

## The Highland Council

### Audit and Scrutiny Committee – 29 September 2016

Agenda Item	6
Report No	AS/14/16

#### Revisions to the Internal Audit Charter

#### Report by Director of Finance

##### Summary

This report refers to a review of the Internal Audit Charter in order to ensure continued compliance with the requirements of the Public Sector Internal Audit Standards, following structural changes within the Service.

#### 1. Introduction

- 1.1 The Public Sector Internal Audit Standards (PSIAS) came into effect from 1 April 2013 and were updated in March 2016. The PSIAS requires that the purpose, authority and responsibility of the internal audit activity are formally defined in an Internal Audit Charter and that this is reviewed periodically.
- 1.2 In response to this requirement, a new Charter was produced and approved by Committee in September 2014. It is now necessary to revise this to reflect recent staffing changes (see 2.4 below). A review has also been undertaken of the Charter and no further changes are considered necessary.

#### 2. Internal Audit Charter

- 2.1 The revised Charter is attached at **Appendix 1** which fully meets the requirements of the PSIAS. This was approved by the Executive Leadership Team at the Weekly Business Meeting on 19 September 2016.
- 2.2 Section 1210 of the PSIAS requires the senior audit post holder to hold a professional accounting or audit qualification, and be “suitably experienced”. This does not detract from the wider structural changes established for Audit and Performance. Audit Scotland have been consulted and fully support the proposals for the new Audit & Performance Team, particularly with a greater focus on best value to add to the statutory functions and reporting associated with both Audit and Performance.
- 2.3 The structural changes, as previously indicated to the Committee, offer the opportunity to bring together two key scrutiny and statutory functions of the Council, which are independent from all other services. There are significant synergies between the two functions, and bringing them together will enhance performance and financial management, whilst also ensuring the principle element of independence.

- 2.4 Following the establishment of an Audit & Performance Team within the Finance Service it is necessary to amend the Internal Audit Charter to assign the responsibilities of Chief Audit Executive (senior audit post definition as per the Standards) which were formerly held by the Head of Audit & Risk Management. These responsibilities will now be undertaken by the Corporate Audit Manager who reports to the Corporate Audit & Performance Manager. The Corporate Audit Manager fully meets the requirements of the Code as outlined in paragraph 2.2 above. In addition, the designation of Audit & Risk Manager will change to Corporate Audit Manager from 1 November 2016, and this is reflected in the amended Charter.
- 2.5 An important element of the Charter is to ensure that the Chief Audit Executive has independence and objectivity within the organisation and this includes:
- The right of free and confidential access to the Audit & Scrutiny Committee, the Pensions Committee and Executive Leadership Team;
  - Contributing to the Audit & Scrutiny Committee agendas;
  - Regularly attending Audit & Scrutiny Committee;
  - Submitting directly to Audit & Scrutiny Committee reports on internal audit activity including the Audit Plan.

The structural changes do not change the important aspect of independence.

- 2.6 As indicated previously to the Audit & Scrutiny Committee, the intention (from 2017) is to have a wider Audit and Performance Plan which will include, subject to Committee consideration and agreement, the various aspects of work indicated in paragraph 2.3 above. The PSIAS have a strong focus on internal controls. Whilst this is of critical importance, the wider work of Audit and Performance will seek to provide further added value to the Council.

### **3. Implications**

- 3.1 Risk implications -The risk of not having a Charter in place, or one which does not comply with the requirements of the PSIAS, is that the Council will not be compliant with the Local Authority Accounts (Scotland) Regulations 2014.
- 3.2 There are no resource, legal; equalities; climate change/carbon clever, rural and Gaelic implications as a direct result of this report.

