ABERDEEN CITY COUNCIL

COMMITTEE	Audit, Risk and Scrutiny Committee
DATE	8 May 2018
REPORT TITLE	Internal Audit Reports
REPORT NUMBER	IA/18/008
DIRECTOR	N/A
REPORT AUTHOR	David Hughes
TERMS OF REFERENCE	2.2

1.   PURPOSE OF REPORT

1.1   To discuss the format of Internal Audit reports resulting from planned activity.

2.   RECOMMENDATIONS

2.1   To consider whether the format of Internal Audit reports meets the requirements of the Audit Risk and Scrutiny Committee and determine whether any changes are required.

3.   BACKGROUND / MAIN ISSUES

3.1   During 2017, the Council's external auditor, KPMG, completed a review of the Council's Internal Audit arrangements. The review was commissioned by Council management to satisfy the Public Sector Internal Audit Standards requirement of having an external assessment at least once every five years as well as to make comparisons to best practice for an entity listed on the London Stock Exchange. This replaced the Aberdeen City Council element of a planned review of the Shared Internal Audit Service that was to be completed through arrangements put in place by the Scottish Local Authorities Chief Internal Auditors' Group.

3.2   One of the findings / recommendations that came out of the KPMG review was as follows:

> **Finding**
>
> The format used to report findings to management and the ARSC has no measure of materiality and in some cases can contain detail on relatively minor points. We note that the reports do not include an executive summary which would concisely outline the number, nature and detail of the key findings for the ARSC.

Equally the gradings used for individual findings have not been agreed with ACC and have not been defined in the charter. There is no overall grading given to a report, only the individual findings which means it is difficult for stakeholders to make comparisons of the risk areas across service lines. We do however note that there is reference to the importance of a finding relative to the service area being reviewed and to the Council at a corporate level.

Risk

Stakeholders could find it difficult to focus on the key risk areas of a report where there is no executive summary of clearly defined grading of findings.

Recommendation

It is recommended that the format of IA reports is reviewed to ensure that it meets the requirements of the ARSC and the key senior stakeholders of the Council. Key points for review should include:

i.   A clear measure of materiality and classification of findings which are defined in the charter.

ii.   Potential introduction of an overall report grading.

iii.   Introduction of an executive summary.

3.3   The above recommendation was reported to the Audit Risk and Scrutiny Committee on 23 November 2017 with an implementation date of April 2018. To implement the recommendation, it was agreed that, in view of the substantially changed membership of the Committee following the May 2017 local government elections, management would engage with the Audit, Risk and Scrutiny Committee regarding the nature and level of reporting required.

3.4   When the Shared Internal Audit Service was implemented in 2015, it was agreed that the work done and reporting thereof would be based on the methodology used in Aberdeenshire Council. Keeping the same methodology between the two Councils helps promote efficiency within the Internal Audit team as different styles are not required dependant on the client.

3.5   Aberdeenshire Council's Internal Audit reports contain all the detail of testing undertaken, whether this covers significant risk areas or areas that could be improved, either in relation to the control environment or efficiency. Whilst some of these areas will be minor in nature, they are included to show the level of coverage, the consideration given to the area under review and, where they relate to governance issues, because they have to be included as required by the Public Sector Internal Audit Standards.

3.6   Recommendations are graded and an explanation of the gradings used is attached as an appendix to each report. The gradings are not included in the Council's Internal Audit Charter as there is no requirement, under the Public Sector Internal Audit Standards, for them to be included. The

Standards are quite specific about what has to be included and to expand the document further could, in Internal Audit's view, make the document more unwieldy.

3.7   The wording in the main body of the reports generally follows the system from beginning to end, showing that the whole system has been considered during testing rather than grouping more material findings at the start of the report. Aberdeenshire Council reports include a detailed executive summary (as appropriate to the findings in the audit), stating either in detail or summary the areas where recommendations for improvement have been made. The more significant areas are highlighted with agreed corrective action, with the less material areas listed.

3.8   The Aberdeenshire Council Audit Committee receives the executive summary from each report. The Chair of the Aberdeen City IJB Audit and Performance Systems Committee recently requested that Internal Audit adopt this approach for reporting to that Committee to ensure that the Committee receives a more proportionate summarised report to allow it to focus on any material matters arising, rather than having, what is effectively, a report for management detailing all the areas examined and issues arising.

3.9   Following the February 2015 meeting of the Audit, Risk and Scrutiny Committee, prior to the shared service commencing, members were asked whether they wished to receive full Internal Audit reports or would be content to receive a detailed executive summary following the Aberdeenshire model. The consensus was that full reports would be desirable in terms of openness. In view of this, a less detailed summary is provided in these reports.

3.10   During the last three years, Internal Audit has received comments from recipients of reports relating to the number of recommendations being made, the grading of those recommendations, and relatively minor issues being included. In response, Internal Audit has attempted to group recommendations where appropriate to reduce the numbers, have discussed the grading applied to recommendations (but not the gradings used), and stated that, although some issues are considered less material by management, there is a requirement to include them, both under the Public Sector Internal Audit Standards and to ensure openness.

