

**Audit Management Team**

**30<sup>th</sup> June 2011**

**Strategic Audit Plan & Annual Internal  
Plan 2011/12**



Report of Manager of Internal Audit & Risk

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**Don McLure, Corporate Director, Resources**

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**PURPOSE OF THE REPORT**

1. The purpose of this report is to:
  - Outline the audit strategy to implement a risk based approach to internal audit to help provide assurance on the effectiveness of risk management across the Council at both a strategic and operational level.
  - Update management with progress made in developing an assurance framework for the Council to help improve the Council's corporate governance arrangements and inform strategic audit plans.
  - Outline the overall strategy for developing strategic and annual audit plans.
  - Present a draft strategic audit plan for the Council to outline how the audit strategy is to be delivered as part of a rolling programme of planned assurance reviews.
  - Present an annual plan for the period July 2011 to June 2012 for approval

**BACKGROUND**

2. The Accounts and Audit (England) Regulation 2011 requires the Council to, "undertake an adequate and effective system of internal audit of its accounting records and its system of internal control in accordance with the proper practices in relation to internal control". The Council has delegated this responsibility to the Corporate Director Resources and the Internal Audit & Risk service carry out the Internal Audit Role.
3. The guidance accompanying the legislation states that proper internal control practice for internal audit is that contained within the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom. This Code

specifies the requirement to adopt a risk based approach to internal audit. The Code also requires the Head of Internal Audit to give an annual opinion on the adequacy and effectiveness of the whole of the council's risk management, control and governance processes.

4. The Institute of Internal Auditors (IIA) define internal auditing as,

“An independent objective assurance and consulting activity designed to add value and improve organisations operations. It helps an organisation accomplish its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management and control and governance processes”.

### **RISK BASED INTERNAL AUDITING (RBIA)**

5. The audit strategy and terms of reference for the audit service are detailed in the Internal Audit Charter approved by Audit Committee and the Corporate Management Team in October 2010 and reflects a risk based approach to internal auditing (RBIA) as required by the CIPFA Code.
6. Internal Audit aims to provide a reasonable level of independent review of the organisation's risk management, control and governance systems through periodic audit plans in a way which affords suitable priority to the organisations objectives and risks.
7. RBIA is an approach that can help to meet these objectives as its helps to embed risk management and internal control into the culture of the organisation.
8. The objective of RBIA is to provide independent assurance to management that:
  - Risk management processes which managers have put in place (covering all risk management processes at corporate, directorate, service and process/system level are operating as intended.
  - The risk management processes are of sound design
  - The responses which management has made to risks which they wish to treat are both adequate and effective in reducing risks to an acceptable level.
  - And a sound framework of controls is in place to sufficiently mitigate risks which management wished to treat.
9. RBIA starts with business objectives and then focuses on those risks that have been identified by management that may hinder their achievement.
10. The role of internal audit is to assess the extent to which a robust risk management approach is adopted and applied, as planned, by management

across the organisation to reduce risks to a level that is acceptable by management.

11. While internal audit's main support is to provide assurance on management's treatments of risk (through governance and control purposes) it may also advise management on other aspects of their responses to risks such as decisions to terminate, transfer or tolerate risks.

### **Strategic Audit planning**

12. The starting point for developing risk based internal auditing is our strategic planning. Those charged with corporate governance need assurance that both strategic and operational risks across all service activities are being managed effectively and our strategic audit plans should reflect this.
13. One of the audit objectives of internal audit is therefore to assess the effectiveness of processes in place for the identification and assessment of risks. This helps to provide assurance that corporate and service strategic risk registers reflect all appropriate risks. This objective needs to be reflected in our planning processes.
14. In preparing our strategic plans we therefore need to understand the Council's:
  - Strategic aims and objectives
  - Business as usual or process objectives (operational objectives)
  - Corporate governance arrangements and the control environment
  - Key risks that may impact on the achievement of strategic and operational objectives
  - Other sources of assurance by which those charged with governance gain confidence that key risks which may impact on the achievement of objectives are effectively identified, assessed and managed.
15. In considering these factors the following observations were noted:
  - The corporate and service strategic aims and objectives of the Council are set out in its Council Plan and Service Plans.
  - The Council's risk management strategy and policy outline the Council's approach to the management of corporate and service strategic risks. Corporate and service strategic risks, the business risks to the achievement of corporate and service strategic objectives, should be documented within corporate and service strategic risks registers.
  - Risks identified in service plans should be reflected in risk registers given the close relationship between strategic performance management and strategic risk management.

