

# **PERTH AND KINROSS COUNCIL**

## **Audit Committee**

**23 May 2018**

### **INTERNAL AUDIT ANNUAL REPORT 2017/18**

#### **Report by the Chief Internal Auditor (Report No. 18/171)**

##### **PURPOSE OF REPORT**

This report presents the year-end report and audit opinion of the Chief Internal Auditor for 2017/18, as set out in Section 7.

#### **1. BACKGROUND / MAIN ISSUES**

- 1.1 The Public Sector Internal Audit standards (PSIAS) require the Chief Internal Auditor to provide an annual opinion which must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. The report must incorporate the opinion, a summary of the work that supports this opinion, a statement on conformance with the PSIAS and the results of the quality assurance and improvement programme. This report fulfils this requirement.
- 1.2 Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. In accordance with the PSIAS, it helps the council accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes.
- 1.3 Perth & Kinross Council's internal controls include the full range of policies, procedures and practices intended to ensure the proper conduct of its operations and the achievement of its objectives. They include processes and procedures, organisational structures, job descriptions, authorisation limits, management supervision, risk management processes, reports and decisions.
- 1.4 It is the responsibility of management to devise, implement and maintain appropriate controls over the activities for which they are responsible. The role of Internal Audit is to provide an opinion to the Council as to the effectiveness of the controls that have been put in place by management in order to ensure that the organisation achieves its objectives. Internal Audit is thus a key part of the process by which the Council ensures the management of the risks that threaten the achievement of its objectives.
- 1.5 Internal Audit's work is planned in such a way as to take account of these risks. Prioritising work towards the areas of highest assessed risk enables the Council to identify and remedy the most material weaknesses in its framework of internal controls.

- 1.6 In line with the PSIAS, Internal Audit undertakes a process of planning resulting in an annual plan. For 2017/18, two reports contained the content of work to be undertaken as part of Internal Audit's planned workload. These were considered and approved in April 2017 (report 17/150) and in September (report 17/312). Taken together, these form the Internal Audit Plan for 2017/18. All Perth & Kinross Council's activities are reviewed as part of the planning process. The plan for 2017/18, taken as a whole, aimed to cover the most significant areas of risk within the resources available whilst ensuring that there was a balance of coverage for all Services. The Internal Audit Plan also included a protocol with Services for the delivery of the plan.
- 1.7 The Internal Audit Plan for 2017/18 incorporated two assignments which were delivered through a service level agreement with Highland Council. This augmented Internal Audit capacity for the year and ensured that there was coverage of IT risks.
- 1.8 This report summarises the audit work carried out in 2017/18 and presents the Chief Internal Auditor's opinion on the effectiveness of the Council's internal control environment for that year.

## **2. INTERNAL AUDIT'S WORK IN 2017/18**

- 2.1 This section presents an overview of Internal Audit's work during 2017/18 in its role as independent reviewer of the Council's systems of internal control.
- 2.2 The Internal Audit Plans approved in April and September 2017 included 29 planned internal audits. Of these, 18 were assurance audits and 11 were consultancy / enabling assignments. In addition, resources were included within the Plan to certify grant claims within the year.
- 2.3 During the year there were two changes to planned work and these were approved by Audit Committee in November 2017 (Report 17/384 refers). Following the approval of the Internal Audit Plan in September 2017, two assignments were included within the plan related to Education & Children's Services. These replaced the assignment entitled New Process Development. In addition, a consultancy assignment on the General Outcome Focussed Assessment was deleted from the plan.
- 2.4 All planned assignments, covering the period from April 2017 to March 2018, have been undertaken. Some assignments, by their nature, will continue into 2018/19. This is due to their being consultancy over projects which extend beyond one financial year. These assignments will be included in work-plans for 2018/19. Work is being concluded on one assignment, Housing Repairs and Improvement Service Financial Controls. 17 Internal Audit reports have been issued for 16 planned Internal Audit assignments and 2 grants have been certified, representing 93% of the anticipated reports arising from Internal Audit work connected with the approved plan. One further report, detailing the outcomes from the continued work on following up the agreed actions arising from 16-05 Financial Assessment and Charging, is due to be

considered by Audit Committee later in 2018, as agreed in November 2017 (report 17/384 refers).

