

Governance, Risk and Best Value Committee

10.00am, Thursday 5 March 2015

Internal audit & risk service delivery update

Item number	7.11
Report number	
Executive/routine	
Wards	

Executive summary

The contract between the Council and PwC for the co-sourced delivery of internal audit and risk management services commenced on 1 April 2013. GRBV have been receiving regular reports on the progress of the co-source arrangement with the most recent report submitted to the May 2014 GRBV meeting.

This report sets out developments in the period from May 2014 to date.

Links

Coalition pledges	PO30
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Single Outcome Agreement	

Internal audit & risk service delivery update

Recommendations

- 1.1 Committee is requested to note the significant progress made by the co-sourced internal audit & risk management service in the period from May 2014 to date.

Background

- 2.1 The contract between the Council and PwC for the co-sourced delivery of internal audit and risk management services commenced on 1 April 2013. GRBV have been receiving regular reports on the progress of the co-source arrangement with the most recent report submitted to the May 2014 GRBV meeting.
- 2.2 This report sets out the developments in the co-source arrangement in the period from May 2014 to date.
- 2.3 Independent positive assessment of the progress of internal audit and risk management within the Council was provided by Audit Scotland within the 2014 Best Value report. The following is a summary of their findings:

“The Council has made good progress in developing its approach to scrutiny and risk management. It aims to use these improved arrangements to identify risks earlier and make improvements.

There is evidence that the revised internal audit arrangements are having a positive impact on a number of areas, including:

- Progress against key performance indicators;
- Financial savings;
- Identifying areas requiring further progress; and
- Positive feedback from council service areas about the value of internal audit reviews.”

Main report

Internal audit

Enhancements in our internal audit standards

- 3.1 At the last update in May 2014, Committee commented that it would be helpful to see objective evidence showing progress being made in developing the internal audit service towards being a leading edge function. With that in mind

the internal audit team has chosen this year to assess its overall standards against a new, voluntary, public sector audit standards framework, the Public Sector Internal Auditing Standards (PSIAS). This framework is considerably more stringent than the CIPFA standards with which the function previously complied. The intent of this intensive review was proactively to drive and demonstrate improvement in the quality of the function and align it with best practice. The assessment was performed by in-house council staff, who also oversaw completion of resultant improvement plans.

- 3.2 In doing so, the internal audit service has improved a number of important areas. By way of example, original findings at the outset yielded absolute compliance with approximately 50% of the specific requirements of PSIAS. Following an extensive remediation effort in the current financial year, we are currently positioned at approximately 95% compliance, with two outstanding areas of improvement currently being worked on.
- 3.3 Examples of significant improvement areas are the enhanced documentation of our Internal Audit Charter, internal procedures and independence requirements, the formal linkage of the risk management framework into the annual audit plan proposed for 2015/16 as well as the creation of a PSIAS compliant Quality Assessment & Improvement Program to replace our previous quality framework. Further detail and specific findings from the PSIAS conformance assessment and improvement plan will be separately reported to GRBV in due course.

Enhancements in our internal audit planning

- 3.4 Risk based auditing - The risk linkage for the 2014/15 audit plan has been significantly enhanced by formally referencing risks from the revised risk registers into the overall assurance map for the year. Whilst risk linkage was applied in relation to the 2013/14 audit plan, this was premised on the early development of the risk management framework. During 2014/15 a formal risk based framework has been implemented as outlined below in this report. This is a significant development in the Council's journey to having a proactive risk based assurance system.
- 3.5 Linkage to Corporate Fraud – The Plan for 2015/16 considers the likelihood of fraud occurring in light of the people/process/systems being reviewed. This should serve to complement the annual fraud assessment, which includes the whistleblowing system and the National Fraud Initiative reviews.
- 3.6 Close alignment of Risk and Health & Safety objectives – As part of the 2015/16 Audit Plan internal audit have proposed a combined assessment programme of schools alongside Health & Safety. Joint independent audits of prioritised schools will improve the consistency and efficiency of assessment of schools from a Health & Safety compliance and financial management perspective. The success/learnings from this pilot will be presented to the GRBV during 2015/16.

