

AUDIT COMMITTEE

17 JULY 2014

INTERNAL AUDIT ANNUAL REPORT

Report from: Internal Audit

Author: Alison Russell, Head of Internal Audit and Counter Fraud

Summary

To inform the Audit Committee of the overall opinion on control for 2013/14 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 Annual Internal Audit Report provides assistance to Members when considering the annual governance statement.

2.2 The Annual Internal 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 that control is **sufficient**. The basis of this opinion is set out in 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 2013/14 and the detailed report as contained in **Annex A** and to consider this report when considering the annual governance statement.

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Background papers

None.

Annual Internal Audit Report 2013/14

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
- 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
- The progress made on the Fraud Resilience Strategy 2012/14
- 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.

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 that control is sufficient.

The economic climate and central government funding reductions continue to represent a challenging time, and Medway Council continues to review and transform itself in order to meet these challenges and ensure service requirements are met.

1.3 This overall audit opinion builds on the outcomes for individual audits, each of which contains an overall audit opinion of one of the following:

- 1 Strong
- 2 Sufficient
- 3 Needs Strengthening
- 4 Weak

Those reports with an audit opinion at level 3 or 4 are always subject to a formal audit follow-up, and some audits with a level 2 opinion are also revisited. The overall opinion is reviewed in light of the progress made by management in addressing the issues identified.

2. Internal Audit Coverage

2.1 A summary of all planned audit work carried out in 2013/14 and presented to Audit Committee between September 2013 and July 2014 is at **Annex B**, along with a record of the audit opinion. All audit reports include an agreed management action plan to address and correct the issues identified. There is also a record in Annex B of follow-ups undertaken and the revised audit opinion.

Governance

2.2 The arrangements for risk management and corporate governance have been confirmed as sufficient and strong respectively in the current and previous years' audits. The review of Corporate Governance provides assurance over the Annual Governance Statement which forms part of the Council's Annual Accounts.

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, an on-going fraud awareness programme, the delivery of the fraud resilience strategy, and the work undertaken on the National Fraud Initiative.

Key Financial Systems

2.4 Every year internal audit undertakes four key audits: Council Tax, Local Business Rates, 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. We have been able to provide assurance that management arrangements are sufficient in all four of these areas.

2.5 Each year the internal audit plan also includes audits of financial systems covering central processes. These areas are covered on a cyclical basis and focus on high value areas and key financial compliance and probity risk areas. In 2013/14 we undertook five key financial system audits and were able to provide assurance that all the arrangements in place were sound. One of the audits related to payroll, a key risk area due to its financial value (the last set of audited accounts for 2012/13 reported salary costs representing some 45% - £186m - of the authority's general fund revenue expenditure). Another audit related to compliance with payment card industry standards in terms of data security.

Procurement, Contract Management, and Pursuit of Value for Money

2.6 The pursuit of value for money is considered as part of every audit but the assurance is largely drawn from audits relating to procurement and contract management.

2.7 Internal Audit undertook an audit of procurement, where annual expenditure is in the region of £230m. The audit focused on arrangements for procuring goods and services over £100k and found that the management controls were strong.

There are strong governance arrangements in place, including documented guidelines, expert advice through the Category Management Team, the use of a procurement gateway process, and the oversight of the procurement board.

2.8 The work undertaken included an audit of Highways Maintenance. This service is delivered by a contractor, and in the first 6 years of the contract expenditure has been in the region of £33.5m. We were able to provide assurance that the arrangements in place were sufficient to mitigate the risks identified.

2.9 Internal Audit also undertook an audit of the transfer of one service to Medway Norse and found that the procurement procedures were followed appropriately with due regard to achieving value for money.

Risk Assessed Work

2.10 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.

2.11 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.

2.12 A sample of the risk areas audited is as follows:

Health Information Governance: The council uses the NHS National Network and as such is required to provide assurance through an annual submission to the Department of Health that it meets the required information governance standards. This audit focused on Public Health's arrangements and we were able to confirm that the arrangements were sufficient. Medway Council recently requested an audit by the Information Commissioner's Office regarding the council's compliance with data protection principles. The draft report was shared with the council in June 2014 and it is expected that the corporate response to this will improve corporate information governance arrangements which, in turn, will further strengthen Public Health processes.

Disclosure and Barring Service (DBS) Central Processes: The Criminal Records Bureau (CRB) and the Independent Safeguarding Authority (ISA) merged into the Disclosure and Barring Service (DBS) on 1 December 2012.

DBS was established under the Protection of Freedoms Act 2012 and the Council therefore has had to put in place new processes and procedures to meet these new requirements. At the time of the audit, which focused on the central processes and structures, these arrangements were being put in place and we were able to confirm that there was sufficient progress being made. A follow up has since been completed which confirms implementation of the outstanding actions. The audit did not include sample testing of the application of these new procedures, but a separate audit is now underway to provide assurance that the new requirements are being complied with.

Medway Action for Families (MAfF): This is the local delivery model of the national Troubled Families Programme which was launched in December 2010 to turn around the lives of 120,000 of the country's most troubled families. The scheme is designed to support multi-agency working, providing a co-ordinated and integrated programme of intervention. Medway was awarded funding to work with 560 families, with a total of £1.16m funds being paid up-front over a three year period, and a further £700k claimable under the payment by results scheme, bringing the anticipated total funding for Medway to £1.8m. The audit found that notwithstanding the positive results achieved and the effectiveness of the integrated approach adopted, the effectiveness of the management of the Troubled Families scheme within Medway needed strengthening. Since that audit was undertaken certification of three payment by results claims has been completed, and most recently a follow up review was undertaken to confirm that the remedial actions have been taken. The follow up confirmed that the arrangements have been strengthened and are now sufficient to support on-going effective delivery of the programme. The council needs to provide PBR claims for all 560 identified families before April 2015 and this a significant challenge, but the current arrangements should be sufficient to enable the council to meet this target.

Foster Care – DBS and Data Protection – the audit identified a number of issues relating to data protection issues within the council. The overall audit opinion was that the arrangements needed strengthening and a follow up is underway. The completion of the follow up will await the Council's receipt of the final report regarding DPA from the Information Commissioner's Office. There is a Security and Information Governance Group which will take the lead in delivering any actions required.

Local Income Management – this audit consisted of a series of nine site visits to review income handling arrangements which were reported individually to management and Audit Committee. These site reports included actions to be taken forward by local management but did not include an audit opinion. An overarching report was issued identifying ways to strengthen arrangements on a council-wide basis. This report contained an overall audit opinion that the local income management arrangements were sufficiently robust.

Probity Reviews – schools

2.13 This is the second full year of a programme of financial probity reviews within schools.

2.14 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.

2.15 The summary report which provides an overall audit opinion on the financial management in Medway’s schools was provided to Audit Committee in March this year. The overall opinion remains at the same level as previously reported, in that the arrangements need strengthening. However we are able to provide assurance that, whilst improvement is still required, our latest reviews indicate that the financial management arrangements in place have been strengthened, and that the level of awareness in schools of probity risks has increased.

2.16 A consultant was appointed early in 2014 to undertake a proportion of the remaining school probity reviews and that arrangement has now been formalised up until July 2015 which is the date by which we intend to have visited all of Medway’s schools. This role is being funded by monies recovered through the courts following an investigation into financial irregularities within a Medway school, and prosecution of a member of school staff.

External Reviews

2.17 The Council was subject to OFSTED inspections relating to the Protection of Children (reported February 2013) and Looked After Children (reported July 2013) which found arrangements in place to be inadequate. A further improvement notice regarding the February 2013 report was issued in July 2013.

2.18 There has been a significant amount of work undertaken to address the issues identified in these reports and Internal Audit has undertaken some monitoring work in relation to this activity and have found that the council is progressing in their work to address the issues identified. There is a clear senior management commitment to address the issues identified, with a Children’s Service Improvement Plan in place identifying actions to be taken, and appointments made to key posts to drive the improvements through. There have been restructures to enhance delivery and there are performance indicators in place which are used to monitor progress against plan. The Council has sought advice and assurance from external sources, including through the External Improvement Board which is chaired by an external professional, and the Council also commissioned a peer review earlier this year of progress made to date.

3. Non-Audit Work

Investigations

3.1 There have been 73 preliminary investigations launched in the year pertaining to members of council staff or contractors. Outcomes of full completed investigations, and any control issues arising, are reported to the Audit Committee.

3.2 Of these investigations pertaining to council staff and contractors 43 relate to activity by the individual as a resident of Medway as opposed to in their role as employee/contractor. Most of these cases relate to housing benefit, council tax fraud investigations, most of which were identified by the Corporate Anti-Fraud Team during their review of the National Fraud Initiative data matching exercise.

3.3 Where significant control issues have been identified in an under investigation then a full audit review is subsequently undertaken 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 annual audit assurance being provided.

Control Advice

3.4 Internal Audit has provided advice to management on a number of control issues including procurement, risk management, payments, imprest accounts and delegated authorities.

Fraud Resilience

3.5 The Fraud Resilience Strategy 2012-14 was progressed throughout the year. Some of the areas were reviewed as part of specific planned audits, others have been subject to consultative support from the Corporate Anti-Fraud Team. The strategy covers both internal and external fraud risks.

3.6 In terms of external fraud work has been undertaken in a number of areas to enhance fraud resilience, including working with management regarding the financial assessments process, blue badge enforcement, and housing fraud.

3.7 A revised strategy for 2014-16 was presented to Audit Committee in March 2014 with the objective of further strengthening the fraud resilience across the council, including raising fraud awareness, building fraud resilience into operation processes, improving internal reporting arrangements, and working with HR to streamline the internal investigations process further.

