



Leicester
City Council

WARDS AFFECTED
All

FORWARD TIMETABLE OF CONSULTATION AND MEETINGS:

Audit & Risk Committee

2nd December 2015

Public Sector Internal Audit Standards and Quality Assurance and Improvement Programme

Report of the Director of Finance

1. Purpose of Report

- 1.1. To present to the Committee the results of a self-assessment of conformance to the Public Sector Internal Audit Standards (PSIAS) and the associated Quality Assurance and Improvement Programme (QAIP).

2. Recommendation

- 2.1. The Committee is recommended:
 - a) to note the contents of this report and
 - b) to make any comments it sees fit to the Director of Finance or the Executive.

3. Summary

- 3.1. The Audit & Risk Committee has adopted the PSIAS as the recognised professional standards to which the Council's Internal Audit service shall operate. The PSIAS require a process of annual assessment of conformance with the Standards. This report presents for the Committee's information and comments the outcome of the self-assessment conducted in summer 2015 (Appendix 1).
- 3.2. The PSIAS also require that a Quality Assurance and Improvement Programme (QAIP) is in place covering all aspects of internal audit activity. The QAIP is presented for the Committee's information and comments at Appendix 2.

4. Report

4.1. Public Sector Internal Audit Standards – assessment of conformance 2015

4.1.1. Under regulation 5(1) of the Accounts and Audit Regulations 2015, the Council:

'...must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance.'

4.1.2. The Public Sector Internal Audit Standards (PSIAS) were formally adopted by this Committee at its meeting on 14th March 2013 as the recognised professional standards for the Internal Audit service. This is reflected in the Internal Audit Charter, the latest update of which is also on the agenda of today's meeting of the Committee.

4.1.3. The PSIAS require a process of annual assessment of conformance with the Standards. A self-assessment against all of the Standards and the accompanying Local Government Application Note (LGAN) was conducted in summer 2015 by the Audit Manager. The Standards are lengthy and detailed so a summary of the outcome is given at **Appendix 1**. Points to note are:

- a) The requirement is conformance as opposed to compliance. In other words, it is sufficient for the intentions to be met even if the specified requirements are not, provided that suitable identified compensating measures are in place.
- b) There is a high degree of conformance. Members will recall that updates have been made to the internal Audit Charter to ensure that it conforms in full and in so doing helps to ensure that the Internal Audit service also conforms.
- c) There are some areas that need to be addressed. These are identified in **Appendix 1** with further commentary in **Appendix 2** on action to be taken. The only significant matter to be addressed is the need by March 2018 to undertake an external assessment by means of a suitably qualified and independent external assessor.

If members wish to see the full details of the Standards and our assessment of conformance against each one, that can be provided.

4.1.4. The Committee is asked to receive the outcome of the self-assessment and make any comments it sees fit.

4.2. The Quality Assurance and Improvement Programme (QAIP)

4.2.1. Standard 1300 of the PSIAS requires that:

'The chief audit executive must develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit activity.'

Interpretation:

A quality assurance and improvement programme is designed to enable an evaluation of the internal audit activity's conformance with the Definition of Internal

Auditing and the Standards and an evaluation of whether internal auditors apply the Code of Ethics. The programme also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement.

4.3. The QAIP for the Council’s Internal Audit service in 2015-16 is given at **Appendix 2**.

5. FINANCIAL, LEGAL AND OTHER IMPLICATIONS

5.1. Financial Implications

An adequate and effective system of internal audit that complies with recognised professional standards is a central component in the processes intended to help ensure that the Council operates efficiently, cost effectively and with integrity. An effective internal audit function is a key means by which the Director of Finance discharges her responsibilities under s151 of the Local Government Finance Act 1972 (see below). Such arrangements are intended to help the Council as it faces the financially challenging times ahead.

Colin Sharpe, Head of Finance, x37 4081

5.2. Legal Implications

Internal Audit’s work promotes sound financial management and legal compliance in all areas subject to review. It is a significant component of the requirements placed upon the Council for ‘the proper administration of its financial affairs’ by s151 of the Local Government Act 1972 as well as the specific requirements for internal audit under the Accounts and Audit Regulations 2015.

