

**Lancashire County Council  
Internal Audit Service**

**Annual report of the chief internal auditor  
for the year ended 31 March 2013**

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## **1 Introduction**

### **Purpose of this report**

- 1.1 This report summarises the work that the county council's Internal Audit Service has undertaken during 2012/13 and the key themes arising in relation to internal control, governance and risk management across the council.

### **The role of internal audit**

- 1.2 The Internal Audit Service is an assurance function that provides an independent and objective opinion on the adequacy and effectiveness of the council's control environment. The Public Sector Internal Audit Standards issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Chartered Institute of Internal Auditors (IIA) require the chief internal auditor to provide an opinion on the council's control environment and a written report to those charged with governance, timed to support the annual governance statement. This report presents my opinion based upon the work the Internal Audit Service has performed during 2012/13.
- 1.3 The scope of our work, management and audit's responsibilities, the basis of my assessment, and access to this report are set out in Annex C to this report.

### **Interim reports**

- 1.4 This report builds on the matters reported in previous years which remain relevant and matters that have been the subject of discussions throughout the year with members of the Management Team and their senior management teams.
- 1.5 I have also reported summaries of key areas of audit work to the Audit and Governance Committee as they have been completed during the year, including a report for the final period of the year.

Ruth Lowry  
Chief Internal Auditor  
Lancashire County Council

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## 2 Summary assessment of internal control

### Overall opinion

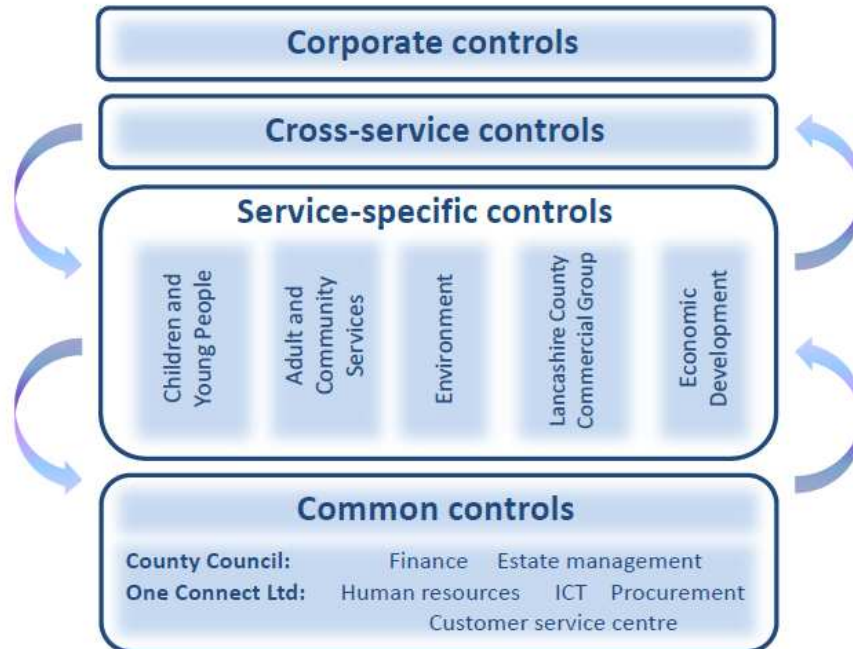
- 2.1 On the basis of our programme of work for the year, I can provide **substantial** assurance overall that there is generally sound system of internal control, adequately designed to meet the council's objectives, and controls are generally being applied consistently. However some weaknesses in the design and inconsistent application of controls put the achievement of particular objectives at risk.
- 2.2 In forming my opinion on the council's internal control environment, risk management and corporate governance, I have considered the work undertaken by the Internal Audit Service throughout the year as well as, to a more limited extent, the work of external assurance providers. Although the results of individual audit assignments are almost evenly spread between substantial/ full assurance and limited/ nil assurance it is clear that real improvements continue to be made in some common areas of control across the council and that the council's risks are adequately controlled and, in overall terms, there is generally a sound system of internal control. There are a number of other areas where controls are either inadequately designed for their current purpose or ineffectively operated in practice and the follow up of action plans agreed with management to remedy this will be a focus of audit work in the coming year.
- 2.3 I have provided more detailed summaries of individual pieces of audit work throughout the course of the year in my progress reports to each meeting of the Audit and Governance Committee.
- 2.4 Explanations of the work we have done are set out below and an explanation of the levels of assurance the Internal Audit Service provides are set out in Annexes A and C. Annex B provides a table of each assurance assignment the team has undertaken during the year and the level of assurance we have provided for each.

