

INTERNAL AUDIT ANNUAL REPORT

AND

ASSURANCE STATEMENT FOR 2016/17

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1. Introduction

1.1 The purpose of this document is to report on the 2016/17 Internal Audit work and to provide the Chief Internal Auditor's annual internal audit opinion on the Council's framework of governance, risk management and control.

1.2 *Governance*

Governance comprises the arrangements put in place to ensure that the intended outcomes for stakeholders are defined and achieved. The fundamental function of good governance in the public sector is to ensure that entities achieve their intended outcomes while acting in the public interest at all times. Acting in the public interest requires: -

- (a) Behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law.
- (b) Ensuring openness and comprehensive stakeholder engagement.

Good governance in the public sector also requires effective arrangements for: -

- (c) Defining outcomes in terms of sustainable economic, social, and environmental benefits.
- (d) Determining the interventions necessary to optimise the achievement of the intended outcomes.
- (e) Developing the entity's capacity, including the capability of its leadership and the individuals within it.
- (f) Managing risks and performance through robust internal control and strong public financial management.
- (g) Implementing good practices in transparency, reporting, and audit, to deliver effective accountability.

1.3 The Council has in place a Local Code of Corporate Governance which complies with the CIPFA/SOLACE publication "Delivering Good Governance in Local Government – Framework". The Local Code is based on six principles outlined in the Framework, as detailed at 3.1.

1.4 *Risk Management*

Risk management is the planned and systematic approach to the identification, evaluation and control of risk. The objective of risk management is to secure the assets and reputation of the Council and to ensure the continued financial and organisational well-being of the Council. The Council approved an updated policy and strategy for 2016 – 2018 in December 2016. The measures which the Council seeks to adopt are principles of good management practice which seek to control and balance risk and opportunity.

1.5 *Control Processes and Environment*

The policies, procedures (both manual and automated), and activities that are part of a control framework, designed and operated to ensure that risks are contained within the level that an organisation is willing to accept.

The control environment includes the following elements:

- Integrity and ethical values;
- Management's philosophy and operating style;

- Organisational structure;
- Assignment of authority and responsibility;
- Human resource policies and practices;
- Competence of personnel.

1.6 *Internal Audit*

The Local Authority Accounts (Scotland) Regulations 2014 came into force on 10th October 2014. These regulations set out the requirements for internal auditing as follows: -

“7.- (1) A local authority must operate a professional and objective internal auditing service in accordance with recognised standards and practices in relation to internal auditing.

(2) Any officer or member of a local authority must, as required by those undertaking internal auditing-

(a) make available such documents of that authority which relate to its accounting and other records for the purpose of internal auditing; and

(b) supply such information and explanation as those undertaking internal auditing consider necessary for that purpose.

(3) A local authority must from time to time assess the efficiency and effectiveness of its internal auditing, in accordance with the standards and practices referred to in paragraph (1).

(4) The findings of the assessments referred to in paragraph (3) must be considered, as part of the consideration of the system of internal control referred to in regulation 5(2), at the meeting referred to in regulation 5(3).”

1.7 These regulations established the statutory duty for the Council to have in place an internal audit service.

1.8 The Internal Audit Charter, as approved by Council in April 2016, defines the purpose, authority and responsibility for the Internal Audit service. The Charter conforms to the Public Sector Internal Audit Standards (PSIAS) which came into force on 1 April 2013, and is consistent with the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards*.

1.9 Internal Audit has organisational independence, and this independence was maintained throughout 2016/17.

1.10 The responsibilities, role and authority of Internal Audit are summarised in the Council's Financial Regulations which state:

“The primary role of Internal Audit is that of an assurance function which provides an independent and objective opinion on the adequacy of the Council's control environment. Internal audit work is designed to add value and improve an organisation's operations, in particular in evaluating and improving the effectiveness of risk management, control and governance processes. In addition to the provision of assurances, Internal Audit undertakes non-assurance work including consulting services and fraud related work.”

1.11 The Internal Audit Strategy is reviewed and produced annually. A planning exercise is carried out each year to determine priorities and to establish and achieve objectives. This helps to control and direct audit work and to ensure the efficient and effective use of resources.