Kamal Adatia, City Barrister & Head of Standards, x37 1401

5.3. Climate Change Implications

This report does not contain any significant climate change implications and therefore should not have a detrimental effect on the Council’s climate change targets.

Louise Buckley, Graduate Project Officer, Climate Change, x37 2293

6. Other Implications

OTHER IMPLICATIONS	YES/NO	Paragraph/References Within the Report
Equal Opportunities	No	
Policy	No	
Sustainable and Environmental	No	
Crime and Disorder	No	
Human Rights Act	No	
Elderly/People on Low Income	No	
Corporate Parenting	No	
Health Inequalities Impact	No	

OTHER IMPLICATIONS	YES/NO	Paragraph/References Within the Report
Risk Management	Yes	The whole report concerns the Council's internal audit process, a main purpose of which is to give assurance to Directors, the Council and this Committee that risks are being managed appropriately by the business. This includes the risks of fraud and financial irregularity.

7. Background Papers – Local Government Act 1972

7.1. Files held by Internal Audit.

8. Consultations

8.1. Via the Finance Management Team all Heads of Finance have been consulted in the preparation of this report.

9. Report Author

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APPENDIX 1
Leicester City Council Internal Audit
Review of Conformance to the Public Sector Internal Audit Standards – 2015

The PSIAS define Internal Audit as follows:

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 Standards are lengthy and detailed. Set out below is a summary of Leicester City Council Internal Audit's 2015 self-assessment of conformance against each of the headings. It is worthy of note that the requirement is conformance rather than strict compliance. In other words, it is sufficient for the intentions to be met even if the specified requirements are not, provided that suitable identified compensating measures are in place. Those items specifically identified as remaining to be addressed are included in the Quality Assurance and Improvement Programme, QAIP, as identified in the table below.

Ref	Conformance with the Standard	Yes	Part	No	Notes	Areas to be addressed
1	Definition of Internal Audit (IA)					
	a) Independent	Y			IA Charter, audit plans, working relationship with management and Audit & Risk Committee	
	b) Objective	Y			IA Charter	
2	Code of Ethics					
	• Integrity	Y			IA Charter, codes of conduct, conditions of service.	
	• Objectivity	Y			Allocation of work, supervisory review, declarations of interests.	
	• Confidentiality	Y			Information governance law and policy, codes of conduct, conditions of service.	
	• Competency	Y			Allocation of work, professional qualifications and continuing professional development.	
	Standards					
3	Attribute Standards					
3.1	1000 Purpose, Authority and Responsibility	Y			IA Charter, Audit & Risk Committee Terms of Reference (both subject to annual review), Finance Procedure Rules.	The IA Charter needs to be updated for the new <i>Accounts and Audit Regulations 2015</i> . (On agenda for Audit & Risk Committee 02/12/2015.) QAIP ref 1.

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Ref	Conformance with the Standard	Yes	Part	No	Notes	Areas to be addressed
	1010 Recognition of the Definition of Internal Auditing, the Code of Ethics and the Standards in the Internal Audit Charter	Y			Explicitly stated in the introductory paragraphs of the IA Charter on the first page.	
3.2	1100 Independence and Objectivity	Y			IA Charter, status of Head of Internal Audit & Risk Management.	
	1110 Organisational independence	Y			In most important respects there is full conformance with the details of the Standard. However: <ul style="list-style-type: none"> • The Audit & Risk Committee as ‘the Board’ does not approve the Internal Audit budget and resource plan. These are part of the overall Finance divisional budget and are subject to the associated approval processes. The Audit & Risk Committee is kept informed about IA developments and resources. The Committee would also be advised about any inappropriate limitations on IA’s scope or resources. • The Audit & Risk Committee does not appoint or remove the chief audit executive (the Head of Internal Audit & Risk Management). This is an officer decision but the Committee would be kept informed. • Feedback is not sought from the Chair of the Audit & Risk Committee for the Head of Internal Audit & Risk Management’s performance appraisal. However, the Director of Finance would know whether or not the Chair of Audit & Risk Committee was happy with the Head of Internal Audit & Risk Management’s performance. 	None. The exceptions identified are considered to be sufficiently covered by compensating measures and are therefore not in need of further resolution.
	1111 Direct interaction with the Board	Y			The Audit & Risk Committee formally has the responsibility as ‘The Board’ for Leicester City Council.	
	1120 Individual Objectivity	Y			Professional standards apply to all staff. Avoidance of conflicts of interest in e.g. allocation of work.	

