

## PERTH AND KINROSS COUNCIL

Audit Sub-Committee – 12 September 2012

## INTERNAL AUDIT TERMS OF REFERENCE

## Report by Chief Internal Auditor

**ABSTRACT**

This report presents a revised and updated 'Terms of Reference' document for Internal Audit.

**1. RECOMMENDATION**

- 1.1 The Audit Sub-Committee is asked to approve the revised and updated 'Terms of Reference' document.

**2. BACKGROUND**

- 2.1 CIPFA's 'Code of Practice for Internal Audit in Local Government in the United Kingdom' ['the Code of Practice'] requires that Internal Audit's purpose, authority and responsibility be formally defined in a manner consistent with the Code of Practice itself. The Code also requires the Chief Internal Auditor to advise on the content of the Terms of Reference and any required amendments. Internal Audit's Terms of Reference document was originally approved by the Council's Audit Sub-Committee in September 2007 [07/594] but has not been updated since.
- 2.2 The purpose of this report is to present a revised and updated Terms of Reference document for approval. The proposed revisions arise from two related sources:
- i Internal Audit's own review of compliance with the Code of Practice, carried out in the Spring of 2007 and in response to the issue of the latest version of the Code of Practice in November 2006;
  - ii A review of compliance with the Code of Practice by the Council's external auditors.

**3. PROPOSALS**

- 3.1 The revised Terms of Reference document is shown in the Appendix. The significant changes from the previous version are as follows:
- i it clearly states that Internal Audit's remit extends to the entire control environment of the organisation [Appendix, 4.4];
  - ii it describes the nature of the Internal Audit planning process [Appendix, Section 6];

- iii the document sets out the Chief Internal Auditor's right to determine the manner in which Internal Audit will report and sets out the normal arrangements for reporting [Appendix, 7.2];
- iv it clearly states the requirement upon the Chief Internal Auditor to deliver an annual audit opinion [Appendix, 7.3];
- v it sets out the right of the Chief Internal Auditor to meet privately with the Audit Sub-Committee [Appendix, 7.5];
- vi it sets out the Chief Internal Auditor's right of access to elected members of the Council [Appendix, 7.5 to 7.7];
- vii it cross-references to the 'Audit Sub-Committee Role and Remit' in describing the way in which Internal Audit will report to committee [Appendix, 7.6];
- viii it describes Internal Audit's role in the development of systems, policies and procedures within the Council [Appendix, 8.4];
- ix it clarifies Internal Audit's role in respect of the investigation of benefit fraud [Appendix, 10.4];
- x it formalises the arrangements for the regular review of the Terms of Reference [Appendix, 12];

3.2 In addition, there are significant additions to the description of Internal Audit's consultancy role (Appendix, Section 8) and in connection with its work in connection with the requirements of external bodies (Appendix, Section 9). Taken together, these amendments are intended to ensure that the Terms of Reference are up to date and compliant with the Code of Practice.

#### **4. CONSULTATION**

4.1 The Depute Director of Housing & Community Care and Finance, the Head of Democratic Services, the Chief Executive and the Council's external auditor have been consulted in the preparation of this report.

#### **5. RESOURCE IMPLICATIONS**

5.1 There are no resource implications arising from this report.

#### **6. COUNCIL CORPORATE PLAN OBJECTIVES 2009-2012**

6.1 The Council's Corporate Plan 2009-2012 lays out five Objectives which provide clear strategic direction, inform decisions at a corporate and service level and shape resources allocation. They are as follows:-

- (i) A Safe, Secure and Welcoming Environment
- (ii) Healthy, Caring Communities
- (iii) A Prosperous, Sustainable and Inclusive Economy
- (iv) Educated, Responsible and Informed Citizens
- (v) Confident, Active and Inclusive Communities

- 6.2 The Chief Executive's Service provides a range of functions for internal and front-line customers alike. These functions support the work of the whole Council by assisting them in the delivery of the Council's Corporate Objectives. As a consequence, this report does not specifically relate to one of the objectives, but assists with the delivery of all five.

