council and Internal Audit to assist with this co-ordination and set out how Internal Audit will assist the External Auditor in their duty to comply with the International Standards for Auditing.

13 Review of the Internal Audit Charter, Strategy and Terms of Reference

- 13.1 In accordance with the mandatory requirements of the PSIAS, the Internal Audit Charter, Strategy & Terms of Reference will be reviewed on an annual basis and where appropriate, presented to the Audit Committee for approval.

Reviewed: October 2013

Approved by Audit Committee November 2013