



<u>Committee and Date</u>	<u>Item</u>
Audit Committee	
25 June 2015	
10.00am	<u>Public</u>

## **ANNUAL REVIEW OF THE EFFECTIVENESS OF THE SYSTEM OF INTERNAL AUDIT AND QUALITY ASSURANCE AND IMPROVEMENT PROGRAMME (QAIP) 2014/15**

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### **1. Summary**

- 1.1 The Accounts and Audit Regulations 2011 require the Council to conduct an annual review of the effectiveness of its internal audit; Audit Committee is required to review this report and its findings.
- 1.2 This report provides the results of a self-assessment of the Internal Audit Service against the requirements of the Public Sector Internal Audit Standards (PSIAS). Compliance with these standards demonstrates an effective Internal Audit service.
- 1.3 This review should be read in conjunction with the Annual Internal Audit report, found elsewhere on this agenda. When read together the two reports demonstrate the effectiveness of internal audit. The update of the self-assessment has confirmed that the Council continues to operate an effective Internal Audit function. There are no areas where the Internal Audit function is not complying with the Code and whilst there are areas of partial compliance, these are not considered significant and do not compromise compliance with the code.

### **2. Recommendations**

- 2.1 The Committee is asked to consider and endorse, with appropriate comment, the conclusion that the Council has an effective system of internal audit in place that complies with the principles of the Public Sector Internal Audit Standards and has planned improvement activities to ensure full compliance.

## REPORT

### 3. Risk Assessment and Opportunities Appraisal

- 3.1 An effective Internal Audit Service provides, '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'. Thereby providing assurances on the Council's internal control systems by identifying areas for improvement or potential weaknesses and engaging with management to address these in respect of current systems and during system design. Internal Audit will also continue to align its work with the Strategic Risk Register.
- 3.2 The use of a consistent framework for internal audit across the UK public sector has benefits for both partnership working and for internal auditors who work across different parts of the public sector. The standards are designed to drive improvement and lead to better public finance arrangements.
- 3.3 The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998 and the Accounts and Audit Regulations 2011.
- 3.4 There are no direct environmental, equalities or climate change consequences of this proposal. Consultation has been used to inform the evidence gathered in support of the self-assessment against the Public Sector Internal Audit Standards (PSIAS).

### 4. Financial Implications

- 4.1 The Internal Audit service is provided within approved budgets. There may be a small cost to enable an external assessment of Internal Audit's conformance with the PSIAS in compliance with standard 1312 (external inspection) to be conducted. Presently this remains unassessed and information will be provided when relevant.

### 5. Background

- 5.1 The Accounts and Audit Regulations 2011 6(3), requires the Council to undertake an annual review of the effectiveness of its internal audit and to report the findings of this review to the Audit Committee. This requirement is valid for the 2014/15 financial year, following which the Accounts and Audit Regulations 2015 no longer require this and any review of Internal Audit is in compliance with the Public Sector Internal Audit Standards (PSIAS).

- 5.2 The PSIAS are mandatory for all principal local authorities and have been effective since April 2013. They consist of:
- Definition of Internal Auditing;
  - Code of Ethics; and
  - Standards for the Professional Practice of Internal Auditing.
- 5.3 In April 2013, CIPFA produced a Local Government Application Note for the United Kingdom Public Sector Internal Audit Standards. Internal Audit is reviewed using this guidance for compliance with the Standards, the results of which are summarised in **Appendix A**.
- 5.4 The PSIAS aim to promote further improvement in the professionalism, quality and effectiveness of internal audit across both the public and private sectors. They reaffirm the importance of robust, independent and objective internal audit arrangements to provide the Head of Finance, Governance and Assurance (the Section 151 Officer) with the key assurances he needs in both managing the financial affairs of the Council and producing the annual governance statement.
- 5.5 In complying with the PSIAS Shropshire Council can provide assurances to Internal Audit's external customers of the teams' professionalism, quality and effectiveness.
- 5.6 **Appendix A** also provides an update against the previously approved improvement plan. The majority of standards are complied with totally. Where there are areas of non-compliance these are detailed below for members to consider further. Where further improvements have been identified in areas of compliance these, along with the actions outlined below, appear in the improvement plan within the appendix, to ensure full conformance to the standards in future.

#### **Areas of potential non-conformance**

- 5.7 **Code of Ethics - Objectivity Standard:** Do internal auditors display objectivity by not taking part in any activity or relationship that may impair or be presumed to impair their unbiased assessment?

**Finding:** It is felt important that internal audit is consulted during system, policy or procedure development. Auditors have been assigned to business review projects where there is a possibility that internal control systems will be affected. This is seen as an opportunity for internal audit to add value and strengthen internal control arrangements. Where specific auditors have been involved in providing system advice they will be excluded from carrying out the audit as far as possible i.e. another auditor would be allocated to the audit. If this was not possible, it is felt the benefit of using the experience of developing controls and procedures outweighs concerns of independence and the review process will help to ensure that the review and report remain objective and evidenced based.

Therefore there is **partial** conformance. This is not considered to be to the detriment of the principles of auditing and the independent review process helps to mitigate any risks, therefore no actions are proposed.

