

# **The Head of Internal Audit Service's Annual Opinion on the overall adequacy and effectiveness of the control environment 2014-15**



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## Background

Leicestershire County Council Internal Audit Service (LCCIAS) adopts the principles of the Public Sector Internal Audit Standards 2013 (the PSIAS) which requires the Head of Internal Audit Service (HoIAS) to give an annual opinion on the overall adequacy and effectiveness of the Council's control environment i.e. its framework of governance, risk management and control. The PSIAS definition of the control environment is to be found at the end of this document, along with further explanation from the Institute of Internal Auditors about what an effective system of internal control facilitates.

The HoIAS annual opinion is for a specific time interval i.e. 2014-15 and combines: -

- an objective assessment, based on the results of individual audits undertaken and actions taken by management thereafter. Individual opinions on what level of assurance can be given as to whether risk is being identified and adequately managed are formed by applying systematic grading to remove any elements of subjectivity. Annex 2 lists the audits undertaken during the year in the respective control environment components (governance, risk management and internal control). The list also contains the individual audit opinion and whether there were any high importance recommendations.
- the professional judgement of the HoIAS based on his evaluation of other related activities.

The results of the above, when combined, form the basis for the overall opinion on the adequacy of the Council's control environment. However, the caveat at the end of the document explains what internal control cannot do i.e. no system of internal control can provide absolute assurance against material misstatement or loss, nor can LCCIAS give absolute assurance, especially given limited resource. The work of LCCIAS is intended only to provide reasonable assurance on the adequacy of the control environment on the basis of the work undertaken and known facts.

## **Governance related internal audit work**

Nineteen audits with a governance theme returned substantial assurance with one of them being graded at full assurance. On the whole, recommendations were relatively minor and where they related to governance, it was to improve it, i.e. not to have to establish it. Only two audits were graded as partial assurance, one of which is still in draft stage. The other audit's high importance (HI) recommendations were reported to the Corporate Governance Committee as is practice, but the HoIAS has since received sufficient evidence for them to be closed.

During the year, the HoIAS gained responsibility for compiling the Annual Governance Statement (AGS), the administration, monitoring and reporting of the corporate risk management framework and counter fraud development. Whilst this has impacted on the resources available to complete the audit plan, nevertheless there are significant benefits to the Council's governance framework with the HoIAS overseeing these elements and dovetailing them to audit requirements.

The HoIAS attends the Corporate Governance Committee to present audit plans and reports on audit, risk and the AGS which enables him to gauge Member level governance at first hand. The HoIAS provides member training on those areas.

During the year, the Committee approved an Internal Audit Charter mandating the purpose, authority and responsibility of the internal audit activity and it adopted the principles of the CIPFA Code of Practice for Managing the Risk of Fraud & Corruption. The Committee also approved a revised code of employee conduct and revised and new policies, strategies and procedures on counter fraud.

The HoIAS has regular discussions with the Chief Executive, Directors and particularly the Chief Financial Officer (CFO) and the Monitoring Officer (MO) on governance issues and related audit aspects. The HoIAS attends Corporate Management Team when required.

Through the results of audits and in other ways the HoIAS is made aware of the governance arrangements between the Council and its key partners including Health, ESPO (where he undertakes the role of HoIAS and attends its committees) and East Midlands Shared Services (where he regularly liaises with his counterpart the HoIA of Nottingham City Council, and receives his reports and annual opinion). The ESPO sub-opinion for governance was positive. For EMSS, despite the HoIA reporting an overall 'limited' assurance opinion, he commented that, *'...2014/15 has seen a demonstrable improvement in the governance processes...and... a year on year improvement in the associated control and governance arrangements'*.

**HoIAS opinion: - Nothing of such significance, adverse nature or character has come to the HoIAS attention. As such reasonable assurance is given that the Council's governance arrangements are robust.**

#### **Risk management related internal audit work**

The majority of audits planned and conducted were 'risk based' i.e. ensuring that the Council's management identifies, evaluates and manages risk to achieving its objectives i.e. ensuring controls are in place to reduce risk exposure.

Seventeen audits with a risk management theme returned substantial assurance. On the whole, recommendations were relatively minor and they related to improving risk management i.e. not to have to establish it. Three audits were graded as partial assurance, one of which is still in draft stage. The other two audits' HI recommendations were reported to the Corporate Governance Committee. The HoIAS has since received sufficient evidence to close them.

During the year, the HoIAS gained responsibility for the administration, monitoring and reporting of the corporate risk management framework and countering the risk of fraud. The PSIAS require that this 'potential impairment' to independence and objectivity is declared in the Internal Audit Charter. A specific audit of the risk management framework was conducted by an auditor who doesn't administer the corporate framework and the engagement was overseen by a manager from outside of LCCIAS. The audit reported an improved maturity to risk management at the Council but with an action plan for further improvements.