Enhancements in internal audit service delivery

- 3.7 Specialist involvement - One of the benefits of the co-source arrangement is the ability to draw down on specialist resource from PwC as and when the need arises. A recent example of this is the use of Health & Safety specialists from the PwC London practice, who constructively challenged the proposed Health & Safety improvement programme, providing guidance and comparison to good practice in order to bring further, focussed assurance to the overall approach. This immediate accessibility to subject matter experts exemplifies the quality and impact of the co-source arrangement. Other key areas within the Council such as ICT and pensions have benefited from this arrangement. Following PwC specialist input, the pensions audit work was well received by all key stakeholders this year following challenging feedback received in 2013/14.
- 3.8 Forward looking reviews - We have successfully piloted the concept of a 'Review Recommend' internal audit report. This form of review is relevant when the design of a key control is understood to be ineffective and there is therefore little value in testing the operating effectiveness of that key control. In this scenario it is of more value to perform a 'Review Recommend' procedure, which enables management to consider options to enhance the control environment. During the year the internal audit team performed a pilot Review Recommend assessment of the leavers process. Such reviews are an example of how internal audit has evolved its ability to act in partnership with management, adding value to the organisation.
- 3.9 Follow up process - We have improved our approach to following up internal audit recommendations. The internal audit team had previously had insufficient information to track the status of all open audit recommendations. As a consequence, internal audit reviews were followed up on a review by review basis between 4-9 months after the issue of the audit report. Recommendations that remained outstanding at the end of a follow up review were not routinely subject to any further review by internal audit. The team have introduced enhancements to management reporting processes, including an improvement in electronic working papers, allowing the team to identify and track the status of all open recommendations council-wide. This has enabled internal audit, for the first time, to produce a complete listing of all open items and sort them by their initial estimated closure date. Each service area now receives automated updates of all outstanding actions, allowing central control over progress and enabling the director and senior management to drive accountability using real time information.
- 3.10 To illustrate the impact of this exception reporting enhancement, since the introduction of the new approach the Corporate Governance directorate's reported outstanding items as at 31 December 2014 has reduced from 42 to 3. Many of these actions had already been completed prior to this change in approach, but their closed status would not have previously been easily

identifiable to internal audit. This illustrates how the new reporting process allows visibility and focus on items requiring management action, driving efficiency and accountability.

Enhancements in internal audit training

- 3.11 The core Council staff have continued to work closely with PwC colleagues allowing knowledge transfer through daily audit activities and also through formal training events. These events focus mainly on technical areas related to the internal audit remit, such as reporting quality, quality assurance and treatment of follow up actions.
- 3.12 Within Q4 we also performed an 'internal controls simulation' which was a facilitated session at PwC's offices involving key Council staff who have an important role in governance, risk and controls. This is a professional development exercise designed by PwC to help Boards enhance their understanding of the overall control environment. Feedback on how this event has helped attendees has been very strong.
- 3.13 The Council's 5 new CIPFA graduate trainees are to be offered 6 month rolling placements within the internal audit service as part of their 3 year training contract within the Council. The intent of this initiative is to encourage our trainee staff members to develop an understanding of the internal audit function and enhance their capability and skills, leading to a pipeline of more qualified in-house personnel.

Operational efficiency

- 3.14 Internal audit have continued to refine the audit process to increase efficiency and are currently anticipating completion of 51 reviews in 2014/15, which is in line with the plan for the year. The number of reviews completed per FTE during the audit year has increased from 6.9 per FTE in 2013/14 to 8.5 per FTE in 2014/15, an increase in productivity of over 23%. Appendix 1 sets out information on agreed key performance indicators under the co-source contract.
- 3.15 As noted previously in this report, the evolution of the follow up process from a physical revisit to a corroborated exception report monthly will significantly increase the ability of the audit team to focus on primary reviews.
- 3.16 We continue to experience inefficiencies in the process of closing out reviews with auditees. This process can be cumbersome and in some cases challenging to complete, tying up internal audit resources and leading to a delay in reports being issued. We are actively considering a number of potential initiatives to streamline this process, which will be discussed with management and reported to a future committee meeting.

