

Report Title: Annual Report on Internal Audit Performance and Effectiveness 2017/18

Report To: Audit and Standards Committee **Date:** 17 July 2018

Ward(s) Affected: All

Report By: Head of Audit and Counter Fraud

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Purpose of Report:

To inform Councillors of the Internal Audit work of the Audit and Performance Division during 2017/18.

To inform Councillors on the outcome of the review of the effectiveness of Internal Audit for 2017/18.

Officers Recommendation(s):

- 1 To note that the Internal Audit coverage in 2017/18 has been sufficient to enable the Head of Audit and Counter Fraud (HACF) to issue an unqualified opinion on the overall adequacy and effectiveness of the Council's control environment (see Section 3).
 - 2 To note the satisfactory outcome of the review of the effectiveness of Internal Audit for 2017/18 (see Sections 7 - 10).
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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 HACF, and to keep the work of Internal Audit under review to ensure that it is able to discharge its functions effectively.

2 Background

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

2.2 The PSIAS have been updated, with new standards published in March 2017. The impact of the new standards was reported to the September 2016 meeting of the Committee.

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

3 Overall conclusions on Internal Audit Performance and Effectiveness 2017/18

3.1 The work carried out by Internal Audit during 2017/18 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 2017/18 that is presented separately to this meeting of the Committee.

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

3.3 The review of the effectiveness of Internal Audit has taken into account the work carried out by the service during 2017/18 and the results of the performance and quality assurance processes that are outlined in Sections 7 to 10 of this report. The results of the review enable the HACF to report that the Internal Audit service at Lewes is fully effective, is subject to satisfactory management oversight and has complied with the PSIAS in all major areas.

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

4 Work of Internal Audit 2017/18

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 2017.

Use of Internal Audit resources

- 4.2 Table 1 shows the total planned audit days compared to the actual audit days spent for 2017/18, together with comparative data for 2016/17. Table 1 shows that for 2017/18 a total of 557 audit days have been undertaken compared to the budget of 622 days.

Table 1: Plan audit days compared to actual audit days for 2017/18

Audit Area	Actual audit days for 2016/17	Plan audit days for 2017/18	Actual audit days for 2017/18
Main Systems	347	295	347
Central Systems	83	65	67
Departmental Systems	86	65	3
Performance and Management Scrutiny	8	45	34
Computer Audit	2	5	5
Management Responsibilities/Unplanned Audits	113	147	101
Days Total	639	622	557

- 4.3 The variance of 65 days has arisen mainly from the retirement of the Senior Auditor in January 2017, with the vacancy filled on 4 September 2017, the additional time being spent on management tasks arising from the JTP, and a period of six weeks absence for a team member following an operation. The overall position gradually improved as the year has progressed, but there was a shortfall in the time available for audit work.
- 4.4 As was anticipated when the Audit Plan 2017/18 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 2018 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 2017/18 Audit Plan (reported January 2018)

5 Review of 2017/18 Audit Plan

- 5.1 As part of the report to the March 2017 meeting of the Committee that detailed the Annual Audit Plan, HACF advised that there would be a nine month review of the Audit Plan for 2017/18 to assess whether any significant changes are necessary.
- 5.2 That review has taken place and the results of the review are now presented to the Committee. The review takes account of a range of issues, in particular the Joint Transformation Programme, the impact of the significant extra work on the Benefits subsidy claim with BDO, the time between the retirement of the Senior Auditor and the arrival of the replacement, and the extra audit days worked by HACF. There has been a significant impact on the number of days available to complete the audit programme for 2017/18, and there has been a need to re-assign some tasks.

5.3 HACF advises that the significant aspects of the annual audit plan will be covered. The exceptions are:

- The audit of Legal Services (in Central Systems) will be scheduled into the Annual Plan for 2018/19.
- The planned audits of Members Allowances and Expenses, and Licensing (in Departmental Systems) will be scheduled into the Annual Plan for 2018/19.

Other audits in the programme for 2017/18 that are planned or underway will continue to a normal conclusion.

Audit Work Undertaken

5.4 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 2017/18 was provided to each meeting of the Audit and Standards Committee.

5.5 *Main Systems:* The initial work was on the testing of the major financial systems in order to gain assurance on the adequacy of internal controls for the Annual Governance Statement (AGS) and to inform BDO's work on the Council's accounts for 2016/17. A final report was issued, together with a separate final report on the issues arising from the review of Non-Domestic Rates (NDR). The corresponding work for 2017/18 is nearing completion and a draft report is being prepared.

5.6 The work on behalf of BDO to test the Council's HB subsidy claim 2015/16 was completed, and the audited claim submitted, during July 2017. BDO's planning for this work had set out the standard testing and identified the likely need for significant additional testing to address the issues noted in the previous year's claim - the standard testing and the initial extra testing were completed in late September. The timetabled date for BDO to have signed off and submitted the audited claim was at the end of November 2016, but that date was not met because of further additional testing, reperformance by BDO, and the resolution of queries and challenges. The overall value of the claim was £36.5m. In July 2017, DWP confirmed the results of the audit - there had been an overpayment of subsidy of £6,976, but with a related understatement of £2,367 the net effect was a recovery of £4,609 by DWP.

