

Strategic internal audit planning and principles for 2017/18

1. Introduction

- 1.1. This paper explains how the internal audit plan for 2017/18 will be constructed. It sets out the planning principles that will be followed, the information required, and how potential areas of audit work will be assessed to prioritise them and construct an effective plan with limited resources.
- 1.2. It will provide an outline of the matters that will be included in the plan for 2017/18 but this will be subject to further development over the coming months and a more detailed plan will be set out in June 2017 for the Committee that will be formed by the Council's next Administration for the remainder of the year and beyond.

2. Context

- 2.1. During 2016/17 the Council commissioned a review of its budget from PricewaterhouseCoopers that validated the financial position reported by the Council in its medium term financial strategy. Their report confirmed that, even if the Council were to reduce its cost base to the median of the lowest quartile of comparable councils' expenditure by 2020/21, it would still incur an in-year deficit of approximately £79 million in that year, and a cumulative deficit by 31 March 2021 of £227 million. The budget now approved for 2017/18 is supported by a contribution from reserves of £57 million, and the need for a further contribution of £87 million in 2018/19 is currently forecast. The Council has therefore recognised that it is critical that significant additional savings are identified as quickly as possible during 2017/18 and delivered during 2018/19 or sooner.
- 2.2. The turbulence of recent years will therefore continue and will affect almost all of the Council's services. Although service restructures are ongoing, at this point not all of the council's services have completed the process. In particular, adults' social care services are currently subject to restructuring as well as to significant process changes; and children's social services are subject to ongoing improvement and review by Ofsted, which has recently reconfirmed its assessment that these services are inadequate.
- 2.3. A new Council will be elected in May 2017 and will form a new Administration, and a new Audit and Governance Committee will be appointed. A more fully developed plan will be taken to that Committee at its meeting in June for its consideration and approval.

3. The purpose of the audit plan

- 3.1. The Council is responsible for a wide range of services across the county and its members and senior management should be aware both of the risks to achieving their service objectives and the risks inherent in their work. Each of these risks should be managed by controls designed to reduce the risk to a corporately acceptable level, and which operate effectively and consistently in practice. The Chief Executive, Audit and Governance Committee, and ultimately the Council, need assurance that these controls have been adequately designed and are operating effectively. In due course the Chief Executive and the Leader of the Council will jointly sign an Annual Governance Statement (AGS).

- 3.2. The Audit and Governance Committee is required by its current terms of reference to review and approve the Council's AGS. It is also required to consider the Head of Internal Audit's annual report and opinion. The Head of Internal Audit is required by professional standards to provide an opinion addressing governance, risk management and control and thereby to provide assurance that the risks to the Council's objectives are being adequately and effectively controlled. The Committee should therefore consider and approve an internal audit plan designed to provide the assurance that the Council, Committee, Leader and Chief Executive of the council need.

4. Statutory and professional requirements relating to internal audit

- 4.1. Internal audit's function is established by the Accounts and Audit Regulations 2015, which are supported by professional standards for internal audit in the public sector and an advisory note specifically for local government in the United Kingdom. The key requirements of the Regulations and of the Public Sector Internal Audit Standards (PSIAS) are set out below.

Relevant regulations

Internal audit: "A relevant authority 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."

Regulation 5. (1)

Review of internal control system: "A relevant authority must, each financial year (a) conduct a review of the effectiveness of the system of internal control [...] and (b) prepare an annual governance statement."

Regulation 6. (1)

Accounts and Audit Regulations 2015

Definition of internal auditing

"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 provision of assurance services is the primary role for internal audit in the UK public sector. This role requires the chief audit executive to provide an annual internal audit opinion based on an objective assessment of the framework of governance, risk management and control."

"Internal auditors must incorporate knowledge of controls gained from consulting engagements into evaluation of the organisation's control processes."

