

**Status of Report:**

**Public**

**Agenda Item:**

**13**

**Meeting:** Combined Fire Authority

**Date:** 9<sup>th</sup> December 2015

**Subject:** Annual Internal Audit Report 2014/15

**Report by:** The Treasurer

**Author:** Adam Stretton (Area Manager – Finance)

**For:** Discussion

## **1. Purpose**

- 1.1 Under the Combined Fire Authority's (CFA's) Financial Procedure Rules the Treasurer is responsible for arranging a continuous internal audit of the CFA's accounts. The audit is designed to cover financial and related systems and the use of assets. This report covers the financial year 2014/15.

## **2. Recommendations**

CFA is asked to note the Annual Internal Audit Report 2014/15.

## **3. Executive Summary**

- 3.1. Detailed information behind how the annual opinion was formed is contained in the Internal Audit Annual Report 2014/15 at **Appendix 1** and the following conclusions have been drawn:
- a) On Governance, nothing of such significance, adverse nature or character has come to the Head of Internal Audit Services (HoIAS) attention. As such reasonable assurance is given that the CFA's governance arrangements during 2014/15 were robust.
  - b) On Risk Management, whilst no specific opinion was reached, management agreed to implement audit recommendations, which will mitigate risk. Therefore reasonable assurance is given that the risk is managed.
  - c) On internal control, reasonable assurance can be given that the CFA's core financial practices remain strong. However, the procurement cards recommendations need reviewing and implementing where accepted.

## **4. Report Detail**

- 4.1. The Internal Audit of the CFA is carried out by Leicestershire County Council's Internal Audit Service (LCCIAS). LCCIAS has adopted the principles of the Public Sector Internal Audit Standards (PSIAS). LCCIAS works closely with the external auditor, PricewaterhouseCoopers (PwC), so as to minimise duplication.

The PSIAS requires the HoIAS to provide an annual report which must include:

- a) An opinion on the adequacy and effectiveness of the CFA's control environment
- b) A summary of the audit work from which the opinion is derived
- c) A comparison of work actually undertaken with work that was planned including a summary of the performance of the internal audit function
- d) A statement on conformance with the PSIAS and the results of the internal audit Quality Assurance and Improvement Programme (QAIP)
- e) Any issues the HoIAS judges relevant to the preparation of the Annual Governance Statement (AGS).

4.2. The annual report contains the HoIAS' annual opinion (the opinion – Annex 1 to the Annual Report) on the overall adequacy and effectiveness of the CFA's control environment. The opinion forms part of the annual review of the effectiveness of the CFA's governance framework when compiling the AGS. In order to fulfil the statutory requirement to have the AGS approved by the end of September, the opinion was extracted from the annual report and included in the AGS.

4.3. The "control environment" covers the framework of governance, risk management and control. The HoIAS 'opinion' is given 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 and the professional judgement of the HoIAS based on his evaluation of other related activities. No system of internal control can provide absolute assurance against material misstatement or loss, nor can LCCIAS give absolute assurance, especially given limited resources. The work of LCCIAS is intended only to provide reasonable assurance on controls on the basis of the work undertaken

4.4. The responsibility for the design, implementation and operation of internal controls rests with managers. LCCIAS's task is to carry out independent and objective 'assurance' type audits of the adequacy and effectiveness of these controls and, if necessary, highlight weaknesses and recommend improvements. 'Consulting' type audits add value by allowing the auditor to give early commentary on management's design of controls in say a new system or process.

4.5. The audit work undertaken during 2014/15 is detailed in annex 2 to the annual report. Where risk levels are considered still to be significant, recommendations are designated as High Importance (HI). Overall assurance ratings were positive with only one requirement to issue a partial assurance relating to pension's administration and specifically the requirement that pension contributions are deducted at the correct banding. However, all recommendations in respect of this report have been agreed and actions implemented.

4.6. The HoIAS' self-assessment against the PSIAS (last conducted in May 2015) identified that current internal audit practices sufficiently conform, however a few specific areas have been identified where action is needed before the HoIAS can claim to fully conform. This was recorded as an area for improvement in the

AGS.

## **5. Report Implications / Impact**

### **5.1. *Legal (including crime and disorder)***

- a) Section 112 of the Local Government Finance Act 1988 states that the CFA should “make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs”. Under the CFA’s constitution, the Treasurer is responsible for arranging a continuous internal audit of the CFA’s accounts.

