

central midlands audit partnership

Derby City Council – Internal Audit Annual Report 2016-17

Audit & Accounts Committee: December 2017



Providing Excellent Audit Services in the Public Sector

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Our Vision

Through continuous improvement, the central midlands audit partnership will strive to provide cost effective, high quality internal audit services that meet the needs and expectations of all its partners.

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1. Introduction

- 1.1 The Public Sector Internal Audit Standards (PSIAS) require the 'Chief Audit Executive' (in the case of Derby City Council the Audit Manager) to provide an Annual Report to support the Annual Governance Statement, which is a statement of the effectiveness of the framework of governance, risk and controls in operation within the Council.
- 1.2 The Internal Audit Annual Report should:-
- include an opinion on the overall adequacy and effectiveness of the Council's internal control environment,
 - present a summary of the audit work on which the opinion is based,
 - draw attention to any key issues that may impact on the level of assurance provided,
 - provide a summary of the performance of the Service
 - comment on compliance with PSIAS.
- 1.3 The internal control environment comprises the Council's policies, procedures and operations designed to:-
- establish and monitor the achievement of the Council's objectives'
 - facilitate policy and decision making'
 - ensure the economic, effective and efficient use of resources'
 - ensure compliance with established strategies, policies, procedures, laws and regulations: and
 - safeguard the Council's assets and interests from losses of all kinds, including those arising from fraud or corruption.

It is the responsibility of the Council to establish and maintain appropriate risk management processes, control systems, accounting records and governance arrangements.

- 1.4 The role of Internal Audit is to provide an assurance to the Council that these arrangements are in place and operating effectively. The Annual Audit Plan sets out proposals on how this will be achieved in the year ahead. The Council's response to internal audit activity (individual audit reports) should lead to the strengthening of the control environment and therefore contribute to the achievement of the organisation's objectives.

Internal audit is best summarised through the definition within the Standards as an *"Independent, objective assurance and consulting activity designed to add value and improve an organisations 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"*.

2. Internal Audit Opinion- 2016/17

The Audit Manager is responsible for the delivery of an annual audit opinion and report that can be used by the Council to inform its governance statement. The annual opinion concludes on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control.

In giving this opinion, there is an understanding that no system of control can provide absolute assurance against material misstatement or loss, nor can Internal Audit give absolute assurance that there are no major weaknesses in the processes reviewed. In assessing the level of assurance to be given, I have based my opinion on:

- written reports on all internal audit work completed during the course of the year (assurance & consultancy);
- results of any issues that have carried forward into the following year
- the results of work of other review bodies where appropriate;
- the extent of resources available to deliver the internal audit work;
- the quality and performance of the internal audit service and the extent of compliance with the Standards; and
- the proportion of City Council's audit need that has been covered within the period.

Audit Opinion - 2016/17

I can confirm that sufficient assurance work has been carried out to allow me to form a conclusion on the adequacy and effectiveness of Derby City Council's internal control environment.

Based on the work undertaken during the year, in my opinion, Derby City Council's framework of governance, risk management and management control is INADEQUATE.

Audit testing has demonstrated that controls were not working in practice across key areas and there was need for urgent remedial actions.

Where weaknesses have been identified through internal audit review, we have worked with management to agree appropriate corrective actions and a timescale for improvement. However some actions have not progressed sufficiently to address the severity of control weaknesses identified.

Audit Opinion Categories:

- **Inadequate System of Internal Control** – Findings indicate significant control weaknesses and the need for urgent remedial action. Where corrective action has not yet started, the current remedial action is not, at the time of the audit, sufficient or sufficiently progressing to address the severity of the control weaknesses identified.
- **Adequate System of Internal Control Subject to Reservations** – A number of findings, some of which are significant, have been raised. Where action is in progress to address these findings and other issues known to management, these actions will be at too early a stage to allow a satisfactory audit opinion to be given.
- **Satisfactory System of Internal Control** - Findings indicate that on the whole, controls are satisfactory, although some enhancements may have been recommended

3. Basis of Audit Opinion

3.1 Internal Audit work completed during 2016/17

In accordance with PSIAS and the Accounts and Audit Regulations 2015, the Chief Audit Executive's annual opinion, is based upon and limited to the work performed by Audit during the year.

Work has been planned and performed so as to obtain sufficient information and explanation considered necessary, to provide evidence to give assurance on the effectiveness of the internal control system.

The 2016-17 Internal Audit plan, approved by the Audit and Accounts Committee, March 2016, was informed by Internal Audit's own assessment of risk and materiality, in addition to consultation with management to ensure it aligned with key risks facing the Council.