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Ref	Conformance with the Standard	Yes	Part	No	Notes	Areas to be addressed
	1130 Impairment to Independence or Objectivity	Y			The Head of Internal Audit & Risk Management has operational responsibility for Risk Management. In the event of an audit of the Risk Management function, the Audit Manager (or from late 2015 a Principal Auditor) would assume the 'chief audit executive' responsibility for the audit and reserve the right to report independently to senior management should the need arise. Regular rotation of staff responsibility is limited by a small team but there is sufficient supervisory review. Audit plans are approved by the Audit & Risk Committee as 'the Board' except for very urgent work, which would be reported in the next IA update report to the Committee.	
3.3	1200 Proficiency and Due Professional Care	Y				
	1210 Proficiency	Y			All members of the IA team have sufficient qualifications, knowledge and experience.	
	1220 Due Professional Care	Y			All audits have agreed terms of reference and there are sufficient audit methods and work plans in place to ensure adequate coverage of governance, risk and control processes.	
	1230 Continuing Professional Development (CPD)	Y			Individual CPD for qualified staff. Annual performance and development reviews (appraisals) for all staff.	Performance and Development reviews have been deferred awaiting the implementation of the organisational review of IA in November 2015. QAIP ref 2.
3.4	1300 Quality Assurance and Improvement Programme	Y			Included in this report to Audit & Risk Committee 02/12/2015; see Appendix 2. The annual review of effectiveness of whole internal audit function is no longer required under the new Accounts & Audit Regulations.	

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Ref	Conformance with the Standard	Yes	Part	No	Notes	Areas to be addressed
	1310 Requirements of the Quality Assurance and Improvement Programme		P		The reviews of conformance, including this one, have all been internal self-assessments. The PSIAS require at least one external assessment every five years; this is to be arranged. Preliminary discussions have been held with other local authority internal audit services with a view to setting up a system of peer review.	Arrangement of an external assessment by a professionally competent external assessor for the annual review in either 2016-17 or 2017-18. QAIP ref 3.
	1311 Internal Assessments	Y			We may need to develop new performance targets and indicators in the new business environment of increased externally traded audit work.	
	1312 External Assessments			N	Not done yet, and therefore no assessment of the professional competence of the external assessor. All this is planned.	Arrangement of an external assessment by a professionally competent external assessor for the annual review in either 2016-17 or 2017-18. QAIP ref 3.
	1320 Reporting on Quality Assurance and Improvement Programme		P		The QAIP has not been reported upon until this report to Audit & Risk Committee 02/12/2015. Broad results of assessments and statements of conformance have been included in IA Annual Reports 2013-14 and 2014-15.	QAIP reported to Committee 02/12/2015.
	1321 Use of 'Conforms with the International Standards for the Professional Practice of Internal Auditing'	N/A			This wording has not hitherto been used by IA. See QAIP, Appendix 2 below.	Once the QAIP has been completed, IA will conform as stated. QAIP ref 3.
	1322 Disclosure of Non-conformance	Y			None identified beyond those items mentioned in this report. None are fundamental.	
4	Performance Standards					
4.1	2000 Managing the Internal Audit Activity	Y			There is nothing in the IA Charter or IA plans or the Council's assurance framework that was not fulfilled by IA in 2014-15.	
	2010 Planning	Y			IA planning is risk-based, by way of reference to the Council's risk registers, consultation with all directors and by means of quarterly plans that enable emerging risks to be accommodated.	

