



<u>Committee and Date</u>	<u>Item</u>
Audit Committee	
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## INTERNAL AUDIT CHARTER

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### 1. Summary

The Internal Audit Team works to a Charter which complies with the Public Sector Internal Audit Standards (PSIAS) as applied in the UK, based on international standards. The Charter is reviewed and considered by the Audit Committee on an annual basis. The PSIAS were refreshed in March 2016 and, to ensure that Shropshire Council's Internal Audit Service Charter reflects the key changes, it too has now been reviewed and refreshed.

### 2. Recommendations

The Committee are asked to consider and endorse, with appropriate comment, the Internal Audit Charter (**Appendix A**).

## REPORT

### 3. Risk Assessment and Opportunities Appraisal

- 3.1 Audit Committee has a key function in ensuring that effective corporate governance arrangements are maintained in the Council. The Internal Audit Charter provides evidence of such arrangements in respect of the Internal Audit function, and has been updated to reflect the recent adoption of the Public Sector Internal Audit Standards.
- 3.2 The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998. There are no direct environmental, equalities, consultation or climate change consequences of this proposal.

## 4. Financial Implications

4.1 There are no direct financial implications from adopting this Charter.

## 5. Background

5.1 Public Sector Internal Audit Standard 1000 requires that Purpose, Authority and Responsibility be defined in an Audit Charter. The Charter establishes Internal Audit's position within the organisation, including the nature of the Audit Service Manager's reporting relationship with the Audit Committee, authorises access to personnel, records, and physical properties relevant to audit work, and defines the scope of internal audit activities. The senior management and board representatives for Internal Audit's client organisations is set out in Annex B of the Charter. Final approval of the Internal Audit Charter resides with Shropshire Council's Audit Committee.

5.2 The Internal Audit Charter refers to;

- The nature of assurance services provided to the Council.
- Organisational independence.
- Individual objectivity.
- Impairment to independence or objectivity.
- Proficiency and due professional care.
- Continuing professional development.
- Quality assurance and improvement programme – internal and external.

5.3 The charter will communicate the contribution that Internal Audit makes to the Council and includes:

- Internal Audit's *mission*
- Purpose, *principles* and responsibilities.
- Independence and objectivity.
- Competencies and standards.
- Planning.
- Nature of work.
- Reporting.
- Quality assurance.
- Fraud and corruption.
- Rights of access.

5.4 The principle changes to the PSIAS are the introduction of a new 'mission' for internal audit, which appears on the front cover of the Charter, and the introduction of ten principles intended to articulate how internal audit effectiveness should be demonstrated. See paragraph eight of the Charter.

5.5 The opportunity to clarify the assurance levels, recommendation categories and any consultancy work for the team has been taken in **Annex A**. Members will already be aware of these since they form part of the regular reports to the Committee. Their inclusion in the Charter provides further clarification to all service users.

- 5.6 **Annex B** also reflects the introduction of an Audit and Performance Panel at Oswestry Town Council to improve their governance procedures and become the recognised board at that Council.
- 5.7 The proposed adjustments can be found at **Appendix A** and appear in **bold font and underlined**

**List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)**

Accounts and Audit Regulations 2015;

Public Sector Internal Audit Standards 2016

**Cabinet Member (Portfolio Holder)**

Malcolm Pate (Leader of the Council) and Tim Barker (Chairman of Audit Committee)

**Local Member** All

**Appendix A** Internal Audit Charter with annexes A and B



# INTERNAL AUDIT CHARTER

## MISSION STATEMENT

***“To enhance and protect organisational value by providing risk-based and objective assurance, advice and insight. To examine, evaluate and report objectively on the adequacy of the risk management, control and governance processes as a contribution to the proper economic, efficient and effective use of Shropshire council resources for the benefit of residents, businesses and external clients.”***

# INTERNAL AUDIT CHARTER

## INTRODUCTION

1. This charter defines for the Council and the community Internal Audit's activities, purpose, authority and responsibilities consistent with the requirements of the Public Sector Internal Audit Standards (PSIAS)<sup>1</sup>. It establishes Internal Audit's position within the Council, including functional reporting relationships with the Audit Committee<sup>2</sup>, authority to access personnel, records, and physical properties relevant to the undertaking of its engagements<sup>3</sup>; and defines the scope of the Internal Audit activity. Final approval of this Charter rests with the Audit Committee<sup>4</sup>.
2. The PSIAS which encompasses the mandatory elements of the Institute of Internal Auditors (IIA) define Internal Audit as follows: *"Internal Audit is an assurance function that provides an independent and objective opinion to the organisation on the control environment, by evaluating its effectiveness in achieving the organisation's objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper economic, efficient and effective use of resource"*.
3. The basis of internal financial administration within the Council lies in the Financial Rules contained in the Council's Constitution. This Charter should be read in conjunction with the relevant sections of these Financial Rules.
4. The authority and requirement for an internal audit function derives from two pieces of legislation: - Section 151 of the Local Government Act 1972 requires that authorities 'make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs'. The Accounts and Audit Regulations 2015, require that a relevant body must 'evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance'. Any officer or member of a relevant body shall if the body requires-make available such documents, records and information and explanations as are considered necessary by the internal auditors.

