Local Members Interest
N/A

Audit and Standards Committee – 13th June 2018

Internal Audit Outturn Report 2017/18

Recommendation

1.   To receive the outturn report containing the annual internal audit opinion for 2017/18.

Report of the Director of Finance and Resources

Background

2.   This report outlines the work undertaken by Internal Audit in respect of the 2017/18 annual plan.

3.   Management is responsible for establishing and maintaining appropriate risk management processes, control systems, accounting records and governance arrangements, i.e. the control environment of the organisation. Internal Audit acts as an independent, objective assurance and consulting activity designed to add value and improve the organisation's operations. It helps the organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes[1].

4.   Internal Audit is required by professional standards, i.e.UK Public Sector Internal Audit Standards (PSIAS), to deliver an annual internal audit opinion and report to those charged with governance timed to support the Annual Governance Statement. In accordance with these requirements the Head of Internal Audit must provide an annual opinion that covers the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. The annual report must incorporate:

- The opinion;
- A summary of the work that supports the opinion; and
- A statement on conformance with PSIAS and the Local Government Application Note (LGAN), highlighting any areas of non-conformance.

5.   The underlying principles to the 2017/18 plan were outlined in the Audit Plan paper presented to and approved by Members of the Audit & Standards Committee on 26 June 2017. Since the original plan was approved a number of additional audits have been required, whilst some planned reviews were no longer needed and several deferred due to operational requirements. The net effect is that the key performance target has been achieved. Work is scheduled to meet the requirements of the business area to ensure the greatest benefit is achieved from the audit work. Therefore it is not uncommon for reports to be at draft report stage at the end of the audit year.

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[1] Public Sector Internal Audit Standards definition of Internal Auditing.

6. Audit opinions are awarded for individual systems and compliance audits within one of the following categories listed below. Further information as to how these are determined is given in Appendix 1.

- Substantial Assurance
- Adequate Assurance
- Limited Assurance

7. Paragraph 9 provides a high level summary of the work undertaken by the Section analysed by the following categories:

- High Risk Auditable Areas
- Main Financial Systems
- Systems Audits (reported by exception, i.e. only those with "Limited Assurance" and/or those with a High Level Recommendation)
- Compliance Reviews
- Financial Management in Maintained Schools including payroll arrangements
- Special Investigations/Fraud & Corruption Related Work.

8. For those areas awarded 'Limited Assurance' action plans have been or are in the process of being agreed with the relevant Director /Head of Service. During 2017/18 Members of the Audit & Standards Committee have continued to receive full copies of all "Limited Assurance", High Risk Auditable areas (regardless of opinion) and Major Special Investigation reports (i.e. greater than £10,000 financial loss/Significant Corruption issues) once finalised. Relevant managers have attended the Committee to provide assurance that appropriate action has been taken regarding the implementation of recommendations. Internal Audit will continue to track and report on the implementation of High Level recommendations, including those contained within reports awarded "Adequate Assurance".

9. 2017/2018 Audit Plan Outcomes

9.1 High Risk Auditable Areas

The County Council made the decision during 2015/16 to replace the Council's Enterprise Resource Planning (ERP) system, SAP, and procure alternative, and separate, Finance and HR systems. In December 2015, the decision was made to procure Integra as the Finance Solution for both schools and the County Council via Entrust (known as My Finance) and in June 2016, the decision was made to procure iTrent as the HR Solution for the County Council via a framework agreement set up by Worcestershire County Council (known as My HR). This framework is managed by a third-party supplier called Liberata, a Business Process Outsourcing organisation, in partnership with Midland HR the system solution provider.

Both projects were successfully launched, My HR went live on 1 September 2017, followed by My Finance on 6 November 2017.

The implementation of these two key fundamental IT systems was represented by two significantly large projects (referred to as the SAP Replacement Programme) and was a huge undertaking and commitment by the Council spanning the whole of 2017/18. As would be expected, Internal Audit deemed the whole of the SAP Replacement Programme to be one of the top ten risks in 2017/18 and allocated 140 days to undertake project

support work to give on-going and timely assurance to senior management over the new control environment including the design of streamlined cost efficient processes.

An Audit Manager and the ICT Audit Manager were seconded onto the My Finance project from May 2017 at the request of the Deputy Director of Finance. This was to ensure advice and guidance relating to best practice, policies, procedures and controls were put in place prior to the launch of both systems. As part of Internal Audit's work, the Audit Managers attended various project workstreams as well as the My Finance Steering Group. The Chief Internal Audit (CIA) was also a member of the My HR Design Authority and attended the SAP Replacement Board. At the conclusion of both projects, Internal Audit delivered a number of audit reports on key project outputs and the resulting opinions are significantly important in providing the annual Head of Internal Audit opinion for this year. The audit opinions for the SAP Replacement Programme audit reviews along with the other high risk audit reviews are summarised in the table below:

System Area	2017/18 Opinion	2017/18 Consultancy
Staffordshire & Stoke on Trent Partnership – Contract Management	Adequate Assurance	
Brokerage Services: Redesign Pathway	Adequate Assurance	
Brokerage Services: Performance Management	Adequate Assurance	
Care Director Upgrade (Data Migration)	Substantial Assurance	
Core Payroll & Schools Payrolls – Retained Client & Control Function	Adequate Assurance	
Liberata Payroll System	Limited Assurance	
Capital Receipting Transformation	Substantial Assurance	
Cyber Security – Incident Preparedness & Response effectiveness	Adequate Assurance	
Strategic Property Asset Management and Governance	Deferred into 2018/19	
**Corporate Scheme of Delegations	Draft Report With Management (Adequate Assurance)	
Service & Commercial Contract Management Arrangements	Adequate Assurance	
Procurement – Commercial Services	Adequate Assurance	
My Finance – System Security	Limited Assurance	
My Finance – User Acceptance Testing (UAT)		√ Project Advisory work prior to go live
My Finance – Data Migration	Adequate Assurance	
My Finance - Interfaces	Adequate Assurance	
My HR – System Security	Limited Assurance	
My HR - UAT Position Statement 1	Substantial Assurance	
My HR - UAT Position Statement 2	Substantial Assurance	
My HR - Data Migration Position Statement 1	Adequate Assurance	
My HR - Data Migration Position Statement 2	Substantial Assurance	
My Archiving – Data Archiving	Adequate Assurance	

