



Audit and Standards Committee Report

Report of: Dave Phillips, Head of Strategic Finance

Date: 18th April 2019

Subject: Compliance with International Auditing Standards

Author of Report: Kayleigh Inman, Senior Finance Manager (Internal Audit)

Summary:

This report has been drafted so that the Audit and Standards Committee can demonstrate to the External Auditors and the wider audience that they have exercised the required oversight to meet the requirements of the International Standards on Auditing. This report draws together much of the work that has been undertaken by the Audit and Standards Committee in the past year.

Recommendations:

- 1) Members are asked to confirm that the report gives an accurate reflection of the reports that they have received and considered throughout the year.
 - 2) Members are also asked to confirm that they now have an overview of the Council's systems of internal control so that they are assured that they are fulfilling the requirements of "those charged with governance" under the International Auditing Standards.
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Background Papers:

Category of Report: Open

* Delete as appropriate

Statutory and Council Policy Checklist

Financial implications
YES /NO Cleared by: K Inman
Legal implications
YES /NO Cleared by:
Equality of Opportunity implications
YES /NO Cleared by:
Tackling Health Inequalities implications
YES /NO
Human rights implications
YES /NO
Environmental and Sustainability implications
YES /NO
Economic impact
YES /NO
Community safety implications
YES /NO
Human resources implications
YES /NO
Property implications
YES /NO
Area(s) affected
Corporate
Relevant Scrutiny Board if decision called in
Is the item a matter which is reserved for approval by the City Council? YES /NO
Press release
YES /NO

Report to the Audit and Standards Committee April 2019

Compliance with International Standards on Auditing (ISA)

Introduction

- 1) **International Standards on Auditing (ISA)** are professional standards for the performance of financial audits of financial information. 'Those charged with governance' oversee the entity's systems for monitoring risk, financial control and compliance with the law.
- 2) As part of the International Standards on Auditing (ISA) there is a requirement for 'those charged with governance; (for Sheffield City Council this is the Audit and Standards Committee) to demonstrate formally that they have exercised adequate oversight of management's processes for identifying and reporting the risk of fraud and possible breaches of internal control, together with overseeing the financial reporting process.
- 3) For the past few years, this report has been produced for the Audit and Standards Committee to enable them to demonstrate that they have taken the appropriate overview of the entire governance framework of the Council, and have therefore meet the requirements of the International Standards on Auditing.
- 4) From 2018/19 the external auditor for SCC changed from KPMG to Ernst and Young (EY). The change in auditor has provided an opportunity for revisions to be made to the format of this report to reflect the requirements and specifications of the new auditors. A copy of the required assurance requested by EY is attached in letter form to this report (Appendix 1). It is the intention of this report to answer each of the auditors' questions and in doing so will demonstrate that the Audit and Standards Committee has the required oversight of the governance framework and management's control processes.

Key Requirements of the International Auditing Standards

- 5) The key elements that are required to be covered by members in relation to the International Auditing Standard (*UK&I*) (IAS) are noted below:
- 6) Under ISA 240 the Council's appointed external auditors (EY) are required to understand how 'those charged with governance' exercise oversight of management processes for:
 - identifying and responding to the risk of fraud in the Council, and the internal control that management has established to mitigate these risks;
 - Determining whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.

- Assessing the risk that the financial statements may be materially misstated due to fraud or error;
- 7) ISA 250 requires that external auditors understand how those charged with governance gain assurance that all relevant laws and regulations have been complied with.
- 8) Additionally those charged with governance must approve the financial statements, so an understanding as to how the Audit and Standards Committee obtains the necessary assurances to discharge this responsibility is also required.

Areas Covered in the Report

- 9) The following sections summarises how the members of the Audit and Standards Committee have been provided with assurance that key elements of the Council's internal control systems are being reviewed and reported upon. This is a consolidation report of items that have been presented to the Audit and Standards Committee throughout 2018/19, and covers the : -
- Annual Accounts (2017/18)
 - System of Internal Control
 - Governance Arrangements (and compliance with laws and regulations)
 - Counter Fraud Arrangements
 - Risk Management
 - Standards Issues
- 10) The Audit and Standards Committee comprises 7 non-executive members of the Council with proportionality applied and a maximum of 3 non-voting co-optees.
- 11) There are also currently three Independent Persons that assist the Monitoring Officer in dealing with standards complaints against Councillors. They attend the meetings of the Committee when there is a Standards focus.
- 12) It is noted that the Audit and Standards Committee have taken a number of steps to help them undertake their roles and responsibilities. This has included taking independent advice and training. Officers of the Council

and External Audit also attend the Committee to present reports and to answer questions raised.

