

Agenda Item No: 10 **Report No:** 111/12

Report Title: Interim Report on the Council's Systems of Internal Control 2012/13

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 on the adequacy and effectiveness of the Council's systems of internal control during the first two months of 2012/13, and to summarise the work on which this opinion is based.

Officers Recommendation(s):

- 1 To note that the overall standards of internal control were satisfactory during the first two months of 2012/13 (as shown in Section 3).
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Reasons for Recommendations

- 1 The remit of the Audit Committee includes the duties to agree an Annual Audit Plan and keep it under review, and to keep under review the probity and effectiveness of internal controls, both financial and operational, including the Council's arrangements for identifying and managing risk.

Information

2 Background

- 2.1 The Internal Audit function at Lewes operates in accordance with the Code of Practice for Internal Audit published by the Chartered Institute of Public Finance and Accountancy (CIPFA). The Code sets out how the Head of Audit and Performance should report to the Audit Committee, including keeping the Committee informed of any emerging issues in respect of internal control, corporate governance and risk management.

3 Internal Control Environment at Lewes District Council

- 3.1 The Annual Report on the Council's Systems of Internal Control for 2011/12 included the opinion of the Head of Audit and Performance that the overall

standards of internal control are satisfactory. This opinion was based on the work of Internal Audit and the Council's external auditors, PKF, and the Council's work on risk management. In the two months since the start of the financial year there has been nothing to cause that opinion to change and there have been no instances in which internal control issues created significant risks for Council activities or services.

4 Internal Audit work 2012/13

- 4.1** This section of the report summarises the work undertaken by Internal Audit during the first two months of the year, compared to the annual plan that was agreed by the Audit Committee in March 2012. Further information on each of the audits completed since the previous meeting of the Audit Committee is given at Appendix A.
- 4.2** Table 1 shows that a total of 132 audit days have been undertaken compared to 122 planned. The variance of 10 days is not significant at this stage, and it is estimated that the audit days will be at or close to plan by the year end.

Table 1: Plan audit days compared to actual audit days for April to May 2012

Audit Area	Actual audit days for the year 2011/12	Plan audit days for the year 2012/13	Actual audit days to date	Pro rata plan audit days to date
Main Systems	268	215	64	
Central Systems	122	85	15	
Departmental Systems	69	145	30	
Performance and Management Scrutiny	39	71	16	
Computer Audit	57	70	1	
Environmental Audit	61	36	1	
Management Responsibilities/Unplanned Audits	169	129	5	
Total	785	751	132	122

Note: The 'Pro rata plan audit days to date' provides a broad guide to the resources required to carry out planned audits. The actual timing of the individual audits will depend on a variety of factors, including the workloads and other commitments in the departments to be audited.

- 4.3** *Main Systems*: The initial main work has been on completing 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 PKF's work on the Council's accounts for 2011/12. A summary report has been finally issued. The work on behalf of PKF to test the Council's subsidy claims for Benefits and NDR for 2011/12 is underway.
- 4.4** *Central Systems*: A final report was issued for the audit of Business Continuity Planning, and audits of Newhaven Business Centre and Partnerships are at the draft report stage.
- 4.5** *Departmental Systems*: A final report was issued for the audit of Contaminated Land and Air Quality. An audit of Environmental Health is at the draft report stage, and an audit of Licensing is underway.
- 4.6** *Performance and Management Scrutiny*: Internal Audit has provided the resources for a review of the organisation's corporate property management on behalf of the Chief Executive, the result of which was an options paper to CMT. There has also been a review of the AGS preparations for 2011/12.

- 4.7** *Computer Audit:* Internal Audit completed the IT aspects of the testing of the main financial systems on behalf of PKF.
- 4.8** *Environmental Audit:* A final report was issued for the audit of EMAS; Management and Coordination.
- 4.9** *Management Responsibilities/Unplanned Audits:* 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. A final report has been issued for the audit of the controls over changes to suppliers' payment details that was requested by the Chair of the Audit Committee. A final report has been issued for the investigation of a reported cash loss at the Fort Road offices.

Follow up of Audit Recommendations

- 4.10** All audit recommendations are followed up to determine whether control issues noted by the original audits have been resolved. The early focus for follow up in 2012/13 has been on confirming the implementation of the recommendations that had been agreed in the previous year. The results of this work are reported separately to this meeting of this Committee.