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Ref	Conformance with the Standard	Yes	Part	No	Notes	Areas to be addressed
	2020 Communication and Approval	Y			All IA plans (annual and quarterly) and update reports (half-yearly and annual) are reported to senior management and the Audit & Risk Committee as 'the Board'. These identify any constraints such as resource shortages.	
	2030 Resource Management	Y			Constraints on audit planning and resources are reported to senior management and the Audit & Risk Committee.	
	2040 Policies and Procedures		P		There is an audit manual but it has largely been superseded by the detailed guidance built in to the Pentana audit IT system supplemented by information available online via the Council's intranet.	Review of the IA Manual, to determine whether to update or whether to abandon in favour of the audit work guidance in the Pentana system plus general information now available on the intranet. A collation of policies and protocols (as opposed to detailed operational procedures) for IA may be appropriate, however. QAIP ref 4.
	2050 Coordination		P		The Council's assurance framework refers to other sources of assurance and IA works in close coordination with the external auditor. Assurance mapping is not done in any comprehensive way by IA but it may be developed under the partnership agreement with Lincolnshire Internal Audit, where the process is well established. Implementation at Leicester would need senior management agreement.	Exploration of the potential for assurance mapping. IA is working in partnership with Lincolnshire County Council, who have developed such a process and this may assist in developing assurance mapping here. QAIP ref 5.
	2060 Reporting to Senior Management and the Board	Y			There are regular, roughly quarterly, update reports to senior management and the Audit & Risk Committee. Respective reports cover both IA and Risk Management; the latter include 'horizon-scanning' for emerging risks. As the Head of Internal Audit & Risk Management is responsible for both functions, there is a high degree of coordination between the two.	

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Ref	Conformance with the Standard	Yes	Part	No	Notes	Areas to be addressed
	2070 External Services Provider and Organisational Responsibility for Internal Auditing	N/A			Not applicable. The IA service is entirely in-house.	
4.2	2100 Nature of Work	Y			The requirements of the definition of IA (see above at the head of Appendix 1) are clearly the essential purpose of IA and underpin the way in which Leicester City Council IA operates.	
	2110 Governance	Y			IA fulfils the requirements as written, except to the extent that IA is not intended to take the place of service management in ensuring effective organisational performance management and accountability. IA takes a leading role in reviewing and updating the governance processes by way of the annual review of the assurance framework and the local Code of Corporate Governance and coordinating the production of the Council's Annual Governance Statement. The Head of Internal Audit & Risk Management coordinates the Audit & Risk Committee's work programme, i.e. its timetable of reports and training, involving all relevant parties. Most such reports are also taken to senior management and this is coordinated by the Head of Internal Audit & Risk Management. IA does not do this more generally, however; nor should it as that is management's role.	
	2120 Risk Management	Y			The required activities fall within the remit of the Head of Internal Audit & Risk Management in his risk management role. As IA reports to the Head of Internal Audit & Risk Management, there has not been a recent detailed IA review of the RM function. However, the proactive approach taken by RM and the close working with IA mean that IA can derive a high level of assurance on the identification and management of risk and its alignment with the objectives of the Council. IA activity is risk-based and reference is made to the relevant risk registers both in audit planning and operational audits. Though relevant to IA, the risk of fraud is covered specifically by the Corporate Investigations Team, which currently sits outside IA. There is regular liaison between the two functions.	

Review of Conformance to the Public Sector Internal Audit Standards – 2015

Ref	Conformance with the Standard	Yes	Part	No	Notes	Areas to be addressed
	2130 Control	Y			Evaluation of the adequacy, effectiveness, design and operation of controls in place is the principal function of IA.	
4.3	2200 Engagement Planning	Y			All audits have agreed terms of reference or an engagement letter (e.g. schools) covering the objectives, scope, timing and reporting. Arrangements are in place for planning audit engagements for organisations other than the City Council under separate trading agreements; for example, Lincolnshire County Council.	
	2210 Engagement Objectives	Y			The objectives of each audit engagement are agreed at the start of the audit. Whether they include all the items listed in the Standards depends on the individual audit.	
	2220 Engagement Scope	Y			The scope of each audit engagement is agreed at the start of the audit. Whether all the items listed in the Standards are included depends on the individual audit.	
	2230 Engagement Resource Allocation	Y			Audits are allocated to staff according to skills, knowledge and availability.	
	2240 Engagement Work Programme	Y			The requirements for audit work programmes are largely set out in the work plans and steps in the Pentana audit IT system.	
4.4	2300 Performing the Engagement	Y			Work is performed in the way specified by the Standard, as follows:	
	2310 Identifying Information	Y			Sufficient, reliable, relevant and useful information is identified subject to IA's general principle of 'we report as we find'; if necessary information is not available, IA will report the fact.	
	2320 Analysis and Evaluation	Y			IA conclusions are based on appropriate analysis and evaluation of the information available. Auditors are alert to the risks of such things as fraud, error and conflict of interests on the part of audit clients when conducting audits. Results of audit work are documented; usually in electronic form, to which access is restricted. IA is bound by the Council's corporate records retention policy.	
	2330 Documenting Information	Y			Documenting of evidence – usually now electronic – is fundamental to the audit process. It is the policy of IA that all audits are performed to the re-performance standard (i.e. such that another competent auditor could re-perform the test and come to the same conclusion) and all audits are subject to supervisory review.	

