

Agenda Item No: 10

Report To: Audit Committee

Date: 18 March 2014

Report Title: Internal Audit – External Quality Assessment against Public Sector Internal Audit Standards

Report Author: Brian Parsons – Head of Audit Partnership



Summary: The report sets out the results of the External Quality Assessment of conformance by Internal Audit against the Public Sector Internal Audit Standards and the responses from the Head of Audit Partnership to the recommendations made by the assessors.

The report provides assurance to the Committee that Internal Audit is already meeting the vast majority of the Standards and that full conformance can be achieved.

Key Decision: No

Affected Wards: N/A

Recommendations: **The Audit Committee is asked to:-**

Note the outcomes of the External Quality Assessment and the action that will be taken to ensure full conformance.

Policy Overview: N/A

Financial Implications: The External Quality Assessment cost £7,000. The cost was shared among the four partner Councils and the cost for each was therefore £1,750. The cost has been met from existing budgets.

Risk Assessment Yes

Equalities Impact Assessment No

Other Material Implications: None

Background Papers: Report to Audit Committee dated 5 March 2013 – Public Sector Internal Audit Standards. Report to Audit Committee dated 26 September 2013 – Internal Audit Charter

Contacts: Brian.parsons@ashford.gov.uk – Tel: (01233) 330442

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Purpose of the Report

1. The report sets out the results of the External Quality Assessment of conformance by Internal Audit against the Public Sector Internal Audit Standards and the responses by the Head of Audit Partnership to the recommendations made by the assessors.
2. The report provides assurance to the Committee that Internal Audit is already meeting the vast majority of the Standards and that full conformance can be achieved.

Issue to be Decided

3. The Committee is asked to note the outcomes of the External Quality Assessment and the action that will be taken to ensure full conformance.

Background

4. The Public Sector Internal Audit Standards (PSIAS) were introduced on 1 April 2013 and set the standard for the way that internal audit is delivered in local government and in the public sector generally.
5. The basis for the Standards is the Institute of Internal Audit's (IIA's) International Professional Practice Framework which includes the Definition of Internal Auditing, Code of Ethics and International Standards. The Public Sector element adds a further dimension and provides clarification on how the international standards should be applied to the public sector.
6. The Standards specify that external quality assessments must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organisation.
7. An external assessment of conformance with the standards covers the same elements of the internal audit function, whether the internal audit service operates in the finance sector, the public sector or within a FTSE top 100 company.
8. It was proposed that Mid Kent Audit would seek an early assessment and the Audit Committee was consulted accordingly.
9. An assessment of Mid Kent Audit was commissioned from the Chartered Institute of Internal Auditors (IIA). The assessment was carried out in January 2014.

10. The assessment was a 'validated self-assessment' based on a checklist completed by Internal Audit management. An evidence file was prepared to support the self assessment.
11. The team from the CIIA carried out their work on-site and had access to all Internal Audit files and records, which are held within the electronic audit management system, Team Mate. The team also conducted a series of interviews, which included the relevant senior officer from each of the four Councils, a Head of Service who was able to provide a 'client' view as the receiver of internal audit services, two of the four Audit Committee Chairmen, the External Auditor (the Director/Assurance for Grant Thornton) as well as the Head of Audit Partnership and the majority of the audit partnership team.
12. The assessment process was intensive, while also being very positive and participative. The assessment team was able to provide examples of good practice from elsewhere and to make suggestions for service improvements.
13. The External Quality Assessment (EQA) of Mid Kent Audit was the first EQA by the Institute of any local authority internal audit service in the country.
14. The report relating to the assessment was issued on 22 January 2014 and is attached at Appendix 1.
15. The report is very positive and confirms that Mid Kent Audit conforms to 50 of the 56 principles and partially conforms to the remaining 6. There were no 'fails'. This is a considerable achievement in the context of the breadth of the PSIAS and provides a high level of assurance to the Committee that the Council receives a very good quality audit service from Mid Kent Audit.
16. A professional, independent and objective internal audit service is one of the key elements of good governance. Conformance with the Standards provides evidence that Mid Kent Audit matches this criterion. This means that Members, officers and the external auditors can place reliance on the work of Internal Audit and that Internal Audit is able to make a significant contribution to the governance of the Authority.
17. There are six recommendations within the EQA report. Responses to the recommendations have been prepared by the incoming Head of Audit Partnership and are shown in the report. The actions will be developed during 2014/15.
18. It is intended that, on completion of the necessary actions, the IIA assessment team will be invited back to reassess the position and subject to the few partial conformances being addressed, will be able to verify that 'Mid Kent Audit conforms to the IIA's professional standards' and PSIAS. It will then be possible for Internal Audit to make this statement in its reports and promotional literature. This will be particularly helpful if Mid Kent Audit is tasked to seek external clients, as it will be possible to use the assessment to evidence the quality of the audit service.