- 1.12 In carrying out the audit planning, consultation is carried out with the senior managers throughout the Council to produce an audit universe which includes a detailed list of Council services assessed on a number of risk factors. Emphasis is also placed on the Council's risk registers when preparing the audit universe and considering which areas should be subject to audit.
- 1.13 This report details the work that has been completed by the Internal Audit section during 2016/17. The report covers planned work, unplanned work and routine audit work which has been completed. It also sets out the assurances that can be given on the Council's corporate governance systems, the systems of internal controls and risk management arrangements.

2. Overall Opinion

- 2.1 The audit work has confirmed that, for the areas subject to audit review during 2016/17 there are adequate and effective controls operating, subject to the following exclusions:

2.1.1 Pickaquoy Centre Trust

The audit found that generally the principles of the Code of Practice of Following the Public Pound were being followed to varying extents within the Service Agreement and that areas of good practice were evident. Areas where improvements could be made were also identified, both with regard to the content of the Service Agreement and the actual operating arrangements between the Council and the Trust.

High priority recommendations were made, these concerned the following: -

- The Service Agreement should be aligned with the achievement of current Council objectives and priorities relevant to the service area, and should be subject to annual review.
- Performance measures should be included within the Business Plan and these should be approved by Council. Performance targets should also be reported on within the End of Year Performance Monitoring report.
- The Business Plan should be submitted within a timescale to allow it to be considered during the Council's budget setting processes.
- The required testing of Environmental Conditions and Ground Maintenance should be completed each quarter.

2.1.2 Orkney Childcare and Young People's Partnership (OCYPP)

The audit confirmed that good management practices were being followed for budgetary control and management of the Partnership budget.

It was also found however that formal communication and agreement to its Terms of Reference was required between the OCYPP and the Integration Joint Board to support joint working and a unified and efficient approach to child and young person support in Orkney.

Some improvements to procedures were also agreed in order to increase compliance with the Council's policy on Funding External Bodies and Following the Public Pound.

2.1.3 Capital Project Review: Photovoltaic Panels on Council Housing

The audit findings confirmed that installation of the panels had not delivered all of the expected benefits as detailed within the Capital Project Appraisal reports. The income received from the panels was considerably lower than estimated due primarily to the Government reducing the Feed-in-Tariff rates available over the period of the installation and registration of the panels.

The project lacked expediency at key points during its duration, particularly relating to the registration of the panels. The delayed registration of installations contributed to the reduced level of income received.

2.2 The Council's performance and risk management system, Aspireview, is used to monitor implementation of agreed internal audit recommendations. When internal audit reports have been finalised they are uploaded to Aspireview and the identified responsible officers for implementing the audit recommendations are then required to provide an update on the progress being made twice per year, as at the end of September and the end of March.

2.3 The updates provided as at 31 March 2017 have been reviewed in order to assess progress. Whilst there are a number of recommendations which are still to be implemented, including recommendations which are overdue in being progressed, there are no recommendations which remain outstanding which impact on the annual internal audit opinion.

3. Corporate Governance

3.1 The Council approved a Local Code of Corporate Governance in July 2012 based on the CIPFA/SOLACE publication "Delivering Good Governance in Local Government – Framework". The Code sets out best practice and defines the principles that should underpin the governance of local authorities. The six core principles are: -

Principle 1: Focussing on the purpose of the authority and on outcomes for the community and creating and implementing a vision for the local area.

Principle 2: Members and officers working together to achieve a common purpose with clearly designed functions and roles.

Principle 3: Promoting values for the authority and demonstrating the values of good governance through upholding high standards of conduct and behaviour.

Principle 4: Taking informed and transparent decisions which are subject to effective scrutiny and managing risk.

Principle 5: Developing the capacity and capabilities of members and officers to be effective.

Principle 6: Engaging with local people and other stakeholders to ensure robust public accountability.

- 3.2 The Local Code incorporated an annual self-assessment process which was carried out between February and May 2016. The process is undertaken to assess compliance with the principles contained within the Code as detailed at 3.1.
- 3.3 Internal Audit carried out a review of the self-assessment process and confirmed that the self-assessment process was comprehensive, reflected an accurate picture, and due to there being a well-defined process in place, was completed within the required deadlines.
- 3.4 The Annual Governance Statement was issued on time and was structured in accordance with the relevant guidance.