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Ref	Conformance with the Standard	Yes	Part	No	Notes	Areas to be addressed
	2340 Engagement Supervision	Y			All audits are subject to supervisory review and sign-off by means of the structured approach enforced by the Pentana audit IT system. Evidence is retained.	
4.5	2400 Communicating Results	Y			All audits result in a report of some kind, either a formal report or a memo or email. There is also a closing meeting unless the client declines the opportunity for this. Reports are mostly by exception, i.e. only adverse findings are reported in detail.	
	2410 Criteria for Communicating	Y			Audit reports are based on standard templates that include all of the Standard's requirements. Audit clients have the opportunity to discuss findings and recommendations prior to finalisation. Recommendations are graded according to materiality based on risk. Each report gives an overall opinion in the form of a level of assurance or other statement.	
	2420 Quality of Communications	Y			Supervisory review processes are in place to ensure that IA reports are accurate, objective, clear, concise, constructive, complete and timely.	
	2421 Errors and Omissions	Y			There are processes to ensure that IA reports do not contain errors or omissions, including supervisory review and the opportunity for clients to confirm factual accuracy by means of closing discussions or draft reports. If an error were identified in an IA report, a corrected report would be issued.	
	2430 Use of 'Conducted in Conformance with the International Standards for the Professional Practice of Internal Auditing'	Y			Individual audit reports do not say this, and we do not see the need. In overall terms, IA operates in conformance with the PSIAS and this is specifically stated, as required, in the IA Annual Report.	
	2431 Engagement Disclosure of Non-conformance	N/A			The situation has not arisen and is not anticipated where non-conformance with the PSIAS affects a specific audit engagement. Full conformance with PSIAS across the entire audit service is the aim and no specific engagement would be considered to fall outside the Standards in whole or in part.	

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Ref	Conformance with the Standard	Yes	Part	No	Notes	Areas to be addressed
	2440 Disseminating Results	Y			Distribution of IA reports to client management follows agreed protocols. All reports are available to the external auditor. The outcomes of all except externally traded audits are reported in summary to the Audit & Risk Committee, with particular attention drawn to those identifying material concerns. Reports are not divulged to anyone else without the client's permission.	
	2450 Overall Opinion	Y			The IA annual opinion on the overall adequacy and effectiveness of the Council's framework of governance, risk management and control is set out in the IA Annual Report. It makes clear that it refers to work completed within the financial year in question and is based solely on IA work done including any assurance derived from other sources. Any qualification of the opinion would be specified but this has never arisen.	
4.6	2500 Monitoring Progress	Y			Implementation of IA recommendations is followed up by IA, usually by means of re-testing the exceptions previously identified and reporting on the outcome. Any significant non-response or non-implementation is reported to the Audit & Risk Committee. The IA opinion (level of assurance) on the audited activity is not revised as the follow-up testing is concentrated on the previous adverse findings, not the whole system. However, many audits include follow-up of previous recommendations and the degree of implementation will influence the ensuing level of assurance.	
4.7	2600 Communicating the Acceptance of Risks	N/A			The situation has never arisen where client management has accepted an unacceptable level of risk. Under the IA Charter, IA reserves the right to escalate such matters to more senior management, the Audit & Risk Committee or the City Mayor.	

APPENDIX 2
Leicester City Council Internal Audit
Quality Assurance and Improvement Programme (QAIP)

Introduction

Under the Public Sector Internal Audit Standards (ref 1300): the Quality Assurance and Improvement Programme (QAIP) is ‘*designed to enable an evaluation of the internal audit activity’s conformance with the Definition of Internal Auditing and the Standards and an evaluation of whether internal auditors apply the Code of Ethics. The programme also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement*’.

Set out below is the QAIP for Leicester City Council Internal Audit for 2015-16.

Conformance with the Definition of Internal Auditing and the PSIAS:

This has been subject to a detailed self-assessment against all aspects of the Standards and the results are summarised in Appendix 1 above. All are deemed to be sufficiently achieved subject to the following exceptions or opportunities to strengthen conformance that have been identified:

No.	PSIAS Ref	Standard	Action needed	Action taken or planned	Notes
1	3.1	1000 Purpose, Authority and Responsibility	The IA Charter needs to be updated for the new <i>Accounts and Audit Regulations 2015</i> .	An update of the IA Charter is on the agenda of the Audit & Risk Committee 02/12/2015.	
2	3.3	1230 Continuing Professional Development (CPD)	Performance and Development reviews have been deferred awaiting the implementation of the organisational review of IA in November 2015.	Staff appraisals will resume once the review of IA has been implemented.	
3	3.4	1310 Requirements of the Quality Assurance and Improvement Programme 1312 External Assessments 1321 Use of ‘Conforms with the International Standards for the Professional Practice of Internal Auditing’	Arrangement of an external assessment by a professionally competent external assessor for the annual review in either 2016-17 or 2017-18.	Identification and engagement of a professionally competent external assessor.	Some discussion has taken place about options for a peer-review by another local authority.
4	4.1	2040 Policies and Procedures	Review of the IA Manual, to determine whether to update or whether to abandon in favour of the audit work guidance in the Pentana system plus general information now available on the intranet. A collation of policies and protocols (as opposed to detailed operational procedures) for IA may be appropriate, however.	Review of IA Manual to determine continuing need in present form.	

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Leicester City Council Internal Audit
Quality Assurance and Improvement Programme (QAIP)

No.	PSIAS Ref	Standard	Action needed	Action taken or planned	Notes
5	4.1	2050 Coordination	Exploration of the potential for assurance mapping.	IA is working in partnership with Lincolnshire County Council, who have developed such a process and this may assist in developing assurance mapping here.	

The QAIP process involves ongoing monitoring of the performance of the internal audit activity. In practice, this means:

Internal Assessment

Continuing assessment and quality assurance includes the following:

- A structured process for conducting audits, largely governed by procedural steps specified within the Internal Audit IT database system (Pentana) for the various types of audit work. The steps and methods themselves are subject to continuing review and update.
- Agreement of terms of reference or equivalent at the outset of every audit.
- Documented supervisory review of all audit work.
- Review and approval of all draft and final audit reports by the Audit Manager or nominated deputy.
- Feedback received via client satisfaction survey questionnaires at the end of each audit.
- All Internal Audit staff are subject to the Council’s code of conduct and other conditions governing ethical conduct including independence, objectivity and impartiality. This includes measures to avoid conflicts of interest.

Periodic assessment includes the following:

- Annual review of conformance to the Public Sector Internal Audit Standards. The outcome of the 2015 review is given above.
- Quarterly and annual reporting to senior management and the Audit & Risk Committee on the performance of Internal Audit and the outcomes of audit work including the annual audit opinion.
- Annual review of the Internal Audit Charter and the Internal Audit Plan and Strategy.
- Reliance on Internal Audit work by the external auditor, with particular reference to coverage of the main financial systems.
- Annual review by the Director of Finance of the effectiveness of the system of internal audit.

External Assessment

Under the PSIAS (ref 1321), *‘External assessments must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organisation.’*

This requirement came into force in 2013 and for Leicester City Council has not yet taken place. As identified in the table above, an external assessment will need to be undertaken by March 2018. The outcome of this will be reported to the Audit & Risk Committee in accordance with the Standards.