

Report to the Audit and Governance Committee



Report reference: **AGC-018-2010/11**
Date of meeting: **15 November 2010**

**Epping Forest
District Council**

Portfolio: **Finance & Economic Development**

Subject: **Internal Audit Assurance Levels**

Responsible Officer: **Brian Bassington (01992 564446).**

Democratic Services Officer: **Gary Woodhall (01992 564470).**

Recommendations/Decisions Required:

The Committee is requested to consider:

(1) the circumstances whereby an audit report is designated as “limited assurance”; and

(2) the circumstances under which a report is referred to Audit & Governance Committee and the Director is required to attend.

Executive Summary:

This report arises from discussions at Management Board on 20 October 2010 and the Corporate Governance Group on 27 October 2010 regarding a report by a Director, which set out concerns regarding the current classification structure of internal audit reports, especially around those classified as “Limited Assurance”. This classification carries with it a number of requirements including a requirement for Directors to attend Audit & Governance Committee to explain / defend the classification given.

A limited assurance classification arises whenever there is a breach of Contract Standing Orders or Financial Regulations and may appear to be irrespective of the nature or severity of that breach and also irrespective of whether in all other respects the audit is entirely satisfactory. This may give the Audit & Governance Committee the impression that the audit outcome is worse than it actually is.

While it is accepted that its entirely proper for matters of serious concern to be raised before the Audit & Governance Committee, this report requests the Audit and Governance Committee to consider reviewing this approach to the limited assurance classification and the proposed priority and assurance definitions attached at appendix A.

Report:

1. Following a recent meeting of the Audit & Governance Committee where the quarterly Internal Audit progress report included a Limited Assurance report which under current arrangements requires the relevant Director to attend, concerns were raised as to the allocation of assurance levels and the assessment of the nature or severity of the breaches that result in the limited assurance.

2. The Chief Internal Auditor (CIA) has met with the two Directors who had raised concerns to discuss the reasoning behind the levels assigned to audit reports and following research of how other public organisations assess assurance levels, the CIA is proposing the

attached clarification of definitions for discussion and adoption.

3. Fifteen public organisations were researched covering different levels of local government, the fire service and higher education, of which seven use the same assurance classification as EFDC but with varying definitions. The assessment of the levels of recommendations and assurance are by their very nature subjective, being based on risk of major error, loss, fraud or damage to reputation. It is felt that the proposed definitions will guide auditors and provide a level of standardisation between reports.

4. The current requirement of relevant Directors to attend Audit and Governance Committee to answer questions on limited assurance reports has evolved over the life of the Committee. It was originally a requirement that the relevant Assistant Director attend if an audit follow up report identified that agreed action had not been taken.

5. It is suggested that consideration should be given to an alternative approach where the Director would submit a written position statement to be presented with the Quarterly Internal Audit Progress Report, which would be subject to a follow up audit review. The Director would then attend the Audit and Governance Committee if any recommendations were still outstanding or if the Audit and Governance Committee were unhappy with the written submission.

6. This would provide a mechanism where breaches are taken seriously and are required to be followed up and dealt with, but are only referred to the Audit and Governance Committee where the Directorate has not dealt satisfactorily with the issues raised. This more balanced approach would ensure that a Director is called to explain in the event that matters are not corrected satisfactorily within agreed time scales or, that matters are worse at the follow up audit.

Resource Implications:

Within the report.

Legal and Governance Implications:

Within the report.

Safer, Cleaner and Greener Implications:

No specific implications.

Consultation Undertaken:

Management Board and Corporate Governance Group.

Background Papers:

Audit files and working papers.

Impact Assessments:

Risk Management

Internal Audit has a primary objective to provide an independent and objective opinion on the adequacy of the Council's control environment, including its governance and risk management arrangements. The proposals referred to in this report will assist the Audit staff in determining the adequacy and effectiveness of the arrangements in place in systems and provide clarity for Directors.

Equality and Diversity

Did the initial assessment of the proposals contained in this report for relevance to the Council's general equality duties, reveal any potentially adverse equality implications? No

Where equality implications were identified through the initial assessment process, has a formal Equality Impact Assessment been undertaken? No

What equality implications were identified through the Equality Impact Assessment process?
There are no specific equalities impacts.

How have the equality implications identified through the Equality Impact Assessment been addressed in this report in order to avoid discrimination against any particular group?
There are no specific equalities impacts.

Priority Ratings

Each audit finding will generate an audit recommendation. These recommendations will be prioritised in accordance with the following criteria:

Priority 1 – Observations refer to issues that are fundamental to the system of internal control. We believe that these issues have caused or will cause a system objective not to be met and therefore require management action as a matter of urgency to avoid risk of major error, loss, fraud or damage to reputation. Failure to apply a Financial Regulation or Contract standing Order will normally be in this category.

Priority 2 – Observations refer mainly to issues that have an important effect on the system of internal control but do not require immediate management action. System objectives are unlikely to be breached as a consequence of these issues, although Internal audit suggested improvement to system design and / or more effective operation of controls would minimise the risk of system failure in this area.

Priority 3 – Observations refer to issues that would if corrected, improve internal control in general and ensure good practice, but are not vital to the overall system of internal control.

Assurance levels:

The level of assurance to be applied will be based on the auditor's assessment of the extent to which system objectives are met, with the agreement of the Chief Internal Auditor. As a guide, the following triggers will be used, taking into account the level of risk of error, loss, fraud or damage to reputation.

Overall assignment rating	Level of assurance and definition Trigger (number of individual audit recommendations)
1 Full Assurance –	There is a sound system of control designed to achieve system objectives, and the controls are being consistently applied. Priority 3s or no audit recommendations.
2 Substantial Assurance –	There is a sound system of control designed to achieve system objectives, and the controls are generally being consistently applied. However, there are some minor weaknesses in control, and/or evidence of non-compliance, which are placing some system objectives at risk. Priority 2s and 1 Priority 1 (if assessed as a low risk).
3 Limited Assurance –	There is a system of control in place designed to achieve system objectives. However, there are significant weaknesses in the application of control in a number of areas, and / or evidence of significant non-compliance, which are placing some system objectives at risk. Between 1 and four 1s and (usually) several Priority 2s.
4 No Assurance –	The system of control is weak, and / or there is evidence of significant non-compliance, which exposes the system to the risk of significant error or unauthorised activity. Five or more Priority 1s.