Risk Assessment

19. Internal Audit needs to be able to demonstrate its quality in order to provide the necessary assurances to management and Members. The EQA provides evidence that this risk has been managed.

Equalities Impact Assessment

20. There are no specific equalities implications.

Other Options Considered

21. There are no relevant other options.

Consultation

22. The Audit Committee was consulted prior to the External Quality Assessment being commissioned.
23. The Deputy Chief Executive and the Chairman of the Audit Committee were invited to give their views as part of the External Quality Assessment.

Conclusion

24. The results of the EQA provide evidence of the effectiveness and quality of the internal audit service (Mid Kent Audit).
25. The implementation of the responses to the EQA recommendations will further improve the quality of the audit service.

Portfolio Holder's Views

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Contact: Brian Parsons, Tel: 01233 330442

Email: brian.parsons@ashford.gov.uk



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**External Quality Assessment Report for
the Mid-Kent Audit Partnership**

Prepared by Chris Baker
on behalf of CIIA's Quality Services,
22nd January 2014.



Our Opinion

The Institute of Internal Audit's (IIA's) International Professional Practice Framework (IPPF) includes the Definition of Internal Auditing, Code of Ethics and *International Standards*. There are 56 basic principles to achieve with more than 150 points of recommended practice. The IPPF also form the basis of the recent Public Sector Internal Audit Standards (PSIAS) applicable to local government, which we have used as the basis for our review.

It is our view that Mid-Kent Audit Partnership conforms to 50 of these principles and the specific interpretations included in the PSIAS. This is an important achievement given the breadth of the PSIAS and the relative pace of change within the sector. The results are consistent with other reviews we have performed illustrating a reasonable baseline position but with scope for improvement.

To achieve full conformance to the Standards and the PSIAS internal audit needs to graduate to greater focus upon risk. In practice this means ensuring audit plans have more emphasis upon strategic risks, audit engagements introduce a focus upon critical success factors and associated risks and the Annual Report and Opinions provides an evaluation of the overall effectiveness of risk management. However, we see this as a progression of the good foundations that have been established and an achievable goal based upon the strong commitment to the Partnership by every member of the consortia.

Provided the Audit Partnership can show the partial conformances have been developed to general conformances this will enable the team to say it 'conforms to the IIA's professional standards' in its reports and promotional literature.



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Public Sector Internal
Audit Standards

Applying the IIA International Standards to
the UK Public Sector

Summary of Mid-Kent Audit Partnership's Conformance	Standards	Does not Conform	Partially Conforms	Generally Conforms	Total
Definition and Code of Ethics	Rules of conduct	0	0	5	5
Purpose	1000 - 1130	0	1	6	7
People	1200 - 1230	0	0	4	4
Performance	1300 - 1322	0	1	6	7
Planning	2000 - 2130	0	3	9	12
Process	2200 - 2600	0	1	20	21
Total		0	6	50	56

GC Generally Conforms means the evaluator has concluded that the relevant structures, policies, and procedures of the activity, as well as the processes by which they are applied, comply with the requirements of the individual *Standard* or element of the Code of Ethics in all material respects.

Achievements of the Audit Partnership



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1. The transition to a single employer structure has been managed with care and sensitivity to achieve continuity.
2. An assurance service that has the freedom to do its job – there are no restriction in terms of scope.
3. Leadership and professionalism - the team is respected and valued by audit committee members and senior executives.
4. Well qualified staff with a good mix of skills – including succession planning.
5. Training and development of staff.
6. Delivery and development of risk management.
7. A structured and consistently applied audit process as set out in a procedures manual.
8. Effective use of TeamMate to enhance efficiency and effectiveness.
9. Stakeholders who believe internal auditors are professional in their approach.
10. A monitoring process for the follow-up of audit recommendations.
11. A broad range of quality measures and indicators to monitor performance.
12. Overall commitment to development and continuous improvement.

