

Item No: 7

Report No: 80/17

Report Title: Annual Report on Internal Audit Performance and Effectiveness 2016/17

Report To: Audit and Standards Committee

Date: 19 June 2017

Ward(s) Affected: All

Report By: Head of Audit and Counter Fraud

Contact Officer

Name: David Heath

Post Title: Head of Audit and Counter Fraud

E-mail: David.Heath@lewes.gov.uk

Tel no: 01273 484157

Purpose of Report:

To inform Councillors of the Internal Audit work of the Audit and Performance Division for 2016/17.

To inform Councillors on the outcome of the review of the effectiveness of Internal Audit for 2016/17.

Officers Recommendation(s):

- 1** To note that the Internal Audit coverage in 2016/17 has been sufficient to enable the Head of Audit and Counter Fraud (HACF, previously HAFP) to issue an unqualified opinion on the overall adequacy and effectiveness of the Council's control environment (see paragraph 3.1).
 - 2** To note the satisfactory outcome of the review of the effectiveness of Internal Audit for 2016/17 (see paragraph 3.3).
-

Reasons for Recommendations

- 1** The remit of the Audit and Standards Committee includes a duty to consider the annual report by the HACF, and to keep the work of Internal Audit under review to ensure that it is able to discharge its functions effectively.

2 Background

- 2.1** The Chartered Institute of Public Finance and Accountancy (CIPFA) has, with the other governing bodies that set auditing standards for the various parts of the public sector, adopted a common set of Public Sector Internal Audit Standards (PSIAS) that were applied from 1 April 2013. The Head of Audit, Fraud and Procurement (HAFP) advised the Audit and Standards Committee of the effect of the standards at its March 2013 meeting.

2.2 The PSIAS have been updated, with new standards published in April 2016. The impact of the new standards was reported to the September 2016 meeting of the Committee.

2.3 The requirements of the PSIAS overlap with those of the Accounts and Audit (England) Regulations 2015, which require that the organisation conducts a review of the effectiveness of Internal Audit at least annually. This requirement has been met by an internal study carried out by the HACF, with the results reviewed by the Deputy Chief Executive and now reported to the Audit and Standards Committee. The review has drawn on the results of the quality review processes that form part of the PSIAS and the associated Local Government Application Note (LGAN) issued by CIPFA.

3 Overall conclusions on Internal Audit Performance and Effectiveness 2016/17

3.1 The work carried out by Internal Audit during 2016/17 is outlined in Section 4 of this report. The audit coverage has been sufficient to enable the HAFP to issue an unqualified opinion on the overall adequacy and effectiveness of the Council's control environment. This opinion is included in the Annual Report on the Council's Systems of Internal Control 2016/17 that is presented separately to this meeting of the Committee.

3.2 In the past year Internal Audit has continued to focus on the Council's main financial systems and the HB subsidy grant claim, whilst at the same time providing resources to assist in the projects that form part of the Council's work on restructuring and regeneration. This approach helps to ensure the adequacy of internal control in key areas, safeguards the Council's subsidy payments, ensures that the work of internal audit is integrated with the work of the external auditors (BDO), and helps to provide assurance on quality and controls in key Council developments. The HACF believes that these are necessary priorities, which also assist in the Council's management and control of risk.

3.3 The review of the effectiveness of Internal Audit has taken into account the work carried out by the section during 2016/17 and the results of the performance and quality assurance processes that are outlined in Sections 5 to 7 of this report. The results of the review enable the HACF to report that the Internal Audit service at Lewes is fully effective, is subject to satisfactory management oversight and has complied with the PSIAS in all major areas.

3.4 In September 2015, Cabinet approved a strategy for the development of shared services between Lewes District Council (LDC) and Eastbourne Borough Council (EBC) based on the integration of the majority of council services via a Joint Transformation Programme (JTP). The full integration of the respective Internal Audit and Fraud Investigation Teams in both councils is due to be in place by 1 July 2017. Progress has already been made in coordinating internal audit activities and in sharing expertise and resources during 2016/17, and this forms the background to the activities outlined in this report.

4 Work of Internal Audit 2016/17

4.1 This section of the report informs Councillors of the work undertaken by Internal Audit during the year, compared against the annual programme that was agreed by the Audit and Standards Committee in March 2015.

Use of Internal Audit resources

- 4.2** Table 1 shows the total planned audit days compared to the actual audit days spent, together with comparative data for 2015/16.
- 4.3** Table 1 shows that for 2016/17 a total of 649 audit days have been undertaken compared to the budget of 636 days.

