

**Lancashire Combined Fire Authority**

**Internal Audit Service**

**Internal Audit Plan: 2018-19**

### **1 Introduction**

- 1.1 This paper sets out a draft plan of work to be undertaken by the Internal Audit Service for the Combined Fire Authority for the coming financial year. The plan amounts to a total resource of 80 audit days, which equates to an overall cost of £26,000 (ex VAT) at our daily rate of £325, which is consistent with prior years.

### **2 The purpose of the audit plan**

- 2.1 Responsibility for maintaining and reviewing the system of internal control and for implementing a system of governance and risk management rests with the Combined Fire Authority. However the process by which the Annual Governance Statement is produced includes obtaining assurances on the effectiveness of key controls and internal audit provides one of the key sources of such assurance.
- 2.2 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 objectives of Lancashire Combined Fire Authority are being adequately and effectively controlled.
- 2.3 The Audit Committee's terms of reference require it to review and approve the internal audit plan. The Committee's views on this proposed plan of work will therefore be welcome.

### **3 Statutory and professional requirements relating to internal audit**

- 3.1 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.

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)*

#### **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, 2017 published by the Relevant Internal Audit Standard Setters*

- 3.2 The regulations therefore establish the requirement for an internal audit function and its provision of an opinion on 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.

#### **4 Internal audit coverage to support an annual overall opinion**

- 4.1 An internal audit plan designed to provide the evidence necessary to support an opinion on governance, risk management and control needs to encompass the following:
- Coverage of the key components of each part of the opinion, namely, governance, risk management and control;
  - Sufficient coverage over operations as a whole so that a fair assessment may be made across the Service;
  - Coverage of the controls that serve to mitigate the most significant risks to an acceptable level;
  - Coverage of the controls that operate most broadly to mitigate the most significant risks in the greatest number of individual instances to an acceptable level; and
  - Follow up of the actions agreed by management to mitigate risks identified through previous audit activity.
- 4.2 Because the overall opinion covers a 12 month financial period, the evidence will relate to the controls in operation for that period.

#### **5 Relationship to the risk management process**

- 5.1 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.
- 5.2 Using the corporate risk register and working with the Director of Corporate Services, we have sought to identify the areas with the greatest inherent risk, where these risks are regarded as having been effectively mitigated by strong controls. These are the controls on which the Combined Fire Authority and

Lancashire Fire and Rescue Service is placing the greatest reliance and over which it therefore needs the greatest assurance.

### **6 The Authority's 'lines of defence' and other sources of assurance**

- 6.1 The Internal Audit Service is only the Combined Fire Authority'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 activity that confirms these controls as the second. 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.
- 6.2 Where it is known that assurance will be provided from another body, (for example, Her Majesty's Inspectorate of Constabulary and Fire and Rescue Service, or the external auditors), the Internal Audit Service will not duplicate work 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.

### **7 The audit approach adopted by the Internal Audit Service**

- 7.1 The Internal Audit Service follows a risk-based audit methodology, working closely with 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. During phase one we establish a framework of risks and controls, which enables us to assess the adequacy of the controls designed to mitigate the risks identified, and during the second phase we test the effectiveness of the controls in operation. The nature of the audit work performed does however vary and can include either or both of these phases.
- 7.2 Whilst a service is in the process of transformation or remodelling we can support the managers in the design of a control framework that will manage the risks to service objectives. This would represent consultancy rather than assurance work.
- 7.3 Where assurance is required over a control system that has not previously been audited in its present form we undertake a full review including both audit phases, and we will provide an opinion on both the adequacy of design and the effectiveness in operation of the controls in place.
- 7.4 Finally we may undertake compliance testing annually of systems we have previously audited because they are fundamental to the overall control framework.
- 7.5 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 other than obtaining management assurances, we will not generally follow up actions designed to mitigate only low risks.

