

Report to: Governance and Audit Committee

Date: 29 March 2018

Subject: **Strategic Internal Audit Plan**

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1 Purpose of this report

- 1.1 To approve the strategic internal audit plan commencing 1 April 2018.

2 Information

- 2.1 This report seeks approval of the strategic internal audit plan and considers options and evaluates the benefits and weaknesses of models for the provision of internal audit within West Yorkshire Combined Authority.
- 2.2 UK Public Sector Internal Auditing Standards, (PSIAS) require the Chief Audit Executive to deliver an annual audit opinion and report that must be used by the organisation to inform its annual governance statement. The internal audit opinion must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. Work undertaken within the audit plan is the principal body of evidence required to substantiate the opinion provided by internal audit. In addition, PSIAS state that the Chief Audit Executive must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organisation's objectives.
- 2.3 Internal audit has developed an approach which has led to the production of a strategic plan, phased over a rolling three year period. This allows greater flexibility in terms of the frequency and depth of audit assignments undertaken and can be used to quantify both short and medium term assurance resourcing requirements. Nevertheless, it will be necessary to review the plan both in year and on an annual basis, to consider changes in organisational risk and assurance requirements.
- 2.4 A consultation programme has been conducted with senior officers from within the Combined Authority and with elected members and the independent member of the Governance & Audit Committee. This has provided a valuable

insight into stakeholder assurance requirements and has contributed to the development of the plan.

- 2.5 The plan is presented under corporate risk categories with clear links to directorate objectives which support the attainment of corporate priorities. The plan also incorporates regulatory and compliance requirements along with, counter-fraud and audit follow up activities. This will seek to provide assurance that the governance and control arrangements continue to operate effectively, minimising the risk of misappropriation, loss and error and that key systems and processes are operating as intended. In addition, allowances for value for money and consultancy activities are provided to allow internal audit to support organisational development and process improvements.
- 2.6 Indicative resource allocations for each audit entity are provided, based on previous audit performance in conjunction with an initial assessment of the scope of each review. The depth of audit testing is established through the evaluation of risk and considers the existence and operation of key controls. Where new areas of assurance have been identified the number of days required to perform this work is determined from an initial overview of these areas and from discussions with senior officers from within the relevant directorates. The plan requires 465 audit days in 2018/19 and 457 days in 2019/2020 and 2020/21. Assurance allocations per risk category are represented as:

| Risk Category | 2018/19 | 2019/2020 | 2020/21 |
|--|----------------|------------------|----------------|
| Financial Risk - <i>Risk of failing to manage finances in accordance with public sector accounting requirements and funding constraints.</i> | 70 | 63 | 70 |
| Legal Compliance Risk - <i>Risks arising from non-compliance with legislative requirements.</i> | 30 | 35 | 30 |
| Governance Risk - <i>Risk that losses or organisational performance is compromised as a result of unclear authorities, structures and accountabilities</i> | 51 | 58 | 41 |
| Operational/ Risk - <i>Risk of impaired service delivery resulting from inadequate or failed internal processes and systems, error and deficiencies in the performance of external suppliers and stakeholders.</i> | 51 | 38 | 53 |

| Risk Category | 2018/19 | 2019/2020 | 2020/21 |
|---|---------|-----------|---------|
| Delivery Change Risk - <i>Risk that programmes and projects are not delivered in time, within budget and do not deliver agreed benefits. Risk of fraud, misappropriation of funds</i> | 55 | 55 | 55 |
| Information and Communication Risks - <i>Failing to provide sufficient, appropriate, consistent and timely information to key internal and external stakeholders.</i> | 16 | 16 | 16 |
| Data Security/Data Protection Risks - <i>Failure to adequately maintain and protect business critical data and appropriately, hold sensitive personal information</i> | 35 | 35 | 35 |

- 2.7 The strategic internal audit plan is attached in full as **Appendix 1** to this report.

Current Service Provision

- 2.8 It is important that the level of activity required to enable an independent opinion to be determined on the Combined Authority's control environment, risk management and governance arrangements is undertaken. The internal audit service is currently provided by a small in-house team headed by the Internal Audit Manager plus three Internal Auditors. The cost of providing the function, based on the present approved establishment in 2018/19 is £151,483. Sections 2.9 to 2.18 of this report considers options and evaluates the benefits and weaknesses of models for the provision of the internal audit function within the West Yorkshire Combined Authority.

Delivery Models

In house team

- 2.9 The Combined Authority has operated to date with an experienced and qualified internal audit function. There are a number of advantages to this approach including, a depth of knowledge of the organisation, ability to respond quickly to management requests, availability to provide consultation/ad-hoc advice, insight into organisational risk management activity, including the early identification of emerging risks and how this informs the assurance process.

- 2.10 An important advantage of the internal sourcing model is that it provides the arena for developing staff within the organisation. Members of the internal audit department are trained on various functions within the organisation and obtain a comprehensive understanding of the key risks and challenges. Other advantages include a higher level of ownership of the internal audit function and a better understanding of the organisation that enhances learning, improves the overall effectiveness of the function and permits internal auditors to nurture the relationships with various process owners.
- 2.11 There is a unified internal audit plan and an agreed audit methodology and, if need be, discussion and decisions can be made quickly to adapt the plan. Having an internal audit team gives internal audit a clear identity and profile and it is part of the organisation's culture. It allows the building and retention of knowledge relating to the Combined Authority which enables internal audit to be valued by the business areas. Finally, the annual budget is part of the organisation's costs and means that people who want advice and guidance on a consultancy basis don't have to be afraid to ask for it on the grounds of cost. This helps to reinforce the message that risk management and control are important.
- 2.12 The key disadvantage of the internal sourcing model is the difficulty internal auditors face in acquiring or maintaining the depth and breadth of specialised skills. This is particularly pertinent for a small team. Also, continuous investment in the in-house internal audit department is required with respect to training, recruitment and the technology used.

