

AUDIT COMMITTEE

10 JULY 2012

INTERNAL AUDIT ANNUAL REPORT

Report from: Internal Audit

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Summary

To inform this committee of the overall opinion on control for 2011/12 based on internal audit's work. This report assists this committee when considering the annual governance statement.

1. Budget and Policy Framework

- 1.1 It is within the remit of this committee to take decisions regarding accounts and audit issues.

2. Background

- 2.1 The Chartered Institute of Public Finance and Accountancy (CIPFA)'s publication "Code of Practice for Internal Audit in Local Government in the United Kingdom" recommends that internal audit should report annually on the operation of control. This is to assist Members when considering the annual governance statement.
- 2.2 The audit plan includes audits of key financial systems, annual governance reviews, and areas of potential high risk to the organisation. Potential high risk areas may have been identified through the Council's risk management process, or by audit as part of the annual planning process .
- 2.3 This Committee receives regular reports on the outcomes of all internal audit activity, which covers audit work and the results of irregularity investigations.

3. Advice and analysis

- 3.1 This is the first annual report presented by the new Audit Services Manager, who joined the Council in August 2011. The report is attached at **Annex A**.
- 3.2 There are no diversity or sustainability implications arising from this report.

4. Risk management

4.1 There are no risk management implications arising from this report.

5. Financial and legal implications

5.1 There are no financial or legal implications arising directly from this report.

6. Recommendations

6.1 Members are asked to endorse Internal Audit's opinions contained **in Annex A** to this report and to consider this report when considering the annual governance statement."

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Background papers

None.

Annual Internal Audit Report 2011/12

1. Summary

- 1.1 The annual assurance on the control environment at Medway Council is based on consideration of:
- effectiveness of internal control
 - management of risk
 - probity and compliance with legal and regulatory requirements
 - appropriate pursuit of economy and efficiency
- 1.2 The assurance provided by Internal Audit is reasonable but not absolute, and is drawn from:
- audit assignments performed in current year
 - audit coverage and opinion from the previous two years
 - management response to audit recommendations
 - control issues identified as a result of investigations undertaken
 - control and risk advice work undertaken as a result of a request by management
 - feedback from external audit
 - the Council's risk management process
 - change management processes

Overall opinion:

The central governance arrangements of the Council, along with the robust processes in place for managing the key financial systems and the management response to issues identified in operational areas, supports an overall satisfactory internal audit opinion. The control arrangements in satellite sites and discreet business areas do represent an area of concern, albeit on an individual basis these do not represent a significant risk to the organisation.

2. Internal Audit Coverage

- 2.1 A summary of all audit work carried out is at **Annex B**. All audit reports include an agreed management action plan to address and correct the issues identified. There is also a record of follow ups undertaken with a record of the revised audit opinion.

Governance

- 2.2 The arrangements for risk management and corporate governance have been confirmed as sufficient in the current, and two previous years' audits. The risk management approach is appropriate for the organisation and ensures there is focus on current threats. The reviews of Corporate Governance have confirmed that the Council's Constitution, political and management structure,

and decision-making processes comply with the requirements of good practice as set out in the CIPFA/SOLACE framework.

2.3 The third element of governance that is reviewed annually is the Council's arrangements for the prevention of fraud and corruption. The previous two years' audits have found the processes in place to be insufficient, and in 2011 PKF were invited to undertake an assessment of the Council's fraud resilience, which identified a number of areas of weakness. A significant amount of work has been undertaken in 2011/12 to strengthen the arrangements, and the most recent audit review has found the processes to be satisfactory. These improvements, undertaken and delivered by Internal Audit, have included:

- development of a fraud risk assessment methodology
- an initial fraud risk assessment
- development of a fraud resilience strategy, a revision of the anti-fraud and corruption policy
- progress on the arrangements for ensuring the Council has addressed the Bribery Act
- increased integration of the work of Internal Audit with the Corporate Anti-Fraud Team to strengthen the prevention, detection and investigation of corporate fraud.

Key Financial Systems

2.4 Every year internal audit undertake the following audits on behalf of external audit: Council Tax, NNDR, Housing Benefit and Housing Rents. These four areas of the Council's work represent a significant proportion of the Council's financial transactions and as such assurance on the processes in these areas represents a significant level of assurance for the Council.