Quality Reviews/Customer Satisfaction Surveys/Performance Indicators (PIs)

- 4.11** The results of the Internal Audit quality reviews, customer satisfaction surveys and PIs for 2011/12 are reported separately to this meeting of the Audit Committee. The results enabled the Head of Audit and Performance 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 and the Accounts and Audit Regulations.

5 Risk Management

- 5.1** Cabinet approved the Risk Management Strategy in September 2003. Since then risk management at the Council has been developed via a series of action plans, with the result that all the elements of the risk management framework set out in the strategy are in place and are maintained at best practice standards.
- 5.2** The risk management process has identified that most risks are mitigated by the effective operation of controls or other measures. However, there are some risks that are beyond its control, for example a major incident, a 'flu' pandemic, a downturn in the national economy or a major change in government policy or legislation. The Council has sound planning and response measures to mitigate the effects of such events, and continues to monitor risks and the effectiveness of controls. The overall satisfactory situation for risk management has helped to inform the opinion on the internal control environment.
- 5.3** In December 2010, the Government published reductions in funding for individual local authorities as part of the national deficit reduction plan. The Council's position is that it must achieve a saving of £1.4m in its gross expenditure over two years, and the Corporate Management Team (CMT) has prepared a planned programme of savings. The Head of Audit and Performance has reviewed with CMT the impact on the control environment of the savings achieved so far, and has obtained assurance that there has been no adverse effect on the operation of controls. This exercise will be ongoing while the Council has in place a programme of savings.

6 System of management assurance

6.1 The Council operates a management assurance system, which enabled senior officers to confirm the proper operation of internal controls, including compliance with the Constitution, in those services for which they were responsible in 2011/12. A joint statement by the Chief Finance Officer (Section 151) and Monitoring Officer confirmed that there were no significant governance issues for the Council in 2011/12. Nothing has arisen in the first two months of the financial year to change these assessments.

7 Corporate governance

7.1 In June 2012, the Head of Audit and Performance reviewed the Council's Local Code of Corporate Governance, and concluded that the arrangements remain satisfactory and fit for purpose. These results are reported separately to this meeting of the Audit Committee.

7.2 The Council is required to produce an Annual Governance Statement (AGS), which outlines the main elements of the Council's governance arrangements and the results of the annual review of the governance framework including the system of internal control. The AGS for 2011/12 is to be reported to the September 2012 meeting of the Audit Committee.

8 External assurance

8.1 The Government relies on external auditors to periodically review the work of the Council to make sure it is meeting its statutory obligations and performing well in its services. The results of these external reviews have helped inform the opinion on the internal control environment. The recent results are summarised below.

8.2 Annual Audit Letter for 2010/11 (November 2011) – This report outlined the key findings from PKF's audit of 2010/11. PKF concluded that:

- the Council had effectively managed the transition to financial reporting under International Financial Reporting Standards (IFRS), and issued an unqualified opinion on the financial statements.
- the key financial systems are generally adequate as a basis for preparing the financial statements, although there are deficiencies in internal controls in some aspects of purchase ordering and the authorisation of manual journals.
- the AGS is not inconsistent or misleading with other information they are aware of from the audit of the financial statements.
- the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, and issued an unqualified value for money opinion.
- the Council has continued to manage its finances well in the year, through robust budget monitoring and members and officer involvement in reviewing financial matters.
- the Council Plan and medium term financial strategy support continued delivery of the Council's core services and key priorities over this challenging period.

8.3 Annual Governance Report for 2010/11 (September 2011) – The key findings and conclusions from this report were summarised in the Annual Audit Letter (see above). In addition, PKF concluded that:

- Internal Audit has satisfactorily carried out a comprehensive programme of work on the key financial systems, and PKF were able to place reliance on this work for their testing of the effectiveness of specific controls.

8.4 Grant Claim Certification for 2010/11 (December 2011) was presented to the January 2011 meeting of the Audit Committee. PKF concluded that:

- the Council's arrangements for preparing grant claims and other returns to Government departments are generally operating adequately, and all final claims were fairly stated in the reports to Government departments.
- the Council should review the effectiveness of the procedures to address issues arising from its quality assurance checks on Housing and Council Tax Benefits claims.
- PKF were able to rely on the work of Internal Audit. and the workbooks were completed to a good standard.

