

## Report of the Chief Auditor

Audit Committee – 12 February 2015

### INTERNAL AUDIT ANNUAL PLAN - METHODOLOGY

<b>Purpose:</b>	This report provides a briefing to the Audit Committee on the methodology used to prepare the Internal Audit Annual Plan in advance of the Annual Plan 2015/16 being reported to the Committee for approval.
<b>Policy Framework:</b>	None
<b>Reason for Decision:</b>	To brief the Audit Committee of the process of preparing the Internal Audit Annual Plan
<b>Consultation:</b>	Legal, Finance, Access to Services
<b>Recommendation(s):</b>	It is recommended that: the Committee note the methodology for preparing the Internal Audit Annual Plan and the proposed changes to be made for the 2015/16 Plan
<b>Report Author:</b>	Paul Beynon
<b>Finance Officer:</b>	Paul Beynon
<b>Legal Officer:</b>	Sharon Heys
<b>Access to Services Officer:</b>	Sherill Hopkins

#### 1. Introduction

- 1.1 A risk based Internal Audit Plan is produced each year which is used to guide the work of the Internal Audit Section over the course of the year.
- 1.2 The Internal Audit Annual Plan is reported to and approved by the Audit Committee in April each year.
- 1.3 The aim of the Internal Audit Annual Plan is to provide sufficient coverage of the Council's risks and services to allow the Chief Auditor to deliver the annual opinion on internal control which informs the Annual Governance Statement.

1.4 This report provides a briefing to the Committee on the methodology used to prepare the Annual Plan in advance of the Plan for 2015/16 being reported to the Committee for approval.

## 2. Internal Audit Plan Methodology

2.1 The requirement to produce an Internal Audit Annual Plan is included in the Public Sector Internal Audit Standards (PSIAS) which are mandatory for all internal audit providers in the UK public sector.

2.2 An extract of the PSIAS requirements regarding internal audit planning is attached in Appendix 1

2.3 An Audit Needs Assessment is completed on an annual basis utilising the risk assessment undertaken for each audit. The risk assessment takes into account a wide range of factors which are grouped into the following categories

- Materiality e.g. income, expenditure
- Control Environment/Vulnerability e.g. previous frauds, staff turnover
- Management Concerns e.g. direct request for help, potential for embarrassment
- Sensitivity e.g. impact on service, effect on Council's welfare

2.4 A copy of the Risk Assessment form used is attached in Appendix 2

2.5 The outcome of the risk assessment is a risk index which is then used to determine the frequency of audit visits as shown in the following table

Risk Index	Risk Factor	Frequency of Visit
0 – 19	Low	4 years
20 – 25	Medium/Low	3/4 years
26 – 40	Medium	3 years
41 – 49	Medium/High	2/3 years
50 +	High	1/2 years

2.6 In addition to the risk assessment process, a number of systems have traditionally been identified, in consultation with our external auditors as fundamental e.g. Payroll, Accounts Receivable, Main Accounting, Council Tax. Until 01/04/14, all fundamental systems were audited annually which accounted for over 350 audit days over the course of the year.

2.7 However following discussions with PwC, it was agreed that the frequency of audit for fundamental systems should also take account of risk. As a result, 8 of the 14 fundamental audits which had received

the highest level of assurance for at least 3 years were moved to a 2 year audit cycle which will save around 120 audit days each year.

- 2.8 The use of the risk assessment process provides every audit in the Council's audit universe with a year when the next audit visit is due which is the starting point for the Internal Audit Annual Plan
- 2.9 Each year, a consultation exercise is held with all Heads of Service and Chief Officers giving them the opportunity to comment on the audit coverage in their area and to ensure that all risks within their services have been identified. Heads of Service and Chief Officers may also request specific reviews or pieces of work by the Internal Audit Section which are considered in light of the total Internal Audit resources available.
- 2.10 A review of the Corporate Risk Register also takes place to ensure that where necessary, Internal Audit resources are targeted at the areas considered to be the highest risk.
- 2.11 The ongoing review of the current year's Annual Plan also informs the planning process e.g. by identifying any emerging risks, new systems, developments or special investigations which may have a wider impact.
- 2.12 The Audit Needs Assessment i.e. the risk assessment process, consultation exercise and review of the Corporate Risk Register provides the total number of audit days required in the year which then has to be matched against the audit resources available.
- 2.13 The audit resources available reduced to 10.6 full time equivalents for 2014/15 due to a Group Auditor leaving under the Council's ER/VR scheme. This level of resources remains the same for 2015/16 as no further cuts have been made to Internal Audit staffing.
- 2.14 The audit resources available have to allow for things such as annual leave, public holidays, training, administration, planning, fraud investigations and a contingency to allow for unplanned work. This provides the productive audit days available to deliver the required audit coverage obtained from the Audit Needs Assessment
- 2.15 Inevitably, the required audit coverage will exceed the available audit resources leading to a further review of the required audit coverage. This review will again be risk based to ensure that the areas of greatest risk are prioritised
- 2.16 The Internal Audit Annual Plan is reported to the Audit Committee at the start of each year for approval. However, the Annual Plan must remain a flexible document that reacts to changing risks and priorities over the course of the year.