### **5.2. *Financial (including value for money, benefits and efficiencies)***

- a) In 2014/15 95 days of internal audit work was undertaken at a cost of £25,650 (£270 per day) which was the same rate charged in 2013/14.

### **5.3. *Risk (including corporate and operational, health and safety and any impact on the continuity of service delivery)***

- a) LCCIAS uses a number of audit techniques to formulate the annual opinion on the control environment. In the case of the CFA much work is based around a “risk based” audit. With this technique key risks (based on likelihood an impact) are identified and agreed at the start of the audit. The quality of controls to mitigate these risks is then tested.

### **5.4. *Staff, Service Users and Stakeholders (including the Equality Impact Assessment)***

- a) None.

### **5.5. *Environmental***

- a) None.

### **5.6. *Impact upon Our Plan Objectives***

- a) The CFA’s Strategic Objective 4 is the attainment of efficiency and the provision of a value for money service. The provision of internal audit assists both effective and efficient management and good corporate governance. It also externally validates the CFA’s progress in this area.

## **6. Background Papers**

- a) Internal Audit Plan 2014/15 – Overview and Scrutiny Committee 26<sup>th</sup> March 2014
- b) Statement of Accounts and Annual Governance Statement 2014/15 (CFA 24<sup>th</sup> September 2015).

## **7. Appendices**

1. Head of Internal Audit Service Annual Report 2014-15

Annex 1 – The Head of Internal Audit Service’s Annual Opinion on the overall adequacy and effectiveness of the control environment 2014/15

Annex 2 – Summary of Internal Audit Service work supporting the HoIAS 2014/15 opinion

# Combined Fire Authority Head of Internal Audit Service Annual Report 2014-15



**Neil Jones CPFA, Head of Internal Audit Service,  
Leicestershire County Council**

**27<sup>th</sup> August 2015**

**COMBINED FIRE AUTHORITY**  
**HEAD OF INTERNAL AUDIT SERVICE**  
**ANNUAL REPORT 2014-15**

**Background**

1. A common set of Public Sector Internal Audit Standards (PSIAS) was adopted in April 2013. The PSIAS encompass the mandatory elements of the Global Institute of Internal Auditors (IIA Global) International Professional Practices Framework (IPPF) as follows: -
  - i. Definition of Internal Auditing
  - ii. Code of Ethics
  - iii. International Standards for the Professional Practice of Internal Auditing
2. Additional requirements and interpretations for the local government sector have been inserted into the PSIAS and all principal local authorities (including combined fire authorities) must make provision for internal audit in accordance with the PSIAS.
3. The objectives of the PSIAS are to: -
  - a. define the nature of internal auditing within the UK public sector
  - b. set principles for carrying out internal audit in the UK public sector
  - c. establish a framework for providing internal audit services, which add value to the organisation, leading to improved organisational processes and operations
  - d. establish the basis for the evaluation of internal audit performance and to drive improvement planning
4. The PSIAS require the Head of Internal Audit Service (HoIAS) to provide an annual report to 'the Board' the Corporate Governance Committee of Leicester, Leicestershire and Rutland Combined Fire Authority (the CFA) timed to support the annual governance statement.
5. The PSIAS state that the annual report must include:
  - a. an annual internal audit opinion on the overall adequacy and effectiveness of the CFA's governance, risk and control framework (i.e. the control environment) and disclosure of any qualifications to the opinion, together with the reasons for the qualification
  - b. a summary of the audit work from which the opinion is derived (including reliance placed on work by other assurance bodies) and disclosure of any impairments or restriction in scope
  - c. a comparison of the work actually undertaken with the work that was planned including a summary of the performance of the internal audit function against its performance measures and targets
  - d. a statement on conformance with the PSIAS and the results of the internal audit Quality Assurance and Improvement Programme (QAIP) and progress against any improvement plans resulting from a QAIP external assessment
  - e. any issues the HoIAS judges particularly relevant to the preparation of the annual governance statement

## **The Annual Internal Audit Opinion on the Adequacy and Effectiveness of the CFA's Control Environment**

6. Annex 1 provides detail on how the annual internal audit opinion was formed, defines the components of the control environment and what it is designed to achieve, and provides a caveat on any opinions reached.
7. Based on an objective assessment of the results of individual audits undertaken, actions by management thereafter, and the professional judgement of the HoIAS in evaluating other related activities, the following sub-opinions have been drawn:-

### Governance

Nothing of such significance, adverse nature or character has come to the HoIAS attention. As such reasonable assurance is given that the CFA's governance arrangements during 2014-15 were robust.

