

**CORPORATE GOVERNANCE COMMITTEE****12 MAY 2014****REPORT OF THE DIRECTOR OF CORPORATE RESOURCES****INTERNAL AUDIT SERVICE PROGRESS REPORT****Purpose of Report**

1. The purpose of this report is to:
 - (a) Give a summary of Leicestershire County Council's Internal Audit Service (LCCIAS) work finalised since the last report to the Committee and highlight audits where high importance recommendations have been made to managers;
 - (b) Provide an update on the County Solicitor's report on the investigation into allegations concerning the conduct of the former Leader of the County Council, Mr David Parsons, regarding his use of County Council resources and action to be taken to recover costs incurred;
 - (c) Provide information on a fraud case that was recently heard at the County Court;
 - (d) Provide a brief update on the implementation of the Public Sector Internal Audit Standards;
 - (e) Provide a provisional annual internal audit opinion on the overall adequacy and effectiveness of the organisation's governance, risk and control framework;
 - (f) Provide a brief summary of LCCIAS performance during 2013-14.

Background

2. Under the County Council's Constitution, the Committee is required to monitor the adequacy and effectiveness of the system of internal audit, which is provided by LCCIAS. To do this, the Committee receives periodic reports on progress against the annual Internal Audit Plan. The Committee is also tasked with monitoring the implementation of internal audit high importance recommendations by managers.

3. Most planned audits undertaken (including those at maintained schools and locality sites) are of an 'assurance' type, which requires an objective examination of evidence to be undertaken so that an independent opinion can be given on whether risk is being mitigated. Other planned audits are of a 'consulting' type, which are primarily advisory and allow for guidance to be provided to management. These are intended to add value, for example, by providing commentary on the effectiveness of controls designed before a new system is implemented. Also, unplanned 'investigation' type audits may be undertaken.

Summary of progress against the Internal Audit Plan 2013-14

4. This report covers audits finalised during the period 1 January to 31 March 2014.
5. Only one maintained school was audited in the last quarter and that was given an opinion on its financial management arrangements of '...well above the pre-set standard', based on the Service's 'MOT' process.
6. The individual opinions are found on the LCCIAS web page. The web link is:- http://www.leics.gov.uk/audit_schools_colleges.htm
7. The outcome of all other audits completed since the last progress report to the Committee is shown in **Appendix 1**. For assurance audits, the 'opinion' is what level of assurance can be given that material risks are being managed. There are four classifications of assurance: full; substantial; partial; and little. A report that has a high importance recommendation would not normally get a classification above partial.
8. **Appendix 2** details high importance (HI) recommendations and provides a short summary of the issues surrounding these. The relevant manager's agreement (or otherwise) to implementing the recommendation and implementation timescales is shown. Recommendations that have not been reported to the Committee before or where LCCIAS has identified that some movement has occurred to a previously reported recommendation are shown in **bold font**. Entries remain on the list until the auditor has confirmed (by specific re-testing) that action has been implemented.
9. To summarise movements within Appendix 2: -
 - a. Four new HI recommendations have been added;
 - b. Three HI recommendations have been closed (Operational risk management in Children and Young People's Services, Integrated Adults System and Partnership Risk);
 - c. Implementation dates for four HI recommendations were further 'extended' to allow for stabilisation or progression of arrangements (Capital Maintenance Programme; Pension Fund Contribution Banding (2) and Employee Annual Leave Recording).

Update on the County Solicitor's report on investigation into allegations concerning a former Member's conduct

10. At the Committee meeting held on 10 February 2014, members were informed that a settlement for Mr Parsons' inappropriate use of the official car and chauffeur had been agreed at £2,385.93. An initial sum of £285.93 had been paid by the date of that Committee meeting.
11. Members requested regular updates at each future meeting of the Committee until such time as the total amount due had been repaid in full. At the time of writing this report, two of the remaining seven equal instalments of £300.00 had been paid (1 March and 1 April) leaving a balance outstanding of £1,500.00. The final instalment is due on 1 September. A further update will be provided to the Committee at its meeting scheduled for 22 September 2014.

Fraud committed at Leicestershire Highways Operations

12. Within its Terms of Reference, one of the Committee's responsibilities is to monitor the effectiveness of officer arrangements for ensuring an adequate internal control environment and combating fraud and corruption. Members may have become aware that two former officers (who were previously employed in the General Engineering Group of the Highways Branch) were found guilty at Leicester Crown Court on Friday 28 March 2014 of 5 charges related to conspiracy to defraud the County Council. The fraudulent activity existed between December 2004 and August 2010. At the time of writing this report, the ex-employees are due to be sentenced on 9 May.
13. The case concluded that the ex-employees and two external associates had created a new company (the Company) which was used to defraud the Council. One ex-employee (a stores controller) created, authorised and placed orders for required goods from the Company. The other ex-employee (his wife) was a director of the Company for part of the period during which the Company was used. Neither of the ex-employees ever declared personal interests in the Company.
14. Goods were provided to the Council but at excessive prices and between 40% and 50% of stores purchases were 'off-contract'. The stores controller abused the trust placed in him. On the occasions that he sought subsequent authorisation by line managers, as part of the order review process, his deception was aided by those managers being less vigilant than they ought to have been.
15. Once financial irregularity had been identified, Leicestershire Constabulary was notified but the Police required the County Council's own investigations to be concluded before acting. In November 2010, the two ex-employees were suspended and the internal investigation continued until their disciplinary hearing in May 2011, at which allegations were considered regarding their failure to: disclose the link with the Company; follow reasonable management