Risk Management

Establishment of an Enterprise Risk Management System

- 3.17 As recognised in the 2014 Best Value report, the Council has made good progress in enhancing its risk management capability.
- 3.18 As previously reported to Committee, an independent third party review commissioned by the Director of Corporate Governance soon after his appointment in 2012 highlighted that the existing risk function was not adequate for an organisation of the scale and complexity of the Council;
- 3.19 In order to provide flexibility, the internal audit co-source contract with PwC, which commenced in April 2013, was framed to include the ability for the Council to draw down risk management expertise as required to assist in developing our risk management capability.
- 3.20 In August 2013 PwC commenced work with the Council to re-design the Council's risk management arrangements to ensure they were fit for purpose. A report was presented to GRBV in November 2013 identifying the key objectives and progress in relation to this project.
- 3.21 Progress included:
- early development of a risk management framework;
 - collation and gap identification of various risk registers and capture on risk management software (Covalent); and
 - working closely with service area management teams to define risk reporting requirements and revise reporting templates.
- 3.22 The design stage of the risk management system has now been completed and implementation is underway. The following is a summary of improvements in this regard:
- 3.22.1 Implementation of the risk framework - A practical Enterprise Risk Management (ERM) system has been implemented during 2014/15. The framework adopted follows best practice for the private and public sectors;
- 3.22.2 Prioritisation of risks – bespoke voting software has been used to anonymously score risks in terms of impact and likelihood in line with the established risk management policy;
- 3.22.3 Governance - Risks are now formally assessed throughout the organisation on a quarterly basis. The Chief Risk Officer chairs 5 Service Area Risk Committees in advance of the new CMT Risk Committee, allowing objective challenge to identify issues which arise during the period. Through the establishment of a formal, dedicated risk committee,

risk now has a distinct forum and has progressed beyond being an item on the CMT standing agenda;

- 3.22.4 Management Information – Professional reporting packs are presented to each risk committee in advance of discussions. These packs are carefully structured to allow all relevant issues to be considered from a risk perspective and facilitate a focused discussion within the management teams. CMT risks now represent a balance of strategic and common council-wide themes; and
- 3.22.5 Cultural awareness of risk – Management understanding of risk management has markedly improved over the past 12 months. CMT now sets the tone by considering risk as a leadership team. During the year, a facilitated workshop within CMT led to the identification of the most appropriate risks to consider, which were then cascaded to the Service Areas to inform their approach.

Linkage between Risk and internal audit activities

- 3.23 An important aspect of the standing agenda for the quarterly Risk Committees is a comprehensive overview of all assurance activity performed in the period and planned for the quarter ahead. This encourages an appropriate thread of discussion between risk and the provision of assurance. A member of the internal audit team is present during each Risk Committee session. This has allowed further quality in the engagement between the risk and assurance systems.
- 3.24 The Council's Risk Management Policy and internal audit charter have been formally updated to meet current practice and the Public Sector internal audit Standards (PSIAS) requirements respectively. This represents continuous improvement in the standards and application around the 'Second and Third Lines of Defence' for the Council.

Conclusion

- 3.25 Significant progress has been made under the co-sourced arrangement since April 2013, with a marked increase in the quality, capability and efficiency of the internal audit service. The journey of transformation is well underway.
- 3.26 In the 9 months since the previous update report, the focus has been on embedding improvements in quality and consistency as evidenced by the PSIAS conformance assessment discussed above, and in driving continuous improvements in service delivery and value adding activity. The continuing progress in risk management with expertise drawn down under the co-source contract has allowed improved alignment between audit and risk management activity, ensuring the audit plan is linked to the high risk areas of the Council and allowing elected members to gain assurance that internal audit activity is focussed on mitigating the Council's key risks.

- 3.27 The initial three year term of the co-source contract will end in April 2016, with the Council having the option to extend for a further year. In October 2015, six months prior to the end of the initial contracted co-source term, officers will report their recommendations with regard to the optimal arrangements for the delivery of the internal audit function to GRBV and to the Council.