2.5 Over the last three years three of these areas have been found to be satisfactory or better. The staffing structures and control arrangements for Housing Rents have been subject to a lot of change over the last three years and weaknesses in the control environment have been identified, although management response to the issues raised has been positive.

2.6 The arrangements for Council Tax, NNDR and Housing Benefit have been subject to change following Better for Less. Internal Audit has completed compliance testing for Q4 and is wrapping up an initial review of the new arrangements. To date no significant issues have arisen.

2.7 The internal audit plan also includes audits of financial systems undertaken on a cyclical basis. All these audits undertaken in 2011/12; payroll, cash and banking and general ledger have achieved an audit opinion of satisfactory or better.

Other Financial Systems and Risk Assessed Work

2.8 The level of assurance provided in the audit opinions in these audits is quite low, but since this area of audit work is largely focused on those areas deemed to be of high residual risk to the Council, this does not necessarily provide a fair representation of the overall level of control across all the Council's operational areas. The reasoning behind utilising a proportion of audit time on areas where there is a high residual risk is to utilise Internal Audit resources to provide independent advice to management in order to strengthen current arrangements and reduce the overall level of risk to the Council. For this reason the internal audit programme of follow up work is critical to the overall level of assurance. The key strategic areas reviewed were as follows:

- Care Director payments and income: both issued in 2011/12, although the fieldwork was undertaken in 2010/11. There were a number of issues arising and both reports resulted in an overall opinion of Insufficient. An exercise is currently underway by management to replace the Care Director system, and initial discussions have taken place between Internal Audit and management to ensure that appropriate controls are built into the new arrangements.
- Blue Badges: weaknesses were found in enforcement, administrative and assessment procedures that expose the Authority to the risk of fraud. Blue Badge fraud is something that the National Fraud Authority has identified as a key risk to all Local Authorities, and is included as an area of focus in the fraud resilience strategy. The Corporate Anti-Fraud Team are progressing the first investigations into Blue Badge fraud and the Fraud Manager is working with management on a number of fraud risk issues. The interim follow up has been completed which has confirmed that there has been significant progress made, and that the overall opinion can already be raised to "Insufficient" and the planned remaining work should ensure that the overall opinion can be raised to "satisfactory" by financial year-end.
- Transport Procurement Unit (TPU): in 2010/11 the arrangements in place for ensuring home to schools transport for SEN children is appropriate and the payments to contractors accurate were found to have significant weaknesses, and as a result of these weaknesses overpayments had been made to contractors. The follow up has now been completed and, on the basis of the improvements made to the procedures in place, the overall opinion has been raised to satisfactory
- Audit work was also undertaken in relation to satellite sites including Markets Income, Rochester Christmas Market, and the Corn Exchange. Each of these pieces of work identified that the controls in place were inadequate and where the risks are ongoing Internal Audit will be undertaking follow up work in order to provide assurance that these matters have been successfully addressed. Whilst these issues need to be resolved the overall level of risk to the Council is comparatively low and as such these reports do not on their own represent a significant risk to the organisation. However, they do collectively raise concerns around the Council's operational management of discreet areas of

business delivery. This concern around the management of risk in satellite sites and discreet business areas is something that Internal Audit are looking to address through a programme of probity reviews.

Probity Reviews

2.9 A number of issues have arisen at satellite sites over the last 3 years, and it has been agreed that Internal Audit will undertake a programme of probity audits in order to review financial and governance arrangements at non-central sites. A summary of the process is attached at **Annex C**.

- Schools: The first of the probity reviews for the 2012/13 programme of audit work in Schools are being reported to this Audit Committee. Five others are underway. At year end Internal Audit will provide an overall audit opinion on the outcomes of these probity reviews.
- Other Satellite Sites: There are no planned probity audits planned in non-School sites in 2012/13. However follow up work will be undertaken in relation to Markets Income and the Corn Exchange where issues were identified in the recent audits undertaken.

3. Non-Audit Work

Investigations

3.1 There have been a number of preliminary investigations undertaken in the year. None of the investigations are considered to have an overall impact on the overall assessment.

