

<b>Audit Committee Meeting</b>		<b>Agenda Item:</b>
<b>Meeting Date</b>	9 March 2015	
<b>Report Title</b>	Swale Internal Audit Charter	
<b>Cabinet Member</b>	Cllr Duncan Dewar-Whalley, Cabinet Member for Finance	
<b>SMT Lead</b>	Mark Radford – Director of Corporate Services	
<b>Head of Service</b>	Rich Clarke – Head of Audit Partnership	
<b>Lead Officer</b>	Rich Clarke – Head of Audit Partnership	
<b>Key Decision</b>	No	
<b>Classification</b>	Open	
<b>Forward Plan</b>	N/A	
<b>Recommendations</b>	<ol style="list-style-type: none"> <li>1. The Audit Committee <b>approves</b> the Internal Audit Charter 2016/17.</li> <li>2. The Audit Committee <b>notes</b> the Head of Audit Partnership's view that the Partnership is operating with sufficient independence and freedom from managerial interference to fulfil its responsibilities in line with Public Sector Internal Audit Standards, and will continue to do so.</li> </ol>	

## **1 Purpose of Report and Executive Summary**

1. To report is provided in order to allow the Committee to consider and approve the revised Internal Audit Charter for 2016/17.

## **2 Background**

- 2.1 An Audit Charter is a requirement of Public Sector Internal Audit Standards (Standard 1000) and is a foundational document setting out the purpose, authority and responsibility of the service. A partial extract, giving an introduction to the position of the Charter within the Standards is below:

## 1000 Purpose, Authority and Responsibility

The purpose, authority and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards*. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.

### *Interpretation:*

The internal audit charter is a formal document that defines the internal audit activity's purpose, authority and responsibility. The internal audit charter establishes the internal audit activity's position within the organisation, including the nature of the chief audit executive's functional reporting relationship with the board; authorises access to records, personnel and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. Final approval of the internal audit charter resides with the board.

### **Public sector requirement**

The internal audit charter must also:

- define the terms 'board' and 'senior management' for the purposes of internal audit activity;
- cover the 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.

### **1000.A1**

The nature of assurance services provided to the organisation must be defined in the internal audit charter. If assurances are to be provided to parties outside the organisation, the nature of these assurances must also be defined in the internal audit charter.

### **1000.C1**

The nature of consulting services must be defined in the internal audit charter.

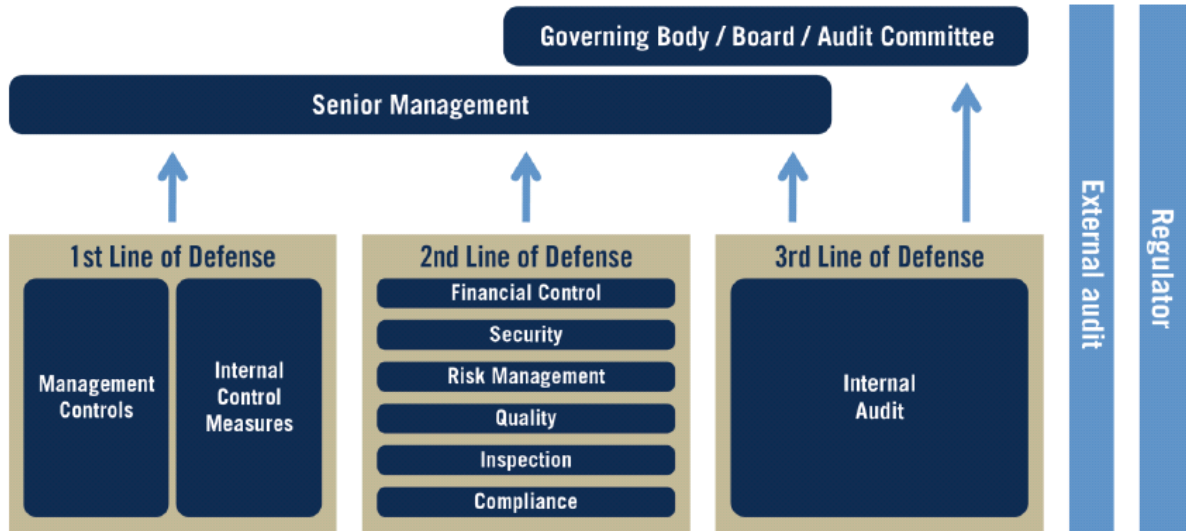
- 2.2 In March 2015 this Committee approved the 2015/16 Charter which was scheduled to be revised and, if necessary, updated each year. This current report includes proposed updates to the 2016/17 Charter.

## **3 Proposals**

- 3.1 Some of the updates for 2016/17 are merely taking the opportunity of a revision to tidy up the document. This includes correcting one or two typographical errors and standardising the terminology (for example, using "Audit Partnership" to refer specifically to this service and leaving "internal audit" to denote the practice of internal audit more generally).
- 3.2 The more substantial part of the update seeks to build on Supplemental Guidance issued recently by the Institute of Internal Audit on how and whether internal audit can take up broader roles within an organisation. These broader roles are often referred to as 'second line of defence' roles.

- 3.3 The ‘three lines of defence’ model is commonly used to describe controls existing within an organisation and is summarised in the diagram below (extracted from the IIA Guidance).

Figure 1



- 3.4 Traditionally, Internal Audit operates solely within the third line and that is the norm in many sectors (even most non-Local Government parts of the public sector). Indeed, the Audit Standards are written in the expectation that internal audit will not have any role outside the third line which may impede (or appear to impede) its independence.
- 3.5 However, the global IIA has been under pressure recently from, among others, the UK Internal Audit Standards Advisory Board (which includes the Mid Kent Head of Audit) to recognise that in many organisations a good audit function could successfully play a number of roles, and that Standards could usefully acknowledge and inform those roles. In particular, the IASAB sought to avoid a situation where existing guidance could be read to forbid auditors from undertaking those roles even where there are clear benefits to them doing so.
- 3.6 In response, the IIA has now issued a Supplemental Guidance report entitled “Internal Audit and the Second Line of Defence”. That Guidance acknowledges that audit services may often possess the skills, knowledge and expertise to successfully fulfil certain second line of defence roles and doing so could be beneficial especially in smaller organisations. Fundamentally, it acknowledges that organisations can – provided they do so knowingly and having weighed up the benefits – accept certain risks to the independence and objectivity of audit.
- 3.7 A key component of accepting those risks is being aware of the safeguards to independence that would operate, and having those safeguards acknowledged and approved by the Audit Committee. The more substantive amendments proposed to the Charter set out those safeguards.

- 3.8 Note that, at present, audit does not occupy any roles that comprise second line of defence functions. The Charter sets out the safeguards that would operate in the event of the Audit Partnership being asked to undertake those roles by Management. In particular, the Charter considers the safeguards that would operate if the Audit Partnership were to play a more prominent role in Risk Management and Counter Fraud, including ownership of relevant corporate policies.
- 3.9 To be clear, the Head of Audit Partnership is satisfied that the Partnership currently operates with required independence and freedom from interference and that it would continue to do so, subject to the described safeguards, in the event of being asked to take on further responsibilities. Consistent with the Public Sector Internal Audit Standards, the Head of Audit Partnership will contact Members immediately in the event of significant threat to independence or interference from Management.
- 3.10 One notable feature is that the revised Charter includes a mechanism for avoiding conflicts of interest in our activities. Reflective of the role of the Audit Committee in providing oversight, the Charter proposes that major additional work requests are subject to consultation between the Head of Audit, Senior Management and the Chair of the Audit Committee prior to approval, and then reported to the next available Committee meeting in full. This type of approach is common within the industry and, for the sake of illustration, would only have been invoked once during 2014/15, for the Planning Shared Service review.
- 3.11 We propose that the Audit Committee approve the Internal Audit Charter for 2016/17.

## **4 Alternative Options**

- 4.1 The Audit Committee as part of its terms of reference must maintain oversight of the internal audit function and its activities. The Charter proposed sets out the basis on which the function operates. We recommend no alternative course of action. However, the Committee may wish to make further comment on the nature of safeguards proposed and, potentially, request to see further reports in the event of the Audit Partnership being asked to take on second line of defence roles.

## **5 Consultation Undertaken or Proposed**

- 5.1 The Charter was shared in draft with the Corporate Services Director through the Shared Service Board.

## 6 Implications

Issue	Implications
Corporate Plan	The role of Internal Audit is to help the Council accomplish its objectives. All audit work considers the adequacy of controls and risks associated with the delivery of the Council's strategic and operational objectives.
Financial, Resource and Property	None identified at this stage.
Legal and Statutory	Internal Audit is a required function in accordance with the Accounts & Audit Regulations 2015.  An Internal Audit Charter is a requirement of the Public Sector Internal Audit Standards.
Crime and Disorder	None identified at this stage.
Sustainability	None identified at this stage.
Health and Wellbeing	None identified at this stage.
Risk Management and Health and Safety	There are no Health and Safety implications identified at this stage.
Equality and Diversity	None identified at this stage.

## 7 Appendices

7.1 The following documents are to be published with this report and form part of the report:

- Appendix I: Swale Internal Audit Charter 2016/17 (track changes version to highlight amendments proposed from 2015/16).
- Appendix II: Swale Internal Audit Charter 2016/17 (without track changes for final approval).

## 8 Background Papers

8.1 An Internal Audit Charter is a requirement of the Public Sector Internal Audit Standards. To view the Standards in full: [Public Sector Internal Audit Standards](#)

The current Internal Audit Charter was approved by Audit Committee in March 2015 and can be found in full in the Committee papers of that meeting.