During 2014-15 the HoIAS observed positive engagement in risk management at both Director (Corporate Management Team) and Member (Corporate Governance Committee) level.

Regarding the Council's partnerships, audits of ESPO's management of its corporate and procurement and compliance risks returned positive assurance ratings. An audit of the Better Care Fund reported effective risk management.

**HoIAS opinion: Management has agreed to implement audit recommendations, which further mitigates risk. Therefore reasonable assurance is given that risk is managed.**

## **Financial (and ICT) Controls related internal audit work**

Thirty-four audits with a financial or ICT control theme returned substantial assurance with three of them being graded at full assurance. In addition, of the sixteen LA maintained schools audited, thirteen were graded 'above the standard' (equivalent to full assurance) with the remaining three 'reaching the standard' (substantial assurance).

Five control theme audits were graded as partial assurance. However, the two relating to Teachers' Pensions were graded 'partial' to match the approach taken by the External Auditors who (following specific rigorous certification instructions) regularly qualified the annual returns for even minor discrepancies. Of the other three partial assurance ratings, both the M-Star and IAS Gate Review audits' high importance recommendations were reported to the Corporate Governance Committee, but the HoIAS has since received sufficient evidence for them to be closed, and the E&T RAS high importance recommendations are only just being reported to Committee.

Nine audits are at draft pending stage. Outcomes shouldn't materially affect the opinion.

The HoIAS was required to certify six grant claims. Grant conditions were complied with.

Whilst the results of audits conducted on financial controls in departments were on the whole positive, because of significant problems experienced during the implementation of the new Integrated Adults System in Adults & Communities Department, planned audits were cancelled. The scale of the problems had been promptly brought to the attention of the Chief Financial Officer (CFO) who deployed senior Strategic Finance staff to solve the problems. The External Auditor was kept informed. The CFO also approved that the HoIAS could divert Internal Audit Service resource to assist by investigating and clearing the large volume of errors, overpayments and invoices 'stuck in the system'. The last page of Annex 2 reports the thirteen examples of 'non-audit' work which accounted for 106 'lost' audit days.

On the basis of audit work undertaken during the 2014-15 financial year, covering financial systems, risk and governance, the HoIA at Nottingham City Council concluded that a limited level of assurance can be given that internal control systems are operating effectively within EMSS. In reaching this conclusion the HoIA acknowledged there had been a demonstrable improvement in the governance processes and that no significant issues had been discovered. In addition it is worth noting that some of the issues raised did not apply to the County Council.

**HoIAS opinion: Reasonable assurance can be given that the County Council's core financial practices remain strong. However, in 2014-15 there were areas of weakness in the control environment, most noticeably in Adults & Communities Department. Management reacted quickly by allocating additional resources and capability and there were significant improvements in the latter part of the year. Even so in respect of this area only limited assurance can be given that internal controls were operating effectively.**

## **The control environment**

The Public Sector Internal Audit Standards 2013 (the PSIAS) contain the following definitions: -

### **Control**

Any action taken by management, the board and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Management plans, organises and directs the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved.

### **Control Environment**

The attitude and actions of the board and management regarding the importance of control within the organisation. The control environment provides the discipline and structure for the achievement of the primary objectives of the system of internal control. The control environment includes the following elements: -

- Integrity and ethical values
- Management's philosophy and operating style
- Organisational structure.
- Assignment of authority and responsibility.
- Human resource policies and practices.
- Competence of personnel.

The Institute of Internal Auditors further explains that the control environment is the foundation on which an effective system of internal control is built and operated in an organisation that strives to achieve its strategic objectives, provide reliable financial reporting to internal and external stakeholders, operate its business efficiently and effectively, comply with all applicable laws and regulations, and safeguard its assets.

### **Caveat**

The Financial Reporting Council in an Auditing Practices Board briefing paper, 'Providing Assurance on the Effectiveness of Internal Control' explains what internal control cannot do, namely: -

'A sound system of internal control reduces, but cannot eliminate, the possibility of poor judgement in decision making, human error, control processes being deliberately circumvented by employees or others, management overriding controls and the occurrence of unforeseen circumstances. A sound system of internal control therefore provides reasonable, but not absolute assurance that an organisation will not be hindered in achieving its objectives, or in the orderly and legitimate conduct of its business, by circumstances which may reasonably be foreseen. A system of internal control cannot, however, provide protection with certainty against an organisation failing to meet its objectives, or all material errors, losses, fraud or breaches of laws and regulations'.