

AUDIT COMMITTEE

22 JUNE 2017

REPORT OF AUDIT AND GOVERNANCE MANAGER

A.1 REPORT ON INTERNAL AUDIT – MARCH – MAY 2017 AND ANNUAL REPORT OF THE AUDIT AND GOVERNANCE MANAGER 2016/17

(Report prepared by Steve Blake)

PART 1 – KEY INFORMATION

PURPOSE OF THE REPORT

To provide a periodic report on the Internal Audit function for March to May 2017 and the Audit and Governance Manager's Annual Report for 2016/17, as required by professional standards.

EXECUTIVE SUMMARY

- An annual self-assessment against the Public Sector Internal Audit Standards has identified a small number of outstanding compliance issues to be addressed during 2017/18 alongside the changes arising from the introduction of revised standards from April 2017.
- 98% of the 2016/17 Internal Audit Plan had been completed by the time of production of this report, with all key systems audits complete or at draft report stage.
- Eleven audits were completed in the quarter of which eight were given either Substantial or Adequate Assurance, three audits were rated Improvement Required and no audits were rated Significant Improvement Required.
- Although the Council's governance arrangements were generally found to be sound there were some significant issues reported that impacted on key or systems in use across the Council therefore giving a wider risk exposure and therefore it has only been possible to give a qualified assurance for the year in the Audit and Governance Manager's annual report. Actions to address the issues identified are ongoing.

RECOMMENDATION(S)

That the report be considered and noted.

PART 2 – IMPLICATIONS OF THE DECISION

DELIVERING PRIORITIES

Provision of adequate and effective internal audit helps demonstrate the Council's commitment to corporate governance matters.

FINANCE, OTHER RESOURCES AND RISK

Finance and other resources

The Internal Audit function is operating within the budget set.

Risk

Review of the functions of the Council by Internal Audit assists in identifying exposure to risk, and its mitigation.

LEGAL

The Council has a statutory responsibility to maintain adequate and effective internal audit.

OTHER IMPLICATIONS

Consideration has been given to the implications of the proposed decision in respect of the following and any significant issues are set out below.

Crime and Disorder / Equality and Diversity / Health Inequalities / Area or Ward affected / Consultation/Public Engagement.

Internal Audit activity assists the Council to maintain a control environment that mitigates the opportunity for crime.

During the course of internal audit work issues regarding equality and diversity, and health inequalities may be identified and included in internal audit reports.

There is no specific effect on any particular ward.

PART 3 – SUPPORTING INFORMATION**BACKGROUND**

The Public Sector Internal Audit Standards require the Audit and Governance Manager to make arrangements for reporting to senior management (Management Board) and to the board (Audit Committee) during the course of the year, and for producing an annual Internal Audit opinion and report that can be used to inform the Annual Governance Statement.

The Accounts and Audit Regulations 2015 make it a statutory requirement that the Council must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance.

CURRENT POSITION**REPORT ON INTERNAL AUDIT FOR MARCH - MAY 2017**

In order to provide the Committee with as up to date information as is possible, this section of the report provides detail relating to the outstanding period in 2016/17 not previously reported, and in addition the early part of the new financial year.

Public Sector Internal Audit Standards

A self-assessment against the standards has been undertaken to establish the level of conformance at the end of the 2016/17 financial year. The standards require that a Quality Assurance and Improvement Programme (QAIP) be produced and presented to the Audit Committee. The QAIP produced reflects any conformance issues identified as currently outstanding (Appendix A). The self-assessment undertaken has identified a small number of conformance issues that had not previously been identified at previous assessments and these have been added to the QAIP. Action is being taken, or is proposed, to deal with

all the entries listed.

As verbally reported to the March meeting of the Committee, a suitably qualified assessor has been appointed to undertake the external assessment required by the standards, and this is scheduled to be undertaken later in the year. The results of that assessment will be reported to the Committee in due course.