- The risk management process provides some assurance on the identification and assessment of business risk. However, whilst providing challenge to the adequacy of controls identified to mitigate identified strategic risks, no assurance is provided that controls are adequate and/or effective. Nor does the risk management process provide any assurance on the management of operational risk.
- Unlike strategic risks, there is no corporate strategy or policy in place for the assessment or documentation of operational risks. Processes in place for the identification and assessment of operational risk will therefore vary from service to service and system to system.
- Where risk management is well embedded, operational risks may already be documented assessed and controls documented. Where it is not, operational risks and controls are unlikely to be documented. If controls are not documented there are unlikely to be management processes in place for providing assurance on their effectiveness.
- Service plans primarily focus on planned improvement of services to meet the strategic objectives of the Council. Business as usual activities are not generally captured within Service plans.
- There is no assurance framework in place that maps out potential sources of assurance on the effective management of risks.

16. Audit resources are limited and therefore our strategic plans need to identify other potential sources of assurance and their reliability to avoid duplication, identify any gaps and target audit resources to those high risk areas where there is little or no assurance.

### **Development of an Assurance Framework**

17. In view of the above observations an assurance mapping exercise has been carried out in consultation with service managers. The background and the approach adopted to develop an assurance framework for the Council is outlined in Appendix 2.

### **Problems associated with the Assurance Mapping exercise**

18. The timing of the exercise coincided with the development of the MFTP and new service improvement plans. In some service areas, given the nature of the service, the gathering of information was seen as a duplication of effort as some of the information relating to service objectives was reflected in the new service plans.

19. It was therefore agreed with management that the exercise would be postponed until such time as the MFTP and service plans were complete so that information could be extracted direct from these wherever possible.

20. As a consequence of this it was also agreed that the timetable for preparing annual audit plans be moved to reflect plans beginning in July rather than April. An interim 3 month plan covered the period ending 30<sup>th</sup> June was agreed pending this move.
21. Using a combination of information from the new service improvement plans, returned questionnaires, interviews held with service managers and internal audit's own data sources, general details of key service activities have been identified and links to corporate objectives established.
22. However, it has not been possible to apply audit need risk criteria to activities as intended as:
- The level of detail as to what was considered to be a key service activity varied considerably across service groupings.
  - Risk information was incomplete or inconsistent and was not sufficient to allow an adequate assessment of the risk or the expected control environment in one area to be scored against that in another area.
  - Budgets had not always or could not be determined for each service activity identified.
  - Whilst some key assurance sources were identified by services to allow an assurance framework to be mapped, (attached at Appendices 3), insufficient information is currently available to assess the extent of assurance provided on the control environment and/ or the reliability of the assurance source provider.

## **AUDIT STRATEGY**

23. The audit strategy applied to the development of our strategic plans and the resultant 2011/12 plan aims to provide balanced assurance over the effective management of strategic risks (business risks) and assurance on the effectiveness of the control environment as a whole, including the on-going management of operational risks.
24. The identification of key service activities through the assurance mapping exercise has provided a basis for the development of a strategic audit plan to allow systematic assurance on each key service activity to be provided as part of a rolling programme of audit assurance reviews over a number of years.
25. The approach adopted is summarised below:

## Assurance Work

26. Assurance on operational risk management is to be provided on each key service activity through a 3/5 rolling programme of governance reviews. Governance reviews may also include providing assurance on strategic risks if applicable.
27. Each service activity governance review aims to provide assurance on the effectiveness of risk management by reviewing arrangements in place for identifying, assessing and responding to potential key risks across the whole control environment defined under the following categories (If applicable) :
- Performance Management
  - Financial Management
  - Legislation
  - Procurement and Contracts
  - Partnerships
  - Project Management
  - People and Culture
  - IT and Systems
28. In preparation of each governance review, reference will be made to strategic risk registers and operational risk registers, if in place, to identify any known risks and the expected control framework in place. Discussions will then be held with key officers to help identify and assess any existing sources of assurance and to help identify any potential additional risk or expected controls using a Control Risk Self Assessment (CRSA) process. Detailed terms of reference, informed by the outcome of the CRSA process, will then be agreed with the nominated key contact to confirm the agreed risks and scope of audit coverage. CRSA documentation will be updated with details of actual controls in place, together with any agreed actions to improve controls, following each audit to aid future self assessments and the monitoring of the effectiveness of the control environment in managing identified risks.
29. The timing of service activity governance reviews will be determined wherever possible with reference to the timing of other known assurance sources, (e.g. scrutiny and overview work programmes, external audit/inspections, previous internal audit coverage or planned audit coverage of related key systems/processes), and any known potential risks that may influence the timing e.g. the impact of efficiency measures included on the MTFP, links to corporate strategic risks or concerns raised by managers.
30. Where risks and control frameworks are well defined and there is evidence that risks and controls are regularly monitored, the scope of audit work will be very light touch, reliance being placed wherever possible on other sources of assurance to avoid any unnecessary duplication. Where this is not the case and the area is considered high risk or there is little or no other source of assurance, additional more specific reviews may need to be programmed. Depending on the potential risks and the availability of audit resources, this may be within the current year or a future year.

31. Assurance on corporate financial risk management will be provided every year as part of rolling 3 year programme of assurance on the key financial systems/sub systems. This area is subject to more regular review because of the risk associated with the failure to maintain accurate financial records.
32. Assurance on the risks associated with core governance processes or systems to be provided every year as part of rolling 3 year programme of assurance reviews with further assurance on compliance being provided wherever possible through all planned assurance review because of the risk associated with the failure to embed on effective culture of good governance.
33. Assurance on strategic risk management is to be provided through specifically targeted reviews of strategic risks where it is considered more appropriate to do so e.g. corporate strategic risks. Priority will be given to those risks which have a high gross score and a low net score, where the effective management of the risk is heavily dependent on the identified controls, and there is little or no other planned source of assurance.
34. Assurance on the effectiveness of the risk management process itself will be provided through the audit approach to be applied to all planned assurance reviews. In helping to embed effective operational risk management through the development of CRSA at the planning stage of individual audits, some assurance that corporate and service strategic risk registers reflect appropriate risks will also be provided.
35. In all assurance work, Internal Audit will aim to place reliance on other sources of assurance to eliminate any potential duplication. Audit resources allocated to an individual assignment will be prioritised to provide assurance on high risk areas where there is little or no assurance that controls are effective in reducing risks to an acceptable level. These areas will be identified through the CRSA process and agreed with the key contact at the planning stage of each audit assignment.
36. No routine cyclical compliance/establishment probity reviews are to be undertaken unless statutory requirement or to address specific identified risk e.g as a result of a fraud or irregularity or management concern.

### **Counter Fraud Work**

37. The risk from fraud and corruption is a recognised strategic risk. The service will continue to promote the Council's Counter Fraud Strategy and associated policies and procedures through corporate initiatives to raise awareness.
38. A risk based counter fraud programme of targeted reviews will be carried out each year to detect and prevent fraud in identified risk areas. This work will be informed by local and national risk assessments such as the Audit Commission's publication, "protecting the public purse". The risk of fraud and corruption will also be considered as a potential risk in all other planned assurance work.

