



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



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27th May 2015

Background

During the financial year 2014-15, Leicestershire County Council Internal Audit Service (LCCIAS) provided internal audit activity to the Eastern Shires Purchasing Organisation (ESPO). 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 ESPO'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 audit 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.
- 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 ESPO 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

An opinion on whether good governance principles have been applied is based on the results of audits of Budget Management; ESPO Services; Business Strategy; Risk Management; Annual Governance Statement; Information Management and Staff purchase scheme. Recommendations were relatively minor and where they related to governance, it was to improve it, i.e. not to have to establish it.

The HoIAS attends the Finance and Audit Subcommittee and appropriate Management Committee meetings to present audit plans and reports, which enables him to gauge ESPO Member governance at first hand. During the year, Management Committee approved an Internal Audit Charter for ESPO mandating the purpose, authority and responsibility of the internal audit activity, and adopted the principles of the CIPFA Code of Practice for Managing the Risk of Fraud & Corruption.

The HoIAS has regular discussions with the ESPO Director and Assistant Director (Finance), the Consortium Treasurer (and where required the Consortium Secretary) on governance issues and related aspects of audits. During the year, the Director of ESPO made arrangements to adopt Leicestershire County Council's (the Servicing Authority's) revised Employee Code of Conduct and a suite of revised and new anti-fraud and corruption policies, strategies and procedures, improving guidance to employees.

HolIAS opinion: - There is a general acknowledgement that there is need for a strong governance framework to achieve the objectives and financial targets contained in the four year Strategy. Otherwise, nothing of such significance, adverse nature or character has come to the HolIAS attention. As such reasonable assurance is given that ESPO'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 ESPO management identifies, evaluates and manages risk to achieving its objectives i.e. ensuring controls are in place to reduce risk exposure.

An audit of the project management arrangements for the replacement of the GEMS energy management system identified two high importance recommendations. Verbal assurances on implementing the actions were received and it is planned to conduct a short follow up audit in 2015-16.

A specific audit of the ESPO risk management framework (corporate risk register) proved there were yet further improvements and good elements of risk management, although re-alignment of key risks to the strands of the four year Strategy and further embedding at operational level would strengthen arrangements. Recommendations have been accepted and so a follow up audit will take place in 2015-16 to confirm their implementation.

Other specific audits conducted that linked to risk management were Applications Management; Supply Chain and Procurement & Compliance Risk Management

The HolIAS advises the External Auditor on ESPO's management of fraud risk.

HolIAS opinion: ESPO has acknowledged the need to implement the GEMS recommendations and there is opportunity to continue improving its risk management framework. Management has agreed to implement all internal audit recommendations which further mitigate risk, therefore reasonable assurance is given that risk is managed.

Financial (and ICT) Controls related internal audit work

A number of financial system audits were undertaken on ESPO's Rebates Income; General Ledger Reconciliations; Trading Performance; Distribution of Surplus; Servicing authority role; Payment Cards; IT General Controls - External Auditor Reliance; Stock Management; Fleet Management and E-Tendering. No findings were of such seriousness as to suggest a fundamental weakness in a main financial system. ESPO volunteered to submit employee and creditors data into the National Fraud Initiative data matching (counter fraud) exercise

HolIAS opinion: Reasonable assurance can be given that the operation and management of the core financial systems of ESPO are of a sufficient standard to provide for the proper administration of its financial affairs.

Dated 27th May 2015
Signed Neil Jones CPFA, Head of Internal Audit Service,
Leicestershire County Council

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'.