### Risk management

Whilst no specific opinion was reached, management agreed to implement audit recommendations, which will mitigate risk. Therefore reasonable assurance is given that risk is managed.

### Financial and ICT Control

Reasonable assurance can be given that the CFA's core financial practices remain strong. However, the procurement cards recommendations need reviewing and implementing where accepted.

## **A summary of the audit work from which the opinion is derived**

8. 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 (HI) recommendations.
9. A high proportion of the audits undertaken were 'assurance' type defined as '*An objective examination of evidence for the purpose of providing an independent assessment*'. Based on the testing undertaken, one was graded 'full' assurance rating with no recommendations. The other audits returned a 'substantial assurance' rating, meaning the controls in place to reduce exposure to risks to achieving the system's objectives were well designed and were being operated effectively. Where there were recommendation(s) to bring about improvements, they did not have a HI rating signifying a particularly serious control weakness had been identified.
10. There was one partial assurance rating because a high important (HI) recommendation (scored against the CFA's risk management criteria) was identified denoting there was an absence of, or a weakness in control and therefore achievement of the service's objectives was open to material risk exposure. This was in relation to the audit of pension's administration and

specifically in the requirement that pension contributions are deducted at the correct banding. However all recommendations in respect of this report have been agreed and their implementation will be followed up.

11. The Treasurer commissioned an audit to investigate further the circumstances surrounding the reported misuse of one of the Authority's procurement cards and to give assurances to management that robust procedures exist to approve card holders and monitor on-going usage. A number of recommendations were made.
12. LCCIAS is the CFA's co-ordinator for provision of data into the biannual 'National Fraud Initiative' (NFI) a nationwide counter-fraud data-matching exercise. A duplicate payment of £4,080 (straddling two financial years) was successfully recovered. All other reports have been investigated with the exception of one pension's report which is still being reviewed by the County Council's pension's section<sup>1</sup>.
13. During 2014-15 the HoIAS did not place reliance on work by other assurance bodies.

<sup>1</sup> Update 28<sup>th</sup> October 2015 – the report has now been reviewed and is satisfactory



**A comparison of work undertaken with work planned including a summary of the performance of the internal audit function**

14. The table below shows planned against actual performance both in terms of number of audits and days allocated. The position is at 23<sup>rd</sup> August 2015

**Table 1 : Overall performance against 2014-15 internal audit plan**

	<u>Audits</u>	<u>Complete @ 23/8</u>	<u>Incomplete @ 23/8</u>	<u>Plan days</u>	<u>Actual days</u>	<u>Net days</u>
B/fwd from 13-14	4	4	0	0	8	0
Planned	13	11	2	78	81	+4
Unplanned	1	0	1	0	4	+3
Client management (inc f/u high recs)	-	-	-	7	10	+3
<b>Total</b>	<b>18</b>	<b>15</b>	<b>3</b>	<b>85</b>	<b>95</b>	<b>+10</b>

15. One planned audit was incomplete at the close of the financial year. Although work commenced in mapping out the 'lines of defence' assurance framework, this work can only be completed within 2015-2016 once revised governance and management structures are known.
16. One planned audit of the Medium Term Financial Planning Cycle (MTFS) was deferred by the Treasurer predominantly due to decisions being made on the Integrated Risk Management Plan (IRMP) which resulted in a revised MTFS being presented to CFA on 8th April 2015.
17. One unplanned audit on reviewing controls for purchasing cards following misuse was incomplete<sup>2</sup>.
18. Client management was higher than planned mostly due to the impact on the HoIAS to develop and deliver key governance improvements i.e. the Internal Audit Charter and increased liaison with the External Auditor over work on pensions.
19. The amount charged for services amounted to £25,650 against a budget of £22,950 with the increased charges for additional work authorised in advance by the Treasurer.