4. Risk Management

- 4.1 The Council has in place a Risk Management Policy and Strategy for 2016 - 2018. The Council's risk management objectives are to: -
1. Ensure that risk management is clearly and consistently integrated and evidenced in the culture of the Council.
 2. Manage risk in accordance with best practice.
 3. Anticipate and respond to changing social, environmental and legislative requirements.
 4. Consider compliance with health and safety, insurance and legal requirements as a minimum standard.
 5. Prevent death, injury, damage and losses, and reduce the cost of incidents and accidents.
 6. Inform policy and operational decisions by identifying risks and their likely impact.
 7. Raise awareness of the need for risk management by all those connected with the Council's delivery of service.
 8. Recognise that good risk management also includes positive risk taking and the identification of opportunities.
- 4.2 The annual governance self-assessment included a review of risk management arrangements. The responses gathered during the self-assessment have been reviewed and have highlighted no concerns regarding the process followed.

5. Achievement of Annual Audit Plan 2016/17

5.1 Planned Audit Work 2016/17

- 5.1.1 The internal audit plan for 2016/17 included audits of core financial systems, other systems, annual audits, corporate reviews, follow up work and computer auditing. A detailed summary of the plan is included as appendix 1 to this report.

5.1.2 The internal audit section has completed the following level of planned work:

Financial systems	- two audits deferred (see para 5.1.3)
Other systems	- six audits complete - one audit substantially complete - one audit deferred - two audits not complete
Annual audits	- nine audits complete
Corporate reviews	- one audit complete
Follow up of action plans	- all audit reports issued have been uploaded and have been monitored via Aspireview
Computer Audit	- one audit complete

5.1.3 Planned audit work which has not been carried out during 2016/17 includes the following: -

- Pension System Migration - It was not possible to carry out the audit during 2016/17 as the pension system migration had not been completed.
- Housing Rents, Capital projects (Appraisal & Management), Grants to funded bodies/third sector (OHAC) and Repairs and Maintenance. These audits were not completed as audit resources had to be diverted to other unplanned audits and investigations. The audits of Housing Rents and Repairs and Maintenance are being included within the audit plan for 2017/18.

5.2 Allocation of Audit Days

5.2.1 In preparing the audit plan for 2016/17, the time required to complete each audit was estimated and days then allocated within the plan. The planning process cannot be an exact science as unplanned issues often arise which have to be addressed immediately. In addition there will be situations where the planned input has to be exceeded for a number of reasons, including the number or materiality of findings encountered, unfamiliarity of staff with new systems, or changes in the personnel involved. A contingency element is allowed for within each annual plan in anticipation of these types of issues arising.

5.2.2 At the end of the year the actual days to complete each audit has been compared to the estimated days. The comparison shows that there were audits which were completed more quickly than expected as well as audits which took longer.

5.2.3 The audit which required a higher number of audit days than had been originally estimated included Procurement (which is substantially complete), the additional time required for this audit was taken from the contingency allowance. The capital project review of photovoltaic panels on Council Housing also required more time than had been scheduled however the time set aside for the capital projects appraisal and management was used to complete this audit.

5.2.4 There were also audits completed which took less time than anticipated including for example the SUMS audit.

5.3 Unplanned Audit Work

5.3.1 Each year the Internal Audit team are asked to undertake audit work that is not included in the annual plan, and a contingency element is built into the plan to allow for this. During 2016/17 the contingency element was exceeded which therefore meant that time had to be diverted from planned audit work, as referred to in 5.1.3.

5.3.2 The unplanned audit work included two investigations. One required substantial internal audit input. This investigation had a significant impact on completion of the internal audit plan for 2016/17.

5.3.3 The contingency allowance included an allocated for audit work connected to the Integration Joint Board. The time allocated for this audit work was also exceeded.

5.3.4 Various other tasks have been carried out throughout the year; whilst these on an individual level do not impact greatly on the audit plan, cumulatively they have taken up a number of days. These tasks include for example responding to service queries, carrying out smaller fact finding exercises, provision of information to external bodies or persons and attending internal meetings.

5.4 Fraud

5.4.1 All frauds over £5,000 require to be reported to Audit Scotland. For 2016/17 no issue was formally reported.

6 Quality Assurance and Improvement Programme

6.1 Internal Audit monitors its performance in a number of ways in order to gauge the effectiveness of the service and to inform future service improvements.

6.2 The PSIAS introduces a specific requirement for the Internal Audit Service to have in place a quality assurance and improvement programme. The purpose of the programme is to “enable an evaluation of the internal audit activity’s conformance with the *Definition of Internal Auditing* and the *Standards* and an evaluation of whether internal auditors apply the *Code of Ethics*. The programme also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunity for improvement.”

6.3 There are two aspects to the programme, an internal assessment and an external assessment.

Internal Assessment

6.4 Internal assessment includes the ongoing monitoring of the performance of internal audit activity. This is part of the day to day work of the Chief Internal Auditor and includes supervision and file review by the Chief Internal Auditor of all audit assignments completed. In addition, Internal Audit produce a mid-year report on the progress made with completing the approved annual plan for the Monitoring and Audit Committee.

- 6.5 Internal assessment also includes a self-assessment which is completed by the Chief Internal Auditor. The “Checklist for Assessing Conformance with the PSIAS and the Local Government Application Note” produced by CIPFA is used for the self-assessment. This provides a very detailed examination of the service and conformance with the required standards. A self-assessment was completed in March 2015 and resulting improvement actions were implemented throughout 2015/16.
- 6.6 The Internal Audit service was also included in the Finance service “How Good is our Council” self-assessment process which took place in 2015/16. This involves a review of a number of factors under the headings of leadership, management, outcomes, processes and stakeholders.
- 6.7 Improvements and developments identified via the self-assessment process have been included within the Internal Audit service actions.
- 6.8 The performance assessment is supplemented by participation in the CIPFA Directors of Finance Performance Indicators benchmarking group. Two indicators are monitored, as follows: -

	2015.16 (OIC)	2015.16 Scottish Comparators	2014.15 (OIC)	2014.15 Scottish Comparators
Cost of internal audit: The cost of internal audit per £million of net expenditure.	£1,582	Highest: £2,098 Lowest: £410	£1,655	Highest: £1,685 Lowest: £570
Efficiency of Adherence to Audit Plan: The actual productive days achieved as a percentage of the productive days as per the audit plan.	91%	Highest: 117% Lowest: 78%	92%	Highest: 110% Lowest: 58%

External Assessment

- 6.9 The Monitoring and Audit Committee approved the Internal Audit Quality Assurance and Improvement Plan on 20 February 2014. Within this plan the Internal Audit teams in Orkney, Shetland and the Western Isles co-ordinate the external assessment of the three Internal Audit services using a framework developed by The Scottish Local Authorities Chief Internal Auditors Group. In November 2015 the Chief Internal Auditor completed the external assessment of the Western Isles Council internal audit service. In June 2016, the assessment on this Council’s service was completed by the Executive Manager for Audit, Risk and Improvement from Shetland Islands Council.
- 6.10 The results of the assessment were reported to the Monitoring and Audit Committee on 29 September 2016. The overall conclusion of the assessment was that the Internal Audit Service substantially conforms with the PSIAS requirements.
- 6.11 There were five areas identified where improvements could be made, these areas were addressed in order for the Chief Internal Auditor to be able to report a position of full compliance with PSIAS. (see table below)

Improvement action recommended	Action taken
1. Electronic documents should be destroyed simultaneously with paper records in accordance with policy requirements.	Data retention timescales were reviewed and electronic internal audit working papers have been either destroyed or archived in accordance with the timescales.

2. To facilitate measurement of customer satisfaction with the internal audit service and overall performance a system should be introduced to obtain feedback following each audit assignment. This should then be considered as part of the Quality Assurance and Improvement programme.	A customer feedback form has been introduced and is issued following the completion of each audit assignment.
3. Consideration should be given to introducing some additional performance indicators. This would again help to inform the Quality Assurance and Improvement Programme.	The customer feedback forms have provided additional performance information, although due to these being introduced mid-year the information is limited for 2016/17.
4. The Internal Audit Charter and Strategy and any other relevant documentation should be revised to reflect that both CMIIA and CCAB are suitable professional qualifications for the Chief Internal Auditor to hold.	The Internal Audit Charter, the Internal Audit Annual Strategy and the Audit Manual have been updated to reflect that both a CCAB (Consultative Committee of Accountancy Bodies) qualification or CMIIA (Chartered Member of the Institute of Internal Auditors) qualification are suitable qualifications for the post of Chief Internal Auditor.
5. The Internal Audit Charter states that management "should inform the Head of Finance and the Council's Internal Audit Section of suspicion of fraud, bribery or irregularity. The Charter and any other documentation should be amended to replace the word should with must.	The Internal Audit Charter and the Corporate Anti-Fraud Policy have been amended so that the documents state that the Head of Finance and Internal Audit must be informed of any suspicion of fraud, bribery or irregularity.

6.12 The Council's external auditors, currently Audit Scotland, assess the Internal Audit Service annually in order to determine the extent of reliance that can be placed on the work of the Service. The external auditors reported the following opinion in their 2015/16 Annual audit report to Members and the Controller of Audit: -

"Internal audit substantially completed its 2015/16 work plan. Our review of internal audit concluded that it complies with the main requirements of the Public Sector Internal Audit Standards and has sound documentation standards and reporting procedures in place. We placed reliance on its key controls work carried out in relation to treasury management."

6.13 In their annual audit plan, February 2016, the Audit Scotland external auditors confirmed that they are planning to place formal reliance on the work of the service as part of their 2016/17 audit.

6.14 In my opinion the Council's Internal Audit Service substantially complies with the PSIAS.

7. Staffing and Training

7.1 The Internal Audit Section consists of 2.8 full time equivalent members of staff. This includes a Chief Internal Auditor, 0.8 FTE and 2 FTE Internal Auditors.

7.2 Training undertaken, by various members of staff, during 2016/17 included: -

- ILEARN courses including:
 - Data Protection
 - Information Security
 - Equality and Diversity
 - Manual handling
 - Freedom of Information
 - Protect against Terrorism
 - Core health, safety and wellbeing
 - Display screen equipment awareness
 - Fire safety awareness
- Prince 2 project management training

7.3 The Chief Internal Auditor is the Council's representative on the Scottish Local Authorities Chief Internal Auditors Group. The group holds quarterly meetings to discuss current audit issues and to share best practice. Three meetings were attended by the Chief Internal Auditor during 2016/17.

7.4 In accordance with the Council's Employee Review and Development Scheme, reviews took place for all Internal Audit staff during June and July 2016.

Olwen Sinclair
Chief Internal Auditor
18 May 2017

Appendix 1

A	Financial Systems	
1	Housing Rents	Deferred to 2017.18
2	Pension system migration	Audit not complete as the system migration had not been completed.
B	Other Systems	
1	Capital Projects (Appraisal and Management)	Time allocated to audit of PV Panels
2	Grants to funded bodies/third sector (OHAC)	Not complete
3	Care home charging	Complete
4	Orkney Childcare & Young People Partnership	Complete
5	Kirkwall Townscape Heritage Initiative	Complete
6	Access to the Countryside	Complete
7	Works and Inspections for Council Owned Properties	Deferred to 2017.18
8	Procurement	Substantially complete
9	Concerto System Migration	Complete
10	Council house photovoltaic panels	Complete
C	Annual Audits	
1	Orkney College – FES return	Complete
2	Orkney College – Discretionary and Childcare Funds	Complete
3	LEADER	Complete
4	Statutory Performance Indicators	Complete
5	Finance Performance Indicators	Complete
6	Cash, asset and security spot checks	Complete
7	Spot Checks – Assets & Misc Funds	Complete
8	Miscellaneous Grant Claims	Complete
9	Election Expenses Accounts (Scottish Parliament and EU Referendum)	Complete
D	Corporate Reviews	
1	Corporate Governance/Risk Management	Complete
E	Follow up of Action Plans	
1	Follow up of Action Plans	Aspireview being used for monitoring progress. Progress made in implementing recommendations is assessed on a six monthly basis
F	Computer Audit	
1	Staffplan System audit	Complete
G	Contingency Allocation	
1	Integration of Health and Social Care Services	Complete