

REPORT TO: SCRUTINY COMMITTEE - 24 JUNE 2015

REPORT ON: 2014/15 INTERNAL AUDIT ANNUAL REPORT

REPORT BY: CHIEF INTERNAL AUDITOR

REPORT NO: 245-2015

1.0 PURPOSE OF REPORT

To submit to Members of the Scrutiny Committee the 2014/15 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 remit of the Scrutiny Committee, as detailed in Report No 274-2014, includes consideration of the strategy, plan and performance of the Council's Internal Audit Service. In addition, the Committee should also 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 Chief Internal Auditor.
- 4.2** The Public Sector Internal Audit Standards (PSIAS) effective from 1 April 2013 apply to all internal audit service providers within the public sector. Under the PSIAS the chief audit executive must provide an annual report to the board timed to support the annual governance statement. In the context of Dundee City Council the "*chief audit executive*" is the Chief Internal Auditor and the "*board*" is the Scrutiny Committee.
- 4.3** The PSIAS specifically states that the annual report prepared by the chief audit executive must include reference to the following:
- The annual internal audit opinion on the overall adequacy and effectiveness of the organisation's governance, risk management and control framework.
 - A summary of the audit work from which the opinion is derived.
 - 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 2014/15 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, 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

Sallie Dailly, Chief Internal Auditor

DATE: 11 June 2015

2014/15 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 2014/15 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, and 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 should they be realised, 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 which it audits. This is essential to ensure that the service provides unbiased judgements and impartial advice to management. Through provision of a high quality, independent, objective assurance and consulting activity, guided by a philosophy of adding value, the service aims to bring a systematic and disciplined approach to evaluating and improving the effectiveness of organisation's business processes. This role includes having an understanding of the key risks faced by the Council.
- The internal audit activity, with strict accountability for confidentiality and safeguarding records and information, is authorised full, free, and unrestricted access to any and 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 on systems, control and risk and specific investigations.
- The existence of internal audit does not however diminish the responsibility of management to ensure that 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.
- 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 activity. This Charter was approved by the Scrutiny Committee in February 2014 (Report No. 75-2014).

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 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 2014/15 financial year was submitted to the Scrutiny Committee in April 2014

(Report No. 186-2014). In line with recognised good practice the 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, currently 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 thereby determine the extent of assurance that can be taken from the work performed and ensure that duplication of effort and unnecessary disruption to services is minimised.

5. AUDIT REPORTS

- Each audit assignment results in an internal audit report which includes an executive summary and also details the audit findings, recommendations and management responses, where appropriate. The audit report essentially 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 namely critical, significant or routine. These judgements are utilised to determine the level of assurance or overall opinion to be assigned to the area which has been subject to review. There are broadly four levels of assurance which can be assigned namely full, reduced, limited and no assurance and this opinion is included in the report's executive summary.
- The findings and recommendations arising from the audit assignments reported upon in 2014/15 have been discussed with appropriate officers of the Council and agreed action plans have been put in place to address areas for improvement. The executive summary from each of these has been submitted to the Scrutiny Committee for consideration.
- Internal Audit also undertakes follow-up work and progress reviews to confirm that management has discharged their responsibility in terms of implementing audit recommendations within the agreed timescale. Such work is also formally reported upon to both the relevant officers, with revised timeframes where appropriate, and also to the Scrutiny Committee.

6. KEY EVENTS DURING 2014/15

- The Council's modernisation agenda continues to be progressed through various initiatives such as the Changing for the Future Programme and also windfall opportunities to review and redesign service delivery. This in turn results in an interesting but nonetheless challenging landscape in terms of the planning and delivery of internal audit services. Steps continue to be taken however to endeavour to proactively manage potential difficulties within this working environment and minimise the potential impact on service delivery.
- During 2014/15 the Internal Audit Service was delivered through the utilisation of both in-house and external resources. The latter was provided through 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 of the in-house members of the team. In addition through this partnership an electronic client feedback questionnaire has been developed. Although it is early days the feedback to date has been positive and is proving beneficial in contributing to the continuous improvement agenda of the service.
- The Internal Audit Service operated in 2014/15 in accordance with the Public Sector Internal Audit Standards (PSIAS). During the year an assessment was undertaken as to the extent to which the current internal audit activity, 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). This report included a summary of the potential areas for improvement and an action plan to address these. Implementation of these actions is currently ongoing and it is envisaged that they will be complete by the end of September 2015. However none of the areas identified are considered to represent a significant deviation from the requirements contained in the PSIAS.

7. PLAN ACHIEVEMENT

- For the 2014/15 financial year the actual number of productive time for audit work was 809 days. Although the number of productive days was broadly in line with the previous year it represented a shortfall of 5% against the budgeted productive days. This shortfall was primarily

due to staff absence which had not been anticipated at the time the plan was compiled. In terms of the total productive days available approximately 81% were spent on direct audit activities and 19% were spent on support activities such as management, audit planning, staff training and development. This was broadly in line with previous financial years.

- The 2014/15 Internal Audit Plan included 33 areas, both at a corporate and departmental level across the organisation, to be reviewed. It also included allocations of audit days for follow-up reviews, progress reviews, finalisation of audit assignments which commenced in the previous financial year, provision of advice to clients on systems, control and risk and specific investigations.
- Whilst work on the majority of the planned areas for corporate and departmental reviews included within the plan commenced in 2014/15 there was, due to a number of factors, some slippage. The reasons underpinning 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. It is intended that as far as practicable key areas of slippage will be covered as part of the 2015/16 work programme.

8. OVERALL ASSESSMENT OF CONTROLS

- Internal Audit activity for the Council during 2014/15 covered a wide spectrum of areas including anti-virus software, business start-ups, capital monitoring, commissioning of care, community planning partnership, data back-up, grant funding, income collection, invoice processing, payment for rewards programme, payroll, performance measures, plant and equipment, schemes of administration, school transport, special collections, tax governance, test purchases and seized goods, welfare reform, 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 processes.
- The 2014/15 reviews of corporate and departmental systems identified that many of the expected controls are in place and operating satisfactorily in the areas examined. However the audit work also identified scope for improvement. Internal audit reports included a range of recommendations and action plans have been developed in consultation with management which, as they are implemented, should improve the overall control environment.
- During the 2014/15 financial year, 25 internal audit reports were issued. A summary of the reports issued and key information pertaining to these is attached at Appendix A. These reports have generally been well received by clients with management agreeing to implement 100% of the recommendations made. A total of 62 recommendations were made in the reports issued. Of these none were categorised as critical, 28 were significant and the remaining 34 were deemed to be routine. This compares to the previous financial year where a total of 70 recommendations were made.
- Analysis of the overall audit opinion for the reports issued highlighted that 16% of the areas reported upon were considered to be well controlled (full assurance), 52% were adequately controlled (reduced assurance) and 32% were requiring improvement (limited assurance). Whilst these statistics show a similar position to 2013/14 a watching brief will continue to be kept on this area. Once again none of the areas reviewed and reported upon were deemed to be so poorly controlled that no assurance could be placed upon the systems and controls being operated.
- The PSIAS requires the Chief Internal Auditor 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 Chief Internal Auditor's opinion which takes due cognisance of the audit work carried out by the Internal Audit Service and other pertinent information. On the basis of the areas used to inform this process for the year to 31 March 2015 the overall audit opinion reached was that reasonable assurance could 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 2014/15 Financial Year

| Report No. | Area Reviewed | Level of Assurance | Recommendations | | | |
|------------|--|--------------------|-----------------|------------|-------------|---------|
| | | | Total No. | Importance | | |
| | | | | Critical | Significant | Routine |
| 2012/23 | Payroll - Overtime Working | L | 3 | - | 2 | 1 |
| 2012/32 | Commissioning of Care | R | 2 | - | 1 | 1 |
| 2012/33 | Business Start-Ups | R | 2 | - | - | 2 |
| 2013/04 | Payment for Rewards Programme | F | 0 | - | - | - |
| 2013/05 | Test Purchases and Seized Goods | L | 4 | - | 2 | 2 |
| 2013/06 | School Transport | L | 4 | - | 2 | 2 |
| 2013/07 | Special Collections | R | 3 | - | 1 | 2 |
| 2013/12 | Performance Indicators | R | 4 | - | - | 4 |
| 2013/13 | Welfare Reform – Scottish Welfare Fund | L | 7 | - | 2 | 5 |
| 2013/19 | Income Collection - Licensing | R | 2 | - | 1 | 1 |
| 2013/26 | Invoice Processing | L | 1 | - | 1 | - |
| 2013/27 | Plant and Equipment | L | 5 | - | 2 | 3 |
| 2013/30 | Tax Governance | R | 4 | - | 2 | 2 |
| 2013/31 | Data Back-up | R | 2 | - | 1 | 1 |
| 2013/32 | Community Planning Partnership | R | 3 | - | 2 | 1 |
| 2014/01 | Housing in Multiple Occupation | R | 2 | - | 1 | 1 |
| 2014/03 | Capital Monitoring | L | 5 | - | 4 | 1 |
| 2014/04 | Grant Funding | L | 2 | - | 2 | - |
| 2014/05 | 2013/14 Grant Claim : Local Air Quality Management | F | 0 | - | - | - |
| 2014/06 | 2013/14 Grant Claim : Air Quality Action Plan | F | 0 | - | - | - |
| 2014/12 | Anti-Virus Software | R | 2 | - | - | 2 |
| 2014/13 | Building Quality Support | F | 0 | - | - | - |
| 2014/21 | Procurement Cards | R | 2 | - | 1 | 1 |
| 2014/23 | Performance Information | R | 1 | - | - | 1 |
| 2014/27 | Schemes of Administration | R | 2 | - | 1 | 1 |

| | | | | |
|---------------------------|-------------|----------------|----------------|-----------|
| Level of Assurance | Full | Reduced | Limited | No |
|---------------------------|-------------|----------------|----------------|-----------|

To the Members of Dundee City Council, Chief Executive and Director of Corporate Services

As Chief Internal Auditor of Dundee City Council, I am pleased to present my annual opinion for the year ended 31 March 2015. 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 Chief Internal Auditor 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 their 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 Chief Internal Auditor 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 Chief Internal Auditor 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 departmental 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 2014/15 Internal Audit Activity

During 2014/15 financial year a total of 25 internal audit reports were issued. These covered a wide spectrum of areas including anti-virus software, business start-ups, capital monitoring, commissioning of care, community planning partnership, data back-up, grant funding, income collection, invoice processing, payment for rewards programme, payroll, performance measures, plant and equipment, schemes of administration, school transport, special collections, tax governance, test purchases and seized goods, welfare reform, stocks and inventories, grant claims and follow-up reviews. The Internal Audit Service also provided advice on the control environment as required.

The 2014/15 audit of corporate and departmental systems has identified that many of the expected controls are in place and operating satisfactorily. The audit work has, however, 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 2015.
- The assessment of risk completed during the preparation of the 2014/15 and 2015/16 audit plans.
- Knowledge of the Council's governance, risk management and performance monitoring arrangements.
- The Self Assessment Checklists completed by the relevant 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 2015.

Sallie M. Dailly

**Chief Internal Auditor
Dundee City Council**

DATE

11 June 2015