

Report to Audit Committee
14 July 2020
Report of Chief Internal Auditor, LGSS
Subject Annual audit report on internal audit and fraud 2019-20

Item

5

Purpose

To inform members of the Chief Internal Auditor's annual audit opinion for 2019-20 and the supporting work of internal audit. The report and the audit opinion within it, form part of the evidence to support the council's Annual Governance Statement 2019-20.

Recommendation

To consider the annual Internal Audit report and opinion, noting the work of Internal Audit team for 2019-20.

Corporate and service priorities

The report helps to meet all the corporate priorities

Ward/s: All wards

Cabinet member: Councillor Kendrick – Resources

Contact officers

See attached report.

Background documents

None

Report

Background

1. Under the Accounts and Audit Regulations 2015, the council “*must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance.*”
2. In 2012 (updated 2017) the relevant internal audit standard setters adopted a common set of standards across the public sector, the *Public Sector Internal Audit Standards (PSIAS)*, which state “*Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s 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*”.
3. The Standards require that the Chief Internal Auditor presents an annual report to the Audit Committee, which in practice is timed to support the authority’s Annual Governance Statement. This is reflected in the ‘Terms of Reference’ of the committee.
4. The annual report is a summary of all internal audit work carried out during the year. Each individual audit report is discussed at its draft stage and agreed action plans put in place. The annual report therefore represents in summary form a considerable degree of consultation with managers during the year.
5. Internal audit work is carried out to fulfil the audit plan, endorsed by the committee and the Corporate Leadership Team. The plan is derived from corporate and service risk registers as well as any inherent risks such as a susceptibility to fraud associated with an individual system. Internal audit work seeks to provide assurance that the risks identified in the registers and within the systems risk matrix are mitigated by a sound system of internal control.
6. This annual report provides members of the Audit Committee with:
 - the Chief Internal Auditor’s opinion for 2019-20
 - a review of the system of internal control;
 - a summary of the work undertaken by internal audit in 2019-20; and
 - an overview of the performance of internal audit.

INTERNAL AUDIT SERVICE

INTERNAL AUDIT ANNUAL REPORT 2019-20

DUNCAN WILKINSON, CHIEF INTERNAL AUDITOR

June 2020

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**LGSS Internal Audit & Risk Management
Annual Report 2019-20**

Norwich City Council

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Section 1

1. INTRODUCTION

1.1 The Annual Reporting Process

1.1.1 The Public Sector Internal Audit Standards (PSIAS) (Performance Standard 2450) state that the Chief Audit Executive (CAE) must deliver an annual internal audit opinion and report that can be used by the organisation to inform its annual governance statement (AGS) that also forms part of the official Accounts for the Council. Norwich City Council's Chief Audit Executive is the LGSS Chief Internal Auditor.

1.1.2 The annual report is required to 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 plan.

Section 2

2. CHIEF INTERNAL AUDITOR OPINION 2019-20

2.1 Chief Internal Auditor Opinion

2.1.1 The CAE required Annual opinion must be based on an objective assessment of the framework of governance, risk management and control and include an evaluation of the adequacy and effectiveness of controls in responding to risks within the organisation's governance, operations and information systems.

2.1.2 My opinion is derived from an assessment of the range of individual opinions arising from assignments contained within the risk-based Internal Audit Plan. This assessment has taken account of the relative materiality of these areas, and management's progress in addressing control weaknesses.

2.1.3 PSIAS also requires the CAE to confirm that the Internal Audit service has operated with an adequate level of resource to deliver an annual audit opinion. Internal Audit operates independently of the organisation, and there have been no compromises of Internal Audit's independence in its operation this year. I confirm the internal audit team's operation was compliant with PSIAS requirements.

*Based on audit work undertaken during the 2019-20 financial year, the CAE is able to conclude with an opinion of a **satisfactory** assurance being given on the internal control environment. This has reduced from the 'good' assurance given in 2018-19.*

Underpinning the satisfactory assurance opinion are the key financial systems. The audit review of these systems has confirmed that they are well established and that they continue to operate effectively in practice.

However, there are outstanding significant recommendations from the work undertaken by Internal Audit relating to the Council's wholly owned company, Norwich Regeneration Ltd (see 4.1.4), and contract management in the Council (see 4.5.3). Good contract management will become increasingly urgent as the Council progresses the planned restructures of some key contracts and delivery vehicles.

