

Item No: 8 **Report No:** 84/14

Report Title: Annual Report on Internal Audit Performance and Effectiveness 2013/14

Report To: Audit and Standards Committee **Date:** 23 June 2014

Ward(s) Affected: All

Report By: Head of Audit and Performance

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Purpose of Report:

To inform Councillors of the Internal Audit work of the Audit and Performance Division for 2013/14.

To inform Councillors on the outcome of the review of the effectiveness of Internal Audit for 2013/14.

Officers Recommendation(s):

- 1** To note that the Internal Audit coverage in 2013/14 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 2013/14 (see Section 3.3).
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Reasons for Recommendations

- 1** The remit of the Audit and Standards 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 previously operated in accordance with the Code of Practice for Internal Audit published by the Chartered Institute of Public Finance and Accountancy (CIPFA). 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 have applied from 1 April 2013. The Head of Audit and Performance (HAP)

advised the Audit and Standards Committee of the effect of the new standards at its March 2013 meeting.

- 2.2** The requirements of the PSIAS overlap with those of the Accounts and Audit (England) Regulations 2011, 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 Head of Audit and Performance, with the results reviewed by the Director of Finance 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 2013/14

- 3.1** The work carried out by Internal Audit during 2013/14 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 2013/14 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 subsidy grant claims, 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 Head of Audit and Performance 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 2013/14 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 Director of Finance 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.

4 Work of Internal Audit 2013/14

- 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 2013.

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 2012/13.
- 4.3** Table 1 shows that for 2013/14 a total of 741 audit days have been undertaken compared to the budget of 774 days. The variance of 33 days is largely because of time spent by a team member in supporting the team's move to the

Council's new IT systems and the departure of a part time member of the Internal Audit team.

- 4.4** The team member took voluntary severance as part of the ongoing Council scheme and left on 6 February 2014. As previously reported, this post will not be replaced, and the future staffing of the Internal Audit team will be 3.2 FTE (compared to 3.8 FTE included in the plan for 2013/14 that was set in March 2013).

Table 1: Plan audit days compared to actual audit days for 2013/14

Audit Area	Actual audit days for 2012/13	Plan audit days for 2013/14	Actual audit days for 2013/14
Main Systems	289	245	260
Central Systems	54	90	31
Departmental Systems	128	155	178
Performance and Management Scrutiny	68	74	64
Computer Audit	20	60	11
Environmental Audit	42	33	65
Management Responsibilities/Unplanned Audits	128	117	132
Days Total	729	774	741

- 4.5** Extra time was needed for Main Systems because of the additional work that has been required for the high priority audits on the main financial systems and the subsidy grant claims (see 4.8 to 4.11). The extra time for Departmental Systems was in carrying out a major audit Planning and Development Control. The additional time for Environmental Audit was mainly due to work carried over from 2012/13, and the need for more detailed review of issues arising from the audits comprising this year's programme (see 4.17). The extra time taken on Management Responsibilities was mainly due to the Equality Analysis study for Internal Audit that was not anticipated at the start of the year and extra work in liaising with BDO.
- 4.6** The extra time required for the work outlined above meant that it was necessary to adjust the programme of audits in other areas. A reassessment of the risks as part of the preparation for the Strategic Plan 2014/17 meant that five audits were moved too later in the audit cycle and three audits that were underway in March 2014 are being completed in 2014/15.

Audit Work Undertaken

- 4.7** 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 2012/13 has been provided to each meeting of the Audit and Standards Committee.
- 4.8** *Main Systems:* The initial work in April 2013 was 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 the work of the external auditor BDO on the Council's accounts for 2012/13. The audit did not identify any significant control issues that would have an impact on the Council's accounts although it was necessary to highlight a recurring issue

in the authorisation of purchase orders and invoices. A summary report was finally issued. From February 2014 the focus has been on the corresponding work with BDO for the 2013/14 financial year. This work has included testing of the Fixed Assets and Council Tax Reduction Scheme systems for the first time.

- 4.9** The priority work with BDO to test the Council's subsidy claims for Benefits and NDR for 2012/13 was completed. The NDR claim was signed off and submitted by BDO without qualification.
- 4.10** The Internal Audit work on the Benefits subsidy claim identified errors in the processing of claims and, at the request of BDO, has again required significant additional testing to determine the extent and impact of the issues noted. The need for additional work on the subsidy claim has had an effect on the progress that has been possible on the audits within Central Systems and Computer Audit. The work on the subsidy claim was completed by the due date, and the claim was signed off and submitted by BDO.
- 4.11** BDO issued a letter of qualification that was supported by statements of the claim adjustments that would be required. The Head of Revenues and Benefits queried the outcome of the BDO audit and the DWP interpretation of the audit findings. The query was on the grounds that the extrapolations used by BDO to estimate the adjustments to the claim appeared, in some cases, incorrect. DWP and BDO have agreed the results of the re-assessment, and this has been confirmed in a written statement. A report on the Benefits subsidy claim work by Internal Audit was finally issued.
- 4.12** *Central Systems:* Final reports were issued for the audits of Insurance and Electoral Registration and Elections. An audit of Communications is being completed in 2014/15.
- 4.13** *Departmental Systems:* Final reports were issued for the audits of Waste and Recycling, the Planning User Group, Housing Management, Cemeteries, and a draft report was issued for the audit of Planning and Development Control.
- 4.14** *Performance and Management Scrutiny:* Internal Audit was represented on the Management Boards for the Agile Working and Food Waste projects to advise on internal control and quality assurance. These projects were completed and Internal Audit contributed to the end of project reviews.
- 4.15** From May 2013, Internal Audit has been performing a quality assurance role on the joint Regeneration and Enterprise Project Board that is managing four regeneration projects. Information obtained from the audit of Economic Development (Departmental Systems) has been used to help with quality improvements in the four projects, and no separate audit report was issued. From January 2014 Internal Audit has been performing a quality assurance role on the project to develop the North Street Quarter of Lewes. The work in support of these projects has been far more than originally anticipated, but has been resourced from the allocation made for VFM work; there was no VFM study during 2013/14 and the topic was removed from the Strategic Audit Plan 2014/17.
- 4.16** *Computer Audit:* Internal Audit completed the IT aspects of the testing of the main financial systems. A final report was issued for the audit of IT Change Control. An audit of IT Security was moved to 2014/15 to limit any disruption to the essential work of the IT Section on the Agile Working project, as shown in

the Strategic Audit Plan 2014/17 that was presented to the March 2014 meeting of this Committee. Two unplanned audits on IT issues are summarised at 4.20.

- 4.17 *Environmental Audit:*** During June 2013, Internal Audit examined the Council's annual EMAS statement prior to its submission to Lloyd's Register Quality Assurance (LRQA) verifier as part of the assessment process. The verifier concluded that the Council continued to meet the requirements of the published standards and the Council's EMAS registration was confirmed. A final report was issued for the 2012/13 audit of EMAS: Waste and Recycling. The 2013/14 programme of EMAS audits was completed, with final reports issued for the audits of EMAS: Management and Control, EMAS: Pollution Prevention and Control, and EMAS: Legal Compliance. This work was extended by the evaluation of various options for the future approach to environmental management at the Council.
- 4.18 *Management Responsibilities and Unplanned Audits:*** This category provides resources for the support for the Audit and Standards Committee, liaison with BDO, managing the Follow Up procedures, as well as for special projects or investigations.
- 4.19** Internal Audit has been coordinating the Council's work for the 2012/13 NFI data matching exercise which is run by the Audit Commission. The base data was forwarded to the Audit Commission in October 2012, and the results were returned to the Council in February 2013 for the investigation of reported matches. This investigation work is ongoing.
- 4.20** Internal Audit reviewed the Health and Safety function at the Council at the request of the Chief Executive, and a final report was issued. The completion of a review of the interfaces between key systems has been delayed in order to take account of the restructuring of the Council and a planned study to make business processes more efficient. A final report has been issued following an examination of the links between the Council and the Bank Automated Clearing System (BACS).
- 4.21** Internal Audit completed the cyclical Equality Analysis report on the service. Some aspects of the planning and conduct of audits were reviewed for possible improvements, and this work was completed by the end of January 2014.

Follow Up of Audit Recommendations

- 4.22** 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.
- 4.23** The early focus for follow up in 2013/14 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 2013 meeting of this Committee. Since then the follow up procedures have concentrated on the recommendations due to be actioned during 2013/14.
- 4.24** Eleven of the recommendations due to be implemented during the year have been implemented. This represents an implementation rate of 61% which is lower than the target of 90%. The factors behind the shortfall are organisational and staffing changes in departments, which have required a focus on other priorities. Internal Audit has confirmed that there are no outstanding issues that

may have created significant risks. The results of the follow up are included in the Performance Indicators given at Section 9 and Appendix A.

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

- 5.1** 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 2013/14 were set out in the Strategic Audit Plan 2013/16 that was presented to the March 2013 meeting of the Audit and Standards Committee, as outlined below.

Service Aim

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

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 to provide a satisfactory and unqualified audit opinion in 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 and Standards 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, BDO.

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 three year audit cycle based on a detailed risk assessment. From February 2014 the staffing of Internal Audit has been set at 3.2 FTE (previously 3.8 FTE).

- 5.2** 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 2013/14, 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 and Standards Committee.

6 Review of Internal Audit Charter

- 6.1** The PSIAS require that the Head of Audit and Performance periodically reviews the Charter and present it to senior management and the Audit and Standards Committee for approval.
- 6.2** The Charter for Internal Audit and Internal Audit Code of Ethics were updated to comply with the PSIAS in March 2013, and the revised documents were approved by the Audit and Standards Committee and circulated to senior managers.
- 6.3** The Head of Audit and Performance 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. The Head of Audit and Performance has confirmed that the documents remain as approved in March 2013, except for recent minor changes to reflect new job titles for some senior positions. 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. If no interim changes are required, the full Charter for Internal Audit and Internal Audit Code of Ethics will be referred to the Audit and Standards Committee for approval every three years.

7 Quality Assurance and Improvement Programme (QAIP)

- 7.1** The PSIAS require that the Head of Audit and Performance 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 as follows.

