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Internal Audit Charter

Herefordshire Council

April 2013

PUBLIC SECTOR AUDIT

Contents

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Distribution

David Powell (Chief Officer –
Finance and Commercial Services)
Audit & Governance Committee

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1. Introduction

1. Introduction

Internal audit within the public sector is governed by the *Public Sector Internal Audit Standards* (PSIAS), on which CIPFA has published a *Local Government Application Note* which provides guidance on the application of the PSIAS to local authorities. The objectives of the PSIAS are to:

- define the nature of internal auditing within the UK public sector;
- set basic principles for carrying out internal audit in the UK public sector;
- establish a framework for providing internal audit services which adds value to the organisation, leading to improved organisational processes and operations, and
- establish the basis for the evaluation of internal audit performance and drive improvement planning.

Under the PSIAS internal audit activity should be driven by an Audit Charter, which is a formal document that defines the following:

- the purpose, authority and responsibility of internal audit activity, along with internal audit's position within the organisation and its access to records, personnel and physical properties relevant to the performance of engagements (*section 2.1.1 and 2.1.2*);
- the scope of internal audit activities (*section 2.1.2*);
- the terms 'board' and 'senior management' for the purposes of internal audit activity (*section 1*);
- the arrangements for appropriate resourcing (*section 1.3*);
- the nature of assurance services provided to the organisation (*section 2.1.2*);
- the nature of consulting services (*section 3.9*);
- the role of internal audit in any fraud-related work (*section 3.7*); and
- arrangements for avoiding conflicts of interest if internal audit undertakes non-audit activities (*section 3.8*).

This document outlines how each of those documents is met. It also sets the methodology used to complete internal audit work (*section 3*) and our quality assurance process (*section 4*).

As required by the PSIAS, this Audit Charter also sets out the "*Definition of Internal Auditing, the Code of Ethics and the Standards*".

1.1.1 The definition of Internal Audit

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

The senior management within the Council are responsible for establishing and maintaining appropriate risk management processes, control systems, accounting records and governance arrangements. Internal audit plays a vital part in advising the organisation that these arrangements are in place and operating properly.

1.1.2 Code of Ethics

Internal auditors in UK public sector organisations must conform to the Code of Ethics as defined by the Institute of Internal Auditors (IAA). The Code of Ethics promotes an ethical culture in the profession of internal auditing. A code of ethics is necessary and appropriate for the internal audit profession, founded as it is on the trust placed in its objective assurance about risk management, control and governance. The Code of Ethics covers four main areas:

- **Integrity** - The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgement;
- **Objectivity** - Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgements;
- **Confidentiality** - Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so; and
- **Competency** - Internal auditors apply the knowledge, skills and experience needed in the performance of internal auditing services.

1. Introduction (*cont.*)

1.1.3 The Standards

The PSIAS encompass the mandatory elements of the Institute of Internal Auditors (IIA) International Standards for the Professional Practice of Internal Auditing (the Standards). These Standards are principle-focused and provide a framework for performing and promoting internal auditing. The standards are adhered to in the delivery of the Council's internal audit plan.

1.2 Organisational Independence

The PSIAS state that the Chief Audit Executive must confirm to the board, at least annually, the organisational independence of internal audit. Organisational independence is achieved when the Chief Audit Executive reports functionally to the board. Examples of functional reporting to the board involves the board approving the internal Audit Charter and the risk based internal audit plan.

1.3 Senior management and the Board

The Chief Audit Executive (referred to as the 'Head of Internal Audit' within Herefordshire Council (the Council)) should discuss the Definition of Internal Auditing, the Code of Ethics and the Standards with senior management and the board. 'Senior management' within the Council has been defined as the Leadership Team, the Chief Executive and the Chief Officer (Finance & Commercial Services), and the 'Board' as the Audit & Governance Committee.

This process occurs through the Audit Charter being submitted and approved by the Leadership Team and the Audit & Governance Committee periodically.