### The council's control framework

- 2.5 Our work has been organised in accordance with the Internal Audit Service's understanding of the council's controls as follows:
- **Cross-cutting controls:** These controls manage the risks arising from the council's over-arching business objectives that cut across all service areas.
  - **Cross-service controls:** These are the controls that support the council's work across some or all of its service areas, either where two or more teams provide a single service, or where risks are common to a number of (or all) service teams.
  - **Common controls:** These are the controls that under-pin the council's work whatever service is being provided and in whatever service or directorate. They manage the risks of its day to day operations that are operated in common across the whole organisation.
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- Service-specific controls: The controls designed to manage the risks arising in individual service areas.

### The council's control framework



### Management's responses to our findings

- 2.6 Each of the issues I have raised during the year has been discussed with the relevant service managers as well as with members of the council's Management Team. Action plans have been agreed and actions are already being implemented; the Internal Audit Service will follow up our findings during the course of 2013/14 and provide support to managers to develop and implement pragmatic solutions to the control issues identified.

### Follow-up of our previous work

- 2.7 We have undertaken work to ascertain progress in implementing agreed recommendations resulting from earlier years' reviews. Whilst progress is generally being made to implement the action plans as agreed, restructuring and the work associated with making significant cost savings, and the loss of some management capacity, has again meant that some management teams have not acted within the timescales they intended. However most of the recommendations we have agreed with management have been or are being implemented and revised action plans have been agreed where necessary.

### Summary of assurance provided by the Internal Audit Service

- 2.8 A summary of all the assurance we have provided during the year is provided in the table below. This includes each internal audit assignment directed to providing controls assurance, but it excludes work for example on the certification of grant funding claims and participation in working groups, which has not been directed at providing controls assurance.
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Assignments relating to:	Assurance			
	Full	Substantial	Limited	None
Corporate and cross-service controls	2	3	2	1
Common controls		8	4	
Service-specific controls		13	13	1
<b>Total assignments = 47</b>	<b>2</b> (4%)	<b>24</b> (51%)	<b>19</b> (40%)	<b>2</b> (4%)
2011/12 (48 assignments)	1 (2%)	25 (52%)	22 (46%)	0 (0%)

### Wider sources of assurance available to the county council

- 2.9 Assurance has been provided to the council by the Audit Commission as the council's external auditor for the year. The Audit Commission issued its annual audit letter relating to 2011/12 in January 2013, and gave unqualified opinions on both the annual financial statements and the council's value for money arrangements. A copy of the report is available at:  
<http://mgintranet/documents/s17641/2011-12%20Lancashire%20CC%20Annual%20Audit%20letter.pdf>
- 2.10 In March 2013 I reported that a short quality screening inspection of the Lancashire Youth Offending Team had been completed by Her Majesty's Inspectorate of Probation (HMIP) to assess the quality and effectiveness of the council's casework with children and young people who have offended. A copy of the report is available at: <http://www.justice.gov.uk/publications/inspectorate-reports/hmi-probation/inspection-reports-youth/inspection-of-youth-offending-work>

## 3 Key issues and themes

- 3.1 Despite the considerable change agenda, overall, the council continues to operate an effective framework of internal control.
- 3.2 There is a clear trajectory of continuous improvement in the common controls that underpin the work of all the council's services, specifically through developments in the use of e-enabled systems and the county's financial software, which are being streamlined and increasingly demand consistency in their operation. Improvements are still ongoing to strengthen these common controls, particularly the corporate financial systems where controls are already generally good. The work arising from the implementation of the upgrade to the financial software has again been subject to close management attention during the year, and there have been major related changes to operating procedures and organisational structures, which will continue into the coming year. This is already resulting in more consistent and efficient control across the whole of the council as systems have been designed around the principles of standardisation, automation, consolidation and simplification.
- 3.3 The council continues to demonstrate considerable ambition in developing its services, at the same time as cost savings necessitate service reductions and
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redesign. Where services and systems are subject to such considerable change it is unsurprising that the related controls also require adjustment.

- 3.4 Reviews of the council's core ICT systems are under way in a number of operational areas, and the replacement of software that has been designed and maintained in-house with off-the-shelf software systems is providing opportunities to strengthen system security and control. In particular, the replacement of the Integrated Social Services Information System (ISSIS) in the coming year will facilitate greatly improved access controls and therefore information security.
- 3.5 However I reported in my last annual report and throughout the year that risks around information governance are not being adequately managed. Work has begun to strengthen the control framework but, whilst progress has clearly been made in designating a senior information risk officer, developing the council's policy framework and a revised suite of draft policies, other work has not progressed quite as successfully. Little action has been taken for some time to ensure that there is any general awareness amongst the council's staff of the need for information security, how to guard this effectively, how to recognise that security has been breached and what action to take if it has.
- 3.6 Information governance is the single most significant control issue currently facing the council and it should be reported in our annual governance statement.
- 3.7 The council is required to comply with a very wide range of legislation. Whilst the Deputy County Secretary and Solicitor reported during the year that "a high degree of assurance can be provided" over the council's "compliance with legislation focussed specifically on local government", he also stated that "a lesser degree of assurance can be provided in relation to legislation that is local government-specific but relates to functions". So, for example, a high court judgement was made in June 2012 against the council and one of its independent reviewing officers (who oversee children's social care). However although our compliance testing has necessarily been limited, we have nonetheless been able to provide full assurance that the two detailed areas we reviewed during the year are compliant with relevant legislation.

## **4 Implications for the annual governance statement**

- 4.1 In making its annual governance statement the Audit and Governance Committee has specifically requested that the council refers to the need to improve its arrangements supporting good information governance. The council also considers the chief Internal Auditor's opinion in relation to its internal control environment, risk management processes and corporate governance.
- 4.2 The annual governance statement should therefore refer to the need to improve the council's arrangements to ensure good information governance.
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## **5 Counter fraud and investigatory work**

- 5.1 The Internal Audit Service provides a counter fraud and investigatory service to management, which is distinct from audit but is related in considering the council's controls and in the skill sets required.

### **Special investigations**

- 5.2 The Internal Audit Service has spent a considerable amount of time on a number of special investigations, largely arising from whistle-blowing and similar calls. We have worked closely with the Human Resources team as well as service teams on a number of financial investigations and related disciplinary procedures, and the volume of work arising from these has been considerable. Work on one case in particular is likely to continue for some time.
- 5.3 We are required to report any individual instances of fraud or financial loss exceeding £10,000 to the council's external auditors. There have been three cases arising during the year which exceed this level, concerning:
- Payments via sub-contractors by a manager within Lancashire Highway Services;
  - Theft of dinner money at a school; and
  - Payment of a deceased person's pension to a relative.
- 5.4 We have worked closely with the Environment Directorate in particular on a number of investigations and disciplinary action, and disciplinary hearings are on-going relating to the sale of scrap metal by council officers that was investigated during 2011/12. It is likely that the publicity generated within a service from one incident has generated others, but we have been discussing with management the need to do more to proactively raise awareness of the issues. There is a need to clearly set out the council's expectations that its staff meet the high ethical standards of behaviour expected in public service.

### **Counter fraud activity**

- 5.5 As part of the county council's duty to protect public funds, the Audit Commission requires all local authorities to participate in the National Fraud Initiative. This is a two-yearly exercise that matches electronic data sets held by public sector organisations to highlight potentially fraudulent activity.
- 5.6 The 2012/13 data was submitted in October 2012 and has generated a total of 65,381 matches, which were received in January 2013. These suggest areas of enquiry that we have prioritised and are currently pursuing with service managers. In particular there are a number of members of staff who receive payments through the accounts payable system as well as payroll system. We are also working with the Your Pension Service to identify overpayments relating to deceased pensioners. This exercise may be available on an annual basis in the future, and the council has expressed an interest in piloting this to ensure that any overpayments are identified and recovered at the earliest opportunity.
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## **6 Internal audit performance**

- 6.1 The outputs of our audit work have been reported in detail to the senior management teams of individual service areas, and the key themes arising for them and for the council as a whole are set out above.

### **Internal audit plan 2012/13**

- 6.2 Overall, we have provided the assurance the council requires and in particular we have completed our work on the council's corporate financial and ICT systems. We will be able to satisfy the external auditor that our work is sufficient for them to take assurance from it in undertaking their work. We have completed 47 individual audit assignments (2011/12: 48) and these are set out in Annex B. We have also followed up the action plans agreed during the previous year and undertaken a number of other projects that have not resulted in controls assurance, or which have resulted in the certification of grant funding claims.