3.11   Consultation has been undertaken with other Scottish Councils to determine those that do use an overall grading for each report, what gradings are used, and how they are determined. There was a fairly even split between those that do give an overall grading and those that don't.

3.12   For those that do there were a variety of options ranging from complex to simple, with some using scoring mechanisms based on the relative significance of the area under review and the significance within that area of issues identified resulting in a score, which was then matched to a specific grading. Whilst these appeared to be "scientific" in their approach, others were based on a narrative description of the level of assurance being provided. It could be argued that some were cumbersome, time consuming to apply, could be subject to additional debate during the report clearance

phase of the audit, and added little additional assurance or clarity for those charged with governance. Any grading arrived at would have to be caveated based on the sample of documentation / transactions tested and there may be issues regarding the level of assurance that could be placed on the overall grading in terms of statistical significance. However, having each report graded could assist in the production of Internal Audit's annual report, providing explicit evidence supporting the annual opinion, and might help direct those charged with governance towards a more detailed examination of reports with a poor grading.

3.13   For those that did not apply a grading there was a general consensus that an overall grading would add little value, with some commenting that an audit report with a lot of significant findings and errors would provide the reader with little or no doubt as to the low level of assurance being provided, whilst a review with minor house-keeping issues may well suggest the opposite (whilst showing the level of consideration having been given to the subject area).

3.14   Internal Audit believes that the wording used in more recent Internal Audit report executive summaries is more explicit and, whilst not referring specifically to the word "assurance", it is clear whether Internal Audit's opinion is positive or negative.

3.15   Discussion with management provided Internal Audit with management's expectation of Internal Audit reports. This commences with management stating through its risk registers what its assessment of risk is in relation to the area subject to audit. The audit report should then give an assessment of the robustness of the control environment established and the level of compliance evidenced measured against management's assessment of risk. Recommendations made by Internal Audit then need to be reviewed by management to determine whether the cost of implementation is justified in view of management's assessment of the risk in not doing so.

3.16   During the discussion it was agreed that whilst there are Corporate and Directorate Risk Registers in place, there is a need to develop operational / functional risk registers to allow the Internal Audit process to measure results of testing against management's assessment of risk. This will be an evolutionary process and, once complete, the need to provide a graded Internal Audit report could be reconsidered, as it is felt that part of the grading mechanism would need to take account of management's assessment of risk.

3.17   Other suggestions made during consultation included having a table in the executive summary detailing the number of recommendations made in the report by classification, and having all recommendations made in an appendix to the report rather than throughout the body of the report as they arise.

3.18   The reporting options that present themselves are as follows:

    1.   Continue producing fully detailed reports for management, with graded recommendations and no overall report grading, with short executive summary, with the full report presented to Committee (status-quo).

2. Continue producing fully detailed reports for management, with graded recommendations and no overall report grading, with longer, more detailed executive summary, with the full report presented to Committee.

3. Continue producing fully detailed reports for management, with graded recommendations and no overall report grading, with longer, more detailed executive summary, with only the executive summary presented to Committee.

4. The above options but with an overall report grading.

5. The above options but with the executive summary containing a table detailing the number of recommendations by classification in the report.

6. The above options but with the recommendations contained in an appendix to the report rather than throughout the body of the report as they arise.

3.19 Whatever option is decided on, the audit reporting process will continue to evolve as the Council's risk management process matures as described in paragraph 3.16 above.

4. FINANCIAL IMPLICATIONS

4.1 There are no direct financial implications arising from the recommendations of this report.

5. LEGAL IMPLICATIONS

5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

6.1 The Internal Audit process considers risks involved in the areas subject to review. Any risk implications identified through the Internal Audit process are detailed in the resultant Internal Audit reports. The purpose of this report is to address concerns raised by the Audit, Risk and Scrutiny Committee.

7. OUTCOMES

7.1 There are no direct impacts, as a result of this report, in relation to the Local Outcome Improvement Plan Themes of Prosperous Economy, People or Place, or Enabling Technology, or on the Design Principles of the Target Operating Module.

7.2 However, Internal Audit plays a key role in providing assurance over, and helping to improve, the Council's framework of governance, risk management and control. These arrangements, put in place by the Council, help ensure that the Council achieves its strategic objectives in a well-managed and controlled environment.

8.   IMPACT ASSESSMENTS

Assessment	Outcome
Equality & Human Rights Impact Assessment	An assessment is not required because the reason for this report is for Committee to review, discuss and comment on the outcome of an internal audit. As a result, there will be no differential impact, as a result of the proposals in this report, on people with protected characteristics.
Privacy Impact Assessment	Not required
Duty of Due Regard / Fairer Scotland Duty	Not applicable

9.   BACKGROUND PAPERS

9.1   Report to Audit, Risk and Scrutiny Committee on 23 November 2017 – Internal Audit Public Sector Internal Audit Standards (OCE/17/26).

10.   REPORT AUTHOR DETAILS

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