### **3. Proposed Changes to Audit Plan 2015/16**

- 3.1 The Internal Audit Monitoring Report Quarter 3 2014/15 elsewhere on the agenda for this meeting again highlights the problems experienced in 2014/15 due to the loss of audit days caused by vacant posts and secondments
- 3.2 As a result of the loss of audit days in the current year, audits with a total of just under 500 days will not be completed and will be deferred to 2015/16.
- 3.3 This is the 2<sup>nd</sup> consecutive year that vacant posts, secondments and special investigations have led to a significant number of audit days being deferred to the following year which clearly impacts on the audits due in the subsequent year.
- 3.4 This situation can't be allowed to continue and a review has been made of the Audit Plan and the method of working to identify changes which can be made to ensure that the Plan put forward for approval each year is realistic and achievable.
- 3.5 It is also intended that the proposed changes will free up audit time to be spent on higher risk services and activities including those appearing in the Corporate Risk Register which will add value to the Council in line with the new definition of Internal Audit put forward in the Public Sector Internal Audit Standards.
- 3.6 As mentioned above, the application of risk to the frequency of fundamental audits has already saved around 120 days/year.
- 3.7 Following consideration by senior Internal Audit staff and a meeting of all staff in the Section to generate ideas, the proposed changes shown below will be used as the basis for preparing the Internal Audit Plan 2015/16
  - A Corporate Fraud Team will be established within the Internal Audit Section with effect from 1<sup>st</sup> June 2015 on a trial 2 year basis following the transfer of the existing Housing Benefits Fraud Investigation Team to the DWP. The Corporate Fraud Team made up of 3 staff will investigate the residual Council Tax Reduction Scheme fraud which will not be investigated by the DWP and will also pick up any other fraud investigations previously undertaken by Internal Audit staff as well as being proactive in fraud prevention across the Council. The Internal Audit Annual Plan currently includes 100 days for fraud investigations which can now be released for audit work.
  - The table in 2.5 above shows that audits of low risk services are planned to take place every 4 years. There are currently 33 audits classed as low risk with a total of 285 days for the audits. It is proposed that the frequency of audit for low risk audits is increased

to 5 years subject to a regular risk assessment of the services to ensure that there have been no changes which impact on the low risk assessment. All low risk audits currently have the 2 highest levels of assurance. This proposed change is likely to save 14 days/year.

- The table in 2.5 also shows that it is planned to audit services classed as medium/low risk every 3 to 4 years. There are currently 42 audits classed as medium/low risk with a total of 375 days for the audits. It is proposed that the frequency of medium/low risk audits is increased to 4 to 5 years again with a regular review to identify any changes to the risk score. There is only 1 audit in the medium/low category which does not have one of the highest levels of assurance. This proposed change is likely to save 31 days/year.
- There are a number of audits where the same audit programme is used over multiple establishments e.g. primary schools, branch libraries, school kitchens, district housing offices, leisure centres. It is proposed that where there are multiple establishments, a self assessment basis is used for the audit. A self assessment questionnaire would be developed which would be completed by the service with the output from the questionnaire being subject to spot checks by Internal Audit to confirm the findings. This approach has already been successfully used for Social Services establishments. In the first year, there is likely to be an investment of time preparing the questionnaires but savings would accrue in future years. If half of the time spent on these audits is saved by using the self assessment approach this would save around 90 days/year.
- A number of other minor changes have also been suggested to the ways of working e.g. reducing the scope of certain audit work, speeding up the process for finalising a draft audit report, reducing sample sizes where appropriate. While it is not possible to identify a saving in terms of days for the minor changes, they will contribute to the desired result by speeding up the process of completing an audit.

#### **4. Equality and Engagement Implications**

- 4.1 There are no equality and engagement implications associated with this report.

#### **5. Financial Implications**

- 5.1 There are no financial implications associated with this report.

#### **6. Legal Implications**

- 6.1 There are no legal implications associated with this report

**Background Papers:** None

**Appendices:** Appendix 1 – Extract from Public Sector Internal Audit Standards  
Appendix 2 – Risk Assessment Sheet

**Extract from Public Sector Internal Audit Standards**

**2010 Planning**

The chief audit executive must establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organisation's goals.

*Interpretation:*

The chief audit executive is responsible for developing a risk-based plan. The chief audit executive takes into account the organisation's risk management framework, including using risk appetite levels set by management for the different activities or parts of the organisation. If a framework does not exist, the chief audit executive uses his/her own judgment of risks after consideration of input from senior management and the board. The chief audit executive must review and adjust the plan, as necessary, in response to changes in the organisation's business, risks, operations, programs, systems, and controls.