5.8 **1100 Independence and Objectivity Standard:** Does the Chief Audit Executive (CAE) confirm to the board, at least annually, that the internal audit activity is organisationally independent? The following examples **can be** used by the CAE when assessing the organisational independence of the internal audit activity: The board:

- **approves the internal audit budget and resources plan.**

**Finding:** It is the responsibility of the Section 151 Officer to ensure that the budget and resources allocated to internal audit are sufficient to ensure delivery of the plan and to report any concerns to the Audit Committee.

- **approves decisions relating to the appointment and removal of the CAE**

**Finding:** It is the responsibility of the Section 151 Officer to ensure that the budget and resources allocated to internal audit are sufficient to ensure delivery of the plan, including the appointment and removal of the CAE, and to report any concerns to the Audit Committee.

Therefore **partial** conformance: Governance requirements 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 their remuneration or performance assessment is not inappropriately influenced by those subject to audit. In the UK public sector, CIPFA advise that this can be achieved by ensuring that the Chief Executive (or equivalent) undertakes, countersigns, contributes feedback to or reviews the performance appraisal of the CAE and that feedback is also sought from the Chair of the Audit Committee, this is completed for Shropshire Council.

Consideration is to be given to extending the opportunity for Chairs of externally serviced Audit Committees and their key officers to provide feedback, through the Section 151 Officer, on the Audit Service Manager's appraisal.

5.9 **1312 External Assessments Standard: Has an external assessment been carried out, or is planned to be carried out, at least once every five years?**

**Finding:** The new standards came in from the 1st April 2013. Therefore, an external assessment under the standards needs to be conducted by March 2018. No plans have been made for such an

assessment, but there is every intention to have one when further guidance on the requirements of the assessment is available.

The shape and size of the present Internal Audit team has changed and it is likely to change again to reflect the business plans of the Council in the future and therefore early completion of such an assessment may only be of short term benefit. Conversely an earlier assessment may inform the delivery of the service going forward. Early discussions with the Section 151 Officer and Audit Committee members have confirmed a preference for a later assessment once more details are known.

Therefore currently we are not conforming to the standard and propose to consider the approach and timing of an external audit assessment with the Section 151 Officer or a self-assessment with 'independent validation' when more guidance is available.

- 5.10 This is not considered a significant variation in respect of the principles of the PSIAS to require specific mention in the Annual Governance statement since the intention is to comply with the PSIAS within the prescribed time frames once further details are known.

<p><b>List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)</b></p> <p>Accounts and Audit Regulations 2011 and 2015 Public Sector Internal Audit Standards 2013 Local government application note for the UK Public Sector Internal Audit Standards CIPFA Completed Conformance Checklist 2014/15 and supporting evidence</p>
<p><b>Cabinet Member (Portfolio Holder)</b></p> <p>Keith Barrow, Leader of the Council and Brian Williams, Chairman of Audit Committee</p>
<p><b>Local Member N/A</b></p>
<p><b>Appendix A: Public Sector Internal Audit Standards 2013 conformance assessment and improvement plan</b></p>

## Appendix A

### Public Sector Internal Audit Standards 2014/15 conformance assessment and improvement plan

Standard	Conformance	Observations and actions proposed	When?	Who?
<b>Definition of Internal Auditing</b>	Yes			
<b>Code of Ethics</b>	Yes	Partial compliance with Objectivity: No action proposed: the independent quality review process of all files and therefore evidence mitigates the slight risks identified in the Audit Committee report		
<b>Attribute Standards</b>				
<b>1000 Purpose, Authority and Responsibility</b>	Yes	<p>Feedback for the Audit Service Managers appraisal from all clients CEO equivalents and Audit Committee Chairs will be considered</p> <p>Partial compliance with ensuring that the budget and resources allocated to internal audit are sufficient to ensure delivery of the plan and approving decisions relating to the appointment and removal of the CAE are not compromised if not completed by the Board. Other compensating controls are in place to mitigate these.</p>	Next appraisal	Section 151 Officer
<b>1200 Proficiency and Due Professional Care</b>	Yes			
<b>1300 Quality Assurance and Improvement Programme</b>	Yes	<p>There is a QAIP in place however, the IA manual and associated procedures would benefit from a review to include those processes which are now electronic and to reflect the standards</p> <p><b>External assessment:</b> Consider the approach and timing of an external audit assessment with the Section 151 Officer or a self-assessment with 'independent validation'.</p>	<p>Ongoing</p> <p>March 2018</p>	<p>Audit Service Manager</p> <p>Section 151 Officer</p>
<b>Performance Standards</b>				

Standard	Conformance	Observations and actions proposed	When?	Who?
<b>2000 Managing the Internal Audit Activity</b>	Yes			
<b>2100 Nature of Work</b>	Yes			
<b>2200 Engagement Planning</b>	Yes			
<b>2400 Communicating Results</b>	Yes			
<b>2500 Monitoring Progress</b>	Yes			
<b>2600 Communicating the Acceptance of Risks</b>	Yes			