

REPORT TO: Business Efficiency Board

DATE: 7 June 2017

REPORTING OFFICER: Operational Director - Finance

SUBJECT: Safeguarding Internal Audit Independence

WARDS: Borough-wide

1.0 PURPOSE OF THE REPORT

- 1.1 Restructuring and rationalisation of the Council's management structures in recent years has resulted in the Head of Internal Audit assuming management roles and responsibilities that fall outside of internal auditing.
- 1.2 The purpose of this report is to provide assurance to the Board that safeguards have been put in place to limit any impairment to independence or objectivity of the internal audit function.

2.0 RECOMMENDATION:

That the Business Efficiency Board notes and endorses the safeguards established to limit any impairment to independence or objectivity of the internal audit function.

3.0 SUPPORTING INFORMATION

- 3.1 The Council's internal audit function sits within the Audit, Procurement and Operational Finance Division under the leadership of a Divisional Manager. The Divisional Manager post is recognised in the Council's Constitution as being the Head of Internal Audit.
- 3.2 Restructuring and rationalisation of the Council's management structures over recent years has resulted in the Council's Head of Internal Audit assuming responsibility for the management of the following functions:
 - Purchase to Pay
 - Procurement
 - Insurance
 - Income Control
 - Client Finance
 - Direct Payments
- 3.3 The Council is also currently consulting with staff on further restructuring of its Finance function. Management's proposals would also see the Head of Internal Audit assume management responsibility for:
 - Income & Assessment
 - Debtors
 - Fraud Investigation

- 3.4 The Public Sector Internal Audit Standards (PSIAS) provide the standards for the Professional Practice of Internal Auditing and are mandatory for all principal local authorities and other relevant bodies subject to the Accounts and Audit (England) Regulations.
- 3.5 There are specific provisions within PSIAS that address the issues of independence and objectivity and independence of the internal audit function:
- Standard 1100 relates to the requirement that the internal audit activity must be independent and internal auditors must be objective in performing their work.
 - Standard 1112 states that internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest.
 - Standard 1130 requires the Chief Audit Executive to disclose the details of any impairment to independence or objectivity, whether in fact or appearance.
- 3.6 Appendix A to this report sets out how the Council has responded to the requirements of PSIAS and established a range of safeguards to limit any impairment to independence or objectivity of the Council's internal audit function.

4.0 POLICY IMPLICATIONS

- 4.1 The Council has formally acknowledged in the Internal Audit Charter, which forms part of Finance Standing Orders, that proper practice for internal audit in local government is defined by the Public Sector Internal Audit Standards and that the Council's internal audit activity shall operate to these Standards and any other relevant guidance.
- 4.2 The Internal Audit Charter also states that the Head of Internal Audit shall be responsible for ensuring the organisational independence of internal audit activity and shall report and explain to the Business Efficiency Board how any potential impairment to independence or objectivity will be managed.

5.0 OTHER IMPLICATIONS

- 5.1 The Council is required to comply with the requirements of the Accounts and Audit Regulations 2015, regarding its "arrangements to undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control". Independence and objectivity are important attributes of an adequate and effective internal audit function.
- 5.2 The Council continues to face significant funding pressures and management's restructuring of the finance function in recent years has released significant financial savings whilst maintaining sound financial governance.

5.3 There are also some less tangible benefits from that have helped improve the internal audit function that have resulted from the Head of Internal Audit assuming management responsibilities for other operational functions. These benefits include:

- Improved awareness of the Council's business and planned developments, which helps to inform internal audit planning;
- Improved appreciation of the challenges faced by service managers at a time of reducing resources, which helps to ensure that audit recommendations are proportionate to the risks faced and practical to implement;
- Closer working between the internal audit team and other colleagues in finance, which greatly assists the audit process and provides for earlier intervention by internal audit when issues are identified.

5.4 There are no additional resource implications arising directly from this report.

6.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES

6.1 An effective internal audit function supports the delivery of all the Council's priorities by promoting probity, integrity, accountability, efficiency and effective management of public funds.

7.0 RISK ANALYSIS

7.1 The purpose of this report is to summarise the safeguards that the Council has established manage any perceived risk or impairment to independence or objectivity of the internal audit function.

8.0 EQUALITY AND DIVERSITY ISSUES

None identified.

9.0 LIST OF BACKGROUND PAPERS UNDER SECTION 100D OF THE LOCAL GOVERNMENT ACT 1972

Public Sector Internal Audit Standards.

