

Governance, Risk and Best Value Committee

10.00am, Tuesday, 26 September 2017

External audit review of internal financial controls, 2016/17

Item number	7.6
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Council Commitments	

Executive summary

As an integral part of the annual audit cycle, the external auditor requires to assess the effectiveness of the Council's internal control framework in preventing material misstatement within its financial statements. This process involves documentation of the Council's key financial systems and the principal controls within these and then sample-testing their effectiveness.

This report presents the main findings of the 2016/17 review, concluding that, while opportunities for further improvement exist, the controls assessed are considered to be well-designed and effective.

External audit review of internal financial controls, 2016/17

1. Recommendation

- 1.1 Members of the Governance, Risk and Best Value Committee are requested to note:
- 1.1.1 the findings of the 2016/17 external review of the effectiveness of the Council's internal controls; and
 - 1.1.2 that a further update on progress in implementation of the improvement actions will be provided to the Committee in January 2018.

2. Background

- 2.1 Section 95 of the Local Government (Scotland) Act 1973 requires local authorities to make arrangements for the proper administration of their financial affairs and to designate an officer to have responsibility for these arrangements. The Head of Finance is the appointed Section 95 Officer for the Council and therefore has overarching responsibility to maintain a sound system of internal control.
- 2.2 As an integral part of the annual audit cycle, the external auditor requires to assess the effectiveness of the Council's internal control framework in preventing material misstatement within its financial statements. This involves documentation of the Council's key financial systems and the principal controls within these and then sample-testing their effectiveness.

3. Main report

- 3.1 Following the appointment of Scott-Moncrieff as the Council's external auditor in October 2016, the majority of the fieldwork and financial systems testing was undertaken between March and May 2017. The key areas examined are set out in Exhibit 1 on page 1 of the report.
- 3.2 For those systems falling within the scope of testing, Scott-Moncrieff's conclusion is that these controls form part of a framework that is well-designed and effective.
- 3.3 A number of opportunities for improvement have nonetheless been identified and these are listed in Section 3 of the external audit report, alongside the Council's response and an indication of the corresponding timescales within

which actions to address any outstanding issues raised will be undertaken. These actions in the main comprise recommended improvements in the maintenance and review of procedural documentation and systems access controls. A progress update will be provided to the Committee in January 2018, by which time it is anticipated that the majority of recommendations will have been fully implemented.

- 3.4 Members of the Committee will be aware of other on-going, complementary work focused upon further strengthening aspects of the Council's internal control framework. Internal audit and risk management arrangements continue to identify areas for improvement and arrangements are in place to monitor implementation of identified actions and lessons learned Council-wide.

4. Measures of success

- 4.1 Improvements to the system of internal control are intended to ensure that assets are safeguarded, transactions properly authorised and recorded and material errors or irregularities either prevented or detected timeously.

5. Financial impact

- 5.1 While there is no specific direct financial impact resulting from the report's contents, enhancements to the effectiveness of the Council's systems of internal control form an essential part of improved governance arrangements.

6. Risk, policy, compliance and governance impact

- 6.1 Improvements to the internal control framework form an integral part of strengthening the wider governance arrangements within the Council.

7. Equalities impact

- 7.1 There are no direct equalities impacts as a result of this report.

8. Sustainability impact

- 8.1 There is no direct sustainability, climate change adaptation or sustainable development impact arising from the report's contents.

9. Consultation and engagement

- 9.1 There is no direct relevance to the report's contents.

10. Background reading/external references

10.1 None.

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11. Appendices

Appendix 1 – City of Edinburgh Council Review of Internal Controls, 2016/17.