Measures of success

- 4.1 The continued development in capabilities of the internal audit and Risk Management teams into leading practice services.

Financial impact

- 5.1 2011/12 was the last full year of the in-house service. The cost of providing this service was £798,000.
- 5.2 The cost of the service in 2012/13 during the transition phase was £804,000.
- 5.3 The cost of service in 2013/14 was £851,000 which included a one off cost of £36,000 for the provision of additional PwC resource to provide support during a period when the core in house resource was reduced due to exceptional circumstances.
- 5.4 The expected cost of the service for 2014/15 is £753,000.

Risk, policy, compliance and governance impact

- 6.1 Efficient and effective risk management arrangements will help ensure that the Council's key risk areas are identified and monitored.
- 6.2 A strong internal audit function will play a significant role in providing assurance over the controls in place to mitigate the Council's most significant risks.

Equalities impact

- 7.1 No full ERIA is required.

Sustainability impact

- 8.1 None.

Consultation and engagement

- 9.1 None.

Background reading/external references

None.

Alastair Maclean

Director of Corporate Governance

Links

Coalition pledges	PO30 - Continue to maintain a sound financial position including long-term financial planning
Council outcomes	CO25 - The Council has efficient and effective services that deliver on objectives
Single Outcome Agreement	Our public services are high quality, continually improving, efficient and responsive to local people's needs
Appendices	Appendix 1 - Key Performance Indicators for Internal Audit

Appendix 1 – Key Performance Indicators for Internal Audit

Key performance indicators	Target to be achieved	Performance to date in 2014/15	Comment
<p>For each audit, planned deadline compared to actual date achieved for:</p> <ol style="list-style-type: none"> 1. Agreeing the scope of audits; 2. Issuing draft audit reports; and; 3. Issuing finalised audit reports. 	<p>95% of audits to meet original planned or agreed updated deadline.</p>	<ol style="list-style-type: none"> 1. Agreeing scope of draft audit - 100%. 2. 95% of draft reports were issued within a reasonable time period once all the requested information was received by management. 3. Issuing final reports – 100% have been issued within an appropriate timescale subsequent to the receipt of satisfactory final management comments/actions. 	<p>This year we experienced greater challenges beyond normal seasonality due to the impact of the referendum and management focus on the BOLD work streams. Internal Audit were required to be flexible in dealing with challenges created by management’s capacity to respond to audit requests.</p> <p>The ‘Leavers Report’ generated significant interest from both CMT & elected members resulting in significant scope additions. This ultimately prolonged the original report issuance date.</p>
<p>Provision of agreed management information and reports within agreed deadline, in particular reporting to the CMT, GRBV and any special reports that have been agreed for submission.</p>	<p>100% of reports to be supplied within the specified deadline.</p>	<p>100% of reports were submitted to CMT & GRBV within timelines agreed with Management and the GRBV Convenor.</p>	

Key performance indicators	Target to be achieved	Performance to date in 2014/15	Comment
Satisfactory feedback from the business post completion of internal audits and/or related initiatives based on post audit/event feedback questionnaire.	A response from the business (auditee) reflecting a 90% satisfaction on quality, effectiveness and timing.	<p>We have obtained a return rate of 85% on our post audit questionnaires so far this year. The results achieved across these three categories can be summarised as:</p> <ul style="list-style-type: none"> • Quality 88% • Effectiveness 88% • Timing 96% 	
Timely follow up on management actions from internal audit reports	90% of follow-up audits commenced within 10 days of the agreed updated start date.	N/A - This KPI is no longer relevant given the changes we have made to the Follow Up process. The introduction of real time tracking of management actions has resulted in the discontinuance of follow up audits.	
The internal audit plan should be completed within the allotted timetable.	90% of the internal audit plan should be completed in-line with the allotted timetable.	100% of the reprioritised internal audit plan completed.	The plan for 2014/15 was re-prioritised during the year with 4 reports due to be carried forward to the 2015/16 audit plan. In addition, 12 audits outside the original plan were undertaken during the year.