



AUDIT COMMITTEE

THURSDAY, 5 JULY, 2018, at 10.15 A.M.

I enclose the following circulation:-

ITEM MARKED TO FOLLOW:

9. Interim Report on the 2017/18 Audit – Report by the External Auditor

28 June, 2018

Director of Business Services

To: Councillors R Cassie (Chair), A McKelvie (Vice Chair), N Baillie, A Bews, A Buchan, M Ewenson, A Fakley, W Howatson, A Kloppert, S Leslie, H Smith, I Sutherland, I Taylor, and B Topping.

Substitute Members: Councillors G Blackett, S Calder, G Carr, I Davidson, S Dickinson, A Hassan, J Hutchison, D Lonchay, G Owen, G Petrie, N Smith, and L Wilson.

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REPORT TO AUDIT COMMITTEE – 5 JULY 2018

EXTERNAL AUDIT – INTERIM REPORT ON THE 2017/18 AUDIT

1 Recommendation

1.1 The Committee is recommended to discuss and note this paper.

2 Background / Discussion

2.1 The external auditor's interim report on the 2017/18 audit is attached. The report sets out the auditor's findings from their annual review of internal financial controls and wider scope responsibilities. This is in line with the Annual Audit Plan which was considered by the Audit Committee in March 2018.

2.2 The Committee is asked to discuss and note the report, attached as appendix 1. Members will note that all recommendations have recently been discussed and agreed and the next step is to consider appropriate action, timescales and lead officers. Audit Committee members will be provided with an updated action plan once completed.

2.4 The Head of Finance and Monitoring Officer within Business Services have been consulted in the preparation of this report and their **comments** are incorporated within the report and are satisfied that the report complies with the Scheme of Governance and relevant legislation.

3 Scheme of Governance

3.1 The Committee is able to consider/comment on this item in terms of Section G.1.5 of the List of Committee Powers in Part 2A of the Scheme of Governance as the report relates to the Council's relationship with its external auditors.

4 Equalities, Staffing and Financial Implications

4.1 An equality impact assessment is not required because this report informs the Committee of the planned scrutiny activity to be carried out by audit and inspection bodies and does not have a differential impact on any of the protected groups.

4.2 There are no staffing and financial implications as a direct result of this report.

Ritchie Johnson
Director of Business Services

Aberdeenshire Council

Management Report 2017/18



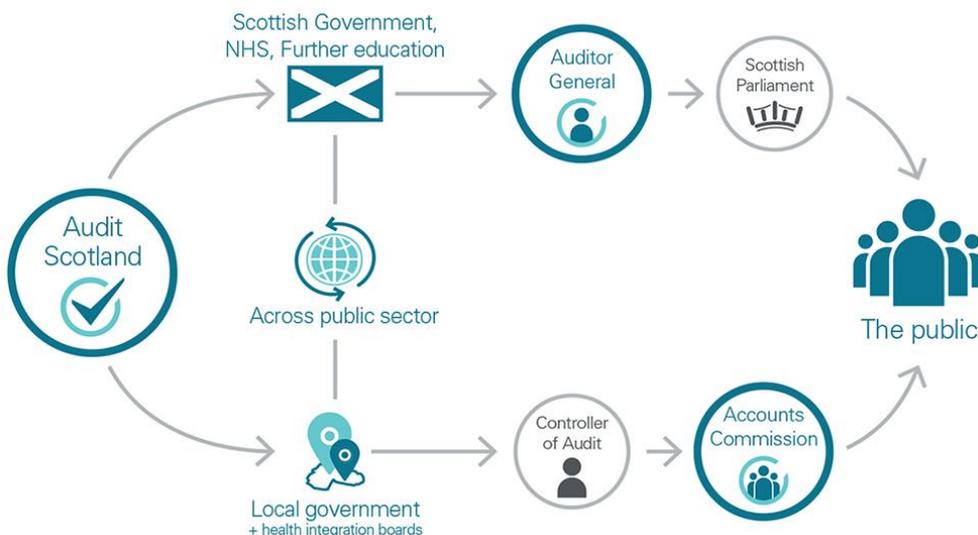
 AUDIT SCOTLAND

Prepared for Aberdeenshire Council
July 2018

Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non – executive board chair, and two non – executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world – class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Key messages

Introduction

1. This report contains our findings from interim audit work carried out at Aberdeenshire Council.
2. Our responsibilities under the [Code of Audit Practice](#) require us to assess the systems of internal control put in place by management. We seek to gain assurance that the audited body:
 - has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements
 - has systems of internal control which provide an adequate means of preventing and detecting error, fraud or corruption
 - complies with established policies, procedures, laws and regulations.
3. Also, we carried out wider scope work around the four audit dimensions set out in the [Code of Audit Practice](#). This report contains findings in relation to work undertaken on the governance dimension.
4. Any weaknesses identified represent those that have come to our attention during the course of normal audit work and therefore are not necessarily all the weaknesses that may exist. It is the responsibility of management to decide on the extent of the internal control system appropriate to the council.
5. The contents of this report have been discussed with relevant officers to confirm factual accuracy. The co-operation and assistance we received during the course of our audit is gratefully acknowledged.

