

HUNTINGDONSHIRE DISTRICT COUNCIL

Title:	Internal Audit Opinions
Meeting/Date:	Corporate Governance Panel – 29 January 2014
Executive Portfolio:	Resources: Councillor J A Gray
Report by:	Internal Audit Manager
Ward(s) affected:	All Wards

Executive Summary

The report explains the terminology associated with the annual internal audit opinion and internal audit reports. This information was requested by the Panel following the review of their own effectiveness in September 2013.

Public Sector Internal Audit Standard (PSIAS) 2450 states that if an overall internal audit opinion is issued it needs to take into account the expectations of senior management (COMT) and the Board (this Panel). Expectations in this context cover the :

1. value of the opinion to the stakeholders
2. timing of the issue of the opinion
3. form of the opinion
4. level of assurance to be provided
5. period or point in time the opinion covers.

The Internal Audit Charter approved by the Panel in March dealt with points 1, 2, 3 and 5. This report deals with item 4.

Internal audit work is planned and performed to obtain appropriate evidence, sufficient to support the assurance opinion stated in individual audit reports. Since 2004, four levels of assurance opinion have been used in internal audit reports to summarise the adequacy of the controls within individual systems or audited areas – **Substantial, Adequate, Limited and Little**. The opinion levels and supporting definitions are regularly reviewed.

Chief Officers' Management Team, in taking into account the current risk appetite (as described within the risk management strategy), require managers to achieve an overall 'adequate' level of assurance across their systems and processes.

The annual internal audit opinion upon the Council's internal control environment is based upon the work carried out by Internal Audit during the year and the assurance made available by external assessors and similar providers. The annual internal audit opinion has always been expressed by using one of the four opinion descriptors noted above. It is proposed that this approach remains.

It is important to recognise that whenever an audit opinion is expressed it is the internal auditors subjective view based upon the findings of their review. Limitations

exist in all systems of internal control. Even when stated positively, the opinion is neither a guarantee, nor should it be taken as providing 'absolute' assurance, that the system is free from error or that it will always meet its objectives.

Financial implications

There are no direct financial implications arising from the report. If the Panel decide that they require 'substantial' assurance across all service areas, it is likely that additional controls will be required to be introduced. The cost associated with these cannot be determined at this time.

Recommendations:

It is recommended that the Panel note the report and the process followed for preparing both the annual and individual internal audit report assurance opinions.

1. INDIVIDUAL INTERNAL AUDIT OPINIONS

- 1.1 At the conclusion of an internal audit review, the auditor will form a judgement, based on the work they have completed, as to the overall assurance opinion they believe should be included in the internal audit report.

There are four opinions available: **Substantial, Adequate, Limited, or Little.**

The opinion issued is based upon the auditors view as to the existence and adequacy of the controls in place to manage the risks within the system under review and the reliance that a manager can place upon those controls. The opinion given is nothing more than a shorthand way of expressing the auditor's level of concern. The focus of attention should be on the specific audits findings and the actions that will address them.

- 1.2 The opinion that is given (see Appendix 1) is included in specific paragraph in the report, e.g.

“Based on the audit work undertaken it is my opinion that the inherent risks are generally well managed although there are some control weaknesses which have been identified. Consequently, if the existing approach is maintained I am able to provide adequate assurance that the system risks are being properly managed”.

- 1.3 Auditors work to the following guidelines when deciding upon the opinion to be given:

Inherent Risks Are	Absence of Controls ¹	Control Failings In System ²	System impact / Implications	Assurance Level Given
Well / over managed	None	None	Objectives achieved	Substantial
Generally well managed	Minor	Minor	Objectives achieved	Adequate
Not adequately managed	Significant	Major	Objectives not met & significant improvements required	Limited
Not being managed	Major	Major	Objectives not met & risk of significant error or abuse	Little

¹ Controls are effective in design

² Controls are effective in operation

- 1.4 Whilst there will be many unique inherent risks within a system, the majority of reviews will also consider a number of common areas and the opinion reached takes into account how well these common areas are managed:

- procedure notes/instructions
- authority to take decisions/compliance with Constitution
- identification and management of service development risks
- data protection/bribery and
- performance management information.