Annual Accounts

- 13) Those charged with governance (the Audit and Standards Committee) are required to approve the financial statements. In order to do this effectively, the Audit and Standards Committee obtains the necessary assurances to discharge this responsibility via a number of submissions/reports.
- 14) In June 2018, the Senior Finance Manager (Strategic Finance) reported upon the arrangements for the production of the 2017/18 annual accounts and provided members of the Audit and Standards Committee with a summary of the Statement of Accounts. An explanation of the core statements and a number of the key notes to the accounts was provided. Officers confirmed that it was appropriate that the financial statements of the Authority were prepared on a going concern basis, and they intend to give the same assurances in relation to 2018/19. Officers also intend to confirm there is no organisational or management pressure to manipulate materially the financial position as reported in the statutory accounts to meet financial or operating targets. External Audit expressed satisfaction with the arrangements.
- 15) A training session, facilitated by an independent provider, was delivered to members of the Audit and Standards Committee to assist with their understanding of the draft accounts.
- 16) The Head of Strategic Finance presented the audited annual accounts at the July 2018 meeting. The Audit and Standards Committee reviewed the accounts and questioned the officers on items contained therein. Where additional information was requested, this was provided to the Committee promptly in a suitable form for discussion.
- 17) The external auditors, KPMG, presented their ISA 260 report to the July 2018 Audit and Standards Committee. The report outlined the work undertaken on the 2017/18 accounts to support their conclusions.
- 18) External Audit identified no significant issues with the Authority's organisational and IT control environment and considered that the overall arrangements in place were reasonable. Further, they concluded that controls over the majority of the key financial systems were sound, noting some minor weaknesses in respect of delays in preparing bank reconciliation.
- 19) In accordance with ISA 260 External Audit are required to report any corrected audit differences to 'those charged with governance'. This includes any material misstatements which have been corrected. The audit identified a total of two significant audit differences. The first of these (relating to debtor, cash and creditor balances) has been adjusted in the

final version of the financial statements. The second adjustment related to fixed asset additions and was not adjusted. There has been no impact upon net assets held or the General Fund as a result of the audit differences. In addition, a small number of minor errors and presentational adjustments were required.

- 20) KPMG concluded that in all significant respects the Authority had proper arrangements to ensure it has taken properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. They concluded that the Authority had proper arrangements to secure economy, efficiency and effectiveness in its use of resources, and issued an unqualified Value for Money conclusion.
- 21) Certificates of Completion of the audits for 2016/17 and 2017/18 cannot be issued until work had been concluded on the outstanding objections received in 2016/17 from local electors. These objections related to the Council's Lender Option Borrower Option (LOBO) loans, and the Council's Private Finance Initiative Schemes. The LOBO objection has now been closed, however work on the PFI issue remains ongoing. Unqualified audit opinions have been issued for both 2016/17 and 2017/18.
- 22) The accounts for 2017/18 were prepared to meet the required timescales for shorter closedown, noting the point above about the completion date.

System of Internal Control

- 23) There is an explicit requirement on officers and members to comply with the Council's Code of Conduct and supporting rules and regulations. As part of the sign-off process for the Annual Governance Statement (AGS), Directors are required to confirm in writing that they have in place adequate systems that ensure compliance with the relevant rules and legislation pertaining to their area of activity and this is used as a basis for the production of the statement. They also confirm that they are managing the risks pertaining to their service.
- 24) Internal Audit planning arrangements are designed to cover the significant risks of the Council and the plans are endorsed by the Audit and Standards Committee. The plan for 2018/19 was presented to the Committee in April, along with a report describing the process for compiling the plan. The new plan for 2019/20 is on the same agenda as this report.
- 25) All reports containing a "high opinion" are submitted to Committee members in full. An auditable area receiving a high opinion is considered by internal audit to be an area where the risk of the activity not achieving objectives is high and sufficient controls were not present at the time of the review. Members can then forward any questions to the Senior Finance Manager, Internal Audit and responses are circulated to all. This process is used ensure members are aware of any breaches of, or deficiencies in internal control.

