

## **INTERNAL AUDIT SERVICE WORK DURING 2012-13**

### **PURPOSE**

**Members have delegated arrangements to the Director**

**Where to find more details on Internal Audit**

**Members' information needed for NFI 2012**

1. Under the County Council's Constitution, members' responsibility for arranging a continuous internal audit of its financial management arrangements has been delegated to the Director of Corporate Resources. This report gives members an outline of the work done by the Internal Audit Service on their behalf during the last financial year.
2. Further information about the Internal Audit Service can be found on the Corporate Information Service (CIS) under internal services; finance; useful links; audit. Annual Internal Audit Service Plans can be accessed on CIS by referring to the Corporate Governance Committee papers.
3. The report also gives members information about data required for National Fraud Initiative (NFI) 2012.

### **SUMMARY OF WORK**

**137 audits completed**

**Concentration on both direct and indirect financial risk**

**Level of assurance given and recommendations made**

**Governance arrangements audited**

**Effectiveness of the system of internal audit monitored by Corporate Governance Committee**

4. During the year, 137 County Council audits were undertaken, 30% of which were school audits. Although some audits react to events, most are part of the annual plan.
5. The selection of these audits is based on a process designed to assess key areas of direct and indirect financial risk.
6. The audits examine the internal controls in place and sample test compliance. Dependant on the results, a level of assurance is given and recommendations are made. Information on individual pieces of work undertaken by the Service is given below.
7. Governance audits included the preliminary work required for the Council's Annual Governance Statement and partnership risk management.
8. The work of the Service is carried out in accordance with a national code of practice. The Accounts and Audit Regulations 2003 (2011) require an annual review of the effectiveness of the system of internal audit. The Head of Internal Audit Service (HoIAS) undertook a self-assessment against the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom, in November 2012. Minor areas of 'partial compliance' were reported, but the outcomes of a service review and adoption of the Public Sector Internal Audit Standards from April 2013 should ensure full compliance.

**OPINION**

**CIPFA Code requires opinion to be given by Head of Audit**

**Assurance given on the overall “internal control environment”**

**The HoIAS opinions for 2012-13**

9. The CIPFA Code of Practice for Internal Audit in Local Government in the UK (2006) requires the Head of Audit to provide an overall opinion on the adequacy and effectiveness of the Authority’s “internal control environment”.
10. The “environment” covers the framework of governance, risk management and control. The ‘opinion’ is given for a specific time interval i.e. 2012-13 and combines an objective assessment, based on the results of individual audits undertaken and actions taken by management thereafter and the professional judgement of the HoIAS based on his evaluation of other related activities.
11. The following conclusions have been drawn: -
  - a. **Governance:** Governance procedures at both strategic and operational level are robust
  - b. **Risk management:** LCC has an improved risk management framework. Whilst there has been evidence of the revised framework being consistently applied during the gathering of information for the Internal Audit Annual Plan, detailed testing of the embedding will be undertaken in 2013-14
  - c. **Internal financial control:** General assurance can be given that the operation and management of the core financial systems of LCC are of a sufficient standard to provide for the proper administration of its financial affairs.

**BACKGROUND**

**Size and primary objective of the Internal Audit Service**

12. During the year the HoIAS undertook a review of the service which reduced the establishment by just over 1. The Internal Audit Service now has just over 13 FTE staff. Its primary objective is to provide management, including members and in particular the Director of Corporate Resources as the ‘Section 151 officer’, with an independent, objective assurance and consulting activity designed to add value and improve the Authority’s operations. It helps the County Council to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

