



# South Derbyshire District Council – Internal Audit Annual Report 2016-17

Audit Committee: 20<sup>th</sup> September 2017



## 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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## Introduction

### Why is an Audit Opinion required

The Public Sector Internal Audit Standards (PSIAS) sets out the requirement for Chief Audit Executive to report to the Board (e.g. the relevant Audit Committee) to help inform their opinions on the effectiveness of the framework of governance, risk and control in operation within the Council.

In accordance with PSIAS, the Chief Audit Executive is required to provide an annual opinion, based upon and limited to the work performed, on the overall adequacy and effectiveness of the organisation's risk management, control and governance processes (i.e. the Council's system of internal control).

The Council's Assurance Framework should bring together all of the evidence required to support the Annual Governance Statement (AGS) requirements. This is achieved through a risk-based plan of audit work, agreed with management and approved by the Board (e.g. the relevant Audit Committee), which should provide a reasonable level of assurance.

The report highlights matters for consideration and refers to plans for further assurance activity in areas of concern. The report is broken down into an overall opinion and a detailed Internal Audit outturn report for all activity in the year to fulfil the requirements of the Accounts and Audit Regulations 2015 and PSIAS.

The annual opinion contributes to the completion of the Annual Governance Statement (AGS). It is specifically timed to be considered as part of the Council's annual review of governance and internal control.

### How an Audit Opinion is Formed

A fundamental role of Internal Audit is to provide members and senior management with independent assurance on the Council's overall control environment, comprising the systems of governance, risk management, and internal control and to highlight control weaknesses together with recommendations for improvement. The annual Audit Plan sets out proposals on how this will be achieved in the year ahead.

The Audit Plan must incorporate sufficient work to enable the Chief Audit Executive to give an opinion on the adequacy of the Council's overall control environment. Internal Audit must therefore have sufficient resources to deliver the Audit Plan.

The audit work planned for 2016/17 has informed the Chief Audit Executive's opinion on the internal control environment that exists within the Council. The Chief Audit Executive reports his overall opinion to the Audit Committee on an annual basis.

The Chief Audit Executive provides this written report to those charged with governance which gives an opinion on the overall adequacy and effectiveness of the organisation's internal control environment. This is timed to support the Annual Governance Statement, which is also being presented to this Committee for review by Members.

Management is responsible for the system of internal control and should set in place policies and procedures to help ensure that the system is functioning correctly. Internal Audit review, appraise and report on the effectiveness of financial and other management controls.

The Chief Audit Executive's overall audit opinion is based on the work undertaken by internal audit in 2016/17. The reporting of the incidence of significant control failings or weaknesses has also been covered in the progress reports to the Committee on Internal Audit's progress against the annual Audit Plan.



### Basis for Opinion

The Internal Audit Service for South Derbyshire District Council is provided by the Central Midlands Audit Partnership (CMAP). The Partnership strives to operate in accordance with standards of best practice applicable to Internal Audit (in particular, the Public Sector Internal Audit Standards – PSIAS) as well as its own Internal Audit Charter.

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 those audits that have carried forward into 2017/18. Each individual audit undertaken contains a control assurance rating (opinion) on the adequacy and effectiveness of controls in place to mitigate the risks identified. Where weaknesses in control are identified, an action plan is agreed with management. Progress with these agreed actions is monitored by Internal Audit during the

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year through follow up audit work.

The Chief Audit Executive will use the individual assurance ratings from the audits conducted in 2016/17 and the progress with agreed actions to form the overall opinion.

In presenting his opinion, the Chief Audit Executive will identify where reliance has been placed on work by other assurance bodies. His opinion will be based on the work of Internal Audit and his understanding of work carried out by external assurance agencies.

In respect of the key financial systems of the Council, based on the Internal Audit work undertaken in the year, the Chief Audit Executive will be able to give an overall assurance on the adequacy and effectiveness of the internal controls operating in these systems.

## Possible Overall Opinions

The Chief Audit Executive's opinion relative to the organisation as a whole could fall into one of the following 3 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.

## 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 Chief Audit Executive of CMAP 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. 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 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.

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## Chief Audit Executive's Opinion 2016-17

Based on the work undertaken during the year, I have reached the overall opinion that there is an **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.