** Currently at draft report stage, therefore the high level recommendation has not been included within this section of the Outturn report. Once finalised the completed report will be circulated to Members of the Audit & Standards Committee.

As would be expected with the implementation of new systems, issues have been identified pre and post systems implementation as time is required to embed business as usual processes. Senior management supported fully the early audit work to identify concerns at the earliest opportunity and the responses to all of the recommendations made as a result of our work have been positive with the implementation of all but two high level recommendations to be completed by 30 September 2018 with the remaining two

recommendations to be implemented by 31 December 2018. It should be noted that whilst manual controls are in place to mitigate some of the risks identified, the control environment of both My Finance and My HR IT systems will be improved significantly when these high priority recommendations are implemented. This will ensure also that the Council's IT systems are utilised to optimum levels.

Two of the Limited Assurance reports issued for the high risk systems areas in 2017/18, fall under the SAP Replacement Programme suite of audit reviews, with the other Limited Assurance report relating to the Liberata Payroll System. The high level issues arising from these reviews are as follows:

System Area	Areas for Improvement
My Finance – System Security	• **Vendor Supplied Accounts** - Five vendor supplied accounts were enabled in My Finance and their passwords had not been changed from those that were supplied with the system due to a lack of understanding of what these accounts are used for and what system processes may be impacted by a password change. • **Access to LOGINDB** - It was found that the LOGINDB can only be accessed through a single account, named LOGINDB. The password for this account was known to more than one individual and provides no accountability for such a highly privileged account. • **Access to SYSADMIN** - It was established through interview and testing that a system access role called SYSADMIN had been assigned to 10 Council employees. As such, a review needs to be undertaken of access roles assigned to users such as system administrators to ensure they do not allow users to perform activities that could allow them to carry out fraudulent activities, commit separation of duties (SoD) violations and cover through deletion, system transactions. • **Change Control Policy** - A formal change control policy for My Finance does not exist to reflect changes made internally by the My Finance support team and those changes made by Capita. • **Separation of Duties** (SoD) - Whilst a SoD matrix had been created, it was incomplete and had not been agreed. As a result, a review had not been undertaken to identify conflicting user roles within My Finance.
My HR – System Security	• **Access to MSS** - The need to review access to Manager Self Service (MSS) and the My HR back-end and to consider the impact of further restricting access through the corporate network or Two Factor Authentication (2FA). Any decision to not further control access to MSS and the back-end should be signed off by the Senior Information Risk Owner (SIRO) or the Senior Leadership Team (SLT). • **Access to SYSADMIN** - Audit testing identified a number of Liberata users with access to the WORCC – SYSADMIN role. This included 4 out of 5 members of the Liberata Staffs Payroll and HR team. • **Separation of Duties (SoD)** - A Segregation of Duties matrix had not been created to identify conflicting user roles within My HR. Internal Audit has also highlighted concerns with access roles provided to Liberata users, which creates potential SoD conflicts. • **SoD Conflict** - Internal Audit testing confirmed a SoD conflict that enables users to approve their own travel claims when tasks have been redirected to them by their line manager. • **Access Restrictions** - Access restrictions were found not

	to have been applied throughout all sections of the My HR system, therefore, payroll data for individuals employed by organisations other than SCC can be accessed via the reporting functionality within My HR.
Liberata Payroll System	Although no high level recommendations were made in the Liberata payroll System review, a significant number of medium level recommendations were made (13) giving rise to the limited assurance opinion awarded in year. Some of the significant areas for concern related to:- • **New Starters -** Errors and omissions were identified in the information recorded on My HR for a sample of new starters. • **Changes to Payroll Records** - Evidence to support changes to payroll records could not be provided, or, could not be verified against the information recorded in the My HR system for a number of the cases reviewed. • **Evidence to Support Payroll Payments** – Evidence to support some payroll transactions (emergency payments/one-off payments) had not been provided to confirm the legitimacy of these transactions. • **Payroll Overpayments –** weaknesses were identified in the recovery of payroll overpayments including timeliness of process. • **Verification Checks** - Verification checks to ensure that amendments have been correctly completed and applied are not recorded to confirm that the transactions have been reviewed and any corrections required.

In addition for those reports relating to high risk auditable areas, with an opinion of at least "Adequate", five high level recommendations were made as follows:

System Area	Areas for Improvement
Brokerage Performance Management	• **Approval for Care Packages** - Our audit review highlighted that the recording of approvals for care packages was not always being adhered to.
Cyber Security – Incident Preparedness & Response Effectiveness	• **Monitoring of System and Network Logs** - The audit review found that although system and network logs are held, they are not being analysed continuously or reviewed periodically to identify anomalies or indicators of compromise.
Procurement - Commercial Services	• **Evidence of Procurement Process Followed** - A review of vendor spend between November 2017 and February 2018 highlighted areas where it is unclear whether a procurement process was followed and should have been and/or expenditure is occurring without an appropriate contract in place.
My Finance - Interfaces	• **Access Permissions** - The Everyone and RESOURCE/Users groups had been granted Read and Execute privileges to the Input, Archive and Output folders on the SQL Server Integration Services (SSIS) cloud server hosting all interface files. This allows access to all network users. As a result, this access should be removed.
My HR – Data Migration Position Statement 1	• **Defect Log** - Although managed, defects found during the data migration were not logged formally in a defect log as per the requirements of the approved Data Migration Approach. Also, there was no documentation to support the prioritisation that was placed on the resolution of these defects.