**What effective controls should be doing**

**Responsibilities of management and auditors in respect of controls**

**Controls cannot eliminate all risks. It is up to management to decide what is an acceptable level of risk**

**Internal Audit works with External Audit (PwC)**

13. Internal audit seeks to ensure that effective controls are in place to ensure that:-
  - a. The assets of the Authority are safeguarded against loss, claim or fraud.
  - b. Decisions are recommended and authorised according to the requirements of the Council's Constitution and departmental procedures. Both accurate and relevant management and financial information is produced to assist in this.
  - c. Resources are used in furtherance of agreed plans in an effective manner which is also efficient and economical taking into account any community or environmental requirements of the County Council.
  - d. Agreed Council policies and legal requirements are being correctly observed.
14. Responsibility for the design, implementation and consistent operation of internal controls rests with departmental management. The Internal Audit Service's task is to carry out an independent 'assurance' type audit of the adequacy and effectiveness of these controls, highlight weaknesses and recommend improvements where appropriate. If high importance recommendations are made then follow up testing is undertaken to confirm action has been implemented. Audit work is often most effective if done during the development of a system which is classified as a 'consulting' type of audit adding value to the design.
15. In some operational systems, particularly in complex financial work and in ICT, specialised skills are required. In such cases, the integrity of individuals has to be relied upon, but risks with a very low likelihood but high impact may occur. Where such a situation is identified by audit, it is the responsibility of management to assess the risk and decide whether it can be reduced further by either additional controls or enhanced post event monitoring. A decision is then required as to whether the level of risk is acceptable or action should be taken to reduce it. If the latter is decided there could be a reduction in efficiency and/or effectiveness. If the former, consideration might be given to the cost of additional insurance arrangements to offset any loss.
16. LCCIAS liaises with the Council's External Auditor, PricewaterhouseCoopers (PwC). This avoids unnecessary duplication on areas where both parties consider coverage is essential. LCCIAS undertakes annual audits on the key financial and ICT systems which External Audit places reliance on when reaching its conclusions for the final accounts. A substantial amount of 'joint' audit work was undertaken in 2012-13.

**Quality assurance**

17. PwC reviews LCCIAS work on the key financial and ICT systems, This supplements the Service's internal quality control checks that take place on each audit. Audit client questionnaires are also used to obtain feedback.

**How Internal Audit Service plans its work**

18. Much audit work can be planned. To this end an annual plan is produced, detailing the main areas of proposed work. The plan for 2012-13 was produced from a risk assessment and a 4-year programme based on numerous potential areas of audit interest.

**Risk based methodology**

19. The risk assessment methodology was revised in 2006 to accommodate the wider potential coverage. The four year strategic plan is based around four factors:- materiality, impact, likelihood and exposure (MILE).

**Consultation including involvement of the Corporate Governance Committee**

20. A risk level 'map' provided the framework for allocating resources. The scores that made up the map were updated and reported to the Corporate Governance Committee meeting in May.

**Audit resource targeted towards prominent risks**

21. For 2012-13 prominent risks identified were achieving efficiency requirements; planning for and successfully implementing the Government's localism, health and education agendas and the County Council's transformational changes, service reviews and development projects; the loss of direct control as a result of increased partnership working and 'outsourcing'; the impact of funding cuts and service reductions on staffing structures and morale; whether there was capacity and knowledge to deliver technology infrastructure; failing to widen the personalisation agenda and failure to safeguard vulnerable children and adults.

**Converted into an annual plan and presented to Committee**

22. Each annual plan therefore takes account of changing circumstances and priorities and is discussed with departmental representatives. The annual plan is presented to the May Corporate Governance Committee for its support. The reports are available for inspection on CIS and the internet.

**Balancing planned work with unexpected issues arising**

23. Inevitably issues arise that require immediate attention. A balance has therefore to be struck using risk assessment between the planned audits and special investigations or other unplanned work in order to keep within the staff time available.

**Unusual impacts occurring**

24. For 2012-13, Committee was also informed about the impact of the HoIAS undertaking a review of the Internal Audit Service structure, processes and technology.

**Types of audits & opinions****Risk based audits looking at controls against major 'inherent' risks****Maintained schools' audit opinions**

**Only one school only just reached the minimum audit standard and no schools were below standard.**

**Overall average grading is well above the minimum standard**

25. Most planned audits undertaken are 'assurance' type, which requires an objective examination of evidence to form an independent opinion on whether risk is being mitigated. The 'opinion' is what level of assurance can be given that material risks are being managed. There are four classifications: full; substantial; partial; and little. A report that has a high importance (HI) recommendation would receive a partial assurance rating. Other planned audits are 'consulting' types i.e. primarily advisory and guidance to management, intended to add value e.g. commentary on the effectiveness of controls designed before a new system is implemented. Also, unplanned 'investigation type' audits may be undertaken.
26. Risk based assurance audits concentrate on identifying specific major 'inherent' risks and controls to reduce these. They are designed to test whether the controls in place protect against likely causes of potential loss are well designed and are consistently applied. Although the importance of auditing financial systems is fully recognised, the plans increasingly emphasise management controls to ensure performance monitoring is undertaken using good quality data. It also recognises the importance of controls to reduce liability and potential claims against the County Council.
27. Maintained schools receive an overall grading based on the Service's "MOT" assessment. Grades range from "far exceeds the standard expected" to "generally reaches the standard, however ...". In addition a school may be judged "below the standard we measure against". The grading system gives judgements on different aspects such as governance, financial management and some non-financial risks. A full listing of areas covered and the way in which a school's audit visit is carried out can be found on Audit Service's CIS pages and on the Education part of the Council's website. The grading of schools visited in the last quarter is also given on the site. A full listing for the year is put up at the end of the financial year
28. One school generally met the standard but with need for major improvements in some areas. No schools scored below the standard.
29. The average MOT score for the year was 89%, which translates into an average opinion of "well above the minimum standard measured against".

