

# Moray Council

Appendix 1

## Management Report 2017/18



 AUDIT SCOTLAND

Prepared for Moray Council

June 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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# Audit findings

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## Introduction

1. This report summarises the key issues identified from the interim audit work carried out at Moray Council. This work included testing of key controls within financial systems to gain assurance over the processes and systems used in preparing the annual accounts. We will consider the results of this testing when determining our approach to the audit of the 2017/18 annual accounts.
2. Our responsibilities under the [Code of Audit Practice](#) require us to assess the system 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. In addition, we carried out work on the audit dimensions as required by the [Code of Audit Practice](#). This focussed on financial sustainability and governance and transparency. Areas where there is scope for improvement are set out in [Exhibit 3](#).
4. Any weaknesses identified represent only those that have come to our attention during the course of our normal audit work and, therefore, are not necessarily all of the weaknesses that may exist. It is the responsibility of management to decide on the extent of the internal control system appropriate to Moray 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.
6. All our outputs and any matters of public interest will be published on our website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

## Conclusion

7. Overall, we found that the key controls in place within Moray Council's main financial systems were operating satisfactorily with the exception of controls in operation over the council's payroll system and changes to supplier bank details. These control weaknesses are summarised in [Exhibit 1](#) together with the additional work we will undertake to get the assurances we require to express our opinion on the 2017/18 financial statements. [Exhibit 1](#) also includes an update on progress made in implementing the agreed recommendations included in our 2016/17 interim report.
8. In terms of our wider dimension audit work we 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 2018.

## Internal controls system and action plan

9. In accordance with ISA 330: the auditor's response to assessed risk, our audit judgements are based on current year testing of controls and, where appropriate, prior year results. Our risk based audit approach allows us to take a three-year cyclical approach to controls testing. This approach enables us to place reliance on previous years' audit work where controls remain unchanged and no significant weaknesses had been identified.

10. Our 2017/18 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, we tested controls in the following areas: budget monitoring and control; feeder system reconciliations and controls for preventing and detecting fraud in areas such as taxation receipts, welfare benefits, grants and other claims. We also assessed the financial controls within social work services to support the assurances required for the audit of Moray Integration Joint Board.



Bank reconciliations



Payroll controls



IT access



Budgets

11. The key control risks identified during the interim audit are detailed in [Exhibit 1](#). These findings will inform our approach to the financial statements audit as detailed in the final column.

### Exhibit 1

#### Key findings and action plan 2017/18

Issue identified	Management response, responsible officer and target date	Additional audit procedures
<b>Audit findings</b>		
<p><b>1. Payroll validation</b></p> <p>A validation exercise to verify the existence of employees on the payroll system has not been undertaken since the introduction of the new payroll system on 1 April 2017. We have been advised that this is due to the organisational structure within the payroll system not being up to date (e.g. vacant posts not being removed from the system and some staff being allocated to the wrong posts).</p> <p><b>Without confirmation, there is a risk that payments are made to people who are not employed by the council.</b></p>	<p>The people manager module has still to be fully developed.</p> <p>Additional consultancy has been secured and a project plan developed outlining implementation work that remains to be completed during the 2018/19 financial year. A Business Objects report is being developed as an interim solution. This work will enable the circulation of establishment lists to managers to be re-introduced.</p> <p><b>Responsible officers:</b></p> <p>Head of Financial Services / Acting Head of HR and ICT</p> <p><b>Target date:</b> October 2018</p>	<p>We will substantively test a sample of paid employees to ensure they are current employees of the council, through confirmation to other records/ management response.</p>

