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LIVERPOOL CITY REGION

LIVERPOOL CITY REGION COMBINED AUTHORITY

HEAD OF INTERNAL AUDIT ANNUAL REPORT AND OPINION 2018-19



Audit and Governance Committee
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1. Executive Summary

- 1.1 The Head of Internal Audit is obliged, under the Public Sector Internal Audit Standards (PSIAS), to provide an annual report summarising the work undertaken by internal audit during the financial year just closed, and to provide an overall opinion of the adequacy and effectiveness of the organisation’s framework of governance, risk management and internal control, derived from this work.
- 1.2 In respect of 2018-19, the Internal Audit Plan approved by this Committee was comprised of 200 days of audit time, to be expended on grant certification work and providing advice and guidance to developing systems. The following work was completed in respect of Liverpool City Region Combined Authority (LCRCA) during the year:
- Advice and guidance to developing systems, such as Adult Education Budget, Housing First and Apprentice Travel Ticket
 - Certification of 131 grants totalling £17,854,071
 - One fraud investigation.
- 1.3 There was no audit work completed specifically in relation to the LCRCA that generated an audit report and audit opinion, because of the fact that the systems and processes associated with the organisation were being formulated during the year.
- 1.4 Based upon the work undertaken by Internal Audit in respect of 2018-19, the opinion of the Head of Internal Audit on the overall adequacy and effectiveness of LCRCA’s framework of governance, risk management and control is:

Overall Opinion 2018-19	Capacity for Improvement
Inadequate	Good



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- 1.5 This opinion relates largely to the lack of embedded internal control and risk management arrangements during the year, and the expectation that there will be rapid progress in 2019-20 to strengthen the control environment. The remainder of this report sets out in more detail how the opinion is derived.

2. Introduction

- 2.1 It is the responsibility of management to establish effective arrangements for governance, internal control and risk management in the organisation.
- 2.2 In accordance with the Accounts and Audit Regulations 2015, LCRCA must ensure that it provides adequate and effective internal audit arrangements in respect of its accounting records and systems of internal control, and that it conducts an annual review of the effectiveness of these. In addition, these arrangements must be delivered in accordance with the Public Sector Internal Audit Standards (PSIAS) and Local Government Application Note (LGAN), which came into effect on 1 April 2013 (and were revised 1 April 2016 and 1 April 2017 and LGAN revised 2019).
- 2.3 The PSIAS represent mandatory best practice for all public sector internal audit service providers in the UK and cover:
- Definition of Internal Auditing
 - Code of Ethics
 - International Standards for the Professional Practice of Internal Auditing.
- 2.4 Further to the 2016 revision to the PSIAS, Internal Audit has adopted the following mission statement:
“To enhance and protect organisational value by providing risk-based and objective assurance, advice and insight.”
- 2.5 It is a requirement of the PSIAS that the Head of Internal Audit provides an annual report to those charged with governance, which should include an opinion on the overall adequacy and effectiveness of the organisation’s framework of governance, risk management and control. This report informs the Annual Governance Statement.
- 2.6 The CIPFA *Statement on the Role of the Head of Internal Audit* (2019) also states that “*The head of internal audit (HIA) plays a critical role in delivering the organisation’s strategic objectives by objectively assessing the adequacy and effectiveness of governance and management of risks, giving an evidence-based opinion on all aspects of governance, risk management and internal control*”.



2.7 In arriving at this opinion, this report sets out:

- A summary of the Internal Audit work undertaken during 2018-19
- A summary of the performance of Internal Audit during the year
- A review of Internal Audit's compliance with the Public Sector Internal Audit Standards (PSIAS)
- A summary of the Quality Assurance and Improvement Programme (QAIP) established during the year
- The overall Head of Internal Audit opinion on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control in 2018-19
- A look ahead to the Internal Audit Plan 2019-20.

2.8 It is worthy of note that in accordance with the separate legal status of Merseytravel, a separate Annual Report and Opinion has been issued in respect of this, and has been reported to the Audit, Risk and Governance Board. For the information of this Committee, the overall opinion in respect of Merseytravel is also provided at section 4 of this report.

2.9 It is confirmed that there was no impairment to internal audit objectivity during 2018-19.

3. Work Completed

Background

- 3.1 The Internal Audit Plan 2018-19 was approved by the Combined Authority at its meeting on 31 May 2018. The Plan agreed was based upon a number of audit days to be spent, 200 in total, rather than a list of audit areas. This was because of the maturity of the LCRCA's systems at that time, and the fact that it was acknowledged that the work completed would be more likely to comprise advice and guidance on developing systems, as well as grant certification work.
- 3.2 Members of this Committee have been kept fully apprised of the delivery of this Plan and the resulting outcomes via the "Internal Audit Performance Report" which has been presented to each meeting of the Committee during the year. This report has detailed those audits undertaken of Merseytravel services provided to LCRCA, so as to provide members of this Committee with transparent information regarding the services LCRCA receives. As these audits inform the Merseytravel Annual Report and Opinion rather than this one, these are not detailed in this report.
- 3.3 In addition, Internal Audit provides consultancy support in response to specific requests from management, which contributes to improving the organisation's governance, risk management and internal control arrangements. Such work can include advice and guidance around the implementation of new systems and procedures, and this has been particularly pertinent during 2018-19 as the LCRCA's arrangements have been developing.

Advice and Guidance on Developing Systems

- 3.4 During the year, advice and guidance has been provided relating to the following areas. This reflects the fact that the activities of the LCRCA were being developed during 2018-19, and so the associated risks were being understood and controls being designed to mitigate these:

Adult Education Budget - Internal Audit has been providing support to the Education and Skills team to develop systems and procedures that will ensure robust audit and assurance arrangements are in place following the devolution of the Adult Education Budget in September 2019 from the Education Skills Funding Agency (ESFA) to the Combined Authority. As well as advice on our own internal systems such as the procurement and payments process, Internal Audit have also provided

advice and guidance in relation to the offer made by the ESFA in relation to proposed working arrangements on audit and assurance, financial health and fraud and investigations. The Adult Education Budget devolved to the Combined Authority is in the region of £51m per academic year.

Housing First - Internal Audit is represented on the Project Board for the development of Housing First, advising on internal control, governance and risk management matters. The project concerns the award of a grant to the Combined Authority from the Ministry of Housing, Communities and Local Government (MHCLG) of £7.7m over three years, to deliver step change in homelessness in the City Region.

Apprentice Travel Ticket – Internal Audit was involved in providing advice to the project officers responsible for the development of a half-price travel offer for apprentices within the Liverpool City Region Combined Authority area, so as to provide assurance that the arrangement is not open to abuse.

Grant Assurance

- 3.5 Work has been undertaken by Internal Audit to review the evidence supporting requests for payment associated with grants. This work is vital in ensuring that grant applicants (including constituent Local Authorities, educational institutions, charities, voluntary organisations and businesses) have complied with the Grant Funding Agreements in place, and that payment is only released when they have done so.
- 3.6 It is worthy of note that the volume and value of grants being presented for audit grew exponentially during 2018-19, (131 claims totalling £17.9m compared to 100 claims totalling £11.6m for 2017-18) and this demonstrates the development of the LCRCA's activities and increased devolution.

3.7 Table 1 shows the grant claims have been audited during 2018-19:

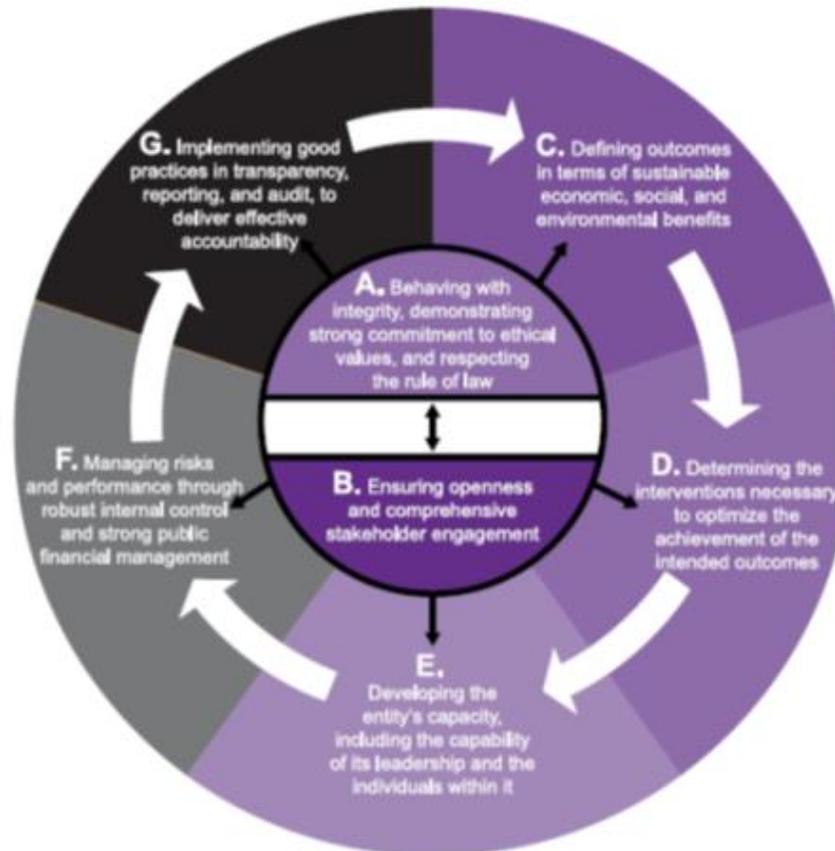
Grant Name	Number of Claims Audited	Value of Claims Audited (£)
Growth Fund (Employment and Skills)	7	410,017
Growth Hub (LEP)	4	504,981
Careers and Enterprise (LEP)	8	170,035
Local Energy Hub (LEP)	1	36,259
Rural Leader	4	71,132
Skills for Growth	6	1,287,414
Single Investment Fund	101	15,374,233
Total	131	17,854,071

Table 1

Corporate Governance

3.8 LCRCA has put in place a Code of Corporate Governance as part of its Constitution, and this has been updated for 2019-20.

3.9 In order to appraise the effectiveness of corporate governance and provide supporting evidence to inform the Annual Governance Statement (AGS), internal audit has conducted a review of Merseytravel's corporate governance arrangements. This has followed the mandatory CIPFA/SOLACE guidance "Delivering Good Governance in Local Government" (2016), which embodies the following Core Principles illustrated by the diagram below:



"Delivering Good Governance in Local Government" (CIPFA/SOLACE) 2016

- 3.10 The work covered the prescribed areas of governance as defined in the guidance, and engaged with all Heads of Service, Directors and the Director General in gaining assurance that there is a comprehensive and effective system of governance in place.

- 3.11 This comprised the completion of a Governance Assurance Statement by each of these senior staff, in which they commented on the adequacy of the governance arrangements within their spheres of influence. The arrangements described in these Statements were generally positive, and highlighted an awareness of the principles of good governance. Also positively, most respondents highlighted their wish to develop and improve their governance arrangements, and identified actions to be taken over the next year to do so.
- 3.12 Also forming part of the review was a piece of work to follow up on the “Key Issues” highlighted in the LCRCA AGS for 2017-18. This identified that progress has been made in addressing these, and the following issues were highlighted for the AGS 2018-19 as a result of the work:

Core Principle	Key Issues
C. Defining outcomes in terms of sustainable economic, social and environmental benefits	<ul style="list-style-type: none"> • To ensure that the City Region’s Local Industrial Strategy is built around the principle of sustainable inclusive growth and reflected in its Single Investment Funding methodology and also through the Skills Strategy and other strategies. • To provide support to delivery partners to overcome barriers to delivery that are inhibiting the timely delivery of the benefits of previous investment decisions. • To proactively enforce compliance with SIF grant funding agreement terms and conditions. • To ensure that subsequent waves of investment decisions place greater emphasis on deliverability.
D. Determining the interventions necessary to optimise the achievement of intended outcomes	<ul style="list-style-type: none"> • To provide support to delivery partners to overcome barriers to delivery that are inhibiting the timely delivery of the benefits of previous investment decisions. • To ensure that subsequent waves of investment decisions place greater emphasis on deliverability.

Core Principle	Key Issues
<p>E. Developing the entity’s capacity, including the capability of its leadership and the individuals within it</p>	<ul style="list-style-type: none"> • Identify an innovative funding model that provides additional capacity in new priority areas without increasing the financial burden on local taxpayers. • Work with government to see how a relaxation of the requirements around the capital and revenue split could benefit the achievement of LCRCA priorities. • Ensuring that the organisations work force adequately meets the needs of the organisation through a focussed programme of organisational development, senior management training and targeted recruitment to address skills and competency gaps.
<p>F. Managing risks and performance through robust internal control and strong public financial management</p>	<ul style="list-style-type: none"> • Quorum continues to be a problem facing both the Audit and Governance Committee and Overview and Scrutiny Committee. This has meant that formal consideration of issues of risk and risk management have at times been left to the full Combined Authority to oversee. However this area remains a challenge that is common to all Mayoral CA’s. • There is a need for continued focus and development of the system of corporate risk management, to continue the positive work commenced during 2018-19 and so as to facilitate the achievement of our corporate objectives. This work will also encapsulate the articulation of the organisation’s risk appetite, so that there is clarity about the extent to which officers are empowered to embrace opportunities within a robust control environment. • The CA needs to employ its resources to develop and embed policies, systems and controls that reflect the

Core Principle	Key Issues
<p>G. Implementing good practices in transparency, reporting and audit to deliver effective accountability.</p>	<p>specific nature of the CA.</p> <ul style="list-style-type: none"> • Work with elected members to ensure that the Audit and Governance Committee can meet in quorate and provide formal consideration of its business in 2019-20 • New arrangements for the CA and LEP will be implemented from May 2019 which will necessitate work to integrate and align the two organisations to clarify roles and eliminate duplication.

Table 2

3.13 These issues will form the basis of focus during 2019-20, with the objective of resolving these during the year.

Risk Management

3.14 The system of corporate risk management is facilitated by Internal Audit, with appropriate operational safeguards in place to preserve independence.

3.15 The Risk Management Policy was fully reviewed and revised during the year, so as to provide more comprehensive guidance to officers on how to approach risk management, and to streamline the process for the escalation and de-escalation of risks to and from the Corporate Risk Register.

3.16 During the year, it was recognised that there was not a systematic, embedded approach to the system of risk management, and that Corporate Risk Register needed to be formalised and reviewed. It is recognised that this was contributed to by the developing nature of systems at that time. This view was informed by the external auditor's "except for" value for money conclusion in their 2017-18 report, and the "inadequate" opinion of the Head of Internal Audit's annual report of the same year. Both of these conclusions were heavily influenced by the lack of embedded arrangements or full, detailed Corporate Risk Register.

- 3.17 This resulted in two risk management workshops with Directors, which resulted in a fully updated and revised Corporate Risk Register. This was subsequently presented to this Committee. However, owing to this timing, the Corporate Risk Register was not established until quarter 4, and arrangements for the routine review of the Risk Register had not been fully formulated.
- 3.18 It is important that the positive progress made in relation to risk management continues in 2019-20, and this is recognised in the Annual Governance Statement 2018-19. This should encompass sustained focus on embedding effective risk management arrangements across the organisation.

Fraud

- 3.19 The Counter Fraud and Corruption Strategy demonstrates the organisation's commitment to creating an anti-fraud culture and maintaining high ethical standards in its administration of public funds. There is also a suite of complementary policies including the Bribery Policy, Money Laundering Policy, Confidential Reporting (Whistleblowing) Policy, Surveillance Policy and Investigation Policy. These link to other policies such as the Gifts and Hospitality Policy and the Employee Code of Conduct. During the year, Internal Audit refreshed those policies under its ownership and these were approved by LCRCA. There is further work to be undertaken corporately to ensure that other policies are reviewed and adopted by LCRCA in the same way.
- 3.20 Internal Audit has a number of responsibilities in the prevention and detection of fraud, bribery and corruption:
- Co-ordination of the organisation's work on the National Fraud Initiative (NFI)
 - Compilation of a Counter-Fraud Internal Audit Plan, which identifies a number of areas for proactive anti-fraud review for completion
 - Co-ordination of the compilation of the Fraud Risk Register, and use of this to inform the proactive counter fraud work undertaken
 - Production and maintenance of a suite of Counter-Fraud policies
 - Investigation of referrals of suspected fraud and irregularity
 - Receiving notification of suspected fraud or irregularity, reports of suspected money laundering (the Head of Internal Audit is the designated Money Laundering Reporting Officer), and the receipt of confidential reports ("whistleblows")
 - Being consulted for advice and guidance on matters of conduct and probity.

- 3.21 A self-assessment of the organisation's counter fraud arrangements against the CIPFA Code of Practice on Managing the Risk of Fraud and Corruption was conducted in 2017-18, and it was subsequently reported that the actions arising from the exercise had been fully implemented. The exercise is to be repeated during 2019-20.
- 3.22 During 2018-19, Internal Audit conducted one investigation into compliance issues identified by the Rural Payments Agency in respect of the Mersey Rural Leader grant. The investigation was concluded during 2019-20 and there was found to be no evidence of fraud, although a number of recommendations have been agreed with management so as to improve controls in respect of the management of the programme, and the implementation of these actions will be monitored and progress reported back to this Committee. The issue was notified to the external auditor for information, but materiality levels involved were not significant enough to warrant formal disclosure.
- 3.23 In terms of proactive counter-fraud work, there was work undertaken to check for duplicate payments and for "ghost" employees. This work was undertaken using the software package "IDEA", and emulates the tests undertaken as part of the National Fraud Initiative.
- 3.24 The organisation participates in the National Fraud Initiative co-ordinated by the Cabinet Office. Data from the Payroll and Creditors systems are uploaded to the dedicated Cabinet Office website, and are matched with data within and between participating bodies so as to identify potential frauds, overpayments and errors. On receipt of the results, the organisation has responsibility to follow up and investigate the matches. The main NFI data matching is undertaken every two years, the results of these matches is fed into a national report at the end of each cycle.
- 3.25 Data for this cycle was uploaded during October 2018 in accordance with the NFI timetable, and matches were received in late January 2019.
- 3.26 Progress in reviewing the matches received has been positive, and it is also positive to say that the matches investigated so date had already been detected by management processes. There is further work to do and once this is concluded, the findings will be reported to this Committee, but it appears unlikely at this stage that there will be significant issues or savings identified.

4. Opinion

4.1 Based upon the work undertaken by Internal Audit in respect of 2018-19, the opinion of the Head of Internal Audit on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and internal control in 2018-19 is:

Overall Opinion 2018-19	Capacity for Improvement
Inadequate	Good

4.2 This opinion indicates that during 2018-19, taking into account all factors detailed below, the operation of governance, risk management and internal control has been judged as **inadequate**, meaning that it does not meet the minimum standards. This has arisen as a result of:

- a lack of embedded risk management arrangements being in place during the year, and the fact that the Corporate Risk Register was only established in the last quarter of the year
- systems and processes for many of the activities of the organisation were being established during the year, as teams were being established and internal controls designed and implemented.

Such an opinion is to be expected in respect of a new organisation, but it is important that the positive steps taken are continued in 2019-20, as the organisation moves into delivery.

4.3 The capacity for improvement rating indicates the extent to which it is the Head of Internal Audit's belief that the level of control will improve over the next year. This is based upon management's response to Internal Audit work, and the indications of positive developments in the area of risk management.

4.4 This opinion is based on the following:

- An assessment of the work delivered by Internal Audit during 2018-19.
- The design and operation of the organisation's governance and risk management frameworks
- The "except for" value for money conclusion issued by the external auditor in respect of 2017-18 on the grounds of risk management



- The extent to which Internal Audit complies with the PSIAS, and the quality and performance of the service, determined through compliance with its Quality Assurance and Improvement Programme (QAIP)
- Reports produced / issues arising as a result of consultancy or investigative work undertaken by the Internal Audit team
- The continued independent status of Internal Audit, as evidenced by auditors' annual declarations in respect of the Code of Ethics.

4.5 It should be noted the opinion does not imply that Internal Audit has reviewed all risks and assurances relating to the organisation and is not an absolute assurance of the effectiveness of internal control arrangements and the management of risk. The purpose of this opinion is to contribute to the assurances available to the organisation which underpin the assessment of the effectiveness of its governance framework, including the system of internal control, which are encapsulated in the Annual Governance Statement.

4.6 As noted in the Introduction to this report, the opinion expressed above does not relate to Merseytravel, which, as a separate legal entity, attracts its own Annual Report and Opinion, which is prepared for the Audit, Risk and Governance Board. However, for the information of this Committee, the opinion provided in respect of Merseytravel was:

Overall Opinion 2018-19	Capacity for Improvement
Adequate	Reasonable

5. Effectiveness of Internal Audit

5.1 In establishing and demonstrating the effectiveness of Internal Audit, there are a number of requirements set out in the PSIAS:

- External peer assessment of compliance with the PSIAS, required every five years
- Internal assessment of compliance with the PSIAS, ideally conducted annually
- Establishment and maintenance of a Quality Assurance and Improvement Programme (QAIP), designed to ensure the quality of internal audit work and its development and improvement over time.

External Peer Assessment

5.2 In 2017, the service was the subject of an external peer assessment, conducted by peer local authorities, of the extent to which the service complies with the mandatory framework for Internal Audit in the UK Public Sector: Public Sector Internal Audit Standards (PSIAS). The overall assessment was that the service “generally complies” with the PSIAS, the highest opinion that can be given. An Action Plan was issued and all recommendations have since been implemented.

5.3 As the PSIAS determine that this must take place every five years, the re-assessment will take place in 2022.

Internal Assessment

5.4 The ongoing internal assessment of compliance has continued during the year, and it is the opinion of the Head of Internal Audit that the service continues to “generally comply” with the PSIAS.

Quality Assurance and Improvement Programme (QAIP)

5.5 During the year, so as to ensure that the Service not only continues to comply with the PSIAS, but to ensure that the service continues to improve, the following actions were taken:

- Staff attendance at relevant professional seminars and completion of relevant Continuing Professional Development requirements for professionally qualified staff
- Increasing the focus on risk in internal audit work and reports
- Appointment of a new Head of Internal Audit who is professionally qualified and suitably experienced
- Recruitment of a Trainee Principal Auditor who is undertaking the CIPFA qualification
- Engagement with Heads of Service and Directors regarding their perception of risk and their associated audit needs
- Development of the relationship with the Audit and Governance Committee, including the development of more effective reporting to the Committee
- Continuous review and update of working practices and reflection of associated changes in the Internal Audit Manual.

5.6 A key element of the QAIP, in evidencing that the service complies with the PSIAS, operates in an efficient and effective manner, and is perceived as adding value to the organisation's operations, is the adoption of a set of key performance indicators (KPIs). These feature in the Internal Audit Performance Report, which is presented to each meeting of the Audit, and Governance Committee. For 2018-19, the KPIs adopted, relating to LCRCA, their year-end results and associated commentary, are shown in the table below:

Key Performance Indicator	Target	Actual	Commentary
1. Public Sector Internal Audit Standards Compliance	100%	100%	The Service maintained its compliance with the PSIAS during the year.
2. Client Satisfaction Percentage of Post Audit Questionnaires with "Completely Satisfied" or "Satisfied" response	90%	100%	Level of response remains rather low at 36%.
3. Management Perception Percentage of positive responses to senior management satisfaction questionnaires in respect of perceived benefits and value of Internal Audit work	95%	100%	Level of response was rather low but comments received were very positive.

Table 4

6. Developments

- 6.1 During the year, the staffing of the team evolved with the appointment of a new Head of Internal Audit, who is CIPFA-qualified and suitably experienced. This appointment provided an opportunity for the review of working practices, reporting and strategic direction of the service, and this modernisation of the service will continue into 2019-20.
- 6.2 The appointment of a Trainee Principal Auditor was also a positive step, in strengthening the capacity of the team, but in allowing the post-holder to undertake CIPFA training under the Apprenticeship Levy, has helped to maximise the organisation's return on the Levy, and will strengthen the skills base of the team.
- 6.3 The relationships held by Internal Audit with stakeholders have continued to be positive during the year, and it is pleasing that despite the year being one of transition, the perception of the service has continued to be good, and its reputation has been maintained. This is reflected in the customer feedback obtained. The service has enjoyed good working relationships with officers across the organisation, and officers are thanked for their support during the year in enabling the completion of audit work and the development of the system of internal control. The relationship with the incoming external auditor, Mazars, has also been good, allowing for a positive level of liaison and co-ordination of effort.
- 6.4 In terms of the relationship of Internal Audit with the Audit and Governance Committee, the arrival of the new Head of Internal Audit has allowed for the forging of a new relationship, streamlined and more effective reporting, and this is felt to be developing positively, with very complimentary feedback having been received from the retiring Chair.

7. Looking Ahead

- 7.1 As the first full year for the new Head of Service, 2019-20 presents an opportunity for the strengthening and modernisation to continue with new focus and impetus. The key developments that are already in train for the year are:
- Development and approval of a fully risk-based Internal Audit Plan, which draws on corporate and service risk information, and the views of internal audit, to arrive at a Plan which is reflective of the key risks facing the organisation. Crucially, this approach encourages a risk focus within audits and the audit report, and also allows for a dynamic approach to the Plan which is able to reflect the changing and emerging risks faced by the organisation.
 - Development of a new internal audit report template with a new “organisational risk opinion”. This echoes the focus on risk and streamlines the previous report that contained two opinions, which could only serve to confuse auditees.
 - Production of a Service Plan which sets a clear strategic direction for the service and its development, linking this to the continued compliance with PSIAS and a stronger QAIP.
 - Strengthening the work undertaken on counter-fraud, to increase the focus on proactive work linked to the key fraud risks facing the organisation.
 - Recruitment of a Principal Auditor to provide increased capacity at a more strategic audit level.
- 7.2 The continued development and progress of the service will be reported to the Audit and Governance Committee, and the service looks forward to sharing its success with the Committee during 2019-20.



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