The Public Sector Internal Audit Standards were updated from 1st April 2017. The key changes can be summarised as follows: -

| Standard | Key Change |
|---|---|
| 1000 – Purpose, Authority and Responsibility | Clarification of the mandatory elements of the Public Sector Internal Audit Standards. Makes reference to the Mission introduced in the 2016 revision |
| 1112 – Chief Audit Executive Roles Beyond Internal Auditing | New standard recognising that the postholder may have other responsibilities, and emphasising the requirement for safeguards to avoid conflicts of interest |
| 1130 – Impairment to Independence or Objectivity | Additional content providing clarification on the provision of assurance services where consultancy and advice has previously been provided |
| 1210 – Proficiency | Revised to reflect the new core principle on being “future-focussed” |
| 1320 – Reporting on the Quality Assurance and Improvement Programme | Adds the expected disclosures required when reporting QAIP results |
| 2000 – Managing the Internal Audit Activity | Revised to include a requirement that for the Internal Audit to be effectively managed consideration is given to “trends and emerging issues that could impact the organisation” |
| 2010 – Planning | Amended wording to the interpretation, ensuring that the Internal Audit Plan is developed with an understanding of the organisation’s strategies, key business objectives, associated risks and risk management processes |
| 2050 - Coordination and Reliance | New interpretation providing improved clarification regarding the placing of reliance on the work of other assurance providers |
| 2060 - Reporting to Senior Management and the Board | Expanded interpretation setting out the key elements that need to be reported to Senior Management and the Audit Committee |
| 2210 - Engagement Objectives | New interpretation setting out different types of criteria to evaluate governance, risk management and controls |
| 2230 – Engagement Resource Allocation | New interpretation defining the knowledge, skills, competencies and quantity of resources to accomplish each audit with due professional care. |

There have been minor revisions to other standards.

In reality many of the aspects of the changes are already undertaken, and require no more than an update of the Internal Audit Manual to reflect the revised standards. The QAIP has been updated to reflect that there is outstanding work to be undertaken to demonstrate compliance with the revised standards.

Standard 2060 Reporting to Senior Management and the Board

Given the nature of this standard, it is appropriate to consider its requirements at this time, so that the changes required can be reflected in this, and future, reports to the Committee. The revised standard requires the following to be reported: -

| Reporting Requirement | Current Arrangements | Proposed Arrangements |
|---|--|--|
| The Audit Charter | Annual review of the Charter reported to Audit Committee | No change |
| Independence of the Internal Audit activity | Referred to in Charter, and in Audit and Governance Manager's Annual report | Comment on any independence issues to be added to periodic reports on Internal Audit |
| The Audit Plan and progress against the plan | Appendix to each periodic Internal Audit report to the Committee identifies progress made. Audit and Governance Manager's Annual Report provides additional detail | Measurement of progress against plan to be reintroduced to periodic reports on Internal Audit |
| Resource requirements | Included in Annual Plan reports. Reference made in periodic reports when significant resource issues arise | No change |
| Results of Internal Audit activity | Included in periodic reports on Internal audit | No change |
| Conformance with the Code of Ethics and the Standards, and action plans to address any significant conformance issues | Included in periodic reports, with Quality Assurance and Improvement Programme reported at least annually | No change |
| Management response to risk, that in the Audit and Governance Manager's judgement, may be unacceptable to the Council | Any such issues arising would be included in periodic reports on Internal Audit | Line to be added to periodic report on Internal Audit to report where no such instances have occurred in the period under review |

Internal Audit Plan – The 2016/17 plan was approved by this Committee on 17th March 2016, with the 2017/18 plan being approved by the Committee at its last meeting on 16th March 2017.

Internal Audit Plan 2016/17 Progress – Appendix B provides detail of the status of each audit in the plan at 31st March 2017 and an updated position for May 2017.

At 31st March 2017 the equivalent of 86% of the 2016/17 plan had been completed. This

was due to a number of audits overrunning their planned time. Whilst there are mechanisms in place to monitor and control time, the nature and complexity of some audits and the issues arising can impact on time performance. All key systems audits are now either complete with a final report issued or at draft report stage.

The Audit and Governance Manager's Annual Report, set out later in this report, identifies that the level of coverage achieved and the effect of the changes made to the plan did not impact materially on the forming of an overall opinion on the Council's Internal Control environment or expose the Council to material risk. The plan is intended to be flexible and subject to change during a financial year, it being recognised that exposure to risk can change. A small number of audits were deferred where circumstances / changes to the Council's operations made the timing of an audit in 2016/17 inappropriate – these audits have been included in the 2017/18 plan.

Although each Internal Audit Plan is described as relating to a specific year, in reality it should be considered as an ongoing rolling plan of work. Audits incomplete at 31st March have been rolled forward and progressed in the early part of 2017/18. With a small number of exceptions these audits have now either been completed or are substantially complete. Where an audit is not shown as completed any issues requiring reporting to the Committee will be brought to the meeting following issue of the final report on each assignment.

Internal Audit Plan 2017/18 Progress – At 31st May 2017, 14% of the plan had been completed – whilst this is marginally behind target it is not at a level that currently gives any cause for concern. Detail has been included in Appendix B of progress to date on each audit.

Independence of the Internal Audit Activity

The Audit and Governance Manager had in the period under review operational responsibilities regarding processes included in the Corporate and Ethical Governance and Risk Management audits. He has declared an interest regarding those audits, and the previously agreed arrangements whereby the Principal Auditor takes managerial responsibility for those audits has been implemented. The only role the Audit and Governance Manager has undertaken in those audits is that of auditee.

There were no other issues identified during the period that impacted on the independence of the Internal Audit function.

Outcomes of Internal Audit Work

The standards require the Audit and Governance Manager to report to the Audit Committee on the outcomes of internal audit work undertaken. 11 Internal Audit reports have been issued since the last report to this Committee.

| Assurance | Colour | Number this Quarter | |
|----------------------------------|---------------|----------------------------|---|
| Substantial | | 4 | |
| Adequate | | 4 | |
| Improvement Required | | 3 | Brief details provided below of key issues identified |
| Significant Improvement Required | | 0 | |

For the purpose of the colour coding approach, both the substantial and adequate opinions are shown in green as both are within acceptable tolerances.

Issues arising from audits completed requiring reporting to Committee are: -

Sundry Debtors

The audit identified ongoing issues regarding debt recovery. Effective processes were not in place to provide regular reports / management information to departments / services on outstanding debts, therefore potentially increasing the risk of failing to detect and act upon debts due to the Council. There had been one instance identified during the year where failure by a department to act at an early enough stage had resulted in a substantial debt accruing, leaving the Council exposed to the risk of being unable to recover that debt. As a result of the audit, mechanisms have been / are being put in place to ensure that appropriate reports are generated and that staff are aware of recovery action required.

Risk Management

The audit focussed on departmental risk management in 2016/17. It identified that the current departmental risk registers contained insufficient coverage and required improvement. Management Team have recognised the need for improving operational risk management within service areas and fully support the implementation of an effective departmental risk management process, and this will be progressed during 2017.

Uniform Application Review

The audit identified that there were many more users than expected with administrator rights, and that there was no effective process in place for determining the correct level of access rights to be applied when users are set up on the system. Management have agreed to review the access needs for those currently with administrator rights, to undertake a security review to rationalise user access rights, and to put in place a process that determines the appropriate level of access when new users are set up. This will be progressed during 2017.

Management Response to Risk

There have been no instances in the period under review where management's response to risks identified in the Internal Audit work undertaken, has in the Audit and Governance Manager's opinion, been unacceptable.

Management Response to Internal Audit Reports

There are processes in place to track action taken regarding issues raised in Internal Audit reports and to seek assurance that appropriate corrective action has been taken, with follow up work being undertaken where necessary.

The number of high severity issues outstanding was as follows: -

| Status | Number | Comments |
|----------------------------|---------------|--|
| Overdue more than 3 months | 0 | |
| Overdue less than 3 months | 1 | Regular reminders issued to relevant managers to establish the action taken / encourage resolution |
| Not yet due | 5 | |

There are no issues to draw to the attention of the Committee regarding high severity issues outstanding.

Quality Assurance – Detail regarding performance has been included in the Annual

Report.

ANNUAL REPORT OF THE AUDIT AND GOVERNANCE MANAGER 2016/17

Opinion on the Overall Adequacy and Effectiveness of the Council's Internal Control Environment

The Internal Audit function completed 37 scheduled audits during the year, and a further 10 2016/17 audits had been completed by May 2017. For the audits completed, assurance was classified as: -

| Assurance | Number of Audits |
|----------------------------------|-------------------------|
| Substantial | 15 |
| Adequate | 24 |
| Improvement Required | 8 |
| Significant Improvement Required | 0 |