Control Advice

- 3.2 Where there have been control issues arising from a preliminary or full investigation then an audit output outlining these issues was shared with management and presented to Audit Committee. In cases where the issues are significant we undertake further work, in the form of follow up, probity review or full audit, in order to provide assurance on the progress made on addressing the identified weaknesses.
- 3.3 Internal Audit has been working with Education Finance in providing fraud awareness and risk and control training to Headteachers and Governors, through presentations, attendance at the Schools Forum, and liaison with School staff and Governors Support based within the Children and Adults Directorate.
- 3.4 Other ad-hoc control advice has been provided including processes for the acceptance of card payments from third parties, the amendment of BACS payment files, the transportation of valuable documents from Riverside to Gun Wharf. More localised control advice has been provided as a result of a number of preliminary investigations which have not warranted an audit output.

Fraud Resilience

- 3.5 Following the receipt of the Fraud Resilience Report by PKF in November 2011 Internal Audit have undertaken an assessment of the Council's fraud risk, based on the areas identified by the National Fraud Authority. The risk assessment supported the development of the Fraud Resilience Strategy and work is ongoing to deliver on the targets contained within that document.

Audit Procedures

- 3.6 The Internal Audit processes and procedures have been subject to review, and an Internal Audit Charter and Manual developed to document the purpose, authority, responsibility of the Audit function and the standards and procedures adopted.
- 3.7 The follow up process has been revised to ensure that audits are subject to an appropriate level of follow up to ensure that assurance can be provided where necessary on the progress made in strengthening the level of control in place.

4. Resources

- 4.1 2011/12 has been a challenging year in terms of Internal Audit resources. The audit team comprises the Audit Services Manager, two Principal Auditors and four Auditors. In year the team has had four new members of staff, each appointment preceded by a period of the post being unfilled.
- 4.2 The Audit Services Manager joined the Council in August 2011, the post having been temporarily covered by the Accounting Manager since April 2011. Three of the four auditors now in post were appointed in 2011/12, and overall the team has carried 233 days of auditor post vacancies in the year.
- 4.3 The new appointments to the auditor post all have knowledge and experience of working at Medway Council, but none have come from a background of Internal Audit. Therefore one of the key priorities of 2011/12 has been to support and develop the new appointees. An induction programme has been followed for all new staff, there have been regular team meetings to cascade information and knowledge, and the Performance Development Review process is being used to identify individual objectives and any training and development requirements. In terms of professional qualification, one of the new auditors has an accounting qualification, and the other two new appointments are currently undertaking an Internal Audit qualification.
- 4.4 The CIPFA benchmarking evidences the continuing low cost of the Council's internal audit team comparative to other Unitary Authorities, and it is a credit to the team that with the resources available, particularly given the vacancies and new appointments, that the work of Internal Audit provides sufficient breadth and depth of assurance to support the overall annual audit opinion.

5. Quality

- 5.1 The quality of the work of Internal Audit is reviewed in the annual Effectiveness Review, the outcome of which is being presented to this meeting by Mick Hayward.

Internal Audit Annual Report 2011/12

	Opinion	Date to AudC
Key Financial Systems		
General Ledger	S	07/12
Cash and Banking	S	07/12
Payroll	S	11/11
Council Tax (2010/11 and 2011/12)	G	07/11 & 03/12
NNDR (2010/11 and 2011/12)	G	07/11 & 03/12
Housing Rents	I	07/11 & 03/12
Housing Benefits (2010/11 and 2011/12)	S	07/11 & 03/12
NNDR (Q4 and new arrangements following B4Less)	•	
Council Tax (Q4 and new arrangements following B4Less)	•	
Housing Benefits (Q4 and new arrangements following B4Less)	•	
Other Financial Systems and Risk Assessed Work		
Schools Financial Control Self Assessment (FCSA) – primary tranche 1 *	•	11/11
Corn Exchange	U	7/12
Care Director Income	I	
Care Director Payments (Residential Payments	I	07/11
Civic Centre Fuel Pumps	U	07/11
Blue Badges	U	11/11
Business Continuity Plan (10/11)	U	11/11
Section 106 Agreements	G	11/11
Vehicle fuel purchasing arrangements	•	11/11
ICT Security	S	11/11
Rochester Christmas Market	I	11/11
Council Plan Monitoring	S	03/12

