

## **Public Sector Internal Audit Standards (PSIAS) Report by Internal Audit Manager**

### **1 Purpose of Report**

The purpose of this report is to:

- inform members of the Audit Committee of the new Public Sector Internal Audit Standards (PSIAS) which came into effect on 1 April 2013, a copy of which accompanies the agenda for this meeting; and
- present to the Audit Committee the new Audit Charter based on the new PSIAS.

### **2 Background**

- 2.1** In April 2013 a new United Kingdom Public Sector Internal Audit Standard (PSIAS) came into force and applies across the whole of the public sector. The PSIAS are based on the Institute of Internal Auditors (IIA) Standards, with a limited number of additional requirements and interpretations that allow the PSIAS to be adapted for the public sector. Midlothian Council must ensure full compliance by the end of March 2014.
- 2.2** The PSIAS replace the Code of Practice for Internal Audit in Local Government in the United Kingdom which was last revised in 2006. In Scottish local government, the PSIAS is mandatory under Section 95 of the Local Government (Scotland Act) 1973.
- 2.3** The Standards have been developed as a result of joint working by: CIPFA; the Institute of Internal Auditors; and a range of other public bodies to tailor the International Professional Practices Framework (IPPF), the mandatory international standards, to meet the requirements of public sector organisations in the UK. The standards have the same status in respect of internal audit as the International Financial Reporting Standards have in respect of accounting and financial reporting.
- 2.4** The Internal Audit service of Midlothian Council complied with the CIPFA Code of Practice prior to the introduction of the PSIAS. Although the new standards have many similarities with the CIPFA Code there are some differences and these are detailed below.

### 3 Report Implications

#### a) Definitions from the PSIAS

The PSIAS require the adoption of certain standard definitions:

Internal Auditing

*“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.”*

This definition has therefore been incorporated into the revised Audit Charter.

The “*Board*” which in Midlothian Council is being taken as the Audit Committee;

“*Senior management*” which in Midlothian Council is being taken as the Corporate Management Team, which includes: the Head of Finance and Human Resources (the section 95 officer); the Chief Executive; and the Director, Corporate Resources.

The “*Chief audit executive*” which in Midlothian Council is being taken as the Internal Audit Manager.

These definitions are in compliance with the standard.

#### b) Reporting Lines

The Internal Audit Manger must report functionally to the Audit Committee. The Internal Audit Manager must also establish effective communication with, and have free and unfettered access to, the Chief Executive and the Chair of the Audit Committee. Examples of functional reporting are provided by the standard and are:

- approving the internal audit charter;
- approving the risk based internal audit plan;
- approving the internal audit budget and resource plan;
- receiving communications from the Internal Audit Manager on the Internal Audit activity’s performance relative to its plan and other matters;
- making appropriate enquiries of Management and the Internal Audit Manager to determine whether there are inappropriate scope or resource limitations;
- approving decisions regarding the appointment and removal of the Internal Audit Manager (**See Note 1**); and
- approving the remuneration of the Internal Audit Manager (**See Note 1**).

**Note 1** - the PSIAS allow for some discretion under the items noted above for Audit Committee involvement. It is recommended that the requirement to be involved in the appointment, removal and performance appraisal of the Internal Audit Manager be delegated to the Chief Executive. Remuneration is based on the Council's job evaluation process. Feedback will also be sought from the Chair of the Audit Committee. The underlying principle is that the independence of the Internal Audit Manager is safeguarded by ensuring that his or her remuneration or performance assessment is not inappropriately influenced by those subject to audit.

**c) Quality Assurance and Improvement Program**

The PSIAS require that a quality and assurance programme must be established that includes ongoing monitoring of the performance of the Internal Audit service through internal assessments, and external assessments. An external assessment must be conducted at least once every five years.

Internal Assessments

There is already a system of ongoing monitoring of the performance of Internal Audit in place. The only change in this regard is that within the Internal Audit Manager's annual assurance statement he / she must report on the results of this internal assessment within the Annual Internal Audit Opinion.

External Assessments

The Internal Audit Manager must agree the scope of external assessments with an appropriate sponsor, eg the Head of Finance and Human Resources, the Chief Executive or the Chair of the Audit Committee as well as with the external assessor or assessment team. This is a new requirement that will need to be monitored to ensure compliance. The Scottish Local Authorities Chief Internal Auditors Group (SLACIAG) which Midlothian Council is a member of are in the process of creating a framework to allow councils to assess each other in order to reduce the cost of external fees.

**d) Code of Ethics and Audit Charter**

The PSIAS include a Code of Ethics which is mandatory for all internal auditors working in the UK public sector. The PSIAS also require internal auditors to have regard for the Committee on Standards of Public Life's Seven Principles. The Code of Ethics is similar to the CIPFA code mentioned in the previously approved Audit Charter.

**e) Qualifications**

The Internal Audit Manager must be professionally qualified (CMIIA, CCAB or equivalent e.g. CIMA) and suitably experienced. Internal auditors are encouraged to demonstrate their proficiency by obtaining appropriate professional qualifications.

The Internal Audit service is already compliant with this requirement and is staffed with a CMIIA, a CIMA, an ACCA and a trainee ACCA.

## **f) Audit Planning and Annual Internal Audit Opinion**

The PSIAS specify that the Internal Audit Manager is responsible for developing a risk based audit plan which must take into account the requirement to produce an annual internal audit opinion. In preparing the risk based audit plan, consideration should be taken of the Council's risk management framework, including using risk appetite levels set by management for the different activities or parts of the organisation. The internal audit annual plan must explain how Internal Audit's resource requirements have been assessed. Where the Internal Audit Manager believes that the level of agreed resources will adversely impact on the provision of the annual Internal Audit opinion, the consequences must be brought to the attention of the Audit Committee.