On a day to day basis, the Head of Internal Audit will report to the Chief Officer (Finance & Commercial Services). The Head of Internal Audit also has direct lines of reporting to the Council's Head of Paid Service (Chief Executive), Monitoring Officer and the Audit & Governance Committee. These officers and the Committee in turn have the ability to liaise directly with the Head of Internal Audit.

1.4 The need for Internal Audit

The need to maintain an internal audit function is implied by Section 151 of the Local Government Act 1972 under which local authorities are required to make proper arrangements for the administration of their financial affairs and to delegate responsibility for those arrangements to one of their officers. The Accounts & Audit Regulations 2011 are explicit about the requirement to maintain an adequate and effective internal audit of accounting records and of the system of internal control in accordance with the proper practices in relation to internal control.

1.5 Leadership and resourcing of the Internal Audit function

KPMG has been engaged by the Council to lead the Internal Audit function. KPMG appoints a senior and experienced auditor to act as the Council's Head of Internal Audit, who reports directly to the Chief Officer (Finance & Commercial Services). The Chief Officer (Finance & Commercial Services) is the Council's Responsible Financial Officer under the terms of Section 151 of Local Government Act 1972.

The Head of Internal Audit is responsible for the day to day management of the Internal Audit Team. The Head of Internal Audit also has the freedom to report to any level of management (officers and Members as appropriate) on audit findings without censure.

The Council is required to provide KPMG with sufficient resources in order to deliver the Internal Audit Plan. This could either be Council staff, staff from its subsidiary entity (Hoople Limited), procuring audit resources directly from KPMG, or any mixture of these options.

1.6 Approval of the Audit Charter

The final approval of this charter rests with the Audit & Governance Committee.

2. The Role of Internal Audit

2.1 The Role of Internal Audit

This section sets out:

- the core role of Internal Audit; and
- the key functions of the Council's Internal Audit section.

2.1.1 Core role of Internal Audit

The role of Internal Audit is to provide assurance to Members and senior management that there are adequate and effective internal control arrangements in place to mitigate key risks and achieve objectives. This covers the Council's entire control environment and not just financial controls.

However, in these ever changing times, Internal Audit should not only provide its core role but provide an added value service. In performing its role, Internal Audit aims to, where appropriate:

- contribute to the improvement of the internal control environment;
- identify opportunities for performance improvement;
- evaluate where systems are over controlled or inefficient; and
- identify cost saving opportunities.

The Contribution of Internal Audit



2. The role of Internal Audit (*cont.*)

2.1.2 The key functions of Internal Audit

The Team's key functions are to:

- Assist the Council in the accomplishment of its objectives by bringing a systematic and disciplined approach to the evaluation and improvement of risk management, corporate governance and internal control processes.
- Assist the Council in the effective discharge of its functions by providing independent analysis, appraisal, advice and recommendations on the activities subject to internal audit review.
- Review, appraise and report on the adequacy and effectiveness of the systems of financial and internal control.
- Review, appraise and report on the relevance, integrity and reliability of financial and other management information.
- Review, appraise and report on the level of compliance with the policies, plans, procedures, statutory requirements and regulations that could have a significant impact on the Council's activities.
- Review, appraise and report on the arrangements for protecting assets from loss resulting from theft, fraud, fire or misuse and, as appropriate, verifying their existence.
- Review and appraise the economy, efficiency and effectiveness with which resources are deployed and recommend improvements in procedures and systems that will reduce wastage, extravagance and fraud.
- Review service delivery arrangements and projects to ascertain whether the activities are being carried out as planned and the results are consistent with the Council's established policies.
- Maintain a programme of review and assessment of the Council's risk management processes in order to provide assurance on their integrity.
- Carry out any ad hoc appraisals, inspections, investigations, examinations or reviews requested by senior management, the Audit & Governance Committee or the political executive.
- Act as the liaison with the Council's external auditors and co-ordinate audit effort with them in order to avoid duplication of effort and increase audit coverage.
- Maintain technical competence through continuing education and active participation in professional activities.
- Adhere to the Code of Ethics, standards and guidelines of the relevant professional institutes.
- Utilise the resources designated for use by the Internal Audit team to maximise the efficiency and effectiveness of the internal audit function.
- Serve on internal working groups as appointed by senior management.

