

**Agenda Item No:** 7 **Report No:** 77/16

**Report Title:** Annual Report on Internal Audit Performance and Effectiveness 2015/16

**Report To:** Audit and Standards Committee **Date:** 20 June 2016

**Ward(s) Affected:** All

**Report By:** Head of Audit, Fraud and Procurement

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### **Purpose of Report:**

**To inform Councillors of the Internal Audit work of the Audit and Performance Division for 2015/16.**

**To inform Councillors on the outcome of the review of the effectiveness of Internal Audit for 2015/16.**

### **Officers Recommendation(s):**

- 1** To note that the Internal Audit coverage in 2015/16 has been sufficient to enable the Head of Audit, Fraud and Procurement (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 2015/16 (see paragraph 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 HAFP, 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 HAFP advised the Audit and Standards Committee of the effect of the 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 HAFP, with the results reviewed by the Director of Corporate Services 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 2015/16**

- 3.1** The work carried out by Internal Audit during 2015/16 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 2015/16 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 HAFP 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 2015/16 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 HAFP 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 2015/16**

- 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. As requested by Councillors, Table 1 includes comparative data for 2014/15.
- 4.3** Table 1 shows that for 2015/16 a total of 602 audit days have been undertaken compared to the budget of 667 days. The variance of 65 days is mainly due to staffing changes and other issues that reduce the time available for audit work. These were reported to the January 2016 meeting of the Committee, and are outlined at 4.4 to 4.6 below.

Table 1: Plan audit days compared to actual audit days for 2015/16

<b>Audit Area</b>	<b>Actual audit days for 2014/15</b>	<b>Plan audit days for 2015/16</b>	<b>Actual audit days for 2014/15</b>
Main Systems	336	285	360
Central Systems	25	50	57
Departmental Systems	79	105	68
Performance and Management Scrutiny	39	45	27
Computer Audit	28	55	2
Management Responsibilities/Unplanned Audits	176	127	88
Days Total	683	667	602

- 4.4** From 1 January 2016, the Principal Audit Manager (PAM) has been taking flexible retirement, which has resulted in a reduction of 20 planned audit days in the period up to the end of March 2016. The Internal Audit Manager at Eastbourne BC has agreed to work for the Council for the equivalent of one day per week, with the time spent on specific audit projects – in the period January to March 2016 this arrangement provided 10 days of audit work. This joint working has helped to deliver progress on shared services between the two councils, and has generated a saving of approximately £8,400 per annum.
- 4.5** One of the Senior Auditors at LDC retired and left the Council on 19 November 2015. The vacancy was filled and the officer commenced work with the Council on 1 March 2016. The impact of the vacancy has been a reduction of 45 days in the time available for audit work in 2015/16.
- 4.6** During 2015/16, HAFP has been involved in a number of studies of procurement and governance issues and, in particular, has been a member of the Core Group that is overseeing the Council's role in the Joint Transformation Programme (JTP). This work has involved 10 days more of HAFP's time than was envisaged in March 2015.
- 4.7** As was anticipated when the Audit Plan 2015/16 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 2016 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 2015/16 Audit Plan (reported January 2016)**

- 4.8** 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 ongoing restructuring and the impact of the significant extra work on the Benefits subsidy claim with BDO. The HAFP plans the following adaptations to the programme of work in the Audit Plan for 2015/16.
- The audits of Change Control and Disaster Recovery from the programme for Computer Audit will be scheduled for future dates in the audit cycle.
  - The audits of Homelessness and Housing Strategy, and Planning and Development Control, from the programme for Departmental Systems will be scheduled for a future dates in the audit cycle.

- The audit of Right to Buy (RTB) from the programme for Departmental Systems will be carried out by the Internal Audit Manager at Eastbourne BC.

Other audits in the programme for 2015/16 that are planned or underway will continue to a normal conclusion.