### **Internal audit performance review**

- 6.3 The Internal Audit Service has again requested client feedback through a questionnaire available to all officers via the Internal Audit Service's page on the council's intranet, and a similar survey to obtain feedback on each individual audit assignment has been established.
- 6.4 As part of the performance management framework for the service, a self assessment against the professional standards in place during the year (the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom, 2006) was undertaken. This self-assessment was verified externally by the Council's external auditor, and the Audit Commission's findings were reported to the Audit and Governance Committee in September 2012.
- 6.5 The Audit Commission concluded that:
- 'the Council's Internal Audit function meets each of the eleven standards for Internal Audit set out in the CIPFA Code of Practice for Internal Audit in Local Government.
- 'Our review has also concluded that the Internal Audit function demonstrates many of the characteristics of best practice as set out in the CIPFA Statement on the role of the Head of Internal Audit and The Excellent Internal Auditor. In particular, the Internal Audit work programme includes proactive fraud awareness work, thematic and corporate reviews to promote good governance across the organisation, and the annual plan is based on a comprehensive risk assessment process.'
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## A Audit assurance levels and classification of audit recommendations

### Audit assurance

**Full assurance:** there is a sound system of internal control which is designed to meet the service objectives and controls are being consistently applied.

**Substantial assurance:** there is a generally sound system of internal control, designed to meet the service objectives, and controls are generally being applied consistently. However some weakness in the design and/ or inconsistent application of controls put the achievement of particular objectives at risk.

**Limited assurance:** weaknesses in the design and/ or inconsistent application of controls put the achievement of the service objectives at risk.

**No assurance:** weaknesses in control and/ or consistent non-compliance with controls could result/ has resulted in failure to achieve the service objectives.

### Audit recommendations

All recommendations are stated in terms of the residual risk they are designed to mitigate.

**Extreme residual risk:** Critical and urgent in that failure to address the risk could lead to one or more of the following occurring: catastrophic loss of the county council's services, loss of life, significant environmental damage or huge financial loss, with related national press coverage and substantial damage to the council's reputation. *Remedial action must be taken immediately.*

**High residual risk:** Critical in that failure to address the issue or progress the work would lead to one or more of the following occurring: failure to achieve organisational objectives, disruption to the business, financial loss, fraud, inefficient use of resources, failure to comply with law or regulations, or damage to the council's reputation. *Remedial action must be taken urgently.*

**Medium residual risk:** Less critical, but failure to address the issue or progress the work could impact on operational objectives and should be of concern to senior management. *Prompt specific action should be taken.*

**Low residual risk:** Areas that individually have no major impact on achieving the service objectives or on the work programme, but where combined with others could give cause for concern. *Specific remedial action is desirable.*

**B Detailed analysis of internal audit assurance assignments  
2012/13**

Audit areas	Assurance			
	Full	Substantial	Limited	None
<b>Corporate and cross-service controls</b>				
<b>Corporate governance</b>				
Staff acceptance of gifts and hospitality, and disclosures of interests			✓	
Members' expenses and allowances – follow-up	Satisfactory progress			
<b>Information governance</b>				
Corporate information governance arrangements				✓
Corporate arrangements for data sharing with partners			✓	
<b>Partnership working</b>				
Funds flow between LCC and One Connect Ltd		✓		
<b>Legislative compliance</b>				
Advance consideration of the legal implications of decisions		✓		
Compliance testing within the Registrars Service	✓			
Compliance testing within the Trading Standards Service	✓			
<b>Business continuity and emergency planning</b>				
Corporate arrangements for emergency planning		✓		
<b>Common controls</b>				
<b>Financial controls</b>				
Accounts payable		✓		
Accounts receivable		✓		
Expenses			✓	
General ledger		✓		
Payroll		✓		
Treasury management		✓		
VAT		✓		
<b>HR controls</b>				
'Connect2HRP' advice to managers		✓		
<b>ICT controls</b>				
Password standards (draft report only)			✓	
Web usage		✓		
Database security			✓	
<b>Controls over management of the council's estate</b>				
Property assets – reactive repairs and maintenance			✓	
<b>Service-specific controls</b>				
<b>Adult and Community Services</b>				
Data quality for performance management – Library Service		✓		
Direct payments			✓	
Cash management at establishments			✓	
Management of case referrals		✓		
Non-residential care system (NRCS)		✓		

