

Committee(s):	Date(s):
Audit and Risk Management Committee	25 th June 2013
Subject: Public Sector Internal Audit Standards (PSIAS)	Public
Report of: Chamberlain	For Information

Summary

The new Public Sector Internal Audit Standards (PSIAS) came into effect on 1 April 2013. These standards are mandatory and will underpin the Internal Audit arrangements within the City of London Corporation.

The Committee should welcome the fact that CIPFA has worked with the other Relevant Internal Audit Standard Setters to develop a set of internal audit standards applicable to all areas of the UK public sector. It is also appropriate that these standards should be based on the mandatory elements of the IIA (Institute of Internal Auditors) International Professional Practices Framework.

Overall, the new standard is continuation of existing best practice and, therefore, is not contentious. It is disappointing that the new standard has not sufficiently reinforced the role of an independent Audit Committee as being best practice for Local Government organisations. Also, the role and relationship with the Chief Finance Officer in being statutorily responsible and accountable for maintaining an effective system of financial control is not given prominence in the PSIAS.

The PSIAS uses a terminology which needs to be applied to the specific context and organisational structure of the City of London Corporation. In particular, it refers to the "Board" which, for most purposes, is the Audit and Risk Management Committee. It also refers to the role of the Chief Audit Executive, which in the City of London Corporation is the Head of Audit and Risk Management.

Implementation of the PSIAS for the City of London will require very few changes to existing processes, which have been based on the previous CIPFA Code of Practice for Internal Audit in Local Authorities in the United Kingdom. The Head of Audit and Risk Management will be expected to report on conformance with the PSIAS in his next annual report for the year 2013/14.

The published PSIAS includes some examples of functional reporting to the "board" which are not typically seen as the responsibility of an Audit Committee in a Local Authority e.g.:

- approving decisions regarding the appointment and removal of the Chief Audit Executive;
- approving the remuneration of the Chief Audit Executive; and

- approving the Internal Audit budget and resource plan.

The underlying principle here is that the independence of the Chief Audit Executive is safeguarded by ensuring that his/her remuneration or performance assessment is not unduly influenced by those subject to audit.

In practice, it is suggested that this would be achieved through the Town Clerk and Chief Executive contributing feedback to the performance appraisal of the Head of Audit and Risk Management and that feedback is also sought from the Chairman of the Audit and Risk Management Committee. The Audit and Risk Management Committee would be consulted through the Chairman of the Committee in the appointment and removal of the Head of Audit and Risk Management.

Another action requiring direct involvement of the Committee will be to revise the Internal audit – Terms of Reference, changing them into an Audit Charter so that they specifically address the additional requirements of the new audit standards.

Departments and Chief Officers will be consulted on the development of the Audit Charter in the Summer 2013, prior to seeking agreement by the Audit and Risk Management Committee at the October 2013 meeting.

Recommendations

Members are asked to:

1. note introduction of the new PSIAS
2. Consider the examples of internal audit functional reporting to the “board” which are not typically seen as the responsibility of an Audit Committee in a Local Authority and the proposed arrangements that will apply.
3. note the work that will need to be undertaken in the coming year to comply fully with the new standards (see paragraph 28)

Main Report

Background

4. The purpose of this report is to inform Members of the new Public Sector Internal Audit Standards (PSIAS), which came into effect on 1 April 2013. These standards are mandatory and will underpin the Internal Audit arrangements within the City of London Corporation. The Head of Audit and Risk Management will be expected to report on conformance with the PSIAS in his annual report for the year 2013/14.
5. The CIPFA Code of Practice for Internal Audit in Local Authorities in the United Kingdom is recognised as best practice and has been adopted by the

City of London. Previous reviews of the effectiveness of Internal Audit have assessed the level of compliance with this standard.

6. A collaboration announced by CIPFA and the Institute of Internal Auditors (IIA) in May 2011 has led to the development of a new set of Internal Audit Standards – the Public Sector Internal Audit Standards (PSIAS) - which now provides a coherent and consistent internal audit framework for the whole of the public sector. These new standards - which effectively replace the CIPFA Code of Practice for Internal Audit in Local Authorities in the United Kingdom - were formally published in December 2012 and are effective from 1 April 2013. The PSIAS Application note for Local Government was published in April 2013 and provides more specific guidance on the application of these standards within the context of Local Government organisations.
7. This report sets out the key requirements of the PSIAS and highlights areas where these differ slightly from the CIPFA Code of Practice. This year's review of the effectiveness of the system of internal audit as reported in the Head of Audit's Annual report (also on the Committee agenda, considers the City of London Corporation's readiness for the new standards.
8. The PSIAS uses a terminology which needs to be applied to the specific context and organisational structure of the City of London Corporation. In particular, it refers to the "Board" which, for most purposes, is the Audit and Risk Management Committee. It also refers to the role of the Chief Audit Executive, which in the City of London Corporation is the Head of Audit and Risk Management.

