

North Lanarkshire Council

Interim Audit Report 2016/17



 AUDIT SCOTLAND

Prepared for North Lanarkshire Council

July 2017

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- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Audit findings

Introduction

1. This report contains a summary of the key findings from our interim audit work at North Lanarkshire Council.
2. Auditing standards require external auditors to obtain an understanding of the accounting and internal control systems that exist within the audited body to allow us to plan the audit and develop an effective financial statements audit approach. They also require us to work closely with internal audit to make best use of the available resources and avoid duplication of effort.
3. This is reflected in our responsibilities under the Code of Audit Practice that we 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.
4. Also, under the Code of Audit Practice (2016) we have carried out work on the wider dimension audit, [Exhibit 1](#). Specific audit work has focused on financial management arrangements and financial sustainability. Our work on governance and transparency is not yet complete and will be included in our annual audit report.

Exhibit 1

Audit dimensions



Conclusion

5. We identified some significant control weaknesses as summarised in [Exhibit 2](#), particularly in segregation of duties and the presence of second officer checks over transactions. This will impact on our audit approach and will require us to complete additional testing to obtain the required assurances for our audit of the 2016/17 financial statements and non-domestic rates grant return.
6. Our audit work identified a robust control operating for the changes to supplier bank details, which includes the completion of a standard checklist. We believe this is an example of good practice and a strong control that mitigates the associated risk of fraud.
7. In terms of our wider dimension audit work we also identified areas where the council could improve current arrangements. These are summarised in [Exhibit 3](#) and will inform our Annual Audit Report which will be issued in September 2017.
8. 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 North Lanarkshire Council.
9. All our outputs and any matters of public interest will be published on our website: www.audit-scotland.gov.uk.
10. 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.

Internal control systems and action plan

11. This work included testing of key controls within financial systems to gain assurance over the processes and systems used in preparing the financial statements. We will use the results of this testing to determine our approach during the 2016/17 financial statements audit.
12. Our 2016/17 testing covered key controls in a number of areas including bank reconciliations, payroll validation and exception reporting, authorisation of journals, change of supplier bank details and IT access controls. Additionally, our testing covered feeder system reconciliations, the issuing of credit notes and controls for preventing and detecting fraud in areas such as applying discretionary discounts and awarding grant payments.
13. To enable us to provide the assurances required for the audit of the North Lanarkshire Integration Joint Board (NLIJB) we also assessed the control environment within social work services and completed some early substantive testing.



Bank reconciliations



Payroll controls



IT access



Journals

14. In accordance with the detail contained within our Annual Audit Plan we were able to rely on the work of internal audit in the following key areas:
- bank reconciliations
 - feeder system reconciliations
 - authorisation of journals
 - council tax discounts.
15. Due to the timing of planned internal audit review, we were unable to rely on the payroll validation and exception reporting and completed this work ourselves. We did however obtain additional assurance from internal audit work on IT access controls.
16. The work of internal audit was clearly documented, the review process was robust and the audit evidence within the files supported the findings included within the reports.
17. The key control risks identified from the audit work undertaken are detailed in [Exhibit 2](#). These findings will inform our approach to the financial statements audit as detailed in the final column.

Exhibit 2

Key findings and action plan

Audit finding	Management response, responsible officer and target date	Additional audit procedures
Audit team controls work		
<p>1 BACS payments</p> <p>The creditors manager is responsible for the daily BACs payments process. No other staff are involved and there are no second officer checks in place. As the creditors manager has full access to the system he has the ability to set up new suppliers, amend bank details and make payments.</p> <p>There is a risk that weaknesses in segregation of duties could result in fraudulent payments that would not be identified prior to processing and may not be identified by budget holders.</p>	<p>The Creditors Manager and Team Leader require full access to all system screens in order to complete the payment run.</p> <p>Management are satisfied that there are adequate alternative controls in place In terms of mitigating this risk to an acceptable level including the use of control totals and the need to match invoices to purchase orders. Additionally the following specific detective controls are in place:</p> <ul style="list-style-type: none"> • A daily report is run/ verified re changes to bank details on transaction value greater than £10k. • A daily report is run on higher value invoices greater than £10k which is verified for authorisation. • Significant anomalies would be picked up by budget holders. <p>No further action proposed</p>	<p>We will identify and review a sample of any payments made by the creditors manager to ensure that transactions are valid (occurred and pertain to the council).</p>