<sup>2</sup> Update at 28<sup>th</sup> October 2015 – the audit is now finalised

**A statement on conformance with the PSIAS and the results of the internal audit Quality Assurance and Improvement Programme (QAIP)**

20. In May 2015, the HoIAS conducted a rigorous challenge and self-assessment of LCCIAS's conformance to the PSIAS. The self-assessment identified that current practices generally sufficiently conform to the PSIAS. However, a few specific areas were identified where action was needed before the HoIAS can claim to fully conform, and state so in documents and correspondence.
21. A summary analysis of conformance (based on 'yes', 'partly' and 'no') is shown in table 2 below. The key to the columns is: -
- Y = fully conforms
  - Y/P = mostly conforms with some minor areas for improvement
  - P = a balanced result which partly conforms
  - P/N = only some conformance with a real need for improvement
  - N = doesn't conform at all

**Table 2 : Summary self-assessment against conformance to PSIAS**

<b>Does LCCIAS conform to PSIAS</b>	<b>Y</b>	<b>Y/P</b>	<b>P</b>	<b>P/N</b>	<b>N</b>
1 Definition of Internal Auditing		X			
2 Code of Ethics		X			
3 Attribute Standards (combined)		X			
1000 Purpose, Authority and Responsibility	X				
1100 Independence and Objectivity		X			
1200 Proficiency and Due Professional Care		X			
1300 Quality Assurance and Improvement Programme				X	
4 Performance Standards (combined)			X		
2000 Managing the Internal Audit Activity			X		
2200 Engagement Planning		X			
2300 Performing the Engagement			X		
2400 Communicating Results		X			
2500 Monitoring Progress			X		
2600 Communicating the Acceptance of Risks			X		

22. A detailed list of actions required has been determined. Of these, the need to embed and review progress against a Quality Assurance and Improvement Programme (QAIP) is a priority. This is a new requirement for all internal audit providers, and whilst it doesn't mean that quality isn't being provided and managed at LCCIAS, there is a formal requirement to document and prove it.
23. PSIAS 1321 informs that the HoIAS may only state that the internal audit activity conforms with the International Standards for the Professional Practice of Internal Auditing when it achieves the outcomes described in the Definition of Internal Auditing, Code of Ethics and Standards and the results of the quality assurance and improvement programme support this statement. For the time being, the HoIAS is continuing to state that LCCIAS abides by the principles of the PSIAS.

**Any issues the HoIAS judges particularly relevant to the preparation of the annual governance statement**

24. During 2014-15 the HoIAS did not come across any governance, risk management or internal control issues that would need to be disclosed as key improvement areas or significant governance issues.
25. However, under PSIAS 1322, whilst the results of the HoIAS' self-assessment against conformance to the PSIAS is not considered a significant deviation from the PSIAS, the reference to continuing actions (including progressing the QAIP) should be recorded as a key improvement area in the CFA's Annual Governance Statement.

Neil Jones CPFA  
Head of Internal Audit Service  
LCCIAS

27<sup>th</sup> August 2015.

**Leicester, Leicestershire and Rutland Combined Fire Authority  
The Head of Internal Audit Service's Annual Opinion  
on the overall adequacy and effectiveness  
of the control environment  
2014-15**



**Neil Jones CPFA, Head of Internal Audit Service,  
Leicestershire County Council**

**19<sup>th</sup> August 2015**

## Background

Leicestershire County Council's Internal Audit Service (LCCIAS) provides the internal audit function for the Leicester, Leicestershire and Rutland Combined Fire Authority (CFA). 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 the CFA'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 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 CFA'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 the small amount of internal audit resource commissioned by the CFA Treasurer. 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**

A governance themed Ethics and Culture audit, returned substantial assurance. The annual Key ICT Controls work (substantial assurance) contains some focus on IT Organisation and Governance and the associated management of risk. Phase one of the electronic fuel management audit concentrated on the governance aspects of the process, including supporting policies and procedures.

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.

Good governance was displayed during the specific risk management audit (see below) when it was identified that the revised procedure had been externally reviewed by peer and other local public sector organisations

Work commenced in mapping out the 'lines of defence' assurance framework. This work will be completed within 2015-2016 once revised governance and management structures are known.