Issue identified	Management response, responsible officer and target date	Additional audit procedures
<p><b>2. Payroll system access</b></p> <p>Five members of staff have access to both the human resources and payroll system areas of iTrent enabling them to create a new employee and make payments through payroll.</p> <p><b>There is a risk that weaknesses in segregation of duties could result in fraudulent payments.</b></p>	<p>Changes have been made to some HR access levels to streamline duties and a comprehensive review will be part of the consultancy work referred to above.</p> <p><b>Responsible officers:</b></p> <p>Head of Financial Services / Acting Head of HR and ICT</p> <p><b>Target date:</b> December 2018</p>	<p>We will substantively test a sample of new employees added by these five members of staff to confirm they are valid employees.</p> <p>We will also substantively test a sample of payments made to these five members of staff to ensure that they are valid.</p>
<p><b>3. Care home payments</b></p> <p>Care homes are required to submit a fortnightly return outlining any changes to the level of care provided prior to payment being made. Our interim testing identified that payment is not withheld if these care schedules are not returned.</p> <p><b>There is a risk that payments have been made to care providers for care services they have not provided.</b></p>	<p>Contracts with care homes are under the direction of Moray Integration Joint Board (MIJB) and the procedures for managing them, including verifying the accuracy of invoices and making payments, will be discussed with MIJB senior management and procedures agreed.</p> <p><b>Responsible officer:</b></p> <p>Head of Financial Services</p> <p><b>Target date:</b> August 2018</p>	<p>We will substantively test a sample of payments to care homes who have not returned their fortnightly schedules and ensure that they are valid through confirmation to other records.</p>
<b>2016/17 Interim Report update</b>		
<p><b>4. Changes to Supplier Bank Details</b></p> <p>All changes to supplier bank details require to be verified prior to processing. However, during our interim testing we identified instances whereby changes had not been verified in line with council procedures.</p> <p><b>If procedures are not followed, there is a risk that unauthorised payments are made to third parties.</b></p>	<p><b>Management response 2016/17</b></p> <p>The council recognises the risk of fraud occasioned by processing fictitious requests to change bank details and has instigated a policy which involves validating such requests before they are actioned. It is accepted that the recording of the validation steps could be improved and staff will be reminded of the importance of evidencing that agreed procedures have been followed.</p> <p><b>Responsible officer:</b></p> <p>Payments Manager</p> <p><b>Target date:</b> August 2017</p> <p><b>Update from management:</b> A review of procedures has been carried out, including that of supplier account changes. A more robust new supplier authorisation process has been implemented that includes referral to Payments Officers.</p>	<p>We will substantively test a sample of supplier bank details to ensure that they have been verified in line with council procedures.</p>

Issue identified	Management response, responsible officer and target date	Additional audit procedures
<p><b>Update from 2017/18 testing:</b> Our 2017/18 audit testing found that 8 of the 20 changes to suppliers' bank details tested had not been checked in line with council procedures and that a further 3 had no evidence that the change had been independently verified.</p> <p><b>Ineffective controls over changes to supplier bank details increase the risk of fraudulent payments.</b></p>	<p><b>Management response 2017/18</b></p> <p>8 of the control weaknesses identified in 2017/18 related to 11 changes to suppliers' bank details which were carried out before the August 2017 action date. Council procedures are now being followed although not always evidenced and staff will again be reminded of the importance of evidencing that agreed procedures have been followed.</p> <p><b>Responsible Officer:</b></p> <p>Payments Manager</p> <p><b>Revised Target date:</b> August 2018</p>	
<p><b>5. Authorisation of Journals</b></p> <p>There is no authorisation of journals posted to the ledger.</p> <p><b>There is a risk that incorrect or fraudulent changes could be processed within the ledger system.</b></p>	<p>In the opinion of management there is no risk of fraud as journals are used to amend coding or make internal recharges within the general ledger and cannot result in cash payments. However, journal types and processes will be reviewed to ensure that this is the case and consideration given to authorisation procedures.</p> <p><b>Responsible officer:</b></p> <p>Head of Financial Services</p> <p><b>Target date:</b> January 2018</p> <p><b>Update from management:</b> A review was undertaken of month 10 journals. Following review, management remain of the view that the risk of incorrect or fraudulent changes processed within the ledger system is extremely low.</p> <p>The benefit of authorisation of journals is outweighed by the cost of implementation and no further action is proposed.</p> <p><b>Risk accepted by management.</b></p>	<p>We will use data analytics to identify and test a sample of high risk journals.</p>
<p><b>6. Changes to Chart of Accounts</b></p> <p>The council does not have a formal process in place for recording new/amended ledger codes requests. Changes are made by the accountancy section following correspondence with the relevant department requesting the change but audit trails of changes were not evident.</p> <p><b>There is an increased risk of misclassification of transactions if there is no audit trail evidencing the basis for changes.</b></p>	<p>Nominals can only be created with the permission of a principal accountant and audit trail reports are available from the financial system</p> <p>This issue is considered to be low risk for the council however management will consider developing a procedure for review of amendments made to the chart of accounts and impact on disclosure.</p> <p><b>Responsible officer:</b></p> <p>Head of Financial Services</p> <p><b>Target date:</b> March 2018</p>	<p>We will review the mapping of balance sheet codes from the ledger to the accounts using data analytics to identify any significant changes and to confirm that the mapping for the balance sheet is accurate and complete. This will confirm the overall net income/expenditure.</p>