Audit finding	Management response, responsible officer and target date	Additional audit procedures
<p>2 Payroll system changes</p> <p>There is no authorisation or second officer checks required for the processing of changes to employee records.</p> <p>There is a risk that incorrect or fraudulent changes could be processed within the payroll system.</p>	<p>The introduction of the full validation exercise at point 3 will contribute to the reduction of this risk. In addition, we will introduce a sample check of changes each month to verify the accuracy and appropriateness of such changes.</p> <p>Payroll & Pension Manager September 2017</p>	<p>We will extend our substantive testing of payroll changes to ensure they have been accurately processed within the system.</p>
<p>3 Payroll validation checks</p> <p>Payroll staff circulate listings of employees who have not been paid for 12 weeks to the relevant managers. There is no process for routinely distributing a list of paid employees to managers. The current process does not require managers to confirm that the listing is correct, only to notify if they identify any issues.</p> <p>There is the risk that the absence of a periodic validation of all staff through positive confirmation of current employment could lead to staff being paid or maintained on payroll standing data after they have left employment.</p>	<p>The current validation exercise will be amended to conduct an annual exercise to allow Services to validate all employees.</p> <p>Payroll & Pension Manager September 2017</p>	<p>We will substantively test a sample of paid employees to ensure they exist as current employees of the council, through confirmation to other records / manager response.</p>
<p>4 Non-Domestic Rates checks</p> <p>Internal arrangements require managers to check 10% of the reliefs awarded each month. Our testing found that there has been no formal review since early 2016. Although we were advised of some ad hoc checks on reliefs there was no evidence retained. The team have recognised this and are taking steps to address the issue.</p> <p>There is a risk that discounts have been awarded to those who do not meet the requirements.</p>	<p>As part of the ongoing restructure, administration of Council Tax and NDR will be combined in one general revenues team. There is a training programme for Council Tax staff which has the checking element built in to the process to monitor the quality of the output and review a minimum of 10 NDR checks each week with the analysis of each individual claim being recorded on our document imaging system. The output will be formally analysed for trends and discussed at full managers' meetings.</p> <p>Other checks which were undertaken to ensure accuracy included a check on all accounts where Small Business Bonus Scheme was in payment to ensure the correct amount of relief was awarded for the 2017/18 financial year. This is not detailed in the recognised format; however each check is documented and provides</p>	<p>We will monitor the council's progress in implementing checking retrospectively and consider whether we need to implement additional substantive testing as part of our financial statements work and as part of the non-domestic rates grant claim.</p>

Audit finding	Management response, responsible officer and target date	Additional audit procedures
	<p>confirmation of the level of checking that was applied to this relief.</p> <p>A bi-annual review is carried out of all reliefs awarded. This allows a regular check on the validity of the awards of relief made.</p> <p>Support & NDR Manager August 2017</p>	

Reliance on internal audit controls work

<p>5 Creditors Feeder authorisation</p> <p>Internal Audit found that Creditors' staff cannot effectively apply the limits from the Authorised Signatory Database for creditors feeders. This is because the values of individual payments within feeders are only known after the feeder is posted. To address this post processing checks are carried out.</p> <p>From internal audit's testing of 5 creditors' feeders, they identified one payment which was above the authorised signatory's limit for payment requests.</p> <p>There is a risk that inappropriate (inaccurate or invalid) payments are made.</p>	<p>Where the value of an individual transaction exceeds the authorised limit, the Creditors team manually apply a 'dispute' and payment is withheld from the feeder pending investigation.</p> <p>The Creditors Manager will instruct the relevant Service Manager to arrange for adequate authorisation levels for staff signing off the feeder.</p> <p>Creditors Manager August 2017</p>	<p>We will review a further sample of payment authorisations and extend our planned substantive testing sample of expenditure to include any payments that exceed delegated authorisation limits to ensure that transactions are valid (occurred and pertain to the council).</p>
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Source: Audit Scotland

Information technology

18. During 2016 North Lanarkshire Council was the victim of two significant ransomware attacks. No ransom was paid and the council was able to recover from the attack due to good work by its ICT department and partners. These incidents, together with the recent WannaCry attacks, demonstrate the need for all organisations to have incident management plans and robust, tested business continuity plans in place.
19. We have recently initiated an information security awareness survey, Your Business @ risk (YB@R), at the council, which we will report in September 2017. This exercise is designed to assess and improve staff awareness in this key area.
20. On 10th January 2017 the air conditioning system failed during a power outage in the Motherwell data centre. This caused equipment to overheat and shutdown, which resulted in some systems being unavailable for a few hours. We understand that the council is considering various options to avoid a recurrence of this event but has yet to make a final decision on the best option.

Early financial statements testing

21. To support the delivery of the financial statements audit we completed some early audit work on the staff costs and social work income and expenditure streams. No issues were identified.

Governance and transparency

22. We also completed a high level review of the 2015/16 audited financial statements to identify areas where the overall transparency of the disclosures could be improved and have had early discussions with finance officers. Early discussions have also taken place on the format of the new income and expenditure statement.
23. The previous external auditor highlighted individual issues with standards of conduct of members and officers:
- "Internal audit are currently investigating a number of serious allegations in relation to the Council's procurement processes."
 - "Our 2014/15 audit identified that a number of entries were found to be missing from councillor register of interests in relation to group companies".
 - "Whether staff associated with the operation and oversight of ...contracts conducted themselves in accordance with the Councils' expectations."
24. Some of the circumstances identified and investigated by the internal auditor have not yet been fully reported to committee while disciplinary processes are still to be completed.
25. As part of our overall approach to the audit of standards of conduct / fraud, we propose to undertake the following areas of work:
- continue to monitor and report on the internal investigations into identified cases
 - review the council's handling of any National Fraud Initiative matches, for evidence of potential fraud / standards of conduct issues
 - assess the completeness of registers of interest of members and officers and assess these against a developing model of best practice
 - develop and pilot an on-line assessment tool for staff which assesses the risk of issues with, and increases awareness of, standards of conduct. In a similar way to the tool described at paragraph 19 (YB@R).