**8 Degrees of assurance**

8.1 For 2018-19 we are revising the way in which we categorise our assurance levels. The previous and revised definitions (of equivalent value) are shown below for information:

Previous definitions and categories	Revised definitions and categories
<p><b>Full assurance:</b> There is a sound system of internal control which is adequately designed to meet the service's objectives and is effective in that controls are being consistently applied.</p>	<p><b>Substantial assurance:</b> the framework of control is adequately designed and/ or effectively operated.</p>
<p><b>Substantial assurance:</b> There is a generally sound system of internal control, adequately designed to meet the service's 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.</p>	<p><b>Moderate assurance:</b> the framework of control is adequately designed and/ or effectively operated overall, but some action is required to enhance aspects of it and/ or ensure that it is effectively operated throughout the service, system or process.</p>
<p><b>Limited assurance:</b> Weaknesses in the design and/ or inconsistent application of controls put the achievement of the service's objectives at risk.</p>	<p><b>Limited assurance:</b> there are some significant weaknesses in the design and/ or operation of the framework of control that put the achievement of the service, system or process' objectives at risk.</p>
<p><b>No assurance:</b> Weaknesses in control and/ or consistent non-compliance with controls could result/ has resulted in failure to achieve the service's objectives.</p>	<p><b>No assurance:</b> there are some fundamental weaknesses in the design and/ or operation of the framework of control that could result in failure to achieve the service, system or process' objectives.</p>

8.2 In December we provided an opinion of **substantial** assurance over the adequacy and effectiveness of the controls operating within the Accounts Payable system. Under the revised assurance categories this would have been reported as **moderate** assurance. Similarly, the **full** assurance provided in relation to Treasury management arrangements would now be reported as **substantial** assurance.

**9 Deployment of audit resources**

- 9.1 The plan is stated in terms of days input, which represents our current best estimate of the way in which the audit resources will be deployed. The plan itself should however be viewed as a fluid document, with the specific content of individual reviews being subject to revision if required following the more detailed scoping meetings held with client management teams prior to formal commencement of individual audit reviews.
- 9.2 The content and outline scope of each audit within the proposed plan, as well as an estimate of the number of audit days considered appropriate, is provided in the table below:

Audit review and anticipated timing	Outline audit scope	Days	Planning principle
<b><i>Governance and business effectiveness</i></b>			
Governance and risk management arrangements  <i>Quarter 4</i>	<ul style="list-style-type: none"> <li>We will consider the robustness of the risk management arrangements from our involvement and attendance at the meetings of the Audit Committee.</li> <li>We will obtain assurance regarding the adequacy of governance arrangements, through our review of the minutes of the Executive Board, the Service Management Team and the Corporate Programme Board.</li> </ul> <p>(The days involved in conducting the above work are incorporated into the 'management' time shown below).</p>	-	Required by the Public Sector Internal Audit Standards - the review will inform our annual audit opinion on risk management, governance and internal control.
Sources of Assurance	<ul style="list-style-type: none"> <li>This work will involve the development of an assurance map for the Service, considering the sources of assurance currently available from both internal and external sources, in order to identify any gaps or duplication in provision.</li> </ul>	10	Phase one (consultancy) support
<b><i>Service delivery and support</i></b>			
Business Continuity arrangements  <i>Quarter 2</i>	<ul style="list-style-type: none"> <li>We will undertake an assessment of the adequacy of the business continuity arrangements in place against best practice guidelines, and conduct selective tests of effectiveness as appropriate.</li> </ul>	6	Phase one and two – we will assess the adequacy of control design and effectiveness in operation