2. INTERNAL AUDIT ACTIONS

- 2.1 Managers are responsible for how their services operate. For that reason, internal audit reports do not include recommendations, but suggested actions for managements consideration.
- 2.2 The actions fall into two categories: red (high risk failings) or amber (medium risk failings).

Red High risk: current controls are inadequate and/or ineffective. The inherent risks have not been properly managed and the resulting residual risk has the potential to seriously affect service delivery. High risk actions must be implemented as the current exposure to risk is unacceptably high, indicating a major control weakness.

Actions will normally be given a red priority when the residual risk identified

- adversely affects the annual *Statement on Corporate Governance*
- may result in the significant loss of funds or assets
- may lead to service delivery failures which could adversely affect the council's reputation
- shows non-compliance with statutory requirements, the Council's Constitution or its codes and/or policies.

Amber Medium risk: current controls that manage the inherent risks need to be improved to further reduce the residual risks and give managers greater confidence in the system. Control weaknesses identified during the audit have the potential to compromise internal control, operational effectiveness or service delivery.

Actions will be given an amber priority when the residual risk identified

- shows non-compliance with established good practice
- the lack of, or failure of performance management or reporting systems
- failures in supporting systems
- non-major failures in controls that potentially affect compliance with key Council responsibilities listed under the High Risk priority definition above.

- 2.3 Red actions that cannot be agreed are referred to the S151 Officer, whilst amber actions that cannot be agreed will be referred to the appropriate member of Chief Officers' Management Team. In this way, the acceptance of the control failing that has been identified has to be formally accepted and understood by senior management. Any actions that fall into this category are reported to the Panel in the interim/annual internal audit report.

3. ANNUAL INTERNAL AUDIT OPINION

- 3.1 The Internal Audit Charter requires that "the annual report shall be timed to support the Council's Annual Statement of Assurance on Corporate Governance and include an opinion on the overall adequacy and effectiveness of the control environment".

Definition of the control environment is included at Appendix 2. The definition has been used since 2006 and been taken directly from the Cipfa Code of

Practice for Internal Audit in Local Government in the United Kingdom. The Cipfa Code is no longer applicable having been replaced by the Public Sector Internal Audit Standards. The Standards do not provide any similar definition of control environment. The definitions in Appendix 2 remain valid.

- 3.2 The annual opinion is based upon the audit work completed in the previous year, results of follow-up work on agreed audit actions that have been introduced (including any changes in 'limited' or 'little' assurance opinions previously issued) and any opinions that can be relied upon from the work of other assurance bodies.
- 3.3 The opinion is again given using one of the four assurance opinions – substantial, adequate, limited or little. The descriptions of these opinions (as described in Appendix 1) is used as the basis for deciding on the overall opinion.
- 3.4 The opinion that is given is in a 'positive' form and so provides the highest level of assurance. In providing positive assurance, the Internal Audit Manager take a definite position – that internal controls are or are not effective or the risks are or are not being managed.
- 3.5 On occasions, the opinion has remained positive, but been qualified. This is useful in situations where there is an exception to the general opinion, e.g. controls were adequate with the exception of accounts payable controls which require significant improvement.
- 3.6 The alternative opinion that can be given is that of 'negative' assurance. This type of opinion does not provide the same assurance value. It is a statement that nothing came to the auditors attention that would indicate inadequate controls are in place. The negative opinion merely states that the internal auditor has not encountered any issues within the work they performed.

4. LIST OF APPENDICES INCLUDED

Appendix 1 – Internal audit opinion statements
Appendix 2 – Definition of internal control environment

BACKGROUND PAPERS

Public Sector Internal Audit Standards.