Scott-Moncrieff
business advisers and accountants

City of Edinburgh Council

Review of internal financial controls
For the year ended 31 March 2017

August 2017

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1

Introduction

Introduction

1. This report concludes our 2016/17 audit of the Council's key financial systems and internal financial controls.

Scope of our audit

2. Auditors are required to carry out the audit of financial statements in accordance with International Standards on Auditing (UK and Ireland) (ISAs). To comply with the requirements of the ISAs we consider the Council's key accounting systems and internal financial controls and determine whether these are adequate to prevent material misstatements in the financial statements.
3. Our approach includes documenting the processes and key internal financial controls within the key financial systems (Exhibit 1) and performing testing to confirm our understanding of the system. For certain systems we also test a sample of internal financial controls to establish whether they provide adequate assurance to support the preparation of the financial statements.
4. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the Council's total audit resource. Each year we aim to place reliance on the work of internal audit wherever possible. Prior to placing such reliance we are required to carry out a review of the internal audit function to ensure that it is sufficient in terms of quality and volume and performed in accordance with accepted internal audit standards. The findings from our review are detailed in this report.

Reporting to those charged with governance

5. This report has been prepared to communicate the findings of our audit to those charged with governance. We have agreed with the Council that these communications will be through the Governance Risk and Best Value Committee.
6. Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls.
7. ISAs require us to report promptly any material weaknesses in the design or operation of

Exhibit 1 – Key financial areas (and associated systems) considered in 2016/17

Council tax	Non domestic rates	Cash receipts and banking
Housing rents	Sundry income	Payroll
Treasury management	Members remuneration / expenses	Expenditure

internal financial controls which have come to our attention.

8. A material weakness in internal control is a deficiency which could adversely affect the Council's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.
9. Any weaknesses or risks identified are only those that have come to our attention during our normal audit work, and may not be all that exist. Communication in this report of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve the Council of its responsibility to address the issues raised and to maintain an adequate system of control.
10. As required under the Code of Audit Practice, this report will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

Adding value through the audit

11. All of our clients quite rightly demand of us a positive contribution to meeting their ever-changing business needs. Our aim is to add value to the Council through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way we aim to help the Council promote

improved standards of governance, better management and decision making and more effective use of resources.

Feedback

12. We always welcome feedback on the quality of our audit work and associated outputs. Please access the following link to provide comments: <https://www.surveymonkey.co.uk/r/S2SPZBX>
13. We would like to thank management and staff who have been involved in our work for their co-operation and assistance during our audit visits.



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Summary of findings

Summary of findings

14. We are pleased to report that our audit work did not identify any significant deficiencies in the adequacy or design of internal financial controls over the Council's key financial systems. We consider these systems to be well designed. However, we identified a number of areas with scope for improvement which, if addressed, would further strengthen the system of internal financial control. Our findings and recommendations are included in section 3 (Action plan).

Internal audit

15. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the Council's total audit resource. Each year we consider whether it is the most effective use of the Council's total audit resource to place reliance on the work of internal audit. When reliance is to be placed over the work of internal audit we carry out an assessment of the internal audit function to ensure this is sufficient in terms of quality and volume, and is performed in accordance with the Public Sector Internal Audit Standards (PSIAS).
16. During our interim audit, we reviewed the Council's internal audit arrangements in accordance with International Standard on Auditing 610 (Using the Work of Internal Auditors), to determine we could rely on the work of internal audit and if so, to what extent. Overall we concluded that we will place reliance on the work of internal audit where appropriate.
17. A formal external quality assessment of internal audit's compliance with the Public Sector Internal Audit Standards (PSIAS) is required at least once every five years. The Head of Audit and Inspection of North Lanarkshire Council completed an External Quality Assessment Review (EQAR) in 2016/17. The review concluded that the Council's internal audit service fully conforms with the PSIAS.

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Action plan

Action Plan

Our action plan details the control weaknesses and opportunities for improvement that we have identified during our audit.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist. The weaknesses or risks identified are only those which have come to our attention during our normal audit work, and may not be all that exist. Communication of the matters arising from the audit of the annual accounts or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Action plan grading structure

To assist the Council in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated. Our rating structure has been revised to ensure consistency with the structure/terminology used by internal audit.

