

## The Highland Council

### Audit and Scrutiny Committee – 17<sup>th</sup> November 2015

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| Agenda Item | 4        |
| Report No   | AS/26/15 |

#### Internal Audit – Resourcing of Internal Audit

#### Report by the Head of Audit & Risk Management

##### Summary

This report considers the resourcing of the Internal Audit and Risk Management Section, particularly in respect of the vacancy of an Auditor post which is shortly to arise. The opportunity to hold this post open and the impact this would have is considered in terms of the following:

- The ability to provide an annual audit opinion as required by the Public Sector Internal Audit Standards.
- The focus and scope of future audit work.
- The frequencies with which audit reviews are undertaken.

#### 1. Background

- 1.1 At the previous meeting on 30<sup>th</sup> September 2015, Members were informed of resourcing issues within the Head of Audit & Risk Management's progress report, regarding an Auditor being on long-term sickness absence following a road traffic accident in July 2015 and an Auditor leaving the Council in November (*nb the leaving date has since been confirmed as 11<sup>th</sup> December*). It was stated in that report that it was the intention to request approval from the Director of Finance to fill this post.

Given the Council's budget position the Director of Finance has since requested that the Head of Audit & Risk Management leaves the vacancy open until an assessment has been made of the minimum level of coverage and level of assurance that Internal Audit needs to provide to the Council.

- 1.2 Agenda item 3 considered the impact of the sickness absence and the vacancy on the Internal Audit Plan for 2015/16 and the knock-on effect in respect of 2016/17. This report therefore considers the longer term impact of not filling the Auditor post vacancy, particularly with regard to whether the Head of Audit & Risk Management will be able to continue to provide an annual audit opinion which is used to inform the Council's Annual Governance Statement.

#### 2. Current Structure and Delivery of Savings

- 2.1 In November 2012 it was reported to the Audit & Scrutiny Committee that, in order to contribute to the Finance Service's savings targets, the Head of Audit & Risk Management had been requested to hold an Auditor post vacant and consider an alternative service model and structure. In this

respect a savings target of £32,000 had been requested, representing 7.5% of the Internal Audit budget.

2.2 A restructuring of the then Internal Audit, Risk Management & Insurance Section subsequently took place and the Finance & Resources Committee of 5<sup>th</sup> June 2013 was informed that this saving had been achieved. The key changes that took place were then reported to the Audit & Scrutiny Committee in November 2013, as follows:

- The posts of Principal Auditor and Insurance & Risk Manager have been deleted and a single new post of Audit & Risk Manager has been created which has been filled.
- One of the Auditor posts has been replaced in the structure by a Trainee Auditor post, to contribute towards the overall savings and to provide for succession planning, particularly to address previous recruitment difficulties at Auditor level.
- Responsibility for insurance matters has passed from the Head of Audit & Risk Management to the Head of Accounting & Budgeting.
- The Audit Assistant and Computer Audit Assistant posts have been redesignated as Assistant Auditor and Assistant Computer Auditor respectively to reflect the changed duties of these posts.

Essentially, the restructuring provided an alternative service model whilst largely maintaining the current level of service in terms of planned audit days.

2.3 In August 2015 the Director of Finance asked each Head of Service to identify a 6% budget saving for 2016/17 onwards. With regard to Internal Audit & Risk Management this represented a saving of £27k against a net budget of £456k. A saving of £29k (6.35%) has been identified which relates to the deletion of 1 FTE vacant clerical post which was inherited from the Fraud Investigation Team when responsibility passed to the Head of Audit & Risk Management on 1<sup>st</sup> August 2015, a reduction of hours following a request from a member of staff to reduce from 35 to 28 hours and a re-designation of an Auditor post to an Assistant Auditor post. Therefore, the overall effect in terms of planned audit days is minimal.

2.4 The non-filling of the Auditor post would provide a further saving of approximately 9% and would reduce the resource of the Audit Team from 10 FTE staff to 8.8 FTE staff, allowing also for the reduction referred to at 2.3 above.

### **3. Public Sector Internal Audit Standards**

3.1 The Local Authority Accounts (Scotland) Regulations came into force on 10<sup>th</sup> October 2014, requiring local authorities to operate a professional and objective internal audit service. Prior to that date there was no statutory requirement for Internal Audit although it was implied through the Local Government (Scotland) Act, 1973 that an Internal Audit service needed to be in place. The Regulations state that this service must be provided in

accordance with the Public Sector Internal Audit Standards which came into force on 1<sup>st</sup> April 2013. Overall, the key aims of the Standards are “to promote further improvement in the professionalism, quality and effectiveness of internal audit across the public sector. They reaffirm the importance of robust, independent and objective internal audit arrangements to provide senior management and the Audit & Scrutiny Committee with the key assurances they need to support them both in managing the organisation and in producing the Annual Corporate Governance Statement.”