### **Audit Work Undertaken**

- 4.9** 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 2015/16 has been provided to each meeting of the Audit and Standards Committee.
- 4.10 *Main Systems:*** The testing of the major financial systems for 2014/15 was completed, and a final report issued. The results provided assurance on the adequacy of internal controls for the Annual Governance Statement (AGS), and helped to inform BDO's work on the Council's accounts. The corresponding work by Internal Audit and BDO for 2015/16 is at the draft report stage.
- 4.11** The summary report on the work to test the Council's subsidy claim for Benefits for 2013/14 was finally issued. The priority work to test the Council's subsidy claim for Benefits for 2014/15 was started in June 2015. Initial results were passed to BDO for evaluation, and BDO confirmed that significant extra testing would be required to determine the impact of the errors noted in processing some HB applications. The timetabled date for BDO to have signed off and submitted the audited claim was at the end of November 2015, but that date was not met because of the extra work that was required. The claim was eventually submitted to DWP, together with a letter of qualification, in March 2016. There was a marginal DWP adjustment to the submitted claim, which was agreed at a total value of approximately £35.8m. The work for the 2015/16 claim is at the initial planning stage.
- 4.12 *Central Systems:*** Final reports were issued for the audits of Ethics 2014/15 and Health and Safety. The audits of Insurance, Electoral Registration and Elections, and Ethics 2015/16 are nearing completion. The audit of Cemeteries is underway.
- 4.13 *Departmental Systems:*** The final reports from the audit of Building Control, Trade Waste and Housing Management were issued. The audit of Right to Buy (RTB) is at the draft report stage.
- 4.14 *Performance and Management Scrutiny:*** Earlier in the year, PAM was part of the officer group that was evaluating the tenders for the systems comprising the New Service Delivery Model (NSDM). HAFP was regularly involved as a member of the project team for the procurement. The procurement of the NSDM systems was halted because it was not consistent with the strategy for shared services with Eastbourne BC. During October 2015, it was confirmed that the Council will integrate staff and services with Eastbourne BC (EBC) under the Joint Transformation Programme (JTP). A full JTP business case has been prepared and agreed by the respective Cabinets at EBC and LDC. All members of the HAFP team have been involved in some capacity in the workshops, activity analysis and oversight of this key project.

- 4.15 Computer Audit:** Internal Audit completed the IT aspects of the testing of the main financial systems. As noted at 4.8 above, the majority of the planned coverage of IT has been rescheduled.
- 4.16 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.
- 4.17** The major project in this category has been Internal Audit's coordination of the Council's response to the 2014/15 NFI data matching exercise. Preparations for the 2104/15 exercise began in April 2014, and the base data was forwarded to the Audit Commission in October 2014. The first matches were returned to LDC in January 2015, detailed across 56 reports. The reports set out the potential frauds among Housing Benefit (HB) claimants, housing tenants, and anyone receiving payments or discounts from the Council. Each report highlighted a number of 'Recommended' matches that appeared to indicate the greatest likelihood of fraud.
- 4.18** Council services nominated officers to investigate the matches in their areas. Because the work is resource intensive, services targeted their efforts with the initial focus on those matches that were recommended for review. The work required the weeding out those matches that were the result of error or coincidence, and then the examination of the remaining matches to assess the likelihood of fraud. Any suspected cases of fraud would be passed to the LDC Investigation Team for action, with any suspected cases of HB fraud referred to DWP.
- 4.19** The exercise ended on 14 April 2016, with the Council required to declare that the recorded results were a reasonable reflection of the current position. In June 2016 the Cabinet Office will issue a national report on the outcome of NFI 2014/15, after which the Council will receive an assessment of its own response to the exercise. As previously, the assessment is likely to say that the Council has not examined all the reported matches. There is no sanction for the Council only partially completing the exercise.
- 4.20** Of the 1,524 reported matches LDC has examined 1,135 (75%). There have been no instances of fraud found on any of the reports, although the exercise has identified 42 HB overpayments resulting from error with a total value of approximately £15,700. These results include the examination of 343 of the 370 recommended matches. The outstanding recommended matches cover student loans – the service examined more than half of the recommended matches for student loans with no errors or frauds found. Services assessed that the results obtained from the work did do not justify further resources being assigned to the examination of more matches, and Internal Audit supports this view.
- 4.21** The conduct and progress of the NFI 2014/15 has been regularly reported to the Audit and Standards Committee.

#### **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. The early focus for follow up in 2015/16 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 2015 meeting of this Committee. Since then the follow up procedures have concentrated on the recommendations due to be actioned during 2015/16.

