Report to	Audit Committee	**Item**
	12 June 2018	
Report of	Chief Internal Auditor, LGSS	**6**
Subject	Annual audit report on internal audit and fraud 2017-18	

Purpose

To inform members of the Chief Internal Auditor's annual audit opinion for 2017-18, 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 2017-18.

Recommendation

To consider the annual Internal Audit report and opinion, noting the work of Internal Audit team for 2017-18.

Corporate and service priorities

The report helps to meet the corporate priority Value for money services

Ward/s: All wards

Cabinet member: Councillor Kendrick – Resources

Contact officers

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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, appendix 1, provides members of the Audit Committee with:

   - the Chief Internal Auditor's opinion for 2017-18;
   - a review of the system of internal control;
   - a summary of the work undertaken by internal audit in 2017-18; and
   - an overview of the performance of internal audit.

INTERNAL AUDIT SERVICE

INTERNAL AUDIT ANNUAL REPORT 2017/18

DUNCAN WILKINSON, CHIEF INTERNAL AUDITOR   1st May 2018

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LGSS Internal Audit & Risk Management
Annual Report 2017/18

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 2017/18**

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 independent of the organisation, and there have been no compromises of Internal Audit's independence in its operation this year. I confirm the above was compliant with PSIAS requirements.

> *On the basis of the audit work undertaken during the 2017/18 financial year, an opinion of **good** assurance is awarded. The internal control environment (including the key financial systems, risk and governance) is well established and operating effectively in practice. In addition, there are no outstanding significant issues arising from the work undertaken by Internal Audit*
>
> *However, no systems of control can provide absolute assurance against material misstatement or loss, nor can Internal Audit give that assurance.*
>
> *I am pleased to report that the level of assurance therefore remains at a similar level from 2016/17.*

Section 3

3.   REVIEW OF INTERNAL CONTROL

3.1   How Internal Control is reviewed

3.1.1   In order to support the annual Internal Audit opinion on the internal control environment, each year Internal Audit develops a risk-based Audit Plan. This includes a comprehensive range of work to confirm that all assurances provided as part of the system of internal audit can be relied upon by stakeholders.

3.1.2   The changing public sector environment and emergence of new risks increasingly necessitates re-evaluation of the Audit Plan throughout the year. The plan, and subsequent revisions is reported to the Audit Committee throughout the financial year.

3.1.3   Each Internal Audit review has 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 part 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 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). All reports with major organisation impacts are reported to CLT, along with the agreed action plan.

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.

3.1.8 Specifically for the compliance reviews undertaken, the following definitions will be used to assess the level of compliance in each individual reviewed:

Opinion for Compliance Audits – Levels of Compliance	
Level	**Definitions**
High	There was significant compliance with agreed policy and/or procedure with only minor errors identified.
Medium	There was general compliance with the agreed policy and/or procedure. Although errors have been identified there are not considered to be material.
Low	There was limited compliance with agreed policy and/or procedure. The errors identified are placing system objectives at risk.

3.2 The Basis of Assurance

3.2.1 The findings and assurance levels provided by the reviews undertaken throughout 2017/18 by Internal Audit form the basis of the annual opinion on the adequacy and effectiveness of the control environment.

3.2.2 In 2017/18, the Audit Plan 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, safeguarding and making every penny count.

4. INTERNAL AUDIT IN 2017/18

4.1 Overview and Key Findings

4.1.1 This section provides information on the audit reviews carried out in 2017-18, by assurance block.

4.1.2 For the reviews undertaken during 2017/18, there were no areas identified where it was considered that, if the risks highlighted materialised, it would have a major impact on the organisation as a whole.

4.1.3 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:

	Essential		**Important**		**Standard**
E	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. The improvement is critical to the system of internal control and action should be implemented as quickly as possible.	**I**	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. The improvement will have a significant effect on the system of internal control and action should be prioritised appropriately.	**S**	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. Management should implement promptly or formally agree to accept the risks.

4.1.4 Essential 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 2017/18 is summarised in Table 1 below:

Table 1: Essential and important recommendations

Audit title	Essential priority recommendations	Important priority recommendations
Housing rent and arrears		4
Housing benefits and council tax reduction scheme		2
Council Tax		1
NNDR		1
Debt recovery (sundry debtors)		11
Business continuity policy and management		10
Total	**0**	**29**

4.2   Financial and Other Key Systems

4.2.1   This is the 2017/18 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 2017/18 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. The level of assurance provided for all key financial systems reviews was good overall. Table 2 below details the assurance levels of all key systems audits undertaken in 2017/18, compared to assurance levels in 2016/17.

