Internal Audit Risk and Assurance ratings

To: Audit & Accounts Committee

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From: Neil Hunter, Head of Internal Audit and Risk Management

1.   Purpose

1.1   The Council's Internal Audit service is proposing a change to the risk and assurance ratings used in audit reports to quantify the level of risk associated with recommendations and/or audit findings.

1.2   This report sets out the proposed changes to the rating system and the reasons for the changes for consideration and approval by Audit & Accounts Committee.

2.   Recommendation

2.1   The Committee is asked to note and comment on the report

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Proposed Changes to Internal Audit's Risk & Assurance Ratings

1   Internal Audit Risk Ratings

1.1   Current Risk Ratings

1.1.1   As part of every piece of audit work, Internal Audit seeks to identify actions that can be taken to mitigate risk, improve efficiency and maximise value. These recommended actions are discussed and agreed with management to develop a formal 'management action plan', incorporated into every Internal Audit report.

1.1.2   Every agreed action is given a risk rating in the management action plan, to make it clear how important it is for the action to be implemented. Currently, the risk ratings in use are:

- **Essential** – Action is imperative to ensure that the objectives for the area under review are met.

- **Important** – Requires action to avoid exposure to significant risks in achieving objectives for the area under review.

- **Standard** – Action recommended to enhance control or improving operational efficiency.

1.2   What are the proposed changes?

1.2.1   Cambridgeshire's Internal Audit team have been working to review processes and procedures, since the service has moved back in-house from LGSS. In discussion with Peterborough City Council's Internal Audit service, it was identified that Peterborough use a four-level risk rating system for their recommended actions, and each risk rating has a standard expected timescale, within which the associated action should be implemented. The ratings used at Peterborough are:

- Essential
- High
- Medium
- Low

1.2.2   Cambridgeshire's Internal Audit service has identified that there would be some benefit to partially aligning our approach to that of the Peterborough service. In particular, agreeing timescales for implementation of agreed actions can often be a problem at the end of an audit which causes delay in issuing the final report; having standard timescales would ensure a more streamlined process.

1.2.3   Moving to a four-rating system would allow more detailed prioritisation of recommended actions, and would also ensure more consistency

between the two Internal Audit services, which is likely to be beneficial in auditing Council services which are shared across both authorities.

1.2.4 Cambridgeshire's Internal Audit service are therefore proposing to implement the following four rating system, with standard timescales for expected implementation of remedial actions:

- **Essential** – Action is imperative to avoid exposure to a significant organisational risk.

- **High** – Action is imperative to avoid exposure to a significant risk to the service area.

- **Medium** – Action is required to avoid exposure to a risk to the service area.

- **Advisory** – This captures consultancy recommendations which are intended to improve operational efficiency or enhance value.

1.2.5 CCC are proposing to use the following standard timescales, which would ordinarily apply to all actions, although services could request an adjustment in exceptional circumstances (for instance, if a major procurement was required to remediate a high risk and it would not be possible to complete this within three months):

- **Essential** – maximum 2 months to implement remedial action and Internal Audit will provide additional assurance over implementation.

- **High** – 3 months to implement remedial action

- **Medium** – 6 months to implement remedial action

- **Advisory** – implementation not followed up by Internal Audit

2. Internal Audit Assurance Ratings

2.1 Current Assurance Ratings

2.1.1 Every Internal Audit review has three key elements:

- Firstly, the <u>control environment</u> is reviewed by identifying the objectives of the system and then assessing the controls in place mitigating the risk of those objectives not being achieved. Completion of this work enables Internal Audit to give an assurance on the control environment.

- However, controls are not always complied with, which will in itself increase risk, so the second part of an audit is to ascertain the extent to which the <u>controls are being complied with in practice</u>. This enables Internal Audit to give an opinion on the extent to

which the control environment, designed to mitigate risk, is being complied with.

- Finally, where there are significant control environment weaknesses or where key controls are not being complied with, further substantive testing is undertaken to ascertain the impact these control weaknesses are likely to have on the <u>organisation's control environment as a whole</u>.

2.1.2 Three assurance ratings are therefore given at the conclusion of each audit: control environment assurance, compliance assurance, and organisational impact.

2.1.3 Currently the following definitions of audit assurance ratings are used for reporting control environment and compliance assurance opinions:

	Compliance Assurance	Control Environment Assurance
Substantial Assurance	The control environment has substantially operated as intended although some minor errors have been detected.	There are minimal control weaknesses that present very low risk to the control environment
Good Assurance	The control environment has largely operated as intended although some errors have been detected.	There are minor control weaknesses that present low risk to the control environment.
Satisfactory Assurance	The control environment has mainly operated as intended although some errors have been detected.	There are some control weaknesses that present a medium risk to the control environment.
Limited Assurance	The control environment has not operated as intended. Significant errors have been detected.	There are significant control weaknesses that present a high risk to the control environment.
No Assurance	The control environment has fundamentally broken down and is open to significant error or abuse.	There are fundamental control weaknesses that present an unacceptable level of risk to the control environment.

2.1.4 The following definitions of assurance ratings are currently used for organisational impact assurance opinions:

Organisational Impact	
Level	**Definitions**
Major	The weaknesses identified during the review have left the Council open to significant risk. If the risk materialises it

	would have a major impact upon the organisation as a whole.
Moderate	The weaknesses identified during the review have left the Council open to medium risk. If the risk materialises it would have a moderate impact upon the organisation as a whole.
Minor	The weaknesses identified during the review have left the Council open to low risk. This could have a minor impact on the organisation as a whole.

2.2 What are the proposed changes?

2.2.1 Internal Audit are proposing to change the 'satisfactory' rating for control environment and compliance assurance. This rating is given when issues identified by Internal Audit are considered to represent a medium level of risk; however in practice the word 'satisfactory' is often interpreted as representing a very positive level of assurance. There is therefore a disconnect between the level of assurance the rating is intending to communicate, and the interpretation of the rating by officers outside Internal Audit.

2.2.2 In light of this, it is proposed to re-name the 'satisfactory' ratings, replacing it with a 'moderate' rating. It is intended that this will more effectively communicate the fact that this is a mid-range level of assurance associated with a medium level of risk.

2.2.3 Some minor elements of re-wording to the definitions of each level of assurance are also proposed, again with the intention of clarifying the level of risk associated with each. Proposed changes are set out in the table below, with additions underlined:

	Compliance Assurance	Control Environment Assurance
Substantial Assurance	The control environment has substantially operated as intended although some minor errors <u>may</u> have been detected.	There are minimal control weaknesses that present very low risk to the control environment
Good Assurance	The control environment has largely operated as intended although some errors have been detected.	There are minor control weaknesses that present low risk to the control environment.
<u>Moderate</u> ~~Satisfactory~~ Assurance	The control environment has mainly operated as intended although ~~some~~ errors have been detected.	There are ~~some~~ control weaknesses that present a medium risk to the control environment.

Limited Assurance	The control environment has not operated as intended. Significant errors have been detected.	There are significant control weaknesses that present a high risk to the control environment.
No Assurance	The control environment has fundamentally broken down and is open to significant error or abuse.	There are fundamental control weaknesses that present an unacceptable level of risk to the control environment OR it has not been possible for Internal Audit to provide an assurance due to lack of available evidence.

2.2.3 No changes to the organisational impact ratings are proposed.