#### **Recommendation**

Members are asked to consider and approve the revised Internal Audit Charter

Designation: Director of Finance

Date: 14 September 2016

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## INTERNAL AUDIT CHARTER

### 1. Introduction

- 1.1 The Public Sector Internal Audit Standards (PSIAS) which came into effect on 1<sup>st</sup> April 2013 require that an Internal Audit Charter is in place in each local authority to define the purpose, authority and responsibility of Internal Audit. The Charter must be consistent with the Definition of Internal Auditing and the Code of Ethics which form part of the Standards. It must also be consistent with the Attribute Standards which address the characteristics of organisations performing internal audit activities and with the Performance Standards which provide quality criteria against which the performance of these activities can be evaluated.
- 1.2 It is a requirement of the PSIAS that the Charter is periodically reviewed and approved by "senior management" and the "board." In the case of the Highland Council this is the Audit & Scrutiny Committee as, under the Scheme of Delegation, it has responsibility for the internal audit activity.
- 1.3 The PSIAS also uses the following terms which are clarified here:
- "chief audit executive" - is the Corporate Audit Manager
  - "board" – is the Audit & Scrutiny Committee
  - "senior management" – refers to the Council's Executive Leadership Team.

### 2. PSIAS Requirements

- 2.1 The PSIAS requires the Charter to:
- (i) Define the terms "board" and "senior management" for the purposes of internal audit activity (*see 1.3 above*).
  - (ii) Recognise the mandatory nature of the Definition of Internal Auditing, the Code of Ethics and the Standards (*see 3.1 and 8.4*).
  - (iii) Define the purpose, authority and responsibility of the internal audit activity (*see 3.1 and 3.2*).
  - (iv) Set out Internal Audit's position within the organisation (*see 3.1, 3.2, 6.1, 6.2, 8.1 and 8.2*).
  - (v) Establish the Chief Audit Executive's functional reporting relationship with the Board (*see 8.1*).
  - (vi) Establish the accountability, reporting line and relationship between the Chief Audit Executive and those to whom the CAE may report to administratively (*see 8.1*).
  - (vii) Establish the responsibility of the board and also the role of the statutory officers with regards to internal audit (*see 4.1, 5.1, 5.2 and 8.1*).
  - (viii) Establish internal audit's rights of access to all records, assets, personnel and premises and its authority to obtain such information and explanations as it considers necessary to fulfil its responsibilities (*see 6.1*).
  - (ix) Define the scope of internal audit activities (*see 6.1 and 6.2*).
  - (x) Recognise that internal audit's remit extends to the entire control environment of the organisation (*see 3.2*).
  - (xi) Establish the organisational independence of internal audit (*see 8.1, 8.2 and 8.3*).
  - (xii) Cover the arrangements for appropriate resourcing (*see 9.2 and 9.3*).

- (xiii) Define the role of internal audit in any fraud-related work and set out the arrangements within the anti-fraud and anti-corruption policies requiring all suspected fraud, corruption or impropriety to be notified to the Chief Audit Executive (see 6.2, 11.1, 11.2 and 11.3).
- (xiv) Include arrangements for avoiding conflicts of interest if internal audit undertakes non-audit activities (see 8.2 and 8.3).
- (xv) Define the nature of assurances provided to the organisation as well as assurances provided to parties external to the organisation (see 3.2 and 3.3).
- (xvi) Define the nature of consulting services (see 7.1 and 7.2).

### **3. Role and Responsibilities of Internal Audit**

3.1 The role of Internal Audit within the Highland Council is best summarised by way of the PSIAS definition of internal auditing which is as follows:

*“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 above role can be further expanded upon as follows:

- (i) Assisting officers and Members of the Council in the effective discharge of their responsibilities. Officers are responsible for establishing and maintaining appropriate risk management arrangements, systems of internal control and governance processes in order to ensure that the Council’s objectives are fulfilled in a manner which complies with the Council’s policies and procedures and in accordance with the law. Internal Audit plays a vital role in advising the Council that these arrangements are in place through the annual Statement on Internal Control which is used to inform the Council’s Annual Governance Statement. The Statement on Internal Control provides an overall opinion on the Council’s entire control environment and is supported, principally, by individual audit assignments identified through the Annual Audit Plan. Reports are produced relating to each assignment which are issued to the respective Service Director and are presented to the Audit & Scrutiny Committee. It shall be the responsibility of Internal Audit to complete sufficient assurance work to support the annual opinion detailed in its Statement on Internal Control.
- (ii) Performing an advice and consultancy role to Senior Management, including the review of internal controls in the introduction of new systems;
- (iii) Investigating any suspected fraud or irregularity. This will include a systems weakness review to establish the reasons why the fraud/irregularity occurred and the impact upon the Council’s internal control environment. Such reviews shall be reported to the respective Service Director and to the Audit & Scrutiny Committee.

It is important to emphasise, with regard to the above, that Internal Audit’s responsibilities extend to the entire control environment of the organisation and is not restricted to financial controls.

3.3 In addition to the work undertaken for the Highland Council, Internal Audit is also responsible for undertaking assurance work and providing an annual Statement on Internal Control in respect of the following:

- (i) The Pension Fund
- (ii) The Valuation Joint Board
- (iii) Hi-Trans.

Internal Audit work is also undertaken on behalf of High Life Highland as provided for within the Service Level Agreement between High Life Highland and the Highland Council.

#### **4. Role and Responsibilities of the Board**

4.1 In terms of the PSIAS, the key duties of the Board (nb the Audit & Scrutiny Committee) are as follows:

- (i) Approving the Internal Audit Charter.
- (ii) Approving the annual risk based Internal Audit plan and any amendments to the plan during the course of the year.
- (iii) Approving the Internal Audit budget and resource plan and establishing that there are sufficient resources with regard to the provision of an annual audit opinion (*See 3.2. (i) above*).
- (iv) Considering communications from the Corporate Audit Manager on Internal Audit performance relative to its plan and other matters.
- (v) Receiving annual confirmation from the Corporate Audit Manager that Internal Audit is organisationally independent.
- (vi) Considering the results of the quality assurance and improvement programme from the Corporate Audit Manager.

#### **5. Role and Responsibilities of Senior Management**

5.1 The key duties of Senior Management (nb the Executive Leadership Team), is as follows:

- (i) Providing input to the annual Internal Audit plan.
- (ii) Actioning Internal Audit reports and follow-up reports.
- (iii) Receiving the results of the quality assurance and improvement programme (*see section 12*) from the Corporate Audit Manager.

5.2 In addition to the above PSIAS requirement, members of the Executive Leadership Team are required to contact the Corporate Audit & Performance Manager where fraud has occurred or is suspected; where a Whistleblowing complaint suggests that an irregularity has been committed or there are sufficient grounds for concern; and when a new system is being introduced or materially altered. These requirements are set out in the Council's Financial Regulations.

#### **6. Scope**

6.1 The scope of Internal Audit work is set out within the Council's Financial Regulations. This allows for unrestricted coverage of the Council's activities and unrestricted access to any information necessary during the course of an audit assignment or investigation including:

- The right of access at all reasonable times to all records, assets, personnel and premises including those of partner organisations and third party service providers, where relevant;
- The requirement to receive such explanations as are necessary concerning any matter under examination.

6.2 Internal Audit will undertake work within a range of activities, including:

- (i) Reviewing controls within existing systems
- (ii) Reviewing controls and proposed controls within systems under development
- (iii) Transactions testing to ensure accuracy of processing
- (iv) Information Technology audit reviews
- (v) Contract audit reviews
- (vi) Investigation of suspected fraud and irregularities
- (vii) Undertaking proactive fraud work
- (viii) Investigation of whistleblowing matters, where appropriate
- (ix) Certifying grant claims
- (x) Undertaking follow-up reviews
- (xi) Providing advice to Services on internal control and governance issues, including consulting services.