**The Service's role in relation to fraud investigations**

30. Although it is not solely responsible for detecting frauds, the Service has an important role in identifying and investigating suspected cases (often in liaison with the Police). The Service's role in anti-fraud and corruption work has been set out in a document outlining the County Council's strategy and procedures. This can be viewed by members on the CIS along with a County Council Statement on Fraud and Corruption. The HoIAS is one of the contact points for "whistleblowers".

### **INFORMATION ON INDIVIDUAL AUDITS**

**Regular progress reports given to Corporate Governance Committee**

31. A report on progress against the annual is provided to the Corporate Governance Committee at each of its regular quarterly meetings. These reports are available to view on CIS. The report includes details of completed work and more information about "high importance" recommendations made and departmental progress in implementing these.

**137 audits were undertaken in 2012-13**

32. 137 audits were carried out during the year. The split was: -
- a. 80 – planned assurance and consulting
  - b. 16 – unplanned (including investigations)
  - c. 41 – maintained schools

**List of the audits undertaken**

33. **Appendix 2** shows in department order a list of the 80 planned assurance and consulting audits undertaken.

**'High importance' recommendations**

34. The following High Importance (HI) recommendations were reported to Corporate Governance Committee. Progress against management's implementation of each HI recommendation is tracked and reported. The recommendation remains 'live' until Internal Audit Service has retested action has taken place.
- a. Registrars income collection – 2 HIs relating to compliance with the Payment Card Industry Standard and accounting for VAT
  - b. Coroners – information security of the Coroners ICT system
  - c. Corporate Governance – the identification and management of 'significant' partnership risk

**Unplanned work including investigations**

35. A wide variety of unplanned work including 'investigations' was undertaken but it is prudent to not disclose the details in this report. Corporate Governance Committee is kept apprised of any significant investigations.



### **NATIONAL FRAUD INITIATIVE**

**Participation in National Fraud Initiative 2012. Members' information was included in the data submission**

36. The Internal Audit Service is the County Council's co-ordinator for the Audit Commission's National Fraud Initiative (NFI). This is an extensive biennial data matching exercise drawing information from local authorities; central government; the NHS; and some private sector pension funds. It should be stressed that no conclusions are drawn about the existence of a match until it has been thoroughly investigated. Reports were released at the end of January 2013 and by the end of May 2013, 63 requests for more information relating to NFI2012 had been received.

**Range of data required by the Audit Commission now extensive**

37. NFI 2012 uses September payments data, *including* payments to members. No changes in areas of coverage were suggested. Further information on NFI can be found on the Audit part of the website under the Fraud subheading which is at the very bottom of the page.

### **OTHER CLIENTS**

**Provide service to a range of other clients**

38. As well as undertaking the County Council's internal audit, LCCIAS also provides internal audit (through service agreements) for a number of organisations which are 'connected' to the County Council through its responsibilities as 'servicing authority' or 'accountable body' i.e. the Pension Fund, ESPO, East Midlands Councils and Bradgate Park Trust. The Service also contracts commercially with the Fire Authority, academy schools and some Leicestershire district councils for ICT audit. Extending the external client base is part of the Service strategy.

### **LINKS WITH OTHER INTERNAL AUDIT SERVICES**

**Midlands and National networks**

39. LCCIAS is an active member of both the Midlands and National Counties audit groups. Networking with peers allows information, ideas and issues to be shared and specific service sessions and training widens LCCIAS knowledge and resource base.

**CONCLUSION****Potential audit coverage  
now very wide**

40. The coverage provided by the Service is very wide, both in terms of department and corporate risk. This allows Directors, management and Members to receive a wide scope of assurance that key risk to achieving objectives is being mitigated.

**Overall summary of  
assurance levels given in  
2012-13**

41. As can be seen from Appendix 2, control gaps and potential risks have inevitably been identified. Overall though, for non-school assurance type audits in 2012-13, over 90% received 'full' or 'substantial' assurance in relation to the material risks identified. This assurance was based on the controls analysed and the tests carried out. The remainder had at least one recommendation with a high importance rating. Special attention is given to high importance recommendations to ensure either acceptance of the Internal Audit Service's recommendation or the proposal of an acceptable management alternative.

**Arbitration process if 'high  
importance'  
recommendation cannot be  
agreed**

42. Refusal of a high level recommendation would be referred to the Department's Director/Director of Corporate Resources for arbitration. There are no unresolved cases in this category

**OFFICER TO CONTACT**

Neil Jones  
Head of Internal Audit  
Service  
Telephone 0116 305 7629