The New Standards

9. The PSIAS contain a number of key public sector requirements as follows:
 - (i) Compliance with the IIA Code of Ethics
10. The IIA Code of Ethics sets out key principles and rules of conduct covering the following: Integrity; Objectivity; Confidentiality; and, Competency. Where individual auditors have membership of another professional body, then he or she must also comply with the relevant requirements of that organisation. The PSIAS also require that internal auditors who work in the public sector have regard to the Committee on Standards of Public Life's Seven Principles of Public Life (sometimes referred to as the "Nolan Principles")
 - (ii) Purpose, Authority and Responsibility
11. The purpose, authority and responsibility of the internal audit activity must be formally defined in an internal audit charter which should:
 - define the terms "board" and "senior management" for the purposes of internal audit activity;
 - cover arrangements for appropriate resourcing;

- define the role of internal audit in any fraud-related work; and
- include arrangements for avoiding conflicts of interest if internal audit undertakes non-audit activities.

12. Within the City of London Corporation, it is anticipated that the Audit and Risk Management Committee will fulfil the functions of the “board”, as defined in the PSIAS, with a few exceptions which are identified in this report at paragraph 15.

(iii) Independence and Objectivity

13. The standard refers to the role of the Chief Audit Executive (CAE), which in the context of the City of London Corporation is the Head of Audit and Risk Management. The standard states that this role must report to a level within the organisation that allows the internal audit activity to fulfil its responsibilities. The Chief Audit Executive must report functionally to the “board”.

14. In practice, this means the Audit and Risk Management Committee (as the “Board”) will be involved in:

- approving the internal audit charter
- approving the risk based internal audit plan
- making appropriate enquiries of management and the Head of Audit and Risk Management to determine whether there are inappropriate scope or resource limitations.

15. The published PSIAS also include some examples of functional reporting to the board which are not typically seen as the responsibility of an Audit Committee in a Local Authority e.g.:

- approving decisions regarding the appointment and removal of the Chief Audit Executive;
- approving the remuneration of the Chief Audit Executive; and
- approving the Internal Audit budget and resource plan.

16. The underlying principle here is that the independence of the Chief Audit Executive is safeguarded by ensuring that his/her remuneration or performance assessment is not unduly influenced by those subject to audit. In practice, it is suggested that this would be achieved through the Town Clerk and Chief Executive contributing feedback to the performance appraisal of the Head of Audit and Risk Management and that feedback is also sought from the Chairman of the Audit and Risk Management Committee. The Audit and Risk Management Committee would be consulted through the Chairman of the Committee in the appointment and removal of the Head of Audit and Risk Management.

(iv) Impairment to Independence or Objectivity

17. Objectivity is presumed to be impaired if an internal auditor provides assurance services for an activity for which they had operational responsibility

within the preceding year, however, internal auditors may provide consulting (advisory) services for activities for which they were previously responsible.

18. Approval must be sought from the board (Audit and Risk Management Committee) for any significant additional consulting services not already included in the audit plan, prior to accepting the engagement. This is currently relevant to the work the City of London internal audit function as it undertakes efficiency review work in support of the Efficiency Board, which is explicitly referred to in the Audit Plans presented to the Committee.

(v) Proficiency and Due Professional care

19. Engagements 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. The Chief Audit Executive must hold a professional qualification (CMIIA, CCAB or equivalent) and be suitably experienced. Internal auditors must enhance their knowledge, skills and other competencies through continuing professional development.

(vi) Quality Assurance and Improvement Programme

20. The Chief Audit Executive must develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit activity. This must include both internal and external assessments. Internal assessments must include both integral day to day monitoring and supervision of activity, as well as periodic self assessments or assessments by other persons within the organisation with sufficient knowledge of internal audit practices. An external assessment should be conducted at least once every five years and progress against any improvement plans, agreed following external assessment and must be reported to senior management and the board (Audit and Risk Management Committee).
21. The last independent review of the City of London internal audit function was conducted in 2009. A reciprocated peer review with the London Borough of Hillingdon had been planned for this year; however, this would not be sufficiently independent to meet the new PSIAS requirements and, therefore, has not been progressed.
22. A peer review process is being established by the London Audit Group, with more than 30 London Boroughs due to participate. The City of London Corporation has already indicated a desire to take part in these arrangements and to be part of the first tranche of organisations to be subject to an external independent review.
23. Instances of non-conformance with the PSIAS should be reported to the board (Audit and Risk Management Committee) and if there are significant deviations, these should be considered for inclusion in the Annual Governance Statement.