*Public Sector Internal Audit Standards, 2016
published by the Relevant Internal Audit Standard Setters*

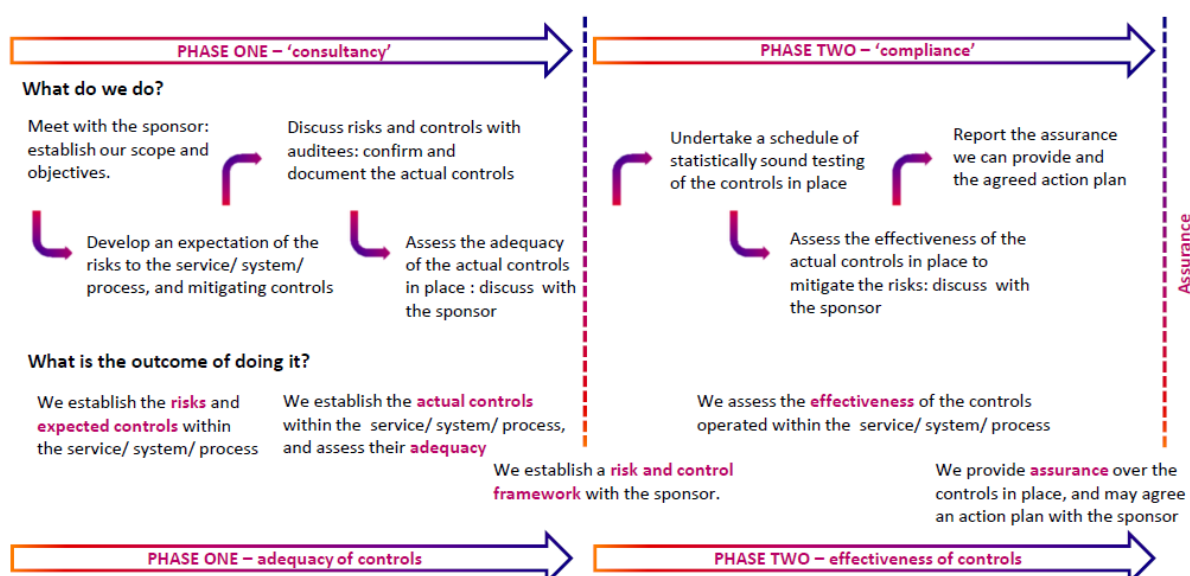
- 4.2. The Regulations therefore establish the requirement for an internal audit function and its provision of an opinion on the council's governance, risk management and control processes, following public sector internal auditing standards. Professional standards likewise mandate the provision of such an

opinion. They also recognise that internal audit involves the provision of both assurance and consultancy services, but assurance is its primary function and any consultancy work must inform the assurance opinion.

5. The audit approach adopted by the County Council's Internal Audit Service

- 5.1. The Internal Audit Service follows a risk-based audit methodology, working closely with the Council's managers to understand the risks to the service, system or process being audited and then testing the controls in place. The audit process therefore involves two phases: establishing a framework of risks and controls and then testing those controls. During the first phase we work closely with the service's managers to document a risk and control framework for a service, system or process, which enables us to assess the adequacy of the controls designed to mitigate the risks identified. During the second phase we test the effectiveness of the controls in place.

A risk-based audit methodology in two phases



- 5.2. The way this approach is applied to any audit varies depending on what assurance can firstly be given by the council's managers that risks are adequately and effectively mitigated.

Full audit including both phases of work

- 5.3. Where assurance is required over a control system that has not previously been audited in its present form, for example because it is new or has been recently changed, but its managers believe that the risks are adequately and effectively controlled, we undertake a full review including both audit phases. We will provide an opinion on the basis of this work.

Work on phase one only

- 5.4. Where the managers of a service, system or process are aware that there are matters to address and are unwilling to assert that risks are adequately and effectively controlled, they may seek support to design and implement appropriate controls. The first phase of any audit may be regarded as consultancy as we work with a service's managers to consider the controls they operate to manage the risks to their service's objectives. This analysis

can be undertaken at any time, particularly whilst a service is in the process of transformation, and can assist managers to design effective procedures. We can use this approach to add value to the organisation without providing any further assurance but, although it would need to be checked and revised, this work may serve as the first phase of a full audit at a later date, perhaps in the following year. (See paragraph 6.10 below.)