39. A contingency provision will be made for support to service managers in the investigation of potential fraud and irregularities, disclosed through audit work or reported by other sources.

### **Grant Certification Work**

40. The service continues to act as independent assessors of grant claims where required. Wherever possible the cost of such work will be recharged to the relevant funding body or spending service.

### **Follow Up**

41. Provision will be made in annual plans to provide assurance that management responds appropriately to address agreed weaknesses in controls, identified through the audit process, which may increase the impact or the likelihood of risk occurring above an acceptable level.

### **Monitoring and Reporting**

42. Provision will be made within the plan for monitoring the delivery of the agreed plans to the required professional standards and for reporting progress to Corporate Directors and the Audit Committee on a quarterly basis. This reporting mechanism will also allow a regular forum for consideration of new or emerging risks.

### **Advice and consultancy role and contingency provision**

43. Given the extent of the transformation and change agenda with which the Council is faced at this time, it is important that audit plans are flexible and allow for the service to be pro active in supporting management in the consideration of control issues relating to new or emerging risks. Consequently it is proposed that only 70% of estimated audit resources available each year is to be allocated to the areas specified above. The remaining 30% will be set aside as a contingency provision to respond to:

- New and emerging strategic risks identified through the corporate risk management process
- New and emerging operational risks identified through consultation with Corporate Directors as part of the quarterly progress monitoring and reporting process
- New and emerging risks identified through undertaking planned assurance reviews
- Support in the development and implementation of projects, processes or new initiatives
- Ad hoc requests for advice and guidance
- Known weaknesses in the control environment identified through fraud and irregularity investigations or planned assurance work where additional or follow up work is required.



44. Service requests are encouraged at any time and will be considered in relation to the risk and the type of audit work required e.g. control design and/or compliance assurance, grant certification work, advice and consultancy etc, and whether or not the service has the necessary skills and resources to undertake the work requested.
45. Any proposals to amend approved plans will be discussed with Corporate Directors and any significant changes will be reported to the Audit Committee for approval.

### **STRATEGIC PLAN 2011/16 & ANNUAL INTERNAL AUDIT PLAN 2011/12**

46. A draft strategic plan is attached at Appendix 4.
47. This reflects audit areas identified through the assurance mapping exercise. Internal audit work carried out in the last 2 years, the resultant assurance opinion, and work being undertaken as part of the interim plan is shown to illustrate the extent of audit coverage and the proposed timing of future assurance work.
48. As part of the consultation process on the development of the plan, management were asked to consider:
- Work deferred/ cancelled from 2010/11 in view of the audit strategy and risk based approach outlined above,
  - Any areas of concern and /or specific projects/new initiatives where internal audit could support managers either in providing assurance or in an advice or consultancy role, for example, helping to review business processes following a change in policy or where operational processes may be considered inefficient.
  - Any factors that may impact on the timing of the rolling programme of planned assurance reviews.
49. The resultant 2011/12 annual audit plan is attached at Appendix 5.
50. The estimated gross audit days available for this period are equivalent to 21.5 FTE. Audit days available to deliver this interim plan is illustrated in the table below:

Full establishment	6786	
Less temporary vacancies due to part time work and secondments	650	
<b>Gross Days Available</b>	<b>6136</b>	<b>100%</b>
Less overheads:		
<i>Uncontrollable</i> , e.g. annual leave, bank holidays, sickness, maternity		17
<i>Controllable</i> , e.g. training, divisional/ departmental duties		13
<b>Productive Days Available</b>	<b>4260</b>	<b>70%</b>
Less days to external organisations:		
Durham Police Authority	188	
Durham and Darlington Fire & Rescue Authority	69	
Pension Fund	40	
Durham Joint Crematorium	22	
Mounsett Joint Crematorium	20	
Stanley Bowls Centre	5	
Durham City Charter	5	
Schools Benevolent Fund	5	
<b>Productive Days Available to Durham County Council</b>	<b>3906</b>	<b>64%</b>
<b>Less over - programming built into interim plan</b>	<b>114</b>	
<b>Net Available days</b>	<b>3792</b>	