Stakeholder feedback



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- The achievements of the Audit Partnership have been reinforced during discussions with audit committee members and senior executives. There is a great deal of respect and appreciation for the retiring Head of Internal Audit and unanimous support for the development of the consortia under new leadership.
- Furthermore, it is widely acknowledged that bringing the team together within a single employer arrangement will enable greater flexibility and variety in internal audit delivery, establish a career path for team members and that in time this will open commercial opportunities.
- At the same time the change in structure and the appointment of a new Head of Internal Audit raises expectations. Most stakeholders are of the opinion that the public sector will continue to operate under severe financial constraints and that further change is an inevitable consequence. Within this environment there is a desire to have an internal audit activity that supports the challenges ahead through trusted advice and guidance.
- This means internal audit must operate at a strategic level supporting the further development of risk management and providing assurance around the things that matter – in other words that the key objectives, projects and initiatives are being delivered. To enable this to happen internal audit will need to devote more time understanding the concerns and assurance needs of its stakeholders through informal as well formal mechanisms.
- As a consequence we have prioritised our ideas and suggestions accordingly.

Supporting continuous improvement



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We set out some ideas for the [Partnership Board and Audit Committee members](#) related to Governance and Risk Management

Risk management

The management of risk has been firmly established at a strategic level and we feel this provides the platform to fully embed a risk culture. We therefore encourage Audit Committees and Senior Executives to reflect upon how risk management can be applied in operational areas.

As this will have resource implications we suggest it may be done in key activities which could include project management, procurement, contract management, fraud prevention etc.

In doing so we also recommend that some time be devoted to thinking about how risk appetite is defined – the limits, boundaries and expectations around strategic and operational risks that will further indicate risks are under control.

Response

*HAP will raise this matter with the Audit Board and onwards to the Audit Committees.
IA will invite each member of the partnership to formulate a risk appetite statement appropriate to their strategic aims and support them in its creation.*

To achieve full conformance to the IIA Standards



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We set our recommendations to enable the Audit Partnership to fully conform to specific IIA Standards in order of importance. (1/3)

Standard 2120 Risk Management

Internal audit has had a significant impact upon the implementation and improvement of risk management. Strategic level risk management is functioning well across the Partnership.

As organisations develop the maturity of their risk management the Standards and the PSIAS require internal audit to provide an independent and objective evaluation of risk processes. Typically, this is done through periodic review of the methodology against best practice and annual assurance that processes are applied effectively and that risks reports are reliable. This is an important next step for internal audit whose opinions upon risk management should be included in Annual Reports as a major contribution to Governance Statements. *(There is a specific requirement in the PSIAS that the risk-based plan must take into account the requirement to produce an annual internal audit opinion).*

While internal audit is capable of undertaking this role their involvement in facilitation means they are close to the process. As a result we would further advise that an external advisor be approached once every five years to give a view on the development of risk management. This could be done on a peer review basis or through a partner organisation such as Zurich insurance.

Response: *HAP will incorporate a view on the effectiveness of the organisation's risk management in IA's 2014/15 Annual Report and Head of Audit Opinion and ensure that appropriate work to support that view is incorporated into audit plans. The question of external review is a matter for the authorities to determine, but IA will undertake research and recommend specific further action where beneficial.*

To achieve full conformance to the IIA Standards



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We set our recommendations to enable the Audit Partnership to fully conform to specific IIA Standards in order of importance (2/3).

Standard 2050 Coordination

Effective coordination of internal audit with other internal and external providers of assurance is an important feature of the Standards. The aim is to avoid overlaps and gaps in assurance so that Councils in the Partnership obtain value for money from anyone who has an audit role. (*PSIAS - The chief audit executive must include in the risk-based plan the approach to using other sources of assurance and any work required to place reliance upon those other sources.*)

The strategic risk registers provide the basis to achieve this coordination and we recommend that internal audit should work with senior executives to map who will provide assurance against the high priority/key risks. This should include operational managers at the point of service delivery, managers of support functions, internal audit and external audit to create a comprehensive assurance map based on the 3 lines of defence model.

Response: *The 2014/15 audit plan will aim to show appropriate links to the strategic risk registers of the authorities. During 2014/15 IA will work with officers to consider sources of assurance across the authorities' key strategic risks and present this to Audit Committees as an assurance map.*

Standard 2010 Planning

To achieve full conformance with the Standards and PSIAS internal audit needs to adopt a fully risk based approach. This not only involves addressing the points on Standard 2130 but also moving to a risk based approach to planning that links audits to the high priority risks included the strategic risks registers. Working towards an assurance map will enable this to occur but for 2014/15 we specifically recommend internal audit plans for each Council in the Partnership should include a selection of audits aligned to strategic risks as a starting point while retaining a selection of reviews from the current audit universe.

Response: *As noted above, during 2014/15 IA will develop an assurance map to demonstrate clear links to the strategic risk registers of each authority. However, as an interim measure, the 2014/15 plans will include an analysis of the current key risks and incorporate and clearly flag a selection of the 2014/15 audits as providing direct assurance against those risks.*

To achieve full conformance to the IIA Standards



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We set our recommendations to enable the Audit Partnership to fully conform to specific IIA Standards in order of importance (3/3).