- 2.5 Unplanned assignments, as a result of investigations or additional requests from Services, have been undertaken during the year. Where appropriate, control issues highlighted as a result of this work are reported to the Audit Committee.
- 2.6 The results detailed in this report relate to all audit reports issued relating to Internal Audit's work during the period from April 2017 to March 2018, both planned and unplanned.
- 2.7 All findings detailed within the reports issued during the year were accepted by management. These reports contain a total of 92 agreed actions, compared with 188 actions in 2016/17. The table below details the rating of the importance of these actions. The figures in brackets relate to the rating of individual actions for the financial year 2016/17:

Critical Risk	0 (0) agreed actions
High Risk	2 (30) agreed actions
Medium Risk	50 (89) agreed actions
Low Risk	40 (69) agreed actions

- 2.8 This represents a decrease in the proportion of high-risk actions from 16% in 2016/17 to 2% in 2017/18. There are corresponding increases in the proportion of medium- and low-risk from 47% and 37% respectively in 2016/17 to 54% and 43%. As in 2016/17, there were no actions arising of a critical nature.
- 2.9 Appendix A shows a summary of Internal Audit's work for Perth & Kinross Council during 2016/17 compared with the original plan as approved by the Audit Committee in April and September 2017 along with the current status of each assignment. The Appendix details additional work, such as internal investigations or non-audit tasks undertaken during the year, where this has resulted in a report to Audit Committee. Internal Audit was actually involved with 50 assignments consisting of 27 planned audit and consultancy assignments, 2 grant certifications, 21 pieces of unplanned work / requests for advice.

### **Areas for Significant Improvement in Controls**

- 2.10 During 2017/18, each audit report was assigned an overall rating, summarising the strength of internal controls in the area under review. These ratings were intended to provide a guide to management in setting priorities for action and to inform the Audit Committee in their scrutiny role. There have been no areas where controls have been described as 'moderately weak' or 'weak'. This compares with 5 areas described as such in 2016/17. There are also no areas where controls have been described as 'unacceptably weak'.

- 2.11 Issued reports during this period contain an assessment of the control environment for a total of 24 control objectives. This compares with 47 control objectives assessed during 2016/17. These assessments of control at the time audits took place are broken down as follows, with the relevant figures for 2016/17 being recorded in brackets:

Strong	10 (8) Control Objectives
Moderately Strong	10 (21) Control Objectives
Moderate	4 (14) Control Objectives
Moderately Weak	0 (1) Control Objectives
Weak	0 (3) Control Objectives
Unacceptably Weak	0 (0) Control Objectives

- 2.12 Overall, this represents an increase in the proportion of strong- and moderately strong- rated control objectives over the two years, these being 42% and 42% respectively for 2017/18 compared with 17% and 45% in 2016/17. The proportion of control objectives rated as 'moderate' has reduced from 30% in 2016/17 to 17% in 2017/18.
- 2.13 During 2017/18, the Council has continued to develop its approach to risk management in line with best practice following Internal Audit involvement in this area in 2015/16. A revised risk management strategy was approved by the Strategic Policy and Resources Committee in February 2017 (Report 17/63 refers). Internal Audit continues to work closely with the Head of Legal and Governance Services to support services to embed effective risk management into their day to day business activities.

### **Follow Up of Action Plans**

- 2.14 The responsibility for considering (and accepting or rejecting) Internal Audit's findings rests with management. Final audit reports record the agreed plan of action, including the individual(s) responsible; the planned timescales for completion; and the evidence required by Internal Audit to verify completion of the action. The audit process is of little value unless action is taken to remedy deficiencies in internal control where these are identified. Hence, a significant part of Internal Audit's role is the following-up of progress with these action plans in line with the requirements of the Public Sector Internal Audit Standards.
- 2.15 A database for recording agreed actions is maintained for this purpose. Services are routinely requested to provide the agreed evidence of completion for actions which are due to have been completed. Where actions have not been completed, an update on progress is requested along with the reason for non-completion and a revised date for completion. The Audit Committee is informed of all actions which have not been completed, along with an Internal Audit opinion on the acceptability or otherwise of the response received from management.

- 2.16 The support of the Chief Executive, Depute Chief Executives, Executive Directors and Senior Management Teams in ensuring that agreed actions are completed has continued during the year.
- 2.17 Of the 92 actions agreed with management (see 2.7 above) 64 had a completion date within 2016/17. Of these 64, 54 have been verified by Internal Audit as having been completed. This represents 84% of actions having been implemented within the year.
- 2.18 In the Chief Internal Auditor's opinion, the procedures in place provide a sound basis for ensuring that progress against the agreed plans is exposed to the proper level of scrutiny.

### **3 THE AUDIT COMMITTEE**

- 3.1 The Audit Committee operates within an approved 'Role and Remit' and, as a formally constituted Committee of the Council. The Committee conducts its meetings in public, thus ensuring a high degree of accountability for its activities.

### **4 RESOURCES**

- 4.1 Internal Audit's budget for 2017/18 was £235,074. Whilst the final outturn figures are not yet available, it is projected that expenditure for 2017/18 on Internal Audit will be in the region of £195,000. This underspend is primarily due to slippage in staffing within the year, however this has not impacted on the delivery of the Internal Audit Plan.
- 4.2 Recent trends in internal audit staffing are as shown below:

	April 2016		April 2017		April 2018	
	No. (FTE)		No. (FTE)		No. (FTE)	
Qualified Staff	1.9	39%	1.7	37%	1.7	44%
Unqualified Staff	3.0	61%	2.9	63%	2.2	56%
Total	4.9	100%	4.6	100%	3.9	100%

Included in the above total for 2017 is a trainee accountant who is currently on placement within Internal Audit. Recruitment activity is due to commence shortly to ensure that an adequate and effective Internal Audit Service can be delivered to the Council.

