

# Report of the Chief Auditor

Audit Committee – 14 March 2017

## 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 2017/18 being reported to the Committee for approval on 28 March 2017.
<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 2017/18
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### 1. Introduction

- 1.1 The Public Sector Internal Audit Standards (PSIAS) provide a framework for the delivery of a professional, independent and objective internal audit service and are mandatory for all internal audit providers in the public sector in the UK.
- 1.2 One of the requirements of the PSIAS is that an annual risk-based Internal Audit plan must be prepared to determine the priorities of Internal Audit and to ensure they are consistent with the Council's goals. The Plan must allow sufficient audit coverage across the whole Council for the Chief Auditor to be able to provide an annual opinion to Council via the Section 151 Officer and Audit Committee on the control environment covering corporate governance, risk management and internal control.

- 1.3 The Audit Plan should ensure that resources are targeted at the areas of the Council's work where it can provide most benefit by providing assurance over key risks and controls.
- 1.4 The Standards state that the Internal Audit Annual Plan must be discussed with senior management which in the Internal Audit Charter is defined as the Corporate Management Team before being reported to the Audit Committee for approval.
- 1.5 This report provides a briefing on the methodology used to prepare the Annual Plan in advance of the Plan for 2017/18 being reported to the Committee for approval at the next meeting.

## **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 The starting point for a risk-based audit approach is gaining an understanding of the Council's objectives and goals as well as the current key risks faced by the Council as recorded in the Risk Registers.
- 2.4 Information is gathered from a number of sources prior to the preparation of the detailed Audit Plan including
  - The Corporate Plan and One Swansea Plan
  - Reports to Cabinet, Council and Scrutiny
  - Risk Registers
  - Areas of concern or request for audit coverage from management or the Audit Committee
  - Other sources of assurance available both from internal and external sources
  - Any recent or proposed significant changes to the Council's systems or operations
  - Previous audit results and Internal Audit's cumulative knowledge of systems and procedures across the Council
- 2.5 Following the gathering of relevant information, an Audit Needs Assessment is completed utilising the risk assessment undertaken for each audit. The risk assessment takes account of 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

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

2.7 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. The frequency of audit visit for medium/low and low risk audits was increased in 2015/16 as one of the changes reported to the Audit Committee at the time which were designed to free up audit resources which could then be used on higher risk audits and added value work.

<b>Risk Index</b>	<b>Risk Factor</b>	<b>Frequency of Visit</b>
0 – 19	Low	5 years
20 – 25	Medium/Low	4/5 years
26 – 40	Medium	3 years
41 – 49	Medium/High	2/3 years
50 +	High	1/2 years

2.8 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. All fundamental systems are audited either annually or every 2 years which recognises the significance of the system to the achievement of the Council's objectives.

2.9 A number of audits are undertaken on an annual basis rather than by the determination of risk e.g. grant certification audits where the work is required under the terms and conditions of the grant, the review of debts written off prior to authorisation, services where significant amounts of cash are handled, etc.

2.10 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 used to develop the Audit Plan.

2.11 Each year, a Consultation Exercise is held with all Heads of Service 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 may also request specific reviews or pieces of work by the Internal Audit Section which will add value to their service. All requests are considered in light of the total Internal Audit resources available.

- 2.12 The Consultation Exercise for the 2017/18 Audit Plan commenced on 1 January 2017.
- 2.13 A review of the Corporate and Directorate Risk Registers also takes place to ensure that where necessary, Internal Audit resources are targeted at the areas considered to be the highest risk.
- 2.14 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.
- 2.15 The Audit Needs Assessment i.e. the risk assessment process, consultation exercise and review of the risk registers will provide the total number of audit days required in the Audit Plan for 2017/18 which then has to be matched against the audit resources available.
- 2.16 The audit resources available in 2017/18 is 9.5 full time equivalents excluding the Chief Auditor.
- 2.17 The audit resources available have to allow for things such as annual leave, public holidays, training, administration, planning, sickness 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.
- 2.18 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 perceived risk are prioritised. The audits which are deferred to reconcile the audit days required to the available audit resources will be low risk or medium/low risk or will have received a high level of assurance at the last audit which indicates good systems and controls are in place.
- 2.19 The Internal Audit Annual Plan is reported to the Corporate Management Team and 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. Equality and Engagement Implications**

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

### **4. Financial Implications**

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

## **5. Legal Implications**

5.1 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																
• 10,001 - 100,000	2																
• 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>																