Standard 1000 Purpose, Authority, and Responsibility

In our experience internal audit charters spell out responsibilities in full (as required by Standard 1000 and PSIAS) to ensure they are tailored to the organisation and there is complete clarity upon the range of services to be performed. In the case of Mid-Kent we suggest this needs to include as concisely as possible the role internal audit has in relation to facilitating risk management and involvement in major projects.

Response: *HAP will review the internal audit charter during 2014/15 as part of its continuing development. This will include seeking to establish and document the role of IA in facilitating risk management and assurance on major projects.*

Standards 1310 Requirements of the Quality Assurance & Improvement Programmes

It is clear from a detailed review of quality measures that the Audit Partnership has committed to a full range of external and internal quality assessments. Quite simply the Standards require the preparation of a schedule or timetable for the future programme to help senior executives and the audit committee understand when quality reports will be received.

Response: *During 2014/15 HAP will develop an appropriate schedule for future quality monitoring and seek to incorporate the schedule, and progress against its targets, within standard Audit Committee reporting.*

Standard 2210 Engagement Objectives

When setting objectives for audit engagements we recommend that assurance be centred upon the criteria for success for that subject area and the management of risks that ensure these criteria are achieved. This may require separate discussions/workshops upon the nature of the criteria and risks but doing so will ensure a fully risk based approach.

Response: *During 2014/15 IA will review the objectives setting stage of the audit procedures manual to ensure that audits begin with an appropriate examination of risk and that the conclusions of that examination drive the nature and extent of the audit.*

Supporting continuous improvement



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We set out some ideas for the Audit Partnership to enhance their overall effectiveness:

Internal Audit Functional Plan

Internal Audit should develop a 2-3 year functional plan that provides a clear view to all stakeholders how the service is going to continue to develop. The plan should include elements on service delivery (assurance mapping, risk management), resourcing, methodology, risk assessment and quality assurance components. It should provide a reference point to assess the continued success of the function in terms of delivering its objectives as defined in the IA Charter. This plan should be presented, approved and delivery monitored by the Audit Committee.

Response: *The incoming HAP will lead on creating a 3 year strategic plan for the service which will be presented to Audit Committees (after appropriate consultation with officers) in 2015.*

Resourcing of IA

Given IA's participation in the RM process and reference points from other EQA reviews the level of IA resource appears reasonable for a developing consortium of this size and ambition. However, we feel there is a skills gap in terms of IT auditing that could perhaps be filled through some form of co-sourcing or in due course the appointment of a senior auditor with experience in that area. In this regard it is better to look to quality rather than quantity to maintain effectiveness and to minimise supervision time. (PSIAS - *The risk-based plan must explain how internal audit's resource requirements have been assessed*).

Response: *The current and future resource needs of the service will be considered as part of the 3 year plan noted above.*

Resource Management

We note audit engagements are consistently exceeding their time allocations (9 of 14 within our review sample). We suggest a more detailed review of why this might be happening and consideration of appropriate corrective action.

Response: *The incoming HAP will reflect on and continue the ongoing review of engagement completion, which has already led to the time recording system becoming universal across the team. Future action, which may include performance indicators or ongoing monitoring, will be considered where appropriate.*

Approach



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We used a variety of methods to form our opinion, including:

- Review of IA's self-assessment against the IPPF.
- Detailed examination of internal audit documentation and engagement files.
- Face to face discussions and telephone interviews with audit committee members and senior executives across the Partnership (a total of 8 shown in table below).
- Face to face discussions with all members of the Internal Audit service.
- Benchmarking IA practice against IIA practice advisories, practice guides, global surveys, UK and Ireland guidance and case studies.
- Comparison to other organisations who have received an EQA.

Participants

Name	Title	Type
Paul Naylor	Deputy Chief Executive - Ashford	Telephone discussion
David Edwards	Director of Shared & Environmental Services - Maidstone	Face to face meeting
Paul Riley	Head of Finance & Resources - Maidstone	Face to face meeting
Paul Clokie	Audit Committee Chair - Ashford	Face to face meeting
Lee Coyer	Head of Finance & Governance – Tunbridge Wells	Telephone discussion
Rodd Nelson-Gracie	Audit Committee Chair - Maidstone	Face to face meeting
Mark Radford	Director of Corporate Services - Swale	Face to face meeting
Andy Mack	External Auditor – Grant Thornton	Telephone discussion