9 Financial Appraisal

9.1 There are no additional financial implications from this report.

10 Risk Management Implications

10.1 If the Audit Committee does not ensure proper oversight of the adequacy and effectiveness of the Council's systems of internal control there is a risk that key aspects of the Council's control arrangements may not comply with best practice.

11 Sustainability Implications

11.1 I have not completed the Sustainability Implications Questionnaire as this report is exempt from the requirement because it is an internal monitoring report.

12 Equality Screening

12.1 This report is for information only and involves no key decisions. Therefore, screening for equality impacts is not required.

13 Background Papers

13.1 Annual Audit Plan 2012/13 and Strategic Audit Plan 2012/13 to 2014/15 that were presented to the Audit Committee on 19 March 2012.

14 Appendices

14.1 Appendix A - Statement of Internal Audit work and key issues.

14.2 Appendix B – Log of Significant Outstanding Recommendations (May 2012).

APPENDIX A

Statement of Internal Audit work and key issues

Audit report: Contaminated Land and Air Quality

Date of final issue: 29 March 2012

Overall opinion:

From the audit work carried out during this review Internal Audit has obtained substantial assurance that there is a sound internal control framework that helps to ensure that the Council meets its statutory duties in respect of contaminated land and air quality. The team is adequately resourced, effective procedures are in place, and performance is monitored. The first version of the Contaminated Land Inspection Strategy (CLIS) has been completed and an Air Quality Management Area continues to operate in Lewes town centre. Of particular note was the successful implementation of a programme to confirm that local businesses maintain best practice standards in managing emissions to air, land and water, work that was previously done by external contractors. The report contains three recommendations.

Main points:

Council strategy for contaminated land

- Under the statutory guidance that supplements the Environment Protection Act 1990 the Council is required to produce and publish a CLIS for identifying contaminated land, and to undertake periodic reviews of the strategy to ensure that it remains effective. The Council has been working in accordance with its current CLIS, which was last updated in 2008. The work has included the identification and inspection of sites that posed the most significant risk because the possible contamination was on residential land. One of these sites has been successfully remediated and the other five sites were found not to have contamination that would be detrimental to human health. The residents of the five sites have been notified accordingly.
- Central government is reviewing the main guidance for contaminated land strategies. The Principal Environmental Health Officer (Environment) believes that, until the government publishes the detail of the revised guidance, it is not appropriate for the Council to review and update its strategy. Internal Audit supports this view as an interim measure, but the outcome of the planned development of previous industrial sites in the District may require a change in approach.

Contaminated land at former gas works sites

- The inspection and remediation of three former gas works sites relies on successful completion of separate development projects that are currently being planned. If any of the sites remain undeveloped, they and other sites would revert to being some of the more likely sources of contamination to receptors in the District. This situation would justify the updating of the Council's Contaminated Land Inspection Strategy (CLIS) and the preparation of new plans for how to remediate the sites that pose the most significant risks.

Air Quality in Newhaven

- Recent monitoring of the air quality in Newhaven has recorded levels of nitrogen dioxide which are at or near the limit at which the Council must declare an Air Quality Management Area (AQMA) and [Page 6 of 12](#) process of putting in place an action plan to improve air quality.

The most likely source of this air pollutant is road traffic. The Council is committed to the regeneration of Newhaven, and a major commercial development project is at the planning stage. Probable outcomes of this development project are an increase in road traffic and a resultant increase in the levels of air pollution. Measures are needed to reconcile the objectives for the regeneration of Newhaven with the Council's statutory duty to improve air quality if pollutants exceed safe levels.

Air quality in Lewes

- In July 2011, the Council produced an Air Quality Progress Report (AQRP) to determine whether there had been improvements in levels of air pollutants in Lewes town centre. Despite progress in some of the activities, the report noted that the annual mean target for nitrogen dioxide continued to be exceeded at a number of locations.
- The Air Quality Action Plan includes a number of Council plans and strategies that are intended to support the measures to improve air quality. Some of these initiatives are delayed or incomplete, and there remains an inability to ensure that plans and strategies that impact on air quality are followed through and implemented successfully. Currently, this work is managed in separate teams and departments, and it is possible that the new Environment and Sustainability Working Group may be able to coordinate activities to ensure progress in these areas.

Audit report: EMAS: Management and Coordination

Date of final issue: 20 April 2012

Overall opinion:

From the work carried out during this review Internal Audit has obtained substantial assurance that there is effective operation of the management procedures and controls that govern EMAS at LDC. There are adequate management structures and systems in place and there is effective management of the relationship with LRQA. There are sound arrangements to ensure that new staff are introduced to EMAS at induction training, and there are satisfactory procedures for monitoring compliance with environmental legislation, particularly where the Council has a duty to comply.

