

# Governance, Risk and Best Value Committee

10.00am, Tuesday 31 July 2018

## Internal Audit Opinion and Annual Report for the Year Ended 31 March 2018

Item number           7.1  
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Executive/routine  
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Council Commitments

### Executive Summary

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This report details Internal Audit's annual opinion for the City of Edinburgh Council (the Council) for the year ended 31 March 2018. Our opinion is based on the outcomes of the audits included in the Council's 2017/18 Internal Audit annual plan, and the status of open Internal Audit findings as at 31 March 2018.

Internal Audit considers that significant enhancements are required to the established control environment and governance and risk management frameworks to ensure that the Council's most significant risks are effectively mitigated and managed, and is therefore reporting a 'red' rated opinion, with our assessment towards the middle of this category.

Whilst no 'Critical' Internal Audit findings have been raised, a number of significant weaknesses in the control environment have been identified. Consequently, we believe that the Council's established control environment; governance; and risk management frameworks have not adapted sufficiently to support effective management of the changing risk environment and the Council's most significant risks, putting achievement of the Council's objectives at risk.

This report is a component part of the overall annual assurance provided to the Council, as there are a number of additional assurance sources that the Committee should consider when forming their own view on the design and effectiveness of the control environment and governance and risk management frameworks within the Council.

This report has been prepared in line with Public Sector Internal Audit Standards (PSIAS) requirements.

## Internal Audit Opinion and Annual Report for the Year Ended 31 March 2018

### 1. Recommendations

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- 1.1 It is recommended that the Committee notes the Internal Audit opinion for the year ended 31 March 2018.

### 2. Background

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- 2.1 The Public Sector Internal Audit Standards (PSIAS) provide a coherent and consistent internal audit framework for public sector organisations. Adoption of the PSIAS is mandatory for internal audit teams within UK public sector organisations, and PSIAS require annual reporting on conformance.
- 2.2 It is the responsibility of the Council's Chief Internal Auditor to provide an independent and objective annual opinion on the adequacy and effectiveness of the Council's control environment and governance and risk management frameworks in line with PSIAS requirements. The opinion is provided to the Governance, Risk, and Best Value Committee and should be used to inform the Council's Annual Governance Statement.
- 2.3 The objective of Internal Audit is to provide a high quality independent audit service to the Council, in accordance with PSIAS requirements, which provides assurance over the control environment established to manage the Council's key risks and their overall governance and risk management arrangements.
- 2.4 Where control weaknesses are identified, Internal Audit findings are raised, and management agree recommendations to address the gaps identified. However, it is the responsibility of management to address and rectify the weaknesses identified via timely implementation of these agreed management actions.
- 2.5 The IA definition of an overdue finding is any finding where all agreed management actions have not been implemented by the final date agreed by management and recorded in Internal Audit reports.

### 3. Main report

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#### Internal Audit Opinion

- 3.1 Internal Audit considers that significant enhancements are required to the control environment and governance and risk management frameworks to ensure that the

Council's most significant risks are effectively mitigated and managed, and is raising a 'red' rated opinion (see category 3 at Appendix 1), with our assessment towards the middle of this category.

- 3.2 Whilst no "Critical" Internal Audit findings have been raised, a number of significant weaknesses in the control environment have been identified. Consequently, we believe that the Council's established control environment; governance; and risk management frameworks have not adapted sufficiently to support effective management of the changing risk environment and the Council's most significant risks, putting achievement of the Council's objectives at risk.
- 3.3 This opinion is reflective of the increased number of findings raised in comparison to prior years; the increasing trend in the percentage of open findings that are overdue; and the 30 historic findings reopened as agreed management actions were either not implemented, or had been implemented but not sustained (further detail is included at paragraphs 3.10 – 3.13 below).
- 3.4 Consequently, the Council should endeavour to improve its control environment and governance and risk management frameworks to ensure that all significant risks are effectively managed and mitigated.
- 3.5 This opinion is subject to the inherent limitations of internal audit (covering both the control environment and the assurance provided over controls) as set out in Appendix 2.
- 3.6 Internal Audit is not the only source of assurance provided to the Council as there are a number of additional assurance sources (for example, external audit) that the Committee should consider when forming their own view on the design and effectiveness of the Council's control environment and governance and risk management frameworks.

### **Basis of opinion**

- 3.7 Our opinion is based on the outcome of 27 audits completed across the Council in the year to 31 March 2018, and the status of open internal audit findings as at 31 March 2018 (see Appendix 5).
- 3.8 The audits included in the plan were designed to test the adequacy of the design and operating effectiveness of the Council's control environment, and governance and risk management frameworks, established to mitigate the Council's most significant risks.
- 3.9 The outcomes of two audits referred to the Governance, Risk and Best Value Committee by the Edinburgh Integration Joint Board are also reflected in our opinion, as these specifically relate to Health and Social Care Partnership services delivered by the Council.
- 3.10 As the Council is the administering authority for Lothian Pension Fund (LPF), our opinion also includes the outcome of the four audit reviews performed for LPF and the status of their open audit findings as at 31 March 2018.

- 3.11 A separate Internal Audit opinion for LPF was prepared and presented at the Pensions Audit Committee on 27 June 2018. This was also a 'red' rated opinion, with our assessment towards the middle of this category.
- 3.12 This opinion does not include audit reviews performed for the Lothian Valuation Joint Board (LVJB) and the other arms-length external organisations that currently receive audit assurance from the Council's Internal Audit team.

### **Audit outcomes**

- 3.13 A total of 126 findings were raised (47 High; 55 Medium; and 24 Low) have been raised across a total of 31 completed audits,
- 3.13.1 **Council** - 25 audits were completed, with a total of 109 findings (38 High; 51 Medium; and 20 Low) raised. This includes the outcomes of 4 reviews carried forward from 2016/17;
- 3.13.2 **EIJB** – 2 audits were completed on behalf of the EIJB that relate to Partnership services delivered by the Council, with a total of 6 findings (5 High and 1 Medium) raised;
- 3.13.3 **LPF** - 4 audits were completed with a total of 11 findings (4 High; 3 Medium; 4 Low) raised; and

Note that this does not include any 'Advisory' findings raised.

- 3.14 40% of the High rated findings raised resulted from the Care Homes Assurance; Health and Social Care Purchasing Budget; Building Standards; Drivers Health and Safety; and GIRFEC - Named Person audits, with management actions owned by the Health and Social Care Partnership; Place; Resources (Customer and Human Resources); and Communities and Families directorates.
- 3.15 All 6 of the High rated findings referred to the GRBV by the EIJB Audit and Risk Committee relate directly to Health and Social Care Partnership services delivered by the Council.
- 3.16 Appendix 3 includes details of all 2017/18 completed and 2016/17 carried forward audits for Council and LPF; and referrals from the EIJB Audit and Risk Committee.
- 3.17 Appendix 4 details the 5 2017/18 audits approaching completion.

### **Status of Internal Audit Findings**

- 3.18 There were 86 open Internal Audit findings across Service Areas as at 31 March 2018 Of these, 41 (47%) were overdue (4 High; 27 Medium; and 10 Low).

### **Comparison to Prior Year**

- 3.19 An amber rated opinion was reported in 2017/18 reflecting that the Council's control environment and governance and risk management frameworks were 'generally adequate but with some enhancements required'. This opinion highlighted weaknesses in the control environment and governance and risk management

frameworks with instances of non-compliance with existing controls that (if not addressed), could put achievement of the Council's objectives at risk.

- 3.18 The change in the Council's control environment and governance and risk management frameworks in comparison to 2017/18 is confirmed by:
- 3.18.1 the increased number of total findings raised, with 126 raised in 2017/18 in comparison to 113 and 115 in 2016/17 and 2015/16 respectively;
  - 3.18.2 the increased number of high rated findings raised with 47 raised in 2017/18 in comparison to 26 and 15 in 2016/17 and 2015/16;
  - 3.18.3 the increasing trend in the percentage of open IA findings that are overdue as at 31 March (42% in 2017/18; 40% in 2016/17; 19% in 2015/16); and
  - 3.18.4 the 30 (11 High and 19 Medium) historic Internal Audit findings that have been reopened (dating back to 1 April 2016) where agreed management actions had not been implemented, or were implemented but not sustained.

#### **Internal Audit Independence**

- 3.19 PSIAS require that Internal Audit must be independent and internal auditors' objective in performing their work. To ensure conformance with these requirements, Internal Audit has established processes to ensure that both team and personal independence is consistently maintained and that any potential conflicts of interest are effectively managed.
- 3.20 We do not consider that we have faced any significant threats to our independence during 2017/18, nor do we consider that we have faced any inappropriate scope or resource limitations (for example headcount restrictions) when completing our work.

#### **Conformance with Public Sector Internal Audit Standards**

- 3.21 Internal Audit has not conformed with PSIAS requirements during 2017/18 for the following reasons:
- 3.21.1 There has been insufficient follow-up of Internal Audit findings between April 2015 and October 2017 to monitor and ensure that management actions have been effectively implemented; and
  - 3.22.1 Long term sickness absence and recruitment challenges within the Internal Audit team has impacted completion of the two internal quality assurance reviews included in the 2017/18 Internal Audit annual plan to ensure consistency of audit quality.
- 3.22 We consider that these resourcing challenges have been managed to ensure sufficient and appropriate audit coverage.

#### **Action taken to address instances of non PSIAS conformance**

- 3.23 A manual follow-up process was implemented immediately following identification of the historic issue, and a new software based automated process was implemented in July 2018.

- 3.24 Resources were drawn down from the existing co-source arrangement with PwC to address resourcing gaps and ensure completion of the annual audit plan.
- 3.25 Internal quality assurance reviews will be reinstated taking effect from 1 April 2018, with two quality assurance reviews have been scheduled for completion in the 2018/19 plan year.

#### **4. Measures of success**

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- 4.1 Effective governance, risk management and internal control within the City of Edinburgh Council.

#### **5. Financial impact**

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- 5.1 No direct financial impact.

#### **6. Risk, policy, compliance, and governance impact**

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- 6.1 This report highlights that the Council is currently exposed to increased volumes of risk that puts achievement of its objectives at risk.

#### **7. Equalities impact**

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- 7.1 Not applicable.

#### **8. Sustainability impact**

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- 8.1 Not applicable.

#### **9. Consultation and engagement**

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- 9.1 Not applicable.

#### **10. Background reading/external references**

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- 10.1 [Public Sector Internal Audit Standards](#)
- 10.2 [Lothian Pension Fund Internal Audit Opinion and Annual Report for the Year Ended 31 March 2018 - Item 5.2 Appendix 2](#)
- 10.3 [Internal Audit Report - Historic Internal Audit Findings](#)
- 10.4 [Internal Audit Opinion and Annual Report for the Year Ended 31 March 2017](#)
- 10.5 [Internal Audit Opinion and Annual Report for the Year Ended 31 March 2016](#)

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## **11. Appendices**

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Appendix 1 Internal Audit Annual Opinion Definitions

Appendix 2 Limitations and responsibilities of internal audit and management responsibilities

Appendix 3 Audits completed between 1 April 2017 and 31 March 2018

Appendix 4 Reviews nearing completion

Appendix 5 Status of Internal Audit Findings as at 31 March 2018

# Appendix 1 – Internal Audit Annual Opinion Definitions

The PSIAS require the provision of an annual Internal Audit opinion, but do not provide any methodology or guidance detailing how the opinion should be defined. We have adopted the approach set out below to form an opinion for Lothian Pension Fund.

We consider that there are 4 possible opinion types that could apply to the Council. These are detailed below:

<p><b>1 Adequate</b></p> <p><i>An adequate and appropriate control environment and governance and risk management framework is in place enabling the risks to achieving organisation objectives to be managed</i></p>	<p><b>2 Generally adequate but with enhancements required</b></p> <p><i>Areas of weakness and non-compliance in the control environment and governance and risk management framework that that may put the achievement of organisational objectives at risk</i></p>
<p><b>3 Significant enhancements required</b></p> <p><i>Significant areas of weakness and non-compliance in the control environment and governance and risk management framework that puts the achievement of organisational objectives at risk</i></p>	<p><b>4. Inadequate</b></p> <p><i>The framework of control and governance and risk management framework is inadequate with a substantial risk of system failure resulting in the likely failure to achieve organisational objectives.</i></p>

Professional judgement is exercised in determining the appropriate opinion, and it should be noted that in giving an opinion, assurance provided can never be absolute.



# **Appendix 2 - Limitations and responsibilities of internal audit and management responsibilities**

## **Limitations and responsibilities of internal audit**

The opinion is based solely on the internal audit work performed for the financial year 1 April 2017 to 31 March 2018. Work completed was based on the terms of reference agreed with management for each review. However, where other matters have come to our attention, that are considered relevant, they have been taken into account when finalising our reports and the annual opinion.

There may be additional weaknesses in the Council's control environment and governance and risk management frameworks that were not identified as they were not included in the Council's 2017/18 annual internal audit plan; were excluded from the scope of individual reviews; or were not brought to Internal Audit's attention. Consequently, management and the Committee should be aware that the opinion may have differed if these areas had been included, or brought to Internal Audit's attention.

Control environments, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making; human error; control processes being deliberately circumvented by employees and others; management overriding controls; and the impact of unplanned events.

## **Future periods**

The assessment of controls relating to the Council is for the year ended 31 March 2017. Historic evaluation of effectiveness may not be relevant to future periods due to the risk that:

- the design of controls may become inadequate because of changes in operating environment, law, regulation or other; or
- the degree of compliance with policies and procedures may deteriorate.

## **Responsibilities of Management and Internal Audit**

It is Management's responsibility to develop and effective control environments and governance and risk management frameworks that are designed to prevent and detect irregularities and fraud. Internal audit work should not be regarded as a substitute for Management's responsibilities for the design and operation of these controls.

Internal Audit endeavours to plan its work so that it has a reasonable expectation of detecting significant control weaknesses and, if detected, performs additional work directed towards identification of potential fraud or other irregularities. However, internal audit procedures alone, even when performed with due professional care, do not guarantee that fraud will be detected. Consequently, internal audit reviews should not be relied upon to detect and disclose all fraud, defalcations or other irregularities that may exist.

# Appendix 3 - Audits completed between 1 April 2017 and 31 March 2018

	No. of findings raised			
Note that no 'Critical' rated audit findings have been raised in 2017/18				
Review Title	High	Medium	Low	Totals
<b>Council Wide</b>				
Drivers	3	6	0	9
Phishing Resilience	2	1	0	3
*Cyber – External Vulnerability	3	2	0	5
<b>Totals</b>	<b>8</b>	<b>9</b>	<b>0</b>	<b>17</b>
<b>Safer and Stronger</b>				
Short Term Homelessness Provision	2	3	1	6
CCTV Infrastructure	2	0	0	2
<b>Totals</b>	<b>4</b>	<b>3</b>	<b>1</b>	<b>8</b>
<b>Resources</b>				
Asset Management Strategy	0	3	2	5
Edinburgh Shared Repairs	0	0	2	2
Treasury Controls Design	0	2	0	2
Starters	2	1	0	3
CGI Contract management	0	2	0	2
*IT Disaster Recovery	1	0	0	1
*ICT Monitoring of Contract Payments	0	1	3	4
<b>Totals</b>	<b>3</b>	<b>9</b>	<b>7</b>	<b>19</b>
<b>Communities and Families</b>				
Foster Care Review	1	2	1	4
*'GIRFEC' – Named Person	3	1	0	4
<b>Totals</b>	<b>4</b>	<b>3</b>	<b>1</b>	<b>8</b>
<b>Strategy and Insight</b>				
Project Benefits Realisation	2	0	0	2
Resilience	2	2	1	5
<b>Totals</b>	<b>4</b>	<b>2</b>	<b>1</b>	<b>7</b>
<b>Health and Social Care</b>				
Care Homes	4	12	4	20
Social Work Centre Bank Account Reconciliations	2	0	0	2
EADP Contract Management	1	2	1	4
<b>Totals</b>	<b>7</b>	<b>14</b>	<b>5</b>	<b>26</b>

# Appendix 3 (cont) - Audits completed between 1 April 2017 and 31 March 2018

Review Title	No. of findings raised			
	High	Medium	Low	Totals
<b>Place</b>				
Port Facility Security Plan	1	4	1	6
Transfer of management dev funding	0	0	0	0
Planning Control - Building Standards	5	0	0	5
Housing Property Services Follow Up	0	1	1	2
Local Development Plan	2	1	1	4
H&S Waste and Recycling	0	4	2	6
<b>Totals</b>	<b>8</b>	<b>10</b>	<b>5</b>	<b>23</b>
<b>Projects</b>				
Ross Bandstand	0	1	0	1
<b>Lothian Pension Fund</b>				
Information Governance	0	2	3	5
IT Resilience and Disaster Recovery	2	0	0	2
Payroll Outsourcing	1	0	1	2
Pensions Tax	1	1	0	2
<b>Totals</b>	<b>4</b>	<b>3</b>	<b>4</b>	<b>11</b>
<b>Reviews referred by the EIJB Audit and Risk Committee</b>				
Heath and Social Care Purchasing Budget Management	4	0	0	4
Review of Social Care Commissioning	1	1	0	2
<b>Totals</b>	<b>5</b>	<b>1</b>	<b>0</b>	<b>6</b>
<b>2017/18 Total – 32 Audits</b>	<b>47</b>	<b>55</b>	<b>24</b>	<b>126</b>
<b>2016/17 Total – 38 Audits</b>	<b>26</b>	<b>65</b>	<b>22</b>	<b>113</b>
<b>2015/16 Total – 35 Audits</b>	<b>15</b>	<b>66</b>	<b>34</b>	<b>115</b>

\* Audits carried forward from 2016/17

## Appendix 4 – 2017/18 Reviews nearing completion

The following table shows the Internal Audit reviews from the 2017/18 Internal Audit plan that are nearing completion at the time of preparing this report.

<b>Service Area</b>	<b>Title</b>
Resources	Customer Transformation
Resources / Place	St James Project
Place	Zero Waste Project
Place	Structures and Flood Prevention
Place	Fleet Project

## Appendix 5 – Status of Internal Audit Findings at 31 March 2018

Directorate / Service Area	Open Findings	Overdue Findings			
		High	Medium	Low	Total
Communities and Families	4	0	2	1	3
Health and Social Care	35	4	8	2	14
Resources (including ICT)	17	0	5	0	5
Pensions	6	0	8	5	13
Place	15	0	4	1	5
Strategy and Insight	6	0	0	1	1
Safer and Stronger Communities	3	0	0	0	0
<b>Total Open and Overdue Findings</b>	<b>86</b>	<b>4</b>	<b>27</b>	<b>10</b>	<b>41</b>