3.2 Although the Public Sector Internal Audit Standards replaced an earlier Code of Practice which similarly guided the profession, the Standards contain 334 best practice requirements compared to 192 requirements within the earlier Code. Not all of these requirements place any burden on the work of Internal Audit, however, there are some requirements which have impacted and which will continue to impact, including:

- The requirement to consult with the Audit Committee in preparing an annual plan of work, thus widening the potential scope of audit work;
- The requirement to consider the means by which each activity reviewed controls its performance, thus ensuring that Internal Audit adds value;
- The requirement to have an annual self-assessment, thus requiring a regular review by the Audit Team of its own policies, procedures and practices
- The requirement to have a formal external assessment against the Standards once in every five years,

3.3 As indicated at 1.1 above, the Standards now require that the Head of Audit & Risk Management brings any resourcing issues which may impact on the provision of the annual audit opinion to the attention of the Audit Committee.

#### **4. Assessment of an appropriate resource level**

4.1 It is unfortunate that whilst the Standards are very prescriptive, they do not stipulate the level of work Internal Audit needs to perform. Instead, they state that “no formula exists that can be applied to determine internal audit coverage needs. However, as a guide, the minimum level of coverage is that required to give an annual evidence-based opinion on the overall adequacy and effectiveness of the organisation’s framework of governance, risk management and control.”

4.2 The current year’s Audit Plan, which was presented to this Committee on 26<sup>th</sup> March 2015, showed that the annual opinion is currently based upon the coverage of all auditable areas (nb, the audits that make up the “audit universe”) within the frequencies set out in the table below. The frequencies are based upon priorities which arise from a combined risk score provided by the respective Service Director and the Head of Audit & Risk Management. The table below provides examples of the audits that are undertaken against each priority and frequency:

|     | Priority                      | Examples  | Frequency     |
|-----|-------------------------------|---|---------------|
| i   | Core/ Critical/<br>Commitment | <ul style="list-style-type: none"> <li>• Procurement</li> <li>• Finance systems</li> <li>• School financial procedures</li> <li>• Grant claim reviews (incl LEADER)</li> <li>• Scrutiny Exercises</li> </ul>  | Annual        |
| ii  | High                          | <ul style="list-style-type: none"> <li>• Waste management</li> <li>• Health, safety and wellbeing</li> <li>• Data Protection</li> <li>• Housing and homelessness</li> <li>• Housing Revenue Account</li> </ul>  | Every 3 years |
| iii | Medium                        | <ul style="list-style-type: none"> <li>• Capital project audits</li> <li>• Common Good Fund</li> <li>• Catering (school meals) &amp; cleaning</li> <li>• Winter maintenance</li> <li>• Property maintenance</li> </ul>  | Every 5 years |
| iv  | Low                           | <ul style="list-style-type: none"> <li>• Trading standards</li> <li>• Insurance</li> <li>• Street cleaning</li> <li>• Discretionary/Ward payments</li> <li>• Community planning partnerships</li> </ul> <p><i>Note: There are no low priority audits within the current year's plan</i></p> | Infrequent    |

It should be noted that the above refer to the planned frequencies only and the actual coverage has been less frequent than that set out above. There are several reasons for this including:

- Resourcing issues. Although the audit plan now allows for a contingency for vacancy management, delivery of the plan has been hindered severely in recent years.
- Complexity of reviews. There have been several reviews, including some recently reported to this Committee (e.g. Corporate Arrears project; IOTA/ICArts and Ben Wyvis School) where the time taken has significantly exceeded the expected budget to the detriment of other planned work. This has largely been due to the complexity of the reviews; the requirement for a wide-ranging scope and the lack of an audit trail.

With regard to the annual work undertaken in respect of the Core/ Critical/ Commitment priorities, comments are as follows:

- Work is undertaken each year on the Council's core financial systems to directly support the Statement on Internal Control (*nb this work also extends to work on behalf of the valuation Joint Board; the Pension Fund and Hitrans where Statements are similarly prepared*) which is required for the Council's Annual Governance Statement. In addition, and as referred to within Audit Scotland's "Review of Internal Controls" report which was presented to this Committee on 30<sup>th</sup> September, Audit Scotland seek to place formal reliance from Internal Audit's work which, it

is understood, helps to reduce the annual audit fee.