The result of each audit completed has been included in periodic reports produced for the Committee during the year. The control and governance arrangements were found to be operating satisfactorily in many of the activities audited during the year, with significant issues identified only in a small number of the audits completed. Summaries of the significant issues identified in the audits completed during the year were included in periodic reports to the Audit Committee, with the Committee's attention drawn to audits on Sundry Debtors, Procurement, S106 Agreements, Housing Allocations, Risk Management, Payroll and Human Resources Computer Application Review, and Uniform Computer Application Review, all of which had been given an assurance rating of Improvement Required. It should be noted that some of the issues identified in these audits were quite specific and that the governance arrangements were otherwise generally found to be of a satisfactory standard, however there were some weaknesses identified relating to key or systems in use across the Council therefore giving a wider risk exposure. No scheduled audit came close to being classified Significant Improvement Required.

Taking into account the issues identified in the audits included in the table above and listed in Appendix B, and where appropriate reviews by other assurance providers, the governance arrangements were generally found to be sound and fit for purpose. However the wider risk exposure linked to some of the significant issues reported result in it only being possible to give a qualified assurance.

The assurance provided is based on the fact that many activities of the Council are audited on a less than annual frequency, and also it is not practical to examine every significant decision / transaction within those functions reviewed in any one year. It would therefore not be possible to provide absolute assurance.

Qualification to the Opinion

The opinion given above is based upon the level of Internal Audit activity that it proved possible to deliver with the resources available during the year. It was not possible to fully complete the planned work during the year as detailed elsewhere in this report, although all key audits have been undertaken or were in progress at the year-end. In forming an opinion, audit outcomes identified, but not reported until the 2017/18 plan year have been taken into account. The level of coverage achieved is considered sufficient to be able to provide the assurance required.

Summary of the Internal Audit Work Undertaken to Formulate the Opinion, and Reliance Placed on the Work by Other Assurance Bodies

The 2016/17 plan made provision for the audit of all key systems. It also included audits of a selection of other functions of the Council, selected using a risk assessment process to produce the plan. In addition audits incomplete at 31st March 2016 were completed during 2016/17. For those audits completed where the assurance was considered Improvement Required brief details of findings were included in the periodic reports presented to the committee throughout the year, and the Committee requested and received further details regarding issues raised as a result these audits where they considered it appropriate.

The audit plan for 2016/17, in addition to assurance work on functions and systems, included some areas of focussed audit activity: -

- The Computer Audit element of the plan was undertaken in house. All audit planned were commenced during the year, with one exception which was commenced in April 2017.
- Planned audit work regarding the Council's Emerging Key Projects was deferred to 2017/18 as none of the projects intended to be covered under this heading had reached a stage during the year that warranted an audit being undertaken.
- One stand-alone Proactive Anti-Fraud Audit was undertaken, with further anti-fraud work undertaken being embedded in some of the assurance audits completed.
- The Internal Audit function undertakes unscheduled investigations and ad hoc audit work as and when required. Whilst there have been no investigations commenced during the year by the team, the Internal Audit function has participated in officer groups formed to deal with issues that have arisen including the debt recovery issue referred to above.

In accordance with best practice and the requirements of the Public Sector Internal Audit Standards, the 2016/17 plan included arrangements for the follow up of issues found at previous audits. This took the form of: -

- Separate follow up audits and embedded follow up work within assurance audits. In these cases any ongoing outstanding issues were formally reported to management, with any significant issues drawn to the attention of the Committee.
- Action Tracking – monthly reminders being issued, and responses verified by evidence where it was appropriate to do so.

The Internal Audit function has also provided advice and assistance to functions of the Council upon request, and during / following audits, as appropriate during the year.

A schedule of the audits undertaken during 2016/17 is included at Appendix B.

Upon completion of each audit a draft report was issued to the appropriate Corporate Director / Head of Department, containing details of any findings requiring addressing that had been identified. Subsequent discussions were held with appropriate senior managers and final reports issued, which included detail of agreed actions to resolve the issues identified. There were no instances, for the reports issued during 2016/17 or subsequently to date, where a satisfactory action had not been identified and agreed, and there were no risks identified where the agreed action was insufficient to mitigate such risks to an acceptable level.

No specific reliance has been placed upon the work of any other assurance provider in lieu of internal audit coverage during the year. There is a requirement however for the Audit and Governance Manager to take account in forming his annual opinion on the overall adequacy and effectiveness of the control environment, of the assurance given by other providers as well as directly by the Internal Audit function. The contents of reports issued

by other providers have therefore been taken into account in the opinion made.

Issues Relevant to the Preparation of the Annual Governance Statement

The overall opinion given in this report is relevant to the Annual Governance Statement, as is the need to highlight the issues raised in audits on Sundry Debtors, Procurement, S106 Agreements, Housing Allocations, Risk Management, Payroll and Human Resources Computer Application Review, and Uniform Computer Application Review all of which had been given an assurance rating of Improvement Required.

Performance of the Internal Audit Function

The performance measures used during 2016/17 were as follows: -

| Performance Measure | Actual 2016/17 | Actual 2015/16 | Actual 2014/15 | Actual 2013/14 | Actual 2012/13 |
|--|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Percentage of Audit Plan Completed | 86%* | 79% | 71% | 94% | 91% |
| Percentage of Satisfactory Responses to Satisfaction Surveys Issued with Final Audit Reports | 100% | 96% | 96% | 100% | 96% |

*At the time of producing this report 98% of the 2016/17 plan had been completed.

The Percentage of Audit Plan Completed performance measure is based upon planned time for the audits undertaken, and excludes ad hoc work. In reality, the actual time on planned audit work exceeded the total planned for 2016/17, the performance measure being reduced as a consequence of overruns of time occurring on a number of audits.

The 2016/17 plan approved by the Audit Committee in March 2016 was of a similar size to that provided in previous years, and was set at a level deemed appropriate to provide an adequate level of Internal Audit coverage. The Audit Plan was subject to adjustment during the year with changes subject to consideration by the Audit Committee, audits incomplete were rolled forward into 2017/18, with those outstanding relating to key systems being progressed early in 2017/18 and the issues arising being taken into account for this report.

All audits are subject to a quality review following completion of the fieldwork stage on each assignment. Audits were not considered complete and reports were not issued until any quality issues identified had been addressed.

Independence of the Internal Audit Activity

The Internal Audit function maintained an independent role during the year, compliant with the requirements of the Public Sector Internal Audit Standards. Effective arrangements as detailed below were in place to maintain independence taking account of the Audit and Governance Manager's other corporate responsibilities. Effective mechanisms were in place to ensure that any other conflicts of interest within the team were identified and addressed on an audit by audit basis, with no instances where there was considered to be any impairment to independence or objectivity.

Compliance with the Public Sector Internal Audit Standards

The Public Sector Internal Audit Standards were introduced from 1st April 2013, and updated in 2016 and 2017. Progress updates have been periodically reported to the Committee, on the work being undertaken to demonstrate conformance with the

requirements of the Standards. Since their introduction alternate solutions have been agreed by the Audit Committee regarding the following standards: -

1110 Organisational Independence

The standards require specific input from the Chief Executive and Chair of Audit Committee regarding the Audit and Governance Manager's performance appraisal. Alternate arrangements that enable both to comment on performance of the Audit and Governance Manager at any time, rather than through the formal appraisal process, have been agreed.

1130 Impairment to Independence or Objectivity

The Audit and Governance Manager had during 2016/17 operational responsibilities regarding Corporate Governance and Risk Management in addition to his Internal Audit duties. The standards identify that audits of activities where such a conflict of interest arises should be overseen by someone outside of Internal Audit. As there are practical issues identifying suitable staff external to the Internal Audit function who do not have a conflict of interest, the alternate arrangement agreed was for the Principal Auditor to undertake the Audit and Governance Manager role for such audits, with the latter's role in the audit being solely that of auditee. This avoids any conflict of interest and ensures that those audits have been managed by a member of staff with Internal Audit skills and expertise. New Standard **1112 Chief Audit Executive Roles Beyond Internal Auditing** applicable from April 2017 provides additional clarification and a requirement to periodically review such arrangements – this will be addressed in a future report to the Committee.

As referred to in the periodic report above, a small number of compliance issues relating to the standards remained outstanding at 31st March 2017, and are listed at Appendix A. Until the external assessment planned for later in 2017 has been undertaken successfully and any issues identified addressed, the Internal Audit function cannot be considered fully compliant with the Standards.

BACKGROUND PAPERS FOR THE DECISION

Internal Audit Reports
Reports to Audit Committee in 2016/17

APPENDICES

Appendix A – Quality Assurance and Improvement Programme
Appendix B – Internal Audit Plan Progress