## **7. EQUALITIES ASSESSMENT**

- 7.1 An equality impact assessment needs to be carried out for functions, policies, procedures or strategies in relation to race, gender and disability and other relevant protected characteristics. This supports the Council's legal requirement to comply with the duty to assess and consult on relevant new and existing policies.
- 7.2 The function, policy, procedure or strategy presented in this report was considered under the Corporate Equalities Impact Assessment process (EqIA) and was assessed as **not relevant** for the purposes of EqIA

## **8. STRATEGIC ENVIRONMENTAL ASSESSMENT**

- 8.1 Strategic Environmental Assessment (SEA) is a legal requirement under the Environmental Assessment (Scotland) Act 2005 that applies to all qualifying plans, programmes and strategies, including policies (PPS).
- 8.2 However, no action is required as the Act does not apply to the matters presented in this report. This is because the Committee are requested to note the contents of the report only and the Committee are not being requested to approve, adopt or agree to an action or to set the framework for future decisions.

## **9. CONCLUSION**

- 9.1 This report presents for approval a revised and updated Terms of Reference document for Internal Audit.

**J CLARK**

Chief Internal Auditor

**Note:**

No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above report.

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**Date:**

August 2012

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## 1 Introduction

- 1.1 These Terms of Reference are produced in compliance with CIPFA's "Code of Practice for Internal Audit in Local Government in the United Kingdom 2006" ['the Code of Practice']. The Terms of Reference set out the purpose, authority and responsibility of Internal Audit in a manner consistent with the Code of Practice.

## 2 Purpose of the Terms of Reference

- 2.1 The purpose of this document is to:

- i establish the responsibilities and objectives of the Council's Internal Audit service;
- ii establish the organisational independence of Internal Audit;
- iii establish the accountability, reporting lines and relationships between the Chief Internal Auditor and:
  - those charged with governance;
  - those to whom the Chief Internal Auditor may report.
- iv recognise that Internal Audit's remit extends to the entire control environment of the Council;
- v identify Internal Audit's contribution to the review of the effectiveness of the control environment;
- vi require and enable the Chief Internal Auditor to deliver an annual audit opinion on the effectiveness of the control environment;
- vii define the role of Internal Audit in any consultancy or fraud-related work;
- viii explain how Internal Audit's resource requirements will be assessed;
- ix establish Internal Audit's right of access to all records, assets, personnel and premises, including those of partner organisations, and its authority to obtain information and explanations;

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- x require the Chief internal Auditor to 'follow-up' the progress of agreed improvement actions arising from audit reports; and
- xi establish the arrangements in place for the review of the Terms of Reference document.

### 3 Responsibilities and Objectives

#### 3.1 The Code of Practice defines Internal Audit in the following way:

"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 resources." [Code of Practice, Page 2]

#### 3.2 Perth & Kinross Council's Chief Internal Auditor will lead the Internal Audit function and is the "Head of Internal Audit" as defined in the Code.

#### 3.3 The primary function of Internal Audit is to provide an opinion to "those charged with governance" on the effectiveness of the Council's control environment [see Section 7].

#### 3.4 The term 'those charged with governance' refers primarily to the Council and its committees, which are ultimately responsible for the organisation's governance arrangements. For the purposes of the Internal Audit process, the principal forum for reporting and accountability will be the Council's Audit Sub-Committee. In addition, Internal Audit's work will aim to assist those senior officers with significant governance responsibilities within the Council, such as the Chief Executive, Executive Directors and those officers with specific statutory responsibilities, such as the Chief Financial Officer and the Monitoring Officer.

#### 3.5 Internal Audit will conduct its work in such a way as to promote improvements across the control environment. In this way, Internal Audit aims to assist the Council in the achievement of its objectives.

### 4 The Control Environment

#### 4.1 The role of internal audit is to independently review the effectiveness of the control environment in order to promote the achievement of the Council's objectives. The scope of Internal audit's remit includes the entire control environment.

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- 4.2 The Council's control environment comprises its systems of governance, risk management and internal control. The control environment exists in order to ensure:
- i the establishment of, and monitoring the achievement of, the Council's objectives;
  - ii compliance with the relevant laws, regulations, policies, plans and procedures;
  - iii the economical, efficient and effective use of the Council's resources;
  - iv proper financial management of the Council, including the reporting of financial management; and
  - v proper performance management and continuous improvement.
- 4.3 It is the responsibility of the Council and its senior officers to maintain the control environment by putting in place appropriate internal controls relating to the activities for which they are responsible. These internal controls include the full range of policies, procedures and practices intended to ensure the proper conduct of the Council's operations and the achievement of its objectives. They may include organisational structures, job descriptions, authorisation limits, management supervision, risk management processes, reports and decisions.
- 4.4 Internal Audit's role will extend to the whole of the Council's control environment. The Chief Internal Auditor will report any restriction or limitation placed on the scope of its work.
- 4.5 In order to carry out its duties, Internal Audit will have the right of access, at all reasonable times, to all Council records or assets (in whatever form), premises and personnel, as well as those of partner organisations.
- 4.6 Internal Auditors may require the relevant persons to provide explanations relating to their knowledge, duties and actions in respect of any part of the Council's control environment.
- 5 Organisational Independence
- 5.1 Internal Audit must be operationally independent of the activities that it audits, in order to enable auditors to perform their duties in a way that

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allows them to make impartial and effective professional judgements and to form objective opinions.