The Council remains committed to environmental issues with the Council Plan for 2011/12 confirming the ongoing support for the protection of the environment and the encouragement of sustainability. As part of this process, the Council has examined the future direction of environmental stewardship and sustainability, and the ways in which major new environmental projects are to be managed. This discussion of future plans created a period uncertainty during 2011 that impacted on the day to day operation of EMAS. These uncertainties are being resolved and there has been positive confirmation of how the remainder of the EMAS registration period will run. The report contains three recommendations.

Main points:

- The period of transition will run for the remainder of the current EMAS registration, with existing working groups operating alongside the newly formed Environment and Sustainability Working Group and a range of new environmental projects. The new arrangements are at an early stage and there is a need to define the relationships between the different groups and their respective responsibilities, so that any

- overlap is minimised and there is clarity of purpose.
- Publicity can be a powerful tool in encouraging further positive developments in environmental management. It would seem reasonable to ensure that there is proper publicity for all the Council's environmental achievements, and for this publicity to maximise the positive coverage given to the work of the new Environment and Sustainability Working Group and to the EMAS system while the EMAS registration is retained. Also, there are some gaps and inconsistencies in the recording of environmental performance and achievements. It is important that these issues are rectified to help reinforce the positive messages about the Council's performance and ensure that EMAS runs strongly to the end of the current registration period.
 - Internal Audit currently carries out audits of EMAS and other functions that include a significant environmental element. There is a need to maintain an adequate coverage of EMAS during the remainder of the Council's registration and ensure proper review of the projects that are to be developed via the Environment and Sustainability Working Group.

Audit report: Controls over suppliers' payment details

Date of final issue: 25 April 2012

Overall opinion:

From the audit work carried out during this review Internal Audit has obtained substantial assurance that the Council operates sufficient controls to prevent unauthorised amendments to suppliers' details being used to create improper payments. For the majority of changes examined in the sample tests the procedures have operated correctly, with sound arrangements for setting up new suppliers and processing changes in suppliers' bank details. There were no known fraudulent payments made in the eleven months from April 2011. The report contains one recommendation which is already being implemented.

Main points:

- There is a need to further clarify the control procedures that are required to validate some changes to suppliers' bank accounts as not all scenarios were modelled when the enhanced control checks were put in place. At the time of the audit there were gaps in the control checks and these reduce the assurance that only valid changes to bank details have been made.
- Post processing checks by the Accounting Technician confirm the accuracy of the input of changes to Agresso but it is not clear what role the checks play in validating the changes that have been requested. The Head of Finance has agreed to examine the scope of the control checks and issue a revised procedure guide.

**Audit report: Reported cash loss at Housing Rents Office,
Fort Road**

Date of final issue: 24 May 2012

Overall opinion:

The Council has gradually been reducing the number of locations at which cash payments can be made, and Fort Road is the last office where significant cash payments are received. Senior officers in Housing Services believe that it is important that tenants are still able to make rent payments, particularly rent arrears, in cash at the Fort Road offices. The reliance on Rent Officers to handle cash has meant it has not been possible to ensure the normal separation of duties in the handling of rent payments at Fort Road, but Internal Audit has previously accepted the assurances that there have been other compensatory controls that have safeguarded the cash. The investigation of the reported £40 cash loss has identified that some of the compensatory controls are no longer fully effective and do not provide the necessary safeguards. The report contains one recommendation.

Main points:

- On 2 March 2012, Internal Audit was advised that an envelope containing £40 cash was missing and an investigation of the discrepancy was needed. During the audit it was noted that the £40 was not lost in that it had already been accounted for via the normal arrangements on the same day. Although the cash was no longer missing, the audit continued with a review of the procedures for handling cash rent payments at Fort Road.
- The procedures and controls covering the receipting, handling and accounting for income by the Rents Section do not comply with the Council's Financial Procedure Rules (FPRs). If cash rent payments are to be retained at Fort Road they should be supported by the full range of cash controls. If for any reason the controls cannot be applied, there should be a decision that cash rent payments are no longer an option and there should be publicity for the alternative methods of payment that are available.

Audit report: Business Continuity Planning (BCP)

Date of final issue: 8 June 2012

Overall opinion:

From the audit work carried out during this review Internal Audit has obtained partial assurance that there is an adequate system of internal control covering the Council's current BCP arrangements. The current BCP has a sound policy base and is a detailed document with comprehensive guidance on the roles and responsibilities for key officers and departments. The plan meets the requirements of the Civil Contingencies Act 2004 in that it is based on a detailed assessment of business risks, includes priorities for service restoration, and sets out the arrangements for ongoing testing. However, there are some BCP issues that need to be addressed, some of which are significant. The report contains four recommendations.

Main points:

- The current version of the BCP was issued in March 2011 and in most respects the arrangements are reasonably documented. However, the changes in organisation and staffing that have occurred since March 2011 have not been carried forward into the BCP, and there are some errors and inconsistencies in the statements of service priorities. It is recognised that documents such as the BCP will need to be periodically amended, and may be out of date for a time until new details are included. It is important that this period of inaccuracy is minimised, and that the production process includes adequate checks to ensure the accuracy and validity of the each new version.
- The current BCP focuses on the Council's own responses to events that might disrupt services. Best practice standards for business continuity planning emphasise the importance of ensuring that where key goods or services are supplied by external providers (whether through contracts, outsourced services or partnership working) the external bodies have effective BCP arrangements. The Council has in the past obtained assurance about the BCP arrangements for a small number of contracts and its key partnerships, but it would seem reasonable for this to be done on a more regular basis.
- The testing regime for the overall BCP is proportionate and achieves a reasonable balance between desk exercises and live testing. However, as was noted in the previous audit of BCP, the Council does not undertake full testing of the IT aspects of the BCP because there is insufficient IT capacity. The set up and testing of standby facilities for all key IT systems would require resources beyond those currently allowed for and could be disruptive to services. This situation will be resolved by the significant updating of the Council's IT infrastructure in 2013, and, at that stage, it will be necessary to develop a testing programme for the IT aspects of the BCP.
- The Council has recognised for some time the risk that the loss of the building or the electricity supply at 4 Fisher Street would cause severe disruption to the IT services for the whole authority. Since June 2010 there has been a BCP exercise dealing with the potential loss of this facility, and a fire in the facility which fortunately had a limited impact. The assessments that took place after both events acknowledged the ongoing risks because of the reliance on the central IT facility. Fire precautions at 4 Fisher Street have been upgraded, but the Council's main IT systems remain at significant risk because it would be impossible to recreate the most important of the Council's IT facilities in a short time if the building was not usable for any reason. For these reasons, there is no assurance that the priorities for the restoration of services that are set out in the BCP can be achieved in all circumstances. This position will not be resolved until the major upgrading of the Council's IT infrastructure is completed, sometime in 2013.
- There is a risk that there will not be adequate paper based systems in place to support Council services in the event of a major disruption to IT systems. The paper based systems that may be required in the absence of IT facilities are a matter for individual service managers to consider in the circumstances of any individual incident, and there has been no pre planning on how paper based systems are to work.

Overall opinion:

The audit has confirmed that procedures and controls within the key systems are operating to a reasonable standard in most respects. The audit has not identified any significant control issues that will have an impact on the Council's main accounts. PKF have agreed that there are no significant control issues to be taken into account for their main audit work in July 2012. PKF have noted some minor issues in respect of ordering and income that were identified by Internal Audit, but PKF are assured that these issues will have no material impact on the accounts.

APPENDIX B

LOG OF SIGNIFICANT OUTSTANDING RECOMMENDATIONS (MAY 2012)

Audit report: Agresso Security Date of final issue: 13 May 2009	Original implementation date	Current position
<p>The report contained 15 recommendations dealing with financial and IT aspects of system security at LDC and the partner authorities, and these were due to be implemented at various times during 2009. Four recommendations were implemented promptly, but eleven were not actioned within the agreed time.</p> <p>Work on the outstanding issues has continued as part of the system update that went live in October 2011. Recommendations have been implemented or superceded by controls in the updated version of Agresso.</p>	<p>July to October 2009</p>	<p>Four recommendations have not yet been actioned, including three that deal with the development of a new Service Level Agreement (SLA) with the partner authorities.</p> <p>The Head of Finance had met with the Head of Audit and Performance to agree an action plan for the remaining recommendations. It has not been possible because of other priorities to complete the action plan, in conjunction with Hastings and Rother, by the intended date.</p>