Issue identified	Management response, responsible officer and target date	Additional audit procedures
	<p><b>Update from management:</b> From January 2018 Accountancy is piloting a review of structure changes on a monthly basis. Nominal changes will be reviewed by a Principal Accountant and other structural changes reviewed by the accountants to confirm structure accuracy for management reporting and SeRCOP reporting</p> <p><b>Recommendation implemented on a pilot basis.</b></p>	
<p><b>7. Refunds</b></p> <p>Prior to issuing refunds, the council does not check other systems to identify whether the taxpayer or tenant has any outstanding debts. Checks of prior year accounts are made within individual systems.</p> <p><b>There is a risk that the council does not receive all income due for the services provided.</b></p>	<p>This has been considered in terms of the council's ability to legally set off credit balances against various sums that may be payable to the council. This is reflected in the council's Debt Management Policy approved by Policy and Resources Committee in 2015.</p> <p>The council intends to investigate the use of a corporate debt module within the Financial Management System. This would provide linked enquiries for debt across all services.</p> <p><b>Responsible officer:</b> Head of Financial Services</p> <p><b>Target date:</b> November 2017</p> <p><b>Update from management:</b> The work undertaken on the implementation of a corporate debt system established that considerable work would be required to automate the matching of accounts from three different systems. The current practice of offsetting Accounts Payable and Accounts Receivable will continue.</p> <p><b>Risk accepted by management.</b></p>	<p>N/A – value for money issue.</p>

Source: Audit Scotland

## Wider dimensions

### Financial Sustainability

**12.** 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). The Accounts Commission has stressed the need for long-term financial strategies, supported by medium-term financial planning, so that councils can respond to the acknowledged demographic and fiscal pressures.

**13.** Last year we reported that the council did not have a medium or long term financial strategy in place. The council has acknowledged, for a number of years, that its current level of service provision is not financially sustainable and since 2014/15 has balanced its annual revenue budget through the use of reserves.



**14.** The council approved its 2017/18 budget in February 2017. The budget included a 3% increase in council tax and identified a funding gap of £11 million. In order to balance its budget, the council agreed to make £3.4 million of savings and use £7.6 million from its reserves. During 2017/18, the budgeted use of reserves was adjusted for additional approved expenditure, additional government grant announced during the year and additional approved savings resulting in a final budgeted use of reserves of £6.5 million. The council reported a year-end underspend for 2017/18 of £1.9 million, in the final Revenue Outturn report, with £4.6 million of reserves used to deliver this position.

**15.** The 2018/19 budget was balanced using £4.5 million of reserves (21% of the unearmarked general fund balance at 31 March 2017) and £6.5 million of identified savings. Current projections indicate that significant savings will need to be found to balance the budget in 2019/20 (£12.4 million plus £7 million reserves) and 2020/21 (£7.8 million), and that by 31 March 2020 reserves will be at the minimum level (£5 million) necessary to provide a contingency for emergencies and unforeseen financial pressures.

**16.** Work has begun to identify savings for 2019/20 but these will take time to develop and implement. The council has agreed to develop a list of short term savings options for consideration in September 2018. This is a challenging timescale, particularly given the recent change in administration, but it is essential that it is met if the council is to set a balanced budget for 2019/20 and beyond.

**17.** The council has made significant savings over recent years but continues to rely on short term one-year savings plans to deliver annual budgets. As part of its '*Modernisation and Improvement Programme*' it has begun to review how it operates but has yet to make the medium and long term transformational changes necessary to deliver sustainable services.

**18.** We reported last year that members must make difficult decisions about the services the council can afford to deliver. Since then, the council has experienced political instability with a number of members leaving the administration, and a new minority administration being formed in June 2018. Previous Best Value reports have highlighted the benefits of cross-party forums and, given the significant financial challenges facing members over the coming months, members should consider setting up a cross-party budget working group to discuss and agree budget priorities and actions.

**19.** We will continue to monitor the council's progress in developing a sustainable model for service delivery over the summer and report our findings in our annual audit report in September 2018.

### Exhibit 3, no. 1

#### National Fraud Initiative

**20.** The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise co-ordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or error. The latest position for Moray Council is summarised in [Exhibit 2](#).

**21.** Overall, our review of the council's NFI processes found that good progress had been made with the 2016/17 NFI exercise. In line with the NFI guidance, the council adopted a risk based approach to the NFI matching exercise, scanning all recommended matches and then testing those assessed as higher risk. A total of four errors (2 housing benefits and 2 duplicate payments) were found with a cumulative value of £7,774, all of which is being recovered. In addition, one case was identified where a deceased applicant had not been removed from the council's housing waiting list.

## Exhibit 2

### National Fraud Initiative

Total number of matches



2,817

Completed/closed investigations



555

Total number of recommended matches



807

Completed/closed recommended matches



338

Source: NFI website

**22.** Separately, the council reviewed all of the matches identified, as part of the 2016/17 NFI recheck exercise, for individuals in receipt of council tax single person discount, and wrote to them asking them to complete a council tax discount validation form. This identified more than 100 council tax payers who were no longer entitled to this discount resulting in a saving to the council of over £54,000. The council intends to do this as an annual exercise and has sent 170 validation forms following receipt of the latest matches in December 2017.

