

Report

Report subject: Terms of Reference for Internal Audit

Report to: Audit Committee

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1 Background

- 1.1 Terms of Reference for Internal Audit were last approved in October 2005. In December 2006 CIPFA published a revised Code of Practice for Internal Audit in Local Government. This is the professional standard to which the Internal Audit team work and forms the 'proper practices in relation to internal control' as required by the Accounts and Audit Regulations 2003 (as amended).

2 Key Changes to the Code

- 2.1 The revised Code of Practice reflects changes arising from the amendments to the Accounts and Audit Regulations in 2006 and changes to corporate governance arrangements, in particular the role of Audit Committees. It also reflects the greater emphasis on risk based auditing.
- 2.2 The new Code of Practice requires that the purpose, authority and responsibility of Internal Audit must be formally defined in terms of reference consistent with the Code. The revised Terms of Reference are at Appendix A. The key requirements of the Terms of Reference should be to:
- a. Establish the responsibilities and objectives of Internal Audit.
 - b. Establish the organisational independence of Internal Audit.
 - c. Establish the accountability, reporting lines and relationships between the Head of Internal Audit and:
 - (1) Those charged with governance
 - (2) Those to whom the Head of Internal Audit may report.
 - d. Recognise that Internal Audit's remit extends to the entire control environment of the organisation.
 - e. Identify Internal Audit's contribution to the review of the effectiveness of the control environment.
 - f. Require and enable the Head of Internal Audit to deliver an annual audit opinion.
 - g. Define the role of Internal Audit in any fraud-related or consultancy work.
 - h. Explain how Internal Audit's resource requirements will be assessed.
 - i. Establish Internal Audit's right of access to all records, assets, personnel and premises, including those of partner organisations, and its authority to obtain such information and explanations as it considers necessary to fulfil its responsibilities.

Source: CIPFA Code of Practice 2006

3 Compliance with the Code

- 3.1 The Terms of Reference comply with the CIPFA Code requirements with the exception of one aspect of reporting arrangements. The Code states that the Head of Internal Audit should not report to or be managed at a lower organisational level than the corporate management team. This presents organisational and structural difficulties for a small council. Instead there are safeguards in place to ensure the independence of Internal Audit through the right of the Chief Auditor to report in her own name and rights of access, as set out in section 4 of the Terms of Reference.

4 Recommendation

- 4.1 It is recommended that the revised Terms of Reference for Internal Audit be approved.

Implications

Financial: None

Legal: None

Human Rights: None

Personnel: None

Community Safety: None

Environmental Impact: None

Council's Core Values: All

Internal Audit Terms of Reference

1. Background and Authority

- 1.1. The requirement for an Internal Audit function derives from local government legislation – section 151 of the Local Government Act 1972 and the Accounts and Audit Regulations 2003 (as amended in 2006). The regulations require the Council to ‘maintain an adequate and effective system of Internal Audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control’.
- 1.2. The guidance accompanying the legislation states that proper internal control practices for internal audit are those contained within the CIPFA Code of Practice for Internal Audit in Local Government 2006. The Terms of Reference have been prepared in accordance with the Code.

2. Objectives and Responsibilities of Internal Audit

2.1. Objectives

- 2.1.1. The objectives of internal audit are set out in the following definition.
- 2.1.2. Internal Audit is an assurance function that provides an independent and objective opinion to the council on the control environment, by evaluating its effectiveness in achieving the council'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.

2.2. Scope

- 2.2.1. The scope of Internal Audit work includes the entire control environment of the council. The control environment comprises the systems of governance, risk management and internal control. It includes all the council's operations, resources, services and responsibilities in relation to other bodies. This coverage will enable Internal Audit to report an opinion on the control environment to the council and contribute to the annual review of its effectiveness.
- 2.2.2. In determining where effort should be concentrated, the Chief Internal Auditor will take account of the council's assurance and monitoring mechanisms (the assurance framework), including risk management arrangements, for achieving the council's objectives. The scope of audit work extends to services provided through partnership arrangements.

2.3. Responsibilities

- 2.3.1. Internal Audit will ensure that its Internal Audit work meets the standards set out in the CIPFA Code of Practice for Internal Audit in Local Government (2006). The standards cover the professionalism required from each auditor, including ethics, due professional care and independence, as well as the conduct of audit work and the organisational provision of internal audit.
- 2.3.2. Internal Audit will ensure that all reviews give assurance to management on internal controls or identify risks to the control environment. Internal Audit will work in partnership with management to provide optimum benefit to the council.
- 2.3.3. 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 council's objectives.

3. Reporting Lines and Relationships

- 3.1. Internal Audit is required to report to ‘those charged with governance’. The council has established the Audit Committee to undertake these responsibilities on its behalf and to advise the council. The committee's Terms of Reference set out its responsibilities for Internal Audit. The Chief Auditor will

report to the Audit Committee the audit opinion on the control environment of the Council. The Audit Committee will approve the Internal Audit plan and review the performance of Internal Audit.

- 3.2. Administratively Internal Audit form part of the Financial Services unit of the council with the Chief Auditor reporting to the Head of Financial Services, as the council's Responsible Financial Officer.
- 3.3. Results of audit work are addressed to Service Unit Heads and Policy Directors as appropriate. Executive summaries are also provided to the Chief Executive and Audit Committee Members.

4. Independence and Accountability

- 4.1. Internal Audit has the right to report in its own name and to have freedom of access to all senior officers and Members. In particular the right of access to the Chair of the Audit Committee, Chief Executive, Monitoring Officer and Responsible Financial Officer are key to ensuring the independence of audit.
- 4.2. Internal Audit will remain sufficiently independent of the activities that it audits to enable auditors to perform their duties in a manner that facilitates impartial and effective professional judgements.
- 4.3. Internal Audit is accountable through the reporting lines identified in section 3 above. In addition Internal Audit's activities will be linked to the council's strategic objectives and conducted in accordance with the council's policies and procedures.
- 4.4. Accountability for the response to the risks identified by Internal Audit lies with management, who either identify and implement the appropriate actions or accept the risk.

5. Audit Responsibilities in relation to Anti-fraud work

- 5.1. Managing the risk of fraud and corruption is the responsibility of management. Internal Audit does not have responsibility for the prevention or detection of fraud and corruption but should be alert to the risks. Managers should inform the Chief Auditor of all suspected or detected fraud, corruption or impropriety so that she can consider the adequacy of the relevant controls and evaluate the implications for the audit opinion on the internal control environment.
- 5.2. Internal Audit will provide advice on the risks of fraud to management and help to raise awareness of fraud issues. This is in accordance with the council's Anti-Fraud Strategy. In circumstances of suspected fraud it may be appropriate for Internal Audit to advise or assist with an investigation, including liaison with the police. Internal Audit's role in investigation is set out in the fraud response plan.

6. Internal Audit's Rights of Access

- 6.1. In accordance with the Accounts and Audit Regulations 2003 the council's Financial Regulations provide Internal Audit with authority to:
 - Access council premises at reasonable times.
 - Access all assets, records, documents, correspondence and control systems.
 - Receive any information and explanation considered necessary concerning any matter under consideration.
 - Require any employee of the authority to account for cash, stores or any other authority asset under his/her control.
 - Access records belonging to third parties, such as contractors when required.

7. **Internal Audit Resources**

- 7.1 The Chief Auditor is responsible for proposing an Audit Plan to the Audit Committee for approval each year. This will be risk-based to reflect the finite resources available. If in the opinion of the Chief Auditor or of the Audit Committee the level of resources in any way limit the scope of Internal Audit or prejudice the ability of Internal Audit to meet its objectives, they should advise the council accordingly.