- 4.23** Of the 21 recommendations due to be implemented during the year, 18 have been actioned. This represents an implementation rate of 86% which is slightly lower than the target of 90%. The factors behind the shortfall are organisational and staffing changes which have delayed some new initiatives.

## **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 2015/16 were set out in the Strategic Audit Plan 2015/18 that was presented to the March 2015 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 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**

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 three year audit cycle based on a detailed risk assessment. From January 2016, the staffing of

Internal Audit has been 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.

The staffing of the service has been enhanced by 1.4 FTE with the addition of the Fraud Investigations Team since November 2014 (see Section 10).

- 5.2** 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 2015/16, 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.

## **6 Review of Internal Audit Charter**

- 6.1** The PSIAS require that HAFP 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 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.
- 6.2** HAFP 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. HAFP has confirmed that the documents remain largely as approved in March 2013, except for minor changes made in May 2015 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.

## **7 Quality Assurance and Improvement Programme (QAIP)**

- 7.1** The PSIAS require that HAFP 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.
- 7.2** The results of the quality reviews and assessments have been considered by HAFP, who confirms that the standards of Internal Audit work comply with the audit manual and the PSIAS.

### **Review by external auditors BDO**

- 7.3** 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**

- 7.4** 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**

- 7.5** 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.
- 7.6** HAFP 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 2016/17.

## **Internal assessment**

- 7.7** 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.
- 7.8** The PAM has carried out the internal assessment for 2015/16, comparing Internal Audit processes and procedures with the requirements of the PSIAS and LGAN. The PAM is not external to internal audit but has the necessary knowledge of internal audit practices, PSIAS, LGAN and IIA practice guidance.
- 7.9** HAFP 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.

## **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.
- 8.2** During May 2016, 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 2015/16. 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 2014/15, 2015/16 and the targets for 2016/17 are detailed at Appendix A. The main factors leading to variances from the performance targets for 2015/16 can be summarised as:



- The staffing changes that have taken place during 2015/16.
- 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 2015/16 programme.

## **10 Fraud Investigation Team**

**10.1** 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 2015/16. This meeting of the Committee is receiving a detailed Annual Report on the Council's work to Combat Fraud and Corruption 2015/16. To avoid duplication, no further comment on the work of the Fraud Investigation Team is included here.

## **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 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.

## **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**

[Strategic Audit Plan](#)

## **16 Appendices**

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

## APPENDIX A PERFORMANCE INDICATORS (PIs) FOR INTERNAL AUDIT

Performance Indicator	Actual 2014/15	Target 2015/16	Actual 2015/16	Target 2016/17
<b>Input of resources</b>				
1 Staffing FTE	3.38	3.25	3.00	3.1
2 Employee costs	£164,592	£154,662	£140,412	£145,290
3 Total costs	£191,750	£187,962	£166,994	£173,620
4 Cost per chargeable day	£280.75	£281.80	£277.39	£273.00
5 Total external audit fee	£73,510	£62,878	£62,878	tbc
<b>Productivity and Efficiency</b>				
6 Number of core systems audits carried out in the year	14	14	14	14
7 Number of days spent on core systems audits	336	285	360	290
8 Number of audits/reviews in original plan	33	39	30	37
9 % of original plan carried out	89%	90%	77%	90%
10 Number of audits/reviews in revised plan	39	-	40	-
11 % of revised plan carried out	90%	90%	82%	90%
12 Number of chargeable days	683	667	602	636
13 Number of non-chargeable days	178	171	222	158
14 % of draft reports issued within 15 days of the end of the audit	90%	95%	86%	90%
<b>Outcome and degree of influence of the service</b>				
15 % of recommendations implemented by the agreed date.	67%	90%	86%	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.

The list of PIs has been adapted to remove the item dealing with the statement provided by BDO on the work of Internal Audit. This statement no longer forms part of the BDO Management Letter.

Items 1 to 4, and 12 – The results reflect the staffing changes that have taken place during 2015/16.

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 2015/16 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 2015/16 includes 49 days in respect of staff vacancies. The result excluding staff vacancies is 173 days, which is close to target.

Item 15 - The factors behind the shortfall for 2015/16 are organisational and staffing changes which have delayed some new initiatives.

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