A planned audit of the Medium Term Financial Planning Cycle (MTFS) was deferred by the Treasurer predominantly due to decisions being made on the Integrated Risk Management Plan (IRMP) which resulted in a revised MTFS being presented to CFA on 8<sup>th</sup> April 2015. The HoIAS attended the Overview and Scrutiny Committee (the Committee) to present internal audit plans and reports. This enabled him to gauge good governance at Member and senior management level at first hand.

At its meeting on 18<sup>th</sup> March 2015, the Committee approved an Internal Audit Charter for the CFA mandating the purpose, authority and responsibility of the internal audit activity. LCCIAS shared the County Council's revised Anti-Fraud and Corruption documents to enable the Treasurer to update the CFA's suite of counter fraud documents to enable it to conform to the principles of the CIPFA Code of Practice for Managing the Risk of Fraud & Corruption.

The HoIAS held regular discussions with the Treasurer and where required the Monitoring Officer (MO) on governance issues and related audit aspects.

**HoIAS opinion: - Nothing of such significance, adverse nature or character has come to the HoIAS attention. As such reasonable assurance is given that the CFA's governance arrangements during 2014-15 were robust.**

#### **Risk management related internal audit work**

In general terms, internal audits planned and conducted are 'risk based' i.e. ensuring that the CFA's management identifies, evaluates and manages risk to achieving its objectives i.e. ensuring sufficient and adequate controls are in place to reduce risk exposure.

A follow up audit was conducted to ascertain whether risk management activities were co-ordinated across the differing service areas and a revised Corporate Risk Management Guidance (Procedure) and Corporate Risk Register (CRR) had been developed and implemented. Implementation was delayed, mainly as a result of management's involvement in the Service's response to industrial action. Whilst progress had been made and recommendations were agreed, an opinion was not reached because at the date of the audit (early February 2015) it couldn't be confirmed whether the CRR (2013-16) was complete and included all key risks. Management accepted that the level of risk was sufficient to emphasise that prompt action was required by June 2015, to approve and implement the full Procedure, and develop a robust Organisational CRR. It was intended to gain Policy Committee approval in June 2015 but that Committee was cancelled.

**HoIAS opinion: Whilst no specific opinion was reached, management agreed to implement audit recommendations, which will mitigate risk. Therefore reasonable assurance is given that risk is managed.**

## **Financial (and ICT) Controls related internal audit work**

Of the six audits with a financial or ICT control theme one was graded at full assurance and four returned substantial assurance.

There was one partial assurance rating in relation to the audit of pensions administration and specifically in the requirement that pension contributions are deducted at the correct banding. However all recommendations in respect of this report have been agreed and their implementation will be followed up.

The Treasurer commissioned an audit to investigate further the circumstances surrounding the reported misuse of one of the Authority's procurement cards and to give assurances to management that robust procedures exist to approve card holders and monitor on-going usage. A number of recommendations were made.

**HoIAS opinion: Reasonable assurance can be given that the CFA's core financial practices remain strong. However, the procurement cards recommendations need reviewing and implementing where accepted.**

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## **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'.



**Summary of Internal Audit Service work supporting the HoIAS 2014-15 opinion**

**Annex 2**

<b>CE</b>	<b>Job</b>	<b>Final report (or position @23/8)</b>	<b>Opinion</b>	<b>HI Rec</b>
G	Ethics & Culture	19/08/2015	Substantial Assurance	
G	Assurance Framework	Ongoing	N/A	
G	Medium Term Financial Planning Cycle	Postponed - Agreed with S112 Officer	N/A	
RM/G	Risk Management Framework	20/03/2015	No opinion	
IC	Reconciliations and balances - 2013-14 accounts final audit	12/08/2014	Full Assurance	
IC	Reconciliations and balances - 2014-15 accounts interim audit	09/04/2015	Full Assurance	
IC	Payroll - 2013-14 accounts - final audit	25/07/2014	Full Assurance	
IC	Payroll - 2014-15 accounts interim audit	14/08/2015	Substantial Assurance	
IC/G	ICT Controls	22/05/2015	Substantial Assurance	
IC	Agresso Business Management System - Duplicate Payments	24/09/2014	Substantial Assurance	
IC/G	Electronic Fuel Management System	07/04/2015	Substantial Assurance	
IC	Pensions	14/08/2015	Partial assurance	Yes
IC	National Fraud Initiative	Work complete 31/3/15	N/A	
IC	Purchase Card Investigation	Draft issued	N/A Investigation	