Note: There can be a maximum of one high level recommendation contained in a report awarded Adequate Assurance.

The entire suite of final audit reports produced as part of the SAP Replacement Programme is contained in the confidential agenda, and will be discussed in detail when the Committee reaches this part on the agenda.

<u>9.2 Main Financial Systems</u>

Coverage of these areas is in line with the audit strategy.

Main Financial System	2014/15 Opinion	2015/16 Opinion	2016/17 Opinion	2017/18	Direction of Travel
Pensions Payroll	Adequate Assurance	Substantial Assurance	Adequate Assurance	Adequate Assurance	→
Pension Fund – Custodian, Investment Managers and Pensions Property.	Substantial Assurance	Substantial Assurance	Substantial Assurance	Substantial Assurance	→
Budgetary Control	Substantial Assurance	Substantial Assurance	Substantial Assurance	Substantial Assurance	→
Pension Fund – Pension Administration	Substantial Assurance	Substantial Assurance	Adequate Assurance	Adequate Assurance	→
Pension Fund - Governance	Not covered in 14/15	Not covered in 15/16	Substantial Assurance	Substantial Assurance	→
Procure to Pay	Adequate Assurance	Not covered in 15/16	Adequate Assurance	Adequate Assurance	→
Sales to Cash	Not covered in 14/15	Adequate Assurance	Limited Assurance	Limited Assurance	→
Debt Recovery (Legal Services) now joint with Sales to Cash since 16/17	Adequate Assurance	Adequate Assurance			
E- Payments	Adequate Assurance	Not covered in 15/16	Not covered in 16/17	Substantial Assurance	↑
Cheque Control	Substantial Assurance	Not covered in 15/16	Not covered in 16/17	Not covered in 17/18	→
Main Accounting	Not covered in 14/15	Substantial Assurance	Project work & reported under the High risk areas	Bank Reconciliations Adequate Assurance	↓
Fixed Asset Register & Capital Accounting	Not covered in 14/15	Not covered in 15/16	Not covered in 16/17	Not covered in 2017/18	→
Treasury Management & Financial Director	IT system – Adequate Assurance	Substantial Assurance	Not covered in 16/17	Not covered in 2017/18	→

There has been one Limited Assurance report issued for the main financial systems areas in 2017/18.

System Area	Areas for Improvement
Sales to Cash	• **Outstanding Debt level** - The amount of outstanding debt over six months old is in excess of the self-imposed limit of £2.25m. No action has been taken to revise the limit. The amount of outstanding debt has significantly increased compared to the position that the Council was in at the time of the last review • **Legal Debt Recovery** - Although a proportion of existing debt referred to Legal Services has been recovered within the year, no new cases have been referred to the Legal Debt Recovery Officer for evaluation and action within 2017/18. Furthermore, not additional cases have been referred to Legal Services. Progress against existing cases is difficult to quantify or monitor, as progress is documented against individual customer accounts and clear records have not been maintained.

For information, for those reports with an opinion of at least "Adequate" for each financial system, two high level recommendations have been made:

System Area	Areas for Improvement
Procure to Pay	• **Vendor Amendments** - Whilst email alerts are triggered when vendor amendments are made, the alerts do not include information regarding the nature of the change. This does not allow management to independently review these changes to ensure they are appropriate. Thus, the current process for ensuring vendor amendments are legitimate is not effective.
Main Accounting System – Bank Reconciliations	• **Matching Process** - The automatic matching function in My Finance has not been fully tested and transaction matching is being completed manually and on a weekly rather than daily basis. This increases the amount of time required to match transactions and reduces the time available to staff to deal with queries regarding unusual entries. Comparison of the year end bank reconciliation (2017/18) with the previous year has also identified a significant increase in the number of unreconciled items.

Note: There can be a maximum of one high level recommendation contained in a report awarded Adequate Assurance.

9.3 Systems Audits – (reported by exception, i.e. only those with Limited Assurance and/or those with a high level recommendation).

System Area	2017/18 Opinion
Fairer Charging & Welfare Benefits	Limited Assurance
Deputyships	Limited Assurance
Special Education Needs and Disabilities (SEND) (Action Plan)	Limited Assurance
Purchasing Cards	Limited Assurance
Mental Health: Recuperation of Health Contributions	Limited Assurance

One other systems audit review has also been awarded a Limited Assurance opinion. This review is at draft report stage, therefore the high level recommendations have not been included within this section of the Outturn report. Once finalised the completed report will be circulated to Members of the Audit & Standards Committee.