## **7. Definition of Consulting Services**

7.1 The PSIAS definition of consulting services is as follows:

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

7.2 The Annual Audit Plan, which is agreed by the Audit & Scrutiny Committee, will identify any assignments which fall within the above definition. In addition, in terms of the requirements of the PSIAS, any significant additional consulting services identified during the course of the year will be approved by the Audit & Scrutiny Committee prior to accepting the assignment. Within the Highland Council it is considered appropriate to define “significant” as any single assignment which is estimated to require a resource of 15 days or more.

## **8. Independence and Objectivity**

8.1 It is a requirement of the PSIAS that appropriate reporting and management arrangements are in place to preserve the Corporate Audit Manager’s independence and objectivity, in particular, to ensure that Internal Audit can provide impartial, unbiased and effective professional judgments and advice. These arrangements are as follows:

- (i) The PSIAS requires that the Corporate Audit Manager reports to a level within the organisation that allows the Internal Audit activity to fulfil its responsibilities and, in this respect, suggests that organisational independence is effectively achieved when the Corporate Audit Manager

reports functionally to the Board. Within Highland Council this requirement is attained through the Corporate Audit Manager reporting in his/ her own name to the Audit & Scrutiny Committee. In addition, Financial Regulations allow the Corporate Audit Manager the right of free and confidential access to the Audit & Scrutiny Committee and the Pensions Committee in order to raise such concern as they may have.

- (ii) In terms of functional reporting, the Chartered Institute of Public Finance & Accountancy and the Chartered Institute of Internal Auditors expect that the Corporate Audit Manager reports to Executive Leadership Team level or higher. Within Highland Council the Corporate Audit Manager reports to the Corporate Audit & Performance Manager for all operational and management issues, but has professional accountability to the Director of Finance who is a member of the Executive Leadership Team. In addition, the Corporate Audit Manager has unrestricted access to the Chief Executive, the Depute Chief Executive and other members of the Executive Leadership Team.
- (iii) The Corporate Audit & Performance Manager shall be responsible for the annual performance appraisal of the Corporate Audit Manager. In terms of the requirements of the PSIAS, the Chief Executive, Director of Finance and the Chair of the Audit & Scrutiny Committee will also be asked to provide input to that review.
- (iv) In accordance with the requirements of the PSIAS, the Corporate Audit Manager will confirm to the Board, at least annually, of the organisational independence of Internal Audit.

- 8.2 Internal Audit will have no direct operational responsibility or authority over any of the activities audited. Accordingly, it will not implement internal controls, develop procedures, install systems, prepare records or engage in any other activity that may impair an Internal Auditor's judgment. However, Internal Audit may be consulted on the implementation of new systems to ensure that, as far as possible, all considerations are taken into account during their implementation. Such involvement shall not preclude Internal Audit reviewing that area and reporting thereon at a later date.
- 8.3 Internal Auditors will complete an annual declaration confirming compliance with rules on independence, conflicts of interest and the offer and/or acceptance of inducements. In compiling the Annual Audit Plan it will be ensured that this recognises and addresses potential conflicts of interest, in particular, by ensuring that staff do not undertake an audit assignment for at least one year in an area where they had previous operational roles.
- 8.4 Internal Auditors will apprise themselves of the "*Definition of Internal Auditing*," the "*Code of Ethics*" and the "*Standards*" and will work in accordance with these in the conduct of their duties.
- 8.5 Internal Auditors will perform work with due professional care, competence and diligence. Although they cannot be expected to identify every control weakness or irregularity their work will be designed to enable them to provide reasonable assurance regarding the controls examined within the scope of the review. In undertaking their work Internal Auditors will be alert to the possibility of intentional wrongdoing, errors and omissions, poor value for money and failure to comply with the Council's policies and procedures. They will ensure that any

suspensions of fraud, corruption or improper conduct are promptly reported to the Corporate Audit Manager for investigation.

