

REPORT TO: SCRUTINY COMMITTEE - 29 JUNE 2016

REPORT ON: 2015/16 INTERNAL AUDIT ANNUAL REPORT

REPORT BY: SENIOR MANAGER – INTERNAL AUDIT

REPORT NO: 230-2016

1.0 PURPOSE OF REPORT

To submit to Members of the Scrutiny Committee the 2015/16 Internal Audit Annual Report. This report summarises the activities of the Council's Internal Audit Service during this period and provides an independent annual opinion on the overall adequacy and effectiveness of the organisation's governance, risk management and control framework based on the work undertaken.

2.0 RECOMMENDATIONS

Members of the Committee are asked to consider and note the contents of this report.

3.0 FINANCIAL IMPLICATIONS

None

4.0 MAIN TEXT

- 4.1** The terms of reference of the Scrutiny Committee, as detailed in Report No 274-2014 (Policy and Resources Committee 10 November 2014, Article V) includes consideration of the strategy, plan and performance of the Council's Internal Audit Service. In addition, the Committee is also required to consider internal audit reports and seek assurance that appropriate action has been taken, monitor the implementation of internal audit recommendations agreed with management and receive the Annual Report of the Senior Manager – Internal Audit.
- 4.2** The Public Sector Internal Audit Standards (PSIAS), which came into effect from 1 April 2013, and were revised from 1 April 2016, apply to all internal audit service providers within the public sector and set out the requirements in respect of professional standards for these services. Professional Standard 2450 – Overall Opinions states that *“the chief audit executive must deliver an annual internal audit opinion and report that can be used by the organisation to inform its governance statement”*. In the context of Dundee City Council, the *“chief audit executive”* is the Senior Manager – Internal Audit and the *“board”* is the Scrutiny Committee.
- 4.3** The PSIAS specifically states that the annual report prepared by the chief audit executive must incorporate:
- the annual internal audit opinion on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control;
 - a summary of the audit work that supports the opinion; and
 - a statement of conformance with the PSIAS including the results of the quality assurance and improvement programme.
- 4.4** It should also be noted that the Local Authority Accounts (Scotland) Regulations 2014 became effective in October 2014. Under these regulations *“a local authority must operate a professional and objective internal auditing service in accordance with recognised standards and practices in relation to internal auditing”*. In this context recognised standards and practices are deemed to be those set out in the PSIAS. These Regulations also require that *“the local authority must conduct a review at least once a year of the effectiveness of its system of internal control”*. In respect of this and from an internal audit perspective there is a requirement that *“the findings from assessments must be considered as part of the consideration of the system of internal control”*.
- 4.5** The Internal Audit Annual Report for the 2015/16 financial year, which is attached for consideration by Members, has been prepared on the basis of the requirements as outlined above.

5.0 POLICY IMPLICATIONS

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management. There are no major issues.

6.0 CONSULTATIONS

The Chief Executive, Executive Director of Corporate Services and Head of Democratic and Legal Services have been consulted on the content of this report.

7.0 BACKGROUND PAPERS

None

Pamela Redpath, Senior Manager – Internal Audit

DATE: 23 May 2016

2015/16 INTERNAL AUDIT ANNUAL REPORT

1. PURPOSE OF REPORT

- To summarise the key areas of activity undertaken by the Council's Internal Audit Service and highlight any matters of significance that have arisen as a result of the audit process during the 2015/16 financial year.
- To provide an independent opinion on the overall adequacy and effectiveness of the organisation's governance, risk management and control framework.

2. GOVERNANCE, RISK MANAGEMENT AND CONTROL FRAMEWORK

- The governance framework comprises the systems and processes as well as the culture and values, by which the Council is directed and controlled and its activities through which it accounts to, engages with and leads the community. It enables the Council to monitor the achievement of its strategic objectives and consider whether those objectives have led to the delivery of appropriate cost effective services.
- The system of internal control is a significant part of this framework and is designed to manage risk to a reasonable level. It cannot eliminate all risk of failure to achieve policies, aims and objectives and can, therefore, only provide reasonable and not absolute assurance of effectiveness.
- The system of internal control is based on an ongoing process designed to identify and prioritise the risks that may impact on the achievement of the Council's policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact they may have if they are, and to manage them efficiently, effectively and economically.

3. ROLE OF INTERNAL AUDIT

- Internal audit forms a fundamental element of Dundee City Council's governance and assurance framework. The Internal Audit Service is independent of the activities it audits. This is essential to ensure that the service provides unbiased judgements and impartial advice to management. Through the provision of a high quality, independent, objective assurance and consulting activity, guided by the philosophy of adding value, the Service aims to bring a systematic and disciplined approach to evaluating and improving the effectiveness of the organisation's business processes. This role includes having an understanding of the key risks faced by the Council.
- The Internal Audit Service, with strict accountability for confidentiality and safeguarding records and information, is authorised full, free, and unrestricted access to all of the organisation's records, physical properties and personnel pertinent to carrying out any engagement and effectively discharging its remit.
- The primary thrust of internal audit work is to review, appraise and report on a wide range of areas. The types of review undertaken are assigned to various themes namely governance, ICT, systems, procurement/contract and financial. In addition, the service may also provide advice and guidance on governance, risk management and internal control and during specific investigations.
- The existence of an internal audit service does not, however, diminish the responsibility of management to ensure that resources are utilised appropriately, in a manner and on the activities intended, and the internal control arrangements are sufficient to address the risks that their services are exposed to.
- The Internal Audit Charter sets out in more detail within the context of Dundee City Council the purpose, authority and responsibility of the Internal Audit Service. The Charter has been updated recently to reflect structural changes within the Council and revisions to the Public Sector Internal Audit Standards and is also presented to Scrutiny Committee today (Report No. 232-2016).

4. AUDIT PLANNING

- A vital element in the effective management of internal audit is planning audit work to ensure that objectives are met, priorities are established, resources are targeted and used effectively, best value is achieved and cognisance is taken of the risk(s) associated within each area.

- The Internal Audit Plan is compiled on an annual basis and provides a summary of the areas where it is planned that work will be carried out during the forthcoming year. The Internal Audit Plan for the 2015/16 financial year was submitted to the Scrutiny Committee in April 2015 (Report No. 141-2015). In line with recognised good practice, the Internal Audit Plan was prepared on the best information available at that time.
- The internal audit arrangements are assessed on an annual basis by the Council's External Auditor, in 2015/16 the External Auditor was KPMG. As part of this, the external auditor considers the activities of internal audit. This is undertaken principally to maintain an understanding of the work undertaken and determine the extent of assurance that can be taken from the work performed. In addition, it helps to minimise duplication of effort and unnecessary disruption to services.

5. AUDIT REPORTS

- Each audit assignment results in an internal audit report, which includes an executive summary as well as audit findings, recommendations and management responses, where appropriate. The audit report provides management with an action plan, which assigns responsibility and details the timetable for implementation of audit recommendations.
- Within all audit reports a judgement is given on the importance of each audit finding i.e. critical, significant or routine. These judgements are utilised to determine the overall level of assurance / opinion to be assigned to the area that has been subject to review. There are generally four overall levels of assurance i.e. full, reduced, limited and no assurance with corresponding standard opinions. The overall opinion is detailed in the executive summary of each report.
- The findings and recommendations arising from the audit assignments reported upon in 2015/16 have been discussed with appropriate officers of the Council and agreed action plans have been put in place to address the areas identified for improvement. The executive summary from each of these has been submitted to the Scrutiny Committee for consideration.
- To confirm that management has discharged its responsibility in terms of implementing audit recommendations within the agreed timescale, Internal Audit also undertakes follow-up work and progress reviews. The outcomes from this work, with revised implementation dates where appropriate, are also formally reported to relevant officers and the Scrutiny Committee.

6. KEY EVENTS DURING 2015/16

- In addition to the change in management of the Internal Audit Service (discussed at section 7 below), and the re-positioning of the Corporate Fraud Team into the Internal Audit Service with effect from 1 June 2015, key events during 2015/16 that are more strategic in nature include the restructure of the organisation itself, preparation for the establishment of the Dundee Integrated Joint Board and other changes driven by the Changing for the Future Programme such as Channel Shift / Digital Council, Property Rationalisation and Mobile Working. The impact that these changes have had (and will continue to have for some time) on services, the positioning of responsibilities and staff have resulted in a challenging environment in terms of the planning and delivery of internal audit services and steps will continue to be taken to ensure that any potential difficulties are identified and managed proactively with a view to minimising any impact on service delivery.
- During 2015/16, the Internal Audit Service was delivered utilising a mix of in-house and external resources. The external resources were provided via PwC who were approved as the Council's co-sourcing partner for the delivery of internal audit services with effect from January 2014 (Report No. 519-2013). This partnership continues to develop and provide benefits such as specialist skills and advice which complement the skills in the in-house team. In addition to delivering specific pieces of internal audit work, PwC manage the client feedback questionnaire process on behalf of the Service. Feedback from clients continues to be positive and contributes where applicable to the continuous improvement agenda of the service.
- The Internal Audit Service operated in 2015/16 in accordance with PSIAS. During 2013/14, an assessment was undertaken as to the extent to which the current Internal Audit Service, policies and procedures conform to expected requirements contained within the PSIAS. The areas that were identified as a result of this exercise were formally reported to the Scrutiny Committee in December 2014 (Report No. 463-2014) in a quality assurance and improvement

programme / action plan. Whilst a number of these recommendations have been implemented / partially implemented, the outstanding areas will be taken forward as appropriate within the next six months along with any other areas for improvement identified following completion of the planned review of conformance against the revised PSIAS. It should be noted that none of the areas identified as requiring improvement at that time were considered to represent a significant deviation from the requirements contained within the PSIAS.

7. PLAN ACHIEVEMENT

- For the 2015/16 financial year the actual number of productive time for audit work was 756 days. Although the number of productive days was broadly in line with the previous year, it represented a shortfall of 9.5% against the budgeted productive days. This shortfall was primarily due to the change in management within the Internal Audit Service and subsequent unforeseen recruitment difficulties, which had not been anticipated at the time the plan was compiled. More specifically, the former Chief Internal Auditor retired on 30 September 2015, at which point the Principal Internal Auditor, who had been successful in obtaining the position, took over. To date, it has not been possible to appoint a successor for the Principal Internal Auditor, however, the latest recruitment drive has been considered a success with the preferred candidate's application currently being progressed. In the interim, some of the resource gap has been bridged through the co-sourcing arrangement with PwC and the utilisation of an agency member of staff. In terms of total productive days, approximately 83% were spent on direct audit activities and 17% were spent on support activities such as strategic management of the Internal Audit Service, audit planning, staff training and development. This split of total productive days is generally in line with previous financial years.
- The 2015/16 Internal Audit Plan included 32 areas, both at a corporate and service level across the organisation, to be reviewed. It also included an allocation of audit days for follow-up reviews, progress reviews, finalisation of audit assignments which commenced in the previous financial year, provision of advice and guidance to clients.
- Whilst work on the majority of the planned areas for corporate and service reviews included within the plan commenced in 2015/16 there was, due to a number of factors, some slippage. The reasons behind this varied and included, the area for review not being as well advanced as planned, organisational changes, staff availability and an increasing number of enquires in respect of ad-hoc advice and guidance. The key areas of slippage will be covered as part of the 2016/17 work programme.

8. OVERALL ASSESSMENT OF CONTROLS

- Internal Audit activity for the Council during 2015/16 covered a wide spectrum of areas including managing client finances, early years income, discretionary housing payments, data matching, income, Protecting Vulnerable Groups scheme, business continuity, business + IT development process, data integrity, corporate policies, pension fund, stocks and inventories, grant claims and follow-up reviews. The range of areas within the business covered continues to reflect the changing landscape and nature of internal audit work and focusses upon evaluating and contributing to improving the organisation's governance, risk management and control framework.
- The 2015/16 reviews of corporate and service systems identified that many of the expected controls are in place and operating satisfactorily in the areas examined. However, audit work also identified a number of areas requiring improvement and, consequently, Internal Audit reports included a range of recommendations and action plans (developed in consultation with management), which, once implemented, will improve the overall control environment. In addition, whilst not specifically informed by the 2015/16 Internal Audit programme of work, a number of areas requiring further improvement were identified including improvements surrounding risk management, grant funding and the internal control framework for financial systems. These areas for improvement should feature in the Continuous Improvement Agenda of the Council's Annual Governance Statement and will be formally reviewed by Internal Audit during the 2016/17 financial year.
- During the 2015/16 financial year, 24 internal audit reports were finalised. A summary of these reports is attached at Appendix A, along with other key pieces of associated information. In general, these reports have been well received by clients with management agreeing to

implement 100% of the recommendations made. A total of 66 recommendations were made in the reports issued. Of these, 2 were categorised as critical, 35 were significant and the remaining 29 were considered to be routine. This compares to the previous financial year where a total of 62 recommendations were made.

- Analysis of the overall audit opinion for the reports issued highlighted that 4% of the areas reported upon were considered to be well controlled (full assurance), 42% were adequately controlled (reduced assurance) and 54% were requiring improvement (limited assurance). A watching brief will continue to be kept on the overall audit opinions. Once again none of the areas reviewed and reported upon in the year were deemed to be so inadequately controlled that no assurance could be placed upon the systems and controls being operated.
- The PSIAS requires the Senior Manager – Internal Audit to deliver an internal audit opinion on the overall adequacy and effectiveness of the Council's framework of governance, risk management and control and that this opinion be used to inform the Council's Annual Governance Statement. This principle is also affirmed in the Local Authority Accounts (Scotland) Regulations 2014. Attached at Appendix B is the Senior Manager – Internal Audit's opinion which is supported by the audit work carried out by the Internal Audit Service and other relevant information. On the basis of the areas used to inform this process for the year to 31 March 2016, the overall audit opinion reached was that reasonable assurance can be placed upon the overall adequacy and effectiveness of the Council's framework of governance, risk management and control.

Summary of Internal Audit Reports Issued during the 2015/16 Financial Year

Report No.	Area Reviewed	Level of Assurance	Recommendations			
			Total No.	Importance		
				Critical	Significant	Routine
2013/21	CeRDMS – Employee Files	L	2	-	2	-
2013/23	Managing Client Finances	L	6	-	2	4
2013/28	Early Years Income	R	4	-	1	3
2014/02	Stocks and Stores	L	2	-	1	1
2014/07	Discretionary Housing Payments	R	3	-	-	3
2014/08	Data Matching	L	2	-	1	1
2014/10	Income	L	2	-	2	-
2014/15	PVG Scheme	L	3	-	1	2
2014/19	Stocks and Inventories	L	2	-	2	-
2014/20	Spreadsheets	R	2	-	1	1
2014/22	Tayside Pension Fund	R	5	1	2	2
2014/25	Payroll – Leavers	L	2	-	2	-
2014/28	Business Continuity	L	1	-	1	-
2014/29	ICT Refresh Programme (Education Network)	R	1	-	-	1
2014/30	Business + IT Development Process	L	2	-	1	1
2015/01	2014/15 Grant Claim: Air Quality Action Plan	F	0	-	-	-
2015/03	Community Equipment Services	R	1	-	1	-
2015/04	Lone Working	R	3	-	2	1
2015/07	Data Integrity	L	5	-	3	2
2015/09	Arrangements for the Management of Asbestos	R	5	-	5	-
2015/10	ICT Resilience	R	2	1	1	-
2015/11	Plant and Equipment	R	4	-	2	2
2015/14	Corporate Policies	L	3	-	1	2
2015/23	Pension Fund	L	4	-	1	3

Level of Assurance	Full	Reduced	Limited	No
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To the Members of Dundee City Council, Chief Executive and Executive Director of Corporate Services

As Senior Manager – Internal Audit of Dundee City Council, I am pleased to present my annual opinion for the year ended 31 March 2016. It should be noted that the statement does not include assurances on group activities.

Respective Responsibilities of Management and Internal Audit in Relation to the Control Environment

It is the responsibility of the Council's officers to determine, establish and maintain sound systems of internal control, to ensure that the organisation's resources are properly applied in a manner and on the activities intended and the internal control arrangements are sufficient to address the risks facing their services. This includes responsibility for the prevention and detection of fraud. Management is also charged with monitoring the continuing effectiveness of the internal control environment and taking action as appropriate. It is the responsibility of the Senior Manager – Internal Audit to provide an annual assessment of the overall adequacy and effectiveness of the Council's framework of governance, risk management and control.

Control Environment

This comprises the governance, risk management and control processes in the context of the Council's defined goals and objectives. The key elements include the following:

- Consistency of operations with established goals and objectives.
- Effectiveness and efficiency of operations and deployment of resources.
- Compliance with significant policies, plans, procedures, laws, and regulations.
- Reliability and integrity of management and financial information processes, including the means to identify, measure, classify, and report such information.
- Safeguarding of assets.

A sound control environment reduces, but cannot eliminate, the possibility of poor judgement in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances. It therefore provides reasonable but not absolute assurance that control weaknesses or irregularities do not exist or that there is no risk of material errors, losses, fraud or breaches of law or regulations. Accordingly, the Council is continually seeking to improve the adequacy and effectiveness of its control environment.

The Focus of Internal Audit Work

Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. Through its work, internal audit helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes. The Council's Internal Audit Service operates in accordance with the Public Sector Internal Audit Standards and the Local Authority Accounts (Scotland) Regulations 2014. The requirements under these Standards represent best practice and these along with the Regulations are mandatory.

The Senior Manager – Internal Audit prepares an annual internal audit plan which outlines the work to be undertaken. The internal audit plan is developed utilising a risk-based methodology based on the audit universe and will take into account the requirement placed upon the Senior Manager – Internal Audit to deliver an annual internal audit opinion on the overall adequacy and effectiveness of the organisation's control environment. In compiling the plan, input from senior management and any other relevant parties will be sought and cognisance is taken of emerging issues. The plan needs to be flexible to be able to reflect the changing risks and priorities of the organisation. The plan, any material changes to the plan during the course of the financial year and any significant matters that may impact upon the delivery of the plan are reported to the Scrutiny Committee at an appropriate juncture.

The Internal Audit Service formally reports upon the areas subject to review. Such reports, which identify system weaknesses and/or non-compliance with expected controls, are issued for the attention of service managers and include appropriate recommendations and agreed action plans. It is management's responsibility to ensure that due consideration is given to internal audit reports. This includes management taking remedial action where appropriate or accepting that there may be a level of risk exposure if the weaknesses identified are not addressed for operational reasons. Internal Audit has a responsibility to ensure that agreed action plans have been implemented. Matters arising from internal audit work are also reported to the Council's Scrutiny Committee, the Chief Executive and the Council's External Auditor.

Summary of 2015/16 Internal Audit Activity

During 2015/16 financial year a total of 24 internal audit reports were issued. These covered a wide spectrum of areas including managing client finances, early years income, discretionary housing payments, data matching, income, Protecting Vulnerable Groups scheme, business continuity, business + IT development process, data integrity, corporate policies, pension fund, stocks and inventories, grant claims and follow-up reviews. The Internal Audit Service also provided advice on the control environment as required.

The 2015/16 audit of corporate and service systems has identified that many of the expected controls are in place and operating satisfactorily. However, the audit work has also identified scope for improvement in some systems which either have weaknesses in them or lack controls. The Internal Audit Service has put forward a range of recommendations in the areas examined and action plans have been developed in consultation with management which, as they are implemented, should result in continued improvement in the control environment.

Limitation of Scope

In the financial year under review there was no limitation of scope or independence placed upon the work undertaken by the Internal Audit Service.

Basis of Opinion

My evaluation of the framework of governance, risk management and control is informed by a number of sources which include the following:

- The audit work undertaken by the Internal Audit Service during the year to 31 March 2016.
- The assessment of risk completed during the preparation of the 2015/16 and 2016/17 audit plans.
- Knowledge of the Council's governance, risk management and performance monitoring arrangements.
- The Self Assessment Checklists completed by the relevant Executive Directors / Heads of Service providing formal assurances in respect of the general control environment within individual services.
- Reports issued by the Council's External Auditor together with reports from other external review and inspection bodies.

Opinion

It is my opinion, based on the above, that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's framework of governance, risk management and control for the year to 31 March 2016.

Pamela Redpath

DATE

23 May 2016

**Senior Manager – Internal Audit
Dundee City Council**