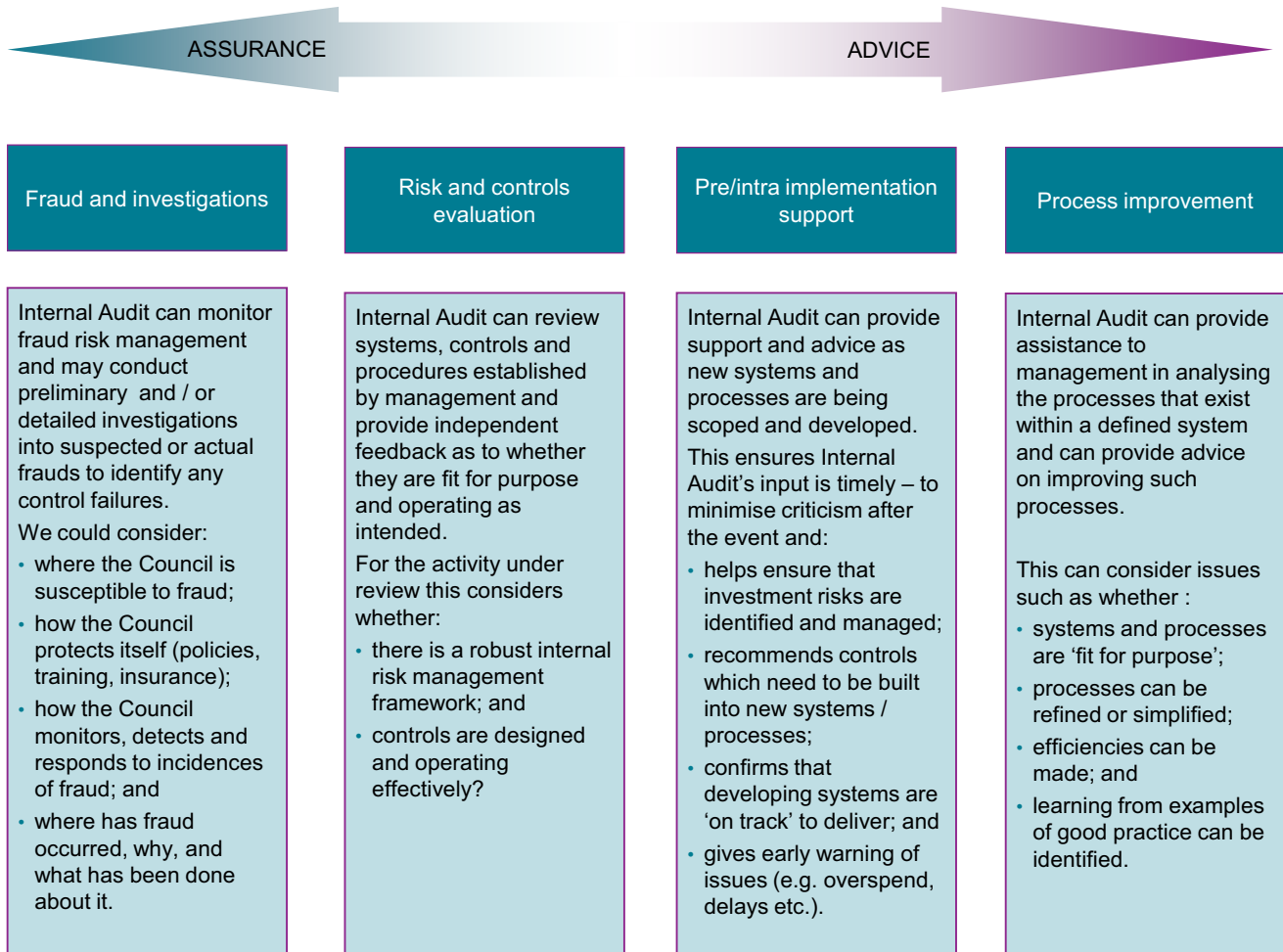
This Charter and the Council's Standing Orders and Financial Regulations confirm the authority conferred on the Internal Audit team by the Council. The Head of Internal Audit and the Internal Audit team have the authority to:

- decide on the nature, scope and timing of audits;
- have access at reasonable times to premises or land used by the Council;
- have access at reasonable times to any employee;
- have access to all assets, records, documents, correspondence and control systems relating to any matter or business of the Council; and
- have any information and explanation considered necessary concerning any matter under examination.

The Council's officers are required to assist the Internal Audit team in the performance of their audit duties and to respond promptly to any requests for information, explanation, discussion, entry to premises or access to documents.

2. The role of Internal Audit (cont.)

Internal Audit can vary its approach between assurance and advice according to the objective of each review. In many cases, it combines approaches to offer a service of value to all who are involved. Examples are shown below.



3. Internal Audit Methodology

3.1 Internal Audit Methodology

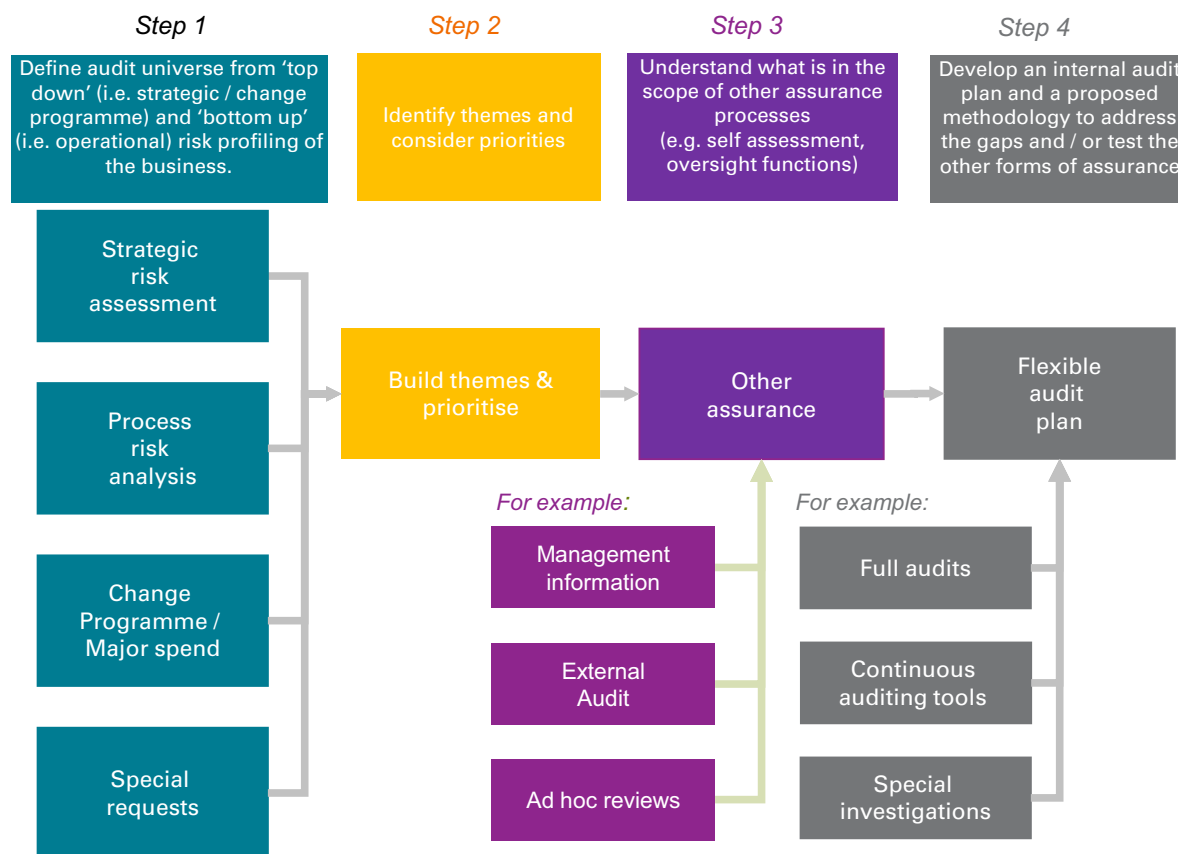
In order to deliver an effective service and met the needs of the Council, KPMG applies a comprehensive internal audit methodology. The key processes of this are as follows:

- preparation of a comprehensive internal audit plan;
- a tailored audit approach using a defined methodology and assignment control documentation;
- regular reporting to management and the Audit & Governance Committee on findings and a review of progress against the plan to ensure the function is delivering the work;
- the use of performance indicators to measure and report on the quality and delivery of the work which the function completes;
- clearly defined processes by which Internal Audit liaises with staff, management and the members of the Audit & Governance Committee; and
- the role of internal audit with regard to anti-fraud and corruption.

3.2 Internal Audit Plan

KPMG will perform an annual risk assessment to inform the development of internal audit plan for approval by the Chief Officer (Finance & Commercial Services) and Audit & Governance Committee. KPMG then oversees and manages the delivery of that plan, remaining alert for any new, emerging or changing risks, and reports the results within the Council's reporting structure. The plan will be based on an assessment of the risk pertaining to the achievement of the Council's objectives.

The plan will form the basis of the annual operational plan for the Internal Audit team. The key steps which are followed in developing the plan are summarised below.



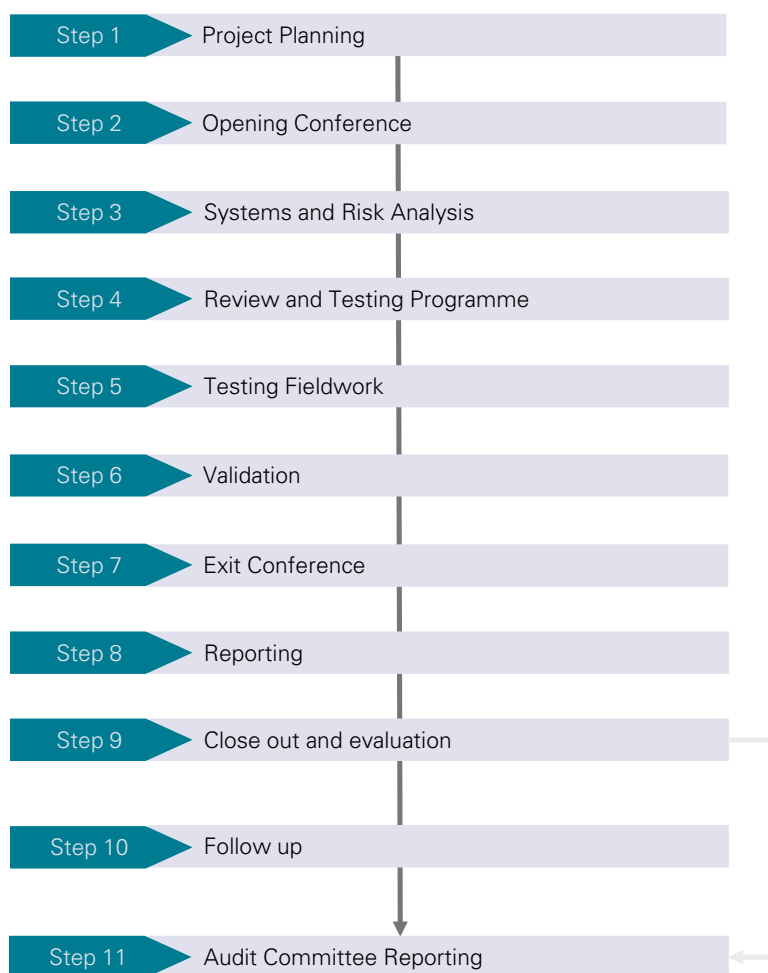
3. Internal Audit Methodology (cont.)

