1.1 INTRODUCTION

1.1 This is a summary of my fifth annual report on the operation of Governance, Internal Controls and Risk Management within the Learning and Skills Council. The report covers all of the Council's operations, including the 47 local Councils, over the period 1st April 2005 to 31st March 2006.

1.2 The reporting timetable and the format of this report have by necessity been foreshortened, as compared to previous years, in order to meet a much reduced timescale arising from earlier closure of the accounts. Additionally, we have had to curtail planned work in order to accommodate bringing our support for 2005-2006 Statements of Internal Control forward by three months.

1.3 A consistent feature of the Learning and Skills Council has been its need to respond to change. 2005-2006 has been no different in this respect, in fact with the pressures and stresses of Agenda for Change, in particular theme 7, 2005-2006 has represented a major challenge to the staff of the Council and the systems it operates. In the main these challenges have been met and the LSC has continued to deliver its objectives. Also this year, the LSC has demonstrated its ability to close its accounts faster, in order to meet the timetable set by the Department for Education and Skills and the Treasury.

1.4 Although focused on general controls, our Control Health Check, across all offices of the Council, has again provided sufficient evidence to allow us to provide an assurance as to the general adequacy of the organisation’s overall control environment. Such assurance cannot be absolute and exceptions have been identified through the year, as well as through the control health checks, that exposed the LSC to the risk of loss and or failure to meet objectives. These exceptions included two cases of suspected internal irregularity that are covered later in this report.

1.5 Agenda for Change including theme 7 has posed a number of challenges to the control environment. Although considerable work during the year has been undertaken to identify these risks, the effectiveness of the organisation's response will not be fully discernable until later this year.
1.6 During 2005-2006 we have detected the same level of dedication and desire to do things appropriately as in previous years. Unfortunately, there have also been a few occasions where control has been undermined by a failure on the part of management to support their staff fully by discharging those duties normally associated with management i.e. checking on critical work of staff, ensuring basic control functions are understood and complied with, ensuring staff know and comply with rules and regulations etc. *Agenda for Change* provides the opportunity to rectify these weaknesses and to re-instate in staff and processes a due regard for controls and their part in helping to protect public funds.

1.7 2005-2006 has to be considered a difficult year for colleagues throughout the Council and I would like to thank them all for continuing to work in a spirit of partnership with Internal Audit.

2 ASSURANCE STATEMENT

2.1 I am satisfied that sufficient internal audit work has been undertaken across all of the Learning and Skills Council’s operations, along with degraded assurances from previous years, to allow me to draw a valid and reasonable conclusion as to the effectiveness of controls over key systems operating within the Council during 2005-2006.

2.2 Unfortunately, the radical nature of the changes facing the LSC with *Agenda for Change* means that few of the assurances given in this report are likely, even in a degraded form, to have currency through the coming year and beyond.

2.3 The Council has since its inception placed a premium upon the acceptance of personal responsibility by senior managers. This year, Executive Directors have presented their statements to their Regional Directors, who in turn, have provided their statements to the Chief Executive. The assurance derived from this regime remains strong and although it will need to be adjusted to meet the changes in the organisation’s structure of governance it will continue to be relevant in the future. This year’s assurances have, as in previous years, been verified and supported by control health checks carried out by internal audit across all Council operations. The effective operation of National and local Audit Committees has also continued to provide separate and independent assurance that risks and internal control issues have been scrutinised and challenged.

2.4 It is my professional opinion that the Learning and Skills Council has, during 2005 – 2006, maintained basically sound systems of Governance, Internal Control and Risk Management sufficient to give a substantial level of assurance. During the year a number of weaknesses in control were identified or circumventions occurred which put the achievement of some local Learning and Skills Council objectives at risk. These instances were in general isolated to specific offices or areas of business and in my opinion are not systemic in nature. Before a full assurance could be considered it will be necessary for the Council to address the weaknesses identified, where they flow through to the reorganised Learning and Skills Council. It will also be necessary to review and revise current control mechanisms in order to ensure that they remain appropriate to the transformed LSC.

2.5 Specific areas where action is likely to be necessary are:

- Continuing improvement in the top level review and monitoring of corporate risks;
- Instituting improvements in the management of contracts (particularly with reference to widening competition and minimising reliance on single tendering);
- Staff declarations of interest;
- Supervisory controls.
2.6 The opportunity to address these issues as part of Agenda for Change should not be missed. The Management Group is currently considering papers on the effectiveness of contract management. In addition, the Chief Executive has accepted a recommendation that senior managers should attend probity seminars and has indicated that such training should be compulsory for all staff at pay bands 4 and 5.

3 SPECIFIC ISSUES

General Comment

The importance of maintaining an environment of strong controls that fosters and facilitates appropriate responses to risks and provides a framework of good governance cannot be overstated. The changes occurring across the Council pose heightened risks, but also the opportunity to review and incorporate flexible and appropriate controls. Our year end control health checks did not identify any weaknesses or omissions which cannot be rectified or which unduly expose the Council to the risk of material loss or failure.

Contract and Procurement management

Contract management has long been an area where the organisation needs to improve, if it is to meet its challenging objectives, not just in its processes but also in the management of those tasked with managing contracts. The advent of Agenda for Change and the in year evolution of regionalisation have led to an increasing focus on provider management and it has been encouraging to note the establishment of contract registers, the deployment of separate, specialist contract teams and improved separation of duties by centralising provider management for given budget lines at designated offices within regions. Also during the year we have identified instances of good practice across the organisation although as often as not these represent situations where laid down procedures have been followed. We have identified poor practices and poor management of contracting staff. The improvements needed are not in themselves major exercises; they centre on staff and managers recognising that a high degree of discipline and rigour is a requirement of processes which result in the expenditure of public funds. Agenda for Change provides the opportunity for such requirements to become part of everyday business.

Risk Management

Across the local Councils, reasonable approaches have in the main been maintained through the past year and, despite inconsistencies in the approaches and methodologies adopted, substantial assurance may be taken. However, across the regions, risk management is still in the implementation stage and have not yet been formalised. The national Risk Manager is facilitating the introduction of regional level stewardship reports. These will be of particular interest to the proposed Regional Audit Committees. With regard to risk management in national office, although there continues to be improvement, there is still someway to go before it will be fully embedded. During the year a revised Risk Management Board has been put in place which should be better placed to foster the step change that is necessary across the organisation. A primary aim of the Board should be to ensure that a consistent methodology for the capture, recording and reporting of risks and responses, within the wider Risk Management Strategy is refined and maintained.

Specific cases of suspected Irregularity
During the year two internal investigations into suspected financial irregularity took place. The first investigated by the Investigations Unit of the LSC involves senior staff of a local office suspected of working in collusion with other staff of the Council and a number of providers. This case is being pursued through the appropriate authorities. The second case investigated by line management supported by internal audit involved staff contracting with family members and friends. This investigation has now been closed.

In both cases contributory factors included controls having been compromised or omitted due to managers not actively checking issues and signing documents without checking that all appropriate action had been taken. Probity and regularity are to be included in mandatory training for senior managers as part of Agenda for Change.
Audit Approach through year

At the beginning of the year we agreed with the Chief Executive, the Director of Finance and the National Audit Committee our audit approach for the year. This we revise once the extent of Agenda for Change became clear.

Our work included:

- Visiting all local Learning and Skills Councils as well as all National Divisions and Groups;
- Carrying out a plan of work, agreed with the National Audit Committee, based upon the risks facing the Learning and Skills Council:
  - WBL (carried over)
  - Procurement and Payments (carried over)
  - Provider Financial Assurance
  - Minerva development
  - Information Management developments
  - ESF
  - ETP/Train to Gain
  - Governance
  - Educational Maintenance Allowances
  - Offender Learning
  - Transfer of systems from DfES
  - Early Closing
  - Risk Management
  - AD Hoc financial control checks (VISAs, GPCs etc)
- Providing guidance and advice during the attendance at Project Boards and Steering Groups (e.g. 14-19 skills agenda);
- Carrying out control health checks at every Learning and Skills Council Office including the National Office (57 locations);
- Providing advice on risks;
- Meeting and discussing with managers control issues;
- Attending 153 local and four National Audit Committees in year.

We continued through the year to place a high degree of reliance on the assurances gained through local Audit Committees. By way of support to local Audit committees we have again issued updated guidance and facilitated a series of seminars for Local Audit Chairs. During the year we have advised and led on the implementation of Regional Audit Committees.

We have co-operated with the Department for Education and Skills Internal Audit through joint working on the Skills agenda as well as providing agreed assurances in respect of:

- Basic Skills/Skills for Life
- Work Based Learning/Apprenticeships
- Learner Support
- ETP/Train to Gain
- Governance Arrangements

As stated above, our approach was risk based and themed. Our findings were related to management through a variety of ways including:
• Formal reports which included agreed improvement plans
• Interim local reports
• Management letters
• Quarterly reports to the Chief Executive
• Annual reports, including “Control Health Checks”
• On-going advice through regular “keeping in touch” meetings.

Quality Assurance

As in previous years, Internal Audit work has been the subject of Quality Assurance reviews carried out in the main by Internal Audit Managers supported by our Operations Co-ordinator. However, following the investigations into control failures at a local office Internal Audit last year rated as having a strong control environment, I undertook the performance of a control health check myself in order to be satisfied that the process was not flawed and I am satisfied that it is not.