In preparing the overall opinion, the Chief Audit Executive has reviewed all audit activity carried out during 2016/17 and noted any issues arising from these audits that have carried forward into 2017/18 (see 4.1).

During the year, audit activity included reviews on the following

- Key financial systems
- Systems based reviews
- Grant certification
- Information Technology
- Procurement/contracts
- Anti-Fraud work
- Consultancy

All audit reviews contain an overall assurance opinion based on the adequacy of the level of internal control in existence at the time of the audit. The rating is determined by the number of control weaknesses identified in relation to those examined, weighted by the significance of the risks

The assurance levels allocated for each audit are graded as

- **None (N)** - We are not able to offer any assurance as the areas reviewed were found to be inadequately controlled. Risks were not being well managed and systems required the introduction or improvement of internal controls to ensure the achievement of objectives
- **Limited (L)** - We are able to offer limited assurance in relation to the areas reviewed and the effectiveness of controls found to be in place. Some key risks were not well managed and systems required the introduction or improvement of internal controls to ensure the achievement of objectives
- **Reasonable (R)** - We are able to offer reasonable assurance as most of the areas reviewed were found to be adequately controlled. Generally risks were well managed, but some systems required the introduction or improvement of internal controls to ensure the achievement of objectives
- **Comprehensive (C)** – We are able to offer comprehensive assurance as the areas reviewed were found to be adequately controlled. Internal controls were in place and operating effectively and risks against achievement of objectives well managed.

The assurance opinion assigned to the individual audit areas reviewed are as detailed below for information.

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Department	% Plan Coverage*	Planned Audits	Audits Completed**	Assurance Rating			
				N	L	R	C
Organisation & Governance	26%	33	29	0	6	17	6
People Services	12%	14	12	0	0	10	2
Communities & Place	12%	12	11	0	2	7	2
Anti-Fraud & Probity	20%	12	12	1	6	4	1
TOTAL				1	14	38	11

*30% of plan time relate to work conducted in respect of consultancy, grant certification, follow up or investigations

**90.1% of plan completed against a target of 91%

From the details above, I have concluded that audit coverage across the Council was adequate and the percentage of plan completion sufficient to provide my opinion. The following key factors arising from audit work undertaken contributed to the adverse opinion

- The high number of audit reviews where our opinion was a none or limited assurance over the adequacy of the control environment-(15/64 audits completed)
- The high numbers and scale of control weaknesses identified from these reviews - (912 controls evaluated, 354 controls not in place or only partially in place)
- The importance of the areas/systems where these weaknesses were identified-(see below)

NO ASSURANCE OPINION

- We were not able to provide any assurance i.e. NO ASSURANCE opinion, with regard to the adequacy of one school's governance arrangements. 22 control issues were identified.

LIMITED ASSURANCE OPINION

The following completed audits, attracted a LIMITED ASSURANCE opinion.

- The Main Accounting-Reconciliation audit review - 18 control weaknesses were identified, of which 5 were assessed as posing a moderate risk with, 13 low risk issues..
- The Health and Safety audit review – 8 control issues were identified, of which 4 were assessed as moderate risk issues and 4 low risk issues.
- The Information Governance audit - 11 control weaknesses were identified, of which 3 issues assessed as moderate risks.
- The Creditors- Accounts Payable audit - 9 control weaknesses identified, 4 assessed as moderate risk and 5 as low risks.
- Liquid logic Social Care IT Security audit -10 control issues identified, 5 were assessed as moderate risk and 5 as low risk. This review highlighted security vulnerabilities in the system that were flagged to management and addressed as a matter of urgency during the audit.
- XN Leisure system IT Security audit undertaken as part of leisure services review – 9 IT systems control issues identified, 2 assessed as moderate and 7 as low risk.
- Active Directory IT infrastructure security audit– 10 control issues identified, 5 were assessed as moderate risk and 5 as low risk.
- Website IT Security audit – 10 control issues identified, 4 were assessed as moderate risk and 6 low risk.

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A limited assurance opinion was also assigned to 6 areas of probity and investigative work undertaken by the Internal Audit team.

- Carelink, - 3 control issues, 1 critical and 2 significant risks
- Morleston Day Centre, 13 control issues, 6 moderate risks & 7 low risks
- Purchase Cards, - 7 control issues, 6 moderate risks & 1 low risk
- Farmers' Market - 5 moderate risk control issues
- Registrars – 10 control issues, 6 moderate risks & 4 low risks
- Adult Learning Centre -, 6 control issues, 5 moderate risks, 1 low risk

Internal Audit undertook sufficient work to enable the Chief Financial Officer to certify a return to DfE stating that adequate assurance had been received over schools' standards of financial management and the regularity and propriety of their spending.

Our data matching exercises produced over 16,800 cases of potential oversights, errors or frauds. Over 99% were resolved without concern and the remainder have been referred for further investigation and resolution

We examined one of the Council's key performance measures as part of our Data Quality review and deemed that the overall control environment was Reasonable.

3.2 Work of other review bodies

In preparing the overall opinion, the Chief Audit Executive has taken into account work undertaken and issues highlighted by External bodies and the assurance provided. The delay in completing the financial statements has meant that this opinion has to be rolling, thus having to taking into account work completed outside of the year. The Children Services Directorate of the Council was subject to an OFSTED Inspection which assessed the service provision as GOOD. The Council's Elections Services were given a clean bill of health following an in-depth review by the Electoral Commission.

3.3 Resources

At the start of 2016/17 Derby City Council had insufficient numbers of staff days to meet its audit objectives and provide a robust opinion. In consultation with the management an additional 400 audit days were acquired to address this. However an external assessment as required by the Public Sector Internal Audit Standards, starting in Mid February 2017, which involved detailed interviews with all staff and in-depth assessment of policies and procedures and documentation, meant that the resources had to be diverted from assurance work towards compiling evidence of conformance with Standards. Backfill resources were purchased, to enable delivery of sufficient planned work.

3.4 Recommendations Action Status

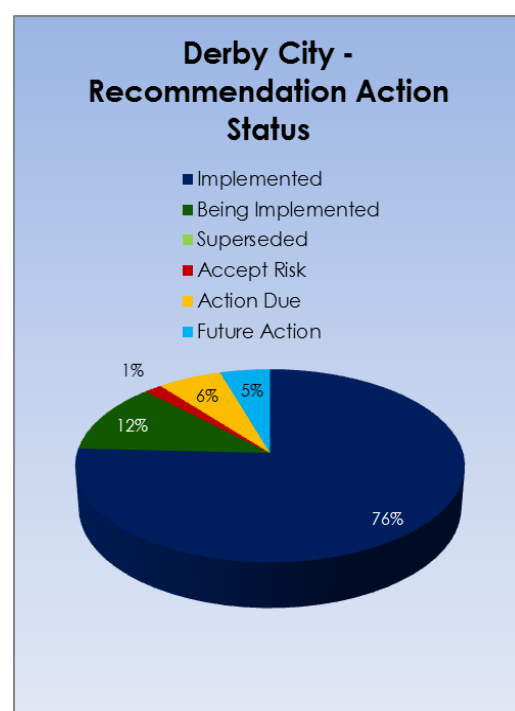
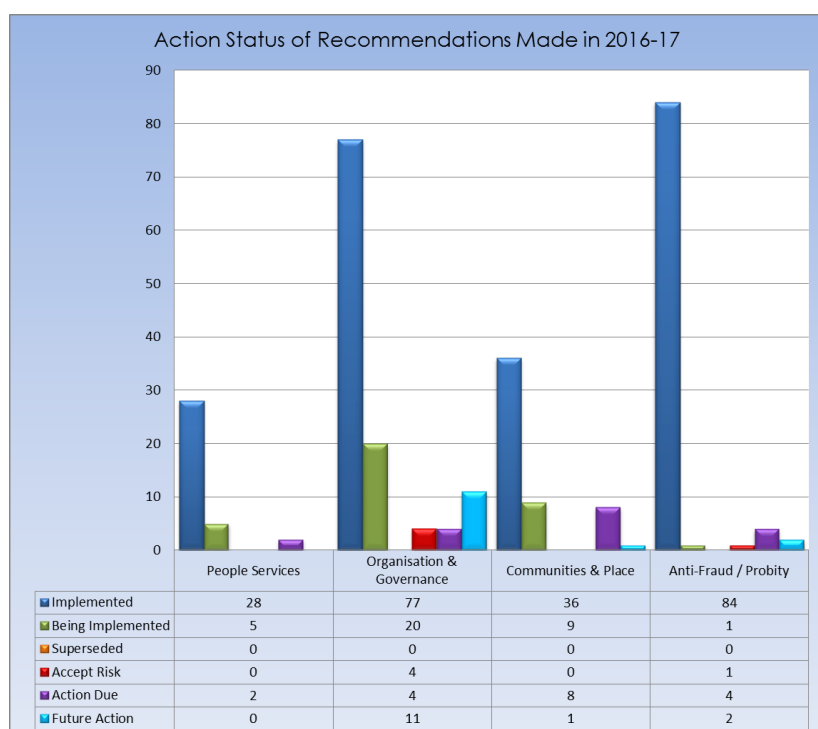
In preparing the overall opinion, the Chief Audit Executive has reviewed the implementation status of recommendations raised during this and previous year. Full implementation of all agreed actions is essential if the benefits of the control improvements detailed in each individual audit report are to be realised.

During 2016/17, we evaluated 912 controls in total of which 558(61%) were assessed as adequate and 354 were assessed as controls partially in place (20%) or not in place (19%).

We attempt to follow-up management's progress in the implementation of agreed actions by requesting an update on each recommendation's implementation status, from officers, where the recommendations' action dates had been exceeded. Each recommendation made by Internal Audit has been assigned an "Action Status" category as detailed below.

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- **Implemented** = Audit has received assurances that the agreed actions have been implemented.
- **Being Implemented** = Management is still committed to undertaking the agreed actions, but they have yet to be completed. (This category should result in a revised action date).
- **Superseded** = Audit has received information about changes to the system or processes that means that the original weaknesses no longer exist.
- **Accept Risk** = Management has decided to accept the risk that Audit has identified and take no mitigating action.
- **Action Due** = Audit have been unable to ascertain any progress information from the responsible officer.
- **Future Action** = The recommendations haven't reached their agreed action date



4. Other key Issues Arising

- 4.1 The unusual circumstances of the Financial Statements for 2015/2016 and 2016/17 not being completed until approximately 18 months after statutory deadlines has meant that this opinion has been developed on a rolling basis, and had to take account of issues that have occurred after the year end, but which may have impacted on the environment prior to sign off of the Financial Statements. The following control issues which arose from audit work done in 2017/18 are noteworthy:
- Revenues Contracts review – discussions are ongoing with management, but our findings indicate significant outstanding debtor balances relating to invoices to users of residential and domiciliary care service provision.
 - Servelec Synergy Children's Database – weaknesses in security over system access as reported to Committee at its meeting on 31st October 2017.

- 4.2 Some matters rising from the Public Interest Report issued by the previous External Auditors in 2015/16 were still being implemented and the process tested. Arrangements are in place for the processes to be reviewed by Full Council in July 2018.

- 4.3 The Council's External Auditors issued a letter to the Secretary of State, notifying the Department that the Council had been issued with recommendations pursuant to S24 of the Local Audit & Accountability Act 2014. The letter dated 27th June 2017 noted that progress made by the Council to address significant control weaknesses highlighted by them during 2016/17 was insufficient and required that an action plan be put in place and progress be monitored.

At their meeting of 28th November 2017, it was observed that members of the Audit and Accounts Committee were unsure as to actual progress being made against the action plan. The Committee which was delegated responsibility for monitoring progress against the action plan has yet to receive an independent assessment of progress against the action plan.

- 4.4 In their report to those charged with governance for 2015/16, the External Auditor observed that "the Council has not worked effectively with CMAP to deliver a robust internal audit". While it is noted that various steps have been implemented to secure improvement to the effectiveness of the relationship, due to pressure to deliver the Financial statements for the two preceding years, efforts have faltered, with audit reviews on financial systems being constrained. The situation is being reviewed with the support of the Head of Paid Service.
- 4.5 The Council's External Auditor has identified in its audit plan for the year ending 31 March 2017 (presented to this Committee on 19 September 2017) issues with the Council's risk management processes that "presents a significant risk in respect of the Council's arrangements for managing risks effectively, and the ability to make informed decisions".

Progress on embedding risk management processes has not been as effective as was originally planned. A number of fundamental deficiencies needed to be addressed and these actions are still on-going. Development work has been on hold since July 2017 when the Insurance and Risk Manager left the Council. The Director of Governance has put in interim measures to address this.

5. Quality & Performance of the Service

5.1 Quality

Our Charter provides partner organisations and stakeholders with a formally defined purpose, authority and responsibility for their Internal Audit activity as well providing arrangements for avoiding conflicts of interests. Our code of conduct requires auditors to complete both an annual declaration as well as an assignment declaration for each audit undertaken

Our work is guided by an Audit Manual based around the PSIAS which references our own processes and documents. We endeavour to maintain this as an up-to-date point of reference for Audit staff which guides them through the relevant standards and our processes.

We use a bespoke Automated Working Papers package using MS Word, MS Excel and MS Access which reflects our own working practices that are designed to ensure consistency and adherence to Auditing Standards.

We use a bespoke database – Audit management System, to record progress data for each audit assignment. This enables tracking and monitoring of time spent and status of audits from start to implementation of recommendations raised.

Following a closing meeting and prior to issuing the draft report each assignment undergoes a two-stage quality control process. The audit file and report produced are subject to robust review and challenge by the Assistant Audit Manager and scrutinised further by the Audit Manager.

We develop the skills and competencies of our staff through a systematic appraisal on a monthly one to one meeting and an annual process. Staff are also encouraged to attend courses staged by the various relevant professional bodies.

5.2 Service Delivery and Productivity

Service Delivery (% of Audit Plan Completed):

At the end of each month, Audit staff provide the Audit Manager with an estimated percentage complete figure for each audit assignment they have been allocated. These figures are used to calculate how much of each Partner organisation's Audit Plans have been completed to date and how much of the Partnership's overall Audit Plan has been completed.

By the end of the Plan year 90.1% of the Audit Plan had been completed against a target of 91%, which is excellent in light of the issues that the Council has been experiencing.

Productivity (Chargeable Days as % of Days Potentially Available for Audit):

Audit staff record the time they spend on audit assignments, administration and management in our bespoke database. Every minute worked is logged against an appropriate code. This time is analysed and compared to planned audit work. Time is analysed between Productive and Non-productive time. We aimed to achieve an increased target productive rate of 72.7% for the year. The average productive rate for 2015-16 was 71.8%, which we managed to increase to an average of 72.5% in 2016-17.

5.3 Customer Satisfaction Returns

The Audit Section sends out a customer satisfaction survey with the final audit report to obtain feedback on the performance of the auditor and on how the audit was received. The survey consists of 11 questions which require grading from 1 to 5, where 1 is very poor and 5 is excellent. Appendix A summarises the average score for each category from the 35 responses received. The average score from the surveys was 50.7 out of 55. The lowest score received from a survey was 32, while the highest was 55.



The overall responses are graded as either:

- **Excellent** (scores 46 to 55)
- **Good** (scores 38 to 46)
- **Fair** (scores 29 to 37)
- **Poor** (scores 20 to 28)
- **Very Poor** (scores 11 to 19)

Overall 26 of 35 responses categorised the audit service they received as excellent; another 8 responses categorised the audit as good and 1 categorised the audit as fair. There were no overall responses that fell into the poor or very poor categories.

6. Compliance with Standards

6.1 External Assessment of Internal Audit

Public Sector Internal Audit Standard 1312 requires that "External assessments must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organisation."

The Council is part of the Central Midlands Audit Partnership. The Head of Partnership requested that Milford Research and Consultancy Limited conducted this external quality assessment of the internal auditing activities of CMAP. The principal objectives of the quality assessment are to assess the internal audit activity's conformance to Standards, evaluate the internal audit activity's effectiveness in carrying out its mission (as set forth in its charter to its partners), and identify opportunities to enhance its management and work processes.

The assessment is based on the following 3 ratings:

Generally Conforms - means that an internal audit activity has a charter, policies, and processes that are judged to be in conformance with the Standards.

Partially Conforms - means deficiencies in practice are noted that are judged to deviate from the Standards, but these deficiencies did not preclude the internal audit activity from performing its responsibilities in an acceptable manner.

Does Not Conform - means deficiencies in practice are judged to be so significant as to seriously impair or preclude the internal audit activity from performing adequately in all or in significant areas of its responsibilities.

The initial assessment was carried out in the period February – April 2017. The consultant has fed back his findings to the CMAP Board and is still engaged to oversee the Change and Development Programme.

	Number of standards	Generally Conforms	Partially Conforms	Does Not Conform
Code of Ethics	4	4	0	0
Attribute Standards	19	12	5	2
Performance Standards	33	28	4	1

He has recently provided an update position on our overall conformance with the Standards and is now content to re-assess our conformance as follows:

	Number of standards	Generally Conforms	Partially Conforms	Does Not Conform
Code of Ethics	4	4	0	0
Attribute Standards	19	19	0	0
Performance Standards	33	33	0	0

The overall opinion is that the internal audit activity **Generally Conforms** with the Standards and Code of Ethics. The Consultant identified some opportunities for further improvement and development which have extensively been addressed. CMAP has made significant progress on its Change and Development

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Programme to enhance and build on the service it provides to partners. All areas of non-conformance now have been addressed via the Change Programme.