I have arrived at this opinion having regard to the following:

- As a result of whistleblowing, a major investigation has been conducted into the procurement and contracting arrangements in the Council's Housing Department. This has attracted a 'Limited' assurance rating. Management has resolved to take appropriate remedial action to improve controls. Whilst significant progress has been made, these remedial actions have yet to be fully completed.
- Evidence of officers over-riding of some of the Council's key controls relating to procurement and contracting was identified. This has resulted in Management taking disciplinary action.
- A further investigation of additional allegations into the procurement and contracting arrangements in the Council's Housing Department has been concluded which identified further examples of issues identified in the original investigation as well as other similar issues. This work attracted a 'Reasonable' assurance rating. Again, Management has resolved to take appropriate remedial action to improve controls. Whilst significant progress has been made, these remedial actions have yet to be fully completed.
- At the request of the Council a wider examination of procurement and contracting arrangements within the Council has been significantly completed. This work is still ongoing, but a number of control weaknesses have already been identified which raises concerns as to whether or not the control weaknesses in the procurement and contracting process were isolated to the Housing Department. These matters are yet to be formally agreed with Management
- The level of coverage provided by Internal Audit was considered adequate. Although, a number of planned audit assignments had to be postponed to accommodate the whistleblowing investigation.
- There were no adverse implications for the Authority's Annual Governance Statement arising from any of the routine work that Internal Audit has undertaken in 2016-17.
- The majority of routine assignments attracted either a 'Comprehensive' or 'Reasonable' assurance rating, with only one attracting a 'Limited' rating.
- All of the issues raised within the internal audit reports have been accepted.

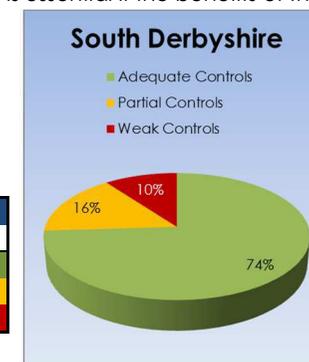
- Internal Audit's recommendations, or alternative proposed actions made by Management in response to the risk issue, have been agreed to be implemented in all cases but three.
- Sufficient audit coverage of the Council's Main Financial Systems has been provided in 2016-17 and attracted either 'Reasonable' or 'Comprehensive'.
- Internal Audit finalised the review of limited part of the Council's Corporate Governance arrangements in the early part of the financial year. Specifically, the process for the compilation of the Council's Annual Governance Statement; the communications protocol for ensuring proper scrutiny of the Council's functions; and the process for ensuring appropriate Member and officer training with regard to governance. The level of assurance was considered 'Comprehensive' and the two low risk recommendations highlighted by the review have since been implemented.
- A Data Quality audit was commenced during 2016-17 and we coordinated a self-assessment of all the Council's performance indicators as well as a close examination of four of the Council's higher risk performance measures. The review has recently been completed and it was deemed that the overall control environment was 'Reasonable'.

This opinion is provided with the following caveats:

- The opinion does not imply that Internal Audit has reviewed all risks and assurances relating to the Council. The opinion is substantially derived from the conduct of risk-based audit work and as such, it is one component that is taken into account when producing the Council's Annual Governance Statement.
- No system of control can provide absolute assurance against material misstatement or loss, nor can Internal Audit give absolute assurance.
- 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.

For those audits finalised during 2016-17, we established the following information about the controls examined:

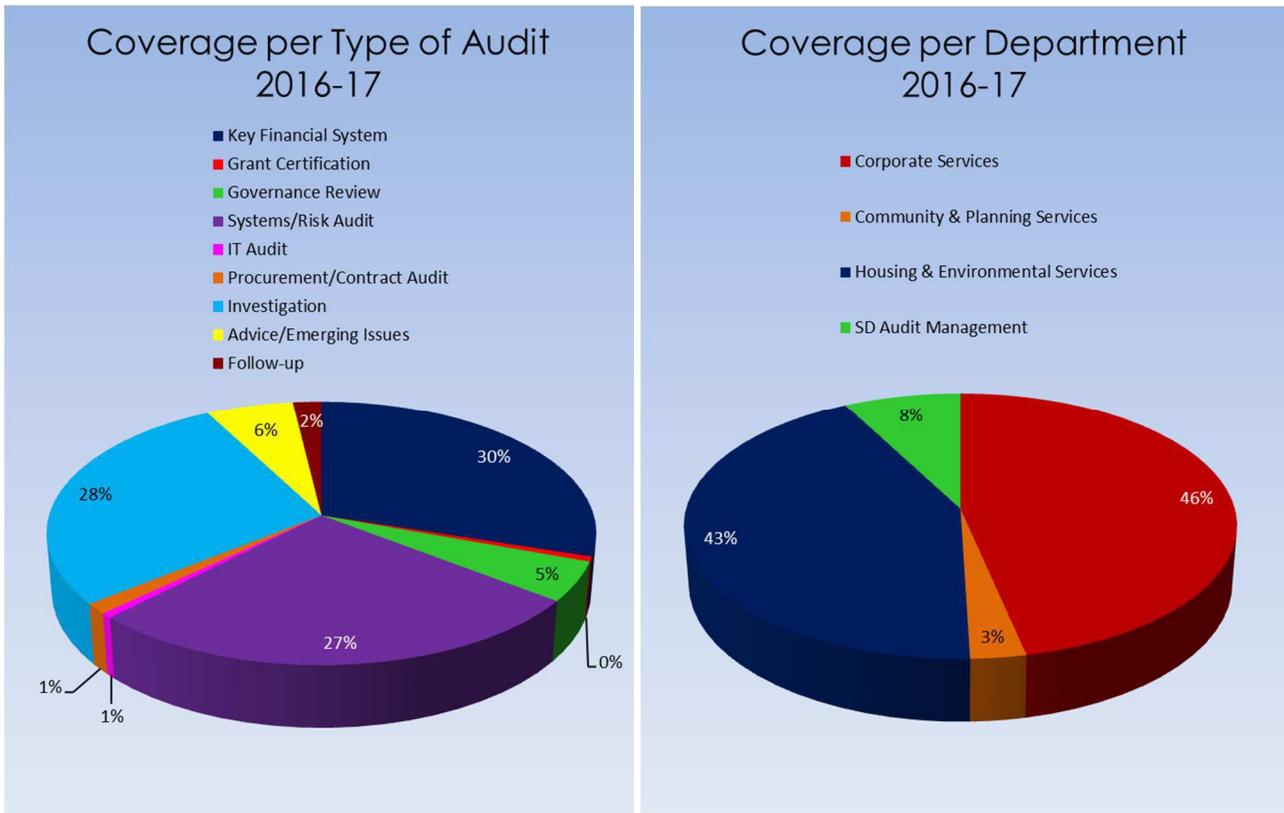
South Derbyshire District Council	2016-17
Evaluated Controls	381
Adequate Controls	282
Partial Controls	60
Weak Controls	39



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## Audit Coverage

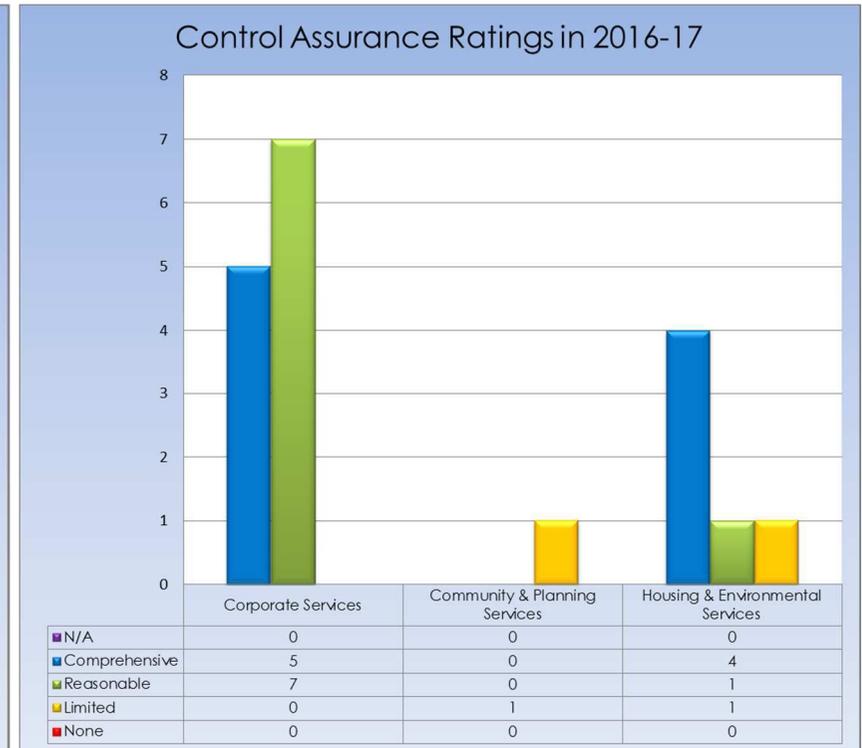
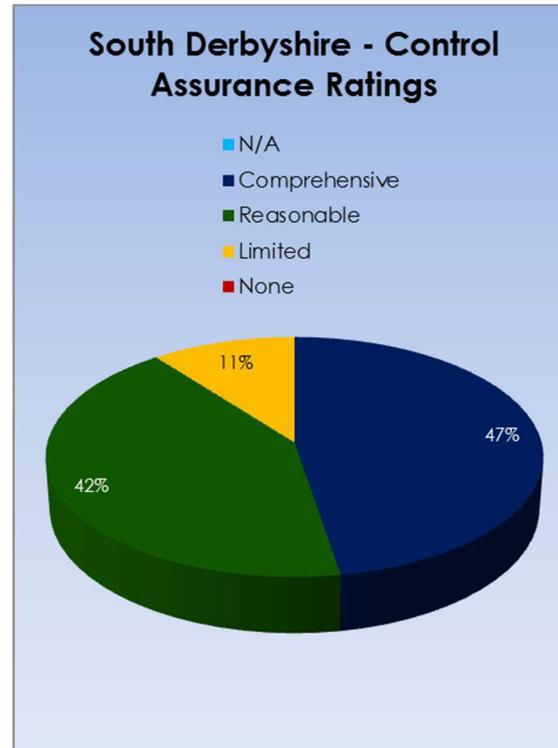
The following charts seek to demonstrate the extent of audit coverage provided to South Derbyshire District Council during 2016-17.