- 26) Bi-annual update reports are provided to the Committee to outline progress on the implementation of recommendations contained within the high opinion reports. The tracker report is used to monitor all recommendations until they are satisfactorily implemented. In addition, issues would be raised from other reports, where Internal Audit are aware of serious breaches of control arrangements or where it is felt that management are not adequately dealing with matters of concern. No such issues have arisen in 2018/19.
- 27) In October 2018, the approach to the Internal Audit Opinions was revised. Opinions are now expressed as assurance statements and are supported by an organisational impact assessment. As part of the new approach, it was agreed that all reports with a 'no assurance' opinion would be submitted to members of the Audit and Standards Committee in full, regardless of the organisational impact. Further it was agreed that 'limited assurance' reports with a high organisational impact would also be provided to members of the Committee.
- 28) The Senior Finance Manager (Internal Audit) produces an independent annual report which was presented to the September Audit and Standards Committee highlighting the work undertaken on the Council's control environment and her opinion on the Council's control arrangements. For 2017/18 the Senior Finance Manager (Internal Audit), was satisfied that the risk management, governance and internal control framework was adequate to allow the Council to conduct its business appropriately.

Governance Arrangements (and compliance with laws and regulations)

- 29) The governance framework of the Council comprises the systems and processes, and cultures and values by which the Council is directed and controlled. The framework enables the Council to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of appropriate, cost-effective services.
- 30) The Council constantly reviews key governance documents, such as the Constitution and the Leader's Scheme of Delegation, supported by the Standing Orders and Financial Regulations to ensure that they are fit for purpose.
- 31) Directors confirm compliance with the governance arrangements as part of their sign off for the Annual Governance Statement (AGS). The 2017/18 AGS highlighted one significant control weaknesses - the ability to comply with Subject Access Requests requirements. This issue was monitored by the Executive Management Team and progress will be reported back to the Audit and Standards Committee as part of the AGS process for 2018/19.
- 32) In September 2018 a report was presented to update members of the Audit and Standards Committee on the work carried out within the Council

to prepare for and comply with the new data protection legislation that came into effect on 25th May 2018. It was noted that compliance to GDPR and data protection is an ongoing activity and the work to develop and maintain compliance moved to the Information Governance Working Group to be part of business as usual.

- 33) As part of the above transition, a GDPR action plan will be used by the Information Governance Working Group representatives to work within their respective portfolios to ensure data protection is embedded into working practice, which can be monitored and measured with the Annual Governance Statement.
- 34) Every executive report must include financial and legal implications and equal opportunities implications as a minimum. The financial and legal implications are signed-off following submission to the relevant professional services. This process gives the Council and Audit and Standards Committee assurance that law and regulations are complied with.
- 35) The Senior Finance Manager (Internal Audit) presented her independent annual report to the September meeting of the Audit and Standards Committee, which supported the Council's Annual Governance Statement. The report gave details of the audit coverage and outlined how overall the response to recommendations made by Internal Audit was positive, with the majority being accepted by management. No material non-compliances with law and regulations have been identified through the audit work performed.
- 36) The Senior Finance Manager for Internal Audit retains the independent access rights to the Chief Executive of the Council, along with the Chair and other members of the Audit and Standards Committee. This has worked well in the year.

Counter Fraud Arrangements

- 37) The primary responsibility for the prevention and detection of fraud rests with both SCC management and those charged with governance. It is important that management place a strong emphasis on fraud prevention, which may reduce the opportunities for fraud to taken place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment.
- 38) The Council's Anti-fraud and Corruption Policy Statement and Framework, clearly states that the Council has a zero tolerance to fraud, and that it expects its employees to uphold the highest ethical standards and to strictly adhere to its anti-fraud framework and associated policies.
- 39) As part of the Officers' Code of Conduct, the Policy Statement - Fraud & Corruption incorporates a message from the Chief Executive which clearly

states the 'zero tolerance' approach of the authority. It incorporates the fact that any instances of fraud or corruption will be treated as gross misconduct.