3.3 Audit Approach

Internal Audit will utilise a risk-based approach to the individual reviews. This involves:

- identifying the risks that may impact on the areas under review achieving their objectives and identifying and evaluating the systems of internal control designed by management;
- compliance testing of the operation of controls; and
- making appropriate recommendations and advising management on how systems of internal control may be streamlined or strengthened.

The different delivery stages of the audit process are shown below. The approach to individual reviews recognises that different approaches will be required in different circumstances, for example in some cases as systems are being developed or revised it may be beneficial for us to defer detailed testing until a later date, but instead focus on understanding and contributing to the development of the design of the control framework.



3. Internal Audit Methodology (cont.)

3.4 Reporting

3.4.1 Individual reviews

On completion of individual reviews, Internal Audit will produce a report for management that will outline the objectives and scope of the work, risks considered during the review, an assessment of the effectiveness of internal controls, an overall opinion and observations on performance improvements. Each report will include an action plan. Management will consider the report and provide management responses to the recommendations made in the report. Internal Audit will then review the appropriateness of these and finalise the report. The overall opinion will be based on the findings flowing from the review. Internal Audit will use the following conclusions (although it should be noted that these represent an indicative approach as the overall assurance provided is a matter of professional judgement).

Conclusion	Definition
No assurance	One or more priority one recommendations and fundamental design or operational weaknesses in more than one part of the area under review (i.e. the weakness or weaknesses identified have a fundamental and immediate impact preventing achievement of strategic aims and/or objectives; or result in an unacceptable exposure to reputation or other strategic risks).
Limited assurance	One or more priority one recommendations, or a high number of medium priority recommendations that taken cumulatively suggest a weak control environment (i.e. the weakness or weaknesses identified have a significant impact preventing achievement of strategic aims and/or objectives; or result in a significant exposure to reputation or other strategic risks).
Adequate assurance	One or more priority two recommendations (i.e. there are weaknesses requiring improvement but these are not vital to the achievement of strategic aims and objectives - however, if not addressed the weaknesses could increase the likelihood of strategic risks occurring).
Substantial assurance	No or priority three only recommendations. (i.e. any weaknesses identified relate only to issues of good practice which could improve the efficiency and effectiveness of the system or process).

3.4.2 Progress reporting

Internal Audit will present regular progress reports to the Audit & Governance Committee. These reports will set out the progress the function has made in completing the internal audit plan, key issues and findings from the audits completed and an update on any other audit and assurance issues.

3.5 Overall opinion

Following our internal audit work for the year Internal Audit will produce an Annual Internal Audit Report. This will summarise the work completed and will provide an overall opinion in respect of the Council's risk, control and governance arrangements. This audit opinion will be based on a review of the following:

- core systems, both financial and other;
- anti-fraud systems;
- corporate systems;
- governance systems;
- IT Systems;
- the level of recommendations agreed for action by management; and
- the results of the recommendations follow-up review.

3. Internal Audit Methodology (cont.)

3.6 Audit Protocols

Internal Audit's work will observe the following protocols:

3.6.1 Individual assignments

- Provide advance notice to the manager of each service area to be audited.
- Conduct a preparatory meeting with the nominated manager of the service being audited to discuss the nature of the audit, the length of engagement and the co-ordination of the review around operational constraints. The detail of the audit programme will be reviewed at that meeting with the nominated manager.
- Conduct interim meetings with the nominated service manager as appropriate to discuss progress with the review and findings as they arise.
- Preparation of a written draft internal audit report following the conclusion of the audit.
- Conduct a final meeting with the nominated service manager to discuss the draft report and confirm the accuracy of the audit findings and the appropriateness of the audit recommendations.
- Agreed amendments to the draft report will be reflected in the final report along with the nominated service manager's response to the recommendations. Final copies of the report will be distributed as appropriate.
- The Head of Service is responsible for making sure that the action plan included in the audit report is implemented.

