

# CHESHIRE EAST COUNCIL

## REPORT TO: Audit and Governance Committee

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**Date of meeting:** 27 September 2013  
**Report of:** Audit Managers  
**Title:** Update on Public Sector Internal Audit Standards (PSIAS) and Audit Charter  
**Portfolio Holder:** Councillor Peter Raynes

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### **1.0 Report Summary**

- 1.1 In order to comply with Public Sector Internal Audit Standards (PSIAS) and the relevant CIPFA/IIA Application Note, the Council must introduce an Internal Audit Charter. This report advises the Committee on the content of a draft Internal Audit Charter which, it is proposed, will form the basis of the Cheshire East Internal Audit Charter. The draft Charter will, following this meeting, be finalised and presented to the Audit and Governance Committee for final approval in November.

### **2.0 Recommendation**

- 2.1 That the Committee notes (i) the contents of this report, (ii) that the draft Internal Audit Charter (Appendix A) will form the basis of the Cheshire East Internal Audit Charter and (iii) that the Charter will be finalised and presented to this Committee for approval in November.

### **3.0 Reasons for Recommendation**

- 3.1 The new Public Sector Internal Audit Standards (PSIAS) came into effect from 1 April 2013. The Authority needs to comply with the Standards, and the relevant CIPFA/IIA Application Note, in order to satisfy proper internal audit practices.
- 3.2 The PSIAS require an Internal Audit Charter (similar to the previous Internal Audit Strategy and Terms of Reference) which must formally define the purpose, authority and responsibility of the internal audit activity as well as the terms 'Board' and 'Senior Management'.
- 3.3 This report has been prepared to stimulate discussion and agreement with senior management and Members particularly with regard to the significant aspects of the Standards that affect the Audit Charter. A draft Internal Audit Charter is attached at Appendix A, that is based on the Institute of Internal Auditors Model Internal Audit Activity Charter. Following this meeting, the Internal Audit Charter will be finalised and presented to the Audit and Governance Committee for final approval in November.

- 3.4 CIPFA guidance does recognise that not all elements of the PSIAS will be in place from 1 April 2013.

#### **4.0 Wards Affected**

- 4.1 All wards.

#### **5.0 Local Wards Affected**

- 5.1 Not applicable.

#### **6.0 Policy Implications**

- 6.1 Not applicable.

#### **7.0 Financial Implications**

- 7.1 There are no direct financial implications arising from this report.

#### **8.0 Legal Implications**

- 8.1 The Accounts and Audit Regulations 2011 require the Council to 'undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with proper practices in relation to internal control'. The PSIAS and the relevant CIPFA/IIA Application Note constitute proper practices as set out in the Regulations.

#### **9.0 Risk Management**

- 9.1 The Audit and Governance Committee is responsible for overseeing the Council's role and responsibilities in respect of Corporate Governance and Audit. The Internal Audit Charter provides evidence of governance arrangements in respect of the provision of the internal audit activity and contributes significantly to effectively managing the risk of non-compliance with the Accounts and Audit Regulations 2011.

#### **10.0 Background and Options**

- 10.1 The Public Sector Internal Audit Standards state that the purpose, authority and responsibility of internal audit must be formally defined in an Internal Audit Charter. These issues have previously been dealt with through the Internal Audit Strategy and Terms of Reference which set out the type of content required by the PSIAS, with financial regulations covering some other high-level aspects of the required content. The adoption of the PSIAS will result in the Charter replacing the Strategy and Terms of Reference and is likely to require amendments to the Council's Constitution.
- 10.2 The Charter establishes Internal Audit's position within the organisation, including the nature of functional and administrative reporting, authorises

access to records, personnel and physical properties relevant to the performance of engagements; and defines the scope of Internal Audit activities. Final approval of the Internal Audit Charter resides with the “Board”.

- 10.3 A draft document, based on the Institute of Internal Auditors Model Internal Activity Charter is attached at Appendix A, which it is proposed will form the basis of the Cheshire East Internal Audit Charter.

#### Relevant Issues

- 10.4 Within the PSIAS, the terms ‘Board’ and ‘Senior Management’ must be interpreted in the context of governance arrangements within Cheshire East Council. The CIPFA/IIA local government application note for the UK Public Sector Internal Audit Standards states it is expected that the audit committee, where one exists, will fulfil the role of the board in the majority of instances.
- 10.5 It is suggested, therefore, that for the purposes of the Internal Audit Charter the term:
- ‘board’ is defined as the Audit and Governance Committee which, in accordance with the Constitution, is responsible for overseeing the Council’s role and responsibilities in respect of Corporate Governance and Audit; and
  - ‘senior management’ is defined as the Corporate Leadership Board which, in accordance with the Constitution, provides strategic advice to the Council and co-ordinates the Council’s activities to ensure high standards of performance.
- 10.6 The Model Internal Audit Activity Charter is based on the original IIA Standards which suggest that the internal audit activity is established by the Board of Directors, Audit Committee or highest level of governing body and that responsibilities are defined by the Board as part of their oversight role. Furthermore, it suggests that the internal activity will govern itself by adherence to the IIA mandatory guidance. The requirement for an internal audit function in local government is detailed within the Accounts and Audit (England) Regulations 2011. The standards for proper practices in relation to internal audit are laid down in the PSIAS 2013.
- 10.7 The original IIA Standards use the term ‘Chief Audit Executive’ (CAE) throughout, and this has been adopted by the PSIAS, as well as in the Application Note. The term, however, only describes a role and the PSIAS state that the specific job title may vary across organisations (the term head of internal audit’ or ‘chief internal auditor’ are more common in the UK public sector). The CAE describes a person in a senior position responsible for effectively managing the internal audit activity in accordance with the Internal Audit Charter, the definition of the Code of Ethics and the Standards. The PSIAS do not stipulate an administrative reporting line for local authorities although CIPFA and the IIA expect that the CAE should not report administratively to or be managed at a lower level than the corporate management team.

10.8 In accordance with current arrangements the Audit Managers will report directly, for administrative purposes, to the Governance and Democratic Services Manager with reporting lines to the Chief Operating Officer (who assumes the role and responsibilities of the Chief Financial Officer, a specific job title more traditionally associated with the public sector). The CIPFA *Statement on the Role of the Chief Financial Officer in Local Government* states that the Chief Financial Officer (CFO) must:

- Ensure an effective audit function is resourced and maintained
- That the authority has put in place effective arrangements for internal audit of the control environment
- Support the authority's internal audit arrangement, and
- Ensure that the audit committee receives the necessary advice and information, so that both functions can operate effectively.

10.9 The relationship between the CAE and the CFO is therefore of particular importance in local government.

10.10 The PSIAS state that organisational independence is effectively achieved when the CAE reports functionally to the Board. The draft Charter includes examples of functional reporting included in the PSIAS although the public sector interpretation and the CIPFA/IIA Application Note both recognise that some of these roles are unusual such as the 'Board' approving the appointment, removal and remuneration of the CAE. 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. The PSIAS suggest that this could, for example, be achieved by the chief executive or the chair of the audit committee being involved in the performance appraisal of the CAE. The application note, however, recognises that in practice remuneration/performance decisions within organisations will depend on the arrangements within the local authority. The Charter will, therefore need to reflect Cheshire East arrangements. As part of these arrangements the Chief Audit Executive will confirm to the board, at least annually, the organisational independence of the internal audit activity.

10.11 The Council is responsible for establishing and maintaining appropriate risk management processes, control systems, accounting records and governance arrangements. Internal audit plays a vital role in advising the Council that these arrangements are in place and operating effectively. The Council's response to internal audit activity should lead to the strengthening of the control environment and, therefore, contribute to the achievement of the organisations objectives.

10.12 The CAE is responsible for the delivery of an annual audit opinion and report that can be used by the Council to inform its governance statement. The annual opinion concludes on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. In the context of the standards, the opinion means that Internal Audit will have done

sufficient, evidenced work to form a supportable conclusion about the activity it has examined. Internal Audit may also undertake non-assurance work including fraud related and consultancy work, at the request of the organisation, subject to there being no impact on the core assurance work and the availability of skills and resources.

- 10.13 CIPFA's 'Statement on the Role of the Head of Internal Audit' states that the CAE (Head of Internal Audit in the original document) must be asked to consider the impact of proposed policy initiatives, programmes and projects as well as responses to emerging risks. CAEs should be made aware of major new systems and proposed initiatives to help ensure risks are properly identified and evaluated and appropriate controls built in. The CAE should consider what if any audit work needs to be done and also how the proposals fit with the organisation's strategic objectives.
- 10.14 There is no longer a requirement to produce an audit strategy, instead a risk based plan must incorporate or be linked to a strategic or high level statement which sets out how the internal audit service will be provided and developed in accordance with the Charter and how it will link to the council's objectives and priorities. Where the CAE believes that the level of agreed resources will impact adversely on the provision of the annual internal audit opinion, the consequences must be brought to the attention of the Board.
- 10.15 The CAE must develop and maintain a formal quality assurance and improvement programme that covers all aspects of the internal audit activity. This programme must include both internal and external assessments. External assessments must be conducted at least every five years by a qualified, independent assessor or assessment team from outside of the organisation. The results of the quality and assurance programme and progress against any improvement plans must be reported in the annual report.
- 10.16 The Internal Audit Charter must be reviewed periodically (as a minimum annually) by the CAE and presented to senior management and the audit committee for approval.

## **11.0 Access to information**

The background papers relating to this report can be inspected by contacting the report writer:

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