instructions; adhere to permitted procurement limits; and only use approved contractors/suppliers. Both ex-employees were dismissed in May 2011 without either attending the disciplinary hearing, as both had resigned shortly beforehand. No managers were disciplined in respect of this matter, but the line managers involved are no longer employed by the County Council.

16. Since the discovery of the fraud a range of control processes were either re-established or implemented:
 - a. A 'Resource Allocation System' now assigns goods to schemes and so is better able to track the individual orders placed and the prices paid for goods.
 - b. The IT business and financial management system has been changed
 - c. I-procurement (including the need to 'approve' orders) now applies
 - d. Environment and Transport Department's Commissioning and Contracts Board undertook a separate review and ensured that, by the end of 2012, the extent of departmental off-contract spend was reduced to 3% for orders over £500
 - e. Internal Audit Service conducted three separate audits of processes and, overall, gave reasonable assurance that control had been re-established. Now that the Court case has been concluded, an in-depth audit of the ordering process within Leicestershire Highways Operations is to be conducted.
17. Management is confident that there are now far better controls in place to detect irregularities in purchasing activities. These, combined with focused internal audits, are expected to ensure against any other form of repetition. In addition there will be a stark warning to other members of staff of the consequences of taking any similar action, the need to abide strictly to the code of conduct and to promptly and accurately declare any personal interests.

Update on the adoption of the Public Sector Internal Audit Standards (PSIAS)

18. Organisations in the UK public sector have historically been governed by an array of differing internal audit standards. The Public Sector Internal Audit Standards (the PSIAS), which took effect from the 1st April 2013, provide a consolidated approach across the whole of the public sector enabling continuity, sound corporate governance and transparency. The PSIAS encompass not only the mandatory elements of the Global Institute of Internal Auditors (IIA), including a standard definition of internal auditing, a Code of Ethics and International Standards for the Professional Practice of Internal Auditing, but also further UK public sector requirements and interpretations.
19. The PSIAS mandate that the purpose, authority and responsibility of the County Council's internal audit activity must be formally defined in an internal audit charter (the Charter). A draft of the Internal Audit Charter for Leicestershire County Council is currently being reviewed by the Chief Financial Officer (i.e. the Assistant Director of Corporate Resources (Strategic

Finance and Property) and the Monitoring Officer. The draft Charter:

- a. recognises the mandatory nature of the PSIAS and relevant legislation;
 - b. defines the scope of internal audit activities;
 - c. establishes responsibilities, objectives & organisational independence;
 - d. establishes accountability, reporting lines and relationships;
 - e. sets out the arrangements for anti-fraud and anti-corruption policies;
 - f. establishes rights of access to all records, assets, people & premises;
 - g. define the terms 'board' & 'senior management';
 - h. covers the arrangements for appropriate resourcing;
 - i. defines the role of internal audit in any fraud-related work;
 - j. includes arrangements for avoiding conflicts of interest.
20. Once it has been reviewed by officers, final approval of the Charter rests with 'the Board'. The PSIAS allow for an organisation's audit committee (in Leicestershire's case the Corporate Governance Committee) to fulfil the role of the Board since it is likely to be the governance group charged with obtaining independent assurance of the adequacy of the risk management framework, the internal control environment and the integrity of financial reporting.
21. A further requirement of the PSIAS is for the HoIAS to develop and maintain a Quality Assurance and Improvement Programme (QAIP) to enable the internal audit activity's conformance against the standards to be assessed. The QAIP for LCCIAS is still being designed, but it is recognised as a service priority since the results of the assessment have to be reported in the HoIAS' annual report. The report must identify any instances of non-conformance. Should there be more significant deviations, they may be included in the finalised Annual Governance Statement. The Corporate Governance Committee (in its role as 'the Board' for the purposes of PSIAS), is responsible for receiving the HoIAS annual report.