### **5 ANTI-FRAUD ACTIVITY**

- 5.1 The responsibility for preventing and detecting fraud and corruption rests with management; it is the responsibility of management to take into account the risks arising from fraud and corruption and to devise and maintain the appropriate internal controls to provide a reasonable level of assurance that the Council's resources are being protected from loss and misappropriation.

- 5.2 Nevertheless, Internal Audit has a number of responsibilities regarding the Council's anti-fraud and anti-corruption arrangements. The year 2017/18 saw a moderate level of audit activity in this area as described below.

### **The National Fraud Initiative**

- 5.3 The National Fraud Initiative (NFI) is a large-scale 'data-matching' exercise that takes place every two years and takes place over two financial years. Perth & Kinross Council participated in the 2016/17 exercise. The NFI involves the comparison of personal data held by public authorities in order to identify anomalies that may indicate fraud or error. This output then forms the basis for a process of investigation within each authority, in order to ensure that errors are recognised and corrected and that, where cases of possible fraud are identified, they are pursued appropriately.
- 5.4 This investigative process, which is driven by Audit Scotland, is co-ordinated by Internal Audit and includes overseeing Services' arrangements for uploading the data securely and the checking of a sample of identified anomalies within the period of the exercise, on the basis of an assessment of risk. Internal Audit facilitates the reporting of progress to our External Auditors, KPMG. There has been an allocation of audit resources towards the completion of this task.
- 5.5 The 2016/17 exercise has been completed during the year and the Audit Committee have been informed of the outcomes (Report 18/108 refers).

### **Anti-Fraud and Anti-Corruption Policies**

- 5.6 The Council's Counter-Fraud and Corruption Strategy, along with associated policies, were presented to and approved by the Strategic Policy and Resources Committee in February 2015 (Report 15/66 refers). Senior Management Teams have been supported in completing risk assessments for their functions and have identified relevant areas of their business where risks require to be managed. Further development has been identified for 2017/18.
- 5.7 The Chief Internal Auditor is the Council's nominated Money Laundering Reporting Officer. There has been one case where money laundering was suspected during the year, relating to concerns raised by officers during a routine financial assessment, and the relevant authorities were informed.

### **'Whistleblowing' Arrangements**

- 5.8 In order to ensure that the Council meets the standards set out in its counter-fraud and corruption arrangements, some aspects of the Council's 'whistle-blowing' arrangements are managed by Internal Audit. This includes the maintenance of a dedicated e-mail address and telephone line for employees with concerns at work, which is routed to Internal Audit. The Council also supports the national charity 'Public Concern at Work' that upholds the rights of those who raise concerns about wrongdoing at their place of work and which operates a free legal advice 'hotline'.

- 5.9 Four contacts were made with Internal Audit of a 'whistleblowing' nature within the year. These cases were resolved and, as there were no control implications arising, reports were not provided to the Audit Committee. The outcomes have fed into the updating of the Audit Universe and in the planning exercise for the 2018/19 Internal Audit Plan.
- 5.10 Whistleblowing arrangements have been in place throughout 2017/18 and are supported by a Whistle-blowing Policy, which is included within the Counter-Fraud and Corruption Strategy.

### **Investigations**

- 5.11 Internal Audit's role includes the assessment of any concerns that are raised through the above arrangements and the conduct of internal investigations where appropriate. A small time allowance is made for work of this sort within the audit plan. As highlighted in 2.5 above, the time spent on investigations was contained within the existing resources in the Internal Audit team.
- 5.12 The year 2017/18 saw a number of investigations requiring input from Internal Audit. Investigative work undertaken within the year has resulted in agreed improvements which will enhance the Council's internal control environment. Where there is scope for improvement to the control environment identified by investigations, this is reported to the Audit Committee.

## **6 COMPLIANCE WITH AUDITING STANDARDS**

- 6.1 The Public Sector Internal Audit Standards have been adopted by Perth & Kinross Council as the relevant professional standards. The outcome of a review of the Standards was reported to Audit Committee and this report remains current (Report 13/147 refers).
- 6.2 The Chief Internal Auditor has undertaken a self-assessment of compliance with the PSIAS and has concluded that the function is generally compliant with the PSIAS. This view is supported by KPMG, the appointed external auditors, (Report 17/306 refers).
- 6.3 The Validated Self Assessment of compliance with the Standards is due to be undertaken by a team from another local authority as part of a formal peer review validation exercise. This is due to commence shortly and the outcome will be reported to Audit Committee. This validation will ensure that the Public Sector Internal Audit Standards are complied with regarding the external quality assessment element.

### **Code of Ethics**

- 6.4 Internal Auditors must conform to the Code of Ethics included within the Standards. This Code incorporates the principles and rules of conduct for Internal Auditors' integrity, objectivity, confidentiality and competency.

## **Public Sector Internal Audit Standards**

- 6.5 The Standards are separated into Attributable Standards (including requirements for the establishment of the internal audit function) and performance standards (including the management and execution of internal audit activity).

## **Performance Measures**

- 6.6 Internal Audit's prime performance measure is the completion of the approved audit plan. Performance against the approved audit plan has been highlighted in Section 2 of this report. All assignments from the 2017/18 plan have been completed. Where appropriate, Internal Audit will have continued involvement in some areas of business activity into 2018/19.

## **Quality Assurance of Internal Audit**

- 6.7 There is a requirement for the annual report to contain a statement on conformance with the PSIAS and the results of the quality assurance and improvement plan.
- 6.8 An External Quality Assessment of the Internal Audit function was due to be completed in 2017/18. The Self Assessment has been undertaken and is awaiting validation as part of the External Quality Assessment framework. This validation is expected to commence shortly.
- 6.9 A quality assurance system was in place in Internal Audit throughout 2017/18 which ensured the quality of Internal Audit work was of a consistent and professional standard.
- 6.10 Improvements highlighted as required by the Chief Internal Auditor as part of the Quality Assurance and Improvement Plan for 2017/18 have been addressed as follows:
- The Audit Committee has been informed of the approach taken for consultancy assignments (Report 17/58 refers) and work has been undertaken to further develop this approach to ensure that;
  - The audit manual continues to be reviewed and updated;
  - Arrangements have been put in place to document and review potential conflicts of interests on the part of Internal Audit staff in line with the Code of Ethics; and
  - Improvements in the process for capturing requests for Internal Audit advice have been embedded.
- 6.11 Further improvements will continue into 2018/19 regarding the formalising of professional development records, and conflicts of interest.

## **7 AUDIT OPINION**



- 7.1** In the Chief Internal Auditor's opinion, reasonable reliance can be placed on the Council's governance arrangements and systems of internal control for 2017/18, subject to management implementation of the agreed actions detailed in Internal Audit reports and summarised at Section 2 above. Whilst limited reliance can be placed on the corporate risk management arrangements in place throughout 2017/18, the ongoing implementation and embedding of the corporate risk management strategy should enable reasonable reliance for 2018/19.

## **8. CONCLUSION AND RECOMMENDATION**

- 8.1** It is recommended that the Committee notes the content of this report and specifically the Audit Opinion at Section 7.

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## 1. IMPLICATIONS, ASSESSMENTS, CONSULTATION AND COMMUNICATION

<b>Strategic Implications</b>	<b>Yes / None</b>
Community Plan / Single Outcome Agreement	None
Corporate Plan	Yes
<b>Resource Implications</b>	
Financial	None
Workforce	None
Asset Management (land, property, IST)	None
<b>Assessments</b>	
Equality Impact Assessment	Yes
Strategic Environmental Assessment	None
Sustainability (community, economic, environmental)	None
Legal and Governance	None
Risk	Yes
<b>Consultation</b>	
Internal	Yes
External	None
<b>Communication</b>	
Communications Plan	None

### 1. Strategic Implications

#### 1.1 Corporate Plan

- 1.1.1 The Council's Corporate Plan 2013 – 2018 lays out five outcome focussed strategic objectives which provide clear strategic direction, inform decisions at a corporate and service level and shape resources allocation. They are as follows:

- (i) Giving every child the best start in life;
- (ii) Developing educated, responsible and informed citizens;
- (iii) Promoting a prosperous, inclusive and sustainable economy;
- (iv) Supporting people to lead independent, healthy and active lives; and
- (v) Creating a safe and sustainable place for future generations.

- 1.1.2 This report relates to all of these objectives.

### 2. Assessments

#### 2.1 Equality Impact Assessment

- 2.1.1 Under the Equality Act 2010, the Council is required to eliminate discrimination, advance equality of opportunity, and foster good relations between equality groups. Carrying out Equality Impact Assessments for plans and policies allows the Council to demonstrate that it is meeting these duties.

- 2.1.2 The information contained within this report has been considered under the Corporate Equalities Impact Assessment process (EqIA) and has been assessed as **not relevant** for the purposes of EqIA.

### **3. Consultation**

#### **3.1 Internal**

- 3.1.1 The Chief Executive and the Head of Finance have been consulted in the preparation of this report.

### **2. BACKGROUND PAPERS**

No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above report.

### **3. APPENDICES**

Appendix A – The 2016/17 Internal Audit Summary