- 5.2 It is the responsibility of the Council to put in place arrangements to ensure that this operational independence is achieved and safeguarded, in a manner consistent with the Code of Practice.
- 5.3 The Chief Internal Auditor has direct access to the Chief Executive, to all Council officers and to the elected members of the Audit Sub-Committee in connection with any relevant matter. The Chief Internal Auditor has the freedom to report in her own name, 'without fear or favour'.
- 5.4 The Chief Internal Auditor will report at least annually on the extent to which organisational independence has been achieved. The Chief Internal Auditor will report in cases where organisational independence has been compromised.
- 5.5 The Chief Internal Auditor will put in place appropriate procedures to ensure an objective approach to audit work on the part of individual auditors and audit contractors.

## 6 Planning and Resources

- 6.1 Internal Audit will plan its work in order to ensure that its objectives are achieved. Internal Audit's plan will be based on its independent assessment of the risks to the achievement of the Council's objectives associated with each activity. Where appropriate, the audit risk assessment will take into account the Council's corporate risk management arrangements.
- 6.2 The Chief Internal Auditor will ensure that annual audit plans reflect a proper degree of understanding of the Council, its objectives and risks. In general, the audit planning process will take into account:
  - i the Council's objectives, as set out in corporate and service plans;
  - ii the views of senior officers in respect of areas of perceived current or future risk;
  - iii the results of past work by internal audit, external auditors and other statutory inspection agencies;
  - iv planned work by external auditors and other statutory inspection agencies;



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v corporate and service risk profiles;

vi other available information relating to significant local or national issues that may affect the Council's control environment.

6.3 The Chief Internal Auditor will assess the level of audit resources required and those available independently of each other and will report on any significant discrepancy between the two.

6.4 The Chief Internal Auditor will prepare an annual audit plan for consideration and approval by the Audit Sub-Committee.

6.5 The Chief Internal Auditor will review progress and will report on any matters that may jeopardise the achievement of the approved plan.

## 7 Reporting

7.1 Internal Audit will report on the results of its work, in order to provide an opinion on the control environment and to assist the Council and its officers in identifying improvements where necessary.

7.2 The Chief Internal Auditor will determine the way in which Internal Audit reports. In general and unless otherwise determined:

i Internal Audit reports will be issued in draft form to the relevant officers for comment and response prior to issue;

ii Internal Audit will invite the relevant officers to propose the actions to be taken (and the associated timescales) in response to the findings of draft reports;

iii Internal Audit will make reasonable efforts to resolve any areas of disagreement with the relevant officers prior to the issue of final audit reports;

iv the Chief Internal Auditor will make arrangements for final Internal Audit reports to be issued to the relevant officers, to Committee Services and to the Council's appointed external auditor;

v final Internal Audit reports will specify the areas of the Council's control environment under review and provide an opinion on their effectiveness;

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vi final Internal Audit reports will be considered by the Council's Audit Sub-Committee.

- 7.3 The Chief Internal Auditor will provide an annual opinion on the effectiveness of the control environment in such a way as to support the production of the Council's Annual Governance Statement. This opinion will note any material weaknesses in the control environment and present an opinion on the adequacy of the improvement action being taken.
- 7.4 The Chief Internal Auditor shall have the right to report to the Accounts Commission and to the Council's appointed external auditor on any relevant matter.
- 7.5 The Chief Internal Auditor shall have the right to report to the Council or any committee on a relevant matter, notwithstanding that the normal reporting route to elected members is to the Audit Sub-Committee. The Chief Internal Auditor may meet privately with the Audit Sub-Committee, subject to the guidance of the Head of Democratic Services.
- 7.6 The normal reporting arrangements to the Audit Sub-Committee will be described in the 'Audit Sub-Committee – Role and Remit' document.
- 7.7 The Chief Internal Auditor shall have access to the elected members of the Council in connection with any relevant matter.
- 7.8 The Chief Internal Auditor shall have access to the Chief Executive in connection with any relevant matter.
- 7.9 Internal Audit is part of the Finance Division within the Chief Executive's Service. Operationally, the Chief Internal Auditor reports to the Depute Director of Housing & Community Care, who supports the work of Internal Audit throughout the Council as part of his strategic role.
- 8 Consultancy and Systems Developments
- 8.1 The Chief Internal Auditor will require to be informed of all significant systems developments within the Council and will determine the extent of Internal Audit's involvement in the development process. Any such contribution will be advisory in nature and will be provided in such a way as to ensure that the impartiality of future audit work is not compromised.
- 8.2 As part of the research and planning undertaken in arriving at the risk-based Internal Audit Plan for the year, the Chief Internal Auditor will take account of significant changes in the Council's environment. Subject to the

