

Report

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Report to:	Risk and Audit Scrutiny Forum
Date of Meeting:	4 September 2012
Report by:	Executive Director (Finance and Corporate Resources)

Subject:	Internal Audit Annual Assurance Report 2011/12
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1. Purpose of Report

1.1. The purpose of the report is to:-

- ◆ report on the progress of Internal Audit for the full year 2011/2012 and to provide an audit opinion on the strength of the Council's control environment

2. Recommendation(s)

2.1. The Forum is asked to approve the following recommendation(s):-

- (1) note that Internal Audit performance is positive
- (2) note that the level of assurance is adequate
- (3) note the overall findings from internal audit work and that these have informed the Council's 2011/12 Governance Statement
- (4) note that a summary of this report was presented to the Executive Committee on 11 July 2012

3. Background

- 3.1. Internal audit activity is delivered in line with the Internal Audit Code of Practice for Local Authorities. The Council's External Auditor (PriceWaterhouseCoopers) monitors the service against this code. A recent review of compliance with this Code assessed the internal audit service within the Council as 88% compliant. Findings from this review and proposed actions will be reported separately to the Forum. As required by the Accounting Code of Practice, this Statement of Assurance has informed the Governance Statement, which is published in the Council's Annual Report.
- 3.2. The internal audit annual plan of work for 2011/2012 was approved by Executive Committee on 23 March 2011. The Plan allowed time to deal with emerging concerns which arise during the year through the inclusion of 220 'contingency' days. The 2011/2012 Plan reflected management concerns and the growing knowledge of key Council risks. Work is ongoing to ensure that links to top risks are strengthened and this will be reflected in a refreshed audit strategy for 2013/2014. The Plan was the subject of extensive consultation and external audit views were also sought. An evaluation of risk was used to prioritise the assignments within the Plan that included both operational and financial audits.
- 3.3. The Risk and Audit Scrutiny Forum met six times during 2011/2012 to review risk management arrangements, consider internal and external audit reports in the main

areas of regulatory, investigative, computer and contract audit, endorse the 2012/2013 Audit Plan, review the activity of the Performance and Review Scrutiny Forum and Finance Resources Scrutiny Forum, endorse the Efficiency Statement and the Governance Statement and action plan.

- 3.4. Recent work has been undertaken with PWC to review the effectiveness of Internal Audit. This review identified some minor actions including the need for an Internal Audit Charter and formalisation of roles, reporting lines and quality procedures. These actions will be addressed in 2012/2013. Internal Audit has developed a more effective working relationship with PWC during 2011/2012 and it is anticipated that this will minimise duplication of audit effort with greater coordination of audit work.
- 3.5. The internal audit manual was comprehensively reviewed and reissued in October 2011 and reflected the development of assurance mapping principles for auditing. This resulted in significant changes to working papers and reporting formats. This has improved the quality of reporting but has impacted on performance through the need for additional training time. This methodology will also be extended to cover the planning process for 2013/2014 and ensure that auditing practices within South Lanarkshire Council continue to be progressive. Adequate provision has been made for training in the 2012/2013 capacity plan.
- 3.6. Internal Audit also delivered services to South Lanarkshire Leisure and Culture, Strathclyde Fire and Rescue and the Lanarkshire Valuation Joint Board under the terms of agreed Service Level Statements. A programme of agreed audits has been delivered for each of these external clients in 2011/12 and annual reports have been prepared and presented to each of the Boards in the period June to September 2012.

4. Internal Audit Performance – 2011/2012

- 4.1. 100% of the agreed plan was delivered by 30 April 2012 with 81% of all jobs delivered within budget. 74% of all draft audit reports were issued within 21 days, below the target of 80%. Significant effort has been made to protect the quality of output and to reach consensus with clients over the content of reports whilst protecting the ability of Internal Audit to express an independent opinion. It is important that this balance is maintained moving forward. Overall, the quality and coverage of reporting has improved as demonstrated by client feedback. The Forum is asked to note this positive position.
- 4.2. For 2012/2013, there is the intention to develop the important consultative role that Internal Audit can play. In 2011/2012, guidance was offered over risks and appropriate workable controls within Iproc and on reconciling asset registers to allow Resources to carry out effective targeted reconciliation of asset registers. There will also be a continuation of the CCM project to inform 'intelligent' sampling and to raise awareness within Resources of the type of control data that can now be readily accessed. Data downloads in 2011/2012 covered Oracle FMS, Payables and ICON and a further 80 days have been allocated in the 2012/2013 Plan.

5. Council wide Performance – Focus on Internal Audit

- 5.1. A sound Council wide approach to audit and inspection is a requirement of the Code of Practice. Individual Resource reports will be issued detailing Resource-specific audit and performance data. This is a new development. Delivery of audit recommendations has improved with 83% of internal audit actions and 85% of external audit actions delivered on time against a target of 80%. Improvement has

been driven by the involvement of the CIAB in 2011/2012 to liaise with appropriate lead officers. Further progress in this area is required and the target has been reviewed in 2012/2013 to 85% to reflect this.

5.2. Feedback is sought from auditees following each assignment and from Heads of Services annually. From 2012/2013, a percentage target return has been set together with a performance target to address any negative feedback or emerging trends. This year the results indicated that:

- all clients were clear as to why work was being undertaken and the associated risks
- the planning process ensured audit objectives covered perceived risks
- auditors understood clients' businesses
- there was perceived to be sufficient audit testing with clients aware of key findings and that auditors had adequate technical skills
- there is universal satisfaction with the reporting process and
- action plans adequately addressed risks

6. Internal Audit Workload – 2011/2012

6.1. The audit plan was approved by the Executive Committee on 23 March 2011 (see Table One below). Work to conclude some 2011/2012 assignments and issue final reports will be carried forward into the first quarter of the 2012/2013 financial year and a specific allowance has been made for this of 40 days.

Table One- Internal Audit workload analysis for 2011/12

	Total No. Jobs
Planned	91
Dropped	(5)
Added	18
b/fwd	8
Adjusted workload	112
Reports completed to draft	112
Drafts o/s at 30 April 2012	0

7. Management of Fraud Risks

7.1. The Internal Audit Section leads on the management of the Council's fraud risk. Mitigation involves co-ordinating investigation of concerns reported during the year, facilitating the National Fraud Initiative (NFI) for the Council as well as promoting more local initiatives. An anti-fraud risk control plan, developed initially in 2009/2010, was completed by 31 March 2012. A Fraud Risk Evaluation Diagnostic assessment was undertaken in 2011/2012 and an action plan has been developed for implementation in 2012/2013. Responsibility for implementation, in the main, lies with Internal Audit although some support from Resources will be required. Time has been included in the 2012/2013 Audit Plan.

- 7.2. In addition to the above investigative work, Internal Audit and Benefits personnel from Housing and Technical Resources continued to work on the NFI during 2011/2012. The NFI is a national data matching exercise which identifies benefits fraud and overpayments. The main exercise was undertaken in 2010/2011 and resulting matches have been investigated during 2011/2012. 98% of all investigations were completed by 31 March 2012.
- 7.3. Total fraud investigated during 2011/2012 amounted to £402k. On investigation, £358k has been proven as founded, of which 96% related to benefit fraud. Of the balance of £44k, £7k was either unfounded or there was insufficient information to pursue and £37k was still work in progress as at 31 March 2012. The total value of concerns investigated has fallen by 51.7% compared to 2010/2011. Standard fraud indicators are included in all audit programmes and testing has not highlighted any major areas of concern.

8. Financial Controls and Findings

- 8.1. Overall, there is an adequate level of financial control across the Council and evidence that control within the Council's main financial systems is improving. A further year of consolidation would provide further comfort over the effectiveness of controls potentially impacting positively on future assessments. There is a good level of assurance that income management (ICON) is working effectively and is well controlled and that electronic procurement (IPROC) has good system controls. Significant improvements within Oracle Payables since June 2010 provided assurance over the adequacy of controls around this main financial system. Many financial controls, however, are not system controls and audit findings have highlighted the importance of basic controls such as segregation of duties, appropriate levels of authorisation, review of transactions and use of reconciliations as effective tools. Highlights in support of this opinion follow and the Forum is asked to note this positive level of assurance surrounding financial controls.
- 8.2. Oracle FMS: In budgetary control, Resources are identifying and investigating differences although some improvements were highlighted in relation to the netting off of income and expenditure, phasing and alignment of budgets to actual spend and consistency of reporting to Committee. There was good assurance over the necessity, accuracy and supporting documentation of journals posted. Two risks remain in relation to the authorisation of some journals and the matching of keying rights to business need.
- 8.3. Accounts Payable: Detailed testing provided comfort over the adequacy of controls. Supplier standing data reviews are however required and segregation of duties could be strengthened.
- 8.4. IProc: Good system controls in place although many of the key controls are not system controls and their effectiveness is dependent on the frequency and robustness of application. There is no specific controls to prevent off-contract buying and further efficiencies could accrue if the volume of non-catalogue and non-iproc spend could be managed together with a restriction in multi-suppliers.
- 8.5. Cash income and Petty Cash Checks: £734.4k was paid out in petty cash in the 2010/2011 financial year. A rolling programme of checks is routinely built into the annual audit plan and visits to establishments managed by Community, Education, Housing and Technical and Corporate Resources were visited during 2011/2012. These visits highlighted a number of common issues such as inappropriate use of

petty cash monies (when an expense claim should have been submitted), issue of receipts and security of keys. Action plans were subsequently agreed for the relevant establishments and progress will be monitored through Figtree. There was generally good assurance that cash income was complete notwithstanding the procedural issues that exist. There was one exception where assurances were poor.

- 8.6. Cheque Issue: During this audit, limited assurance could be gained that operational controls were sufficient to prevent internal fraud although financial controls would identify any potential cheque fraud. Cheque stocks were inadequately controlled and a lack of written procedures and sufficient audit trail were also identified as areas of concern. Implementation of an agreed action plan is currently underway.

9. Operational Controls and Findings

- 9.1. Operational control across the Council is also adequate with again, evidence that the control environment is improving. Like local financial controls, operational controls exist but on occasion lacked implementation by local managers. Controls such as proper processes and accuracy and completeness of documentation are a recurrent theme and key controls rely on management checks and monitoring. The focus on procedures is welcomed, but some work is required to ensure adherence to procedures and that a full audit trail is available to support all activity. Details in support of this opinion follow and the Forum is asked to note this level of assurance surrounding operational controls
- 9.2. Governance and risk management: The FAN self-assessment is having a positive impact on the quality and level of output from Resources and complies with CIPFA best practice. Overall there is a reasonable level of assurance over the process, although further progress should be made to ensure consistency in scoring, that actions have end implementation dates and an adequate audit trail is available to fully support the Governance Statement.
- 9.3. Information Governance: Following an Information Governance study by PWC, two strands of improvement work were taken forward within South Lanarkshire Council. An Information Governance Group was established and the development of a framework of corporate assurance. This corporate assurance took the form of checks to be included in each and every audit and the implementation of a rolling programme of audit assignments. Any significant issues arising from the checklist would be incorporated in individual action plans. The 2011/2012 Plan included work to review Super User expertise and user access. Findings are reported at 9.7. Through the Information Governance Group, information governance checklists have been completed by Housing and Technical, Community and Enterprise and Finance and Corporate Resources with either yes or partial compliance in most areas. The Information Governance Group chair has recently retired and a new chair was appointed. A renewed focus is required to ensure that self-assessments are completed annually and returned to use as a catalyst to drive improvement.
- 9.4. Vulnerable clients: Early Years provider payments are matched to service provision, and contractual arrangements are working well with variations communicated. Improvements were identified in relation to monitoring of attendance and census returns. Payments to care homes were also found to be adequately controlled although it was recommended that amendments should be documented separately and that monitoring arrangements should continue to be strengthened. Good

procedures governing adult protection case files were in evidence although various improvements were recommended to address adequacy of evidence recorded, administrative processes and mitigate the risk of actions not being able to be substantiated if challenged.

- 9.5. Contracts and procurement: A number of issues were identified around pre-contract risk methodology. Audit testing highlighted that there were no standard procedures, no consistent evidence of appraisals and that there were a lack of contingency measures. Work by Procurement has recently led to the issue of a draft Sourcing Methodology although this was not in place at the time of the audit. Some risks may be mitigated as a result. A review of tendering procedures for supplies below £50k found issues with controls and instances where the Council's standing orders were not complied with. Specific areas for improvement including the development of a more proactive approach that ensured that total spend was monitored, that spend was linked to existing contracts and that EU thresholds were not breached.

The 2011 PCA was assessed as being a reasonably fair process and there had been a good level of improvement from the position last year. Elements within the Improvement Action Plan and Procurement Strategy have started to provide positive outcomes. Further improvement in the score is expected in 2012. Leasing contracts were found to have good controls in place that ensure decisions made represent value for money. External independent scrutiny also supported this view. Resources should however ensure that all documentation is retained and that future decisions are documented. The usage and procurement of Motor Parts were found to be adequately controlled with specific improvements required in relation to documentation and audit trails.

- 9.6. Roads costing: The new system was in the early stages of implementation when reviewed by Internal Audit and more time is needed to assess the full potential. Adequate controls were deemed to be in place but material improvements are needed in relation to the accuracy of data substantiating costs. An action plan was agreed and a follow up audit is planned as part of the 2012/2013 Audit Plan.
- 9.7. IT software acquisitions, governance and user access and controls: Adequate controls across all areas. Positive assurance over technical and procurement aspects of software acquisition but consistent documentation of all aspects of the project required along with more transparency over appropriate authorisation. All of the expected strategic level of governance controls have been confirmed to be in place and there is a good level of assurance that the IT governance framework is sound. Users were found to be competent, activity adequately controlled and controls commensurate with number of users. Formal procedures in this area could be improved along with set-up, ongoing house-keeping arrangements, training and regular review of user activity.
- 9.8. Telecommunications: Good assurance that charges for telephones are correct, properly managed and allocated. Residual risks remain around Resources not performing sufficient checks on telephone charges, budget setting being based on historical, rather than projected, usage and a lack of transparency over charging.
- 9.9. Licensing and legislative compliance: Adequate assurance that there are arrangements for identifying and complying with legislation and over licensing procedures. Due to a lack of centralised records of legislative changes it was not possible to confirm completeness or that all controls, as declared by Resources,

were in place and working satisfactorily. Clear definition of lead officer responsibilities would facilitate a more corporate approach.

- 9.10. **Benefits:** Year on year greater reliance is being placed on the Resource's own internal audit team. Based on audit work undertaken by Internal Audit, adequate assurance can be placed on the effectiveness of the system of internal controls within benefits processing. Good assurance surrounding EDRMS that controls are in place and working although, as is common in new systems, there are some areas for improvement. Council Tax Discount and Exemptions replaced the original agreed assignment of Local Authority Error at the request of the Revenue and Benefits Manager. The audit concluded that changes affecting discounts and exemptions are identified regularly and dealt with in accordance with procedures. Trends are monitored and reported but efficiencies could be gained from more regular retrospective checks. Review work began during the audit assignment and identified potential recoveries of £190k. There is an expectation that the full implementation of recommendations will increase the level of assurance to good. Going forward, the impact of the Welfare Reform Bill is being monitored by a Council Working Group. Internal Audit are represented on the Group and future audit plans will address emerging risks as identified.

10. Follow-up

- 10.1. Informal follow-up is undertaken on a monthly basis and this information informs the performance indicator reported monthly. Benefits have accrued from the new practice of using CIAB members to collate feedback on implementation.

Formal follow-up is also undertaken in the year with a specific allowance included in the annual audit plan to allow an independent check on all high priority actions that have fallen due for implementation within the current financial year. Year on year progress has been made in this area and of the fourteen formal follow-up audits included in the Plan, 79/107 actions were followed up with 64/79 actions confirmed as fully implemented. 10/79 actions were found to be outstanding and the remaining five either partially implemented or superseded. Implementation of audit recommendations is key to securing improvements in the control environment and there will be a renewed focus in this area in 2012/2013.

11. Other Areas of Reliance

- 11.1. Audit Scotland reports are now routinely reported to CMT and this Forum. Reports are prepared covering the key messages and their application to South Lanarkshire Council. Any relevant actions are identified and a responsible officer allocated. Progress is monitored by Audit and Improvement Services. The Assurance and Improvement Plan for 2012/2015 prepared by Audit Scotland indicated that, by the end of 2011/2012, three risk areas of uncertainty exist for South Lanarkshire Council. These will be addressed by the Council and will be monitored by the LAN. The 2012/2013 Plan has time allocated to assist in preparation for the 2012 PCA and this will provide some assurance around procurement arrangements. None of these impact on the audit opinion expressed.
- 11.2. As part of year end procedures, the Audit Manager should be supplied with a copy of all external reports and inspections. There were no Authority inspections undertaken by the Scottish Housing Regulator or the Care Inspectorate during the year. An inspection of Sheltered Housing and Homelessness Support Services has been completed but not formally reported as yet, although verbal indications are positive. The Care Inspectorate have undertaken a number of establishment inspections

during the year and reported positive assessments. Education Scotland inspected fourteen schools and ten Early Years establishments in the year. The overall evaluation of all of these inspections was positive with over 88% of all areas evaluated as satisfactory or above. A visit from HMRC during the year assessed the organisation as low risk.

12. Summary of Overall Assurance and Audit Opinion

- 12.1. 94% of all planned audits provided positive assurance as to the adequacy and effectiveness of controls.

Internal control remains, primarily, a management responsibility to ensure that the Council conducts its business in a sound, structured and efficient manner, to ensure adherence to policies and safe-guard the assets and records of the Council. The presence of an internal audit function does not negate the importance of effective internal controls. Internal Audit cannot be expected to give total assurance that control weaknesses or irregularities do not exist but the above adequate financial and operational audit opinions (refer paragraphs 8 and 9) are based upon the audit work undertaken during the year and knowledge of the Council's governance and risk management arrangements. The Forum is asked to note the above findings will inform the Council's annual Governance Statement. As required by the Code of Practice, a signed Annual Internal Statement of Assurance is included in appendix one based on the view of the Council's own internal audit function.

13. Employee Implications

- 13.1. The Internal Audit service in 2011/2012 was delivered by a team of sixteen (14.85 FTE). Of the team of sixteen, ten are professionally qualified through either IIA or one of the CCAB bodies.

- 13.2. A significant change in working practices was implemented in 2011/2012 to develop assurance mapping principles for audit testing and reporting. This involved a significant investment in time to develop new procedures and train the team. The implications of this on the delivery of audit assignments have been more significant than first anticipated with approximately 10% of total available time being spent on training. This has led to improved audit reporting with a focus on 'assurances' and risks and the required mitigating actions. Work on a two year improvement plan resulting from Empower, the Council's self assessment tool has been completed. This action plan was originally developed for Risk Management and Internal Audit and 95% of actions are complete or nearing completion.

14. Financial Implications

- 14.1. The Internal Audit service, during 2011/2012 spent £570,306 against a budget of £522,042 (to period 14). The planned overspend related to one-off costs which were accommodated within the overall position for Finance and IT Resources.

15. Other Implications

- 15.1. Procurement remains a key area for improvement with progress continuing to be made with the Procurement Strategy presented to Committee in September 2011 and the Procurement Review to the Forum in February 2012. The 2012/2013 Audit Plan includes an allowance 150 days for contract audit and also specific procurement assignments to provide assurance around QuickQuote, the 2012 PCA assessment and the e-tendering process. Further time can be accommodated within general contingency time, if required, to address emerging risks.

15.2. In order to demonstrate continuous improvement within the audit section, a Continuous Controls Project was launched in 2010/2011. This project regularly downloads data from financial systems and analyses it to identify anomalies. This then focuses audit testing on high risk areas which is an improvement on random sampling. Data has already been used in twelve audit assignments with time and quality benefits. These reports will be developed through time and used to further strengthen the financial control environment.

16. Equality Impact Assessments and Consultation Arrangements

16.1. There is no requirement to carry out an impact assessment in terms of the information contained within this report.

16.2. Resource Heads of Service are consulted on every planned audit assignment following completion of fieldwork. Resources and elected members are also consulted during preparation of the annual audit plan.

Paul Manning

Executive Director Finance and Corporate Resources

27 August 2012

Link(s) to Council Values and Objectives

- Governance and Accountability

Previous References

- 2011/12 progress reports to the Risk and Audit Scrutiny Forum

List of Background Papers

- Figtree statistical and assurance and Eureka time recording extracts
- Code of Practice for Internal Audit for Local Authorities – CIPFA
- Fraud statistics and NFI six monthly update to RASF January 2012
- The Role of the Head of Internal Audit – CIPFA (2010)

Contact for Further Information

If you would like to inspect the background papers or want further information, please contact:-

Yvonne Douglas, Audit Manager

Ext: 5957 (Tel: 01698 455957)

E-mail: yvonne.douglas@southlanarkshire.gov.uk

To the members of South Lanarkshire Council, the Chief Executive and Executive Directors

As Audit Manager of South Lanarkshire Council, I am pleased to present my annual statement and report on the adequacy and effectiveness of the internal control system of the Council for the year ended 31 March 2012.

Respective responsibilities of management and internal auditors in relation to internal control

It is the responsibility of the Council's senior management to establish an appropriate and sound system of internal control, exercise good governance and to monitor the continuing effectiveness of that system.

It is the responsibility of the Audit Manager to provide an annual overall assessment of the robustness of the internal control system and the Council's governance arrangements as far as they are reflected in audit work. The Audit Manager cannot be expected to give total assurance that control weaknesses or irregularities do not exist but can form an opinion based on work undertaken during the year and her knowledge of control systems.

The work of Internal Audit

Internal Audit is an independent appraisal function established to review the internal control system as a service to the Council. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to general governance arrangements and more specifically the proper, economic, efficient and effective use of resources.

The Internal Audit Service operates in accordance with the Chartered Institute of Public Finance and Accountancy's Code of Practice for Internal Audit in Local Government in the United Kingdom. The section undertakes an annual programme of work approved by the Risk and Audit Scrutiny Forum and the Executive Committee. All plans are based on a formal risk evaluation process, which reflects agreed and emerging risks and changes within the Council.

All internal audit reports identifying risks, areas for improvement and/or non-compliance with expected controls are brought to the attention of management and include appropriate recommendations and agreed action plans. It is management's responsibility to ensure that proper consideration is given to internal audit reports. Internal auditors ensure that management has understood agreed actions or assumed the risk of not taking action through a system of closing meetings. Follow-up statistics and further audits are used to determine that agreed actions are implemented. Significant matters arising from internal audit work are reported to the Chief Executive and the Council's Risk and Audit Scrutiny Forum.

Basis of opinion

My evaluation of the control environment relates only to South Lanarkshire Council and is informed by a number of sources including audit work undertaken during the year, external inputs and involvement in risk and governance activities.

Limitation of scope: No individual audit assignments were specifically limited in scope at the outset but scopes were amended to reflect the progress of the job under scrutiny, the local policy applying at the time of the audit and the resources available.

Subject to the constraints raised in the Internal Audit Annual Assurance Report, it is my opinion, based on the above, that adequate assurance can be placed upon the reasonableness and effectiveness of the Council's internal control system in the year to 31 March 2012.

Signature:-

Yvonne Douglas BA CA

24 May 2012