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<sup>1</sup> PSIAS apply the IIA International Standards to the UK Public Sector and have been endorsed as proper practices by CIPFA, the internal audit standard setters for Local Government.

<sup>2</sup> See glossary for translation of the terms used in the Public Sector Internal Audit Standards in respect of Shropshire Council's Internal Audit activity and those of its external clients.

<sup>3</sup> Engagement is the term in the PSIAS used to represent audit work.

<sup>4</sup> The Audit Committee is referenced in the PSIAS as the Board.

5. The Financial Rules (Part 4, Appendix C2) state the Section 151 Officer has a 'statutory responsibility for the overall financial administration of the Council's affairs and is responsible for maintaining an adequate and effective internal audit'.
6. In accordance with good practice, this Charter will be reviewed annually by the Audit Committee after consultation with senior management<sup>5</sup>.

## **INTERNAL AUDIT PURPOSE AND RESPONSIBILITIES**

### **Purpose**

7. Internal Audit led by the Head of Internal Audit<sup>6</sup> 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 evaluating and improving the effectiveness of risk management, control and governance processes.'<sup>7</sup>

### **Principles**

8. **Internal Audit, the auditors and the internal audit activity, comply with the following principles in delivering and achieving internal audit's mission:**
  - **Demonstrates integrity.**
  - **Demonstrates competence and due professional care.**
  - **Is objective and free from undue influence (independent).**
  - **Aligns with the strategies, objectives, and risks of the organisation.**
  - **Is positioned appropriately and resourced adequately.**
  - **Demonstrates quality and continuous improvement.**
  - **Communicates effectively.**
  - **Provides risk-based assurance<sup>8</sup>.**
  - **Is insightful, proactive, and future-focused.**
  - **Promotes organisational improvement.**

### **Objectives**

9. Internal Audit's objective is to give assurance and an opinion to the Section 151 Officer, Audit Committee and the Council, on the adequacy of the Council's risk management, governance and control environment and the extent to which it can be relied upon, in line with the Accounts and Audit (England) Regulations 2015.

### **Responsibilities**

10. Internal Audit is responsible for conducting an independent appraisal of all the Council's (and that of its external clients) activities, financial or otherwise, including services provided in partnership or under contract with external

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<sup>5</sup> Senior management comprises of the Head of the Paid Service, Monitoring Officer, Section 151 Officer and directors.

<sup>6</sup> The Audit Service Manager is the Council's Chief Audit Executive as defined in the PSIAS.

<sup>7</sup> Source Public Sector Internal Audit Standards April 1<sup>st</sup> 2013.

<sup>8</sup> **Assurance opinions and recommendation categories are defined in Annex A**

organisations. It provides this service to the Council and all levels of management.

11. Internal Audit complies with the requirements of the Public Sector Internal Audit Standards (PSIAS) including the Definition of Internal Auditing, **the Principles** and the Code of Ethics (see **Annex A**) and other relevant guidance; including those issued by individual auditors' professional bodies.
12. The scope of internal audit includes:
  - reviewing, appraising and reporting on the following:
    - the soundness, adequacy and application of internal controls;
    - the extent to which the Council's assets are accounted for and safeguarded from losses of all kinds arising from fraud and other offences, waste, extravagance, inefficient administration, poor value for money or other causes;
    - the suitability and reliability of financial and other management data developed within the Council;
  - carrying out selected value for money reviews of the efficiency and economy of the planning and operation of the Council's functions;
  - providing a responsive, challenging and informative internal advice and consultancy service for committees and services;
  - undertaking any non-recurring studies as directed by the Section 151 Officer;
  - advising on or undertaking fraud investigation work, with the exception of benefit fraud, in accordance with the Council's Fraud Investigation procedure, prosecutions policy and the disciplinary guide;
  - Participating in the National Fraud Initiative; and
  - periodically undertaking an audit needs assessment taking into consideration the authority's risk management process.
13. Internal Audit also carry out special reviews or assignments where requested by management, which fall outside the approved work plan and for which a contingency is included in the audit plan.

#### **INDEPENDENCE AND OBJECTIVITY**

14. Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out their responsibilities in an unbiased manner.
15. Objectivity is an unbiased mental attitude that allows internal auditors to perform audit reviews in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not allow their judgement on audit matters to be influenced, distorted, or subordinated by others.
16. Threats to objectivity and independence must be managed at the individual auditor, audit, functional and organisational levels.

17. Internal Audit has no executive responsibilities and is independent of the activities that it audits to enable Auditors to provide impartial and unbiased professional evaluations, opinions and recommendations. Internal Audit is free to plan, undertake and report on its work as the Head of Internal Audit deems appropriate, in consultation with relevant managers.
18. The Head of Internal Audit has direct access to the Section 151 Officer, the External Auditor, senior managers, the Leader, Audit Committee and other members as required.
19. The Head of Internal Audit fosters constructive working relationships and mutual understanding with management, external auditors and with other review agencies.
20. Constructive working relationships make it more likely that internal audit work will be accepted and acted upon, although the internal auditor does not allow their objectivity or impartiality to be impaired.
21. Internal auditors are required to have an impartial, unbiased attitude characterised by integrity and objectivity in their approach to work. They avoid conflicts of interest and a register of interests is maintained. Audit reviews are planned to ensure potential conflicts are avoided. Auditors should not allow external factors to compromise their professional judgement and must maintain confidentiality in their work.
22. The Head of Internal Audit cannot give total assurance that control weaknesses or irregularities do not exist. Managers are fully responsible for the quality of internal control within their area of responsibility. They should ensure that appropriate and adequate risk management processes, control systems, accounting records, financial processes and governance arrangements i.e. the control environment, exist without depending on internal audit activity to identify weaknesses.
23. The Head of Internal Audit is to be consulted about significant proposed changes in the internal control system and the implementation of new systems and shall make recommendations on the standards of control to be applied. This need not prejudice the audit objectivity when reviewing the systems at a later date.

#### **COMPETENCIES AND STANDARDS**

24. Audits must be performed with proficiency and due professional care. Internal auditors must possess the knowledge, skills and other competencies needed to perform their individual responsibilities.
25. The Head of Internal Audit holds a relevant professional accountancy qualification and is suitably experienced. In addition the Head of Internal Audit must maintain a team of staff who are properly trained to fulfil all their



responsibilities and continue to enhance their knowledge, skills and competencies through continuing professional development.

26. Internal auditors are expected to:
- exercise due professional care based upon appropriate experience, training, ability, integrity and objectivity;
  - apply confidentiality as required by law and best practice and
  - obtain and record sufficient audit evidence to support their findings and recommendations.

### **INTERNAL AUDIT PLANNING**

27. The Head of Internal Audit produces the Council's annual risk based audit plan, in consultation with the Section 151 Officer, to establish priorities, achieve objectives and ensure the efficient and effective use of audit resources. The plan takes into account the Accounts and Audit (England) Regulations 2015, the management of risk, previous internal/external audit work, discussions with the Head of the Paid Service and senior managers, external networking intelligence, local and national risks, comments from the Audit Committee and any requirements of the External Auditor.
28. The Plan is subject to regular reviews and revisions as required to reflect changes to the risk environment and these changes are approved when significant. The Plan includes an element of contingency to allow Internal Audit to be responsive to changing risks and requests for assistance from managers. It is the responsibility of the Section 151 Officer to ensure that the budget<sup>9</sup> and resources allocated to Internal Audit are sufficient to ensure delivery of the plan and to report any concerns to the Audit Committee. The Audit Committee agree the annual risk based plan and any significant change to the plan during the year.

### **NATURE OF WORK**

29. The internal audit activity must evaluate and contribute to the improvement of governance, risk management and control processes using a systematic and disciplined approach.

### **Governance**

30. The internal audit activity must assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:
- promoting appropriate ethics and values within the organisation;
  - ensuring effective organisational performance management and accountability;

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<sup>9</sup> The budget, including the remuneration the Audit Service Manager is approved by Council.

- communicating risk and control information to appropriate areas of the organisation;
- coordinating the activities of, and communicating information among, the audit committee, external and internal auditors and management;
- the internal audit activity must assess whether the information technology governance of the organisation supports the organisation's strategies and objectives.

### **Risk Management**

31. Determining whether risk management processes are effective is a judgment resulting from the internal auditor's assessment that:
  - organisational objectives support and align with the organisation's mission;
  - significant risks are identified and assessed;
  - appropriate risk responses are selected that align risks and their mitigation with the organisation's risk appetite;
  - relevant risk information is captured and communicated in a timely manner across the organisation, enabling staff, management and the board to carry out their responsibilities.
32. The internal audit activity must evaluate the potential for the occurrence of fraud and how the organisation manages fraud risk.
33. When assisting management in establishing or improving risk management processes, internal auditors must refrain from assuming any management responsibility by actually managing risks.

### **Control**

34. The internal audit activity must evaluate the adequacy and effectiveness of controls in responding to risks within the organisation's governance operations and information systems regarding the:
  - achievement of the organisation's strategic objectives;
  - reliability and integrity of financial and operational information;
  - effectiveness and efficiency of operations and programmes;
  - safeguarding of assets; and
  - compliance with laws, regulations, policies, procedures and contracts.
35. In accordance with the PSIAS, most individual audits are undertaken using the risk based systems audit approach, the key elements of which are listed below:-
  - identify and record the objectives, risks and controls;
  - establish the extent to which the objectives of the system are consistent with higher level corporate objectives;
  - evaluate the controls in principle to decide whether or not they are appropriate and can be reasonably relied upon to achieve their purpose;
  - identify any instances of over and under control;

- determine an appropriate strategy to test the effectiveness of controls, i.e. through compliance and/or substantive testing;
- arrive at conclusions and produce a report, leading to management actions as necessary and providing an opinion on the effectiveness of the control environment.

36. To reduce duplication of effort Internal Audit will work in partnership to identify and place reliance on assurance work completed elsewhere in the Council. A computerised audit management system, supported by working papers, is used to streamline working practices. This reflects best professional practice.

### **INTERNAL AUDIT REPORTING**

37. Internal Audit findings are reported in writing to appropriate managers against four assurance opinions (good, reasonable, limited and unsatisfactory). The Head of Internal Audit sets standards for reporting and makes arrangements for their review and approval before issue. The reports:

- prompt management action to implement recommendations for change, leading to improvement in performance and control;
- provide a formal record of points arising from the assignment, and where appropriate, of agreements reached with management;
- state scope, purpose and extent of conclusions;
- make recommendations relative to the risk which are appropriate, relevant and flow from the conclusions;
- acknowledge the action taken or proposed by management; and
- ensure that appropriate arrangements are made to determine whether action has been taken on internal audit recommendations, or that management has understood and assumed the risk of not taking action.

38. The Head of Internal Audit reports regularly to the Section 151 Officer and at least three times a year to the Council's Audit Committee on progress against the annual audit plan and other issues of concern in respect of the control environment and emerging issues. The Audit Committee meet at least four times per year and they have a detailed work plan agreed for the year. In addition, the Head of Internal Audit produces an annual report to the Section 151 Officer and Audit Committee on the main issues raised by Internal Audit during the year and on the performance of Internal Audit. In particular the annual report:

- includes an opinion on the overall adequacy and effectiveness of the Council's control environment;
- discloses any qualifications to that opinion, together with the reasons for the qualification;
- presents a summary of the audit work undertaken to formulate the opinion, including reliance placed on work by other assurance bodies;

- draws attention to any issues the Head of Internal Audit considers particularly relevant to the preparation of the Annual Governance Statement;
- compares the work actually undertaken with the work as planned and summarises the performance of the Internal Audit function against its performance measures and criteria;
- comments on compliance with these standards and communicates the results of the Internal Audit quality assurance and improvement programme.

## **QUALITY ASSURANCE**

39. In order to ensure Internal Audit independence, the audit of any areas managed by the Head of Internal Audit will be carried out by an appropriate auditor and reviewed by an audit senior. The Head of Internal Audit will take no part in the audit or review process other than in the role of auditee. The final report will be issued to the Section 151 Officer as the Head of Internal Audit's line manager.
40. The Head of Internal Audit will develop and maintain a quality assurance and improvement programme covering all aspects of the internal audit activity and conforming to the relevant standards. This will include an on-going internal assessment covering adequate supervision of work performed, an internal review process and the retention of appropriate evidence. In addition, at least once every five years, an external assessment of Internal Audit by an appropriate person<sup>10</sup> external to the Council will be conducted. The timing, form of the assessment, qualifications of any external assessor, results and any improvement plans will be agreed with and reported to the Audit Committee in the annual report<sup>11</sup>. Significant deviations will be considered for inclusion in the Annual Governance Statement.
41. The Head of Internal Audit develops and maintains a set of performance measures which are reported to the Section 151 Officer and Audit Committee.

## **FRAUD AND CORRUPTION**

42. The Internal Audit Service is not responsible within services for the prevention or detection of fraud and corruption. Managing the risk of fraud and corruption is the responsibility of management.
43. The Head of Internal Audit should be informed of all suspected or detected fraud, corruption or impropriety and will consider the implications when giving an opinion on the adequacy and effectiveness of the relevant controls, and the overall internal control environment.

## **RIGHTS OF ACCESS**

44. Under the Council's Financial Rules, internal auditors have the authority to:
- access at reasonable times, premises or land used by the Council;

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<sup>10</sup> Qualified independent assessor or assessment team

<sup>11</sup> For both internal and external reviews

- access all assets, records, documents, correspondence and control systems except for those from which they are statutorily prevented;
- require and receive any information and explanation considered necessary concerning any matter under consideration;
- require any employee of the Council to account for cash, stores or any other Council property under his/her control and produce supporting evidence and assets for inspection if required;
- access records belonging to third parties, such as contractors, when required.

**Reviewed 15<sup>th</sup> September 2016**

## Public Sector Internal Audit Standards

The definition of Internal Auditing within the Standards is: 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.

### Assurance

Is provided on the organisation's risk management, governance and internal control processes to confirm that they are operating effectively. Audit assurance opinions are awarded on completion of audit reviews reflecting the efficiency and effectiveness of the controls in place. Opinions are graded as follows

<u>Good</u>	<u>Evaluation and testing of the controls that are in place confirmed that, in the areas examined, there is a sound system of control in place which is designed to address relevant risks, with controls being consistently applied.</u>
<u>Reasonable</u>	<u>Evaluation and testing of the controls that are in place confirmed that, in the areas examined, there is generally a sound system of control but there is evidence of non-compliance with some of the controls.</u>
<u>Limited</u>	<u>Evaluation and testing of the controls that are in place performed in the areas examined identified that, whilst there is basically a sound system of control, there are weaknesses in the system that leaves some risks not addressed and there is evidence of non-compliance with some key controls.</u>
<u>Unsatisfactory</u>	<u>Evaluation and testing of the controls that are in place identified that the system of control is weak and there is evidence of non-compliance with the controls that do exist. This exposes the Council to high risks that should have been managed.</u>

Audit recommendation categories are an indicator of the effectiveness of the Council's internal control environment and are rated according to their priority

<u>Best Practice (BP)</u>	<u>Proposed improvement, rather than addressing a risk.</u>
<u>Requires Attention (RA)</u>	<u>Addressing a minor control weakness or housekeeping issue.</u>
<u>Significant (S)</u>	<u>Addressing a significant control weakness where the system may be working but errors may go undetected.</u>
<u>Fundamental (F)</u>	<u>Immediate action required to address major control weakness that, if not addressed, could lead to material loss.</u>

## Consultancy Activity

Audit can, where resources and skills exist, provide independent and objective consultancy services, which apply the professional skills of Internal Audit through a systematic and disciplined approach, and may contribute to the opinion that Internal Audit provides on the control environment.

Consultancy comprises the range of services, which may go beyond Internal Audit's usual assurance roles, provided to assist management in meeting the objectives of the Council.

The nature and scope of the work may include:

- Facilitation;
- Process and / or control design;
- Training;
- Advisory services;
- Risk assessment support.

As with any piece of work, it is important to define clearly the terms of reference for the involvement of Audit in any consultancy activities, so that both the client and the auditor know what is expected from the involvement of Audit.

Any auditor asked to provide consultancy services or undertake a consultancy-style activity should consult their manager or the Head of Internal Audit before agreeing to provide such services.

## Code of Ethics

Internal auditors in UK public sector organisations must conform to the Code of Ethics within the Standards. If individual internal auditors have membership of another professional body then he or she must also comply with the relevant requirements of that organisation.

**There are four principles in the code of ethics:**

1. **Integrity** – The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgement.
2. **Objectivity** – 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.

3. **Confidentiality** – 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.
4. **Competency** – Internal auditors apply the knowledge, skills and experience needed in the performance of internal audit services.

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.<sup>12</sup>

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<sup>12</sup> Information can be found at [www.public-standards.gov.uk](http://www.public-standards.gov.uk)



## Glossary of Terms for External Clients where they are different to the Council

### Shropshire and Wrekin Fire and Rescue Authority

Senior Management	Chief Fire Officer and direct reports Treasurer
Board	Audit and Performance Management Committee Fire and Rescue Authority

### Oswestry Town Council

Senior Management	Town Clerk
Board	Town Council <b>Audit &amp; Performance Panel</b>

### STaR

Senior Management	Managing Director and direct reports
Board	Finance, Audit and Risk Sub Committee

### West Mercia Energy

Senior Management	Treasurer Managing Director
Board	Joint Committee

### Shropshire County Pension Fund

Senior Management	Pension Fund Administrator
Board	Pensions Committee