Financial sustainability

26. Council's deliver a range of services, both statutory and discretionary, to local communities. Financial sustainability is concerned with the robustness of the financial planning arrangements in place to identify and address financial risks in the medium (two to five years) and longer term (longer than five years).
27. North Lanarkshire Council's long term financial strategy (2014/15 to 2023/24) was approved in May 2014 and considers a range of scenarios and the associated savings required to present a balanced budget. The intention was that the long term financial plan would be reviewed and refined as new information became available. The updating of this long term financial strategy was delayed until June 2017 to align with the incoming new political administration and the Scottish Governments planned Spending Review.
28. In previous years the council has prepared a medium term Financial Outlook to assess the financial position for the following 2 years, identifying likely budget

gaps and enabling early work on potential savings plans. The latest was presented to the Policy and Resources Committee in Autumn 2015 covering 2016/17 and 2017/18. In 2016 the council moved to a condensed 1 year revenue budget due to the challenge in setting a balanced 2016/17 budget. In June 2016 a report was presented to the Policy and Resource Committee entitled 'Development of a strategic approach to budgeting' which outlined proposals for a new budget strategy and supporting framework including a governance structure to ensure its delivery. A cross-party Sounding Board was created to change the direction of the council's budget setting process away from the traditional incremental approach to a more policy led strategic approach. Updates to the 2017/18 Financial Outlook were included as part of the process to inform the council in setting the 2017/18 budget.

29. The extent of the financial challenges being faced across the public sector increases the importance of strong medium and long term financial planning which can be used to inform the budget setting process and the identification and delivery of savings which support the ongoing delivery of council services and strategic priorities.

Exhibit 3 - point 1

30. At 1 April 2016 the council had a general fund balance of £64 million of which £52 million was earmarked for specific purposes. The largest element relates to the council's change management fund (£25 million). At period 12 the council is reporting that £41 million, or 78% of the earmarked balance, as planned will be used during 2016/17, including £7.5 million to balance the revenue budget.
31. The council considered the 2017/18 revenue budget at a meeting on 23 February 2017. The approved 2017/18 budget continued the council tax freeze and details a 2017/18 savings gap of £19 million that needs to be addressed through a range of measures. These measures include the use of £11 million of reserves on a one off basis for 2017/18 on the confirmation that there were firm plans in place to replace this funding by 1 April 2018.

Financial management

32. In February 2016 the council approved a balanced 2016/17 revenue budget of £746 million, including the use of £2 million of reserves to balance the budget. A further £32 million of financial savings were also required. This includes £13 million of base budget adjustments which were accepted as having minimal or no impact on staff, services or existing policies, for example improvement in council tax collection processes and targeted delivery of procurement efficiencies. In addition £19 million of thematic savings were identified by services from areas such as service prioritisation, asset management and procurement. Each savings option was specific with detail as to how these will be achieved and what financial impact they will have. Savings options are clearly embedded within the budget setting process.
33. Throughout the year budget monitoring reports have been reported to the Corporate Management Team on a monthly basis and the Policy and Resources (Finance and Customer Services) committee on a quarterly basis. In addition each service reports to the relevant sub committee on their progress against their revenue and capital budgets quarterly. Appropriate arrangements are in place to allow the council to identify and respond to any issues quickly through the budget monitoring process.
34. Throughout 2016/17 the council reported an anticipated year end surplus. This has increased rapidly in the final 6 months of the year from an estimated surplus of £2 million at period 6, to an anticipated £13 million at period 12. This is primarily due to underspends in staff costs and property costs, and additional Scottish Government funding received in year. The council is anticipating that approximately £8 million of reserves will be used to deliver this position, of which £7.5 million will come from earmarked reserves. This

includes £5.4 million to the IJB to mitigate the impact of re-grading of Home Support Workers. Services are reporting that £27 million (83%) of the identified savings are being achieved with alternative savings options for £4 million identified and the remaining £1 million offset by underspends in service areas.

Wider dimension action plan

35. The wider dimension risks identified in the previous paragraphs are detailed in [Exhibit 3](#). These findings will inform our Annual Audit Report conclusions in each of the wider dimension audit areas.

Exhibit 3

Key findings and action plan

Issue identified	Management response	Responsible officer and target date
Financial sustainability		
<p>1 Medium and long term financial planning</p> <p>The long term financial strategy has not been updated since it was approved in May 2014. In addition the council has recently moved from the preparation of a 2 year financial outlook to a condensed 1 year process in response to the short term financial challenges being faced.</p> <p>There is a risk that the lack of medium and long term financial planning will impact on the council's ability to achieve financial sustainability.</p>	<p>As planned the long term financial strategy will be updated over the summer to provide a sound forward planning platform.</p>	<p>Head of Business for Financial Solutions</p> <p>September 2017</p>

Source: Audit Scotland

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