**Public sector requirement**

The risk-based plan must take into account the requirement to produce an annual internal audit opinion and the assurance framework. It must incorporate or be linked to a strategic or high-level statement of how the internal audit service will be delivered and developed in accordance with the internal audit charter and how it links to the organisational objectives and priorities.

**2010.A1**

The internal audit activity's plan of engagements must be based on a documented risk assessment, undertaken at least annually. The input of senior management and the board must be considered in this process.

**2010.A2**

The chief audit executive must identify and consider the expectations of senior management, the board and other stakeholders for internal audit opinions and other conclusions.

**2010.C1**

The chief audit executive should consider accepting proposed consulting engagements based on the engagement's potential to improve management of risks, add value and improve the organisation's operations. Accepted engagements must be included in the plan.

**2020 Communication and Approval**

The chief audit executive must communicate the internal audit activity's plans and resource requirements, including significant interim changes, to senior management and the board for review and approval. The chief audit executive must also communicate the impact of resource limitations.

## **2030 Resource Management**

The chief audit executive must ensure that internal audit resources are appropriate, sufficient and effectively deployed to achieve the approved plan.

### *Interpretation:*

Appropriate refers to the mix of knowledge, skills and other competencies needed to perform the plan. Sufficient refers to the quantity of resources needed to accomplish the plan. Resources are effectively deployed when they are used in a way that optimises the achievement of the approved plan.

### **Public sector requirement**

The risk-based plan must explain how internal audit's resource requirements have been assessed.

Where the chief audit executive believes that the level of agreed resources will impact adversely on the provision of the annual internal audit opinion, the consequences must be brought to the attention of the board.



## City and County of Swansea - Risk Assessment Sheet - Internal Audit Section

Establishment/Site/System: \_\_\_\_\_

File Ref: \_\_\_\_\_

Completed By: \_\_\_\_\_ Date: \_\_\_\_\_ Approved (and copied to PFile/RAFile.) By: \_\_\_\_\_ Date: \_\_\_\_\_

Tick each factor that applies and score 1 point (except A) - maximum 5 points per category

A. Materiality	B. Control Environment / Vulnerability	C. Management Concerns	D Sensitivity														
<p>Value of funds that pass through the system and/or direct expenditure <u>plus</u> income = £ _____</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%;"><u>Annual Value (£)</u></td> <td style="width: 30%;"><u>Score</u></td> </tr> <tr> <td>• &lt; 1,000</td> <td style="text-align: center;">0</td> </tr> <tr> <td>• 1,000 - 10,000</td> <td style="text-align: center;">1</td> </tr> <tr> <td>• 10,001 - 100,000</td> <td style="text-align: center;">2</td> </tr> <tr> <td>• 100,001 - 1m</td> <td style="text-align: center;">3</td> </tr> <tr> <td>• 1m - 5m</td> <td style="text-align: center;">4</td> </tr> <tr> <td>• &gt; 5m</td> <td style="text-align: center;">5</td> </tr> </table>	<u>Annual Value (£)</u>	<u>Score</u>	• < 1,000	0	• 1,000 - 10,000	1	• 10,001 - 100,000	2	• 100,001 - 1m	3	• 1m - 5m	4	• > 5m	5	<ul style="list-style-type: none"> <li>• Previous frauds if &lt; 5 years</li> <li>• Opinion rating less than 'satisfactory'</li> <li>• Last audit review &gt; 3 years ago (date _____)</li> <li>• High staff turnover</li> <li>• New system(s) operating</li> <li>• High degree of devolution</li> <li>• Complex system(s) operating</li> <li>• Critical reports from outside bodies etc.</li> </ul>	<ul style="list-style-type: none"> <li>• Direct requests for help</li> <li>• Potential for embarrassment</li> <li>• Specific problem areas</li> <li>• Control weaknesses</li> <li>• Assets at risk</li> <li>• Significant cash income (e.g.: &gt; £10K p.a.)</li> </ul>	<ul style="list-style-type: none"> <li>• Political sensitivity of activity</li> <li>• Large no. of sub-systems, interlinked or dependent systems</li> <li>• Effect on Authority's welfare</li> <li>• Unwelcome disclosure</li> <li>• Impact on service</li> <li>• Impact on other depts.</li> </ul>
<u>Annual Value (£)</u>	<u>Score</u>																
• < 1,000	0																
• 1,000 - 10,000	1																
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• 100,001 - 1m	3																
• 1m - 5m	4																
• > 5m	5																
Total Score (max 5)																	
Weighting	5	8	4														
Weighted Scores																	
Total WS =risk index	<b>Low 0 to 19, Medium/Low 20 to 25, Medium 26 to 40, Medium/High 41 to 49, High 50 and above</b>																