The Head of Internal Audit Service's Annual Opinion on the overall adequacy and effectiveness of the control environment 2016-17

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Background

The Head of Assurance Services, Corporate Resources Department undertakes the role and responsibilities of the County Council's Head of Internal Audit Service (HoIAS). The HoIAS manages Leicestershire County Council's Internal Audit Service (LCCIAS). LCCIAS adopts the principles of the Public Sector Internal Audit Standards (the PSIAS) revised from April 2016, which require the HoIAS to give an annual opinion on the overall adequacy and effectiveness of the Council's control environment (its framework of governance, risk management and control). The PSIAS definition of the control environment is 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 (financial year 2016-17) and combines:

- An objective assessment, based on the results of individual audits undertaken and actions taken by management thereafter. Individual internal 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. Annex 2 lists the audits undertaken during the year and in order of the respective control environment components (governance, risk management and internal control). The list also contains the individual audit opinion and denotes whether there were any high importance recommendations.

- 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 HoIAS overall opinion on the adequacy of the Council's control environment (see definitions). 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

Nine assurance audits (see definitions) and eight consulting audits (see definitions) were identified as being mostly governance related. A further fourteen maintained school audits were undertaken where audit coverage includes school governance. 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 HI recommendation denotes that there is either an absence of control or evidence that a designated control is not being operated and as such the system is open to material risk exposure. It is particularly important that management quickly addresses those recommendations denoted as HI and implements an agreed action plan without delay. Corporate Governance Committee (the Committee) has responsibility to consider major Internal Audit findings and 'High Importance' (HI) recommendations and to monitor the response to major findings and the implementation of those recommendations.

One assurance audit (School capital programme) returned a partial assurance rating including one HI recommendation, which was implemented within a reasonable timeframe and closed.

During the year, the HoIAS has recognised further developments in the processes established for compiling the Annual Governance Statement (AGS), a revised Local Code of Corporate Governance, the administration, monitoring and reporting of the corporate risk management framework and counter fraud development.

The HoIAS attends the Committee to present plans and reports on the internal audit activity, and other reports (in his role of Head of Assurance Services) on risk management (including counter fraud and insurance) and the AGS. Overseeing these functions enables him to gauge Member level governance at first hand.

During the year, the HoIAS observed the Committee approval of the revised Internal Audit Charter mandating the purpose, authority and responsibility of the internal audit activity and its consideration of the arrangements supporting LCCIAS undertaking the internal audit function for Leicester City Council. The Committee also approved a revised Members' Planning Code of Good Practice and revised and new policies, strategies and procedures on risk management, counter fraud, treasury management and finance and contract procedure rules.

The HoIAS is part of a senior management group also comprising the Director of Law & Governance, the Chief Financial Officer, the Head of Democratic Services and the Assistant Chief Executive which each year reviews the draft Annual Governance Statement (AGS). For 2016-17, the group determined that matters arising at the implementation stage of the Help to Live at Home (HTLAH) programme should be reported as a significant governance issue.

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 internal audit aspects. The HoIAS attends Corporate Management Team when required.

HoIAS opinion: - There has been transparent reporting of the HTLAH situation in the AGS. Nothing else of 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.

Four specific risk management type assurance audits were conducted. Two audits (Learning Disability Transitions and Staff Mandatory Training) returned partial assurance ratings because of HI recommendations. The Learning Disability Transitions HI recommendations were implemented within reasonable timeframe and closed. The Mandatory Training HI recommendation is not due to be implemented until June but there is evidence of progress.

An audit conducted in the previous financial year 2015-16 on the processes for risk assessing transport provision for children with SEN, contained three HI recommendations. Whilst these haven't been closed off, the Committee is kept informed of the substantial progress made.

During 2016-17, Internal Audit Service provided challenge and advice to the completion of 24 Information Security Risk Assessments (ISRA). Information and technology (I&T) plays a critical role for all services provided by the Council. Therefore, it is vital that I&T risks are effectively identified, assessed, managed and reviewed at the appropriate times.

Failure to identify, assess and mitigate I&T risks can lead to serious data breaches, non-compliance with legislation, financial losses and disruption to business activities. The increase in cyber-crime should be taken into account. The Council is not immune to cyber-attacks and needs to take all necessary steps to identify and mitigate the risks associated with an attack.

Other risk management work was undertaken in consulting audits and developments to the overall control environment. One investigation was undertaken into how the risks for contract extensions are identified and acted upon.

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

The Head of Assurance Services continues to have responsibility for countering the risk of fraud and the overall administration, monitoring and reporting of the corporate risk management framework. The PSIAS require that this 'potential impairment' to independence and objectivity for the HoIAS is declared in the Internal Audit Charter. There was development of counter fraud policies and initiatives and the risk management framework including a protocol for transitioning project and programme risks to service delivery (business as usual) risks. Risk scores and escalations continue to be challenged. There was positive engagement in risk management at both Director (Corporate Management Team) and Member (the Committee) level.

There was not an independent assessment of the effectiveness of the risk management framework in 2016-17 but one is planned for 2017-18.

HoIAS opinion: Management has shown good engagement around risk and agreed to implement audit recommendations, which further mitigates risk. Therefore reasonable assurance is given that risk is managed.

Financial (and I&T) Controls related internal audit work

Twenty nine assurance audits were undertaken that were predominantly a financial or I&T control theme. Whilst nine remain in draft and hence the opinion isn't finalised or reported, fifteen returned substantial assurance, and four grants met their conditions in order to be certified. In addition, fourteen maintained school audits were undertaken where audit coverage includes school financial control. All of those audits returned substantial assurance.

One audit on Financial Assessments Process & Deprivation of Assets returned a partial assurance rating. However, this was due to the relatively high number of recommendations made, none of which were graded individually as HI, therefore not reported to nor monitored by the Committee, but implementation of recommendations will be scrutinised by IAS.

Whilst the results of audits conducted on financial and I&T controls were on the whole positive, there has been an increase in investigations, albeit not specific to any particular service or theme. Management acted quickly and appropriately to improve the controls required.

Some Internal Audit Service resource was diverted to assist other functions, namely investigating minor insurance claims and clearing homecare payments queries. Whilst these are not pure audit functions they do add to financial control.

HoIAS opinion: Whilst recognising there have been some control failings during the year, reasonable assurance can be given that the Council's core financial and I&T controls remain strong.

Other assurances – East Midlands Shared Service (EMSS)

Internal audit activity for EMSS is the responsibility of the Head of Internal Audit (HoIA) at Nottingham City Council. For 2016-17 the HoIA concluded, '*On the basis of audit work undertaken during the 2016-17 financial year, covering financial systems, risk and governance, a "significant" level of assurance could be given that internal control systems are operating effectively within EMSS and that no significant issues had been discovered'*.

Definitions

The revised 2016 Public Sector Internal Audit Standards (the PSIAS) define the following: -

Assurance audit

An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management and control processes for the organisation. Examples may include financial, performance, compliance, system security and due diligence engagements.

Consulting audit

Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organisation's governance, risk management and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation and training.

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'.