REPORT TO AUDIT & GOVERNANCE
Date of Meeting: 25TH JUNE 2014

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Report of: AUDIT MANAGERS
Title: **ANNUAL REPORT OF INTERNAL AUDIT FOR THE YEAR ENDED 31 MARCH 2014**

Is this a Key Decision?

No
* One that affects finances over £1m or significantly affects two or more wards. If this is a key decision then the item must be on the appropriate forward plan of key decisions.

Is this an Executive or Council Function? COUNCIL

1.   What is the report about?

The annual Internal Audit Report conforming to the Public Sector Internal Audit Standards and timed to inform the Council's Annual Governance Statement, including the quarterly update on the progress of Internal Audit work.

2.   Recommendations:

Members are recommended to:

2.1   Note the contents of the Annual Internal Audit Report.

2.2   Decide whether the audit report recommendations not accepted by management, as detailed in Appendix C, are acceptable risks to the Council.

2.3   To approve an external assessment of the Internal Audit Service against the Public Sector Internal Audit Standards.

3.   Reasons for the recommendation:

To comply with the Public Sector Internal Audit Standards and Corporate Governance best practice.

4.   What are the resource implications including non financial resources.

None.

5.   Section 151 Officer comments:

There are no financial implications to this report

6.   What are the legal aspects?

7.   Monitoring Officer's comments:

8.   Report details:

8.1 The Public Sector Internal Audit Standards, which came into effect in April 2013, require that:

- The Audit Manager must deliver an annual internal audit opinion and report that can be used by the organisation to inform its governance statement.
- The annual internal audit opinion must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control.

- The annual report must incorporate:
  - the opinion;
  - a summary of the work that supports the opinion; and
  - a statement on conformance with the Public Sector Internal Audit Standards and the results of the quality assurance and improvement programme

8.2   OPINION ON THE COUNCIL'S CONTROL ENVIRONMENT

a)   Internal Control Statement

In accordance with the Accounts and Audit Regulations 2011 the Council is responsible for maintaining an adequate and effective system of internal audit.

It is the responsibility of senior management to establish an appropriate and sound system of internal control, and to monitor the effectiveness of these systems. It is the responsibility of Internal Audit to provide an annual overall assessment of the robustness of the internal control system.

The main objectives of the internal control systems are to ensure:

- compliance with the Council's policies, procedures and directives in order to achieve the Council's objectives
- high standards of Corporate Governance are achieved and maintained throughout the Council
- that assets are safeguarded
- the relevance, reliability and integrity of information, and the completeness and accuracy of records
- compliance with statutory requirements, recognised standards and best practice.

Systems of control can only ever provide reasonable, but not absolute, assurance that control weaknesses and irregularities do not exist, and that there are no risks of material errors, losses, fraud or breaches of laws or regulations. The Council is therefore continually seeking to improve the effectiveness of its systems of internal control.

Internal Audit is charged with continually reviewing the system of internal control system on behalf of the Council and its management. Internal Audit objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources. The work of Internal Audit is based upon a risk assessment of the Council's financial and non-

financial systems, from which an annual audit plan is established that was referred to the Audit and Governance Committee in March 2013 for approval.

b)   Basis of Opinion

Our evaluation of the control environment is informed by a number of sources:

- the work undertaken by Internal Audit during the year to 31 March 2014
- the acceptance of significant recommendations by management
- reports issued by the External Auditors
- risks identified in the Council's Corporate risk register
- the review of the adequacy and effectiveness of the Council's system of internal control as it relates to corporate governance, risk management and quality of data arrangements
- other sources of assurance and information

c)   Public Sector Internal Audit Standards (PSIAS)

Internal Audit operates in line with the Public Sector Internal Audit Standards. This year a self assessment has been conducted to identify the level of conformance with the standard. The PSIAS has 326 elements of which Exeter's Internal Audit Service is compliant with 266, partially compliant with 20 and non compliant with 3 (the remainder were not applicable to Exeter). A summary of the self assessment findings are included in Appendix A along with the results of the quality assurance and improvement program.

In line with the standards Internal Audit must be independently assessed against the standard at least once every 5 years. It is proposed to appoint an external assessor to conduct a review during 2014. We seek this committee's approval to proceed with this.

d)   Work undertaken in year

The Audit Progress Table shows the work completed during this year (see Appendix B).

A summary of the work undertaken by Internal Audit in the previous quarter is presented to this committee throughout the year, therefore only a summary of the work undertaken in the last quarter has been included to avoid duplication (see Appendix C). This also includes details of the recommendations not accepted by management during the last quarter and requires consideration by this committee.

In addition to the planned work, Internal Audit has also worked on a number of reported concerns and investigations. A summary of this work is included in Appendix D.

e)   Areas of Concern

As a result of the audit work that has been undertaken throughout the year some issues, that have an impact on the organisation as a whole, have been identified. The main areas of concern that we wish to highlight are:

i) Separation of Duties – with considerable changes to the structure of the Council as it transforms the way in which services are delivered; separation of duties continues to be an area of concern. There is a risk that inadequate separation of duties could weaken the system of internal control, resulting in an increased risk of irregularities, errors and fraud. Therefore, it is important that the introduction of new processes and changes to existing processes are effectively managed to ensure that essential internal controls are not compromised.

ii) Data Quality – during the year a number of internal audit reports identified some data quality issues, some more significant than others. The decision making process relies on accurate data and data errors can have a financial impact on the Council, therefore, it is important that managers remind staff of the importance of accurate data input.

iii) Debtors system – an audit of the debtors system identified this system to have a fundamental weakness as reported to this committee on 27 November 2013. Whilst the weaknesses in this system are unlikely to have caused a material discrepancy, it does mean that the Council has not been collecting its debts as effectively as it should. It should be noted, however, that follow-up audit work during 2013/14 has re-categorised this system to significant improvement required rather than fundamental weakness.

iv) Service Risk Registers - The Corporate Risk Register was reviewed and updated in June 2013. However, there are currently no service operational risk registers in place. This could mean that not all operational risks are being identified and managed.

Effective management of service risks can help with:
- service delivery – increase in number of targets achieved, improved internal controls, added value across service areas
- financial performance – reduced level of fraud, increased capacity through reduction in decisions that need reviewing or revising, improved income generation
- human resources management – reduced staff turnover, absenteeism and stress
- corporate governance and compliance systems – fewer regulatory visits, reduction in legal challenges, increased public satisfaction

A full review of the Council's risk management process is currently in progress the results of which will be reported to the next meeting.

v) Partnership Working Protocol - the Council currently does not have a protocol for partnership working.

Partnership working is playing an increasingly important role in the future of policy development and service delivery for the public sector. It is important to understand that partnership working at any level, however small or seemingly insignificant, may carry important legal and financial implications for the Council. Partnership working presents a number of challenges which need to be considered at the outset of any joint working venture.

A Partnership Working Protocol provides:

- clear guidance and allows a Council wide approach to developing partnership working initiatives
- a framework within which partnership working across the Council can improve and develop practical advice and assists Council Officers, elected Members and external bodies who are actively involved in partnership working or who are considering entering into a partnership initiative

vi) Business continuity – Although under review, the Council does not have an agreed Business Continuity process in place leaving the Council at risk of service delivery failure in the event of an incident.

Business Continuity (BC) is defined as the capability of the organization to continue delivery of products or services at acceptable predefined levels following a disruptive incident. *(Source: ISO 22301:2012)*

vii) Risk of Fraud – the risk of fraud is a continual threat to any organisation and all managers and employees need to be proactive in preventing fraud. Employees have received anti-fraud training via an e-learning module but it is important to continue to maintain awareness of fraud risks.

viii) Shared ICT Service – should this initiative be agreed this could have a significant impact on the Council as the organisation's services are reliant on ICT, therefore it is important that any changes are carefully planned and managed. Internal Audit is continuing to seek assurances about the project as it progresses. The interim board has appointed Grant Thornton to review the business case and Internal Audit will be placing reliance on their work.

d)   Opinion

From the audit work undertaken during the year, and despite the areas of concern that we have identified above, we consider that the key systems are operating soundly and that there are no fundamental breakdowns of controls resulting in material discrepancy.

However, as mentioned above, as no system of control can provide absolute assurance against material loss, nor can Internal Audit give that assurance, this statement is only intended to provide an opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control system in the year to 31 March 2014.

9.   How does the decision contribute to the Council's Corporate Plan?

Good governance contributes to the Council's purpose of a "Well Run Council".

10.   What risks are there and how can they be reduced?

N/A

11.   What is the impact of the decision on equality and diversity; health and wellbeing; safeguarding children, young people and vulnerable adults, community safety and the environment?

N/A

12.   Are there any other options?

N/A

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