Audit areas	Assurance			
	Full	Substantial	Limited	None
Payment and monitoring system (PAMS)		✓		
Preferred provider scheme			✓	
Vulnerable adults' domiciliary services and day centres –follow-up	Satisfactory progress			
<b>Public health</b>				
Information on the resources transferring to the council		✓		
<b>Children and Young People</b>				
Emergency payments to families			✓	
Financial, operational and safeguarding procedures in children's residential homes		✓		
Independent reviewing officers			✓	
Partnership working with the NHS to support children with mental health needs				✓
Provision for children with disabilities (direct payments)			✓	
School budget formula and pupil forecasting		✓		
Working with Troubled Families Programme – governance, and operation of the programme		✓	✓	
Case file audit process			✓	
<b>Schools and sixth form colleges</b>				
School audit visits and follow-up (overall, combined assessment)		✓		
School audits – follow-up	Satisfactory progress			
Thematic school review: income			✓	
Premises management framework for schools			✓	
<b>Environment</b>				
Analysis of overtime and additional payments		✓		
Carbon reduction commitment		✓		
Concessionary travel			✓	
Flood risk management		✓		
Highways purchasing and use of sub-contractors			✓	
Closed landfill sites – follow-up	Satisfactory progress			
Development control (s278) – follow-up	Satisfactory progress			
<b>Lancashire County Commercial Group</b>				
Food stocks, consumption, ordering and invoicing			✓	
<b>Counter fraud</b>				
Street works and the risk of bribery		✓		
<b>Total of all assurance assignments (47)</b>	<b>2</b>	<b>23</b>	<b>20</b>	<b>2</b>
	<b>4%</b>	<b>49%</b>	<b>43%</b>	<b>4%</b>

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## **C Scope, responsibilities and assurance**

### **Approach**

- C.1 In accordance with the CIPFA Code of Audit Practice, 2006, the scope of internal audit encompasses all of the council's operations, resources and services including where they are provided by other organisations on their behalf.

### **Responsibilities of management and internal auditors**

- C.2 It is management's responsibility to maintain systems of risk management, internal control and governance. Internal audit is an element of the internal control framework assisting management in the effective discharge of its responsibilities and functions by examining and evaluating controls. Internal auditors cannot therefore be held responsible for internal control failures.
- C.3 However, we have planned our work so that we have a reasonable expectation of detecting significant control weaknesses. We have reported all such weaknesses to management as they have become known to us, without undue delay, and have worked with management to develop proposals for remedial action.
- C.4 Internal audit procedures alone do not guarantee that fraud will be detected. Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud or other irregularities which may exist, unless we are requested to carry out a special investigation for such activities in a particular area.
- C.5 Internal audit's role includes assessing the adequacy of the risk management processes, key internal control systems and corporate governance arrangements put in place by management and performing testing on a sample of transactions to ensure those controls were operating for the period under review.

### **Basis of our assessment**

- C.6 My opinion on the adequacy of control arrangements is based upon the result of internal audit reviews undertaken and completed during the period in accordance with the plan approved by the Audit Committee. Sufficient, reliable and relevant evidence has been obtained to support the recommendations made.

### **Limitations to the scope of our work**

- C.7 There have been no limitations to the scope of the audit work.

### **Limitations on the assurance that internal audit can provide**

- C.8 There are inherent limitations as to what can be achieved by internal control and consequently limitations to the conclusions that can be drawn from our work as internal auditors. These limitations include the possibility of faulty judgement in decision making, of breakdowns because of human error, of control activities being circumvented by the collusion of two or more people and

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of management overriding controls. Further, there is no certainty that internal controls will continue to operate effectively in future periods or that the controls will be adequate to mitigate all significant risks which may arise in future.

- C.9 Decisions made in designing internal controls inevitably involve the acceptance of some degree of risk. As the outcome of the operation of internal controls cannot be predicted with absolute assurance any assessment of internal control is judgmental.

### **Access to this report and responsibility to third parties**

- C.10 This report has been prepared solely for Lancashire County Council. It forms part of a continuing dialogue between the Internal Audit Service, the chief executive, Audit Committee and management of the council. It is not therefore intended to include every matter that came to our attention during each internal audit review.
- C.11 This report may be made available to other parties, such as the external auditors and One Connect Limited. No responsibility is accepted to any third party who may receive this report for any reliance that may be placed on it and, in particular, the external auditors must determine the reliance placed on the work of the Internal Audit Service.