The rating structure is summarised as follows:

Finding rating	Assessment rationale
Critical	A finding that could have a: <ul style="list-style-type: none"> • Critical impact on operational performance; or • Critical monetary or financial statement impact; or • Critical breach in laws and regulations that could result in material fines or consequences; or • Critical impact on the reputation or brand of the organisation which could threaten its future viability.
High	A finding that could have a: <ul style="list-style-type: none"> • Significant impact on operational performance; or • Significant monetary or financial statement impact; or • Significant breach in laws and regulations resulting in significant fines and consequences; or • Significant impact on the reputation or brand of the organisation.
Medium	A finding that could have a: <ul style="list-style-type: none"> • Moderate impact on operational performance; or • Moderate monetary or financial statement impact; or • Moderate breach in laws and regulations resulting in fines and consequences; or • Moderate impact on the reputation or brand of the organisation.
Low	A finding that could have a: <ul style="list-style-type: none"> • Minor impact on the organisation's operational performance ; or • Minor monetary or financial statement impact; or • Minor breach in laws and regulations with limited consequences; or • Minor impact on the reputation of the organisation.
Advisory	<ul style="list-style-type: none"> • A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.

Payroll		
Rating	Issue & Recommendation	Management Comments
Medium	<p>Payroll procedures</p> <p>Procedures have not been documented for all key aspects of the payroll process. For example, we were unable to identify procedures covering amendments over employees standing information.</p> <p>We also noted that where procedures are in place, these are not subject to regular review and approval.</p> <p>There is a risk that key payroll processes and controls are not being implemented correctly or effectively.</p> <p>The Council should develop comprehensive procedures that cover all key aspects of the payroll process. Documented procedures should be approved by the appropriate level, made accessible to all relevant staff and subject to regular review.</p>	<p>This is currently part of an improvement project for People Support to document a comprehensive set of payroll procedures. This work is linked to ongoing process improvement activities to be completed in advance of the new Business World system. A further exercise will be undertaken to review the procedures when the new Business World System is operational.</p> <p>From 2018, the payroll procedures will be audited and updated by the Payroll Specialist on a six-monthly basis. Updates will be communicated to the team/relevant stakeholders, highlighting specific changes.</p> <p>Responsible Officer: Payroll Specialist, Customer</p> <p>Completion Date: January 2018</p>
Medium	<p>System access</p> <p>There is no regular review of user access to the payroll system to ensure this is up-to-date and appropriate given the employees current role.</p> <p>This was also identified by the Council's previous external auditors, Audit Scotland.</p> <p><i>"We identified a number of system users during our controls review where their system access rights did not appear appropriate for their roles."</i></p> <p>There is a risk that inappropriate transactions may be processed.</p> <p>The Council should ensure user access to the payroll system is reviewed on a regular basis.</p>	<p>Access rights for all payroll employees to be reviewed and ICT updated with list of requirements for systems access. This process will be reviewed on a quarterly basis.</p> <p>Responsible Officer: Payroll Specialist, Customer</p> <p>Completion Date: October 2017</p>

Revenue expenditure

During our interim audit we documented the following systems (in the context of purchasing for the Council):

- Oracle – General operating expenditure
- Swift - Payments to care homes and foster carers
- Tranman - Supplier payments for fleet hires, fleet maintenance, and fleet purchases
- CFATS Telford - City development costing system to commission/pay subcontractors

