

AUDIT COMMITTEE

22 MARCH 2016

INTERNAL AUDIT UPDATE (2015-16 PLAN)

Report from: Katey Arrowsmith, Head of Audit & Counter Fraud
Audit & Counter Fraud (Chief Audit Executive)

Summary

To inform Members of the internal audit work completed since the meeting of the Audit Committee on 12 January 2016.

1. Budget and Policy Framework

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

2. Background

- 2.1. The Accounts and Audit Regulations 2015 require the council to “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”. The Public Sector Internal Audit Standards (PSIAS) require Internal Audit to report periodically to senior management and the board on the internal audit activity’s purpose, authority, responsibility and performance relative to its plan. The Revised Internal Audit Plan for 2015-16 was approved by the Audit Committee on 12 January 2016.

3. Update on planned audit work

- 3.1. Appendix A of this report shows the current status of all audit work from the 2014-15 Annual Audit Plan completed since the last meeting of the Audit Committee. Appendix A also shows the current status of all audit reviews on the Revised 2015-16 Annual Audit Plan. An overall audit opinion is provided for each assurance review and management action plans are agreed with client management prior to a final report being issued. Opinions are not provided in the outputs of individual probity and site reviews; instead these form the basis of summary reports providing an overall opinion on each category of site reviewed.
- 3.2. Appendix B of this report provides a summary of the results of each audit review where a final report has been agreed since the last update provided to the Audit Committee in January 2016. This appendix also details the grant and payment by results claims certified by Internal Audit since January.

3.3. Appendix C of this report provides the definitions of the assurance opinions and recommendation priorities in use, as agreed by the Audit Committee in July 2013.

4. Internal Audit Resources

4.1. As Members will be aware Medway Council has entered into a shared management arrangement for Internal Audit & Counter Fraud Services. The two councils entered into a shared service agreement to fully share internal audit & fraud services from 1 March 2016. A series of reports elsewhere on this agenda present Members with details of the working arrangements and work programme for the team for the 2016-17 financial year and beyond.

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. The Accounts & Audit Regulations 2015 require local authorities to: *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.* The Section 151 Officer of a local authority is responsible for establishing the internal audit service.

8. Recommendations

8.1. Members are asked to note progress on the 2015-16 Internal Audit Plan and the outcomes of the work of Internal Audit.

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Background Papers

None

Appendices:

Appendix A - Annual Internal Audit Plan 2014-15 – items completed

Appendix B - Summary Information on completed audits

Appendix C - Definitions of Audit Opinions and Recommendation Levels

Annual Internal Audit Plan 2014-15 – items completed

Audit review	Current status	Opinion
Schools probity reviews:		
Halling Primary School	Final report issued	---

Annual Internal Audit Plan 2015-16 – progress update

Audit review	Current status	Opinion
Assurance – opinion reviews		
Housing Maintenance	Final report issued – reported to previous Audit Committee meeting	Strong
South Thames Gateway Building Control Partnership	Final report issued – reported to previous Audit Committee meeting	Sufficient
Debtors	Final report issued	Sufficient
Planning	Final report issued	Strong
Health and Safety	Draft report issued, with client for consideration	
Leisure Memberships	Draft report issued, with client for consideration	
Data Quality – Transparency Reporting	Draft report issued, with client for consideration	
Corn Exchange	Fieldwork underway	
Adoption Services	Fieldwork underway	
Care Act	Fieldwork underway	
Bank Account Management	Not yet started	
Assurance – Probity reviews		
St Augustine's of Canterbury RCP	Final report issued – reported to previous Audit Committee meeting	
Featherby Infant School and Nursery	Final report issued – reported to previous Audit Committee meeting	---
Featherby Junior School	Final report issued	---
Cash security check – Splashes	Completed and reported to client	---
Cash security check – Deangate Ridge	Completed and reported to client	---
Cash security check – Strood Sports Centre	Completed and reported to client	---
Cash security check – Hoo Sports Centre	Completed and reported to client	---

Appendix A

Audit review	Current status	Opinion
Cash security check – The Strand	Completed and reported to client	---
Cash security check – Medway Park	Completed and reported to client	---
St Mary's Island	Draft report issued, with client for consideration	
Hempstead Juniors	Draft report issued, with client for consideration	
Libraries – Payroll	Fieldwork underway	
Theatres – Income collection	Fieldwork underway	
Innovation Centre Medway	Fieldwork underway	
Assurance – Follow up reviews		
Capital Projects	Audit Committee briefing note issued	Sufficient
Staff Allowances and Loans	Final report issued – reported to previous Audit Committee meeting	Sufficient
Disclosure and Barring Service	Final report issued – reported to previous Audit Committee meeting	Sufficient
Change Management	Fieldwork underway	
Grant Management	Fieldwork underway	
Assurance – Grant Certification		
Medway Action for Families May 2015 Claim	Completed	---
Local Transport Capital Block Funding 2014-15	Completed	---
Medway Action for Families January 2016 Claim	Completed	---
Consultancy work		
Medway Action for Families	Completed check of process to evidence claims	---
Medway Norse – SEN Transport	Fieldwork underway	
Local Growth Fund – Transport Projects	Fieldwork underway	
Purchase cards	Fieldwork underway	
Payroll Electronic Notification Forms	Not yet started	
Procurement Governance	Not yet started	

SUMMARY INFORMATION ON COMPLETED AUDITS

DEBTORS

(final report issued 7 March 2016)

1. Management Summary

- 1.1. The council generates income from various sources, most of which is from Council Tax, Business Rates (NNDR), Housing Rents and Social Services related activities. Service managers are responsible for administering the collection of income in these areas. For other sources of income generation (e.g. charges for shared services with the Health Authority, school services, and allotments), invoices are raised on the council's Sales Ledger. There were approximately 16,000 invoices raised on the Sales Ledger in 2014/15, with a total value of raised debt in excess of £106m.
- 1.2. The Exchequer Services Team in Finance are responsible for processing invoices, credit notes and refunds; the team are supervised by the Exchequer Services Principal Officer (ESPO) and the member of staff responsible for debt recovery is supervised by the Senior Debt Recovery Officer.
- 1.3. The objective of this audit was to provide an opinion on the effectiveness of controls to minimise the risks that:
- Details of debt held on the Sales Ledger may be inaccurate;
 - Debt recovery processes may be ineffective;
- This audit concentrated on General Debtors (Company 6) and did not include testing on companies 1-5 or 7&8. The effectiveness of these controls and the opinions are shown below.

2. Risk 1: Details of debt held on the Sales Ledger may be inaccurate; Opinion: Sufficient

- 2.1. Each individual debtor should have a unique debtor number so that the council can easily identify outstanding debt. Access to create new debtors and amend existing debtors is restricted on the system to staff in the Exchequer Services Team. The procedure for creating new debtors is initiated via emails from individual departments; departments are asked to check the system to confirm that a new debtor record is required and then the Exchequer Services Team process this request. Analysis of a report of all debtors on the system found a significant number of duplicates; Internal Audit will work with the ESPO and the system accountant to assist with cleansing this data.
- 2.2. The Exchequer Services Team are responsible for raising all invoices, based on requests received from services; the Exchequer Services Team are responsible for checking that requests have been authorised by an appropriate member of staff prior to raising the invoice. Review of a sample of invoices found that this process is being followed, all were considered appropriate and had been authorised correctly.
- 2.3. Some departments within the council are able to raise periodic invoices or templates as they are known; this means they can set up a facility to raise regular invoices without the need to resend a request. This is mainly used for monthly rent

payments, monthly Lifeline payments and recurring licence fees. It is important that when the council are no longer providing the service, the regular invoice/template is cancelled as soon as possible to prevent unnecessary invoices being raised. Departments are required to provide email confirmation of cancellation of templates; the cancellation form is combined with a form to request the raising of a credit note on an account. During the review of the credit note process a potential problem was observed whereby the cancellation of template invoices was being overlooked by the exchequer team. The ESPO has agreed to revise the form to make the cancellation section more prominent and provide extra training to the staff involved in this process.

- 2.4. When invoices have been raised in error it may be necessary to raise a credit note to the account. After reviewing a report from the systems team, based on data for 2014-15, it was found that approximately 5% of invoices raised have a credit note raised. This figure would be higher for 2015-16 but has been adjusted to take into account a service no longer using the sundry debtor system and one that is planned to leave in April 2016. Review of a sample of credit notes raised found that they were valid and properly authorised.
- 2.5. The debtors system has very sophisticated user access controls in place. A review of processes related to raising invoices, raising credit notes and recovery work found that only the system administrators had access to all processes and other users are restricted to only one or the other of these processes. The system administrators are also responsible for a monthly reconciliation of total numbers of staff with access to the entire system. Arrangements are in place for payroll data to be matched to current users to ensure all staff with access to the system are still employed at the council or are authorised users of the council's partners.

3. Risk 2: Debt recovery may be ineffective; Opinion: Needs Strengthening

- 3.1. The total value of invoices raised in 2014-15 was approximately £106m, with the outstanding debt for the year as at 16 January 2016 of £1.9m, less than 2%. The system automatically raises a reminder for all invoices that are unpaid after 30 days though some of these invoices are manually suppressed if a payment plan has been put in place or if they are for a Lifeline payment. Overdue invoices for Lifeline clients are monitored by the department and due to the nature of the service, they will contact customers by telephone rather than by letter.
- 3.2. If invoices remain unpaid for more than 90 days, the debt recovery assistant (1FTE) begins to investigate the debt. Unpaid invoices will be marked as 'under query' and efforts will be made to recover the debt. The DRA follows the process set out in her procedure notes but the council does not have a specific debtors recovery policy. Debtors are referred to the council's legal department or passed to a debt recovery agency if all other resources are exhausted. If a debt is more than two years old and all efforts to recover the debt have failed, the debt will be referred back to the department that raised the debt for authority to write it off. The council's constitution allows for directors to authorise the write off of debts up to £5,000, with the Chief Finance Officer able to authorise the write off of debts up to £25,000. A sample of write offs was reviewed and the correct procedures regarding limits of authorisation had been followed and evidenced.
- 3.3. If debt occurs because a valid invoice is unpaid it can be written off, however if the invoice is raised in error i.e. after a company is no longer trading, a credit note

should be raised. If this process is not adhered to there is a risk that the council's income could be overstated. Audit testing carried out in this review identified instances where this distinction has not been followed in practice and it is suggested that guidance should be provided to departments on this matter. All departments should make regular checks on all templates that have been set up to make sure they are still valid. However it was noticed on several occasions that when debt was being written off due companies going in to liquidation, another invoice was subsequently being raised due to the template not being cancelled.

- 3.4. Bad debt provision is currently only raised by some departments; all departments that raise invoices should expect some level of non-payments and therefore should make some provision for bad debts.
- 3.5. Currently there are no formal arrangements in place to monitor the performance of either internal or external debt recovery. The total debt outstanding as at December 2015 was £7.5m, with 78% of this debt relating to the years 2014-15 to date. The remaining debt of £1.6m is split between £900K that is still being actively pursued and £706K that is to be written off/back by March 2016. The constitution does not require that there is any reporting of bad debts that are written off, however it would be considered good practice to produce an annual report of all debt written off for presentation to Cabinet; the Head of Finance Operations has agreed to prepare this from March 2016.

4. Conclusion and overall audit opinion

- 4.1. Our overall opinion on the effectiveness of the controls within the sundry debtor system is **Sufficient**. The procedures in place for the team who process information through the sundry debtor system works were found to be working well, though the quality of the information that is provided by service departments requires improvement and the ESPO has agreed to amend some of the stationery and implement some additional training to address the problems identified in this report. All departments have been advised that un-recoverable debt of more than two years old will be written back to them and it will be their responsibility to write off the debt if necessary. One significant and three material level recommendations have been made to address the issues identified.

PLANNING

(final report issued 9 March 2016)

1. Management Summary

- 1.1. The planning department are responsible for processing and making decisions on planning applications. Planning operates a quality management system to ensure that all applications are treated fairly, consistently and in line with all local and national requirements. The Quality Management system, standard BS EN ISO 9001:2008, is externally assessed and audited by BSi, an accredited certification body. The income generated from planning applications for 2014/15 was £1.1m. Two risk areas relating to the planning application process were reviewed to determine the effectiveness of controls and the opinions are shown below.

2. Risk 1: That the scope of the Planning Quality Management framework (ISO) is unclear or incomplete. Opinion: Strong

- 2.1 The planning process works well, the quality management framework is clear and complete, there is clarity over roles and responsibilities for managing it, and it covers all aspects of the planning process. All the staff involved have the skills, knowledge, experience and training to undertake their roles. There are procedures in place to escalate problems and there is adequate reporting to senior management and the planning committee who have a responsibility for the planning process. Income collection is not covered by the quality management framework but there are arrangements in place within the planning team to monitor this.
- 2.2 While there is no corporate approach to quality management, the Head of Planning feels that the planning process benefits from having ISO accreditation; it helps new members of the team to pick up the processes more easily and helps deal with any complaints that may be received, by demonstrating that all applications are treated consistently and within the government guidelines. The Head of Planning also meets with local developers, agents and other planning officers throughout Kent and the feedback gained from these meetings makes him feel that the accreditation is beneficial. The accreditation ISO logo is included on emails and letters sent out to the public but other opportunities for publicising the quality of the planning service such as on the council's website have not been fully explored.

3. Risk 2: The Council may not receive the correct amount of income. Opinion: Sufficient.

- 3.1 The Council receive payments for planning applications via cash, cheque, card payments and online via the government's Planning Portal website. The processes in place to calculate and allocate these funds are carried out by the validation team; audit testing carried out found that all fees were calculated correctly in accordance with the government fee structure. Where refunds were tested they were always authorised appropriately and the planning software system was updated accordingly. If any cheque payments were returned unpaid from the bank the correct procedures were followed.
- 3.2 Income recorded through the planning software system is currently reconciled monthly by the Business Development Manager (BDM), who is independent of the validation team; this income is matched to the council's Financial Management System data. Following interviews and observations we noticed that although this reconciliation was being carried out regularly the evidence was not being retained. The BDM has now set up a spreadsheet to record this reconciliation and is now able to monitor any on-going unmatched entries more easily.

4. Conclusion and overall audit opinion

- 4.1 Our overall opinion on the planning process is **Strong**. The quality management framework works well. The correct amount of income for planning fees is being received and reconciled and the processes for monitoring this have now been improved. One material level recommendation has been made to address the issues identified.

CASH SECURITY CHECKS – LEISURE SITES

(site reports issued to client)

At the request of Leisure Management, Internal audit were asked to review the cash collection and banking processes in place across all the leisure centres sites to ensure appropriate controls are in place and to help improve consistency. Individual site reviews were carried out at:

- Splashes,
- Deangate Ridge,
- Strood Sports Centre,
- Hoo Sports Centre,
- The Strand,
- Medway Park.

These reviews found that cash handling processes across the sites were broadly consistent, though some variations were identified in the template forms/documents in use and in which roles had responsibility for counting floats and cashing up.

In all instances, the reviews found key sound control arrangements in place to manage floats, cash up tills and record income on the Clarity system and the council's financial management system. The reviews also found income collected for the days tested was banked and shown on the council's financial management system accurately.

The reviews did however identify some minor instances of failures to comply with the control processes set out, and provided a suggested action plan for management to improve records evidencing checks carried out on floats and till cashing up, and for corrections to be made to the Clarity system to reflect any under/over bankings.

School Probity Reviews

The Guide to the Law, provided by the Department for Education, defines the required school governance structure for ensuring financial probity. The governing body hold the headteacher to account for ensuring there are appropriate and effective financial management and governance arrangements in place. The school business manager (SBM) or equivalent is responsible for the delivery of sound financial administration. Medway Council's Chief Finance Officer, under Section 151 of the Local Government Act 1972, has a legal responsibility for ensuring the proper administration of the Council's financial affairs, including schools in Medway under Local Authority control.

Internal Audit is conducting a programme of financial probity audits in all the schools Medway Council has oversight responsibility for. Each probity audit seeks to identify any weaknesses in the financial management arrangements, provide guidance and advice to the school on how to strengthen current arrangements, and provide reasonable assurance that there are no financial irregularities.

Each audit provides assurance on the overall financial management of the school by:

- Analysis of financial (transactional) data to determine a risk profile for income and expenditure;
- Determination of control arrangements, as set out in the school's finance policy and confirmed through interviews with the headteacher and the finance officer;
- Targeted testing in the areas of greatest potential risk and / or potential anomalies identified during the risk assessment.

An overarching report is provided at year end to provide assurance and an overall audit opinion on the financial management arrangements in Medway Schools.

<p style="text-align: center;">Halling Primary School <i>(final report issued 21 January 2016)</i></p>

1. Introduction

- 1.1. The Guide to the Law, provided by the Department for Education, defines the required School governance structure for ensuring financial probity. The Governing Body hold the Headteacher to account for ensuring there are appropriate and effective financial management and governance arrangements in place. The School Business Manager (SBM) or equivalent is responsible for the delivery of sound financial administration. Medway Council's Chief Finance Officer, under Section 151 of the Local Government Act 1972, has a legal responsibility for ensuring the proper administration of the Council's financial affairs, including Medway Schools under Local Authority control.
- 1.2. Internal Audit is conducting a programme of financial probity audits in all the schools Medway Council has oversight responsibility for. Each probity audit seeks to identify any weaknesses in the financial management arrangements, provide guidance and advice to the school on how to strengthen current arrangements, and provide reasonable assurance that there are no financial irregularities.

- 1.3. A report for each audit is provided to the individual School, Senior Management within the Council, and once finalised to the Council's Audit Committee. A report providing assurance on the overall financial management in Medway Council's schools is provided at year end, drawing on the findings of the individual probity reviews undertaken. The audit provides assurance on the overall financial management of the school by:
- Analysis of financial (transactional) data to determine a risk profile for income and expenditure;
 - Determination of control arrangements, as set out in the school's finance policy and confirmed through interviews with the Headteacher and the Finance Officer;
 - Targeted testing in the areas of greatest potential risk and / or potential anomalies identified during the risk assessment.

2. Findings

- 2.1. Halling Primary School is an average sized primary school for children aged five to eleven years with a pupil roll of approximately 230 places. The Business Manager supports the Headteacher with the management of financial processes. The school has a below average number of disabled pupils and pupils with special educational needs.
- 2.2. The school's finance policy provides a sound framework for financial management, establishing appropriate roles and responsibilities for the governing body, finance committee and headteacher. We were able to account for all staff on the payroll and were satisfied that the school's processes would continue to ensure only legitimate staff were paid. The school made creditor payments through SIMS. The school does not have a credit card and uses very little petty cash although it does have two debit cards. The school receives income from a number of sources, the most significant of which is school meals.
- 2.3. There were a few areas we examined in more detail due to the value or nature of the transactions:
- Staff paid by timesheets (e.g. overtime)
 - Procurement and payments
 - Payments to staff
 - Assets
 - School Meal Income
- 2.4. We confirm we found no probity issues but agreed an action plan to strengthen current arrangements.

3. Conclusion

- 3.1. We are able to provide assurance that the school has reasonable controls in place to manage its financial processes and we did not identify any probity issues in our testing of payments, procurement and income.

Featherby Junior School
(final report issued 7 March 2016)

1. Introduction

- 1.1. The Guide to the Law, provided by the Department for Education, defines the required School governance structure for ensuring financial probity. The Governing Body hold the Headteacher to account for ensuring there are appropriate and effective financial management and governance arrangements in place. The School Business Manager (SBM) or equivalent is responsible for the delivery of sound financial administration. Medway Council's Chief Finance Officer, under Section 151 of the Local Government Act 1972, has a legal responsibility for ensuring the proper administration of the Council's financial affairs, including Medway Schools under Local Authority control.
- 1.2. Internal Audit is conducting a programme of financial probity audits in all the schools Medway Council has oversight responsibility for. Each probity audit seeks to identify any weaknesses in the financial management arrangements, provides guidance and advice to the school on how to strengthen current arrangements, and provides reasonable assurance that there are no financial irregularities.
- 1.3. The audit provides assurance on the overall financial management of the school by:
- Analysis of financial (transactional) data to determine a risk profile for income and expenditure;
 - Determination of control arrangements, as set out in the school's finance policy and confirmed through interviews with the Headteacher and the School Business Manager;
 - Targeted testing in the areas of greatest potential risk and / or potential anomalies identified during the risk assessment.
- 1.4. It should be noted that for the duration of the audit fieldwork and presentation of the findings, the school was managed by the Acting Headteacher.

2. Findings

- 2.1. Featherby Junior school is a larger than average school and has approximately 350 pupils on roll between the ages of 7 to 11. The proportion of disadvantaged pupils supported by the pupil premium and those who have special educational needs is above average. The finance officer supports the acting headteacher with the management of financial processes.
- 2.2. The school's finance policy provides a sound framework for financial management, establishing roles and responsibilities for the governing body, headteacher and the finance officer. We were able to account for all staff on the payroll and were satisfied that the school's processes would continue to ensure only legitimate staff were paid. The school made creditor payments by cheque through SIMS and internet payments were made on the school credit card. The school does not use petty cash. The school runs a significant number of trips resulting in a relatively high level of income. There were no obvious

missing income streams. There were a few areas we examined in more detail due to the value or nature:

- Procurement & payments;
- Declarations of interest;
- Assets;
- Timesheets
- Credit cards
- Income.

2.3. We confirm we found no probity issues but agreed an action plan to strengthen current arrangements. The school will need to pay particular attention to arrangements to:

- Ensure the authorising signatory has confirmed overtime claims are accurate;
- Confirm that all income due has been received and accounted for correctly.

3. Conclusion

3.1 We are able to provide assurance that the school has reasonable controls in place to manage its financial processes and we did not identify any probity issues in our testing of payments, procurement and income.

Grant Certification

Certain grants require certification by internal audit, and also some programmes of work include an element of payment by results (PBR) which need to be certified prior to claim. Below is a list of grant and PBR certificates, those in bold having been completed since the last Audit Committee meeting.

Grant	Date Signed off	Value
Medway Action for Families Payment by Results May 2015	8 January 2016	n/a

Definitions of Audit Opinions and Recommendation Levels

Definitions of audit opinions	
Strong (1)	<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 ongoing compliance with all requirements.</p>
Sufficient (2)	<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>
Needs Strengthening (3)	<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>
Weak (4)	<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>

Definitions of audit recommendation levels	
Significant (High)	The finding highlights a weakness in the control arrangements that expose the Council to significant risk (determined taking into account both the likelihood and the impact of the risk).
Material (Medium)	The finding identifies a weakness in the control arrangements that expose the Council to a material, but not significant, risk (determined taking into account both the likelihood and the impact of the risk).
Point of Practice	Where the finding highlights an opportunity to enhance the control arrangements but the level of risk in not doing so is minimal, the matter will be shared with management, but the detail will not be reflected in the audit report.