

Agenda Item	6
Report No	AS/8/19

## HIGHLAND COUNCIL

**Committee:** Audit & Scrutiny Committee

**Date:** 13<sup>th</sup> June 2019

**Report Title:** Internal Audit Annual Report 2018/19

**Report By:** Corporate Audit Manager

### 1. Purpose/Executive Summary

- 1.1 The attached report includes an assessment of the Council's framework of governance, risk management and control, and the associated opinion which provides information for the Council's Annual Governance Statement.

### 2. Recommendations

- 2.1 The Committee is invited to note the content of the report, the audit opinion provided and to raise any relevant points with the Corporate Audit Manager.

### 3. Annual Report 2018/19

- 3.1 The Public Sector Internal Audit Standards requires that the Chief Audit Executive (the Corporate Audit Manager):

*“Delivers an annual internal audit opinion and report that can be used by the organisation to inform its governance statement.*

*The annual internal audit opinion must conclude on the overall adequacy and effectiveness of the organisation’s framework of governance, risk management and control.*

*The annual report must also include a statement on conformance with the Public Sector Internal Audit Standards and the results of the quality assurance and improvement programme.”*

These requirements have been met by the report provided at **Appendix 1** with section 2 of the report used to inform the Council’s Annual Governance Statement.

- 3.2 The annual report also provides an overview of the Internal Audit Section’s activities and performance data for 2018/19.

### 4. Implications

- 4.1 There are no Resource, Legal, Community (Equality, Poverty and Rural), Climate Change/Carbon Clever, Risk or Gaelic implications. Any issues identified have already been addressed within previous reports to Committee.

Designation: Corporate Audit Manager

Date: 31<sup>st</sup> May 2019

Author: Donna Sutherland

Background Papers:

**Appendix 1**



**The Highland Council**

**Internal Audit Annual Report 2018/19**

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## **1. INTRODUCTION**

- 1.1 The purpose of this report is to provide an annual Internal Audit opinion for the period 1<sup>st</sup> April 2018 to 31<sup>st</sup> March 2019, and a report that can be used by the Highland Council to inform its Annual Governance Statement.
- 1.2 This report has been produced in accordance with the requirements of the Public Sector Internal Audit Standards (the Standards) which came into effect from 1<sup>st</sup> April 2013 and apply to all internal audit service providers. These Standards were developed in collaboration between the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Chartered Institute of Internal Auditors (CIIA).
- 1.3 Section 2450 of the Standards states that "*the annual Internal Audit opinion must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. In addition, the annual report must incorporate:*
  - *The opinion;*
  - *The summary of work that supports that opinion; and*
  - *A statement on conformance with the Standards and the results of the quality assurance and improvement programme*".
- 1.4 This report also includes an overview of the Internal Audit Section's activities for the financial year 2018/19.

## **2. ANNUAL GOVERNANCE STATEMENT**

### **2.1 Internal Control**

The Council's Financial Regulations require Service Directors to ensure the principles of internal control are incorporated in the working practices of their Services.

Internal control is defined as *"the whole system of checks and controls, financial or otherwise, established by management in order to provide reasonable assurance"* regarding the achievement of one or more of the following objectives:

- The reliability and integrity of information.
- Compliance with policies, plans, procedures, laws, regulations and contracts.
- The safeguarding of assets.
- The economical and efficient use of resources.
- The accomplishment of established objectives and goals for operations or plans.

Any system of control can only provide reasonable, and 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 laws and regulations. Accordingly the Council should seek continual improvement in the effectiveness of its systems of internal control.

### **2.2 Internal Audit**

The Standards define internal auditing as *"an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes"*.

The work undertaken by Internal Audit is documented in an audit report and issued to management. Any areas of concern together with the management agreed actions and target dates for implementation are summarised in an Action Plan within the report. It is the responsibility of management to ensure that implementation of these actions takes place as agreed. The Internal Audit Section will undertake periodic follow-up reviews to ensure that the management agreed actions have been satisfactorily implemented and the results of this are reported to the Audit & Scrutiny Committee.













The Internal Audit Section operates in accordance with the Standards and as required, a risk based tactical audit plan is produced each year, and submitted for approval to the Audit & Scrutiny Committee. Organisational independence is demonstrated by the Corporate Audit Manager reporting in her own name to senior management, and having direct access to the Chief Executive, Audit & Scrutiny Committee, Pensions Committee, and/ or other Members as considered appropriate.