Assurance could not be provided regarding the operation of the following control objectives:

System Area	Areas for Improvement
Fairer Charging & Welfare Benefits	• **Timely Authorisation of Care Packages** - It was identified that care packages are not authorised promptly, causing significant delays in producing invoices and resulting in service users accumulating large care charges and SAP records were not up-to-date with deferred care charge invoices • **Write-Off Process** - Debts expected to go uncollected had not been written off, and debts are not written off regularly.
Deputyships	• **Capital Balances** - Caseworkers were not monitoring those capital balances used by the Department of Works and Pensions (DWP) to calculate the benefit awarded to ensure that they are an accurate reflection of the amount of capital held by the client. • **Transaction Review** Internet banking transactions (relating to Client bank accounts) were not subject to an appropriate level of review. • **Compliance with Investment Policy** - Testing found that in some cases, client funds (where they exceeded £35k) had not been invested in accordance with the Investment Policy. • **Non-Compliance with Standards** - Areas of non-compliance with the Office of Public Guardian (OPG) Standards for Public Authority Deputies(the standards) were identified in relation to waiting list clients, insurance, security, inventory, personal possessions, property decisions and the sale of property.
Special Education Needs and Disabilities (SEND) (Action Plan)	• **Quality Assurance Process** - The Local Area Review SEND Self Evaluation document (LAR SEF) has not been quality assured. • **LAR SEF** - The LAR SEF was not linked clearly to the SEND Strategy 2018 – 2021 and risk areas had not been prioritised.
Purchasing Cards	• **Purchase Card Transaction Approval** - Purchase card transactions were not always approved in a timely manner, leading to the transaction being auto approved. In addition, there was not always evidence that purchase card transaction line items had been checked prior to approval and narrative descriptions were not always added to describe the nature of the expenditure which also assists with the approval process. In addition, warning emails to card holder approvers have ceased, where approvers have not approved transactions by the deadline date and have had to be auto approved by the Payments Team. • **Cash Only Purchase Cards** - Weaknesses were found in how cash withdrawals using a purchasing card and cash subsequent spent were being accounted for not only within the RBS system but also the manual local records held by establishments.
Mental Health: Recuperation of Health Contributions	• **Terms of Reference** - Terms of Reference for the Quality Assurance Panel (QAP) have not been revised, agreed and formally issued to confirm accountabilities and requirements, including quorum requirements for decision making. • **Decisions/Approval Process** - Although processes have been identified to ensure that agreement from all parties is obtained prior to final agreement of a jointly funded care

	package, further clarification and liaison between the stakeholders is required to ensure that decisions/approval is obtained in a timely manner and evidenced appropriately.

The following table lists those systems audits where high level recommendations have been made to address control weaknesses within Adequate Assurance reports:

System Area	Areas for Improvement
Capital Property Works - Planned (Schools & Non-School)	**Capital Works – Approval of Variations** - thresholds for when changes to costs require approval have not been determined and changes may not have been authorised by officers with appropriate decision making authority.
Strategic Workforce Planning	**Strategy Workforce Development Plan** - A Strategic Workforce Development Plan is not in place to support achievement of the organisations strategic objectives.
Recruitment - Core	**Training for Recruiting Managers** - Mandatory training for recruiting managers has been taken down from the Go platform for improvements to be made; this has now been offline for several months and has resulted in managers recruiting new staff without completing the training.
MTFS – Delivery Plan	**Delivery Plan Savings Lines** - There are several savings related lines in the Delivery Plan where detailed work to quantify and operationalise that saving is still in development. However, the Council has not quantified the risk of non-delivery in financial terms.
All Aged Disability – Supported Living	**Personal Budgets and Support Plans -** Support planning has not been completed and personal budgets have not been agreed by providers and SCC Commissioners.
Deprivation of Liberty Safeguards follow up	**Statutory Timescales For Assessments** – Statutory timescales for carrying out assessments were routinely not being met and there is a lack of consequence where Staffordshire and Stoke On Trent Partnership (SSOTP) are not completing assessments in line with expected targets.
IR 35 Legislation (Personal Services Companies)	**Monitoring Changes to IR35 status -** There are no controls in place for monitoring changes of IR35 status due to contract length, or review of the ongoing substance of the contract where changes may have occurred.

Note: There can be a maximum of one high level recommendation contained in a report awarded adequate assurance.

9.4 Compliance Reviews

	Audit Opinion			Total No.
Audit Type	**Substantial Assurance**	**Adequate Assurance**	**Limited Assurance**	
Compliance - Adults				
Comforts Funds	13	0	0	13
Other Compliance				
Educational Endowment Funds	5	0	0	5
Compliance Reviews	**18 (100%)**	**0 (0%)**	**0 (0%)**	**18**

The above reviews related to the audit of accounts and no issues were identified.

9.5 Financial Management in Maintained Schools

9.5.1 Schools Payroll

Previously HRSSC was responsible for payroll services to schools, however from September 2016 these services have been provided by a number of different bodies. In 2017/18, as a result of the changes Internal Audit has undertaken a themed audit review of payroll services to provide assurance on the internal control environment operating in schools for payroll. The detail from the themed audit reviews on payroll is provided at section 9.5.2 below.

9.5.2 Schools Compliance

Audit Type	Audit Opinion			Total No.
	Substantial Assurance	Adequate Assurance	Limited Assurance	
Schools Compliance – High Schools	0	5	1	6
Schools Compliance – All other schools	1	12	1	14
Payroll Audit themed review	6	12	0	18
TOTAL	7 (18%)	29(77%)	2 (5%)	38

The compliance and payroll themed reviews identified non-compliance with key controls in the following areas:

Schools – General Compliance

Governance
- Scheme of Delegation requires amendment/approval (*19 schools)*
- Budgets have not been set or approved in accordance with the Scheme of Delegation (*4 schools*)
- Governing Body Agendas and minutes not held by the school (*2 schools*)
- Policies not approved in accordance with the Scheme of Delegation (*1 school)*
- No debt management policy or does not cover all areas of income (*9 schools*)
- Pecuniary interest register not up to date or held/published in accordance with guidance (*5 schools*)
- School Fund not audited and approved in accordance with requirements of Financial Regulations (*10 schools*)
- Lease not in the name of the school/or copy not held by the school (*2 schools*)