## Control Assurance Ratings

All audit reviews contain an overall opinion based on the adequacy of the level of internal control in existence at the time of the audit. These are graded as either:

- **N/A** – The type of work undertaken did not allow us to reach a conclusion on the adequacy of the overall level of internal control.
- **Comprehensive** - 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 the achievement of objectives were well managed.
- **Reasonable** - 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.
- **Limited** - We are able to offer limited assurance in relation to the areas reviewed and the 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.
- **None** - We are not able to offer any assurance. 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.



This report rating is determined by the number of control weaknesses identified in relation to those examined, weighted by the significance of the risks.

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## Performance Measures

### 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 88.2% of the Audit Plan had been completed against a target of 91%.

### 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.

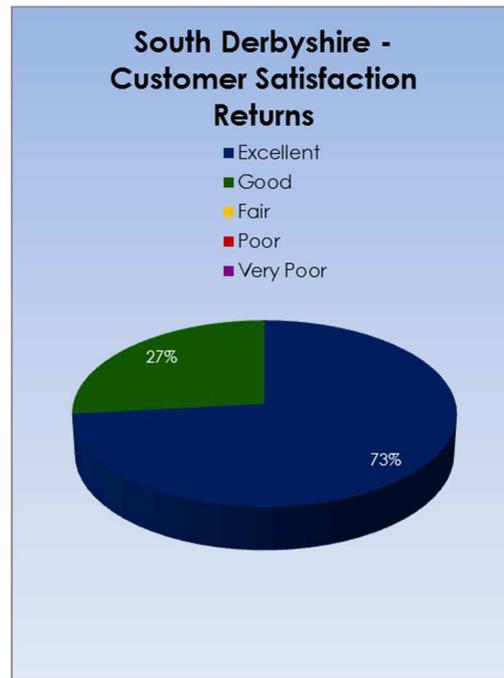
### Customer Satisfaction Returns

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 15 responses received. The average score from the surveys was 50.6 out of 55. The lowest score received from a survey was 41, while the highest was 55 which was achieved on 5 occasions.

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 11 of 15 responses categorised the audit service they received as excellent; the remaining 4 responses categorised the audit as good. There were no overall responses that fell into the fair, poor or very poor categories.