Rating	Issue & Recommendation	Management Comments
<p>Medium</p>	<p>Procedures</p> <p>During our review we noted the following in respect of procedures:</p> <ul style="list-style-type: none"> • CFATS Telford – No procedures are in place for the processing of work orders and certificates. • Tranman – Procedures for the ordering and receipting of goods and services have not been reviewed since 2009. On discussion with management this review has subsequently been undertaken and procedures updated. • Swift – Procedures for the processing of direct payments via Allpay do not include detail on how to reformat payment files, upload to Allpay or process payments to individual pre-loaded cards. <p>If relevant procedures are not in place or are not reviewed and updated on a timely basis there is a risk that some key controls are not observed.</p> <p>The Council should ensure procedures cover all key aspects of the system. Documented procedures should be approved by the appropriate level, made accessible to all relevant staff and subject to regular review.</p>	<p>Documented procedures for the processing of work orders and certificates in CFATS Telford are being developed.</p> <p>Once complete these will be reviewed annually.</p> <p>Responsible Officer: Business Support Manager, Customer</p> <p>Completion Date: December 2017</p> <p>Tranman procedures for the ordering and receipting of goods and services have now been updated and will be reviewed annually.</p> <p>Responsible Officer: Fleet and Workshops Manager, Place</p> <p>Completion Date: Ongoing</p> <p>SWIFT – Procedures for processing payments in Allpay have been updated.</p> <p>SWIFT development team will update online procedures accordingly</p> <p>Responsible Officer: Customer Manager – Transactions Assessment and Finance, Customer</p> <p>Completion Date: December 2017</p>

Revenue expenditure

Medium

System access

On review of the CFATS Telford system we noted that there is no formal documentation retained for the addition of users onto the system or any amendments made to their access levels.

In addition there are no controls in place to identify and remove leavers from the system on a timely basis.

The Council should ensure user access is reviewed on a regular basis.

A log has now been established for new user and access level change requests.

An audit of current users is being undertaken to ensure appropriate user access levels and to identify and remove leavers.

User data will be subject to six-monthly review, although the scope for more regular reconciliation with data from existing leavers processes is being explored.

Responsible Officer: Business Support Manager, Customer

Completion Date: December 2017

Medium

Documentation

During review of both the Oracle and the CFATS Telford systems we were unable to evidence that the following key controls were in operation:

- Oracle – Review of the daily amendments report which details all amendments made including addition of new suppliers.
- CFATS Telford – Reconciliation of work performed and work requested prior to payment being processed.

As these controls are not documented there is no audit trail in place to enable us, or any other interested party, to evidence their operation. There is a risk that these controls are not being adhered to.

The Council should ensure evidence is retained for all key controls in operation.

CFATS - Controls will be documented as part of the development of the procedural documentation referenced above.

Responsible Officer: Business Support Manager, Customer

Completion Date: December 2017

Oracle

Responsible Officer: Chief Procurement Officer, Finance

Completion Date: December 2017

Members remuneration and expenses

Rating	Issue & Recommendation	Management Comments
Medium	<p>Guidance</p> <p>Guidance on members' remuneration and expenses has not been updated since March 2012 and makes reference to legislation that is out of date.</p> <p>The Council should update the guidance and ensure that new and re-elected members have access to this. Going forward, the guidance should be subject to regular review to ensure it remains up to date.</p>	<p>Guidance will be updated and published on the ORB and shared with elected members. This information will be signposted in future inductions for new elected members. The guidance will be reviewed annually as part of the Customer review of policy and procedures.</p> <p>Responsible Officer: Transaction Team Manager: People Support, Customer</p> <p>Completion Date: October 2017</p>

Non domestic rates

Rating	Issue & Recommendation	Management Comments
Low	<p>Reliefs/exemptions – spot checks</p> <p>The Quality Assurance team performs spot checks on the reliefs/exemptions.</p> <p>NDR spot checks were scheduled to take place in January 2017. However, due to resource constraints, this work was not able to be performed. We understand spot checks will resume in 2017/18.</p> <p>We recommend that the Council make arrangements for the spot checks to resume in 2017/18.</p>	<p>Spot checks are underway and will be concluded by November 2017. Activities are being scheduled within the business as usual plans for future years.</p> <p>Responsible Officer: Rating Manager</p> <p>Completion Date: November 2017</p>



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