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availability of resources, the Chief Internal Auditor may include an allowance of resources towards advisory work to support the Council in building in controls for new systems at the outset.

- 8.3 With the exception of investigations into fraud and/or corruption [for which see Section 10], Internal Audit is not normally a provider of internal consultancy services, i.e. work specifically commissioned by officers of the Council. Such work tends to involve a departure from the prioritised risks incorporated into the audit plan. Any request will be assessed in accordance with the risk to the Council and the Audit Sub-Committee will be updated with any deviation from the Internal Audit Plan.
- 8.4 Where the Council requires that internal Audit carries out consultancy work, the Chief Internal Auditor will report on the situation, setting out the likely impact on planned audit work.
- 8.5 The Chief Internal Auditor will, in drawing up the audit plan, consider the resources necessary to provide ad-hoc advice within the Council on matters relating to the control environment.

## 9 Work for External Bodies

- 9.1 Some aspects of Internal Audit's work are determined effectively by a requirement placed upon it by external bodies, rather than through the risk-based planning process described above. These include the audit of grant claims on behalf of funding providers such as the Scottish Executive.
- 9.2 The Chief Internal Auditor will, in drawing up the audit plan, consider the resources necessary to complete such work of this nature as is required by the Council. Where the level of work is excessive, the Chief Internal Auditor will report on the situation, setting out the likely impact on planned audit work.

## 10 Fraud and Corruption

- 10.1 Managing the risk of fraud and corruption is the responsibility of management. It is not the primary purpose of Internal Audit to detect fraud and corruption within the Council. However, the risk of fraud or corruption will be considered and taken account of (along with other types of risk) in developing Internal Audit's plan.

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- 10.2 From time to time, Internal Audit may consider it necessary, or may be required, to undertake investigatory work beyond that required to deliver an audit opinion. The Chief Internal Auditor will:
- i make reasonable arrangements to ensure that Internal Audit is equipped to undertake this type of work;
  - ii ensure that a reasonable allowance is made for the resources likely to be required for investigation-related work.
- 10.3 Where the level of investigation work is excessive, the Chief Internal Auditor will report on the situation, setting out the likely impact on planned audit work.
- 10.4 Where other agencies within the Council also deal with the investigation of fraud and/or corruption (for example, benefit fraud), the Chief Internal Auditor will consider, as part of the planning process, the audit work required to provide an independent opinion on their effectiveness.
- 10.5 The Chief Internal Auditor is responsible for:
- i developing and maintaining the Council's procedures for the reporting of suspected fraud or corruption, both internally and externally to the Council;
  - ii developing and maintaining the Council's procedures for responding to suspected fraud or corruption, in accordance with the requirements of the Council;
  - iii the conduct of internal investigations into suspected fraud, corruption or other irregularity, in accordance with the requirements of the Council;
  - iv facilitating the above by maintaining appropriate working relationships between Internal Audit and the police and other investigating agencies.
- 11 Follow-Up
- 11.1 The Chief Internal Auditor will put in place appropriate arrangements for tracking progress with the improvement actions agreed with management.
- 11.2 The Chief Internal Auditor will report to the Audit Sub-Committee any significant issues arising from this process.

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## 12 Approval and Review

- 11.1 It is the responsibility of the Audit Sub-Committee to consider and approve Internal Audit's Terms of Reference.
- 11.2 The Chief Internal Auditor will review this document annually and will advise the Audit Sub-Committee on any amendments considered to be necessary.
- 11.3 No change to Internal Audit's Terms of Reference shall be made unless both the Council's appointed external auditor and the Chief Internal Auditor have been consulted and have been given a reasonable opportunity to present to the Audit Sub-Committee their views on the proposed changes.

