

EAST RENFREWSHIRE COUNCIL13 September 2017Report by Audit and Scrutiny CommitteeANNUAL STATEMENT ON ADEQUACY OF INTERNAL CONTROLS**PURPOSE OF REPORT**

1. To provide a statement on the adequacy and effectiveness of the internal controls operating within the Council during 2016/17.

RECOMMENDATION

2. It is recommended that the Council note the internal audit annual statement on the adequacy and effectiveness of the internal controls operating within the Council during 2016/17.

BACKGROUND

3. The Audit and Scrutiny Committee's terms of reference include a requirement for it to review the control environment and make an annual statement to the Council on its evaluation of internal controls. To assist with the evaluation, Internal Audit is required to provide the Committee with an annual statement on the adequacy and effectiveness of internal control. The statement for 2016/17 was submitted to the Committee on 17 August 2017 as an Appendix to the Internal Audit Annual Report 2016/17.

INTERNAL CONTROL FRAMEWORK

4. As highlighted in the report submitted to the Audit and Scrutiny Committee by the Chief Auditor, in order to ensure the proper conduct of its business, the Council has a responsibility to develop and implement systems of internal control. The presence of an effective internal audit function contributes towards, but is not a substitute for, effective controls and it remains primarily the responsibility of line management to ensure that internal controls are in place and are operating effectively. A sound control system will help safeguard assets, ensure records are reliable, promote operational efficiency and ensure adherence to Council policy and procedures. Such systems of internal control can provide only reasonable and not absolute assurance against loss.

5. As part of its Standing Orders and in order for the business of the Council to be dealt with in an efficient manner, the Council has in place both a Scheme of Administration and Scheme of Delegated Functions. The former indicates the business to be dealt with by the various bodies of the Council, whilst the latter gives details of the authority delegated to officers by the Council. In addition to this, a comprehensive set of approved Financial Regulations is in place, which ensures that the financial administration of the Council is dealt with in a proper manner. The Council's Financial Regulations incorporate the requirement to present to the Audit and Scrutiny Committee each year an Annual Audit Report showing the activity of the Internal Audit service and progress achieved against the Internal Audit Plan. An assurance statement, on the adequacy of controls, must form part of that report.

6. As commented on by the Chief Auditor in the report she submitted to the Audit and Scrutiny Committee on 17 August, internal control systems need to be monitored so that management and Members may be sure that they continue to be effective. For the systems to be effective, monitoring of the internal controls is done at a number of levels, for example, assessment by line management; internal audit and external audit review and subsequent reporting to management of identified weaknesses and recommendations; and monitoring by the Audit and Scrutiny Committee. If monitoring of internal control is to be effective, then senior management must foster an environment where internal control is the responsibility of all staff.

ANNUAL ASSURANCE STATEMENT

7. As explained in the annual assurance statement prepared, the Chief Auditor's evaluation of the internal control environment was informed by a number of sources:-

- The audit work undertaken by Internal Audit during the year to 31 March 2017
- The audit work undertaken by Internal Audit in previous years
- The assessment of risk completed during the preparation of the strategic audit plan
- Assessments of the general control environment within individual departments as completed by each director
- Reports issued by the Council's external auditors and other review agencies such as the Care Inspectorate, Education Scotland, Scottish Housing Regulator and Audit Scotland
- Knowledge of the Council's governance, risk management and performance monitoring arrangements
- Any other items brought to the attention of internal audit staff by whatever means which may warrant further investigation

8. The Audit and Scrutiny Committee has received regular progress reports from the Chief Auditor on the work of Internal Audit.

9. The statement concludes that it is the opinion of the Chief Auditor, based on the information available and work carried out, that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control system in the year to 31 March 2017 except for creditors. It states that two areas of control weakness have been identified within creditors.

10. Firstly, it is stated that the creditors team were subject to a fraudulent request to change a supplier's bank details. The statement explains that the usual checks were not carried out and the bank details were amended, adding that two subsequent valid invoices were then paid by BACS using the fraudulent bank details; and that, fortunately, the Council did not lose any funds as the bank identified an anomaly with the payment and refunded the Council the full amount paid of £2.3 million.

11. The statement also refers to the second area where controls failed which was in checking for duplicate invoices prior to payments being made. It explains that this issue was previously brought to management's and the Audit and Scrutiny Committee's attention following an internal audit report issued in November 2016. The statement clarifies that management accepted the recommendation but failed to implement the control in full, adding that checks are currently being undertaken to ascertain the scale of erroneous/duplicate payments that have been made and recover any outstanding sums. A full update on this issue was given to the Audit and Scrutiny Committee on 17 August, including details of recovery action taken.

12. Both issues were also referred to in other reports on the Audit and Scrutiny Committee agenda for 17 August, including the Interim Audit Report 2016/17 prepared by the External Auditor; and the Update on Invoice Payments in East Renfrewshire Council. The Head of Business Change and Revenues will be submitting a further update on invoice payment process related issues to the Committee in 6 months prior to the end of the current financial year.

13. The Audit and Scrutiny Committee considered and approved the internal audit annual statement on the adequacy of internal control as prepared by the Chief Auditor (see Appendix 1) on 17 August 2017.

RECOMMENDATION

14. It is recommended that the Council note the internal audit annual statement on the adequacy of internal control in 2016/17.

Report Author:

Linda Hutchison, Clerk to the Audit Committee 577 8388

email: linda.hutchison@eastrenfrewshire.gov.uk

Background Papers: Internal Audit Annual Report 2016/17

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INTERNAL AUDIT ANNUAL STATEMENT ON THE ADEQUACY OF INTERNAL CONTROL

As Chief Auditor of East Renfrewshire Council, I am pleased to present my annual statement on the adequacy and effectiveness of the internal control systems of the Council for the year ended 31 March 2017.

Respective responsibilities of management and Internal Audit in relation to internal control

It is the responsibility of the Council's senior management to establish an appropriate and sound system of internal control and to monitor the continuing effectiveness of that system. It is the responsibility of the Chief Auditor to provide an annual overall assessment of the robustness of the internal control systems.

Sound internal controls

The main objectives of the Council's internal control systems are:

- To ensure adherence to management policies and directives in order to achieve the organisation's objectives;
- To safeguard assets;
- To ensure the relevance, reliability and integrity of information, so ensuring as far as possible the completeness and accuracy of records; and
- To ensure compliance with statutory requirements.

Any system of control can only ever provide reasonable and not absolute assurance that control weaknesses or irregularities do not exist or that there is no risk of material errors, losses, fraud, or breaches of laws or regulations. Accordingly, the Council is continually seeking to improve the effectiveness of its systems of internal control.

The work of Internal Audit

Internal Audit is an independent appraisal function established by the Council for the review of the internal control system as a service to the organisation. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of the Council's resources.

The Internal Audit service operates in accordance with the Public Sector Internal Audit Standards (PSIAS) which came into effect on 1 April 2013. The service undertakes an annual programme of work approved by the Audit Committee based on a five year strategic plan. The strategic plan is based on a formal risk based audit needs assessment which is revised on an ongoing basis to reflect evolving risks and changes within the Council.

All internal audit reports identifying system weaknesses and/or non-compliance with expected controls are brought to the attention of management and include appropriate recommendations. It is management's responsibility to ensure that proper consideration is given to internal audit reports and that an appropriate action plan is provided in response to audit recommendations. Internal Audit is required to ensure that appropriate arrangements are made to determine whether action has been taken on internal audit recommendations or that management has understood and assumed the risk of not taking action. Significant matters arising from internal audit work are reported to the Chief Executive and the Council's Audit and Scrutiny Committee.

Basis of Opinion

My evaluation of the control environment is informed by a number of sources:

- The audit work undertaken by Internal Audit during the year to 31 March 2017
- The audit work undertaken by Internal Audit in previous years
- The assessment of risk completed during the preparation of the strategic audit plan
- Assessments of the general control environment within individual departments as completed by each director
- Reports issued by the Council's external auditors and other review agencies such as the Care Inspectorate, Education Scotland, Scottish Housing Regulator and Audit Scotland
- Knowledge of the Council's governance, risk management and performance monitoring arrangements
- Any other items brought to the attention of internal audit staff by whatever means which may warrant further investigation.

Opinion

It is my opinion, based on the information available and work carried out, that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control system in the year to 31 March 2017 except for creditors.

Two areas of control weakness have been identified within creditors. Firstly, the creditors team were subject to a fraudulent request to change a supplier's bank details. The usual checks were not carried out and the bank details were amended. Two subsequent valid invoices were then paid by BACS using the fraudulent bank details. Fortunately, the council did not lose any funds as the bank identified an anomaly with the payment and refunded the Council the full amount paid of £2.3 million.

The second area where controls failed was in checking for duplicate invoices prior to payments being made. This issue was previously brought to management and Audit and Scrutiny Committee attention following an internal audit report issued in November 2016. Management accepted the recommendation but failed to implement the control. Checks are currently being undertaken to ascertain the scale of erroneous/duplicate payments that have been made.

Michelle Blair ACA
Chief Auditor

2 August 2017