5.7 The work on the HB subsidy claim for 2016/17 is well advanced. BDO had identified the need for significant additional testing to address the issues noted in the 2015/16 claim and other errors noted in the current claim. The timetabled date for BDO to sign off and submit the audited claim was the end of November 2017 but, because of the significant extra work required and BDO's other commitments, Internal Audit is now working towards the submission of the claim by mid - August 2018.

5.8 *Central Systems:* A final report was issued for the audit of Ethics (2017). A final report has been issued for a review of EBC/LDC compliance with aspects of the Regulatory Powers Act (RIPA). CMT requested a similar review of compliance with the General Data Protection Regulation (GDPR) at both councils – the interim results have been reported to CMT, and a follow up

review of progress is underway. HACF has carried out an independent consultancy review of options for the future management of the Lewes and Eastbourne Leisure Trusts – the results of the review were reported to the November 2017 meeting of the Committee. HACF is leading on an audit of the Joint Ventures and Council Companies that have been established by both EBC and LDC to help provide services and improve the councils' respective financial positions – the audit is underway.

- 5.9 Departmental Systems:** The audit of Estates Management, incorporating work on the corresponding function at EBC, began in early 2017 but was put on hold to free resources for the work on the HB subsidy claim and the testing of the major financial systems. The audit is at the draft report stage.
- 5.10 Performance and Management Scrutiny:** The main work in this category was in reviewing the data that supported the Annual Governance Statement (AGS) for 2017, and specific tasks related to the Internal Audit aspects of the Council's Joint Transformation Programme (JTP). Recent work has been the review of risk management issues linked to the report on Risk Management and the Strategic Risk Register that was reported to the March 2018 meeting of the Committee
- 5.11 Computer Audit:** Internal Audit completed the IT aspects of the testing of the main financial systems.
- 5.12 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.
- 5.13** HACF carried out an independent consultancy review of the options for the future management of strategic procurement at both councils. The results of the review were reported to the November 2017 meeting of the Committee. A final report has been issued for a review - also carried out by HACF - of the Prevent and Protect Strategy.
- 5.14** CMT requested Internal Audit to carry out an assurance review to support the establishment of the newly configured Health and Safety (H&S) service. The review includes site visits to two key service areas – the Eastbourne Crematorium and the Waste and Recycling (W&R) service for LDC. A final interim report has been issued on the W&R aspects of the review – the visit to Eastbourne crematorium has yet to be arranged.
- 5.15** The major project in this category is the Council's response to the 2016/17 NFI data matching exercise. Preparations for the 2016/17 exercise began in April 2016, and the first matches were returned to LDC in January 2017. Further reports have been received since then and there are now over 2,000 matches detailed across 93 reports. The reports set out the potential frauds among HB claimants, housing tenants, and anyone receiving payments or discounts from the Council.
- 5.16** Initially, Council services nominated officers to investigate the matches in their areas, targeting the 'Recommended' matches that appeared to indicate the greatest likelihood of fraud. The work requires 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 Counter Fraud Team for action, with any suspected cases of HB fraud referred to DWP.

- 5.17** The exercise to investigate reported matches has found no cases of fraud or error so far. Because the work is resource intensive and services have experienced staffing issues during the JTP process, the investigation of matches is now being done in Internal Audit but not as a priority task.
- 5.18** The conduct and progress of the NFI exercise has been regularly reported to the Audit and Standards Committee.

6 Follow Up of Audit Recommendations

- 6.1** As part of the control procedures detailed in the Internal Audit Manual all audit recommendations are followed up. The purpose of this is to check whether all accepted recommendations have been implemented. The early focus for follow up in 2017/18 was on confirming the implementation of the recommendations that had been agreed in the previous year. Since then the follow up procedures have concentrated on the recommendations due to be actioned during 2017/18.
- 6.2** The results of the follow up work for 2017/18 show 100% implementation of those recommendations for which it has been possible to confirm management action. For some audits the results of the follow up are not yet confirmed. This information will be provided to the Committee at its next meeting.

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

- 7.1** 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 2017/18 were set out in the Annual Audit Plan 2017/18 that was presented to the March 2017 meeting of the Audit and Standards Committee. The aims and objectives were updated in January 2018 as part of the work on the revised Charter for Internal Audit and Counter Fraud (see section 8). The revised statements are as follows:

Service Aim

- 7.2** Internal Auditing is an independent and objective assurance and consulting activity designed to add value and improve the operations at both councils. Counter Fraud is an independent and objective activity designed to help prevent and detect fraud, and undertake appropriate investigations when necessary. Working together, these activities help the councils accomplish their objectives by bringing a systematic and disciplined approach to improving the effectiveness of risk management, control and governance processes.

Service Objectives

The Internal Audit service 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 Councils' Audit Plans
- To provide an efficient and effective Counter Fraud Team that supports the councils' 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.

Internal Audit Strategy

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

For the majority of 2017/18, the staffing of Internal Audit has been at 3.6 FTE, after the filling of an Auditor vacancy. The creation of the merged Audit and Counter Fraud service for Lewes and Eastbourne from July 2017 has enabled the movement of work and resources between the respective teams.

- 7.3** The HAFP has compared the performance of the Internal Audit service with the aim, objectives and strategy, and has examined the organisation, working methods, 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 2017/18, indicate 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.

8 Review of Internal Audit Charter

- 8.1** The PSIAS require that HACF periodically reviews the Charter and present it to senior management and the Audit and Standards Committee for approval. The Charter for Internal Audit and Internal Audit Code of Ethics were approved by the Audit and Standards Committee in March 2013, and were subject to minor changes to comply with the updated PSIAS in 2016.
- 8.2** HACF reviews the documents annually to confirm that they remain valid and up to date, and that Internal Audit activities are operated in accordance with the requirements of the documents. The creation of the merged Audit and Counter Fraud service for Lewes and Eastbourne provided the opportunity for a fundamental review of the documents. An updated Charter of Internal Audit and Counter Fraud was presented to the January 2018 meeting the Committee, and was approved.

9 Quality Assurance and Improvement Programme (QAIP)

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

Review by external auditors BDO

- 9.3** 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

- 9.4** Each audit assignment is subject to quality reviews by the Audit Manager (AM) 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

- 9.5** The PSIAS set 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.
- 9.6** HACF has previously agreed with the Audit and Standards Committee to put in place suitable arrangements for an external assessment, and report the arrangements to the Committee. As anticipated the most economic arrangements involve the internal audit services in neighbouring authorities in a shared assessment process. The planned External Peer Review of LDC Internal Audit is being carried out by the Principal Auditor at Chichester District Council, and is underway. The results of the review will be reported to September 2018 meeting of the Committee.

Internal assessment

- 9.7** 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.
- 9.8** The Audit Manager (AM) at LDC has carried out the internal assessment for 2017/18, comparing Internal Audit processes and procedures with the requirements of the PSIAS and LGAN. The method of assessment is that used by the peer review team from Chichester District Council that is conducting the external assessment. The AM is not external to internal audit but has the necessary knowledge of internal audit practices, PSIAS, LGAN and IIA practice guidance.
- 9.9** HACF has reviewed the results of the internal assessment, and confirms that Internal Audit either Conforms Fully or Generally Conforms with the detailed requirements of the PSIAS and LGAN in the planning, management, conduct and reporting of engagements. The Generally Conforms results are mainly in areas such as staffing, training, and appraisals where standard Council procedures show some minor differences from the PSIAS. HACF does not propose, or is unable, to make changes in these areas. HACF is examining a possible change in the preparation of the Annual Audit Plan to incorporate consideration of risk maturity and risk appetite, in order to comply with PSIAS requirements.

10 Feedback from Users

- 10.1** 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.
- 10.2** As part of the arrangements for the external assessment of Internal Audit (see 9.6), HACF has adopted the survey questionnaire that is recommended by the PSIAS. During May 2018, the survey questionnaires were sent to the Chief Executive, members of the Corporate Management Team (CMT), Heads of Service and the Chair of the Audit and Standards Committee. The previous questionnaire asked clients to rate various aspects of the Internal Audit service and past results were Very Good, Good or Satisfactory. The PSIAS questionnaire includes 17 positive statements about the role, organisation and work of Internal Audit and the relationship with the rest of the Council, and asks clients to show whether they Do not agree, Partially agree, Generally agree, Fully agree.
- 10.3** The survey results show that 94% of the responses were either Generally agree or Fully agree. The remainder were either Partially agree (4%) or unable to comment (2%). One client did not agree with a statement about the Council using the knowledge of Internal Audit to improve business processes. HACF will use the Partially Agree and Do not agree responses to explore with clients how to improve the specific aspects of the service.
- 10.4** The survey results have been copied to the peer review team at Chichester District Council to form part of the external assessment.

11 Performance Indicators (PIs)

- 11.1** Proposals for a revised set of PIs for Internal Audit were agreed at the September 2013 meeting of the Committee, and the agreed PIs have formed the framework for the reporting on Internal Audit performance since then.
- 11.2** As part of the standardisation of the shared Internal Audit service at both Lewes and Eastbourne, HACF is examining the range of PIs that will cover the merged service. The proposals for the shared PIs, together with PI results for 2017/18, will be presented to the September 2018 meeting of the Committee.

12 Counter Fraud Team

- 12.1** Each meeting of the Audit and Standards Committee receives a full update on the work of the Counter Fraud Team, and normally this report would include details of their work during 2017/18. This meeting of the Committee is receiving a detailed Annual Report on the Council's work to Combat Fraud and Corruption 2017/18. To avoid duplication, no further comment on the work of the Counter Fraud Team is included here.

13 Financial Appraisal

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

14 Sustainability Implications

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

15 Risk Management Implications

15.1 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.

16 Equality Screening

16.1 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.

17 Background Papers

[2017/18 Annual Audit Plan](#)

18 Appendices

Appendix A: Table of abbreviations

APPENDIX A

TABLE OF ABBREVIATIONS

Table of abbreviations

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