	Opinion	Date to AudC
Governance		
Corporate Governance (2010/11 and 2011/12)	S	07/11 & 07/12
Risk Management (2010/11 and 2011/12)	S	07/11 & 07/12
<i>Prevention of Fraud and Corruption (2010/11)</i>	<i>I</i>	<i>07/11</i>
Prevention Fraud and Corruption (2011/12)	S	07/12
Probity Reviews		
All Saints School	•	07/12
St Margarets	•	
Temple Mill	•	

Follow Ups Undertaken 2011/12					
Audit	Yr Audit Report Issued	Audit Opinion	Follow Up Opinion	Direction of Travel	Date to Audit Committee
Transport Procurement Unit	2010/11	U	S	▲	07/12
Blue Badges	2011/12	U	I	▲	Interim follow up 07/12
Rochester Christmas Market	2011/12	U	I	▲	03/12
Markets Income	2011/12	U	I	▲	03/12
Halling Primary School – Financial Controls based on FCSA	2010/11	•	•	▲	
Business Continuity	2011/12	U	•	•	Progress update 07/12
Temple Mill	2011/12	•	•	•	

Follow Ups Not Yet Completed – with original audit opinion of U or I			
Audit	Yr Audit Report Issued	Audit Opinion	Status
Civic Centre Fuel Pumps	2011/12	U	Delayed pending decision re site redevelopment. Follow up planned for 2012/13
Corn Exchange	2011/12	U	Not Due
Housing Rents	2011/12	I	Not Due
Business Continuity (Final)	2011/12	U	Progress Update 7/12
Blue Badges (Final)	2011/12	I	Interim follow up completed

Key: G = Good, S = Satisfactory, I = Insufficient U = Uncontrolled
 • = Work carried out but no opinion provided in that area

Probity Reviews

The Audit Committee approved the Internal Audit Strategy 2012/13 in March 2012. Included in the Strategy was the plan to undertake a series of financial and governance probity reviews.

Probity reviews provide the opportunity for delivering a series of targeted audit reviews of financial management in areas of the Council's business that do not represent a significant financial risk.

The findings of the reviews are divided into "probity issues" and "control weaknesses". Broadly, any finding where rules, regulations, or recognised good practice appear to have been flouted, resulting in some form of gain to an individual or group, would be classed as a probity matter. Where a probity issue is identified Internal Audit will undertake further work to determine whether the probity issue is a matter for further investigation.

Each individual probity case has to be assessed on its own merits, and will take into account a whole range of factors in order to determine the action to be taken. Internal Audit will undertake further audit work and liaise with HR and other oversight roles across the Council in order to ensure that serious breaches are handled appropriately. A number of these concerns may be resolved satisfactorily without any need for launching a full investigation. In these instances the key role of Internal Audit is to ensure that management address the matter immediately in order to ensure Council assets are safeguarded, and any financial loss or reputational damage is minimised. A probity review would not be deemed to be complete whilst there are any outstanding probity issues.

If on closer inspection there is evidence that casts doubt on an individual's integrity then a full investigation would be undertaken, in line with current practice. The probity review would be halted whilst this investigation is undertaken, and the result of this investigation would be presented to Audit Committee.

Most of the audit findings from these reviews would relate to control weaknesses as opposed to probity matters. Where a control weakness is identified this will be discussed with management and a plan of action agreed in order to address these points. Where control weaknesses are significant and wide-spread they may result in such a level of concern as to be classed as a probity matter, and may also warrant a full audit. If a full audit was required then approval would be sought, from the Committee, to revise the annual plan of work to accommodate it.

The output of each individual review does not include an audit opinion. However, at year-end a summary report of the probity reviews conducted in year will be provided to Audit Committee and this will include an overall audit opinion on the strength of the control framework. Due to a number of concerns that had arisen regarding the control arrangements within Medway's Schools the intention for 2012/13 is to use all the resources allocated to probity audits to review the financial and governance arrangements in place within Medway's Schools.