Table 1: Plan audit days compared to actual audit days for 2016/17

Audit Area	Actual audit days for 2015/16	Plan audit days for 2016/17	Actual audit days for 2016/17
Main Systems	360	290	352
Central Systems	57	70	83
Departmental Systems	68	70	86
Performance and Management Scrutiny	27	45	8
Computer Audit	2	45	2
Management Responsibilities/Unplanned Audits	88	116	118
Days Total	602	636	649

- 4.4** As has been predicted for some months the final results are close to plan, with a variance of just 13 days. There were staffing changes during the year, including the retirement of one of the Senior Auditors at LDC in January 2017. The potential shortfall in audit days did not arise because HACF has been involved in more audit work that was originally envisaged.
- 4.5** As was anticipated when the Audit Plan 2016/17 was prepared, the ongoing restructuring of the Council necessitated a review of the annual programme. The results of this review exercise were reported to the January 2017 meeting of the Committee. The appropriate sections of that report are included below to remind Committee members of the changes that were agreed.

Review of the 2016/17 Audit Plan (reported January 2017)

- 4.6** The review has taken place at the nine month stage, and the results of the review are now presented to the Committee. The review was scheduled to take account of a range of issues, in particular the Joint Transformation Programme, the impact of the significant extra work on the Benefits subsidy claim with BDO, the retirement of the Senior Auditor and the extra audit days worked by HAFP. There has been little overall impact on the number of days available to complete the audit programme for 2016/17, but there has been a need to re-assign a number of tasks.
- 4.7** HAFP advises that all significant aspects of the annual audit plan will be covered. The exceptions are:
- As previously reported, the planned audit of IT Security and Networks will not be possible because of the retirement of the Senior Auditor who was the specialist computer auditor. The audit will be scheduled for a future date in the audit cycle.

- The planned audit of Members Allowances and Expenses is scheduled into the Annual Plan for 2017/18 that is presented separately to the Committee.

Other audits in the programme for 2016/17 that are planned or underway will continue to a normal conclusion.

Audit Work Undertaken

- 4.8** The paragraphs below summarise the main functional areas reviewed in the year and the key audits undertaken and completed. More detailed information on the audits completed in 2016/17 has been provided to each meeting of the Audit and Standards Committee.
- 4.9 *Main Systems:*** The initial work was on the testing of the major financial systems in order to gain assurance on the adequacy of internal controls for the Annual Governance Statement (AGS) and to inform BDO's work on the Council's accounts for 2015/16. A final report was issued. The corresponding work for 2016/17 is at the draft report stage.
- 4.10** The priority work to test the Council's subsidy claim for Benefits for 2015/16 was started in June 2016. BDO's initial planning for this work had set out the standard testing requirements and identified the likely need for significant additional testing to address the issues noted in the previous year's claim. The standard testing and the initial additional testing were completed in late September. The timetabled date for BDO to have signed off and submitted the audited claim was at the end of November 2016, but that date was not met because of the extra work that has been required. This has included further additional testing, reperformance by BDO, and the resolution of queries and challenges that have continued into April 2017. The audited claim is expected to be submitted at some time during June 2017.
- 4.11** The work for the 2016/17 claim is at the planning stage, with the aim of ensuring a shared and consistent EBC/LDC approach to the audit of the HB subsidy claims at both councils.
- 4.12 *Central Systems:*** Final reports were issued for the audits of Ethics (2016), Newhaven Business Centre, Insurance, Electoral Registration and Elections, and for the priority audit of Business Continuity Planning (BCP). The results of the joint review of the EBC/LDC Leisure Trusts have been discussed with CMT, and a draft report has been issued. The current audit of Ethics (2017) is underway.
- 4.13 *Departmental Systems:*** The final reports from the audits of Right to Buy (RTB), Private Sector Housing and Cemeteries have been issued. The audit of Estates Management, incorporating work on the corresponding function at EBC, began in January 2017 but has been put on hold to free resources for the work on the HB subsidy claim 2015/16 and the testing of the major financial systems.
- 4.14** The final report from the audit of RTB included an estimate of the impact of the discounting errors in completed and ongoing RTB sales in the period 2012/13 – 2015/16. The estimated loss to LDC was approximately £100,000. Immediate action was taken to correct the prices of ongoing sales, as was reported to the

September 2016 meeting of the Committee. The effect is that the loss to LDC has been reduced to £88,000.

4.15 Performance and Management Scrutiny: The main work in this category has been in reviewing the data that supported the Annual Governance Statement (AGS), and specific tasks related to the Internal Audit aspects of the Council's Joint Transformation Programme (JTP).

4.16 Computer Audit: Internal Audit completed the IT aspects of the testing of the main financial systems. As noted at 4.7 above, the majority of the planned coverage of IT has been rescheduled.

4.17 Management Responsibilities and Unplanned Audits: This category provides resources for activities such as support for the Audit and Standards Committee, managing the Fraud Investigations Team, liaison with BDO, managing the Follow Up procedures, as well as for special projects or investigations.

4.18 There has been one unplanned audit that has been completed - a small scale exercise to review cash handling procedures at the Lewes Tourist Information Centre (TIC), and there were no significant outcomes. Follow up has confirmed that the further preventative measures that were planned by the TIC Manager have been actioned. Two reviews - Strategic Procurement, and the EBC/LDC response to the Prevent and Protect Strategy – both to be carried out by HACF, are underway.

4.19 The major project in this category has been the work on the National Fraud Initiative (NFI) data matching exercise. Internal Audit continues to coordinate the Council's work on NFI data matching exercises. Council services submitted the various data ranges in mid-October 2016 and afterwards dealt with a number of queries from the Cabinet Office. .

4.20 Internal Audit, the Investigations Team and service managers prepared for the receipt of the reported matches, and nominated officers to investigate matches in their service areas. The reported matches arrived in late January 2017 - there are 2,006 separate matches detailed across 93 reports; additional reports are expected as the exercise progresses. Each report sets out different types of potential frauds among benefit claimants, housing tenants, and anyone receiving payments or discounts from the Council. The exercise involves analysis of the matches to weed out those that are the result of error or coincidence, and then the examination of the remaining matches to assess the likelihood of fraud. The exercise is at an early stage, with 322 matches examined and no fraud or error noted so far. The Audit and Standards Committee will be kept advised of progress.

5 Follow Up of Audit Recommendations

5.1 As part of the control procedures detailed in the Internal Audit Manual all audit recommendations are followed up. The purpose of this is to check whether all accepted recommendations have been implemented. The early focus for follow up in 2016/17 was on confirming the implementation of the recommendations that had been agreed in the previous year. The results of this work were reported to the June 2016 meeting of this Committee. Since then the follow up

procedures have concentrated on the recommendations due to be actioned during 2016/17.

- 5.2** The results of the follow up work for 2016/17 show 100% implementation of those recommendations for which it has been possible to confirm management action. For some audits the results of the follow up are not yet confirmed. This information will be provided to the Committee at its next meeting.

6 Review of the Internal Audit Service against its aims, strategy and objectives

- 6.1** The LGAN requires that the Internal Audit service is periodically reviewed against its aims, strategy and objectives. The aim, objectives and strategy for the service for 2016/17 were set out in the Annual Audit Plan 2016/17 that was presented to the March 2016 meeting of the Audit and Standards Committee, as outlined below.

Service Aim

Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps the Council accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Service Objectives

The Internal Audit function is provided internally, and has the following service objectives:

- To provide an efficient and effective Internal Audit function which achieves its service standards, and improves performance where possible.
- To deliver the Council's Annual Audit Plan and Strategic Audit Plan.
- To provide an efficient and effective Investigations Team that supports the Council's Anti-Fraud and Corruption Strategy by carrying out a planned programme of work to help prevent and detect fraud, and provide resources to investigate suspected fraud cases.

The desired outcome is for the Council to be able to demonstrate an effective control environment with no significant control issues, and to provide a satisfactory and unqualified audit opinion in its Annual Governance Statement (AGS).

The Council's AGS reports on the effectiveness of the governance framework, and is approved by the Audit and Standards Committee. The AGS is based upon the results from the Council's assurance arrangements, and the work by Internal Audit and the Council's external auditors, BDO.

Internal Audit Strategy

The Internal Audit service is provided internally. The staffing is set at the level necessary to ensure audit coverage of the key areas within the Annual Audit Plan based on a detailed risk assessment.

From January 2016, the staffing of Internal Audit was set at 2.9 FTE but with support from the Internal Audit Manager at Eastbourne BC adding the

equivalent of an extra 0.2 FTE for specific assignments. This level of staffing has not been maintained throughout 2016/17, but there has been no adverse impact on the number of direct audit days (see 4.2 to 4.5).

- 6.2** The HAFP has compared the performance of the Internal Audit service with the aim, objectives and strategy, and has examined the organisation, working methods, performance and quality standards of the service. The review results, together with the details given in the Annual Report on the Council's Systems of Internal Control 2016/17, demonstrate that the Internal Audit service achieves its service aim, objectives and expected outcome, and operates in accordance with the Internal Audit Strategy as approved by the Audit and Standards Committee.

7 Review of Internal Audit Charter

- 7.1** The PSIAS require that HACF periodically reviews the Charter and present it to senior management and the Audit and Standards Committee for approval. The Charter for Internal Audit and Internal Audit Code of Ethics were approved by the Audit and Standards Committee in March 2013, and were subject to minor changes to comply with the updated PSIAS in 2016.
- 7.2** HACF reviews the documents annually to confirm that they remain valid and up to date, and that Internal Audit activities are operated in accordance with the requirements of the documents. HACF has confirmed that the documents remain largely as approved in March 2013, except for the minor changes. If there is a need for more significant changes to the documents they will be presented to the Audit and Standards Committee for approval, and circulated to senior managers.

8 Quality Assurance and Improvement Programme (QAIP)

- 8.1** The PSIAS require that HACF develops and maintains a QAIP that covers all aspects of Internal Audit activity, and which includes periodic assessments of quality, performance and conformance with the standards. The main elements of the QAIP are set out below.
- 8.2** The results of the quality reviews and assessments have been considered by HACF, who confirms that the standards of Internal Audit work comply with the audit manual and the PSIAS.

Review by external auditors BDO

- 8.3** BDO make use of Internal Audit's work for their audits of key financial systems and the audits of the grant subsidy claim for HB, and use Internal Audit results to inform their opinion of the Council's control environment.

Quality reviews by Internal Audit

- 8.4** Each audit assignment is subject to quality reviews by the Principal Audit Manager (PAM) to establish that the field work and audit reports have been prepared and completed in accordance with audit manual procedures, quality standards and the objectives of the audit.

External assessment

- 8.5** The PSIAS set new requirements in terms of external assessments, which must be conducted at least every five years by a qualified, independent assessor (or assessment team) from outside the organisation. LDC has until March 2018 to have carried out an external assessment.
- 8.6** HACF has previously agreed with the Audit and Standards Committee that he will put in place suitable arrangements for an external assessment, and will report the arrangements to the Committee. As anticipated the most economic arrangements will involve the internal audit services in neighbouring authorities in a shared assessment process. During March 2015, the outline arrangements for the assessments were agreed with the authorities comprising the Sussex Audit Group. Following a pilot assessment at a neighbouring authority, Lewes is scheduled to be assessed later in 2017.

Internal assessment

- 8.7** The PSIAS require that there are annual internal assessments that are carried out by people external to Internal Audit, but with a sufficient knowledge of internal audit practices, including knowledge of the PSIAS, the LGAN and/or IIA practice guidance.
- 8.8** The Audit Manager (AM) at LDC has carried out the internal assessment for 2016/17, comparing Internal Audit processes and procedures with the requirements of the PSIAS and LGAN. The AM is not external to internal audit but has the necessary knowledge of internal audit practices, PSIAS, LGAN and IIA practice guidance.
- 8.9** HACF has reviewed the results of the internal assessment, and confirms that Internal Audit works in accordance with the detailed requirements of the PSIAS and LGAN in the planning, management, conduct and reporting of engagements.

9 Feedback from Users

- 9.1** Customer satisfaction surveys have been part of Internal Audit's quality assurance measures since 2001. The PSIAS and LGAN require that performance monitoring arrangements include obtaining feedback from stakeholders.
- 9.2** During May 2017, feedback questionnaires were sent to the Chief Executive and members of the Corporate Management Team (CMT), and to those service managers who have had direct contact with Internal Audit during 2016/17. All comments from that exercise were reported as Very Good, Good or Satisfactory.

10 Performance Indicators (PIs)

- 10.1** Proposals for a revised set of PIs for Internal Audit were agreed at the September 2013 meeting of the Committee, and the new PIs formed the framework for the report on Internal Audit Benchmarking that was presented to the December 2013 meeting of the Committee.

10.2 The Performance Indicator (PI) results for 2015/16, 2016/17 and the targets for 2017/18 are detailed at Appendix A. The main factors leading to variances from the performance targets for 2016/17 can be summarised as:

- The staffing changes that have taken place during 2016/17.
- The need to apply significant additional resources to the work on the HB subsidy claim with BDO that has impacted on the resources available for other audits in the 2016/17 programme.

11 Fraud Investigation Team

11.1 Each meeting of the Audit and Standards Committee receives a full update on the work of the Fraud Investigations Team, and normally this report would include details of their work during 2016/17. This meeting of the Committee is receiving a detailed Annual Report on the Council's work to Combat Fraud and Corruption 2016/17. To avoid duplication, no further comment on the work of the Fraud Investigation Team is included here.

12 Financial Appraisal

12.1 There are no additional financial implications arising from this report.

13 Sustainability Implications

13.1 I have not completed the Sustainability Implications Questionnaire as this report is exempt from the requirement because it is a progress report.

14 Risk Management Implications

14.1 The risk assessment shows that if the Audit and Standards Committee does not ensure that Internal Audit is able to discharge its functions effectively there is a risk that a key aspect of the Council's internal control arrangements will not comply fully with best practice. At present, this risk is mitigated by an effective Internal Audit service that is subject to proper management oversight and monitoring by the Audit and Standards Committee.

15 Equality Screening

15.1 I have given due regard to equalities issues and, as this is an internal progress monitoring report with no key decisions, screening for equalities is not required.

16 Background Papers

[2016/17 Annual Plan](#)

17 Appendices

Appendix A: Performance Indicators (PIs) for Internal Audit.

Appendix B: Table of abbreviations

APPENDIX A PERFORMANCE INDICATORS (PIs) FOR INTERNAL AUDIT

Performance Indicator	Actual 2015/16	Target 2016/17	Actual 2016/17	Target 2017/18
Input of resources				
1 Staffing FTE	3.00	3.1	3.1	3.1
2 Employee costs	£140,412	£145,290	£140,160	£149,900
3 Total costs	£166,994	£173,620	£164,197	£175,300
4 Cost per chargeable day	£277.39	£273.00	£253.00	£281.83
5 Total external audit fee	£62,878	£64,516	tbc	tbc
Productivity and Efficiency				
6 Number of core systems audits carried out in the year	14	14	14	14
7 Number of days spent on core systems audits	360	290	352	295
8 Number of audits/reviews in original plan	30	40	37	39
9 % of original plan carried out	77%	90%	89%	90%
10 Number of audits/reviews in revised plan	40	-	40	-
11 % of revised plan carried out	82%	90%	100%	90%
12 Number of chargeable days	602	636	649	622
13 Number of non-chargeable days	222	158	115	140
14 % of draft reports issued within 15 days of the end of the audit	86%	90%	92%	90%
Outcome and degree of influence of the service				
15 % of recommendations implemented by the agreed date.	86%	90%	tbc	90%
16 All comments from client satisfaction questionnaires in Categories 1 (Very Good), 2 (Good) or 3 (Satisfactory).	100%	100%	100%	100%

Notes

All the PIs are for the Internal Audit service. There are no PIs for the Fraud Investigations Team.

Items 1 to 4 – The results reflect the savings that are related to the staffing changes that have taken place during 2016/17, offset by the additional costs arising from the increased number of days spent by HACF on audit work. For 2017/18, the forecast increase in costs and the forecast reduction in audit days lead to an increase in the cost per chargeable day.

Items 7 to 11 – The time spent on core systems audits reflects the significant additional resources required for the work on the HB subsidy claim with BDO, and this has impacted on the resources available for other audits in the 2016/17 programme.

Item 10 - This reflects the position by the end of the year, with audits having been added to/taken from the plan. No target or forecast is appropriate.

Item 13 – The result for 2016/17 reflects reduced staffing and the focus on core activities.

Item 15 - The results of the follow up work for 2016/17 show 100% implementation of those recommendations for which it has been possible to confirm management action. For some audits the results of the follow up are not yet confirmed.

Item 16 – This includes results from questionnaires sent to audit clients, and members of the Corporate Management Team.

Appendix B: TABLE OF ABBREVIATIONS

Table of abbreviations

AGS – Annual Governance Statement
BCP – Business Continuity Planning
BDO – BDO, the Council's external auditors. Formerly BDO Stoy Hayward
CIPFA – Chartered institute of Public Finance and Accounting
CMT – Corporate Management Team
DWP – Department of Work and Pensions
EBC – Eastbourne Borough Council
FTE – Full Time Equivalent
HACF – Head of Audit and Counter Fraud
HB – Housing Benefit
IT – Information Technology
JTP – Joint Transformation Project
LDC – Lewes District Council
LGAN – Local Government Application Note
NFI – National Fraud Initiative
PIs – Performance Indicators
PSIAS – Public Sector Internal Audit Standards
QAIP – Quality Assurance and Improvement Programme
RTB – Right to Buy