

Item No: 8 **Report No:** 109/12
Report Title: Annual Report on Internal Audit Performance and Effectiveness 2011/12
Report To: Audit Committee **Date:** 25 June 2012
Ward(s) Affected: All
Report By: Director of Finance
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Purpose of Report:

To inform Councillors of the internal audit work of the Audit and Performance Division for 2011/12.

To inform Councillors on the outcome of the review of the effectiveness of Internal Audit for 2011/12.

Officers Recommendation(s):

- 1** To note that the internal audit coverage in 2011/12 has been sufficient to enable the Head of Audit and Performance to issue an unqualified opinion on the overall adequacy and effectiveness of the Council's control environment (see Section 3.1).
 - 2** To note the satisfactory outcome of the review of the effectiveness of Internal Audit for 2011/12 (see Section 3.3).
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Reasons for Recommendations

- 1** The remit of the Audit Committee includes a duty to consider the annual report by the Head of Audit and Performance, 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 Internal Audit function at Lewes operates in accordance with the auditing guidelines published as a Code of Practice for Internal Audit by the Chartered Institute of Public Finance and Accountancy (CIPFA). This was updated in December 2006 and the key changes reported to the Audit Committee at its March 2007 meeting.

2.2 The requirements of the CIPFA Code of Practice overlap with those of the Accounts and Audit Regulations. The Regulations require that there be an annual report on the effectiveness of Internal Audit. This requirement has been met by an internal study carried out by the Head of Audit and Performance, with the results independently reviewed by the Director of Finance and now reported to the Audit Committee. The review has drawn on the results of quality review processes that were approved by the Audit Committee in March 2007 and existing performance information that has been reported for some time.

3 Overall conclusions on Internal Audit Performance and Effectiveness 2011/12

3.1 The work carried out by Internal Audit during 2011/12 is outlined in Section 4 of this report. The audit coverage has been sufficient to enable the Head of Audit and Performance 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 2011/12 that is presented separately to this meeting of the Audit Committee.

3.2 In the past year Internal Audit has continued to focus on the Council's main financial systems and subsidy grant claims. This approach helps to ensure the adequacy of internal control in key areas, safeguards the Council's subsidy payments and supports the Council's external auditor, PKF. The Head of Audit and Performance believes that these are necessary priorities, which have had no adverse effect on 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 2011/12 and the results of the performance and quality assurance processes that are outlined in Sections 5 to 10 of this report. The results of the review enable the Director of Finance to report that the Internal Audit service at Lewes is fully effective, is subject to satisfactory management oversight and complies with the CIPFA Code of Practice 2006 and the Accounts and Audit Regulations 2003 (amended in 2006).

4 Work of Internal Audit 2011/12

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 Committee in March 2011.

Use of Internal Audit resources

4.2 Table 1 shows the total planned audit days compared to the actual audit days spent. As requested by Councillors, Table 1 includes comparative data for 2010/11.

4.3 Table 1 shows that for 2011/12 a total of 785 audit days have been undertaken compared to the budget of 753 days. The variance of 32 days is largely due to administration and training being less than was anticipated when setting the annual plan.

Table 1: Plan audit days compared to actual audit days for 2011/12

Audit Area	Actual audit days for 2010/11	Plan audit days for 2011/12	Actual audit days for 2011/12
Main Systems	240	190	268
Central Systems	70-	100	122
Departmental Systems	221	150	69
Performance and Management Scrutiny	20	80	39
Computer Audit	67	65	57
Environmental Audit	27	36	61
Management Responsibilities/Unplanned Audits	126	132	169
Days Total	771	753	785

- 4.4** The main variances are the additional time needed for audits of Main Systems, Environmental Audit and Unplanned Audits. Extra time was needed for Main Systems because of the additional testing that has been required for the work with PKF on the main financial systems and the subsidy grant claims (see 4.7 and 4.8). The additional time for Environmental Audit is mainly due to work carried over from 2010/11, the need for more detailed examinations in the audits comprising this year's programme, and extra work in assessing the possible future direction of environmental audit (see 4.13). The additional time for Unplanned Audits reflects the work required for the review of Property Services contracts, and the recent audit of the controls over changes to suppliers' payment details that was requested by the Chair of the Audit Committee (see 4.16).
- 4.5** The extra time required for audits of Main Systems, Environmental Audit and Unplanned Audits meant that it was necessary to adjust the programme of audits in other areas. Three audits that were underway in March 2012 are being completed in 2012/13. Some audits have been moved to later in the audit cycle, as was reported in the Strategic Audit Plan for 2012/15 that was presented to the March 2012 meeting of the Audit Committee.

Audit Work Undertaken

- 4.6** 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 2011/12 has been provided to each meeting of the Audit Committee.
- 4.7** *Main Systems:* The initial work was on completing the testing of the main financial systems to gain assurance on the adequacy of internal controls for the Annual Governance Statement (AGS) and to inform PKF's work on the Council's accounts for 2010/11. Additional unforeseen work was needed to meet the PKF request for increased sample sizes and an extended test period. A summary report and a separate report on the issues arising from the testing of Expenditure and Creditors were finally issued. The corresponding reviews and testing for the 2011/12 accounts were completed in April 2012 and a summary report has been issued.
- 4.8** During the period between the reviews of the main financial systems, the main work was to review the Council's subsidy claims for Benefits and, to a lesser

extent, NDR for 2010/11 on behalf of PKF. The Benefits subsidy claim required additional testing to assess the potential effect of errors noted by the initial sampling. PKF have confirmed that the NDR and Benefits claims have been signed off without qualification, and that they were able to place reliance on the work of Internal Audit. The corresponding reviews for 2011/12 are underway.

- 4.9 Central Systems:** Final reports were issued for the audits of Document Image Processing, Project Management, Equality and Diversity, Building Maintenance, and Business Continuity Planning. Audits of Partnerships and the Newhaven Business Centre are at the draft report stage.
- 4.10 Departmental Systems:** Final reports were issued for the audits of Clean and Green, Housing Management, Private Sector Housing, Contaminated Land and Air Quality. An audit of Environmental Health is at the draft report stage. Audits of Tourism and Economic Development, and Planning and Development Control were moved to 2012/13.
- 4.11 Performance and Management Scrutiny:** The main areas of work have been the review of the Annual Governance Statement (AGS) for 2010/11, a study of risk data compiled for the Council's risk registers and the development of an audit approach for Programme Nexus and its constituent projects. No new VFM study was started in the year.
- 4.12 Computer Audit:** Final reports issued for the audits of Computer Software and IT Security. Internal Audit at Lewes worked with colleagues in Hastings Borough Council (BC) and Rother District Council (DC) to review the update of the Agresso financial management system that is shared by the three authorities. Internal Audit at Rother DC led the review because the main work on the update was being coordinated at that authority prior to its implementation in October 2011.
- 4.13 Environmental Audit:** During May 2011, Internal Audit examined the Council's annual EMAS statement prior to its submission to the Lloyd's Register Quality Assurance (LRQA) verifier. The verifier's assessment of the statement and Internal Audit's coverage of EMAS during 2010/11 informed the LRQA decision to confirm the Council's EMAS registration for the period up to May 2014. The final reports from the 2010/11 programme were issued earlier in this year, and the final reports have been issued for the three audits from the 2011/12 programme – EMAS: Water and Energy, EMAS: Transport and EMAS: Management and Coordination. The work on this last audit involved research on the future approach to environmental audit and its links with the new Environmental and Sustainability Working Group (ESWG).
- 4.14 Management Responsibilities and Unplanned Audits:** This category provides resources for special projects or investigations, Internal Audit advice on internal control and probity, as well as the resources for the support for the Audit Committee, liaison with PKF and managing the Follow Up procedures.
- 4.15** Internal Audit has been coordinating the Council's response to the 2010/11 NFI data matching exercise which is run by the Audit Commission. The matched data was reported to the Council in February 2011, and the investigation of the matches by Council managers has been an ongoing project that is now complete. Internal Audit has provided guidance and reviewed the draft

procedure rules as part of the development of the East Sussex Procurement Hub, has reviewed the agreement for the Council's new bill payment collection service and examined the draft tender for the Council's banking contract.

- 4.16** Internal Audit is working with colleagues in Audit and Performance (APD) to review the Council's risk management methodology and the pam (Platform for Achieving More) risk tool to further develop risk management at the Council. Final reports were issued for the reviews of contracts let by Property Services and the controls over changes to suppliers' payment details.

Follow Up of Audit Recommendations

- 4.17** 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.
- 4.18** The early focus for follow up in 2011/12 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 2011 meeting of this Committee. Since then the follow up procedures have concentrated on the recommendations due to be actioned during 2011/12. The majority of recommendations have been implemented but the final results cannot yet be confirmed. This information will be provided to the Audit Committee as soon as it is available (see Appendix A).

5 Review of the Internal Audit Terms of Reference

- 5.1** The CIPFA Code of Practice (2006) requires that the Internal Audit Terms of Reference be approved and regularly reviewed by the authority. At Lewes the Internal Audit Terms of Reference are included in the Charter for Internal Audit that is approved by the Audit Committee.
- 5.2** The Head of Audit and Performance can confirm that the Charter for Internal Audit has been updated to take account of the changes in the organisation of the Council in 2011. In other respects, the Charter reflects the management processes and working practices that were approved by the Audit Committee in March 2007. As a result, the Internal Audit Terms of Reference are in accordance with the CIPFA Code of Practice 2006 and the Accounts and Audit Regulations 2003 (amended in 2006).

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

- 6.1** The CIPFA Code of Practice (2006) requires that the Internal Audit service is periodically reviewed against its aims, strategy and objectives. The aim, objectives and strategy for the service are set out in the Strategic Audit Plan 2012/15 that was presented to the 19 March 2012 meeting of this Committee, as outlined below.

Service Aim

Internal Audit at Lewes is an independent assurance function established within the Council to provide an objective opinion on the control environment by evaluating its effectiveness in achieving the organisation's objectives. Internal

Audit examines, evaluates and reports on the adequacy of the control environment as a contribution to the Council's proper, economic, effective and efficient use of resources.

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.

Expected Outcome

The Council is able to demonstrate an effective control environment with no significant control issues, and make a satisfactory and unqualified declaration on its Annual Governance Statement (AGS).

Internal Audit Strategy

The Council's AGS reports on the effectiveness of the governance framework, and is approved by the Audit Committee at its September meeting. 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, PKF.

The Internal Audit service is provided internally. The staffing is as approved by the Council on 23 February 2000 and is set at the level necessary to ensure audit coverage of the key areas within the three year audit cycle based on a detailed risk assessment.

Results of the review

- 6.2** The Head of Audit and Performance 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 2010/11, demonstrate that the Internal Audit service achieves its aim, objectives and expected outcome, and operates in accordance with the Internal Audit Strategy as approved by the Audit Committee.
- 6.3** The Head of Audit and Performance can also confirm that the Internal Audit function at Lewes continues to meet best practice standards, which includes compliance with the CIPFA Code of Practice.

7 Customer Satisfaction Surveys/Feedback from Users

- 7.1** Customer satisfaction surveys have been part of Internal Audit's quality assurance measures since 2001/2002 and a survey form is sent out with each final report. The results for the 2011/12 met target with 100% of comments reported as Very Good, Good or Satisfactory as shown in the table at Appendix A.
- 7.2** The CIPFA Code of Practice 2006 requires there to be periodic feedback from users on the Internal Audit service as a whole. A feedback questionnaire was

sent to the Chief Executive and members of the Corporate Management Team (CMT) in May 2012. All comments from that exercise were reported as Very Good or Good.

8 Added Value of Internal Audit

- 8.1** The CIPFA Code of Practice 2006 requires there to be an assessment of the extent to which Internal Audit adds value and assists the Council in achieving its objectives. As an internal facing (back office) service, Internal Audit is able to contribute to the Council's aims, objectives and service priorities by supporting the corporate governance, business planning, performance management and internal control arrangements which help service managers and Councillors to focus on and deliver the priority services.
- 8.2** The May 2012 feedback questionnaire (see 7.2 above) included a question on the overall value of Internal Audit as an aid to management. All comments from the Chief Executive and members of CMT were reported as Very Good or Good.

9 Performance Indicators (PIs)

- 9.1** The Performance Indicator (PI) results for 2010/11, 2011/12 and the targets for 2012/13 are detailed at Appendix A. The results for 2011/12 show that performance was at target or better than target in seven of the eight PIs. The results for PI8 (% of recommendations implemented by the due date) cannot yet be confirmed.

10 Quality reviews

- 10.1** The Internal Audit team carries out an annual peer review of a sample of audit files to establish that the work has been done in accordance with audit manual procedures, quality standards and the objectives of the audit. The results of the June 2012 review are satisfactory.
- 10.2** PKF undertakes separate reviews of the Internal Audit work for the managed audit of key financial systems and the audits of the grant subsidy claims for HB and NDR. Taken together these two major exercises represent a significant part of the annual workload for Internal Audit. The results of the PKF reviews were that PKF were able to rely on the work of Internal Audit, which was completed to a good standard.
- 10.3** The results of the internal and external reviews have been considered by the Head of Audit and Performance, who confirms that the standards of Internal Audit work comply with the audit manual and the CIPFA Code of Practice.

11 Financial Appraisal

- 11.1** There are no additional financial implications arising from this report.

12 Sustainability Implications

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

13 Risk Management Implications

- 13.1** The risk assessment shows that if the Audit 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 Committee.

14 Equality Screening

- 14.1** 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.

15 Background Papers

- 15.1** Strategic Audit Plan 2011/14 presented to the Audit Committee on 14 March 2011.

16 Appendices

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

APPENDIX A PERFORMANCE INDICATORS (PIs) FOR INTERNAL AUDIT

Performance Indicator	Actual 2010/11	Target 2011/12	Actual 2011/12	Target 2012/13
Cost of input 1 Stay within total for Internal Audit Section budget.	Within budget	Within budget	Within budget	Within budget
Productivity and Process Efficiency 2 % of Audit Plan completed. 3 Number of productive audit days achieved. 4 % of draft reports issued within 15 working days of the end of the audit.	92% 771 95%	90% 753 95%	93% 785 95%	90% 751 95%
Compliance with professional standards 5 Positive opinion from PKF review of Internal Audit as per Management Letter.	Positive opinion	Positive opinion	Positive opinion	Positive opinion
Outcome and degree of influence of the service 6 All comments from client satisfaction questionnaires in Categories 1 (Very Good), 2 (Good) or 3 (Satisfactory). 7 % of recommendations agreed compared to number made. 8 % of recommendations implemented by the agreed date.	100% 100% 90%	100% 100% 90%	100% 100% TBC	100% 100% 90%

Notes:

- The target for the % of Audit Plan completed (**2**) was increased from 85% to 90% for 2011/12.
- TBC – The final results for the % of recommendations implemented by the due date (**8**) have yet to be confirmed.