

**The Head of Internal Audit Service's Annual Opinion  
on the overall adequacy and effectiveness  
of the control environment  
2015-16**



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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 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. 2015-16 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 its 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**

Forty three audits were identified as being mostly governance related. Two (Debt Write Off - validation of circumstances and Contract Dashboard) returned only reasonable assurance which meant there were a number of important recommendations which individually weren't High Importance (HI) and hence wouldn't be reported to the Corporate Governance Committee, but collectively the recommendations were a concern and this was spelled out to management to ensure sufficient attention was paid.

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.

A further thirty two audits were conducted at maintained schools in which (local) governance features as part of the testing. All of the schools received a minimum opinion of substantial assurance and one scored full assurance.

During the year, the HoIAS has witnessed continuing improvements in the processes established for compiling the Annual Governance Statement (AGS), the administration, monitoring and reporting of the corporate risk management framework and counter fraud development.

The HoIAS attends the Corporate Governance Committee to present audit plans and reports on audit, risk counter fraud and the AGS which enables him to gauge Member level governance at first hand. The HoIAS provided training to the new Chair and another new Member on those areas. The Committee received a presentation on counter fraud which explained Members' governance roles and responsibilities in that area.

The HoIAS has regular private 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.

The HoIAS has been directly involved in two areas of high prominence for the Council; its preparations for the Goddard Inquiry and the development of a Combined Authority.

Directly, through the results of audits and in a variety of other ways the HoIAS is made aware of the governance arrangements between the Council and its key partners including Health and ESPO (where he undertakes the role of HoIAS and attends its committees). The ESPO sub-opinion for governance was positive. For East Midlands Shared Services (EMSS) the HoIAS regularly liaises with his counterpart the Head of Internal Audit (HoIA) of Nottingham City Council, and receives his reports and annual opinion). On the basis of audit work undertaken during the 2015-16 financial year, covering financial systems, risk and governance, the (HoIA) at Nottingham City Council concluded that a "significant" level of assurance can be given that internal control systems are operating effectively within EMSS. In reaching this conclusion the HoIA acknowledged that once again 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 Leicestershire County Council.

Five governance themed audits are at draft pending stage. Outcomes shouldn't materially affect the opinion.

**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.

Thirty two audits with a risk management theme were undertaken. One audit conducted at the request of the Environment & Transport Department on the processes for risk assessing transport provision for children with SEN, returned a partial assurance rating with three HI recommendations. These were reported to the Corporate Governance Committee and will remain in its domain until the HoIAS is satisfied they have been adequately implemented.

On the whole, recommendations in other audits were relatively minor and they related to improving risk management i.e. not to have to establish it.

The HoIAS has responsibility for the administration, monitoring and reporting of the corporate risk management framework and countering the risk of fraud. In line with a PSIAS requirement this 'potential impairment' to independence and objectivity is declared in the Internal Audit Charter.

A follow up self-assessment of the risk management framework was conducted and the conclusions (further stabilisation in the maturity of risk management arrangements) have been reviewed and agreed by a manager from outside of LCCIAS.

During 2015-16 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.

Four risk management themed audits are at draft pending stage. Outcomes shouldn't materially affect the opinion.

**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 audits with a financial or ICT control theme were undertaken and the majority returned substantial assurance. One audit conducted at the request of the Director of Finance on the processes for identifying and controlling the costs associated with children with learning disabilities and SEN transitioning from the children's to adults' budget returned a partial assurance rating with three HI recommendations. These were reported to the Corporate Governance Committee and will remain in its domain until the HoIAS is satisfied they have been adequately implemented.

A further thirty two audits were conducted at maintained schools in which financial internal controls features as part of the testing. All of the schools received a minimum opinion of substantial assurance and one scored full assurance. The HoIAS was required to certify two grant claims and the Supporting Leicestershire Families returns. Conditions were complied with.

Six internal control themed audits are at draft pending stage. Outcomes shouldn't materially affect the opinion.

Whilst the results of audits conducted on financial controls in departments were on the whole positive, problems continued to be experienced in Adults & Communities Department financial systems. During the year, the Director of Finance took strategic decisions to take managerial control over part of the Community Care Finance responsibilities for debts and payments. Internal Audit Service reports and staff have assisted with these changes.

The Director also approved that the HoIAS could divert Internal Audit Service resource to assist Strategic Finance staff in investigating and clearing errors and imbalances in financial systems. The last page of Annex 2 reports the 'non-audit' work which accounted for 114 'lost' audit days.

**HoIAS opinion: Reasonable assurance can be given that the County Council's core financial practices remain strong. However, in 2015-16 there were areas of weakness in the control environment, most noticeably in Adults & Communities Department. Whilst the Director of Finance has taken action to ensure significant improvements, in respect of A&C only limited assurance can be given that internal controls operated 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'.

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