- 40) Within Internal Audit, counter fraud resources are allocated in the annual Internal Audit plan as presented to the Audit and Standards Committee in April 2018.
- 41) In June 2018, a report was produced for the Audit and Standards Committee to summarise the reactive and pro-active fraud activity undertaken by Internal Audit in 2017/18. Internal Audit conducted three pro-active counter fraud exercises. Issues from these reviews were discussed and actions agreed with the relevant managers in the areas concerned. These reviews did not identify any instances of fraud being undertaken. A similar report will be presented in due course for 2018/19.
- 42) The report also contained a full suite of updated policies covering the various elements of the fraud and corruption framework for the Council. The policies now form a suite which gives a consistent approach for the identification of fraud risks and their mitigation. There is also a process to allow managers to investigate potential fraud risk effectively in line with the other relevant policies and procedures.
- 43) Any Individual incidents of a material scale will continue to be reported to the Audit and Standards Committee by Internal Audit, and the Audit and Standards Committee can call in officers to respond to the issues raised. Internal Audit has detected no material frauds during the year (to date).
- 44) The Cabinet Office is responsible for the National Fraud Initiative and the exercise for 2016/17 is being concluded. The required data sets were submitted in October 2018, which resulted in a significant number of data matches being received in February 2019.
- 45) The matches were distributed to the relevant sections across the Council and Capita who were responsible for checking these matches, taking the appropriate actions (recovery and sanctions) and for recording the outcomes onto the central NFI database. There are a number of different categories of matches dependent upon the strength of the data. The Council concentrates effort in those areas where the most significant results are found. Internal Audit has provided support throughout the year to services to ensure the strong data matches were investigated and the outcomes appropriately recorded.
- 46) Appended to the 2018 Fraud Report was a completed checklist for 'those charged with governance'. The document was prepared by Internal Audit to highlight to the Audit and Standards Committee that the Council has in place adequate arrangements for the prevention, detection and investigation of fraud that may occur within SCC.

- 47) SCC has an extensive Whistleblowing Policy that contains an explanation on whistleblowing arrangements and the reporting access routes including the details of designated contact officers. The Human Resources Service maintains a central register of allegations. Whistle blowing allegations are all reviewed and where appropriate fully investigated by someone independent of the area.
- 48) Regular meetings now take place with Human Resources and representatives of Internal Audit where issues pertaining to fraud are raised and discussed. Much of the fraud investigation work is undertaken by management supported by Internal Audit and HR.

Risk Management

- 49) The Council has a risk management framework in place that has been agreed by Cabinet. The Corporate Risk Manager attended the Audit and Standards Committee in July 2018 and January 2019 to present to members a report on the current risk management reporting arrangements within the Council and measures being implemented to further strengthen and improve those arrangements. The report included the risk trend analysis as well as the current and emerging risk to delivery of the Council's strategic objectives and the controls in place to manage those risks. Included within the presentation was consideration of the corporate risk around the financial position of the Council and demand pressures, particularly in relation to adult and children's social care. Audit and Standards Committee members are given the opportunity to question any issues raised.
- 50) There is a requirement that all reports that are presented to the Council's Cabinet contain the key risks that relate to the subject area, and these are scrutinised by the members. There is also a process in place to record and manage the risks in relation to programmes and projects as part of the progress reports submitted to members.

Standards Issues

- 51) The latest version of the Procedure for Dealing with Standards Complaints was approved by the Audit and Standards Committee on 16 November 2017 and by Full Council on 6 December 2017, with a new requirement to review the procedure on an annual basis by the Monitoring Officer in consultation with the Independent Persons. A report was submitted in September 2018 proposing some slight revisions as a result of the complaints considered this year.
- 52) A report was submitted to the Committee in July 18 providing an update on complaints made and actions taken.

Requested actions

- 53) Members are asked to confirm that this report gives an accurate reflection of the items that they have received and considered throughout the year.
- 54) Members are also asked to confirm that they have an appropriate overview of the Council's systems of internal control so that they are assured that they are fulfilling the requirements of "Those Charged with Governance" under the International Auditing Standards.

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