Table 2 – Key Financial Systems Audits 2017/18

Key Financial Systems:	Audit Opinion 2017-18		Audit Opinion 2016-17	
	Environment	**Compliance**	**Environment**	**Compliance**
Accounts Receivable	Substantial	Substantial	Substantial	Substantial
Purchase to Pay	Substantial	Substantial	Substantial	Substantial
Payroll	Substantial	Substantial	Substantial	Substantial
Housing Rents &	Good	Good	Good	Good

Arrears				
Housing Benefits	Good	Satisfactory	Substantial	Good
Council Tax	Substantial	Good	Substantial	Substantial
NNDR	Substantial	Good	Substantial	Substantial
Treasury Management	Substantial	Substantial	Substantial	Substantial
Debt Recovery	Satisfactory	Satisfactory	Good	Satisfactory

4.2.3 The housing rents and arrears review concluded that the control environment and compliance assurance was good. A recommendation was made to periodically review instalment payment arrangements for recovery of debts to ensure that a realistic amount is being recovered. In addition a recommendation was also made that procedures are put in place for debts to be progressed to small claims court when internal recovery attempts have failed.

4.2.4 The review of housing benefits concluded that there was good assurance over the control environment and satisfactory assurance for compliance. The service has acknowledged that due to resourcing issues there are backlogs in work required to recover overpayments. Recovery work is being carried out for new cases of overpayments, but older debt is not being regularly reviewed.

4.2.5 The debt recovery review concluded that control environment and compliance assurance was satisfactory. Since the last audit there has been a re-organisation of financial services and new staff within the exchequer team. The transactional finance and systems manager is currently seconded full-time as the implementation lead for the new financial and HR system, for which the planned commencement date for the finance system is April 2019. Existing strategies, policies and procedures will need to be reviewed and updated alongside the new financial system.

4.3 Making every penny count

4.3.1 This assurance block incorporates the on-going work on initiatives to promote the value of making every penny count across the organisation.

4.3.2 A review of invoices over £500 identified that authorisations on the financial system (Oracle) are not always completed by the budget holder, or in line with the delegation forms for authorisation of payments. From the invoices tested, it was considered that the various payments had been authorised by an appropriate manager, however the delegation forms were not always set up in line with these requirements. It was recommended that as part of the project for installation of the new finance system, the council should seek opportunities to improve the system hierarchies / authorisations of

payments. As management were already aware of this, and the project is now in progress, there were no actions reported.

4.4   Anti-fraud and corruption

4.4.1   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.

4.4.2   Internal audit was not involved in any major investigations during the year. There were a small number of low-level data breaches which were reviewed by the data breach response group which involved the principal audit manager/principal auditor, in accordance with the council's incident response plan. Actions were put in place to reduce the risk of recurrence.

4.4.3   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 2017-18 Council Tax Single Person Discount exercise were made available in February 2018. The results will be analysed in 2018/19.

4.5   Policies and procedures

4.5.1   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.

4.5.2   This provided assurance that policies, such as Business Continuity Policy and Information Governance policies are regularly and updated. This helps ensure they are effective and fit for purpose.

4.5.3   The review of the business continuity policy concluded that the control environment and compliance assurance was satisfactory. Whilst the corporate business continuity policy is a detailed and usable plan for incident management, it is incomplete and has not yet been widely published.

4.5.4   The review of information governance policies concluded that the control environment and compliance assurance was good. Overall the systems are operating as intended, there is good assurance, and there were no significant recommendations.

4.6 Compliance

4.6.1 Compliance work is fundamental, as it provides assurance across all Directorates and therefore underpins the Head of Internal Audit opinion on the control environment. The audit coverage for compliance is underpinned 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.

4.6.2 The Plan for 2017/18 included coverage of compliance in the following areas:

- Compliance with grants to voluntary organisations
- Compliance with procurement cards

4.6.3 The sample testing undertaken for these reviews did not identified any significant non-compliance issues and in both cases no recommendations were made.