The Council's corporate risk register is in need of urgent review by officers followed by the prescribed member challenge. An updated risk register would be able to capture and assess the key controls in place to mitigate the triggers and consequences to identified risks. This would be of significant benefit to stakeholders when assessing the management of risks and triggers in emerging areas such as the commercial investment strategy and service delivery & contract management. The Annual Governance Statement should specifically reference these three areas (Risk Management, NRL and contract management) and include an agreed action plan to improve governance of these risks during 2020/21.

No systems of control can provide absolute assurance against material misstatement or loss, nor can Internal Audit give that assurance.

- 2.1.4 It is highlighted that the work supporting the above opinion pre-dates the current Covid19 pressures and Council operations. Covid19 as a national, unprecedented incident will have undoubtedly presented challenges to governance and control systems. It is essential the 2020/21 internal audit programme properly reflects that risk environment to ensure an evidenced and properly informed 2020/21 audit opinion and annual governance statement.

Section 3

3. REVIEW OF INTERNAL CONTROL

3.1 How Internal Control is reviewed

- 3.1.1 In order to support the annual CAE opinion on the internal control environment, each year Internal Audit develops a risk-based Audit Plan. This includes a comprehensive range of work to evidence the assurances provided to stakeholders as part of the system of internal audit.

- 3.1.2 The changing public sector environment and emergence of new risks increasingly necessitates re-evaluation of the Audit Plan throughout the year. Suggestions for change to the agreed Plan are discussed with the Director of Resources (on behalf of CLT) who also makes suggestions for inclusion or deletion. Changes to the Audit Plan agreed by the Director of Resources are reported to the Audit Committee as part of the quarterly updates.
- 3.1.3 Each internal audit review has up to three key elements. Firstly, the control environment is reviewed by identifying the objectives of the system and then assessing the controls in place mitigating the risk of those objectives not being achieved. Completion of this work enables Internal Audit to give an assurance on the control environment.
- 3.1.4 However, controls are not always complied with, which will in itself increase risk, so the second element of an audit is to ascertain the extent to which the controls are being complied with in practice. This enables Internal Audit to give an opinion on the extent to which the control environment, designed to mitigate risk, is being complied with.
- 3.1.5 Finally, where there are significant control environment weaknesses or where key controls are not being complied with, further substantive testing is undertaken to ascertain the impact these control weaknesses are likely to have on the organisation's control environment as a whole.
- 3.1.6 Up to three assurance opinions are therefore given at the conclusion of each audit: control environment assurance, compliance assurance, and organisational impact. To ensure consistency in reporting, the following definitions of audit assurance are used:

Control Environment Assurance	
Level	Definitions
Substantial	There are minimal control weaknesses that present very low risk to the control environment.
Good	There are minor control weaknesses that present low risk to the control environment.
Satisfactory	There are some control weaknesses that present a medium risk to the control environment.
Limited	There are significant control weaknesses that present a high risk to the control environment.
No Assurance	There are fundamental control weaknesses that present an unacceptable level of risk to the control environment.

Compliance Assurance	
Level	Definitions
Substantial	The control environment has substantially operated as intended although some minor errors have been detected.
Good	The control environment has largely operated as intended although some errors have been detected.
Satisfactory	The control environment has mainly operated as intended although errors have been detected.
Limited	The control environment has not operated as intended. Significant errors have been detected.
No Assurance	The control environment has fundamentally broken down and is open to significant error or abuse.

3.1.7 Organisational impact will be reported as major, moderate or minor (as defined below).

Organisational Impact	
Level	Definitions
Major	The weaknesses identified during the review have left the Council open to significant risk. If the risk materialises it would have a major impact upon the organisation as a whole.
Moderate	The weaknesses identified during the review have left the Council open to medium risk. If the risk materialises it would have a moderate impact upon the organisation as a whole.
Minor	The weaknesses identified during the review have left the Council open to low risk. This could have a minor impact on the organisation as a whole.

3.2 *The Basis of Assurance*

3.2.1 The findings and assurance levels provided by the reviews undertaken throughout 2019-20 by Internal Audit form the basis of the annual opinion on the adequacy and effectiveness of the control environment.

3.2.2 In 2019-20, the Audit Plan (approved by the Council's Audit Committee) has been based on assurance blocks that each give an opinion on the key control environment elements, targeted towards in-year risks, rather than a more traditional cyclical approach that looks at each system over a number of years. The Audit Plan reflects the environment in which the public sector audit operates, recognising that this has changed considerably over the past few years with more focus on, for example, better assurance and governance.

Section 4

4. INTERNAL AUDIT IN 2019-20

4.1 Overview and Key Findings

4.1.1 This section provides information on the audit reviews carried out in 2019-20, by assurance block.

4.1.2 Where reviews identify opportunities for improvement, these are agreed with management as part of an action plan. The actions are prioritised according to the significance of the control weakness, and urgency of implementing the improved control. Actions are given a rating of essential, important or standard priority:

E Essential	I Important	S Standard
<p>Failure to address the weakness has a high probability of leading to the occurrence or recurrence of an identified high-risk event that would have a serious impact on the achievement of service or organisational objectives, or may lead to significant financial/ reputational loss.</p> <p>The improvement is critical to the system of internal control and action should be implemented as quickly as possible.</p>	<p>Failure to respond to the finding may lead to the occurrence or recurrence of an identified risk event that would have a significant impact on achievement of service or organisational objectives, or may lead to material financial/ reputational loss.</p> <p>The improvement will have a significant effect on the system of internal control and action should be prioritised appropriately.</p>	<p>The finding is important to maintain good control, provide better value for money or improve efficiency. Failure to take action may diminish the ability to achieve service objectives effectively and efficiently.</p> <p>Management should implement promptly or formally agree to accept the risks.</p>

4.1.3 Essential and important priority actions are actively monitored by Internal Audit to ensure they are implemented promptly, and progress is reported to the Audit Committee during the year. An overview of essential and important recommendations made in 2019-20 is summarised in Table 1 below:

Table 1: Essential and important recommendations

2019-20 Audit title	Essential priority recommendations	Important priority recommendations
Review of Mailings Using the Insertion Machine	0	5

Payroll	0	3
Housing Rents/Arrears	0	1
Housing Benefits	0	3
Council Tax	0	0
NNDR	0	0
Treasury Management	0	1
Contract Management	5	3
Scheme of Delegation Compliance	0	2
Commercial Property Investment Strategy	0	1
Contract Extensions	0	1
Annual Key Policies and Procedures Review	0	3
Total	5	23

4.1.4 The 2018-19 internal audit review of the Councils wholly owned company Norwich Regeneration Ltd (NRL) identified 8 recommendations as follows:

2018-19 Audit title	Essential priority recommendations	Important priority recommendations
Norwich Regeneration Ltd	5	3

4.1.5 Internal Audit has not had assurance from management that all of the recommendations made following the review of NRL (reported to Audit Committee in March 2019) have been fully implemented. In addition there has been no confirmation that arrangements for an independent internal audit of the company have been made. Without these key recommendations being implemented the Council has no reliable assurance that outcomes expected of the Company are being achieved (or indeed reasons why outcomes are not as expected) nor any assurance that those governance arrangements and practices operating within the company are in line with those expected by the Council. It should also be noted that internal audit was not asked to review or challenge any of the revised business cases relating to the Council's relationship with this Company. Robust and independent scrutiny and oversight of NRL remains a significant risk (representing opportunity and threat) to the Council and the governance arrangements of this partnership should be the subject of a full audit during 2020/21.

4.2 *Financial and Other Key Systems*

4.2.1 This is the 2019-20 suite of annual core systems reviews, undertaken to provide assurance to management and External Audit that expected controls are in place for key financial systems; that these controls are adequately designed and are routinely complied with in practice. The work is focused on the systems that have the highest financial risk; these are agreed in advance with External Audit and assist in providing assurance to External Audit that systems recording transactions within the 2019-20 financial year are free

from material misstatement. These reviews also give an opinion as to the effectiveness of financial management procedures and the arrangements to ensure the integrity of accounts.

- 4.2.2 Audit coverage during the year has provided sufficient evidence to conclude that the key financial control systems are sound and that these controls continue to work well in practice although there are some minor areas where improvements have been recommended. Table 2 below details the assurance levels of all key systems audits undertaken in 2019-20, compared to assurance levels in 2018-19.

Table 2: Key Financial Systems Audits 2019-20:

Key Financial Systems:	Audit Opinion 2019-20		Audit Opinion 2018-19	
	Environment	Compliance	Environment	Compliance
Accounts Receivable	Good	Good	Substantial	Substantial
Purchase to Pay	Good	Satisfactory	Substantial	Substantial
Bank Reconciliation	Good	Satisfactory	No Audit	No Audit
Payroll	Satisfactory	Substantial	Completed in 19-20	
Housing Rents & Arrears	Good	Good	Good	Good
Housing Benefits	Good	Good	Good	Good
Council Tax	Substantial	Good	Good	Good
NNDR	Substantial	Good	Substantial	Good
Treasury Management	Good	Good	Good	Good

- 4.2.3 The above provides a strong basis for assurance and effective financial management across all key financial systems.
- 4.2.4 The payroll system review concluded the control environment was satisfactory and the compliance was substantial. The findings identified that (as at October 2019) the co-operation agreement with Sefton had not been signed, third party assurance from the payroll provider over their payroll IT systems and processes is not yet held and that copies of monthly payroll reports used for the finance reconciliations are accessible by some staff who do not need access to these records.

4.3 *Anti-fraud and corruption*

- 4.3.1 This is a high-risk area across the public sector. LGSS Internal Audit undertakes work on anti-fraud and corruption which includes both reactive and pro-active elements, along with a number of initiatives to raise awareness of the council's anti- fraud and corruption culture.

- 4.3.2 Internal audit investigated one referral under the Whistleblowing Policy. Recommendations were made and accepted fully by management although these should be followed up to ensure compliance as part of the 2020/21 internal audit coverage.
- 4.3.3 The Council fully participates in a national data matching exercise known as the National Fraud Initiative (NFI) which is run by the Cabinet Office to prevent and detect fraud. Data matching, between public and private sector bodies, flags up inconsistencies in data that may indicate fraud and error and helps Councils to complete proactive investigations. Reports from the 2018-19 exercise were made available in February 2019. The results were analysed in 2019-20 with no major issues to report.

4.4 *Risk Management*

- 4.4.1 The current corporate risk register was presented to Audit Committee in January 2020 to allow committee to consider whether the control environment outlined in the register is sufficient to mitigate the triggers identified and therefore effectively manage the corporate risks of the Council, i.e. within the accepted risk appetite.
- 4.4.2 The corporate risk register is in need of updating and full adherence to the agreed risk management process, including member challenge, should be a priority for the Council in 2020/21.

4.5 *Contract Management*

- 4.5.1 The absence of robust contract management arrangements for key contracts of the Council has directly impacted on the CAE annual assurance.
- 4.5.2 An internal audit review of contract management arrangements concluded that the control environment and compliance assurance was limited with a total of 18 recommendations made. Internal audit has not received any response from management regarding the issue of this report. Therefore, there has been no agreement of the numerous recommendations made and no timetable for implementation presented. Examples of weaknesses identified as part of the audit review included a lack of evidence being retained supporting incentivisation share for the Council, annual open book reviews not being completed and multiple issues regarding the collection and monitoring of key performance indicators (KPI's).

4.6 *Policies and procedures*

- 4.6.1 Effective policies and procedures drive the culture and risk appetite of the organisation and ensure key control principles are captured. A number of

policies and procedures were reviewed to ensure they were; up to date; fit for purpose; effectively communicated; routinely complied with across the organisation; monitored and routinely improved.

4.6.2 Internal audit reviewed procedures in place, such as an overarching policy framework, to ensure that key policies are reviewed, updated and effectively communicated and also that this framework is complied with. The review gave satisfactory assurance over the control environment and compliance. The review confirmed the Council does not have an appropriate policy framework in place which ensures that key policies are reviewed, updated and effectively communicated. A number of the key policies have not been updated within the last three years and/or do not detail who is responsible for reviewing and updating and embedding these policies.

4.7 *Compliance*

4.7.1 The planned audit work assessing compliance with key controls is informed by an assessment of the Council's framework of controls (often directed by policies and procedures) and includes a focus on those core areas where a high level of compliance is necessary for the organisation to carry out its functions properly. The work involves compliance checks across the organisation to provide assurance on whether key policies and procedures are being complied with in practice. As a part of this work, the existing controls are challenged to ensure that they are modern, effective and proportionate.

4.7.2 The Plan for 2019-20 included coverage of compliance in the following areas:

- Corporate Key Performance Indicators
- Scheme of Delegation
- Commercial Property Investment Strategy
- Contract Extensions

4.7.3 Good assurance was given for compliance with agreed key controls.

4.8 *Other Work*

4.8.1 Internal Audit continues to provide advice and guidance to officers on a wide range of issues, including the interpretation of Council policies and procedures, risks and controls within systems or processes, and ad-hoc guidance on queries relating to projects or transformation. Internal Audit aims to provide clear advice and risk-based recommendations with a view to reducing bureaucracy whilst maintaining a robust control environment. Where appropriate, we also refer queries or concerns on to specialist services such as Information Governance or IT Security.

- 4.8.2 In addition to audit reviews, a member of the audit team sat on the Corporate Information Assurance Group, which reviews network issues, data protection, information risk and assurance, security breaches and information management.
- 4.8.3 There were a number of data incidents which were reviewed by key employees, including a member of the audit team, in accordance with the Council's incident response plan. A particular data breach raised concerns about the process using the outward mail insertion machine, consequently the Director of Resources commissioned internal audit to review the controls within the process and procedure notes for sending out mail. Internal audit identified recommendations for further development which were all agreed by the service.
- 4.8.4 The Internal Audit team reviewed disabled facility grant capital expenditure. This enabled the Council to provide a statement of assurance to Norfolk County Council that capital expenditure had been spent according to their grant conditions.
- 4.8.5 The Principal Auditor sat on the joint ventures project board with the Senior Auditor attending the project groups, these have been to provide a 'critical friend' role rather than giving assurance.

4.9 *Summary of Completed Reviews*

- 4.9.1 A summary of all audit reports issued in 2019/20 is attached at Appendix 1.

Section 5

5. INTERNAL AUDIT PERFORMANCE AND QUALITY ASSURANCE

5.1 Delivery of the 2019-20 Internal Audit Plan

- 5.1.1 It is good practice to keep audit plans under review and update them to reflect emerging risks, revisions to corporate priorities, and resourcing factors which may affect the delivery of the audit plan. It was agreed that the final internal audit plan for Norwich City Council delivered through LGSS, would provide 450 days of audit activity and quarterly updates are provided to the Audit Committee. As at March 2020 the actual delivery of internal audit days was approximately 500 days with a greater emphasis on training and development of the two colleagues that will remain working for the Council on 1st April 2020 including giving these colleagues an increased exposure to roles currently carried out by the Internal Audit Manager. This has inevitably resulted in a pressure on days that has been absorbed by LGSS internal audit i.e. an over delivery of days against those planned.

5.1.2 Internal audit has complied with all of their LGSS performance measures for the duration of 2019-20.

5.2 *Customer Feedback*

5.2.1 When final reports are issued, Internal Audit issue Customer Feedback Questionnaires to all officers who receive the final report, and request feedback. Officers have the opportunity to score the Internal Audit team against a range of criteria on a scale of:

- Excellent
- Good
- Satisfactory
- Poor

Officers also have the option of providing more detailed feedback.

5.2.2 Two questionnaires were returned following audit reports issued in 2019-20, both responses received a score of 'good' with no additional feedback.

5.3 *Compliance with Public Sector Internal Audit Standards*

5.3.1 The internal audit service has operated in compliance Public Sector Internal Audit Standards throughout the year.

INTERNAL AUDIT
6.0 Summary of Completed Reviews 2019-20:

The table below summarises the Internal Audit reviews that were completed during the 2019-20 financial year.

Audit title	Control Environment assurance	Compliance assurance	Organisational impact
Anti-Fraud and Corruption			
National Fraud Initiative	Embedded assurance		
Fraud Investigations	No level of opinion was allocated.		
Key Financial Systems			
Accounts Receivable	Good	Good	Minor
Purchase to Pay	Good	Satisfactory	Minor
Payroll	Satisfactory	Substantial	Minor
Housing Rents and Arrears	Good	Good	Minor
Housing Benefits	Good	Good	Minor
Council Tax	Substantial	Good	Minor
NNDR	Substantial	Good	Minor
Bank Reconciliations	Good	Satisfactory	Minor
Treasury Management	Good	Good	Minor
Risk Management			
Strategic Risk Management	Embedded assurance		
Contracts			
Contract Management	Limited	Limited	Moderate
Joint ventures	No level of opinion was allocated		
Policies & Procedures			
Key Policies & Procedures	Satisfactory	Satisfactory	Minor
Compliance			
Key Performance Indicators	In progress		
Scheme of Delegation Compliance	Good	Substantial	Minor
Commercial Property Investment Strategy	Good	Good	Minor
Contract Extensions	Satisfactory	Good	Minor
Grant assurance			
Disabled Facility Grant	Embedded assurance		