



## **AUDIT COMMITTEE – 16TH OCTOBER 2018**

**SUBJECT: INTERNAL AUDIT SERVICES REVISED METHODOLOGY FOR 4 TIER  
AUDIT OPINIONS, RISK RATINGS AND ASSURANCE - DRAFT  
REPORT**

**REPORT BY: CORPORATE DIRECTOR FOR EDUCATION AND CORPORATE  
SERVICES**

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### **1. PURPOSE OF REPORT**

- 1.1 Following the July Audit committee and the ISA 260 report from External Auditors Grant Thornton it was agreed by management that additional information would be provided to the Committee in respect of audit assignments undertaken. This has prompted a review of the current method of rating audit findings and how these relate the “opinion” expressed in respect of the assignment. These opinions generated from assignments support and inform the overall statement of assurance given by the Internal Audit manager included in the Annual Governance Statement (AGS).
- 1.2 This review has suggested some revision in the opinions that are generated and the extension of this process to further inform and support the opinion expressed in the AGS.
- 1.3 Risk can be defined as the probability of a hazard, or an adverse or negative occurrence, which, may be financial or cause other liabilities or losses or stop an organisation achieving its strategic objectives. Organisations can avoid or reduce risks by adopting pre-emptive actions such as systems of controls, policies and procedures which may reduce or mitigate these risks. The need to manage and report on risks is seen as an essential part of good corporate governance.
- 1.4 Internal audit plays a role in this by performing reviews of these systems of controls, policies and procedures and reporting their findings to management, and summarising these in an annual report which supports the AGS.
- 1.5 To inform Members of the revised methodology used by internal audit to assign risk assigned to the findings or points arising from an audit and the consequent priority rating of the recommendations arising.
- 1.6 The number and risk/ priority ratings of each individual finding within an audit will then inform the overall “opinion” for each audit and the level of assurance that can be attributed to the system of internal controls or other processes in operation.
- 1.7 It has been agreed by Management following the July Audit Committee that audits within certain opinion categories will be reported to audit committee in future, in order to assist and inform members in respect of their role and to provide assurance to members of the Audit Committee.

### **2. SUMMARY**

- 2.1 Currently audits are rated with 3 opinions, namely Good, Satisfactory and In need of Improvement. These opinions being evaluated based on the individual findings, the nature of system or establishment and the materiality or significance of the area under review.

- 2.2 Following the July Audit Committee it was agreed by management that additional information would be provided to the Committee in respect of audit assignments undertaken. In particular, all of those noted as "in need of improvement" would in future be reported to Committee. In addition those audits noted as satisfactory which on follow up have not shown any improvement also be reported to Committee.
- 2.3 It was also noted that the opinions given in each assignment are silent as to the level of assurance that can be placed on the finding in relation to how this supports the overall Annual Governance Statement opinion. For example while a system or process may be rated in need of improvement, little or no assurance can be placed on it however if it is not material or high risk then it will have little impact on the overall Annual Governance Statement assurance opinion.
- 2.4 It is considered that it will assist members if they were to have a full understanding of the opinions and level of assurance that are reported. Also it would be informative to give detail as to how individual findings are rated and how the proposed new overall opinions are evaluated and the overall assurance reported.
- 2.5 As the Committee are aware the Audit section undertakes a number of different types of audit assignments. These mainly fall into the following categories,
- Systems audits,
  - Establishment audits,
  - Contract audits,
  - Value for Money
  - Reviews and grant reviews
  - Other regularity work plus other best practice advice and guidance,
  - Special investigations and other focussed reviews,

For example, systems audits may generate 2 opinions;-an opinion of the system and if detailed testing has been performed a second opinion of the compliance with this system is also reported. Whereas establishments usually generate one overall opinion in respect of compliance and best practice.

Other audits such as grant audits will only generate an opinion as required by the external funder's terms and conditions. Investigations may lead to referrals to management or Human Resources and consideration of disciplinary action in a few rare cases, so these outcomes are generally individually tailored to the specific matter under review.

- 2.6 Following the July Audit Committee the Acting Internal Audit Manager has reviewed the processes undertaken in the main audit type with a view to improving the overall consistency of the evaluation process relating to individual findings and the overall opinion/s generated and the associated level of assurance that can be applied to the system or establishments control processes. This concluded that a fourth category of opinion should be considered, together with more clarity over those areas assigned as "satisfactory" and their capacity to show improvement, which directly informs the agreed recommendations made in July.
- 2.7 For future Audit Committees when an audit assignment is completed and the report issued and agreed, and the opinion generated results in it falling into these categories the related service manager or other establishment head / managers will be invited to attend Audit Committee.
- 2.8 As a result there is a need for a consistent and objective evaluation methodology applied irrespective of the individual system, process, establishment etc. that is under review.
- 2.9 It is suggested that four opinions be used namely

1. Effective
2. Effective with opportunity to improve (to be reported to Audit Committee if no improvement seen on follow up of recommendations made)
3. In need of improvement (To be reported to Audit Committee)
4. Inadequate and in need of immediate improvement (To be reported to Audit Committee)

2.10 The Audit Committee will in future be receiving regular reports of audits undertaken, their findings and overall opinions and level of assurance, which will be consolidated into the Annual Governance Statement process.

2.11 The Public Sector Internal Audit Standards also require an annual report to support the Annual Governance Statement process, this is one further action to strengthen conformance with the standard.

### **3. LINKS TO STRATEGY**

3.1 The work of Internal Audit Services provides assurance on the robustness of internal controls and the corporate governance arrangements operating within the Authority and identifies areas for improvement. Strong corporate governance arrangements are an essential element of ensuring that the Council's key priorities are effectively delivered and this in turn contributes to the following Well-being Goals within the Well-being of Future Generations Act (Wales) 2015: -

- A prosperous Wales.
- A resilient Wales.
- A globally responsible Wales.

### **4. THE REPORT**

4.1 Internal Audit assurance is a disciplined approach that evaluates and improves the effectiveness of risk management in an organisation. The Institute of Internal Auditors state that the activities involved in managing risks plays a central role in maintaining a sound system of internal control. While the responsibility for identifying and managing risks belongs to management, one of the key roles of Internal audit is to provide assurance that those risks have been properly managed. In order to effectively report to management it is necessary to have in place a consistent and objective set of criteria to evaluate findings that are reported

4.2 Assurance is the general term for evaluating a wide range of risks that an organisation may face. If risks are well managed or controlled it can be said that there is a good level of assurance, and the management can have confidence that risks are being well managed and controlled. The internal audit processes provides an independent perspective, which is evidence based in respect of the assurance that can be placed on the systems of control processes operating within the Council. Individual opinions will support the overall assurance statement required as part of the Annual Governance statement which forms part of the year - end financial statements.

4.3 Overall assurance can be an evaluation from the findings and opinion arising from an individual audit report, taking into account the individual risk assessment of the system or process and its materiality or impact.

Levels of assurance generally fall into the following categories and can be evaluated from the opinions reported and individual findings in the audit report

- High

- Where a control system is considered good and no high risk points or findings have been noted.
  - The number of findings are generally low in number or impact
  - Where an establishment audit findings show good compliance to external or centrally regulated corporate systems and no high risk points or findings have been noted
  - Materiality and significance and inherent risk of the system, process, establishment etc. under review also needs to be considered in this evaluation.
- Moderate
    - where a control system is considered good and audit findings are low in number , minor, low risk, only merit attention or are considered low impact
    - Where an establishment audit findings show only minor noncompliance minor risks or low risk issues or which are considered low impact
    - Materiality and significance and inherent risk of the system, process, establishment etc. under review also needs to be considered in this evaluation.
- Partial
    - Weaknesses are noted in the control system which are medium risk or impact
    - A relatively large number of points are noted over a number of different processes under review
    - Weaknesses are noted in the establishment review which are medium risk or impact
    - Large scale noncompliance with central or corporate systems or best practice are noted
    - Materiality and significance and inherent risk of the system, process, establishment etc. under review also needs to be considered in this evaluation
- Minimal
    - The control system/s in operation have procedural or control weaknesses considered to be high risk or high impact
    - High risk findings are noted in an establishment review
    - Materiality and significance and inherent risk of the system, process, establishment etc. under review also needs to be considered in this evaluation
- None
    - There is no effective control system or it is not fit for purpose

4.4 Opinion/s arising in audit reports will vary in nature depending on the audit assignment.

- Systems audits,  
Usually 2 opinions are generated, one on the effectiveness of the internal control processes in place. This is done by means of questionnaires, or system notes, walkthroughs etc. The other opinion is generated in respect of the compliance to the system; this is evaluated by specific testing of control processes as applied to sample transactions within the processes. In some cases if no testing is done then a control process opinion only will be generated
- Establishments audit, grants  
Usually one opinion is generated based on an evaluation of the findings noted
- Other regularity work e.g. National Fraud Initiative data matches  
Findings factual and evidence based but may be indicative of failure in systems and processes in which case an adverse opinion may be generated
- Advice guidance and consultancy or special investigations  
Opinions may be more complex and specific to the items under review. These are usually discussed with Head of Service and other relevant stakeholders when the report is being formulated.

4.5 It is proposed that opinions of audit reports which consequently support assurance are evaluated as one of the following :-

- Effective
- Effective with opportunity for improvement
- In need of Improvement
- Inadequate and in need of immediate improvement

- 4.6 In general overall opinions will be limited by the risk evaluation of the highest risk point. So any audit with at least one high risk point must be in need of some improvement by its very definition. In some cases Managers may put in place improvements or revised procedures between the field work or draft audit report and the issue of the final report. While this may mitigate the risk and should be noted in the report, any opinion must reflect the findings noted at the actual time the testing was performed.
- 4.7 All opinions must be evidence based and supported by documentary or system records which can be supplied to Head of Service and Service managers, Head teachers etc. in discussions and clearance meetings where the final audit report and opinion is agreed. Where Head of Service or Service managers disagree on the evaluation these may be referred to s151 officer for final determination.
- 4.8 More detailed criteria/ rationale relating to how these opinions are evaluated can be defined in the table in Appendix 1
- 4.9 Individual findings reported and the associated recommendations for improvement fall into 3 categories and are focussed on impact and risk. This assists management to prioritise the implementation of recommendations to address or mitigate the risks or breaches in procedures noted with immediate attention being addressed to those high risk or more critical /high impact areas first
- 4.10 Points noted and related recommendations fall into 3 categories as listed in appendix 2 .
- 4.11 Relationship between audit opinions and assurance is important when producing the Annual Governance Statement. The AGS along with the Public Sector Internal Audit Standards requires the Internal Audit Manager to report to Audit Committee by incorporating a Statement of Assurance in respect of the Councils systems of Internal Controls and governance arrangements in the Annual audit report. As a result this statement needs to be evidence based, reliable, consistent in form from one year to the next and able to withstand challenge and scrutiny
- 4.12 It can be seen that when coming to an evaluation of the level of assurance that can be gained from the audit assignment there is an interaction or relationship between the system opinion and the compliance opinion (if there is one). In general it would be reasonable to assume that the potential for immediate improvement is high where there is a generally good / effective system or there is system with few risks (even if considered “high risk”) as managers have the scaffold around which to quickly improve compliance with the existing control processes and procedures.
- 4.13 Where a system of controls is weak, in need or improvement or ineffective, capacity to improve quickly will be limited by resources and time, and improvements may take longer to embed. As a result assurance from such audit opinions that can be gained would be lower.
- 4.14 Where a system of controls is in need of improvement, unfit for purpose or inadequate, the evaluation of compliance is rendered meaningless. Also in general the concept applied is that any assurance attributable to the system can only be as high as the lowest evaluation or opinion. So those areas where the overall opinion or system opinion is inadequate or in need of improvement, assurance has to be limited or may even be non-existent

NB Such evaluations must take into account the system and process under review and its individual risk assessment within the audit universe and its individual materiality and significance.

4.15 The relationship between the opinion/s generated in the report and overall assurance that will support the AGS can be shown in the following tables.

### Systems

System	Compliance	Assurance gained
Effective	N/a or Effective	High
Effective	Effective with opportunity for improvement	Moderate
Effective	In need of Improvement	Partial
Effective	Inadequate and needs immediate improvements	Partial /minimal *
Effective with opportunity for improvement	N/a or Effective	Moderate
Effective with opportunity for improvement	Effective with opportunity for improvement	Partial
Effective with opportunity for improvement	In need of Improvement	Partial / Minimal *
Effective with opportunity for improvement	Inadequate and needs immediate improvements	Minimal *
In need of Improvement	Compliance opinion irrelevant	Minimal/none *
Inadequate and need immediate improvements	Compliance opinion irrelevant	Minimal/ none *

\*NB Such evaluations must take into account the system and process under review and its individual risk assessment within the audit universe and its individual materiality and significance.

### Establishments and other assignments

Opinion	Assurance
Effective	High
Effective with opportunity for improvement	Moderate
In need of Improvement	Partial/ minimal*
Inadequate and need immediate improvements	Minimal/ none *

\*NB Such evaluations must take into account the system and process under review and its individual risk assessment within the audit universe and its individual materiality and significance.

4.16 As a result of introducing a standard audit opinion with these 4 tiers, will promote a greater level of assurance on each system of internal controls under review. It also has an added benefit of the Audit Committee receiving reports with a clearly structured risk and assurance level. This will promote the analysis of findings and support the system of Corporate Governance within the Authority.

- 4.17 Approval of this criteria relating to the rationale behind all audit opinions inform the Audit Committee in respect of the categories of reports that will in future be reported and support the Annual Governance Statement process. In addition it will ensure in future the Annual Governance Statement is consistent, transparent and effective.

## **5. WELL-BEING OF FUTURE GENERATIONS**

- 5.1 This report contributes to the Well-being Goals as set out in Links to Strategy above. It is consistent with the five ways of working as defined within the sustainable development principle in the Act in that consideration is being given to clarifying and improving the future reporting to the Audit Committee

## **6. EQUALITIES IMPLICATIONS**

- 6.1 There are no equalities implications

## **7. FINANCIAL IMPLICATIONS**

- 7.1 There are no direct financial implications arising from this report.

## **8. PERSONNEL IMPLICATIONS**

- 8.1 There are no direct personnel implications arising from this report.

## **9. CONSULTATION**

- 9.1 All consultation responses have been reflected in this report.
- 9.2 This methodology has been approved by the Corporate Governance Panel

## **10. RECOMMENDATIONS**

- 10.1 The Audit Committee is asked to note the content and endorse the evaluation process that is applied in rating each finding, the opinions and overall level of assurance generated by each assignment, and how it supports and informs the overall AGS process.

## **11. REASONS FOR THE RECOMMENDATIONS**

- 11.1 To ensure that there is transparent and clear criteria relating to the rationale behind all audit opinions.
- 11.2 To inform the Audit Committee in respect of the categories of reports that will in future be reported and support the Annual Governance Statement process.
- 11.3 In addition it will ensure in future the Annual Governance Statement is consistent, transparent and effective, and enhance conformance with the PSIAS.

## **12. STATUTORY POWER**

- 12.1 Local Government Act 2000.

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Appendices: - Appendix 1: Audit Report Opinions and Criteria  
Appendix 2: Points Noted and Risk Ratings