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INTERNAL AUDIT OPINION STATEMENTS

The following information is an extract of the information contained in the internal audit manual.

Assurance opinion options	Audit Report paragraph
<p>Substantial</p> <p>There are no weaknesses in the level of control for managing the material inherent risks within the system. Testing shows that controls are being applied consistently and system objectives are being achieved efficiently, effectively and economically apart from any excessive controls which are identified in the report.</p>	<p>Based on the audit work undertaken it is my opinion that the inherent risks in the system are</p> <p>(option 1) being well managed and that key controls are being applied consistently and effectively.</p> <p>(option 2) too low, and the system is being over managed.</p> <p>Consequently, if the existing approach is maintained I am able to provide substantial assurance that the system risks are being properly managed.</p>
<p>Adequate</p> <p>There are minor weaknesses in the level of control for managing the material inherent risks within the system. Some control failings have been identified from the systems evaluation and testing which need to be corrected. The control failings do not put at risk achievement of the system's objectives</p>	<p>Based on the audit work undertaken it is my opinion that the inherent risks are generally well managed although there are some control weaknesses which have been identified</p> <p>Consequently, if the existing approach is maintained I am able to provide adequate assurance that the system risks are being properly managed.</p>
<p>Limited</p> <p>There are weaknesses in the level of control for managing the material inherent risks within the system. Too many control failings have been identified from the systems evaluation and testing. These failings show that the system is clearly at risk of not being able to meet its objectives and significant improvements are required to improve the adequacy and effectiveness of control.</p>	<p>Based on the audit work undertaken it is my opinion that the inherent risks are not being adequately managed. There is a clear risk that the system will fail to achieve its objectives.</p> <p>Consequently, if the existing approach is maintained I am able to provide only limited assurance that the system risks are being properly managed.</p>

Little

There are major, fundamental weaknesses in the level of control for managing the material inherent risks within the system. The weaknesses identified from the systems evaluation and testing are such that the system is open to substantial and significant error or abuse and is not capable of meeting its objectives.

Based on the audit work undertaken it is my opinion that the inherent risks in the system are not being managed properly. The system is not capable of achieving its objectives.

Consequently, if the existing approach is maintained I am able to provide little assurance that the system risks are being properly managed.

Guide to selecting the assurance opinion

This guide is intended to be the starting point (rather than being an authoritative key) for deciding upon the actual assurance opinion to be given. Opinions can't be judged solely on the basis of the number of actions in a particular category. The auditors judgement on the controls in place, controls that are absent and the consequences arising from, or likelihood of events occurring due to the residual risks, all need to be considered.

The Audit Manager agrees all assurance opinions reported. All audits where Little assurance is given will be highlighted in the Annual Governance Statement.

Red	Amber	Inherent Risks are	Level of Assurance
No	No	well managed, over managed	Substantial No report, memo only
No	Yes	generally well managed	Adequate
Yes	Yes	not being adequately managed	Limited
Yes	Yes	not being managed	Little

The selection of the Limited or Little assurance opinion will depend upon the significance and number of red suggested actions.

Internal Control Environment

The following definitions are contained in the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom (2006).

Internal control environment:

The control environment comprises the systems of governance, risk management and internal control. The key elements of the control environment include:

- establishing and monitoring the achievement of the organisation's objectives
- the facilitation of policy and decision-making ensuring compliance with established policies, procedures, laws and regulations – including how risk management is embedded in the activity of the organisation, how leadership is given to the risk management process, and how staff are trained or equipped to manage risk in a way appropriate to their authority and duties
- ensuring the economical, effective and efficient use of resources and for securing continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness
- the financial management of the organisation and the reporting of financial management
- the performance management of the organisation and the reporting of performance management

Internal control

A term to describe the totality of the way an organisation designs, implements, tests and modifies controls in specific systems, to provide assurance at the corporate level that the organisation is operating efficiently and effectively.