Income
- Income is not banked promptly and/or intact (*8 schools*)
- Income is not recorded or receipted in accordance with Financial Regulations (*6 schools*)
- There is a lack of separation of duties or independent check in the income and banking process (*13 schools*)
- Cash is not held securely and/or may not be held in accordance with SCC Insurers cash holding limits (*5 schools*)
- Lettings are not administered appropriately (*5 schools*)
- Lettings charges are not made in accordance with policy or reviewed and approved annually (*2 schools*)
- Invoices have not been raised in the finance system or unofficial invoices have been

raised (*4 schools*)
- Income from Parent Pay is not paid directly into the County Council's bank account (*1 school*)
- Access rights to Parent Pay are not controlled appropriately (*1 school*)
- No independent reconciliation or review of Parent Pay postings (*4 schools*)

Procurement
- No financial limits set for declared pecuniary interest in companies (*3 schools*)
- Procurement/procurement card transactions not in accordance with Scheme of Delegation and Procurement Regulations (*12 schools*)
- Purchase card is not held/ used in accordance with the Purchase Card Manual/Financial Regulations (*2 schools*)
- Incorrect accounting for VAT (*8 schools*)

Imprest Accounts *
- There is no independent reconciliation of the imprest account (*1school*)
- Imprest account not administered appropriately (*1school*)

*The implementation of My Finance has seen the closure of imprest accounts held by schools.

Expenditure
- Lack of supporting documentation to evidence expenditure incurred (*1 school*)

Schools – Payroll Themed Audit

- Authorisations for appointments, terminations and variations could not be evidenced and/or retained on personnel files (*9 schools*)
- Additional hours claim forms not signed by employee and/or not authorised in accordance with Scheme of Delegation (*10 schools*)
- Validation checks and agreement/authorisation of the payroll is not evidenced (*12 schools*)
- Service level agreement for current year to confirm services to be provided/costs not received (*5 schools*)
- Contract for provision of payroll services not authorised in accordance with Scheme of Delegation (*1 school*)
- No contingency arrangements for payroll services to cover key staff absences (*4 schools*)
- Data is not being transferred securely (*8 schools)*
- Procedures not in place to ensure the prompt receipt of contracts of employment (*3 schools*)
- Pre-recruitment checks could not be verified (*2 schools*)
- Lack of separation of duties between input of payroll information and checking of payroll reports (*7 schools*)
- No evidence to support the recruitment and interview process (*1school*)
- Mileage and expense claims not reviewed, authorised in accordance with Scheme of Delegation or supported by receipts (*2 schools*)
- Salary overpayments identified by the school have not been queried with the provider (*1 school*)
- Payroll reports held on personal drives and not accessible to other relevant staff as required (*1 school*)

9.6 Special Investigations/Fraud & Corruption Related Work

A summary of work undertaken in relation to fraud and corruption and specific counter fraud testing is attached as **Appendix 2** in the confidential part of the agenda. Overall, the counter fraud and corruption work carried out in 2017/18 indicated that there are minor lapses in the application of controls leading to an increase in the risk of fraud. The table below summarises those exercises and investigations which involved confirmed financial loss. Reports have been issued to ensure that the control weaknesses have been addressed and re-occurrence prevented.

Area	Financial Value £	Control Objective
Internal Special Investigations of Fraud	11,238	This figure includes suspected loss from ongoing investigations.
NFI* **(all losses are subject to recovery action)**	73,317	Duplicate Payments
	2,100	Payments to Care Homes for Deceased Residents -excludes figures previously reported to the Audit & Standards Committee as part of the 2016/17 outturn report , 26th June 2017 (£52k)
	6,195	Personal Budget Payments to Deceased Residents
	12,382	Payments to Deceased Pensioners
Total	**105,232**	

NFI = National Fraud Initiative. This is a national exercise currently administered by the Cabinet Office. Data submitted by the Council is crossed checked against other public sector organisations' data highlighting potential areas of fraud. These are then investigated locally. Detailed reports are reported regularly to Members of the Audit & Standards Committee highlighting the results of this work.

The quantity of concerns referred to Internal Audit has increased during the year to 25 (38% increase on 2016/17). Potentially, this is due to new anonymous methods of reporting fraud becoming available (such as the online reporting form). The actual loss related to referrals has increased from £4,690 in 2016/17 to £11,238 in 2017/18. This value is not seen to be material. These types of investigation are very resource intensive particularly if the matter is referred to the Police for criminal action to be taken. The level of resource available to perform this area of work has been limited during the year.

In order to evaluate the effect this element of Internal Audit work has upon the wider control environment, a threshold of £300,000 financial loss per annum has been set. When this level is exceeded it is considered to have a material effect on the control environment. This year's level of actual financial loss does not indicate detected fraud is a significant problem to the Council.

It should be noted that the figures below include error and losses identified during the NFI 2016 exercise. As outlined in Appendix 2, these losses include both fraud and error, much of which we expect to be recovered. Of the £105,232 identified as losses from fraud and error in 2017/18, only £11,238 relates to suspected fraud against the Council, the remainder (£93,994) being errors identified during the NFI. The table below shows the trend of actual financial loss due to fraud and error over recent years:

Year	Financial Value	Direction of Travel
2011/12	£179,312	↑
2012/13	£29,831	↓
2013/14	£101,753	↑
2014/15	£94,140	↓
2015/16	£73,115	↓
2016/17	£56,690	↓
2017/18	£105,232	↑

The special investigations category consists of two elements: firstly financial loss above £300,000 and secondly an evaluation of the control environment based on the counter fraud and corruption work outlined as a separate item on the agenda. Proposed percentage allocations are as follows:

Special Investigations		Fraud and Corruption Work	
£0 – below £50,000 loss	50%	Procurement /Contract arrangements	10%
£50,000 - £150,000 loss	40%	Physical Cash/Asset management arrangements	10%
£150,000 - £200,000 loss	30%	Payment mechanisms	10%
£200,000 - £300,000 loss	20%	Payroll /Expenses	10%
Above £300,000 loss	10%	Income	10%

Based on the above criteria the overall score awarded for this category is **90%** (i.e.40% for the special investigations elements as the actual financial loss incurred is between £50,000 - £150,000. 50% has been awarded for the fraud and corruption elements based on the details outlined in the report contained in the confidential agenda).