- It is a requirement of various grant conditions that annual work is undertaken and fee income is earned for some of this work.
- An allowance is made for reviews conducted by the Scrutiny Working Group to be undertaken. A recent meeting between the Chair & Vice Chair of this Committee; the Council Leader, the Chief Executive and the Head of Audit & Risk Management suggested that a programme of scrutiny reviews should be developed with a view to undertaking additional work to that currently undertaken.

It should also be noted that when the Audit Plan for 2016/17 is prepared, further consideration will be given to the priorities referred to above. For example, in view of the findings of the recent project reports on the Corporate Arrears project and Ben Wyvis School project, project audits will be undertaken annually rather than every 5 years, following the recommendation of this Committee.

- 4.3 In respect of 4.2 above, the Head of Audit & Risk Management is able to give an annual opinion which is informed not only by the annual work undertaken on the Council's core financial systems but on the Council's wider control environment, including the systems within all Services. To provide appropriate assurance these systems need to be audited within a reasonable frequency and the table at 4.2 above sets out what is believed to be a reasonable frequency.
- 4.4 A comparison with other Councils shows that the audit coverage provided by the Highland Council's audit team is generally at the lower end of the scale, with many others undertaking reviews of high and medium priority areas more frequently. To some extent this level of coverage is reflected within the Scottish Directors of Finance performance indicator which considers the cost of internal audit per £ million of net expenditure. The Highland Council shows the 5th lowest cost for the year 2014/15.

## **5. Impact of not filling an Auditor post**

- 5.1 In terms of whether the non-filling of the vacant Auditor post would impact adversely on the annual audit opinion, the following conclusions have been drawn:
- (i) Importantly, an annual audit opinion would still be able to be provided. However, the provision of that opinion would be at risk in the event of further resourcing issues (nb vacancies or long-term sickness).
  - (ii) Recently Internal Audit has become a statutory requirement and the Public Sector Internal Audit Standards have placed increasing demands and expectations on Internal Audit.
  - (iii) Audit work would need to focus on the primary role of Internal Audit which the Standards refer to as the provision of assurance services resulting in an annual opinion on the adequacy and effectiveness of

the Council's framework of governance, risk management and control. Work would also need to be prioritised around the audit reviews (*mainly key financial systems*) on which Audit Scotland are intending to place reliance. However, in addition to this, there are other commitments that remain which Internal Audit must fulfil, including:

- Annual audits of grant claims.
- Work on behalf of High Life Highland in accordance with the Service Level Agreement.
- Assurance work to support the Statement on Internal Control in respect of the Valuation Joint Board, the Pension Fund and Hi-trans.
- Fraud investigation work and counter-fraud work, particularly around compliance with the 2014 Chartered Institute of Public Finance and Accountancy (Cipfa) Code on Managing the Risk of Fraud and Corruption.
- Income generating IT Audit work for other Councils per Service Level Agreements.
- Provision of advice, for example, on matters of governance and internal control.
- Following up previously agreed audit recommendations and actions.
- Risk management duties.

- (iv) The frequencies which are currently referred to as high, medium and low priority (see examples in the table at 4.2 above) would need to be re-considered with a view to increasing the intervals between planned audit work. For example, this could be accommodated by amending the frequency of the medium priority audits from every 5 years to every 6 years. In addition, it may also be necessary to amend the frequency of high priority audits from every 3 years to every 4 years.
- (v) Additional demands would be placed upon the Audit & Risk Manager post which would hinder progress on risk management duties which need to be taken forward, including the revision of the Council's Risk Management Strategy and the reformation of the Council's Risk Management Group.
- (vi) Efforts will continue to be taken to maximise the work of Internal Audit. For example, the format of audit reports has recently been amended to reduce the time taken to produce these and similar new ways of working would continue to be explored

## **6. Implications**

- 6.1 Resource implications are referred to throughout this report and, in addition, risk implications are referred to at 5.1 (iii). There are no Legal; Equalities; Climate Change/Carbon Clever; Gaelic and Rural implications as a direct result of this report.

**Recommendation**

Members are asked to note the resourcing of Internal Audit and, in particular, the opportunity to review the implications of not filling an Auditor post which will shortly become vacant. Members are asked to note that the Head of Internal Audit & Risk Management would still be able to form an annual audit opinion as required by the Public Sector Internal Audit Standards although this would be “at risk” in the event of further resourcing issues. However, there would be an impact on the wider work of the Internal Audit & Risk Management Section.

Designation: Head of Audit & Risk Management

Date: 5<sup>th</sup> November 2015

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Background Papers: