

## **AUDIT COMMITTEE**

**11 JULY 2013**

### **INTERNAL AUDIT ANNUAL REPORT**

Report from: Internal Audit

Author: Alison Russell, Audit Services Manager

#### **Summary**

To inform the Audit Committee of the overall opinion on control for 2012/13 based on internal audit's work. This report assists the 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 recommendation is now also included within the Public Sector Internal Audit Standards as a requirement. This report provides assistance to 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 all forms of audit work, and the results of irregularity investigations.

#### **3. Advice and analysis**

3.1 The overall opinion is that the central governance arrangements of the Council, along with the robust processes in place for managing key financial systems and the management response to issues identified in operational areas, supports an overall internal audit opinion of satisfactory. The control

arrangements in satellite sites and discreet business areas are an area of concern, albeit on an individual basis these do not represent a significant risk to the organisation. This is explored within the Annual Internal Audit Report, which 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 note Internal Audit's opinion on internal control for 2012/13 as 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 2012/13

### 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:
- The Council's documented policies and procedures
  - The Council's governance arrangements, including risk management
  - Audit assignments performed in current year
  - Audit coverage and opinion from the previous two years
  - Management response to issues identified by audit
  - 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
  - Outcome and management response to external assurance reviews.
- 1.3 The current economic climate represents a challenging time for all Local Authorities, with increasing pressure on diminished resources, and significant changes nationally to the scope of the role of Local Authorities, such as taking responsibility for Public Health, and the new Council Tax Reduction Schemes. Medway Council has been going through a period of significant change as it undergoes restructuring of the organisation in order to meet the national changes and achieve a more streamlined, customer focused service.

#### **Overall opinion:**

**The central governance arrangements of the Council, along with the robust processes in place for managing key financial systems and the management response to issues identified in operational areas, supports an overall internal audit opinion of satisfactory. The control arrangements in satellite sites and discreet business areas are 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 planned audit work carried out in 2012/13 is at **Appendix 1**. 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 satisfactory 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 is the Council's arrangements for the prevention of fraud and corruption. A significant amount of work has been undertaken over the last two years to strengthen the arrangements, and assurance has been provided through consideration of fraud risk in all audits undertaken, the on-going delivery of the fraud resilience strategy, and the annual audit which has found the processes to be satisfactory.

## Key Financial Systems

- 2.4 Every year internal audit undertakes the following audits which external audit place reliance upon: 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 The arrangements for the management of Council Tax, NNDR and Housing Benefit have all been subject to change with the roll out of Better for Less. As such we undertook additional audit work in 2012/13 in order to provide assurance over the revised arrangements in place. We have been able to provide audit opinions of satisfactory or higher in relation to the new arrangements in these three areas. Housing Rents was not subject to such levels of change and was also deemed to be satisfactory.
- 2.6 The internal audit plan also includes audits of financial systems undertaken on a cyclical basis. In 2012/13 we undertook an audit of creditors, where the controls in place were found to be satisfactory, and also completed a 2011/12 audit of debtors where there were actions to be completed in order to ensure the arrangements were sufficiently robust. We are pleased to note that our work on the audit follow up has confirmed that action has been taken to address the weaknesses identified.
- 2.7 In relation to procurement our probity audits have included reviews of purchasing which have found no significant control weaknesses. This year we also undertook an audit of the contract management of waste collection and disposal. The approximated cost over the life of the two waste contracts is £264million. We found that the contract specification, diligence of monitoring and accuracy of data were all satisfactory. There was a lack of meaningful KPIs in place to measure the contractor performance effectively

and, given the total value of the contracts, we deemed this to be a material weakness and the overall opinion was therefore that the management of the contract was insufficient. We are however pleased to note that management have already begun work on developing revised KPIs.

- 2.8 The Category Management Team, launched in November 2012, provides advice and guidance on procurement issues, and works with services and suppliers to achieve higher standards of delivery and reduced costs. We are currently undertaking an audit of the new category management arrangements, and have liaised with the team on a number of matters, including discussions regarding internal audit assurance for the new facilities management joint venture company which went live in June 2013, and provision of a procurement fraud awareness training session in April 2013.

### Risk Assessed Work

- 2.9 The inclusion of other audits in the annual plan is determined based on ensuring there is appropriate coverage (over a three year period) of the key risks facing the council. Key risks are identified through the council's own risk management process, which identifies those areas which represent a high residual risk, taking into account the current control arrangements in place. This information is supplemented by senior management input into the annual audit planning process, often proposing audits of areas of recent change or increased risk. As we are focusing on these areas of high residual risk it is common to find the audit opinions in these audits can be lower than the assurance provided in the audits of key financial systems.
- 2.10 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. Consideration is also given to ensuring that we focus our audit work on those areas where we can add value, through the provision of assurance and risk and control advice.
- 2.11 A sample of the areas audited is as follows:

Data Quality – Economic Downturn: this audit focused on providing assurance on the data being used to monitor the risk of “downturn in the economy” included in Medway’s strategic risk register. Management has identified this as a risk with a very high likelihood and a critical impact. The audit concluded that there was a clear understanding of the nature and level of the risk, effective reporting on the management actions being taken, and effective monitoring of the council’s ongoing vulnerability.

Public Health Transition: From 1 April 2013, as a result of the Health and Social Care Act 2012, Local Authorities have increased statutory duties for public health, and new arrangements for commissioning services have been introduced. This audit, undertaken prior to April 2013, provided assurance on

the transitional arrangements in place to meet the new obligations on the council. The audit sought to provide assurance that the Authority had made adequate progress, and had reasonable plans in place, to ensure it was ready to meet its obligations. The audit found that the project management methodology used was sound and appropriate structures were being readied for 1 April 2013, which addressed the key risks identified.

Local Authority governance arrangements regarding Academies: The Government introduced academies in 2000, and at this time the intention was to accelerate the improvement of schools serving the most disadvantaged communities. The academy framework changed under the Academies Act 2010. The new act allows any school that is performing well to apply to convert to become an academy. At the time of the audit 17 secondary and eight primary schools in Medway had converted to academy status. The audit reviewed the effectiveness of controls within the council to protect Medway's financial position and assets at the point in time when a school converts to an academy. The audit also considered whether conversions to academy present any additional risks to the council. The audit found that the council has appropriate mechanisms in place to protect the council's financial position and assets at the time of conversion, and appropriate oversight and liaison with those academies for which the council has no accountable role. The audit did identify a need to strengthen the arrangements for the three academies where the council acts as a co-sponsor.

HR Data Security – the audit identified a number of issues that posed a risk of inappropriate access to confidential personal documentation, including insufficient lockable cupboards, unrestricted access to incoming post and payroll documentation held in the archive storage area. The swift actions taken by management when they were notified of the control weaknesses identified were reflected in the report and overall opinion. The audit follow-up in approximately six months time will enable us to confirm that these improvements have been sustained.

Grant Management – This audit provided assurance on the high level processes in place to manage and account for grant income. In 2011/12 Medway Council received approximately £400m in revenue grant income (out of £600m total revenue income) from over 100 separate grants. In addition, £55m of the Council's £75m Capital expenditure for the year was funded by government grants and other contributions. Key controls in place to mitigate the risks are the financial planning and budgeting processes, the delegation of responsibility to specific officers to manage and monitor the grant income and expenditure, and the annual external audit review of a suite of grant income streams. The Authority is currently compiling two grants registers (one for capital and one for revenue) which it will use to monitor the receipt of income, compliance with any terms and conditions, including completion of any returns required. This has not yet been implemented fully, but will provide a good tool for the Authority to strengthen its grant income management in the future.

## Probity Reviews

- 2.12 This is the second year of a series of financial probity reviews being undertaken, focused on reviewing financial management in Medway's schools.
- 2.13 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 undertake further work to determine whether the probity issue is a matter for full investigation.
- 2.14 The individual reviews undertaken resulted in 19 separate reports, covering nearly 20% of the total number of pupils in Medway's Schools, and providing assurance over just above 23% of the total Medway's School budget. The output of each individual review does not include an audit opinion. However, a summary report of the probity reviews conducted in year was provided to Audit Committee, which contained an overall audit opinion that the financial controls in place across Medway's Schools were insufficient.

## External Reviews

- 2.15 OFSTED published a report for Medway in February 2013 on Local Authority arrangements for the protection of children. The inspection found that the council's arrangements were inadequate, and provided an action plan for addressing the issues identified. We are liaising with management in order to gain assurance on the progress being made to strengthen the arrangements, but are satisfied that there is a high level board in place with responsibility for monitoring the implementation of the required actions, and a deadline of September 2013 to report on delivery.

## **3. Non-Audit Work**

### Investigations

- 3.1 There have been twenty-six preliminary investigations launched in the year pertaining to members of council staff or contractors. Outcomes of full investigations, and any control issues arising, have been reported to Audit Committee on completion of the investigation. Where significant control issues have been identified the area is then subject to audit review, and an overall audit opinion provided, in order to provide assurance that the control issues have been addressed. None of the investigations undertaken in year are considered to have an overall impact on the overall assessment.
- 3.2 A number of investigations resulted in savings being made as inappropriate financial arrangements were halted. Recovery of actual funds as a result of investigations and probity reviews, in the 2012/13 year, totalled £263,653,

including £170,999 returned to the council through the courts following a lengthy audit and police investigation.

### Control Advice

- 3.3 Internal Audit has continued the programme of enhancing financial arrangements and fraud resilience across the Council, including delivery of presentations and procedural guidance.
- 3.4 Other ad-hoc control advice has been provided including advice on the procedures for confirming authorised signatories as part of transactional management, Data Protection Policy, and guidance on the disposal of fixed assets. More localised control advice has been provided during the conduct of planned audits or investigations.

### Fraud Resilience

- 3.5 The Fraud Resilience Strategy 2012-14 covers all the high fraud risk areas facing Local Authorities, as detailed in the Audit Commission's annual report "Protecting the Public Purse". Updates on delivery of this strategy have been provided to Audit Committee in-year. A number of the planned audits cover areas that have been identified as high risk areas, for instance grants and schools.

### Audit Procedures

- 3.6 The Internal Audit processes and procedures have been subject to review, and the Internal Audit charter and manual revised to reflect the Public Sector Internal Audit Standards that apply from April 2013.
- 3.7 Audits, probity reviews and follow-ups have been undertaken in line with the manual, with all audit outputs subject to supervisory review. Audits where there has been an audit opinion of "insufficient" or "uncontrolled" have been subject to follow-up in line with the process introduced for 2011/12. The overall audit opinion is revisited at the time of the audit follow-up and revised where appropriate.

## **4. Resources**

- 4.1 The audit team comprises the Audit Services Manager, two Principal Auditors and four Auditors. The annual audit plan for 2012/13 was determined based on these anticipated available resources. Despite time having been lost to sickness, including one auditor being on long-term sickness absence since January 2013, the audit plan has been sufficiently progressed to support this Annual Report.
- 4.2 The Audit Services Manager and two Principal Auditors are all Chartered Members of the Institute of Internal Auditors, and as such undertake continuing professional development. Training and development of the team has been ongoing, through external and internal training, coaching, and



monthly team meetings. Professional training, provided by the Institute of Internal Auditors, has been undertaken by two of those auditors who joined Audit Services in 2011/12 from other posts within the Council. The other recent appointee has an accounting qualification.

- 4.3 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 long term sickness absence of one auditor, 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 2012/13

	Opinion	Date to Audit Committee
Debtors Income	I	09/12
Controls over local bank accounts - Schools	I	09/12
Council Tax (Quarter 4 2011/12 under new arrangements)	G	09/12
NNDR (Quarter 4 2011/12 under new arrangements)	G	09/12
Housing Benefit (Quarter 4 2011/12 under new arrangements)	S	09/12
Council Tax	G	07/13
Housing Benefits	S	07/13
Housing Rents	S	07/13
NNDR	G	07/13
Grant Management	S	07/13
Creditor Payments	S	07/13
Schools Financial Management	I	12/12
Waste Management Contracts	I	03/13
Data Quality – Downturn in the Economy	S	03/13
IT External Assurances	S	12/12
HR Data Security	S	12/12
Events	S	03/13
Parking	S	07/13
Public Health Transition	S	12/12
Project Management	•	12/12
Academies – LA governance arrangements	S	07/13
Corporate Governance	S	07/13
Risk Management	S	07/13
Prevention of Fraud and Corruption	S	07/13

	Opinion	Date to Audit Committee
Personal Budgets	S	07/13
<b>Probity Reviews –</b>		
Local Management of Payroll Processes	•	12/12
All Saints	•	07/12
St Margarets	•	07/12
Temple Mill Primary	•	07/12
St Peter's Infant	•	09/12
Sherwin Knight Junior	•	09/12
Sherwin Knight Infant	•	09/12
Woodlands Primary	•	12/12
Woodlands Primary - Capital Work	•	12/12
The Howard	•	12/12
The Howard – property scheme	•	12/12
St Michaels RC Primary	•	12/12
Temple Mill Primary (post probity review)	•	12/12
Saxon Way Primary	•	03/13

<b>Follow Ups Undertaken 2012/13</b>					
Audit	Yr Audit Report Issued	Audit Opinion	Follow Up Opinion	Direction of Travel	Date to Audit Committee
Markets Income	2011/12	I	S	▲	09/12
Civic Centre Fuel Pumps	2011/12	U	S	▲	12/12
Corn Exchange	2011/12	U	S	▲	03/13
Housing Rents	2011/12	I	S	▲	09/12
Blue Badges (interim review and then confirmed 2012/13)*	2011/12	U	I	▲	07/12
Business Continuity (Interim Review 2012/13) **	2011/12	U	●	●	●
General Ledger	2011/12	S	S	▶	12/12
Debtors	2011/12	I	S (Draft Report)	▲	To be finalised

\*The outstanding issues are being progressed, and Audit Committee will receive regular reports of progress as part of the Fraud Resilience Strategy.

\*\*The interim review noted a lot of progress but also noted that the arrangements would not be finalised until after the roll out of Better for Less. The intention was to undertake a follow-up this year to provide assurance on the revised arrangements but the delays in the roll out of Better for Less means that this is not possible. The intention is to undertake an audit of business recovery and continuity arrangements in 2014/15.

<b>Follow Ups Not Yet Completed – with original audit opinion of U or I</b>			
Audit	Yr Audit Report Issued	Audit Opinion	Status
IWorld Access	2012/13	I	Due for completion October 2013
Schools Financial Management	2012/13	I	Continuation of probity reviews and planned 2013/14 overall report
Waste Management Contracts	2012/13	I	Due for completion by December 2013
Controls over Local Bank Accounts - Schools	2012/13	I	Due for completion December 2013

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