(vii) Managing the Internal Audit Activity

24. The Internal Audit plan must be based on a documented risk assessment, undertaken at least annually. The input of senior management and the board (Audit and Risk Management Committee) must be considered in this process. Internal Audit must evaluate the effectiveness and contribute to the improvement of risk management processes. Internal auditors must develop and document a plan for each engagement, including the engagement's objective, scope, timing and resource allocations. Internal auditors must document relevant information to support the conclusions and engagement results.
25. The Chief Audit Executive must deliver an annual internal audit report that can be used by the organisation to inform its governance statement. This annual report must include an internal audit opinion on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. The annual report should also include:
- a summary of work that supports the opinion; and
 - a statement on conformance with the PSIAS and the results of the quality assurance and improvement programme. For the City of London Corporation, this is the annual review of the effectiveness of Internal Audit, which is reported within the Head of Audit's Annual report and opinion.

PSIAS v CIPFA Code – Key Differences:

26. The PSIAS have been developed following collaboration between CIPFA and the IIA, professional bodies that have complementary strategies and values and a shared commitment to Internal Audit. It, therefore, comes as no surprise that there are no fundamental differences between the PSIAS and the CIPFA Code of Practice. The main differences between PSIAS and the Local Government Code are as follows:-
- Independence and Objectivity – the PSIAS is not so concerned with “line management arrangements”, but more with independence of function and reporting;
 - PSIAS makes no mention of the role and relationship with the Chief Finance Officer in being statutorily responsible and accountable for maintaining an effective system of financial control:-
 - Impairment to Independence and Objectivity – the PSIAS set a timeframe (one year) whereby objectivity is presumed to be impaired, if an internal auditor provides assurance services for an activity for which they previously had operational responsibility;
 - Quality Assurance and Improvement Programme – the PSIAS require an external assessment of the internal audit activity, at least once every five years;
 - Risk Management – the PSIAS contain more detail on the role of Internal Audit in risk management;
 - Overall Opinion – PSIAS require the annual audit opinion to be accompanied by a statement on compliance with the mandatory standards.

27. Overall, the new standard is a continuation of existing best practice and therefore, is not contentious. It is disappointing that the new standard has not sufficiently reinforced the role of an independent Audit Committee as being best practice for Local Government organisations.
28. Also, the role and relationship with the Chief Finance Officer in being statutorily responsible and accountable for maintaining an effective system of financial control is not given prominence in the PSIAS. In particular, there is no mention in the PSIAS of the responsibilities that fall on the Chief Financial Officer through the Local Government Finance Act to support the Audit Committee and ensure internal audit is independent and effective. There is only limited reference to these responsibilities within the PSIAS Local Government Application note.
29. The following actions will be required, over the next few months, to ensure full compliance with the new Standards
- Redevelop the Internal audit – Terms of Reference into an Audit Charter, so it specifically addresses the additional requirements of the new audit standards. In addition, it intended that the creation of this charter will be used as an opportunity to document formally and agree performance expectations of both internal audit and Departments in making the internal audit process operate effectively. Departments and Chief Officers will be consulted on the development of this charter in the Summer 2013, prior to seeking agreement by the Audit and Risk Management Committee at the October 2013 meeting.
 - Some updating of the internal audit manual is required to ensure it reflects some of the new terminology introduced by the PSIAS. This will be completed by August 2013.
 - Implement formal arrangements for the Audit and Risk Management Committee Chairman and Town Clerk and Chief Executive to have input to the performance appraisal of the Head of Audit and Risk Management for the 2013/14 year end.

Conclusion

30. The Committee should welcome the fact that CIPFA has worked with the other Relevant Internal Audit Standard Setters to develop a set of internal audit standards applicable to all areas of the UK public sector. It is also appropriate that these standards should be based on the mandatory elements of the IIA International Professional Practices Framework.
31. Implementation of the PSIAS for the City of London will require very few changes to existing processes, which have been based on the previous Code of Practice for Internal Audit in Local Authorities in the United Kingdom.

Appendices

▪ **Appendix 1: Public Sector Internal Audit Standards**

Background Papers:

- 20th September 2012 Audit and Risk Management Committee - Public Sector Internal Audit Standards
- PSIAS Local Government Application Note

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