## **9. Annual Audit Plan**

- 9.1 The Internal Audit service is delivered on the basis of a risk-based Plan as required by the PSIAS, taking account of the Council's organisational objectives and priorities. The Plan sets out the audits required for Internal Audit to adequately review the Council's activities, taking into account the requirement to produce an annual Internal Audit opinion within the Statement on Internal Control. The Plan will be prepared following consultation with the Executive Leadership Team and the Chair of the Audit & Scrutiny Committee. In addition, there will be liaison with External Audit and other relevant inspection and review bodies to ensure that audit resources are utilised as effectively as possible.
- 9.2 The Plan will provide a broad scope of each audit assignment together with the resources required and the respective priorities. The Plan will be kept under review to identify any amendment needed to reflect changing priorities and emerging risks. It will be flexible, containing an element of contingency to accommodate assignments, fraud investigations and staff vacancies which could not be reasonably foreseen. Any significant deviation from the Plan will be reported to the Audit & Scrutiny Committee for approval and also to the Executive Leadership Team.
- 9.3 In preparing the Plan, if it is identified that there is a shortfall in the resources available to effectively deliver this, the Executive Leadership Team and the Audit & Scrutiny Committee will be advised accordingly. In addition, should circumstances arise during the year that resources are falling below the minimum level required to provide an annual opinion (*see 3.2.(i) above*) the Corporate Audit Manager will similarly advise the Executive Leadership Team and the Audit & Scrutiny Committee.

## **10. Reporting**

- 10.1 Draft audit reports will be issued to the relevant client officers, identified when the assignment terms of reference are drafted and agreed. Final reports will incorporate the response from the client officer in terms of the agreed actions to address any control weaknesses together with the respective action dates. Explanations for any control weaknesses not actioned will also be provided. Final reports will be provided to the appropriate Directors, Senior Managers and External Audit, for information and will then be presented to the next available Audit & Scrutiny Committee.
- 10.2 Each audit report shall provide an overall opinion which will assist the Corporate Audit Manager in compiling the Annual Statement on Internal Control.
- 10.3 Internal Audit will monitor action taken by management to implement agreed recommendations and will report on this on a six-monthly basis to the Audit & Scrutiny Committee.
- 10.4 At each meeting of the Audit & Scrutiny Committee Members shall receive a progress report from the Corporate Audit Manager, identifying any significant areas of work and any resourcing issues.
- 10.5 In addition to the Annual Statement on Internal Control, the Corporate Audit Manager will also prepare an Annual Report, incorporating the results of the Quality Assessment and Improvement Programme.



## **11. Fraud and Corruption**

- 11.1 The Council's Financial Regulations require that *"whenever any matter arises which involves, or is thought to involve any suspected irregularities, the Head of Service concerned will immediately notify the Corporate Audit & Performance Manager. The Corporate Audit & Performance Manager will take such steps as are considered necessary to investigate any such matters."*
- 11.2 The Council has an Anti-fraud and Anti-corruption Policy and an Anti-fraud and Anti-corruption leaflet which outlines the Council's commitment to creating an anti-fraud culture and maintaining high ethical standards in the administration of public funds. Service Directors are responsible for ensuring that their employees are aware of this policy and the need for adherence.

## **12. Quality Assurance**

- 12.1 The Corporate Audit Manager will ensure that an up to date Audit Manual is maintained which sets out the expected standards of the audit service, and will monitor compliance with these standards, including the planning, conduct, and reporting of audit activities. The appropriate training will be provided to ensure that all staff have the necessary skills to undertake their duties.
- 12.2 It is a requirement of the PSIAS that a quality assurance framework is established including internal and external assessments of the Internal Audit service. In order to comply with this requirement, assessments will be undertaken as follows:
- (i) An annual self-assessment of compliance against the PSIAS will be undertaken using the CIPFA checklist
  - (ii) External quality assessments will be undertaken once every five years.

The results of internal and external audit assessments, together with any areas of non-conformance and its impact, will be reported to the Audit & Scrutiny Committee together with any improvement plans arising.

**This Charter will be regularly reviewed in order to reflect changes which occur within the Council and the Auditing profession. Any such revisions will be approved by the Audit & Scrutiny Committee.**

September 2016