**23.** The results of the 2016/17 NFI exercise were reported to the Audit & Scrutiny Committee in November 2017.

### Transparency

**24.** Internal Audit reports are not presented in full to the Audit & Scrutiny Committee, nor are they made available to members by some other means (for example, placing them on the members' portal). Instead a summary internal audit report is presented to the Committee. Generally, these summary reports include the executive summary for each main project completed by Internal Audit and accompanying action plan detailing recommendations made and management responses. We noted, however, that a number of projects were only reported in summary form (i.e. without the executive summary and action plan) during 2017/18. The majority of summary reports are presented in public session with only one 2017/18 internal audit report considered in private.

**25.** We believe that all internal audit reports should be available in full to audit committee members within a reasonable timescale of completion. It is acknowledged that some of these reports may require to have restricted public access in accordance with Schedule 7A of the Local Government (Scotland) Act 1973.

### Exhibit 3, no. 2

### Registers of Interests

**26.** In our 2016/17 Interim Report, we concluded that the council's register of interests met basic requirements, as set out in statutory guidance, for elected members. Arrangements for staff were less well developed, and we recommended that the council could make improvements to these arrangements by:

- asking all directors, and other key staff, to complete a register of interest return
- including a requirement to disclose family members interests as part of register of interest returns

- ensuring that registers of interest for members are refreshed and updated on the website and that this includes "nil returns".

**27.** Following the council's response to our recommendations we have reviewed our assessment, and can confirm that a register of senior officers' interests has been prepared and is published on the council's website. Both the members' and senior officers' registers of interest are updated every six months. We noted, however, that there is no reference to the disclosure of family members' interests as part of the register of interest returns for members as required by section 5 of The Councillors' Code of Conduct.

### Exhibit 3, no. 3

## Wider dimension action plan

**28.** The wider dimension risks identified in the previous paragraphs are detailed in [Exhibit 3](#). These findings will help inform our annual audit report conclusions on each of the wider dimension areas.

### Exhibit 3

#### Key findings and action plan 2017/18

Issue identified	Management response	Responsible officer and target date
<b>Audit findings</b>		
<p><b>1. Financial sustainability</b></p> <p>The current level of service provision is not financially sustainable. The council continues to rely on short term one-year savings plans and the use of its reserves to deliver annual budgets whilst maintaining services at previous levels. The council has not developed a transformational plan to deliver services sustainably over the medium and longer term.</p> <p>Previous Best Value reports have highlighted the benefits of cross-party forums and, given the significant financial challenges facing members over the coming months, members should consider setting up a cross-party budget working group to discuss and agree budget priorities and actions.</p> <p><b>There is a risk that members are unable to agree and implement a sustainable model for service delivery before the council's reserves are exhausted.</b></p>	<p>The Corporate Plan recognises the need for a programme of modernisation and improvement to support the council's priority of having a financially stable council.</p> <p>The report on Corporate and Financial Planning to council on 28 June referred to the need to develop a transformation programme and a separate report to that council meeting recommending the employment of advisers to assist the council in doing so was approved. The report identified the need for a short term financial plan to balance the 2019/20 budget to run in parallel with a medium-term approach to develop a transformation programme and a long term financial plan reflecting council priorities and building control of major risks.</p> <p>The council has recently had a change in administration. As the new administration is a minority administration then some form of cross party working will be vital. It is unclear at this early stage how that is likely to develop.</p>	<p>Corporate Management Team and Heads of Service</p> <p>Short term plan; report to council in September 2018</p> <p>Initial diagnostic work: December 2018</p>

Issue identified	Management response	Responsible officer and target date
<p><b>2. Transparency</b></p> <p>Internal audit reports are not provided in full to members of the Audit &amp; Scrutiny Committee.</p> <p><b>There is a risk that members are unable to properly scrutinise internal audit's findings.</b></p>	<p>Full internal audit reports will be placed on the members portal to mitigate the identified risk.</p>	<p>Internal Audit Manager</p> <p>October 2018</p>
<p><b>3. Registers of Interest</b></p> <p>Members' register of interest forms do not ask members to consider the need to declare the financial or non-financial interests of family members.</p> <p><b>There is a risk that registerable interests of members are not adequately identified in the interests of openness and transparency.</b></p>	<p>The forms used are considered to be set out in accordance with the Code of Conduct. The Standards Commission Guidance is provided to councillors to assist their declarations of interest and that guidance includes reference to declaring financial or non-financial interests relating to family.</p> <p>This element will be highlighted when the six-monthly reminders about keeping declarations up to date are sent to members.</p>	<p>Democratic Services Manager</p> <p>September 2018</p>

Source: Audit Scotland

# Moray Council

## Management Report 2017/18

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN  
T: 0131 625 1500 E: