

## **AUDIT COMMITTEE**

**14 JULY 2015**

### **ANNUAL INTERNAL AUDIT REPORT 2014-15**

Report from: Internal Audit

Author: Katey Arrowsmith, Head of Internal Audit & Counter Fraud

#### **Summary**

This report provides the annual internal audit opinion on the overall adequacy and effectiveness of the council's governance, risk and control framework, in support of the Annual Governance Statement.

This opinion is primarily based on the interim report prepared by the previous Head of Internal Audit & Fraud for the period 1 April 2014 to 20 March 2015, supplemented by the work of the team to the end of June as overseen by the new post-holder.

#### **1. Budget and Policy Framework**

1.1 Council delegates responsibility for the oversight and monitoring the effectiveness of internal audit to the Audit Committee.

#### **2. Background**

2.1 The Accounts and Audit Regulations 2015 require that *"A relevant authority must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance."* For local government, the Public Sector Internal Audit Standards (PSIAS) are supplemented as proper practice by CIPFA's Local Government Application Note to the Standards (LGAN). The PSIAS and LGAN require internal audit to report periodically to those charged with governance on the internal audit activity's purpose, authority, responsibility and performance relative to its plan. The PSIAS also require the Head of Internal Audit & Counter Fraud to *"deliver an annual internal audit opinion and report that can be used by the organisation to inform its governance statement."*

2.2 The purpose of this report therefore, is to inform members of the annual opinion by the Head of Internal Audit & Counter Fraud on the overall adequacy and effectiveness of the council's internal control environment and to provide a summary of the internal audit work completed to support that opinion.

### **3. Opinion of the Head of Internal Audit & Counter Fraud on the council's internal control environment**

In my capacity as the Chief Audit Executive, with responsibility for the provision of Internal Audit Services to the council, it is my opinion that Medway Council's system of internal control adequately contributes to the proper, economic, efficient and effective use of resources in achieving the council's objectives. This opinion is based on the work of the Internal Audit service during 2014-15.

Whilst it has been identified that the authority has mainly established adequate internal controls within the areas subject to internal audit review during 2014-15, there are areas where compliance with existing controls should be enhanced or strengthened or where additional controls should be introduced to reduce the risk of loss to the authority. Where such findings have been made by internal audit, recommendations have been made to management to improve the controls within the systems and processes they operate. The results of all audit work completed are reported to the Audit Committee in accordance with the Internal Audit Charter.

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness.

### **4. Internal Audit arrangements and details of work to support the opinion on the internal control environment**

#### **4.1 Internal Audit Resources**

4.2 The Internal Audit Team has experienced significant staffing changes in the 2014-15 financial year. At the beginning of the year the team comprised the Head of Internal Audit & Counter Fraud, two Principal Auditors and four Auditors and the annual audit plan for the year was determined based on these anticipated available resources. During the year:

- Two Auditors left the team and two new Auditors were recruited, the period in which the posts were vacant equates approximately 0.75FTE.
- One Auditor reduced their hours from full time to 0.73FTE from 1 April 2015.
- The Head of Internal Audit & Counter Fraud reduced her hours to 0.6FTE from October 2014, and left the council's employment on 31 March 2015. The new Head of Internal Audit & Counter Fraud is 0.6FTE.
- One Investigations Officer from the Corporate Anti-Fraud Team has taken on a hybrid role, spending 60% of their time on internal audit work from 1 April 2015.
- One Principal Auditor post was made redundant with the post-holder leaving the council's employment on 12 May 2015.
- One Auditor left the council's employment at 31 May 2015.

4.3 The net result of these changes is a lower level of resources available to complete the 2014-15 annual audit plan that was anticipated when the plan was developed. As such it has not been possible for the team to complete 100% of

the planned work. Despite this, resources available have been directed to the areas of highest risk and have delivered sufficient work to support this Annual Report and opinion given.

4.4 The Head of Internal Audit & Counter Fraud and Principal Auditors are Chartered Members of the Institute of Internal Auditors, and as such undertake continuing professional development. These officers have provided each team member with specific training during the course of each audit undertaken in response to each auditor's particular needs. It is considered that this approach has been effective in practice and has contributed to the continuation of the quality of audit reviews carried out by the team. In addition all members of the team in post attended the annual Kent Audit Conference in October 2014. The main purpose of the event was to bring together public sector audit staff within Kent to discuss current audit issues, provide networking opportunities and encouraged joint working and information sharing.

#### 4.5 Annual Audit Plan

4.6 The Internal Audit Plan for 2014-15 was presented to the Audit Committee on 20 March 2014. The plan includes both Assurance & Consultancy work:

- Assurance work – this relates to audit work which informs the opinion of the control environment given in this report. This work focuses on planned audit reviews of key financial systems, other financial systems, operational audits and control environment reviews and also picks up on the follow up of audit recommendations made.
- Consultancy work – this relates to Internal Audit team members' involvement in corporate and other known projects, requests received by the team for consultancy or responsive work, advice or information and involvement in work conducted by the Corporate Anti-Fraud team.

4.7 The team have completed fieldwork and issued final reports for a total of 70% of the plan compared to a target of 85%. This comprises 76% of programmed audits, 66% of school probity reviews and 83% of follow up reviews. It should be noted that fieldwork has been completed on a further 12% which will be finalised shortly. This shows a decrease on the team's performance in 2013-14 due to the staffing changes experienced. (96% achieved in 2013-14).

#### 4.8 Assurance work

4.9 The Internal Audit team has primarily focused on assurance work, including finalising audits commenced during the 2013-14 financial year. A summary of all work carried out for the 2014-15 audit plan to date, and presented to Audit Committee in between September 2014 and July 2015, is provided at Appendix A. All audit reports include an agreed management action plan to address and correct the issues identified including follow-up reviews in line with the Internal Audit Charter.

4.10 The assurance work conducted in the year focussed on four key areas:

##### 4.10.1 Governance and Key Financial Systems:

The audit of corporate governance confirmed that the Annual Governance Statement is an accurate reflection of the council's governance arrangements in 2014-15. The review of Corporate Governance provides assurance over the Annual Governance Statement

which forms part of the council's Annual Accounts. While the audit of Risk Management has not yet been finalised for 2014-15, this audit has previously provided strong assurance, and all indications to date are that there are no significant issues arising in this area. The internal audits of key financial systems carried out in the year did not identify any significant issues.

#### 4.10.2 Procurement, Contract Management, and Pursuit of Value for Money:

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. There was only one audit undertaken in 2014-15 which concentrated on contract management issues, and that related to the management of community equipment. The audit was undertaken on request from management and was largely a consultancy exercise. As such an overall opinion was not included in the output but issues were shared with management to ensure that the issues identified are addressed new contract arrangements address. However in 2013-14 Internal Audit undertook an audit of procurement which confirmed that the governance arrangements, including the involvement of Category Management, were strong.

Internal Audit have liaised with Category Management regarding a number of issues in the 2014-15 year, including their review of contract regulations, the on-going contract management of Medway Norse, the procurement relating to the Local Growth Fund projects, and their on-going review of council suppliers. This liaison with Category Management has demonstrated that it continues to provide expert advice, and the governance arrangements remain strong.

The audit of Asset Management Divestments included consideration of whether the asset disposal arrangements were undertaken in such a way as to demonstrate the pursuit of value for money. The overall audit opinion in relation to this process was that the arrangements were strong.

#### 4.10.3 Risk Assessed Work:

The inclusion of other audits in the annual plan has been 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 the team focusses 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.

#### 4.10.4 Probity Reviews – schools:

This is the final year of a three year programme of financial probity reviews within schools. 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.

There have not been any significant control issues or probity issues identified in the work carried out on the 2014-15 plan, although individual reviews have identified control issues which need to be addressed.

#### 4.11 Consultancy work

4.12 The consultancy work conducted in the year focussed on three key areas:

##### 4.12.1 Investigations:

There have been 21 preliminary investigations launched in financial year 2014-15 and five in the 2015-16 year to the date of this report. Outcomes of full completed investigations, and any control issues arising, are reported to the Audit Committee. Where 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.

##### 4.12.2 Control Advice:

During the year the team responded to 15 requests for advice and information, including requests primarily concerning procurement, risk management, payments, imprest accounts and delegated authorities. This is considered to be a fundamental service provided by the team, enabling officers to consult with Internal Audit and address control concerns and issues as they arise, helping to maintain the internal control arrangements of the council.

##### 4.12.3 Grant Certification:

Internal Audit has provided audit certification of claims for 11 grant schemes and including certification of the Payment by Results claims for Medway Action for Families.

#### 4.13 Quality Assurance & Improvement Programme

4.14 The PSIAS require internal audit to develop and maintain a quality assurance and improvement programme to evaluate compliance with the PSIAS, and to assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement.

4.15 An annual self-assessment is conducted against the Public Sector Internal Audit Standards; the review conducted in March 2015 for the 2014-15 financial year found that team are operating in compliance with the PSIAS.

4.16 All audit work subject to a quality control review by a supervising officer to ensure that evidence is sufficient to support the conclusions, work is high quality and in line with the Public Sector Internal Audit Standards. An additional quality sample check of audit files by the Head of Internal Audit & Counter Fraud was introduced in 2014-15 to identify enhancements to procedures.

- 4.17 The work of the team is monitored against seven key Performance Indicators (KPIs) agreed with the Audit Committee; performance for the 2014-15 financial year is provided at Appendix B.
- 4.18 In previous years, the Accounts & Audit Regulations have required an authority to conduct an Annual Review of the Effectiveness of Internal Audit; this has been presented to the Audit Committee at its meeting in July. The 2015 Accounts & Audit Regulations no longer include this requirement. Instead, the Public Sector Internal Audit Standards require internal audit teams to have an external assessment of their compliance with the Standards every five years. The council are anticipating that an external body will be instructed to conduct an assessment of the Medway team in the 2016-17 financial year; the results of this assessment will be presented to the Audit Committee.
- 4.19 To more fully demonstrate how the team meets the requirements of the PSIAS in advance of an external assessment, a formal Quality Assurance & Improvement Plan will be prepared during the 2015-16 year and presented to the Audit Committee.

## **5. Risk management**

- 5.1 This report, summarising the work of the internal audit function, provides a key source of assurance for the council on the adequacy and effectiveness of its internal control arrangements.

## **6. Financial implications**

- 6.1 There are no direct financial implications to this report; however an adequate and effective internal audit function provides the council with assurance on the proper, economic, efficient and effective use of council resources in delivery of services, as well as helping to identify fraud and error that could have an adverse effect on the financial statements of the council.

## **7. Legal implications**

- 7.1 Section 151 of the Local Government Act 1972 requires that *“A relevant authority must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance.”* Proper practice has been defined as that contained within the Public Sector Internal Audit Standards and the CIPFA Local Government Application Note to the Public Sector Internal Audit Standards.

## **8. Recommendation**

- 8.1 Members are requested to note the Annual Internal Audit Opinion for 2014-15 and consider this when considering the council’s Annual Governance Statement.

### **Lead officer contact**

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## **Appendices**

Appendix A – Delivery of Audit Plan

Appendix B – Delivery against agreed KPIs in 2014-15

Appendix C – Definitions of Audit Opinions

## **Background papers**

There are no background papers to this report.





## Annual Internal Audit Report 2014-15: Delivery of Audit Plan

	Opinion	Date to Audit Committee
<b>Full Audits</b>		
Council Tax	2	07/15
Local Business Rates	2	07/15
Housing Benefit	2	07/15
Housing Rents	2	07/15
Corporate Credit Cards	2	07/14
Taxation – Creditor Payments	2	07/15
Local Payment Arrangements (overall)	2	07/15
IT Systems – Integra Access	2	07/15
School Financial Management	2	07/15
Capital Projects	2	07/15
Client Financial Affairs	2	03/15
Change Management – lessons learned from Better for Less	3	03/15
Children’s Services Action Plan	2	09/14
Disclosure and Barring Service	3	01/15
Staff Allowances and Loans	3	01/15
Contract Management – Community Equipment	n/a	03/15
Risk Management	2	07/15
Corporate Governance	1	07/15
Data Quality – Fraud Reporting	•	NC
IT Systems – LAGAN	•	NC
Domiciliary Care	•	NC
Early Help Services – Financial Controls	•	NC
Better Care Fund	•	NC

	Opinion	Date to Audit Committee
Economic Development	•	NC
Treasury Management	•	NC
<b>Probity Reviews</b>		
<i>Schools:</i>		
Hempstead Junior School	•	07/14
St Benedict's RCP School	•	07/14
Thames View Primary School	•	09/14
Luton Junior School	•	09/14
Maudene School	•	01/15
English Martyrs RCP School	•	01/15
Hempstead Infant School	•	01/15
Horsted Federation	•	01/15
Hoo St Werburgh Primary & Marlborough Centre	•	DR
Danecourt School	•	01/15
Rivermead	•	01/15
Abbey Court	•	07/15
Balfour Infants	•	07/15
Barnsole Primary	•	07/15
Fairview Community Primary School	•	F
Greenvale Infant and Nursery School	•	F
Halling Primary School	•	F
New Road School and Nursery Unit	•	07/15
St Helen's CEP	•	DR
St Johns CEVC	•	07/15
St John Fisher	•	07/15

	Opinion	Date to Audit Committee
St Mary's Catholic Primary	•	F
St Thomas of Canterbury RCP	•	07/15
St William of Perth RCP	•	DR
The Pilgrim's School	•	DR
The Rowans	•	07/15
Swingate Primary School	•	07/15
Walderslade Primary School	•	07/15
Wainscott Primary School	•	07/15
Will Adams Centre	•	07/15
<i>Children's Centres</i>		
Riverside Primary	•	DR
Burnt Oak Primary School	•	DR
Deanwood Primary School	•	DR
Delce Infant and Nursery School	•	DR
Miers Court Primary	•	DR
Oaklands Federation	•	DR
St Margarets Troy Town CEVC	•	DR
<i>Local Payment Arrangements:</i>		
The Old Vicarage	•	01/15
Public Health	•	01/15
MACLS	•	03/15
<i>Grant Certification:</i>		
Adoption Reform Grant – 2013/14	•	07/14
Individual Electoral Registration – 2014/15	•	07/14
Care Bill Implementation Grant – 2014/15	•	07/14

	Opinion	Date to Audit Committee
Local Transport Capital Block Funding 2013/14	•	01/15
Medway Action for Families – Payment by Results – May 2014	•	07/14
Medway Action for Families – Payment by Results – July 2013	•	07/14
Medway Action for Families – Payment by Results – July 2014	•	09/14
Medway Action for Families – Payment by Results – October 2014	•	01/15
Medway Action for Families – Payment by Results – February 2015	•	03/15
DCLG grant – Rogue Landlords	•	01/15
DfE Innovation Programme seed grant – Adolescents in Care or on Edge of Care	•	01/15

Follow Ups Undertaken 2014/15					
Audit	Year Audit Report Issued	Audit Opinion	Follow Up Opinion	Direction of Travel	Date to Audit Committee
Medway Action for Families			2	▲	07/14
Corn Exchange Financial Systems			3	◀▶	09/14
Medway Norse and SEN Transport – update			3	▲	03/15
Local Welfare Provision – update			n/a	▲	03/15
Foster Care – DPA Issues				▲	N/A
Grant Management					P
Disclosure and Barring Service					P
Staff Allowances and Loans					P

**Key:**      1 = Strong      2 = Sufficient,      3 = Needs Strengthening      4 = Weak  
 ● = Work carried out but no opinion provided in that area  
 P = Audit in planning stage      F = Fieldwork in progress  
 DR = Draft report issued      NC = Audit not completed

### Delivery against agreed KPIs in 2014-15

KPI		Target	Delivery
1. Audit Planning	<p>Proposed Annual Audit plan shared with Chief Executive, Chief Finance Officer, Directors and External Audit prior to presentation to the Audit Committee in March.</p> <p>The Annual Audit plan is drawn up in such a way as to ensure it provides appropriate and sufficient coverage to support the Annual Audit Opinion.</p>	Confirmation in the annual audit opinion that there is sufficient coverage to provide such an opinion.	Target met: coverage considered sufficient.
2. Quality	Delivery of audits to agreed scope, and any change to the scope informed to the Director or Assistant Director in a timely manner. Measured through feedback from Director/Assistant Director at the Draft Final Report stage of each full audit.	Target Satisfaction Level – 90%	Data not available.
3. Professional training	All audit staff undertake some relevant professional training in year and meet all CPD requirements set by professional bodies.	All staff undertake training.	Target met: all staff undertook audit training in year.
4. Completion of the audit plan	Delivery of the agreed annual audit plan. Measuring delivery of actual number of full audit reports presented to Audit Committee by July each year, against total outputs included in the annual audit plan provided to the Audit Committee in March of the prior year. The statistics will be provided separately for full audits and the delivery of probity reviews.	Target – 85%	Target not met: 70% overall completed. (Comprises 76% of programmed audits, 66% of school probity reviews, 83% of follow-up reviews).
5. Delivery of follow-ups	Measured against the timescale agreed with management.	No follow up to slip by more than 3 months.	Target met: all follow ups completed on time.

<b>KPI</b>		<b>Target</b>	<b>Delivery</b>
6. Compliance with Public Sector Internal Audit Standards	Measured against the CIPFA PSIAS compliance check list.	100% compliance or agreed, documented and reported exceptions.	Target met: 100% compliance in March 2015 self-assessment.
7. External audit	Annual liaison with External Audit regarding the Annual Internal Audit Plan.	External Audit satisfied with the quality of work undertaken by Internal Audit so that they are content to place reliance on the work performed.	Data not available.

## DEFINITIONS OF AUDIT OPINIONS

<b>Strong (1)</b>	<p><u>Risk Based:</u> Appropriate controls are in place and working effectively, maximising the likelihood of achieving service objectives and minimising the Council's risk exposure.</p> <p><u>Compliance:</u> Fully compliant, with an appropriate system in place for ensuring on-going compliance with all requirements.</p>
<b>Sufficient (2)</b>	<p><u>Risk Based:</u> Control arrangements ensure that all critical risks are appropriately mitigated, but further action is required to minimise the Council's risk exposure.</p> <p><u>Compliance:</u> Compliant with all significant requirements, with an appropriate system in place for monitoring compliance. Very minor areas of non-compliance.</p>
<b>Needs Strengthening (3)</b>	<p><u>Risk Based:</u> There are one or more failings in the control process that leave the Council exposed to an unacceptable level of risk.</p> <p><u>Compliance:</u> Individual cases of non-compliance with significant requirements and/or systematic failure to ensure compliance with all requirements.</p>
<b>Weak (4)</b>	<p><u>Risk Based:</u> There are widespread or major failings in the control environment that leave the Council exposed to significant likelihood of critical risk. Urgent remedial action is required.</p> <p><u>Compliance:</u> Non-compliant, poor arrangements in place to ensure compliance. Urgent remedial action is required.</p>