10. Overall Opinion on the Control Environment

Following discussion at the Audit & Standards Committee at its meeting on 30 July 2012, it was agreed to endorse the methodology outlined below, which was used as the basis to form the annual assessment of the overall internal control environment. It is not proposed to amend this method for the 2017/18 assessment.

Current Methodology

Each separate category of audit work is assessed against a benchmark of achieving a score of at least 90% of the total number of audits performed being awarded an opinion of "Adequate or above" within each category. For a reason of simplicity, each category attracts equal weighting and a simple pass / fail assessment is used to differentiate the overall opinion between "Substantial, Adequate and Limited" as illustrated below:
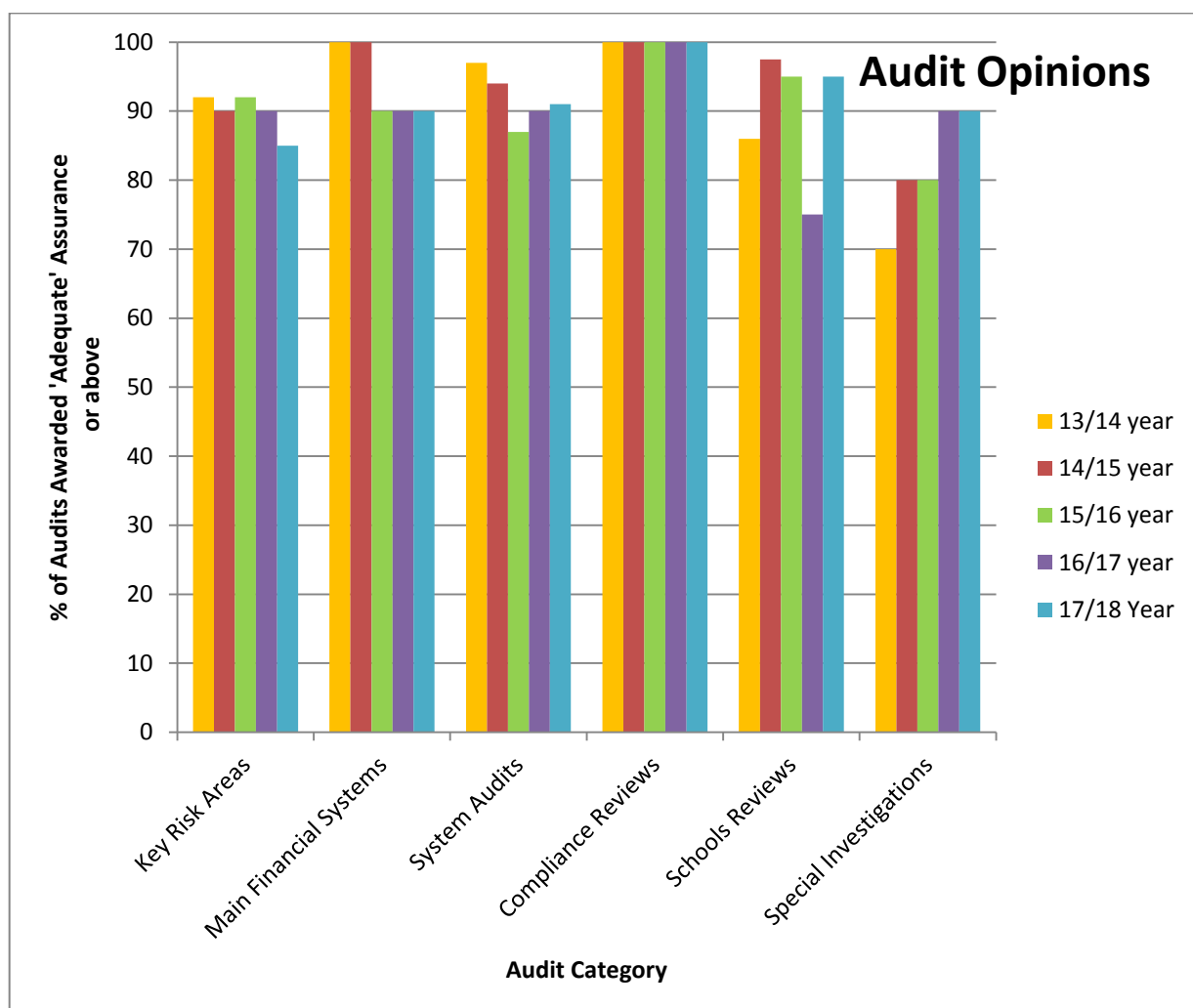
Overall Opinion Level	No of categories achieving the 90% benchmark
Substantial Assurance	6 out of the 6 categories
Adequate Assurance	4 or 5 out of the 6 categories
Limited Assurance	3 and below out of the 6 categories

Implications

The following table details the calculation of the 2017/18 overall assessment:

Audit Category	% awarded an opinion of at least "adequate"	Pass/Fail
Key Risk Areas *(paragraph 9.1)*	85%	Fail
Main Financial Systems *(paragraph 9.2)*	90%	Pass
System Audits *(paragraph 9.3)*	91%	Pass
Compliance Reviews *(paragraph 9.4)*	100%	Pass
Financial Management in Schools *(paragraph 9.5)*	95%	Pass
Special Investigations/Fraud & Corruption Related Work *(Paragraph 9.6)*	90%	Pass
Overall Total		**5 out of 6 categories passed**

The chart below details the audit opinions given to the key audit categories and provides a comparison with those awarded over the last five years, 2013/14 to 2017/18:

Audit Opinions

% of Audits Awarded 'Adequate' Assurance or above — Audit Category

Legend:
- 13/14 year
- 14/15 year
- 15/16 year
- 16/17 year
- 17/18 Year

Based on the above, an **"Adequate Assurance"** opinion has been given on the overall adequacy and effectiveness of the organisation's governance, risk and control framework, i.e. the control environment in 2017/18. This year has been dominated with the replacement of both the Council's Financial and HR IT systems which was a huge undertaking and commitment spanning much of 2017/18. This area was considered by Internal Audit as a high risk in this year, and a significant amount of audit work has been undertaken during the year to help support the design and implementation of a robust control environment. Although My HR and My Finance were launched successfully in September 2017 and November 2017 respectively, our early audit work carried out as part of the SAP Replacement Programme has highlighted a number of high level issues in relation to the system security arrangements for both My HR and My Finance, which has resulted in these areas being awarded a limited assurance opinion in 2017/18. It should be noted that whilst manual controls are in place to mitigate some of the risks identified, the control environment for both IT systems will be improved significantly when these high priority recommendations are implemented and will ensure that the Council's IT Systems are utilised to optimum levels . The changing payroll control environment for the Council's core payroll has identified a number of areas for improvement, which has also resulted in the system being awarded a limited assurance opinion this year. Although the schools compliance element of the assessment has achieved the benchmark, there are still some areas of non-compliance in relation to payroll controls which have been identified and further recommendations have been made to address these. The main financial systems element of the assessment has also achieved the benchmark, however, the direction of travel for a few aspects has not been maintained and in particular, the level of outstanding debt continues to grow, exceeding the Council's internal target and further improvements are required in respect of the debt recovery process.

A number of other audit reviews during 2017/18 have identified high level issues which have resulted in these systems being awarded limited assurance opinions. The overall number of limited assurance opinions being awarded has increased since last year. Whilst one reason is the implementation of two key IT systems and associated changes to process, another reason may be due to issues of capacity within the Council to undertake key activities. It is important that the key actions identified in these audits are addressed, implemented as agreed and progress monitored to ensure that the necessary steps have been taken to strengthen the control environment. This will be a key focus for the 2018/19 Internal Audit Plan.

11. Performance Measures

Key performance indicators (KPI) for the Internal Audit Service are detailed below. The Service has met its key performance target of more than 90% of reports being issued to draft report stage for both systems and compliance audits during 2017/18. The Service continues to meet the KPI targets for the quality questionnaire feedback.

Description	Target %	2015/16 %	2016/17 %	2017/18 %
Reports issued to draft report stage:				
➢ Systems Audits	**90**	93	91	92
➢ Compliance Audits	**90**	99	100	95
Average score for Quality Questionnaires from clients is equal to or exceeds the 'good' standard:				
➢ System Audits	**90**	100	100	100
➢ Compliance Audits	**90**	100	100	100

12.   Performance against the UK Public Sector Internal Audit Standards

The UK PSIAS came into force on 1 April 2013 with the aim of promoting further improvement in the professionalism, quality, consistency and effectiveness of internal audit across the public sector. These have been updated periodically since. A Local Government Application Note has also been developed by the Chartered Institute of Public Finance and Accountancy (CIPFA) to provide further explanation and practical guidance on how to apply the standards.

The Internal Audit Service works to an Audit Charter approved regularly by the Audit & Standards Committee. This Charter governs the work undertaken by the service, the standards it adopts and the way in which it interfaces with the Council. A detailed paper outlining how the Service meets the specific requirements of PSIAS & LGAN was presented to the Committee in June 2014 and since this date, self-assessments have been undertaken. This year, however, has seen the Service's inaugural External Quality Assessment (which is required to be conducted once every five years). Last year, the CIA commissioned CIPFA to undertake a full External Quality Assessment of the Internal Audit Service. The review was carried out between 21 and 25 January 2018 through a process of interviews and document review. The full assessment results were reported to the last Audit & Standards Committee held on 12 March 2018 which outlined the overall conclusion and opinion of the assessor.

For ease of reference, the key highlights from the External Quality Assessor's report published in February 2018 were that 'the review established that there were no areas of non-compliance or partial compliance with the standards identified'. Based on the work undertaken the overall conclusion is –' it is our opinion that Staffordshire County Council's Internal Audit Service Generally Conforms to the requirements of the Public Sector Internal Audit Standards and those of the Local Government Application Note.' This is the highest category level that can be awarded via the CIPFA assessment process. One recommendation was made, together with three suggestions for improvement. The details together with the agreed action to address the recommendations were included within the action plan at section 7 of the assessor's report which has previously been reported to the Audit & Standards Committee.