Safeguards to limit any impairment to independence or objectivity of the Council's internal audit function

The arrangements established by management to meet the relevant Public Sector Internal Audit Standards relating to auditor independence and objectivity are set out below:

Standard 1100 - Internal audit activity must be independent and internal auditors must be objective in performing their work

- The Council has established a requirement that the Head of Internal Audit must hold a recognised accountancy or internal audit qualification. As a qualified CIPFA member, the Head of Internal Audit is consequently bound by the Statement of Professional Practice on Ethics (SOPP). Adherence to the SOPP is an obligation of membership of the Institute, and all members and students are required to act in accordance with it. As is general practice in all professional bodies, departures from the standard may be subject to disciplinary action. The SOPP contains principles relating to integrity, objectivity, professional competence and due care.

Standard 1112 - Internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest

- Internal auditors, including the Head of Internal Audit, are required to follow the code of ethics in the Public Sector Internal Audit Standards. All officers involved in delivering internal audit work are therefore required to sign an annual declaration acknowledging those responsibilities and providing a commitment to fully comply with these requirements whilst working for the Council. The declaration also requires internal auditors to declare:
 - any conflicts of interests that could adversely affect their independence and objectivity;
 - any operational responsibilities that they have held within the preceding 18 months;
 - any relatives or close associates who are either employed by the Council or are an elected member of Halton Borough Council;
 - the nature of any involvement they have in organisations that provide goods or services to the Council.
- As employees of Halton Borough Council, internal auditors are also required to comply with the Council's Employee Code of Conduct. The Code acknowledges that the public is entitled to expect the highest standards of conduct from all employees who work for local government and to expect that the conduct of employee should never be influenced by improper motives.
- At an operational level, in planning internal audit assignments there will inevitably be occasions where internal audit work is undertaken relating

to business areas for which the Head of internal Audit is responsible for managing. Potential conflicts of interests are therefore managed by the following arrangements:

- Terms of reference for the review are agreed and shared with the Operational Director – Finance in advance of the audit commencing to ensure that planned audit coverage is appropriate.
- The draft report following the audit review is shared with the Operational Director – Finance at the same time as being presented to Head of Internal Audit for review. This removes the opportunity for the suppression of any audit findings.
- The Principal Auditor has direct right of access to the Operational Director – Finance and therefore has the opportunity to raise any issues or concerns without having to go through the Head of internal Audit.

Standard 1130 – Requirement for the Chief Audit Executive to disclose the details of any impairment to independence or objectivity, whether in fact or appearance

- The Council has established an Internal Audit Charter that forms part of Finance Standing Orders, and explains the Head of Internal Audit's responsibility for ensuring the organisational independence of internal audit activity and reporting and explaining to the Business Efficiency Board how any potential impairment to independence or objectivity will be managed.
- The annual Internal Audit Plan is reviewed by Management Team and approved by the Business Efficiency Board. This ensures that appropriate scrutiny is applied to planned audit coverage. The narrative supporting the Plan also sets out an overview of the arrangements to mitigate any potential impairment to independence and objectivity.

Other safeguards to limit any impairment to independence or objectivity

- Arrangements exist for a five-yearly external assessment of the Council's internal audit activity, which will include a review of the Head of Internal Audit's independence and objectivity. The results from that review will be reported to the Business Efficiency Board later this financial year.
- The business areas for which the Head of Internal Audit has management responsibility form key parts of the Council's finance function and are therefore subject to other forms of assurance in addition to review by internal audit. These arrangements include:
 - Annual external audit review of the key financial systems that provide material disclosures for the financial statements, i.e. creditors, debtors and income collection and reconciliation.

- Annual review of the insurance claims handling arrangements by the Council's insurer.
 - Periodic review of the Council's deputyship arrangements by the Office of the Public Guardian.
 - Periodic review of the Council's VAT accounting arrangements by HMRC.
 - Ongoing scrutiny through the Council's performance management framework.
- As part of the annual audit of the financial statements, the Council's external auditor completes a high-level review of the Council's internal audit arrangements and reports the findings of this review to the Business Efficiency Board.
 - The Head of Internal Audit reports functionally to the Business Efficiency Board. This arrangement includes presenting quarterly progress reports to the Board summarising all internal audit work completed and provides the opportunity for scrutiny and challenge by members.
 - Ongoing line management arrangements for the Head of Internal Audit include regular supervision meetings with the Operational Director – Finance. This provides opportunity to discuss issues, developments and the performance of the internal audit function, in addition to the other business areas for which the Head of Internal Audit is also responsible.

Conclusion

The combination of all the safeguards described above is considered sufficiently adequate to manage any actual or perceived impairment to the independence or objectivity of the internal audit function arising from the Council's Head of Internal Audit assuming management roles and responsibilities that fall outside of internal auditing.