51. Each area of audit activity has been allocated an audit type which is consistent with the CIPFA Benchmarking Club to allow comparable performance data to be captured and monitored.
52. Once approved, the timing of each assurance review will be allocated to a quarter end period. Any timing requests will be incorporated wherever possible.
53. To enable reporting to be carried out at the financial year end, for opinion purposes and benchmarking, the interim 3 month plan together with the first 3 quarters of the agreed annual plan July to June, will be incorporated into a plan of work to be carried out during the financial year 2011/12.
54. Monitoring of the plan will continue during the year through quarterly progress reporting to provide feedback on delivery and to discuss any new or emerging risks.
55. Work will continue during the year to develop the assurance mapping framework. This will help improve the co-ordination of key sources of assurance and improve the reporting of the outcomes of assurance work undertaken to Audit Committee to inform members understanding of the Council and their evaluation of the effectiveness of its corporate governance arrangements.

## **RECOMMENDATIONS**

56. That the audit strategy to improve the risk based approach to internal auditing and the development of draft strategic and annual audit plans is noted.
57. That the draft strategic plan for 2011-2016 is noted and that the annual audit plan covering the period July 2011– June 2012 is approved.
58. That it be noted that work will continue during the year to monitor and improve draft strategic plans and that consultation on the development of each subsequent annual audit plan will continue as usual as part of the annual planning process.

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**Appendix 1: Implications**

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**Finance**

There are no direct financial implications arising for the Council as a result of this report, although we aim through our audit planning arrangements to review core systems in operation and ensure through our broad programme of work that the Council has made safe and efficient arrangements for the proper administration of its financial affairs.

**Staffing**

None

**Risk**

This report requires no decision and so a risk assessment has not been carried out

**Equality and Diversity**

None

**Accommodation**

None

**Crime and disorder**

None

**Human rights**

None

**Consultation**

None

**Procurement**

None

**Disability Discrimination Act**

None

**Legal Implications**

None

### ASSURANCE MAPPING EXERCISE

1. The development of an assurance mapping framework is needed to help improve the corporate governance arrangements of the Council by clearly demonstrating where and how the Council receives assurance that its business is run effectively and efficiently, highlighting any gaps or duplication that may indicate where further assurance is required or perhaps where assurance could be achieved more effectively.
2. The Council needs assurance to be able to fulfil its statutory responsibility to publish an annual governance statement (AGS) as part of its Annual Statements of Accounts, providing external accountability for how the Council conducts its business.
3. The Audit Committee approves the AGS on behalf of the Council and therefore has responsibility for seeking assurance on behalf of the Council that the Council's Corporate Governance arrangements are effective. To fulfil this role the Committee need to consider that assurance they need, how they get and how reliable it is.
4. An assurance questionnaire was developed and issued to each head of service asking that these be completed for each key operational service activity or system. The purpose of the completion of the questionnaire by the relevant service manager was to identify:
  - Key service activities and objectives
  - How each key service activity supported the delivery of Council's strategic aims and objectives
  - All potential risks which may impact on the achievement of identified objectives
  - Ways in which management gained assurance that potential risks were been managed effectively
  - Activities on which managers required further assurance e.g. where there is little or no assurance available.
5. Assurance mapping templates were developed for each directorate to capture the data from the questionnaires.
6. Each key service activity on which assurance is required represents a potential audit area; collectively the audit universe. In order to determine the priority for audit coverage, an audit need risk assessment was to be carried out using a scoring mechanism based on the following criteria:
  - Links to Council Aim and Objectives
  - Assessment of Identified Risk
  - Significance of service activity in terms of resources (budget)

- Assessment of maturity/effectiveness of the control environment
7. The gross score for each activity was then to be offset by an assessment of other sources of assurance disclosed through the assurance mapping exercise.
  8. Net scores associated with each service activity were then be used to populate a 3/5 year strategic audit plan.