Grant Certification

3.8 Internal Audit has provided audit certification of a number of grant schemes and also certified the payment by results (pbr) claims for Medway Action for Families.

Audit Procedures

3.9 The Internal Audit processes and procedures have been developed to ensure compliance with the Public Sector Internal Audit Standards (Local Government Application Note).

3.10 The Internal Audit charter has been updated and presented to Audit Committee at this July meeting. The internal audit manual has been reviewed in year and is currently being updated further.

4. Resources

4.1 The audit team comprises the Head of Internal Audit, two Principal Auditors and four Auditors. The annual audit plan for 2013/14 was determined based on these anticipated available resources. Despite time having been lost to sickness, and one auditor on secondment to the Corporate Finance Business Support team since December 2013, the audit plan has been sufficiently progressed to support this Annual Report.

4.2 The Head of Internal Audit and two Principal Auditors are 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 and another auditor has an accounting qualification.

4.3 The CIPFA benchmarking results evidence 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 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, the Chief Finance Officer. This report also records Internal Audit performance against the 7 agreed KPIs.

5.2 Current procedures include a review of all audit evidence by the audit supervisor prior to issuing a draft audit report. An additional quality sample check of audit files by the Head of Internal Audit and the Principal Auditors is being introduced for 2014/15 to ensure standard are complied with consistently.

Internal Audit Annual Report 2013/14

Audit Work Reported to Audit Committee September 2013 to July 2014	Opinion	Date to Audit Committee
Full Audits		
Innovation Centre Medway	2	09/13
National Fraud Initiative	2	09/13
Carbon Reduction Commitment	•	09/13
Local Business Rates (Part 1)	2	11/13
DBS Central Processes	2	11/13
School Financial Management	3	03/14
Foster Care – DBS and DPA	3	03/14
Maintenance Contracts - Highways	2	03/14
Medway Action for Families	3	03/14
Council Tax	2	07/14
Local Business Rates (Part 2)	2	07/14
Housing Benefits	2	07/14
Housing Rents	2	07/14
Risk Management	2	07/14
Corporate Governance	1	07/14
Procurement	1	07/14
Local Welfare Provision	3	07/14
Medway Norse – SEN Home to School Transport	2	07/14
Asset Management Divestments	1	07/14
Grant Payments	3	07/14
Health Information Governance	2	07/14
PCI DSS Compliance	2	07/14

Audit Work Reported to Audit Committee September 2013 to July 2014	Opinion	Date to Audit Committee
Payroll	2	07/14
Residential Care Payments (part 1)	•	07/14
Residential Care Payments (part 2)	2	07/14
Trading Standards/Commercial Environmental Health	2	07/14
Corporate Credit Cards	2	07/14
Probity Reviews		
<i>Schools:</i>		
St Margarets Infants	•	09/13
Park Wood Infants	•	09/13
St Nicholas CEVC Infant	•	09/13
Hilltop Primary	•	09/13
Balfour Junior	•	11/13
Bligh Federation	•	11/13
Byron Primary	•	03/14
Parkwood Junior	•	03/14
St Thomas More RC Primary	•	03/14
Luton Infant	•	03/14
Hempstead Juniors	•	07/14
St Benedicts RCP	•	07/14
<i>Local Income Management:</i>		
The Villager	•	09/13
Trading Standards	•	09/13
Duke of Edinburgh Awards	•	09/13
Handitills	•	09/13
Upnor Castle	•	09/13

Audit Work Reported to Audit Committee September 2013 to July 2014	Opinion	Date to Audit Committee
AASSA	•	09/13
Lifeline/Telecare	•	03/14
Community Hubs	•	07/14
<i>Grant Payments:</i>		
Rural Liaison Grant	•	09/13
Succes	•	11/13
Adaptations	•	03/14

Follow Ups Undertaken 2012/13					
Audit	Yr Audit Report Issued	Audit Opinion	Follow Up Opinion	Direction of Travel	Date to Audit Committee
IWorld Access	2012/13	3	2	▲	03/14
HR Data Security	2012/13	2	2	◀▶	n/a
Waste Management Contracts	2012/13	3	2	▲	11/13
Local Bank Accounts in schools	2012/13	3	2	▲	03/14
Debtors	2011/12	3	2	▲	09/13
Medway Action for Families	2013/14	3	2	▲	07/14
Disclosure and Barring Service	2013/14	2	2	◀▶	n/a

Follow Ups Not Yet Completed – with original audit opinion of U or I			
Audit	Yr Audit Report Issued	Audit Opinion	Status
Foster Care – DBS and DPA	2013/14	3	In progress
Local Welfare Provision	2013/14	3	Due September 2014
School Financial Management	2013/14	3	Addressed through 2014/15 Probity Programme
Grant Payments	2013/14	3	Due November 2014

Key: 1 = Strong 2 = Sufficient, 3 = Needs Strengthening 4 = Weak
 ● = Work carried out but no opinion provided in that area