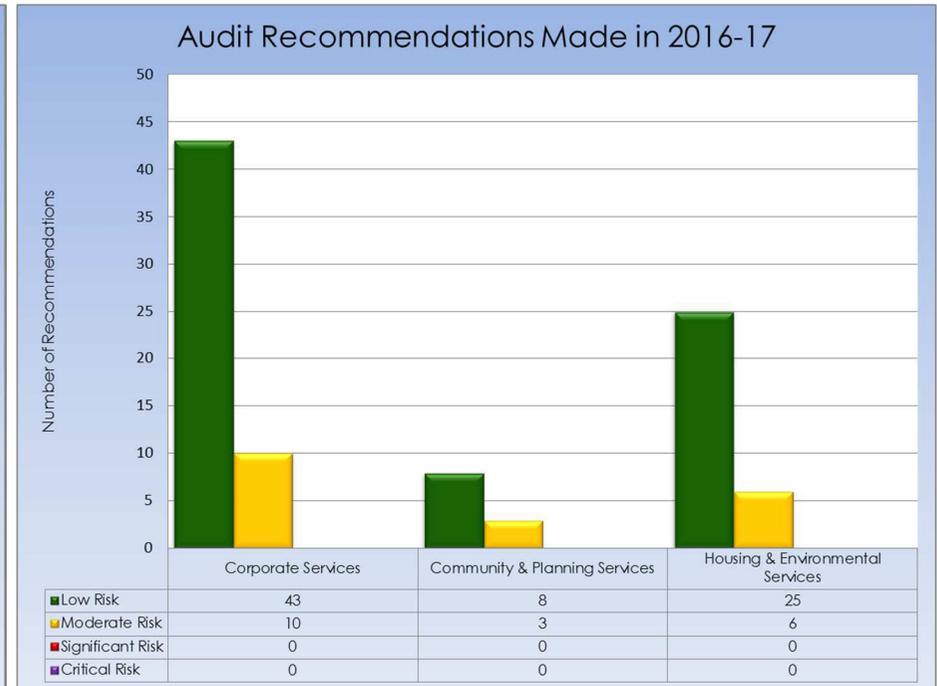
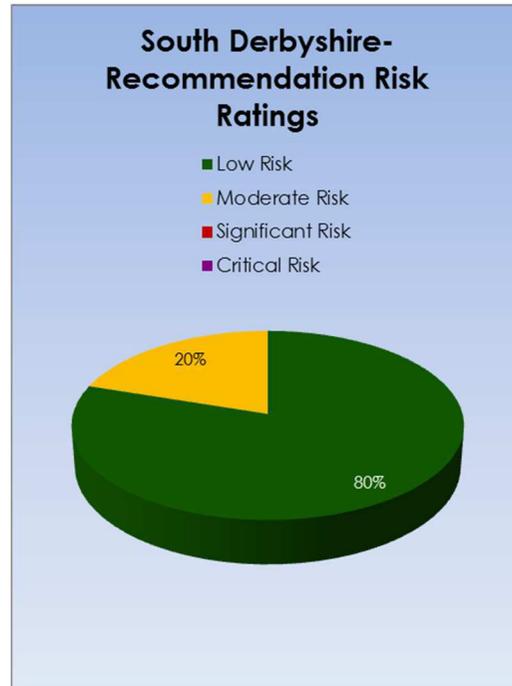


## Audit Recommendations

To help management schedule their efforts to implement our recommendations or their alternative solutions, we have risk assessed each control weakness identified in our audits. For each recommendation a judgment was made on the likelihood of the risk occurring and the potential impact if the risk was to occur. From that risk assessment each recommendation has been given one of the following ratings:

- **Low risk.**
- **Moderate risk.**
- **Significant risk.**
- **Critical risk.**

These ratings provide managers with an indication of the importance of recommendations as perceived by Audit; they do not form part of the risk management process; nor do they reflect the timeframe within which these recommendations can be addressed. These matters are still for management to determine. A summary of recommendations made, by directorate, for 2016-17 is shown in the table below.



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## Recommendations Action Status

Internal Audit sends emails, automatically generated by our recommendations database, to officers responsible for action where their recommendations' action dates have been exceeded. We request an update on each recommendation's implementation status, which is fed back into the database, along with any revised implementation dates.

Each recommendation made by Internal Audit has been assigned one of the following "Action Status" categories as a result of our attempts to follow-up management's progress in the implementation of agreed actions. The following explanations are provided in respect of each "Action Status" category:

- **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).
- **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.
- **Accept Risk** = Management has decided to accept the risk that Audit has identified and take no mitigating action.
- **Superseded** = Audit has received information about changes to the system or processes that means that the original weaknesses no longer exist.