Provisional annual internal audit opinion on the overall adequacy and effectiveness of the organisation's governance, risk and control framework

22. A public sector requirement within the PSIAS is that the HoIAS must provide an annual report to the Board timed to support the annual governance statement. The report must include an annual internal audit opinion on the overall adequacy and effectiveness of the organisation's governance, risk and control framework (i.e. the control environment) and a summary of the audit work from which the opinion is derived (including reliance placed on work by other assurance bodies). The PSIAS definition of the control environment is included at appendix C.
23. Each internal audit report may contain recommendations for improvements. The number, type and importance of recommendations affects how the auditor reaches their objective opinion on the level of assurance that can be given, that controls are suitably designed and applied effectively, and that material risks will likely not arise. The combined sum of individual audit opinions and

other assurances gained, allows the Head of Internal Audit Service (HoIAS) to form the annual internal audit opinion. The overall opinion is the professional judgement of the HoIAS based on the results of a number of individual engagements and other activities for a specific time interval.

24. The annual internal audit report will be delayed to the Committee's September's meeting, pending the HoIAS' assessment against the QAIP (see paragraph 21). In addition, at the time of writing this report, colleagues at Nottingham City Council Internal Audit Service (NCIAS) will not have concluded their audits on the key financial systems at East Midlands Shared Service (EMSS).
25. For those two reasons, it's prudent that the HoIAS issues a provisional opinion for Leicestershire. Should any changes be required, there is time to reflect this in the finalised and approved Annual Governance Statement in September.

Provisional opinion

26. In 2013-14 there was a small increase in the number of key risk audits that returned only 'partial' assurance ratings. This applied to governance, risk management and internal control functions. This is most likely an indicator of the increasing pressures and strains on staff, processes and systems during a time of unprecedented change, since all but one of the audits were in areas of new development or transition and hence controls and practices hadn't fully bedded down. Whilst management continued to accept the need for remedial action, there has been slippage in implementing some 'high importance' recommendations. There will be a need to monitor improvements to these areas as they move to 'business as usual', so that they do not slip off the radar behind further transformation. Nevertheless, the governance and level of attention paid by members and management to such issues is a comfort.
27. On the whole, reasonable assurance can be given that the Council's control environment is sound and that governance, risk and control frameworks are adequate and effective.

2013-14 LCCIAS Performance

28. The PSIAS advise reporting the Service's key performance measures in the annual report. However, because the report will be considered in September, it's felt prudent to report them now at the end of the financial year. The results below cover Leicestershire County Council, Leicestershire Pension Fund, East Midlands Councils and Bradgate Park Trust. Performance against the ESPO audit plan will be reported to its Finance and Audit Subcommittee in June.

Measure	Target	Actual	Reason
The amount of the Internal Audit Plan	Less than 10% of the total original planned	24% (400	Overheads incurred was greater than

not achieved during the year	jobs time	days)	planned, especially unplanned sickness, implementing a new MIS and developing traded services.
The number of audits completed	At least 90% of those planned	83%	As above, plus: A number of audits (for a variety of reasons) exceeded budgeted time which impacts on completion of other planned jobs. There were a number of 'postponements' pending forthcoming significant change programmes that meant it was not an appropriate time to audit.
The timeliness of reporting issues	Maintained school audit reports – 95% issued within three weeks of the conclusion of the visit. Assurance audits - 90% of draft reports issued within three months of the agreed field work start date.	100% 89%	Only 1% below target.
Return rate of client questionnaires	50% return	37%	Returns continue to dwindle, but of those returned customer satisfaction remains very high.
Performance against budget	Balanced budget	Surplus	Mostly a result of additional income generated trading with academies, including unforeseen teachers pensions audits and also additional work for a District Council.

29. Given the competing demands on the Service, including the need to extend trading to sustain service levels, performance was adequate and there was

sufficient resource input to allow the HoIAS to be able to form an annual opinion on the adequacy and effectiveness of the control environment.

Resource Implications

30. None

Equal Opportunities Implications

31. There are no discernible equal opportunities implications resulting from the audits listed.

Recommendation

32. That the contents of the report be noted.

Background Papers

The Constitution of Leicestershire County Council

Report to the Corporate Governance Committee on 14 June 2013 - Internal Audit Plan for 2013-14

Report to the Corporate Governance Committee on 13 February 2013 – East Midlands Shared Service Internal Audit Plan Update

Reports to the Corporate Governance Committee on 15 May and 29 June 2012 – Response to a request for an audit by Mr G.A. Boulter c.c. and reports to the Corporate Governance Committee on 14 June, 23 September and 25 November 2013 – Investigation into allegations concerning Members' conduct

Report to the Corporate Governance Committee on 26 November 2012 – Annual Review of Effectiveness of the System of Internal Audit and 13 February 2013 – Internal Audit Service Progress Report

Circulation under the Local Issues Alert Procedure

None.

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Appendices

- Appendix 1 - Summary of Final Internal Audit Reports issued during the period 1 January to 31 March 2014
- Appendix 2 - High Importance Recommendations
- Appendix 3 - The Public Sector Internal Audit Standards (PSIAS) definition of control environment

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