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Audit review and anticipated timing	Outline audit scope	Days	Planning principle
<b>Business processes</b>			
Accounts payable <i>Quarter 3</i>	<p>The audit will consider whether there are adequate and effective controls in place to ensure:</p> <ul style="list-style-type: none"> <li>• Compliance with financial regulations and the scheme of delegation.</li> <li>• Processes employed for the ordering, receipting and payment of goods and services is appropriate and efficient.</li> <li>• Inaccurate, illegitimate or duplicate orders/ invoices are not processed and paid.</li> </ul>	10	Phase two (compliance) audit
Accounts receivable <i>Quarter 3</i>	<p>The audit will consider whether there are adequate and effective controls in place to ensure:</p> <ul style="list-style-type: none"> <li>• Invoices are raised on a timely basis for all goods and services provided.</li> <li>• Invoices are cancelled or written off appropriately.</li> <li>• Income is correctly accounted for.</li> <li>• Debtors are actively managed so as to reduce the level of bad debts and loss of income.</li> </ul>	5	Phase two (compliance) audit
General ledger <i>Quarter 3</i>	<p>The audit will consider whether there are adequate and effective controls in place to ensure:</p> <ul style="list-style-type: none"> <li>• Access to the accounting systems is appropriately managed and controlled.</li> <li>• There are no unauthorised changes to the accounting records.</li> <li>• Financial data is complete, timely and accurate.</li> <li>• Misappropriations or errors are detected.</li> </ul>	5	Phase two (compliance) audit
HR/ Payroll <i>Quarter 3</i>	<p>The audit will consider whether there are adequate and effective controls in place to ensure:</p> <ul style="list-style-type: none"> <li>• Access to the HR and payroll systems is appropriately managed and controlled.</li> <li>• Key HR and payroll data and information is securely retained.</li> <li>• No unauthorised or invalid appointments have been made and</li> </ul>	10	Phase two (compliance) audit

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Audit review and anticipated timing	Outline audit scope	Days	Planning principle
	<p>valid appointments have been correctly established.</p> <ul style="list-style-type: none"> <li>• No unauthorised or inaccurate payments or adjustments to pay have been processed.</li> <li>• Staff are paid in a timely manner.</li> <li>• Payroll costs and deductions are correctly accounted for.</li> </ul>		
<p>Treasury management</p> <p><i>Quarter 4</i></p>	<p>The audit will consider whether there are adequate and effective controls in place to ensure:</p> <ul style="list-style-type: none"> <li>• The regulatory framework/ internal treasury management strategy/ policy is followed.</li> <li>• Treasury management reports to members are accurate and clear.</li> <li>• Investment and borrowing decisions are based on accurate and complete cash flow forecasting data.</li> <li>• There is effective scrutiny of Treasury management activity by those charged with governance.</li> </ul>	5	Phase two (compliance) audit
<p>Pension administration</p> <p><i>Quarter 4</i></p>	<p>The audit will consider whether there are adequate and effective controls in place to ensure:</p> <ul style="list-style-type: none"> <li>• Eligible employees have been automatically enrolled into the pension scheme.</li> <li>• Transfers in or out of the scheme are processed promptly and correctly.</li> <li>• Retirement payments or death grants are subject to appropriate supervisory review and oversight during processing.</li> <li>• The pension administration IT system is correctly configured to support accurate calculation and payment of pensions.</li> </ul>	5	Phase two (compliance) audit
<b><i>Follow up audit activity</i></b>			
<p>Training, learning and development</p>	<ul style="list-style-type: none"> <li>• Each review will incorporate a self-assessment by management of the progress made in implementing agreed actions; and</li> <li>• Selective test checking of controls introduced to address identified unmitigated risk.</li> </ul>	4	Required by the Public Sector Internal Audit Standards
<p>Rota management</p>			



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Audit review and anticipated timing	Outline audit scope	Days	Planning principle
<b><i>Other components of the audit plan</i></b>			
Management activity	<ul style="list-style-type: none"> <li>• Attendance at meetings of the Audit Committee.</li> <li>• Production of the annual audit plan.</li> <li>• Preparation of the monitoring reports.</li> <li>• Preparation of the annual report of the head of internal audit.</li> <li>• Liaison with external audit.</li> </ul>	10	Compliance with the terms of the Internal Audit Charter
National Fraud Initiative	<ul style="list-style-type: none"> <li>• Tasks associated with data preparation and submission.</li> <li>• Support to staff in the testing of the data matches identified.</li> </ul>	2	Contribution to fraud prevention
<b><i>Assigned days</i></b>		<b>72</b>	
Contingency	<ul style="list-style-type: none"> <li>• These days are being held as a contingency pending the outcome of the HMICFRS inspection, scheduled for summer 2018.</li> </ul>	8	
<b><i>Approved days</i></b>		<b>80</b>	