Co sourcing

- 2.13 In an internal audit co-sourcing model, management retains control over the internal audit function while at the same time leveraging the internal audit resources of the third party service provider, which provides access to valuable and diverse specialised skills as needed. This allows the organisation to retain control over the service and provides access to increased depth of resource and specialisms. This model encourages managers and employees to take an interest in internal audit from the perspective of contributors. The internal audit function is able to contract and expand to reflect fluctuations in demand.
- 2.14 One of the main deficiencies of the internal audit co-sourcing model is that it requires continuous coordination from the organisation to ensure seamless delivery of the internal audit services, as the responsibility of managing the internal audit function remains with the organisation. Considerable investment is required to ensure the required organisational knowledge is retained and successfully transferred.
- 2.15 There are two methods of providing co-sourcing. The first includes the establishment of a core internal audit team, led by the Head of Internal Audit. Members of this team are essentially audit generalists. A partner provides subject matter specialists and covers any resourcing gaps in the in-house

provision. In the second method the Head of Internal Audit is provided in-house but a partner provides the core internal audit team and audit specialists.

- 2.16 Whichever method is selected it is important to ensure that accountabilities and responsibilities (on both sides) are clearly set out in the contract. The organisation needs to establish how it expects the relationship to operate including the frequency of meetings, attendance at Audit Committee, set expectations of time and personnel on site, quality assurance requirements and audit methodology applied. In addition issues relating to communication and reporting lines between the audit function and service provider, and wider business need defining.

Outsourcing

- 2.17 The key benefit of a fully outsourced internal audit service model is that the service provider is ultimately responsible for the internal audit function however, management direction may be limited but is still required. It is likely that the outsource provider will have a wide access to skills and specialisms and responsibility for recruitment and training costs will reside with the provider. There is the prospect that organisational independence may be perceived to be improved.
- 2.18 The main drawback of this option is that expertise does not reside in-house and accordingly, there is a limitation on the ability to transfer knowledge and build the capabilities of the internal audit function within the organisation. There may also be a perception that responsibility for internal control, risk and governance has been transferred outside the organisation and a lack of in-depth understanding of activities reviewed. The perceived quality and skills provided may, in reality, be lower than anticipated. There is a risk that costs may increase unless the scope of engagement is tightly framed and monitored. Finally, independence may be compromised due to management influence on renewing contracts.

Proposed Delivery Model

- 2.19 It is proposed that a model which retains a dedicated internal team but allows for the procurement of identified external audit specialisms will provide the most effective means of delivering the internal audit function to the Combined Authority. These specialisms may be procured on the open market or through a service level agreement with another local authority internal audit function.
- 2.20 It is also necessary to provide improvements to the structure of the internal delivery team to allow increased emphasis and focus on strategy, planning, delivery, reporting, and performance whilst providing greater flexibility and resilience within the function.
- 2.21 To achieve these objectives it is proposed that the post of the Head of Internal Audit be redefined. The key responsibilities of this role would be for setting and delivering strategic objectives and plans, developing and leading the service, developing policies, monitoring and ensuring the adequate resourcing

of the function, liaising with key stakeholders including the Governance & Audit Committee and the Combined Authority's Leadership Team and providing commentary on the status of the organisations control environment, risk management and governance arrangements. The post will also lead on counter-fraud initiatives and investigations and meet statutory requirements by being the Combined Authority's Responsible Officer - this is the person, appointed with overall responsibility for maintaining and operating this whistleblowing policy nominated contact for reported incidents and money laundering reporting officer.

- 2.22 A post of Principal Auditor would allow the day to day supervision of work undertaken within the audit plan to be undertaken and allow capacity to undertake a number of more complex reviews within the plan. In addition, this post would be responsible for ensuring the implementation and operation of internal audit quality processes, determining the scope of audit assignments t and liaising on audit findings, monitoring the progress of management in implementing audit recommendations and deputising for the Head of Internal Audit when necessary.
- 2.23 Internal auditor post(s) will perform the bulk of audit testing under the direction of the Principal Auditor. These are audit generalists roles and would include participation in the audit planning process, performing audit testing, participating in audit closures and the completion of internal audit reports to draft stage. These roles may be suitable for employees appointed through the Combined Authority's apprenticeship scheme. The internal team would then be supplemented by external specialist resource. Further work would be required to identify the most appropriate mix of directly and indirectly employed resource.
- 2.24 This approach will allow the necessary number of audit days required to deliver the audit plan in each of the three years of the strategy to be delivered, as well as ensuring the required skills to be secured.

3 Financial Implications

- 3.1 The costs of resourcing the current internal audit establishment are identified at £151,483. These include on-costs for employers National Insurance and pension contributions and are set at the top of current grading bands.
- 3.2 Costs will need to be established for any preferred option and an appropriate budget established.

4 Legal Implications

- 4.1 The Accounts & Audit Regulations require the West Yorkshire Combined Authority to maintain an adequate and effective internal audit.

5 Staffing Implications

- 5.1 The preferred option would require the reappraisal of the internal audit structure and roles. Full consultation would take place with any affected staff.

6 External Consultees

- 6.1 No external consultations have been undertaken.

7 Recommendations

- 7.1 That the Strategic Internal Audit Plan be approved.
- 7.2 That the Committee consider the options and determine if it wishes to progress with the proposed option put forward or whether further information is required, for example with regard to costs, in order to reach a decision.
- 7.3 That the Committee determine whether it wishes to consider further detailed and costed options at its next meeting or to delegate a final decision to the Chair.

8 Background Documents

None.

9 Appendices

Appendix 1 - Strategic Internal Audit Plan