The key areas for improvement identified as part of last year's self-assessment have continued to be actioned during 2017/18 and progress is reported below:

Action Points	Current Status
Determining the arrangements relating to the future five yearly external assessment;	**Completed** - As detailed above, the external quality assessment took place in January 2018 and the results reported to the Audit & Standards Committee on 12th March 2018. The assessment took place to meet the PSIAS timescales (n.b. by the end of March 2018, all internal audit services were required to have an external assessment).
The need to formalise Internal Audit's approach to using other sources of assurance i.e. assurance mapping;	**In Progress** - Three pilot exercises have now been undertaken in order to evaluate the differing approaches to assurance mapping. This area will be taken forward in 2018/19 and a suitable approach agreed and formalised. This exercise will need to take account of the work being performed within Risk Management to enhance the Strategic Risk Registers.

The work undertaken by the Internal Audit Service during 2017/18 and reported within the Annual Outturn Report has been performed in accordance with PSIAS. In relation to this, there are no impairments or restrictions in scope or impairments in independence or objectivity during the year which prohibit the CIA or the Service from delivering the annual Head of Internal Audit opinion for 2017/18.

13. Equalities Implications

There are no direct implications arising from this report.

14. Legal Implications

There are no direct implications arising from this report.

15. Resource and Value for Money Implications

The net budget of the Internal Audit Section is estimated at £619,310 of which £53,400 relates to payments to external providers.

16. Risk Implications

Internal Audit objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources. Internal Audit will continue to align its work with the Corporate Strategic Risk Register.

17. Climate Change Implications

There are no direct implications arising from this report.

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List of Background Papers
Audit Management System
Annual Audit Plan & Strategy 2017/18
2017 Audit Charter
Progress Reports to Audit & Standards Committee
Various Internal Audit Reports

Recommendation Risk Ratings

At the conclusion of each audit, control weaknesses are rated based on their potential impact against the organisation and likelihood of any associated risks occurring.

The scoring matrices below are used by Auditors as a guide to assessment of each control weakness, and therefore generating the priority rating of the resultant recommendation.

Priority ratings may be adjusted subsequently; for example, in a minor system with a total budget of £100,000, financial loss of £5,000 would be considered more a more significant risk to system objectives than the matrix below would initially suggest.

Impact Ratings

Risk Type	Marginal 1	Significant 2	Fundamental 3	Catastrophic 4
Financial	Lack of VFM or overspend resulting in a financial loss below £10,000	Lack of VFM or overspend resulting in a financial loss between £10,000 and £100,000	Lack of VFM or overspend resulting in a financial loss between £100,000 and £0.5m	Lack of VFM or overspend resulting in a financial loss in excess of £0.5m
Reputation	Adverse publicity unlikely (e.g. Just can't demonstrate that probity has been observed.)	Needs careful public relations (e.g. Minor theft of property or income.)	Adverse local publicity (e.g. Minor fraud case.)	Adverse national publicity (e.g. Major fraud or corruption case.)
Legal/Regulatory	Breaches of local procedures / standards	Breaches of regulations / standards	Breaches of law punishable by fines only	Breaches of law punishable by imprisonment
Legal/Regulatory	Not an issue that would interest the External Auditors	An issue that may require further checks to satisfy the External Auditor that control is sufficient.	Would warrant mention in the Annual Audit Letter or Annual Governance Statement (AGS).	Could lead to qualification of Council's Statement of Accounts
Legal/Regulatory	Unlikely to cause complaint / litigation	High potential for complaint, litigation possible	Litigation to be expected	Litigation almost certain and difficult to defend
Performance	Doesn't materially affect a departmental performance indicator or service objective.	Has a material adverse affect on a departmental/corporate performance indicator or service objective.	Could adversely affect a number of departmental/corporate performance indicators or could seriously damage Departmental objectives / priorities.	Could call into question the Council's overall performance framework or seriously damage a Council objective / priority.
Service Delivery	Doesn't affect any identified objectives	Adversely affects a service objective	Seriously damage Departmental objective / priority	Seriously damage any Council objectives / priorities
Service Delivery	No significant disruption to service capability	Short term disruption to service capability	Short term loss of service capability	Medium term loss of service capability
Service Delivery	No more than 3 people involved	No more than 10 people involved	Up to 50 people involved	More than 50 people involved
Health & Safety	No injuries beyond "first aid" level	Medical treatment required - long term injury	Extensive, permanent injuries; long term sick	Death

Likelihood ratings:

Risk Score	Description	Example Detail Description
5	Very Likely	Likely to occur within a year / Over 80% Probability of Likelihood
4	Likely	Likely to occur within 1 to 3 Years / 60%- 80% Probability of Likelihood
3	Possible	Likely to occur within 3 to 5 Years / 40%-60% Probability of Likelihood
2	Unlikely	Likely to occur within 5 to 10 Years / 20%-40% Probability of Likelihood
1	Remote	Likely to occur greater than 10 Years / Less than 20% Probability of Likelihood

Priority Ratings Matrix

Risk Score >=	<	Recommendation Rating
1	5	Minor Priority
6	10	Low Priority
10	13	Medium Priority
15	21	High Priority

Internal Audit Assurance Ratings

Each Internal Audit report completed provides a level of assurance of either Limited, Adequate or Substantial Assurance. The following table is a guide to how assurance levels are determined. Dependent on the nature of the recommendations raised, the Internal Audit function may increase or decrease the level of assurance provided. For example a single, very significant control weakness may give rise to only one recommendation but severely compromise the effectiveness of a system and therefore result in a limited assurance report, or on occasion an audit may give rise to recommendation numbers close to the thresholds shown below for two or more categories of recommendation.

Assurance Level	Typical Findings
Limited	Either: 2+ high priority recommendations, 8+ medium priority recommendations, or 13+ low priority recommendations
Adequate	Either: 1 high priority recommendation, 3-7 medium priority recommendations, or 7-12 low priority recommendations
Substantial	0 high priority recommendations, 0-2 medium priority recommendations, and 0-6 low priority recommendations