Work on phase two only

- 5.5. The second phase of an audit is intended to provide assurance over the effective operation of control systems that have already been assessed as being adequately designed. This may follow immediately after the first phase as part of a full audit, or we may undertake compliance testing annually of systems we have previously audited because they are fundamental to the council's overall control and remain largely unchanged.
- 5.6. Where the service, system or process has been audited before but is of such significance to the council that further assurance is required over its continued effective operation, we will undertake repeated compliance testing of key controls.

Follow-up work

- 5.7. Where managers can confirm that action has been taken as agreed during a previous audit to mitigate any high or medium risks identified we will seek evidence to support this, but we will not generally follow up actions designed to mitigate only low risks.

Degrees of assurance

- 5.8. The assurance we provide falls into four categories: full, substantial, limited and none.
- Full assurance: there is a sound system of internal control which is designed to meet the service objectives and controls are being consistently applied.
 - Substantial assurance: there is a generally sound system of internal control, designed to meet the service objectives, and controls are generally being applied consistently. However some weakness in the design and/ or inconsistent application of controls put the achievement of particular objectives at risk.
 - Limited assurance: weaknesses in the design and/ or inconsistent application of controls put the achievement of the service objectives at risk.
 - No assurance: weaknesses in control and/ or consistent non-compliance with controls could result/ have resulted in failure to achieve the service objectives.

6. Planning principles

- 6.1. Having identified the requirement to provide an overall opinion on governance, risk management and control process a number of principles guide the decisions regarding the work to include in the annual audit plan. These are set out below and address the practical interpretation and application of professional requirements within the county council.

Internal audit coverage to support an annual overall opinion

- 6.2. An internal audit plan designed to provide the evidence necessary to support an opinion on governance, risk management and control should arguably encompass the following:
- Coverage of the key components of each part of the opinion: aspects of the Council's governance, risk management and control.
 - Sufficient coverage of controls across the Council's operations as a whole, so that a fair assessment may be made across the organisation.
 - Coverage of the controls that serve to mitigate the Council's most significant risks to an acceptable level, and particularly those that operate most widely across the council.
 - Assessment of the actions being taken to develop improved controls in the areas of greatest unmitigated risk.
- 6.3. It will therefore be necessary as a minimum to audit aspects of the Council's governance and risk management processes, as well as a range of control processes.
- 6.4. A control framework applicable to the Council's governance, risk management and control has been drafted and summarised in the diagram shown below. The internal audit plan will be designed to address, proportionately, the coverage required across this controls framework to cover the whole organisation. Where the council achieves its objectives in conjunction with partners we will also seek assurance over the work of those key partnerships.

A framework for governance, risk management and control					
Governance and democratic oversight					
Corporate governance framework	Decision-making		Oversight and scrutiny		Policy setting
Business effectiveness					
Risk management	Performance monitoring and management	Organisational design		Financial governance and planning	Working in partnership with others
Service delivery					
Development and corporate services	Commissioning	Operations and delivery			
		Adult services	Children's services	Community	Public health
Economic development Design & construction Planning & environment	Asset management	Social care Learning disabilities & mental health	Social care Adoption & fostering SEN & disability Traded services	Highways Public & integrated transport Waste management	Health equity, welfare & partnerships Wellbeing, prevention & early help Emergency planning
Service support					
Legal services	Core business systems development		Programme management	Business intelligence	Customer contact
Business processes					
Financial systems and processes		Procurement	Facilities management		Human resources
Budget monitoring		Contract monitoring and management	Information management		Payroll processing
Investment			Business continuity		ICT systems

Relationship to the risk management process

- 6.5. A risk-based audit plan will take into consideration the risks assessed as most significant by the organisation's managers, and should seek to provide assurance over the operation of the controls that serve to reduce the most significant risks to the greatest degree. This information will be taken from the council's corporate and service-based risk registers.
- 6.6. The corporate risk register provides a snapshot at any point in time of the matters that present the greatest unmitigated risk to the council. They are therefore matters that the Council's Management Team will be working most actively to manage but they will not yet be regarded as adequately or effectively controlled. These are areas over which advisory work may be more appropriate than assurance.
- 6.7. Using risk registers prepared by individual services and working with the council's managers we aim to identify the areas with the greatest inherent risk, but where these risks are regarded as having been effectively mitigated by strong controls. These are the controls on which the council is placing the greatest reliance and over which it therefore needs the greatest assurance.
- 6.8. The outcome of our work is primarily assurance that controls are adequately and effectively designed to mitigate risks to the Council's objectives, but also pragmatic action plans intended to enable managers to mitigate risk where the council remains exposed to an unacceptable degree of risk. The judgement regarding what degree of risk is acceptable is for the council rather than the Internal Audit Service to make. Where action plans have been agreed we will follow them up and assure the Committee that action is being taken.
- 6.9. The audit plan will therefore be focussed on the key areas of risk to the Council, which may alter during the course of the year. It will be flexible and individual assignments may be added to it, or removed from it over time.

The audit response to significant risks known to be not acceptably mitigated

- 6.10. The requirement for audit assurance arguably depends on whether or not risks are regarded by management as being mitigated to an acceptable degree. An internal audit function would normally aim (as a minimum) to substantiate assertions by management that an organisation's risks are adequately and effectively controlled but, where a management team is unable to make such an assertion it is highly unlikely that an internal audit would conclude any more positively. Similarly, where risks are recorded on the corporate risk register as being inadequately mitigated they are by definition subject to work by the organisation's most senior managers and any internal audit assurance work is unlikely to conclude that the service, system or process is as yet subject to adequate or effective control. Therefore, where management is unwilling to provide positive assurance, the internal audit service will not generally plan any other assurance work. However this negative assurance will inform the head of internal audit's overall opinion.

- 6.11. The Internal Audit Service may instead plan to provide consultancy to support the organisation and its managers, rather than assurance, in these cases as set out in paragraph 5.4 above.
- 6.12. There are a number of areas where management is continuing to make control improvements during 2017 and 2018. The plan will therefore need to be flexible and may be amended during the year. Large areas of the council that are subject to further significant improvement work include:
- Actions to stabilise and secure the council's financial position, including further cost-cutting measures and service reductions.
 - Children's social care, as action is taken in response to on-going monitoring visits by Ofsted.
 - Adults' social care, as the service works with Newton Europe to reconfigure the way it operates, and is restructured.
 - The transition of service users between children's and adult's social care support services.
 - Implementation and operation of the council's ICT strategy.
 - Asset management, following the implementation of new systems to manage highways and property assets.
 - Improved financial systems, in particular the council's income and debt collection, and payments to suppliers of social services.

The council's 'lines of defence'

- 6.13. The Internal Audit Service is only the council's third line of defence in a model that represents management as the first line, responsible for directly assessing, controlling and mitigating risks; and any in-service compliance function that confirms these controls as the second. For example the social care services impose independent compliance checks on front-line staff and their managers to ensure that social work is adequately supervised and its quality regularly checked. Where such 'second line' compliance functions are available, we focus our audit work on assessing the control exerted by them rather than on repeating their work.

Period covered by the audit plan

- 6.14. Because the overall opinion covers a twelve month period, the evidence to support it must relate to the controls in operation for that period. The plan therefore chiefly addresses work for just one year, but projections may be made into audit requirements for future years. The work in any annual plan will rarely be fully complete at the end of the year but we will always plan to report on the year's work by the time the council prepares its annual governance statement shortly after the year end.

Other sources of assurance

- 6.15. There may be other sources of assurance available to the committee and Council from external organisations, for example the external auditor or Ofsted, and when we become aware of such assurance we will not duplicate work in that area but will take it into account if it is relevant to the overall

opinion on governance, risk management and control. We will ensure as far as possible that the committee is made aware of such assurance.

Internal audit sponsorship and auditors' engagement with management

- 6.16. We need to direct our audits to individuals who are able to sponsor the work and take responsibility for any remedial actions required to mitigate any unacceptable risks: these will normally be the council's directors. We therefore need to work with the council's directors, but also the heads of service and key managers, to scope our work and agree the audit outcomes.
- 6.17. Where controls are operated by BT Lancashire Ltd (BTLS) to manage the council's risks then, by agreement, we will work with the relevant directors within BTLS to provide assurance over the controls the council relies upon in the same way as if the controls were operated by the county council itself.
- 6.18. Some business processes are the responsibility of more than one service area and, where processes span more than one service, we may plan a short series of individual but connected audits. These may in turn require sponsorship at a more senior level within the organisation and we will consult the Management Team on the best way to approach such work.
- 6.19. The Internal Audit Service has no specific in-house expertise in the specialist area of technical ICT audit work. It is already working with BTLS to identify appropriate sources of assurance and this will continue into 2017/18.

Funding and grant certification work

- 6.20. The Internal Audit Service is required as part of the funding requirements of certain central government departments to certify certain aspects of the way funding has been spent. This provides little direct assurance to the county council but is necessary to secure elements of its funding.
- 6.21. We are aware of the testing requirements imposed by the Department for Work and Pensions on its Troubled Families Programme and are working with the Wellbeing Prevention and Early Help Service to process funding claims under this programme.
- 6.22. We are also aware of the need to certify funding claims in relation to capital improvements to the county's highways and also various strands of economic development. However although we make some efforts to understand what funding may be subject to certification, new requirements occasionally emerge during the year.

7. Inputs to the planning process

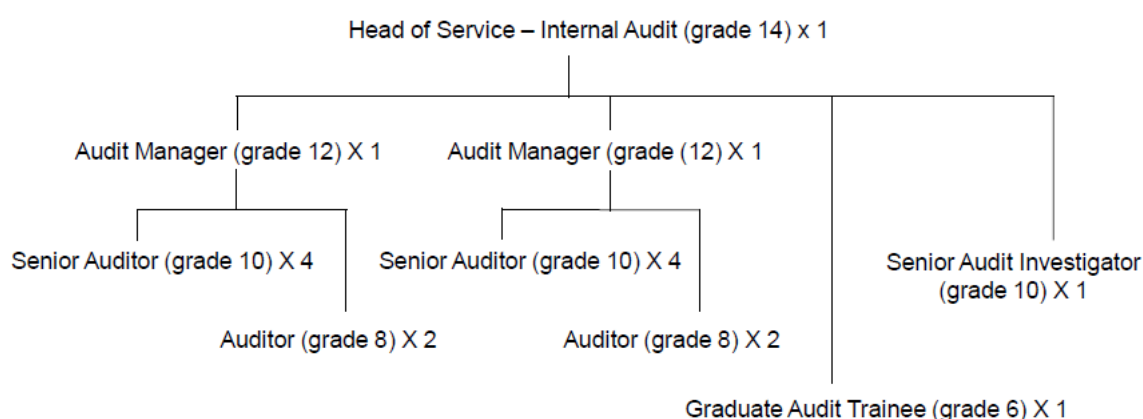
- 7.1. At this point some consultation has taken place with some members of the council's Management Team, directors and heads of service. However further discussion will be necessary to ensure a fuller understanding of the risks to the council's services and the areas that will be most appropriately subject to detailed audit work. Discussions have been arranged with a number of key directors and managers and will take place over the coming weeks.
- 7.2. The Internal Audit Service has regular access to Management Team's agendas and papers, and access on request to the papers of the council's other management teams, including service risk registers. These will be

reviewed in more detail and will support the forthcoming discussions with directors and managers. Management Team regularly considers financial reports from the director of resources which set out the expenditure in each of the council's services, and these provide an indication of the scale of the services as well as the council's financial position. Information from the new team set up to monitor and control the council's staff resources has also been obtained and likewise provides an indication of the scale of the council's services in terms of the numbers of staff employed.

- 7.3. During the last year the council's risk management process has been formalised and risk registers are now routinely available for each of the council's services, as well as being prepared at a corporate level. These registers will be reviewed to identify the risks that individual services assess as most significant and the controls that mitigate these. We will also identify the services that are inherently the most significant to the council in terms of their budgets and numbers of staff.

Audit resources

- 7.4. The plan will also take account of the internal audit resources available and, for the first time in some years, the service will start the year with all the posts in its establishment filled. Having been restructured, the service now employs 17 staff as follows:



8. Internal audit work for the first quarter of 2017/18

- 8.1. Work is nearing completion on a number of audits in the previous plan and draft reports have been prepared but will be finalised relating to:
- Corporate performance monitoring.
 - Oversight by the council of schools' financial management.
 - The accounts payable system.
 - Controls over VAT levied and paid by the council.
- 8.2. Work has only recently begun or is continuing on audits in the previous plan, relating to:
- Compliance with the scheme of delegation to officers.
 - The effective operation of the Audit and Governance Committee.

- Specific aspects of the Council's oversight of the pension fund.
 - The escalation of matters of matters of strategic or political importance, specifically within areas of children's services.
 - The identification of and responses to external feedback on children's services and schools.
 - Data held on the Lancashire Adult Services system.
 - Case management in adult social care, specifically the assignment of officers to cases, timely completion of action, and delegation of responsibilities to accredited social workers.
 - The commissioning, design and monitoring of the capital programme. Work during 2016/17 has covered the first phase of our audit process but will continue into 2017/18, when controls testing will take place.
 - The administration of the Pension Fund to serve its members.
 - The management of the Pension Fund's investments.
 - Treasury management of the council's funds.
- 8.3. By agreement with directors and key managers where necessary, we will undertake or extend work previously set out in the plan for 2015/16, 2016/17 and beyond as follows:
- Further compliance testing of risk management, especially as the new system becomes further embedded and the procedures are amended to address the practical issues that arose during the first year of operation.
 - Completion of the audit of the operation of the Audit and Governance, and work with the new administration to implement any amendments to the committee's operation, for example to its terms of reference.
 - Continuation of the audit of the commissioning, design and monitoring of the capital programme into the second phase of the audit process – testing the effectiveness of the controls documented in 2016/17.
 - Audit of the operation of the Premises Compliance Team in strategic premises management and the council's compliance with applicable legislation.
 - Continuation of the audit of controls over the council's over, and ensuring the alignment of, the council's establishment and budgets.
 - Revision of the full audit, and follow up of the action plan to address, accounts receivable and debt management.
 - Full audit of the accounts payable system, particularly in respect of payments to providers of both adults' and children's social care and the linkages with the Liquidlogic software.
 - Compliance testing of the more stable financial systems, and extension of full audit work to more of the feeder systems.

- Audit of the effectiveness of inputs to the payroll processing system, following work by the council's Human Resources service and BTLS to improve these.
 - Certification of the Growth Hub funding to the Lancashire Enterprise Partnership as required by the terms of the grant from the Department for Business, Innovation and Skills.
- 8.4. New audit work, not yet begun or discussed in any detail with the council's managers, could be undertaken if this can be accommodated in the following areas:
- The way that contracts are monitored by services across a sample of key contracts.
 - The use of agency workers, focussing particularly on their employment (and tax) status and references.
 - Audits of the identity checks undertaken on potential service users before access is granted to a sample of services.
 - Compliance with the council's policies relating to the use of closed circuit television and other public or covert surveillance.
- 8.5. A much fuller assessment of the work of the Internal Audit Service for 2017/18 will be brought to the Audit and Governance Committee at its meeting in June 2017, after further discussions and agreement with the council's Management Team, directors and heads of service.
- 9. The Internal Audit Service's responsibilities in relation to fraud and investigations**
- 9.1. In addition to our audit work the Internal Audit Service provides support to the council's management team in managing the risk of fraud. It provides an investigatory service to support management in responding to instances of suspected fraud or impropriety and also undertakes proactive work to identify and pursue indications of potentially fraudulent activity, both through corporate systems testing and through additional testing of other areas particularly susceptible to fraud.
- 9.2. There are some synergies in the skills required of both internal audit and investigations work, and the information arising around the investigation of allegations of fraud or impropriety may also indicate potential lapses in controls or of the culture of the organisation, which are of interest to internal auditors.
- 9.3. Our audit plan will integrate our assurance work (specifically our compliance testing) with our proactive counter fraud testing, particularly in areas susceptible to fraud and misappropriation of assets. In particular we have recently been provided by a large number of data matches to investigate under the National Fraud Initiative and will work to understand the reasons for these matches throughout the course of the year.