3.6.2 Audit & Governance Committee

The Head of Internal Audit is required to report to the Audit & Governance Committee. To facilitate the work of the Audit & Governance Committee the Head of Internal Audit will:

- attend its meetings and contribute to setting the agenda (for those meetings where there are 'audit' agenda items);
- participate in the Committee's review of its own remit and effectiveness;
- ensure that it receives, and understands, documents that describe how internal audit will fulfil its objectives (e.g. the audit plan, annual work programmes, progress reports);
- report the outcomes of internal audit work in sufficient detail to allow the Committee to understand what assurance it can take from that work and/or what unresolved risks to issues it needs to address;
- establish if anything arising from the work of the Committee requires consideration of changes to Internal Audit's programme; and
- present an Annual Internal Audit Report including an overall opinion on the control environment, the extent to which the audit plan has been achieved, and a summary of any unresolved issues.

3.7 Deterring and Detecting Fraud

Managing the risk of fraud and corruption and the deterrence of fraud is a responsibility of management. The Internal Audit team is responsible for examining and evaluating the adequacy and effectiveness of actions taken by management to fulfil this obligation.

The Chief Officer (Finance & Commercial Services) will decide, in consultation with the Head of Internal Audit, the scope of any internal enquiries or investigations, subject to consultation with the relevant member of the Council's senior management team as appropriate.

The Council's anti-fraud and corruption policy requires officers to notify Audit Services of all suspected or detected fraud, corruption or impropriety.

The results of all fraud and corruption work, and knowledge regarding levels of detected or suspected fraud, corruption and impropriety, are used to inform the Head of Internal Audit's annual risk-based audit plan and annual internal audit opinion.

3. Internal Audit Methodology (cont.)

3.8 Conflicts of interest

Internal Audit shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organisation.

If a conflict of interest appears to arise from Internal Audit's input into non-audit activities, this should be discussed and resolved with input from the Head of Internal Audit, the Chief Officer (Finance & Commercial Services) and the Chair of the Audit & Governance Committee.

3.9 Consulting services

The Chief Officer (Finance & Commercial Services) along with other Council officers may request Internal Audit's input into non-audit work. These reviews could include advising officers in the design of processes and controls within a new system, reviewing documentation which is to be followed by officers to assess its suitability or undertaking ad-hoc reviews to assist in resolving a control issue that has arisen.

These type of reviews may impact on the delivery of audit work, could raise conflict of interest issues or require specialist input. All these requests should be reviewed, discussed and approved by the Head of Internal Audit so that any such issues are resolved and prior to the commencement of the work.

4. Quality Assurance

4.1 Quality Assurance

We have a quality assurance and improvement programme that covers all aspects of the internal audit activity. This programme is designed to enable an evaluation of internal audit conformance with the PSIAS and the Code of Ethics. The programme also assesses the efficiency and effectiveness of internal audit and identifies opportunities for improvements within the function's internal procedures to ensure that the service it delivers is of an appropriate quality and in compliance with professional standards.

As part of this process we will also be working to a number of performance measures, these are detailed below:

Performance Measure	Target
Terms of Reference agreed and issued 5 working days prior to start of audit	95%
Draft Report issued 10 working days after the de-brief meeting	95%
Management responses received within 10 working days of issue of draft report	95%
Final report issued within 5 working days of management responses being received	95%
Proportion of recommendations agreed by management	95%
Client Satisfaction Rate	90%

We will report against the indicators, together with results of the quality and assurance programme and progress against any improvement plans as part of the Annual Internal Audit Report.



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