

NORTH WEST LEICESTERSHIRE DISTRICT COUNCIL

AUDIT AND GOVERNANCE COMMITTEE – 26 JUNE 2013

Title of report	PUBLIC SECTOR INTERNAL AUDIT STANDARDS
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Purpose of report	To provide the committee with an overview of the Public Sector Internal Audit Standards
Reason for Decision	To comply with the Public Sector Internal Audit Standards
Council Priorities	Value for Money
Implications:	
Financial/Staff	None
Link to relevant CAT	None
Risk Management	The audit planning process is based on risk assessment
Equalities Impact Assessment	N/A
Human Rights	N/A
Transformational Government	No direct implications
Consultees	None
Background papers	CIPFA Local Government Application Note for the United Kingdom Public Sector Internal Audit Standards
Recommendations	THAT THE COMMITTEE NOTES THE IMPLICATIONS AND ACTIONS NECESSARY TO MEET THE PUBLIC SECTOR INTERNAL AUDIT STANDARDS

1. INTRODUCTION

1.1 With effect from 1st April 2013 all public sector bodies are required to adopt the Public Sector Internal Audit Standards [the Standards]. The objectives of the standards 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.

The purpose of this paper is to provide the Audit and Governance Committee with an overview and implications of the Public Sector Internal Audit Standards.

2. BACKGROUND

2.1 Organisations in the UK public sector were covered by a variety of internal audit standards. Within Local Government (up until 1 April 2013) the standards were those prescribed in the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Internal Audit in Local Government in the United Kingdom 2006 [the 2006 Code].

2.2 Collaboration between CIPFA and the Institute of Internal Auditors (IIA) has led to an agreement between the relevant internal audit standard setters to develop a set of internal audit standards applicable to all areas of the UK public sector.

2.3 With effect from 1st April 2013 internal audit services across the public sector will be governed by the Public Sector Internal Audit Standards. The Standards apply to all internal audit service providers, whether in-house, shared services or outsourced.

2.4 CIPFA has also produced an Application Note as the sector –specific requirements for local government organisations. The PSIAS and the Local Government Application Note together supersede the 2006 Code.

3. THE STANDARDS

3.1 The Standards consist of three component parts:

- Definition of Internal Auditing;
- Code of Ethics
- A series of ‘attribute’ and ‘performance’ standards’.

3.2 As per the Standards, the definition of Internal Auditing is as follows:

“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”.

3.3 Appendix A details the Code of Ethics contained within the Standards.

3.4 The Standards refers to the Chief Audit Executive (CAE) as “a person who is 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.” The CAE at the council will be the Senior Auditor.

3.5 The foundations of the Standards are not fundamentally different to those adhered to under the 2006 Code. However, there are some key variances which include the requirement for:

- **Internal Audit Charter** - a formal document that defines the purpose, authority and responsibility of the internal audit activity. 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.

The Internal Audit Charter is currently being developed and will be reported to the Corporate Leadership Team and Audit and Governance Committee in September for approval.

- **Independence** – the internal audit activity must be independent and internal auditors must be objective in performing their work. The CAE must report to a level within the organisation that allows the internal audit activity to fulfil its responsibilities. The CAE must confirm to the board, at least annually, the organisational independence of the internal audit activity.

Organisational independence is effectively achieved when the CAE 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 communication from the CAE on the internal audit activity’s performance relative to its plan and other matters;
- approving decisions regarding the appointment and removal of the CAE;
- approving the remuneration of the CAE; and
- making appropriate enquires of management and the CAE to determine whether there are inappropriate scope or resource limitations.

The reporting requirements will be detailed within the Internal Audit Charter. The Board is described as:

“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”.

At this council this will be the Audit and Governance Committee.

The CAE must also establish effective communication with, and have free and unfettered access to, the chief executive and the chair of the audit committee.

Governance arrangements 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. This can be achieved by ensuring that the chief executive undertakes, countersigns, contributes feedback or reviews the performance appraisal of the CAE and that feedback is also sought from the chair of the audit committee.

- **Quality review and improvement programme** – the CAE must develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit activity.

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

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

Internal assessments consist of periodic self assessments or assessments by other persons within the organisation with sufficient knowledge of internal audit practices.

External assessments must be conducted at least every five years by a qualified, independent assessor or assessment team from outside the organisation.

- 3.6 Any areas of non-conformance must be reported to Senior Management, the Board and detailed within the Annual Report and Opinion. More significant concerns must be considered for inclusions in the governance statement.

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*

The Seven Principles of Public Life (The Nolan Principles)

Selflessness	Holders of public office should act solely in terms of the public interest. They should not do so in order to gain financial or other benefits for themselves, their family or their friends.
Integrity	Holders of public office should not place themselves under any financial or other obligation to outside individuals or organisations that might seek to influence them in the performance of their official duties.
Objectivity	In carrying out public business, including making public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit.
Accountability	Holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate to their office.
Openness	Holders of public office should be as open as possible about all the decisions and actions they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands.
Honesty	Holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest.
Leadership	Holders of public office should promote and support principles by leadership and example.