Review by external auditors BDO

- 7.2** BDO undertakes separate reviews of the Internal Audit work for the audits 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 BDO reviews were that BDO were able to rely on the work of Internal Audit, which was completed to a good standard.

Quality reviews by Internal Audit

- 7.3** Each audit assignment is subject to quality reviews by the 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.
- 7.4** In previous years, Internal Audit has carried out an internal Peer Review of audit files for systems audits and VFM reviews to confirm that the work has been done in accordance with audit manual procedures, quality standards and the objectives of the audit. This peer review has not taken place in 2013/14 because there has been no VFM work and comparatively few systems audits as a result of the focus on the key financial system and subsidy claims. Also, the new review processes associated with the QAIP have added to the resources expended on internal review processes, and the peer review has been dropped on the grounds of efficiency and economy.

- 7.5** The results of the internal and external quality 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 PSIAS.

External assessment

- 7.6** 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.
- 7.7** The Head of Audit and Performance 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 a future meeting of the Committee. It is likely that the most economic arrangements will involve the internal audit services in neighbouring authorities in a shared assessment process.

Internal assessment

- 7.8** The PSIAS require that the internal assessments 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.
- 7.9** The PAM has carried out the internal assessment for 2013/14. The PAM is not external to internal audit but has the necessary knowledge of internal audit practices, PSIAS, LGAN and IIA practice guidance. The Head of Audit and Performance 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. Minor adaptations to Internal Audit practices have been made during 2013/14 to bring them fully into line with the PSIAS and LGAN.
- 7.10** There were two issues of non-compliance with the PSIAS in areas related to the organisation of Internal Audit. These concerned the arrangements for the annual appraisal for the Head of Audit and Performance and the oversight of assurance audit work on the other responsibilities (eg Procurement, Risk Management) of the Head of Audit and Performance. New procedures are being agreed with the Director of Finance and the issues of non-compliance will be resolved.

8 Feedback from Users

- 8.1** 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, and the Head of Audit and Performance has chosen to consult with a wider group of stakeholders for 2013/14.
- 8.2** During April 2014, feedback questionnaires were sent to the Chief Executive and members of the Corporate Management Team (CMT), to members of the Audit and Standards Committee and to those service managers who have had direct contact with Internal Audit during 2013/14. All comments from that exercise were reported as Very Good, Good or Satisfactory.

9 Performance Indicators (PIs)

- 9.1** 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.
- 9.2** The Performance Indicator (PI) results for 2012/13, 2013/14 and the targets for 2014/15 are detailed at Appendix A. The results for 2013/14 show that performance was at target or better than target in 10 of the 17 PIs.

10 Financial Appraisal

- 10.1** There are no additional financial implications arising from this report. However, it should be noted that the requirement to undertake an external assessment of Internal Audit every five years (see 7.6 – 7.7) will create an additional cost to the Council.

11 Sustainability Implications

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

12 Risk Management Implications

- 12.1** 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.

13 Equality Screening

- 13.1** 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.

14 Background Papers

- 14.1** [Strategic Audit Plan 2013/16 presented to the Audit and Standards Committee on 18 March 2013.](#)

15 Appendices

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

APPENDIX A PERFORMANCE INDICATORS (PIs) FOR INTERNAL AUDIT

Performance Indicator	Actual 2012/13	Target 2013/14	Actual 2013/14	Target 2014/15
Input of resources				
1 Staffing FTE	3.8	3.8	3.8	3.2
2 Employee costs	£160,954	£167,630	£167,539	£153,003
3 Total costs	£192,869	£203,936	£200,167	£163,091
4 Cost per chargeable day	£264.57	£263.48	£270.13	£249.76
Productivity and Efficiency				
5 Number of core systems audits carried out in the year	12	12	14	14
6 Number of days spent on core systems audits	289	245	260	285
7 Number of audits/reviews in original plan	52	48	48	37
8 % of original plan carried out	81%	90%	79%	90%
9 Number of audits/reviews in revised plan	53	-	59	-
10 % of revised plan carried out	92%	90%	83%	90%
11 Number of chargeable days	729	774	741	653
12 Number of non-chargeable days	246	221	225	168
13 % of draft reports issued within 15 days of the end of the audit	94%	95%	81%	95%
Compliance with professional standards				
14 Positive opinion from BDO review of Internal Audit as per Management Letter.	Positive opinion	Positive opinion	Positive opinion	Positive opinion
15 Total external audit fee	£74,740	£72,872	N/A	£70,520
Outcome and degree of influence of the service				
16 % of recommendations implemented by the agreed date.	76%	90%	61%	90%
17 All comments from client satisfaction questionnaires in Categories 1 (Very Good), 2 (Good) or 3 (Satisfactory).	100%	100%	100%	100%

Notes

Item 1 Actual for 2013/14 reflects the average staffing FTE taking account of the departure of a part time member of the Internal Audit team who took voluntary severance as part of the ongoing Council scheme, and left on 6 February 2014.

Item 9 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 17 includes results from questionnaires sent to audit clients, members of the Corporate Management Team and, in a new development, members of the Audit and Standards Committee.