



AUDIT COMMITTEE – 17TH OCTOBER 2017

SUBJECT: INTERNAL AUDIT SERVICES – ANNUAL OUTTURN REPORT 2016/17

REPORT BY: INTERNAL AUDIT MANAGER

1. PURPOSE OF REPORT

1.1 To inform Members of the work carried out by Internal Audit Services during 2016/2017.

2. SUMMARY

2.1 It is a requirement both of the Public Sector Internal Audit Standards (PSIAS) and the Council's own Financial Regulations that an annual audit activity plan is prepared to ensure that there is an effective and efficient use of audit resources. In addition to producing the audit plan, it is also a requirement that the Internal Audit Manager produces an outturn report which provides members of the Audit Committee with an overview of the work undertaken by Internal Audit Services during the previous financial year and provides an insight into the range of issues that the service is involved with in addition to the core audit work undertaken.

3. LINKS TO STRATEGY

3.1 The work of Internal Audit Services provides assurance on the robustness of internal controls and the corporate governance arrangements operating within the Authority and identifies areas for improvement. Strong corporate governance arrangements are an essential element of ensuring that the Council's key priorities are effectively delivered and this in turn contributes to the following Well-being Goals within the Well-being of Future Generations Act (Wales) 2015: -

- A prosperous Wales.
- A resilient Wales.
- A healthier Wales.
- A more equal Wales.
- A Wales of cohesive communities.
- A Wales of vibrant culture and thriving Welsh Language.
- A globally responsible Wales.

4. THE REPORT

4.1 The 2016/17 Annual Audit Plan was prepared on a risk-based approach and is structured around four key principles: -

Systems

System audits would be prioritised and would focus on both controls in operation and compliance with approved processes and procedures.

Establishments There would be a medium-term strategy to ensure adequate coverage in this area in order that all establishments receive a periodic audit visit. Details of the visits undertaken during the year are provided in Appendix A.

Regularity The safeguarding of assets, income and control of expenditure would remain a priority.

Advisory A consultative approach to be encouraged in order to promote an open and transparent culture to include the sharing of best practice and early input from Internal Audit in developing processes and procedures.

- 4.2 Internal Audit Services has continued to maintain its organisational independence throughout the year and continues to report functionally to the Audit Committee in accordance with the Public Sector Internal Audit Standards (PSIAS). The service has operated without interference or undue influence from those subject to audit and no impairments to independence or objectivity have arisen during the period.
- 4.3 As reported to the Audit Committee in December 2016 a self-assessment has been undertaken of compliance with the Public Sector Internal Audit Standards (PSIAS). The conclusion arising from the self-assessment was that the main areas of the Standards are well covered and no fundamental issues remain outstanding. Actions identified during the self-assessment process are being addressed by the Internal Audit Manager.
- 4.4 At the time of preparing the 2016/2017 Annual Audit Plan the Section's actual establishment was 8.24 fte (full time equivalent) staff, which equates to 2151 staff` days. Of this total, 1530 days were allocated to specific audits with the remaining 621 days being classified as overheads to cover holidays, sickness, training, management issues and other non-directly allocated time.
- 4.5 The following table provides an overview of the actual allocation of audit staff time for 2016/2017 against the original plan. One of the main performance measures currently adopted by Internal Audit is a comparison of how time is actually spent compared to the audit annual plan. This requires all staff to complete timesheets and allocate time spent against the appropriate client.

Directorate	Planned Coverage (Days)	Actual Coverage (Days)	Variance (Days)	Variance (%)
Education & Lifelong Learning	273	328	+55	+20.1
Social Services	171	113	-58	-33.9
Environment	288	170	-118	-40.9
Corporate Services	405	537	+132	+32.6
Corporate	313	217	-96	-30.7
Contingency	80	-	-80	-
Total allocated time	1530	1365	-165	-10.8
Overheads	621	646	+25	+4.0
Total available days	2151	2011	-140	-6.5

- 4.6 The above table shows how actual coverage has varied from that originally planned prior to the start of the year. Variances arise due to a number of factors including but not limited to the following: -
- A reduction in the total available days is due to a combination of a vacant post and a temporary work pattern reduction.
 - The actual audit reviews may take longer than planned (this is a particular issue with new or unfamiliar areas).
 - Initial findings may be complex and additional audit work or further requests for information and explanations may be required.

- Additional time may also be incurred on audits where adequate information and explanations are not supplied promptly by management thus requiring further time to be incurred chasing explanations.
- Additional risk areas not originally scoped may be identified during audits which may require further work as part of an existing audit or an additional audit review.

4.7 As the Internal Audit Service becomes more responsive to the needs of the organisation the annual planning process is becoming more difficult to accurately predict what will be required over both the short and medium-term. Variances from the initial plan to outturn as noted above will not be unusual as new and emerging risk issues arise and this will inevitably result in re-prioritisation of audits within the plan. The pace of change in respect of structures and service delivery across the organisation will further complicate resource allocation and will inevitably lead to future audit plans becoming more generic in nature and thus more flexible to allow for new or emerging issues to be accommodated. As a result the Audit Committee will receive an in-year progress report on the agreed Audit Plan.

4.8 Due to the nature of internal auditing, performance monitoring and target setting have always been key drivers by which management can assess the effectiveness of the Internal Audit Service. Resource planning, time recording and benchmarking have long been used by Internal Audit to direct and inform the audit process. Performance measures are important for two reasons: -

- They enable progress over a period of time to be monitored (given that historic data is available to establish a sound base).
- They enable targets to be set for future improvement.

4.9 The main performance measures for Internal Audit for 2016/17 covered the following areas: -

- Sickness Absence.
- Productivity.
- Completion of audit plan.
- Costs remaining within budget.

4.10 Details of actual performance against specific performance measures are provided below: -

4.10.1 **Sickness Absence** - The percentage sickness absence during 2016/17 was 1.23% (1.06% in 2015/16).

4.10.2 **Draft reports to be issued to management within 10 working days following the completion of the audit fieldwork** - Based on a sample analysis an average of 16.5 days (11.6 days in 2015/16) was achieved. This measure tends to fluctuate year-on-year due to the impact of workload, unplanned work and the complexity of the audit work undertaken.

4.10.3 **The level of directly allocated time to be 70% of total time available** - A level of 68% (69% in 2015/16) was achieved.

4.10.4 **To issue all final reports within 5 days of management clearing the draft report** - Based on a sample analysis an average of 5.5 days (4.9 days in 2015/16) was achieved.

4.10.5 **Audit staff to be available from 8.30 to 5.00, Monday to Thursday, 8.30 to 4.30 on Fridays** - This target was achieved.

4.10.6 **To draw up and have agreed an Annual Plan by the 31st March** - The 2016/17 audit plan was agreed by the Audit Committee on 9th March 2016.

4.10.7 **To ensure costs are in line with budget** - This was achieved.

- 4.11 The regularity work carried out by Internal Audit Services is designed to assess overall compliance with management policies and procedures. This work is supplemented and complemented by system reviews to measure and recommend on the level and effectiveness of internal controls.
- 4.12 Internal Audit reviews concentrate on the negative aspects and this can sometimes give a misleading picture of the financial control environment of an organisation. Whilst there may be, in an organisation as large as Caerphilly CBC, areas of concern in relation to the detailed financial administration there are also many examples of good practice.
- 4.13 During 2016/17 all appropriate audit reports were given an audit opinion on the adequacy of the systems reviewed, the controls in place, and compliance with those controls to provide an overview of the whole control environment and evidence to support the financial element of the Council's annual governance review process.
- 4.14 Due to the diversity of the work undertaken reports and opinions are tailored to suit each situation. This approach has evolved over time based on experience and knowledge of the organisation. Reports arising from audit reviews of the Council's establishments use a three tier assessment consisting of (1) good (2) satisfactory and (3) in need of improvement. Audit reviews of systems although using the 1, 2, 3 system above, can include an assessment of both the system controls in place and the compliance with those controls, thus producing two opinions per review.
- 4.15 Audit reviews (including follow-up audits) have been carried out across a wide variety of areas in order to gain an overall opinion on the effectiveness of the internal control system operating within the Council, which has been reflected in the Annual Governance Statement (AGS).
- 4.16 In the majority of cases management and the auditees have accepted the recommendations made by Internal Audit. Recipients of audit reports (excl. establishments) are required to submit action plans to the Internal Audit Section to ensure proposals have been actioned or are being adequately progressed. During the year 11 action plans relating to previous years systems audits were reviewed and of the three establishments identified as needing to improve during the previous year two were visited again and the other one is due to be revisited in the current year.
- 4.17 Those areas identified as not being satisfactory have been or are being dealt with via an ongoing audit process thus ensuring issues are resolved appropriately. None of the issues identified are considered to be material in the context of the whole authority and are not felt to be significant enough to warrant disclosure within the annual review of the Council's governance arrangements.
- 4.18 The following sections of the report provide further details of the variety of activities that the Internal Audit Service was involved in during the year: -
- 4.19 Establishment Audits
- 4.19.1 Due to the decentralised nature of some of the Council's operations additional risks occur that are best reviewed and dealt with on site. Periodic visits to stand alone sites not only acts as a deterrent but also provides an opportunity to fill knowledge gaps, correct poor practices or errors and to identify and pass on best practice. Visits to operational establishments are made on cyclical basis with those that are given the 'in need of improvement' ranking receiving a revisit to monitor improvement progress.
- 4.19.2 Eleven establishment audits that were undertaken in the previous financial year were finalised with the final reports being agreed and issued. Of these eleven audits one was rated as 'good', eight were rated as 'satisfactory' and the remaining two were rated as 'in need of improvement'. The 'in need of improvement' establishments are both schools, one was revisited and a date for a revisit has been arranged for later in the year for the other. In both schools attention was drawn to the accuracy and completeness of the school meals records,

expenditure documentation and control, and the administration of the school private funds. There were also some specific issues for each school which were highlighted for the school management to focus upon.

- 4.19.3 Establishments in receipt of an audit visit during the year included 27 schools, 1 leisure facility, 4 social services establishments and 2 other miscellaneous establishments (see Appendix A). Twenty six of these have been finalised and reports agreed and issued. The remaining eight were at the draft report stage at the end of the year, awaiting final agreement from clients prior to the issue of the final reports.
- 4.19.4 In respect of the twenty six finalised audits nine were rated as 'good', fourteen rated as 'satisfactory' and three as 'in need of improvement'. The three rated as 'in need of improvement' are all schools and two have been scheduled for a revisit and one has already been visited and has shown sufficient improvement to have its opinion upgraded to 'satisfactory'.
- 4.19.5 In respect of the eight audits at the draft report stage at the year end, six were considered to be satisfactory and two were ranked as 'in need of improvement' (both schools). Both schools ranked as 'in need of improvement' were re-visits and both have received a visit from the Internal Audit Manager.
- 4.19.6 The themes identified during the audit process were around school meal administration and records, income records and banking, payroll documentation, ordering procedures and the administration of school private funds.
- 4.19.7 At the request of one of our comprehensive schools an exercise was undertaken to look into a potential irregularity within the school's financial administration. A report was issued to the Headteacher which was used in an investigation and also later informed improvements in procedures and practices.

4.20 Systems Audits

- 4.20.1 Systems work is carried out on the main financial systems of the Council e.g. payroll, creditor payments etc., together with other financial and non-financial systems. Systems audits are prioritised on a risk based approach with those involving cash handling, large values or high volumes of transactions being considered to be higher risk. Systems audits assess the risks and controls in existence in a system, together with an opinion on the compliance to these controls.
- 4.20.2 All system audits with findings of moderate risk or above will result in an agreed action plan of recommended improvements and these are subject to review once the respective implementation dates have elapsed.
- 4.20.3 Fifteen system audit jobs were brought forward from the previous year. Fourteen of these have since been finalised with twelve having final reports agreed and issued. These audits produced twenty four opinions of which four were 'good', eight were 'satisfactory' and twelve were 'in need of improvement'. The six audits generating the twelve 'in need of improvement' opinions were Customer First cash offices, purchase ledger, purchase ledger feeders, expenses, Supporting People and school meal income and arrears. Action plans have been agreed with management and the follow-up process will revisit these areas to ensure that agreed improvements have been made. Further details of the issues identified are set out in Appendix B of this report.
- 4.20.4 During the year twenty systems audits, ten grant audits and eleven action plan reviews were undertaken. Eight systems audits producing finalised and issued reports resulted in eleven audit opinions of which ten were satisfactory or above. The remaining 'in need of improvement' opinion was in respect of the WHQS project, further details of which are provided in Appendix B. All ten grant audits were found to be satisfactory and the grant certificates were signed accordingly, with the total value of the grant claims being

approximately £21.5 million. The action plan reviews were all signed-off in response to management assurances that improvements have been actioned.

- 4.20.5 Analysis of reported findings and opinions from these audits is an ongoing process which is used to inform the planning, prioritisation and risk assessments of future annual plans.
- 4.21 Other advisory or miscellaneous work undertaken
- 4.21.1 Audit staff have participated in a working group and undertake periodic testing of our conformity with the Payment Card Industry (PCI) Standards. The Authority continues to be fully compliant with the PCI Standard. This is an ongoing requirement.
- 4.21.2 Audit staff have also contributed to a corporate services working group looking at the potential risks and suitable solutions to administering and complying with a new taxation regulation in respect of self-employment and small registered companies, referred to as IR35. This work will be ongoing into the New Year.
- 4.21.3 The Internal Audit Manager has met with the Head of Internal Audit in Bridgend CBC to share best practice and explore lessons learned from Bridgend's roll-out of a formal governance review process in respect of educational establishments. Work has been undertaken to adapt our corporate governance checklist process for use by schools.
- 4.21.4 A proportion of the work of the Internal Audit Service during 2016/17 requires involvement in the development of new and existing systems and procedures. Whilst this work does not form part of the assurance work undertaken it is considered beneficial for early audit involvement to avoid future problems due to control weaknesses. All opportunities are taken to proactively promote good practice and to strengthen both existing and new control processes and as such resource and time is allocated to this advisory/consultancy role. This is reflected in the opinions reported in the Annual Governance Statement (AGS).
- 4.21.5 Advice has been provided in the early discussions around cashless catering systems and procedures in relation to schools.
- 4.21.6 Internal Audit staff have continued to provide advice and support to staff on Standing Orders for Contracts, Financial Regulations and financial best practice including tailored training or instruction as and when required. An interim consultation and review of the appropriateness of Financial Regulations and Standing Orders for Contracts was undertaken during the year and this did not identify any major issues that required immediate attention.
- 4.21.7 The Internal Audit Manager is a member of the Corporate Governance Review Panel and facilitates the annual review process which takes place throughout the year culminating in the draft Annual Governance Statement being presented to the Audit Committee for consideration. Work has also been ongoing throughout the year to keep the corporate process in line with current guidance and to monitor progress in respect of actions identified in previous reviews.
- 4.21.8 The Internal Audit Manager also produced an Assurance Framework document which was endorsed by the Audit Committee in December 2016 and is intended to be a useful diagrammatical representation of the processes and control mechanisms that the Authority has in place contributing to the governance of the Authority. It will also aid understanding of the connections between the various elements of the governance structure along with the responsibility for the various tiers on assurance.
- 4.21.9 Internal Audit has continued supporting the Welsh Housing Quality Standard (WHQS) project with the ongoing development of systems and processes. Ongoing monitoring work has taken place in respect of reviews of data compliance, contract pain/gain mechanism and risk management processes and advice and support in respect of E invoicing and contract benchmarking.

- 4.21.10 An exercise has been undertaken to review the values and volumes of retrospective orders being processed within the corporate payment system and monitoring has continued throughout the year to establish a base line against which future performance improvements will be measured.
- 4.21.11 An exercise was undertaken to review the administrative processes and procedures in operation within the Outdoor Education Service. A report was agreed and issued with an overall opinion of satisfactory.
- 4.21.12 The Internal Audit Manager has been supporting the Acting Head of Human Resources & Organisational Development, as appropriate, with the ongoing investigation in respect of three senior officers.
- 4.21.13 Internal Audit staff facilitated the biennial National Fraud Initiative (NFI) data matching exercise, which is a national mandatory programme involving 1300 public sector organisations to help prevent and detect fraud. The NFI plays an important role in protecting the public purse and is one element of an effective anti-fraud strategy. The NFI is run by the Cabinet Office and the Wales Audit Office (WAO). Data was uploaded in late 2016 and matches were published in January and work is ongoing in a number of service areas to investigate these, and the exercise is due to be completed later in 2017. WAO have advised they have selected Caerphilly for review in respect of our participation and contribution to the exercise and WAO have met with audit staff to discuss this. When the exercise is completed the national findings will then be collated and published by WAO in 2018 and subsequently reported to the Audit Committee.
- 4.21.14 Ninety five contractors' final accounts were audited during the year with a combined value of over £41m (2015/16 - 97 accounts with a value of £23m). Apart from two minor overpayments and six procedural reporting issues the discipline of having to submit accounts for auditing is continuing to work well and is minimising the incidence of errors or procedural issues being overlooked.
- 4.21.15 Internal Audit Services receives and assesses all anonymous communications received by the Authority to ensure that they are properly considered. During the year there were 106 anonymous letters logged by Internal Audit which, where appropriate, were passed to the relevant departments for action (76 in 2015/16). These communications cover a wide range of issues from possible benefit frauds, neighbour disputes, anti-social behaviour and other potential illegal behaviours. However, Internal Audit Services focus on system control failures and staff related issues and only three such issues were raised during the year with all being satisfactorily investigated. Additionally, cheques returned to the Council are also scrutinised within Internal Audit Services to identify system and/or control issues. Eighty four cheques were returned during the year. Both these operations act as a barometer in respect of underlying issues and are used to inform the Internal Audit planning process in respect of identifying areas that require future coverage.
- 4.21.16 Internal Audit Services staff have attended the Learning from Complaints Group which compliments the work undertaken within Internal Audit in respect of anonymous referrals.
- 4.21.17 Compliance work was undertaken to assist with the ongoing IT security accreditation (BSISO/IEC27001:2013). As part of a rolling review process, 5 reviews have been undertaken within the IT department which contribute to the ongoing BSI 27001 accreditation in respect of the security arrangements within the service area. All five reviews were determined to be satisfactory.
- 4.21.18 A review of the Authority's counter fraud framework was undertaken using a Chartered Institute of Public Finance (CIPFA) checklist to assess its potential for future reviews. In addition a fraud risk register was drafted to sit alongside the assessment and both draft documents are currently being considered as potential assurance documents in future years.

- 4.21.19 The Audit team undertook a self assessment review against the requirements of the Public Sector Internal Audit Standard (PSIAS) the results of which were reported to the Audit Committee in December 2016. Overall it was considered that no fundamental issues were identified and all areas of the Standards had been covered. Some areas for improvement were identified and the self-assessment is currently undergoing a peer review to validate its robustness, the results of which will be reported to the Audit Committee once completed.
- 4.21.20 As part of a reciprocal arrangement set up by the Welsh Chief Auditors Group the Internal Audit Manager undertook a peer review of Rhonda Cynon Taff Internal Audit Service's self-assessment.

4.22 Training and advice

- 4.22.1 Internal Audit Services continue to participate in the South Wales Chief Auditor Group Training Programme and during the year three staff attended a session on Project Management. Two audit staff also attended a WAO seminar considering the type of involvement and role Internal Audit Sections could have in the future in respect of the 'Well being of Future Generations Act'.
- 4.22.2 The Internal Audit Manager attended one Welsh Chief Auditors Group meeting and also contributed to the annual benchmarking exercise that is co-ordinated by the Group. This annual exercise allows a number of comparisons to be made between Welsh Authorities' audit teams which can then be used for improvement purposes.
- 4.22.3 Internal Audit staff have continued to participate in the specialist practitioners groups, set up by the Welsh Chief Auditors Group, dealing with topical audit issues and the development of a best practice approach. This is seen as an important ingredient in ensuring Internal Audit staff are continuing their professional development and are aware of the wider issues affecting the delivery of an effective Internal Audit Service.
- 4.22.4 The Interim Head of Corporate Finance has held an 'Away-Day' with the Internal Audit Team to consider the proposals for improvement relating to Internal Audit in the WAO report "Review of arrangements to address external audit, inspection and regulation recommendations and proposals for improvement – Caerphilly CBC". A follow up session has also taken place to update the staff on progress made with the completion of the agreed actions and the position going forward.

5. **CONCLUSIONS**

- 5.1 This report has been prepared as a review of Internal Audit activity during 2016/2017. It not only highlights the extent of the work completed but also the diversity.
- 5.2 No fundamental issues have come to light as a result of audits carried out on both the major financial systems and other financial and administrative systems and procedures. Where issues have been identified and brought to the attention of management an action planning process is in place to drive through the necessary improvements. Overall it is considered that the Council continues to operate within a control environment that should minimise the risk of loss to the Authority.

6. **EQUALITIES IMPLICATIONS**

- 6.1 This report is for information purposes only, therefore the Council's full equalities impact assessment process has not been applied.

7. FINANCIAL IMPLICATIONS

7.1 There are no direct financial implications arising from this report.

8. PERSONNEL IMPLICATIONS

8.1 There are no direct personnel implications arising from this report.

9. CONSULTATION

9.1 All consultation responses have been reflected in this report.

10. RECOMMENDATIONS

10.1 The Audit Committee is asked to note the content of this annual review of the operation of the Internal Audit Service.

11. REASONS FOR THE RECOMMENDATIONS

11.1 To ensure that the Audit Committee is aware of the level of Internal Audit coverage and the overall opinion derived from undertaking this work.

12. STATUTORY POWER

12.1 Local Government Act 2000.

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Appendices:

Appendix 1 Schedule of establishment visits undertaken during 2016/17

Appendix 2 Table of issues identified for those audits ranked as in need of improvement