The Internal Audit Manager must deliver an annual internal audit opinion and report that can be used by the Council to inform its governance statement. The annual Internal Audit opinion must conclude on the overall adequacy and effectiveness of the Council's framework of governance, risk management and control. The annual report must incorporate:

- the opinion;
- a summary of the work that supports the opinion; and
- a statement on conformance with the Public sector Internal Audit Standards and the results of the quality assurance and improvement programme.

The Internal Audit service already produces an Annual Internal Audit Opinion and follows a risk based audit plan. There are therefore few additional requirements in this area.

## **g) Audit Work**

The PSIAS make specific requirements of Internal Audit in relation to Governance, Risk Management, Control, and Consultancy. These are summarised below.

### **(i) Governance**

Internal audit must assess and make appropriate recommendations for improving the governance arrangements in its accomplishment of the following objectives:

- promoting appropriate ethics and values within the Authority;
- ensuring effective organisational performance management and accountability;
- communicating risk and control information to appropriate areas of the Council; and
- coordinating the activities of and communicating information among the Audit Committee, internal and external auditors and management.

### **(ii) Risk Management**

Internal Audit must evaluate the effectiveness and contribute to the improvement of risk management processes. Internal Audit must also evaluate the potential for the occurrence of fraud and how the organisation manages fraud. Internal auditors must refrain from assuming any management responsibility by actually managing risk.

(iii) Control

Internal Audit must assist the organisation in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement.

(iv) Consultancy

The Standards recognise that Internal Audit can perform added value work in the form of consultancy assignments. These reviews may assist management in improving their management of risks and improve the achievement of organisational objectives. The relative costs and benefits should be assessed before the assignment is accepted. Approval must be sought from the Audit Committee for any significant consulting assignment that is not already included in the audit plan.

Most of these requirements are largely in line with the current arrangements for Internal Audit. The only significant change to take note of is that authorisation must be sought from the Audit Committee for major pieces of consultancy work.

**h) Communicating the Acceptance of Risk**

The Internal Audit Manager must establish a follow up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action. Where the Internal Audit Manager concludes that management has accepted a level of risk that may be unacceptable to the Council, the Internal Audit Manager must discuss the matter with senior management. If the Internal Audit Manager determines that the matter has not been resolved, this must be communicated to the Audit Committee.

This is already in line with current Internal Audit practice.

**3.1 Resource**

The requirement for Internal Audit to have an external assessment at least once every five years may have a financial implication. This could be achieved by employing the services of an external audit firm or the internal audit team of a neighbouring council.

There may be a financial implication if the Internal Audit Service's resources are deemed to be inadequate to fulfil the requirements set in the PSIAS.

### 3.2 Risk

The PSIAS require Internal Audit to evaluate the effectiveness of the Council's Risk Management arrangements and contribute to improvements in the process.

### 3.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

- Community safety
- Adult health, care and housing
- Getting it right for every Midlothian child
- Improving opportunities in Midlothian
- Sustainable growth
- Business transformation and Best Value
- None of the above

### 3.4 Impact on Performance and Outcomes

Applying the framework of the PSIAS will give The Audit Committee assurance that the Internal Audit service is keeping up to date with legislative requirements and current best practice.

### 3.5 Adopting a Preventative Approach

The PSIAS are applicable from 1 April 2013 which means the Internal Audit Service will need to take steps to be fully compliant by 31 March 2014.

### 3.6 Involving Communities and Other Stakeholders

There are no Communities or other stakeholder issues with regard to this report.

### 3.7 Ensuring Equalities

There are no equalities issues with regard to this report.

### 3.8 Supporting Sustainable Development

There are no sustainability issues with regard to this report.

### 3.9 IT Issues

There are no IT issues with regard to this report.

## 4 Summary

Compliance with the PSIAS is mandatory for all Internal Audit services in the Public sector.

The Council's Internal Audit Service is committed to adhering to the requirements of the new PSIAS and has updated the Audit Charter to reflect the required changes. An assessment of the level of compliance with the standard will be undertaken in 2013/14 and the results will be included in the annual assurance statement.

## **5 Recommendations**

The Audit Committee is invited to:

- 5.1** note the changes outlined in this report that have been introduced to allow compliance with the standards;
- 5.2** to endorse the proposal that the Chief Executive and Chair of the Audit Committee have direct involvement with the appointment, removal, remuneration setting and performance appraisal of the Internal Audit Manager; and to
- 5.3** approve the new Internal Audit Charter shown at Appendix 1

**Date 18<sup>th</sup> June 2013**

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### **Background Papers:**

Appendix 1 – Midlothian Council Internal Audit Charter

**Declaration Box**

**Instructions:** *This box must be completed by the author of the report. The box will be copied and saved by the Council Secretariat who will delete it from the report prior to photocopying the agenda.*

**Title of Report:**

**Meeting Presented to:**

**Author of Report:**

*I confirm that I have undertaken the following actions before submitting this report to the Council Secretariat (Check boxes to confirm):-*

- All resource implications have been addressed. Any financial and HR implications have been approved by the Head of Finance and Human Resources.*
- All risk implications have been addressed.*
- All other report implications have been addressed.*
- My Director has endorsed the report for submission to the Council Secretariat.*

*For Cabinet reports, please advise the Council Secretariat if the report has an education interest. This will allow the report to be located on the Cabinet agenda among the items in which the Religious Representatives are entitled to participate.*

*Likewise, please advise the Council Secretariat if any report for Midlothian Council has an education interest. The Religious Representatives are currently entitled to attend meetings of the Council in a non-voting observer capacity, but with the right to speak (but not vote) on any education matter under consideration, subject always to observing the authority of the Chair.*