Conclusion

6. As reported in our 2016/17 Interim Report, payment of invoices which are not initiated by an electronic purchase order continue to be an area of audit risk. Such invoices require to be manually authorised and we continue to find instances where officers authorising invoices for payment are approving amounts above their approved authorisation limits. In order to mitigate this control weakness, we will carry out additional testing again this year to ensure we have sufficient assurances in respect of the council's 2017/18 expenditure.
7. With regard to our wider scope responsibilities, we have highlighted a number of areas where the council's existing arrangements could be enhanced. These include – counter fraud arrangements, compliance with laws and regulations and whistle blowing arrangements.
8. The appendix summarises the weaknesses identified and the action agreed by management to strengthen the relevant controls. At this stage, management have agreed the recommendations in principle but due to the extent of work involved in implementing some of the actions, management need space to consider the implications further before committing to target dates. On this occasion we are supportive of this approach as its important agree realistic dates.

9. We would anticipate agreeing an action plan over the next 4 – 6 weeks. Thereafter, the actions will form part of our outstanding recommendations report which will come forward to the next meeting of the Audit Committee in September 2018.

10. All our outputs and any matters of public interest will be published on our website: www.audit-scotland.gov.uk.

Financial controls

Financial Controls



Bank reconciliations



Payroll controls



IT access



Budgets

11. On an annual basis, International Standards on Auditing (ISAs) require us to consider the council's internal financial controls. Our Audit Approach identifies the systems set out in Exhibit 1 as the key financial systems we should consider within public bodies. When conducting our system assessments, we focus on the key financial controls in operation within each system. Exhibit 1 also sets out the key financial controls we believe should exist and operate each year.

Key financial systems and expected internal financial controls

Key financial systems	General ledger, Payroll, Accounts payable, Accounts receivable, cash and bank
Expected key controls	<ol style="list-style-type: none"> 1. Regular bank reconciliations are carried out 2. Feeder Systems are reconciled to the General Ledger 3. Controls covering payroll validation and exception reporting are in place 4. IT access controls are in place for each financial system 5. Journals are properly authorised 6. Monitoring and review of budgets 7. Payments are only made to valid suppliers 8. Arrangements are in place to mitigate risk of fraud in relation to taxation receipts, welfare benefits, grants and other claims.

12. In accordance with *ISA 330: the auditor's response to assessed risk*, our audit judgements are based on an annual assessment of key financial systems supported by a mix of annual testing of controls, reliance on the results of previous years and assurances taken from the work of internal audit.

13. Our annual assessment includes carrying out a walkthrough test of each system to confirm that key controls were operating as expected. Our risk based audit approach allows us to take a three-year cyclical approach to controls testing. Where we have confirmed that the controls remain unchanged and no other significant issues have arisen, we can place reliance on previous years' audit results.

14. In order to provide a more cyclical approach to our work and spread the work over the period of our 5 year audit appointment, we tend to include an element of controls testing on an annual basis

15. Exhibit 2 summarises the control weaknesses identified from our work in the following areas:

- follow up of previous year risks
- In 2017/18, we focused our specific testing on significant feeder systems which transfer information into the General Ledger from other financial systems. This strengthens our assurances around the operation of the ledger which is the source system for the data used to produce the council's annual accounts.

Exhibit 2 System control weaknesses

• Invoices requiring manual approval

In our 2016/17 Interim Report, we identified payment of invoices which are not initiated by an electronic purchase order as an area of audit risk. Whilst confirming the operation of key financial controls in 2017/18, we again confirmed this area to be a risk as officers are approving invoices which exceed their approved authorisation limits. While we propose to carry out additional substantive testing to provide the necessary assurances we need in respect of our audit of the council's accounts, officers need to minimise the risk of irregularity. This risk was identified last year and is carried forward as part of our outstanding recommendations report.

The council's Payment Authorisation procedures (included on Form AP03) state that the checking officer should confirm that invoices are addressed to Aberdeenshire Council. We identified one paid invoice in our sample which was not addressed to the council. The invoice related to payment for a venue hire for a meeting that was arranged by another council but where it was agreed that Aberdeenshire Council would make the payment. This was the only such invoice identified from our sample and we are satisfied that it related to valid expenditure.

Refer Action Plan, number 1

• CareFirst reconciliations

As part of our review of the Accounts Payable system, we identified that significant levels of transactions are processed through the CareFirst system. This is a case management system commonly used by councils for recording care packages and other arrangements for social care service users. Data from the system is used in making payments to pay care providers and also, for billing service users for contributions towards their own care. At the year end, information on unpaid authorised care packages is extracted from the system and used to calculate the accrual required for inclusion in the council's annual accounts. Due to the scale of the figures included in the annual accounts, we undertook a walkthrough of CareFirst to strengthen our understanding of the operation of the system and increase the level of assurance we could take from the controls in place.

An interface between CareFirst and the General Ledger is run every four weeks. As part of this process any items that are rejected by the interface are reviewed and updated by the Social Work Finance Team. We found appropriate controls in place with regard to the creditors interfaces but found no reconciliation between the debtors' interface file and the General Ledger. This control is in place for the creditors interfaces.

Refer Action Plan, number 2

Wider scope

Wider governance arrangements

16. The wider scope of public audit contributes to conclusions on the appropriateness, effectiveness and impact of corporate governance arrangements. In addition to the responsibilities for public bodies and auditors set out in Audit Scotland's Code of Audit Practice, CIPFA/SOLACE set out principles of good governance within their 'Delivering Good Governance' Framework 2016 which councils are required to comply with and to report on accordingly, within annual governance statements.

17. Arising from our wider scope work on governance, set out below are our findings in respect of the council's:

- arrangements for the prevention and detection of fraud and error
- whistle blowing policy
- compliance with laws and regulations
- other matters.

Arrangements for the prevention and detection of fraud and error

Council arrangements

18. Public bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper measures in place.

19. In examining the appropriateness of the council's arrangements, we consider the policies in place and frequency of review and update. In respect of fraud, a counter fraud policy should set out the council's approach to managing risks and therefore minimise the risk of fraud/irregularity and define the response for action should an incident occur. In terms of reporting, it is good practice to submit an annual fraud report to the audit committee summarising performance against the policy and including any changes in the council's arrangements during the year, the number of fraud cases for the year, key findings and lessons learnt.

20. There is an outstanding recommendation from our 2016/17 Interim Report for the council to refresh and relaunch its fraud policy, and prepare an annual fraud report. We understand these matters will be addressed by September 2018 when a report and refreshed policy will be considered by the audit committee.

Standards of conduct

21. The risk of irregularity is increased if proper standards of conduct are not operating effectively. In considering a council's conduct arrangements we routinely examine:

- the policies in place covering standards of behaviour and integrity expected of elected members and staff
- induction and reminder processes for key policies as awareness of procedures can be a strong deterrent in itself.
- the extent of self-declaration routinely required from elected members and staff. In particular, maintenance of registers of interest, gifts and hospitality and conflicts of interest.

22. The council has a range of employee policies and procedures which are accessible on the intranet. These include policies relating to employment (e.g. pay, leave entitlement), wellbeing (e.g. flexible working, stress) and disciplinary. In relation to conduct, there are policies covering gifts and hospitality and social media but there is no obvious policy covering the council's arrangements for managing conflicts of interest.

23. It is becoming more common for councils to produce codes of conduct setting out values and standards of behaviour and probity expected from staff. This may be no more than bringing together existing values and policies within a single code but in doing so promotes staff conduct which is an important aspect of a council's counter fraud arrangements. Aberdeenshire Council may wish to consider introducing such a code as part of its refresh of its counter fraud policy.

24. The council has a Register of Interests for Members and members are regularly reminded of the need to ensure it is kept up to date. Officers are required to complete a register for Gifts and Hospitality. There is now an expectation that a register of interests is also held for officers. While the CIPFA/SOLACE framework refers to all staff, in our view it would be sufficient to extend the arrangements to senior officers with delegated responsibilities and other officers with significant responsibility for managing critical areas of spend who are in positions of influence e.g. procurement. With the absence of such a register, there is a risk that significant conflicts of interest are not disclosed either intentionally or unintentionally.

25. This area should be reviewed to ensure conflicts of interest are adequately managed and monitored and that there are appropriate safeguards in place for both the council and its staff.

Refer Action Plan, number 3

26. This process would also assist the Head of Finance in identifying transactions which should be disclosed as related party transactions in the council's annual accounts. The Code of Practice for Local Authority Accounting defines related parties as bodies or individuals that have the potential to control or influence the council or to be controlled or influenced by the council and thereby restricting the council's ability to operate independently.

Whistleblowing Policy

27. The council refreshed its Whistleblowing Policy and Procedures in September 2017. These provide comprehensive guidance to staff on the raising of such issues and the process involved. However we were unable to identify how many cases had been raised with the council in the last year as no central record of cases is maintained or reported. In the absence of a central record, there is no formal process for identifying and taking forward lessons learnt from each case.

28. As stated in paragraph 20, we previously reported similar findings in respect of fraud cases. It would make sense to include whistleblowing activity as part of the recommended annual report to be considered by the audit committee.

Refer Action Plan, number 4

Compliance with laws and regulations

29. International Standards of Auditing (ISAs) require the auditor to have a general understanding of the legal and regularity framework which will impact on an organisation's annual accounts. In respect of local government, the following legislation provides the main framework that we as auditors consider as a matter of routine within our audit work:

- Local Government (Scotland) Act 1973
- The Local Government in Scotland Act 2003 (2003 Act)
- Statutory Guidance under section 12 of the 2003 Act
- The Local Authority Accounts (Scotland) Regulations 2014
- The Local Government (Capital Finance and Accounting) (Scotland) Regulations 2016
- Charities and Trustee Investment (Scotland) Act 2006

30. In addition, the auditor considers how a council complies with **other** laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the accounts but where non-compliance could have a material effect on the amounts disclosed.

31. In conducting our work in this area, we seek to understand how the council assures itself on compliance with regulations that if breached, could have a material impact on the financial statements. For example, potential litigation or a fine would have material implications for the accounts. This could arise from of a health and safety issue, a serious breach of regulations such as data protection or equal pay claims.

32. While there are a range of processes in place to ensure the council operates appropriately, there is scope for the Strategic Leadership Team to consider the key regulations it would seek to receive assurances on each year and the format those assurances would take. Once implemented, we would suggest such assurances are obtained at an appropriate stage to inform the production of the council's annual accounts.

Refer Action Plan, number 5

Other matters

Risk management arrangements

33. Quarterly Risk Management reviews are prepared for the Council's Strategic Leadership Team and made available to Members. The Audit Committee has delegated responsibility to review the adequacy of risk assessment arrangements and procedures. The last report was presented to the Audit Committee in December 2016 which is now some time ago.

Refer Action Plan, number 6

Information Management Strategy

34. The current Information Management Strategy covers the period 2013-2016. While we understand there are plans to refresh the strategy, work had been delayed due to competing work priorities. With the implementation of General Data Protection Regulations (GDPR) last month, the planning and training carried out by the council in response to the new regulations should provide useful material when updating the strategy.

Refer Action Plan, number 7

Trust Funds

35. A Charitable Management Plan has been in place for the Aberdeenshire Charitable Trust (known as ACT2) since March 2017. We consider the plan to be an example of good practice as it outlines the roles and duties of the Trustees, the application process for funds and specifies the division of the purposes of the Trusts by ward. We noted however that no such plan exists for the Aberdeenshire Educational Trusts which have total funds of £3.8m available, significantly more than the £0.5m available from ACT2.

Refer Action Plan, number 8

Appendix

Key findings and action plan 2017/18

Issue identified	Management response	Responsible officer and target date
Audit findings		
<p>1.Invoice not addressed to Aberdeenshire Council</p> <p>We identified one paid invoice which was not addressed to Aberdeenshire Council.</p> <p>Risk: Payments are processed for inappropriate good/services.</p> <p>Recommendation: Staff should be reminded that only invoices addressed to Aberdeenshire Council should be accepted for payment.</p>	<p>Agreed</p>	<p>Target date to be confirmed when impact of recommendation has been fully considered by officers. (In approx 4 weeks)</p>
<p>2.Care First Debtors Reconciliation</p> <p>No reconciliation is carried out between the Debtors interface file from Care First and the total per the general ledger system.</p> <p>Risk: Differences are not timeously identified and resolved which may provide an opportunity for inappropriate actions.</p> <p>Recommendation: A reconciliation should be carried out and reviewed on a regular basis between the Care First debtors interface and the general ledger.</p>	<p>Agreed</p>	<p>Target date to be confirmed when impact of recommendation has been fully considered by officers. (In approx 4 weeks)</p>
Audit dimensions - issues and risks		
<p>4.Register of Interests/Conflicts of interest</p> <p>We reviewed the council's approach to its register of interests for both members and officers. We concluded that whilst the council could demonstrate its arrangements in respect of members, similar procedures could be implemented in respect of senior/specialist staff. Whilst a register is in place to record officers' gifts and hospitality, there is no register of officers' interests.</p>	<p>Agreed</p>	<p>Target date to be confirmed when impact of recommendation has been fully considered by officers. (In approx 4 weeks)</p>

Issue identified	Management response	Responsible officer and target date
<p>From a review of employee policies, there was no obvious policy covering the council's approach to managing staff conflicts of interest.</p> <p>Risk: There is a risk that officers in may be operating inappropriately if there are undisclosed conflicts of interest.</p> <p>Recommendation: The requirement to maintain a register of interests should be extended to members of the Strategic Leadership Team and other key officers with financially critical responsibilities e.g. Procurement. Arrangements for managing potential staff conflicts of interest should be reviewed. Overall, arrangements should be regularly monitored to ensure that appropriate safeguards are in place for both the council and its staff and that the arrangements are regularly monitored.</p>		
<p>4.Register of Whistleblowing cases</p> <p>While the council has received a small number of whistle blowing cases, no central register of cases is maintained or formally reported to the Strategic Leadership Team or the Audit Committee.</p> <p>Risks: The council is not responding to cases in a consistent fashion and in the absence of a lessons learnt review, there is a failure to corporately share lessons and implement improvements.</p> <p>Recommendation: A central register of whistleblowing cases should be developed and maintained. The number, issues arising and outcomes of cases should be reported regularly to the Strategic Leadership Team and Audit Committee and summarised annually. (Include as part of the annual fraud report already recommended)</p>	<p>Agreed</p>	<p>Target date to be confirmed when impact of recommendation has been fully considered by officers. (In approx 4 weeks)</p>
<p>5.Compliance with Laws and Regulations</p> <p>It is difficult to easily demonstrate each year how the council complies with laws and regulations where there may be hidden potential for the council to incur significant additional costs if there were a breach. .</p>	<p>Agreed</p>	<p>Target date to be confirmed when impact of recommendation has been fully considered by</p>

Issue identified	Management response	Responsible officer and target date
<p>Risk: The council fails to comply with legislative and/or other regulatory requirements and consequently is liable for significant additional costs.</p> <p>Recommendation: Procedures should be developed to identify regulations which if breached, could result in a significant cost/penalty for the council and therefore have a material impact on its financial position and annual accounts.</p>		<p>officers. (In approx 4 weeks)</p>
<p>6.Risk Management</p> <p>Quarterly risk management reviews are prepared for the Strategic Leadership Team and made available to members. While the Audit Committee is responsible for reviewing the adequacy of the council's risk management arrangements, it has not received a report since December 2016.</p> <p>Risk: Risk management arrangements are not subject to effective scrutiny.</p> <p>Recommendation: A review of risk management arrangements should be considered by the Audit Committee at least on an Annual basis. .</p>	<p>Agreed</p>	<p>Target date to be confirmed when impact of recommendation has been fully considered by officers. (In approx 4 weeks)</p>
<p>7.Information Management Strategy</p> <p>The Information Management Strategy has not been updated since 2013.</p> <p>Risk: The council's longer term IT plans are unclear and projects being taken forward in the interim may no longer be relevant or appropriate to the council's priorities.</p> <p>Recommendation: The strategy should be reviewed and updated as appropriate.</p>	<p>Agreed</p>	<p>Target date to be confirmed when impact of recommendation has been fully considered by officers. (In approx 4 weeks)</p>
<p>8.Charitable Management Plan</p> <p>The Trustees of the Aberdeenshire Charities Trust (ACT2) approved a Charitable Management Plan in March 2017. No similar plan exists for Aberdeenshire Educational Trusts which holds significantly more funds than ACT2.</p> <p>Risk: The roles and duties of Trustees and the process for</p>	<p>Agreed</p>	<p>Target date to be confirmed when impact of recommendation has been fully considered by officers. (In approx 4 weeks)</p>

Issue identified	Management response	Responsible officer and target date
<p><i>application for funds is not clearly understood.</i></p> <p>Recommendation: A Charitable Management Plan for the Aberdeenshire Educational Trusts.</p>		

Source: Audit Scotland

Aberdeenshire Council

Interim Report 2017/18

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