4.7 ICT Audit

4.7.1 Reviews undertaken this year include a review of financial system (IT general controls) and information security.

4.7.2 The review of information security identified that the systems are operating as intended, there is good assurance on both the adequacy of the system and compliance and no significant recommendations were made.

4.7.3 The review of financial system (IT general controls) concluded that there was good assurance over the control environment and compliance and no significant recommendations were made.

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 Internal audit also leads on maintaining the council's assurance framework and co-ordinating risk management work across the organisation. Internal audit maintained the corporate risk register in conjunction with Heads of Service, and reported updates to the Corporate Leadership Team, Audit Committee and Cabinet. Two risks are above the Councils risk appetite score, and these have been reported to Cabinet who approved that all reasonable mitigation had been taken.

4.8.3 In addition to audit reviews, the Principal Audit Manager/Principal Auditor sat on the Corporate Information Assurance Group, which reviews network issues, data protection, information risk and assurance, security breaches and information management. This included information security resilience exercises which helps to ensure that the Council can react promptly to incidents, and identify opportunities to improve controls which could reduce the risk of future incidents.

4.8.4 There were a small number of low-level data incidents which were reviewed by key employees, including the Principal Audit Manager/Principal Auditor, in accordance with the Council's incident response plan. Actions were put in place to reduce the risk of recurrence.

4.8.5 The Internal Audit team reviewed disabled facility grant capital expenditure. This enabled Council to provide a statement of assurance, to Norfolk County Council, that capital expenditure had been spent according to their grant conditions.

4.8.6 The Council is implementing a new Finance System for HR and Finance. Internal audit has been assisting the project team by proactively providing advice on governance, facilitating project risk register updates and appropriate internal controls. This will help to mitigate potential control weaknesses prior to system go-live.

4.9 Summary of Completed Reviews

4.9.1 A summary of all audit reports issued in 2017/18 is attached at Appendix 1.

Section 5

5. INTERNAL AUDIT PERFORMANCE AND QUALITY ASSURANCE

5.1 Delivery of the 2017/18 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 would deliver 450 days of audit activity and quarterly updates are provided to CLT and the Audit Committee every quarter.

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   A total of 6 questionnaires were returned following audit reports issued in 2017/18, all responses received either good or excellent 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.

APPENDIX 1

INTERNAL AUDIT

6.0   Summary of Completed Reviews 2017/18:

The table below summarises the Internal Audit reviews that were completed during the 2017/18 financial year.

Audit title	Control assurance	Compliance assurance	Organisational impact
Making Every Penny Count			
Invoices over £500	Good	Good	Minor
Transformation projects	*Embedded assurance		
Anti-Fraud and Corruption			
National Fraud Initiative	*Embedded assurance		
Fraud Investigations	No level of opinion was allocated.		
Key Financial Systems			
Accounts Receivable	Substantial	Substantial	Minor
Purchase to Pay	Substantial	Substantial	Minor
Payroll	In progress	In progress	Minor
Housing Rents & Arrears	Good	Good	Minor
Housing Benefits	Good	Satisfactory	Minor
Council Tax	Substantial	Good	Minor
NNDR	Substantial	Good	Minor
Treasury Management	Substantial	Substantial	Minor
Procurement Governance	In progress	In progress	Minor
Debt Recovery	Satisfactory	Satisfactory	Moderate
Compliance			
Business Continuity Policy	Satisfactory	Satisfactory	Moderate
Information Governance Policies	Good	Good	Minor
Policies & Procedures			
Grants to Voluntary Organisations	Substantial	Good	Minor
Use of Government Procurement Cards	Substantial	Substantial	Minor
ICT and Information Governance			
Information Security	Good	Good	Minor
Financial Systems IT & General Computer Controls	Good	Good	Minor
Governance			

Audit title	Control assurance	Compliance assurance	Organisational impact
Attend Information Governance Group	*Embedded assurance		
Attend Data Breach Response	*Embedded assurance		
Attend Corporate Governance Group	*Embedded assurance		
Risk Management			
Risk Management	*Embedded assurance		
Risk Management Policy	*Embedded assurance		
Grant assurance			
Disabled Facility Grant	*Embedded assurance		
Cycle highways grant	*Embedded assurance		

* Embedded assurance applies to projects / audits where auditors attended project boards or other working groups.