The Standards require that there is periodic self-assessment against the Standard's requirements and that an external assessment is conducted at least once every five years by a qualified, independent assessor from outside the organisation. The Council elected to participate in an arrangement of peer reviews through the Scottish Local Authorities Chief Internal Auditors Group (SLACAIG) which developed a standard methodology and programme of reviews. During the first cycle, the Highland Council's assessment was undertaken in 2017 by the Audit & Risk Manager, West Dunbartonshire Council and in 2018, the Corporate Audit Manager undertook the external assessment of Midlothian Council. The second review cycle, which the Highland Council will participate in again, is presently being planned by SLACAIG.





There is no change from the self-assessment against the standards reported last year whereby full compliance with the standards has been achieved as shown in Table 1 overleaf.

**Summary of conformance with the Standards**

*Table 1*

Reference	Assessment Area	Fully Conforms 	Generally Conforms 	Partially Conforms 	Does Not Conform 
Section A	Definition of Internal Auditing				
Section B	Code of Ethics				
Section C	Attribute Standards				
1000	Purpose, Authority and Responsibility				
1100	Independence and Objectivity				
1200	Proficiency and Due Professional Care				
1300	Quality Assurance and Improvement Programme				
Section D	Performance Standards				
2000	Managing the internal Audit Activity				
2100	Nature of Work				



Reference	Assessment Area	Fully Conforms 	Generally Conforms 	Partially Conforms 	Does Not Conform 
2200	Engagement Planning				
2300	Performing the Engagement				
2400	Communicating Results				
2500	Monitoring Progress				
2600	Communicating the Acceptance of Risks				

### **2.3 Internal Audit work**

The 2018/19 audit plan was approved by the Audit & Scrutiny Committee on 28/03/18. All audit reports issued are provided as a standing agenda item to each Committee meeting together with progress against the Plan. Where the Plan has required to be adjusted during the course of the year all amendments have been set out in the progress report and have been approved by Members.

A summary of the audit reports issued together with the audit opinion and grades is provided at Section 3.2.

### **2.4 Areas of concern**

Any areas of concern identified from an audit review will result in an audit recommendation being made which is contained within an action plan. These recommendations are graded as high, medium or low; high defined as "*major issues that managers need to address as a matter of urgency*".

During 2018/19, a total of 73 audit recommendations were made with 21 of these were classified as high grade. A full breakdown of the audit grades and the overall audit opinions can be found at Table 2 on pages 9 – 10. There are no particular themes or issues identified within the high graded recommendations.

There are 2 audit reports of concern, both of which were reported to the Audit & Scrutiny Committee on 27/03/19, and these have been highlighted in the Annual Governance Statement:

#### Inverness and Highland City Region Deal (CRD)

The CRD is a tripartite agreement between the Council, UK and Scottish Governments and has a funding package of £53.1m. The audit contained the opinion of limited assurance due a number of issues particularly the need to strengthen existing governance arrangements including Member scrutiny and to improve the arrangements relating to the forecasting, claiming and administration of grant funds.

An action plan has been agreed to address the areas of concern identified and this will be followed up in the normal manner to ensure that the management agreed actions are satisfactorily implemented.

#### Compliance with the Carbon Reduction Commitment Energy Efficiency Scheme 2017/18

It is a requirement of the scheme that carbon use is reported and internally audited on an annual basis. This audit report contained the opinion of limited assurance for the fourth consecutive year. This was due to concerns about the accuracy and completeness of the information reported, and the failure to implement previously agreed management actions.

The 2018/19 year is the final year of the scheme before it is abolished and replaced by the climate change levy. The audit review of the 2018/19 compliance year will be undertaken in quarter 3 and this will include following up the 2017/18 audit's action plan to ensure that this was implemented as agreed.

### **2.5 Action Tracking**

As part of the audit process, all audit recommendations these are action tracked to ensure that the agreed actions were implemented as agreed. The results of the action tracking, including delays in achieving the target dates are reported to the Audit & Scrutiny Committee on a six-monthly basis with reports provided on 14/06/18 and 29/11/18.

The action tracking process also allows for revision of the agreed action target dates. All actions were either satisfactorily implemented or revised target dates were agreed.

## **2.6 Assurances from Services**

As part of the Annual Accounts process, the Chief Executive and Service Directors are asked to provide assurance that the following statements are valid:

- That Financial Monitoring Statements are regularly reviewed at Service Management Meetings.
- That Staff have been made aware of Financial Regulations and Contract Standing Orders.
- That Staff have been made aware of the Code of Conduct, Information Systems Security, Fraud and Corruption and Whistle blowing policies.
- That the Service has a robust scheme of delegation and that Staff have been informed of their supervisory and accountability responsibilities and that their responsibilities are documented in a Job Description.
- That segregation of duties is an important control mechanism operation within the Service and where it has not been possible to operate such a control a suitable alternative is in place.
- That appropriate targets have been established within the Service to measure financial and other performance.
- That a formal system of project management, including project governance operates within the Service.
- That appropriate arrangements are in place to govern companies.

The necessary assurances have been provided and no issues have been highlighted which affects the Annual Governance Statement which forms part of the Council's Annual Accounts.

## **2.7 Governance arrangements**

The Council has a Local Code of Corporate Governance which is updated each year. The Head of Corporate Governance is responsible for:

- Overseeing the implementation of the Local Code of Corporate Governance and monitoring its operation
- Reviewing the operation of the Local Code of Corporate Governance in practice
- Reporting annually on compliance with the Local Code and any changes required to maintain it and ensure its effectiveness.

A report to the Audit & Scrutiny Committee on 29/11/18 provided details of progress in delivering the 2017/18 Code. This referred to one action with slippage which was being carried forward into the next year with an updated target date of February 2019 for completion. This action relating to the development of a medium term financial strategy was completed with the multi (three) year budget agreed by Council on 14/02/19.

The 2018/19 Code was also approved by Committee on 29/11/18. Review of the Code established that the format accords with best practice; the CIPFA/ SOLACE Guidance Note for Scottish Authorities – Delivering Good Governance in Local Government (2016) and sets out the seven core principles and their associated sub-principles.

## **2.8 Risk Management**

Risk management is a key element of Corporate Governance. The Council has a risk management strategy which demonstrates its commitment to maintaining a structured approach to risk management and ensuring that it effectively manages its risks. This was updated in line with current best practice and approved by the Audit & Scrutiny Committee on 28/03/18. The strategy is reviewed annually with minor changes made in March 2019.

The Corporate Risk Register is reviewed on a six-monthly basis and the results of these reviews were reported to the March and September meetings of the Audit & Scrutiny Committee.

## **2.9 Audit Opinion**

On the basis of the work undertaken during the year, it is considered that the key systems operate in a sound manner and that there has been no fundamental breakdown in control resulting in material discrepancy. However as no system of control can provide absolute assurance against material loss, nor can Internal Audit give that assurance, it is the audit opinion 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<sup>st</sup> March 2019.

### 3. INTERNAL AUDIT GRADINGS AND OPINIONS

3.1 During the year, a total of 18 final reports were issued. Where the report contains an audit recommendation, this is given a grading of high, medium or low. In addition, the report contains an overall audit opinion which is used to inform the annual statement on internal control. With regard to the audit opinion, there are five levels of assurance which have the following definitions:

Level	Definition
<b>Full Assurance</b>	There is a sound system of control designed to achieve the system objectives and the controls are being consistently applied.
<b>Substantial Assurance</b>	While there is a generally a sound system, there are minor areas of weakness which put some of the system objectives at risk, and/ or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk.
<b>Reasonable Assurance</b>	Whilst the system is broadly reliable, areas of weakness have been identified which put some of the system objectives at risk, and/ or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk.
<b>Limited Assurance</b>	Weaknesses in the system of controls are such as to put the system objectives at risk, and/ or the level of non-compliance puts the system objectives at risk.
<b>No Assurance</b>	Control is generally weak, leaving the system open to significant error or abuse, and/ or significant non-compliance with basic controls leaves the system open to error or abuse.

3.2 Table 2 below, provides a summary of the audit reports issued together with the audit opinion, number of recommendations and a breakdown of the associated grades.

*Table 2*

Report Name	Report Date	Audit Opinion	Recommendations			
			No.	High	Medium	Low
Developer's Contributions	08/05/18	Reasonable Assurance	3	1	2	0
Commissioning of Throughcare and Aftercare services	07/06/18	Reasonable Assurance	4	2	2	0
Review of the administration and payments in respect of Fostering, Adoption and Kinship Care	17/07/18	Substantial Assurance	6	0	6	0
Review of ICT projects	31/07/18	Reasonable Assurance	2	1	1	0
Review of IT controls surrounding payments to creditors	05/09/18	Reasonable Assurance	5	1	4	0
Affordable housing	05/09/18	Substantial Assurance	6	0	4	2
Review of School Funds	06/09/18	Reasonable Assurance	3	2	1	0
Use of Purchase Cards	10/09/18	Reasonable Assurance	6	3	2	1
Compliance with the Carbon Reduction Commitment Energy Efficiency Scheme 2016-17	11/09/18	Limited Assurance	6	2	4	0
LEADER Programme 2017-18	09/11/18	Full Assurance	1	0	1	0

Report Name	Report Date	Audit Opinion	Recommendations			
			No.	High	Medium	Low
Housing Information System	13/11/18	Substantial Assurance	3	0	2	1
Rental Income - follow up	19/11/18	Reasonable Assurance	4	2	2	0
Inverness Townscape Heritage Project	27/11/18	Reasonable Assurance	5	0	3	2
Inverness and Highland City-Region Deal	08/03/19	Limited Assurance	5	2	2	1
Review of the arrangements for the procurement and payment of Homeless services - follow up	12/03/19	Limited Assurance	1	1	0	0
Review of VAT arrangements	14/03/19	Reasonable Assurance	3	2	1	0
Compliance with the Carbon Reduction Commitment Energy Efficiency Scheme 2017-18	15/03/19	Limited Assurance	4	0	4	0
Winter Maintenance	18/03/19	Reasonable Assurance	6	2	3	1
<b>Totals</b>			<b>73</b>	<b>21</b>	<b>44</b>	<b>8</b>

#### 4. PERFORMANCE DATA

##### 4.1 Performance Data

In accordance with the requirements of the Standards, a Quality Assurance Improvement Programme is in place which gives assurance over, and measures the Internal Audit activity. The performance indicators were reported either within the annual report or on a quarterly basis to Committee. As part of the Lean review (see section 5.1) it was agreed that the Key Performance Indicators would be reviewed with better indicators developed to measure the effectiveness of Internal Audit. These new indicators will come into place for 2019/20 and will be regularly reported to Committee. The indicators set out in Table 3 below were already in place and will continue to be reported.

**Table 3**

Category	Performance Indicator	Target	2016/17	2017/18	2018/19	Within Target?
<b>Financial</b>						
Cost of Internal Audit	Actual net expenditure v budgeted net expenditure, expressed as a percentage	<100%	92%	90%	93%	√
	Cost per £m net expenditure	Within lowest quartile (8 <sup>th</sup> or less) of CIPFA benchmarking comparators	Y, 5th	Y, 7th	Not yet available	N/A
<b>Quality</b>						
Client Feedback	Percentage of satisfaction from individual audit engagements expressed through Client Audit Questionnaire	75%	85%	85%	82%	√
	Percentage of Client Audit Questionnaires returned	70%	90%	81%	93%	√
<b>Business Processes</b>						
Implementation of Recommendations	Percentage of recommendations accepted v number of recommendations made	95%	99%	99%	99%	√
Timeliness of Final Report	Percentage of draft reports responded to by client within 20 days of issue	85%	54%	64%	68%	×
	Percentage of final reports issued within 10 days of receipt of management response	90%	97%	100%	95%	√

The timeliness of the final report is reported on a quarterly basis to Committee and details provided of any delays. The main dip in performance arose during quarter 2 both for the Client Audit Questionnaires and delays in responses to draft audit reports. However, the majority of these were just over the e of 20 days deadline. Other reasons for delays were negotiating agreement upon the audit report findings and co-ordinating responses where actions were required from a number of officers across different Services.



## **5. OVERVIEW OF 2018/19**

### **5.1 Lean Review**

The Audit & Performance Team undertook a Lean review of the internal audit process. A total of 7 main process improvements were identified and an improvement plan was agreed to address these. Details of the review and plan were reported to the Audit & Scrutiny Committee on 29/11/18. As part of the lean process six and twelve month reviews are required to ensure that the improvements have been adopted and working as expected. Therefore, time has been allocated in the 2019/20 Audit Plan for these reviews to take place.

### **5.2 Staffing Issues**

The Audit Team was restructured during the year and this came into effect on 01/09/18 with the creation of 2 new Senior Auditors and 2 Assistant Auditor posts. An Auditor resigned and 3 posts were filled which left a vacant Senior Auditor post. This post has recently been advertised externally and it is anticipated that interviews will take place later in June.

In addition, there was a budget saving of 1 FTE required for 2019/20. This has been achieved as 2 part-time Assistant Auditors (1.2 FTE) left in March 2019.

The revised Team Structure from 01/04/19 is 9 FTE comprising of the Corporate Audit Manager, 2 Senior Auditors, 4 Assistant Auditors and 2 Corporate Fraud Investigators.

### **5.3 Corporate Fraud Work**

In early May 2018, the Council hosted a Serious Organised Crime Prevention Course in conjunction with Police Scotland for the North of Scotland. Delegates from various organisations attended over the 2 days and covered topics which included cyber-crime, elicitation and bank mandate fraud, insider threats and money laundering. Details of the learning outcomes and actions arising were reported to the Audit & Scrutiny Committee on 14/06/18. Work is continuing within the Team in order to improve the Council's resilience to address the risks of fraud and corruption.

Tenancy fraud investigations are an ongoing commitment and during the year a total of 6 houses were recovered.