
Meeting: **Audit Committee**

Date: **27 June 2011**

Subject: **Internal Audit Annual Audit Opinion**

Report of: **Director of Customer and Shared Services**

Summary: This is the annual report of the Head of Internal Audit to those charged with governance on the overall adequacy and effectiveness of Central Bedfordshire Council's financial and other management internal controls.

Contact Officer: Kathy Riches , Head of Internal Audit

Public/Exempt: Public (with exempt appendices A and C)

Wards Affected: All

Function of: Audit Committee

CORPORATE IMPLICATIONS

Council Priorities:

The activities of Internal Audit are crucial to the governance arrangements of the organisation and as such are supporting all of the priorities of the Council.

Financial:

None directly from this report. However, sound systems assist in preventing loss of resources (by other wastage or fraud), thereby improving effectiveness and efficiency.

Legal:

None directly from this report.

Risk Management:

No risk management implications come directly from this report but the Audit Plan was produced using a risk based approach, following the completion of a detailed Audit Needs Assessment which took into account strategic and service area risks.

Staffing (including Trade Unions):

None directly from this report.

Equalities/Human Rights:

None directly from this report.

Community Safety:

None directly from this report.

Sustainability:

None directly from this report.

RECOMMENDATION:

That the Audit Committee note and comment on the contents of the report.

Background

1. The Accounts and Audit Regulations 2003 (as amended 2006) require the Council to maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with proper internal audit practices. Proper practice is defined as the CIPFA Code of Practice for Internal Audit in Local Government 2006 (the Code). In accordance with the Code, the Head of Internal Audit is required to provide a written report to those charged with governance, timed to support the Annual Governance Statement, which should include an opinion on the overall adequacy and effectiveness of the Council's control environment.
2. This report:
 - Presents an opinion on the overall adequacy and effectiveness of Central Bedfordshire's internal control environment, along with any qualifications to that opinion
 - Summarises audit work undertaken from which that opinion is derived
 - Highlights significant issues identified as part of Internal Audit's work, including those that are particularly relevant to the Annual Governance Statement
 - Compares the Internal Audit work actually undertaken with the work that was planned and summarises the performance of the internal audit function against its performance measures and criteria.

Responsibilities

3. It is a management responsibility to develop and maintain the internal control framework and to ensure compliance. It is the responsibility of Internal Audit to form an independent opinion on the adequacy of the system of internal control.

Internal Control Environment

4. The Code defines the control environment as comprising the Council's systems of governance, risk management and internal control.
5. In order to form an opinion on the overall adequacy and effectiveness of the control environment, the internal audit activity is planned to provide coverage of financial controls through review of the key financial systems, and internal controls through a range of operating activity both within directorates and cross cutting, using a risk based approach. The work undertaken by Internal Audit helps inform the Annual Governance Statement.

The Audit Methodology

6. Internal Audit complies with the CIPFA Code of Practice. There are documented Terms of Reference, as set out in the Internal Audit Charter, that specify the objectives and scope of Internal Audit. The Head of Internal Audit has undertaken a self assessment of compliance with the Code. In accordance with the requirements of the Accounts and Audit Regulations 2003 (as amended 2006) the Chair of the Audit Committee, supported by the Deputy Chairman, has carried out a review of the effectiveness of the System of Internal Audit. The scope of the review covered compliance with the CIPFA Code of Practice for Internal Audit 2006, and reporting on performance and outcomes to the Audit Committee.
7. The Internal Audit Strategy and Plan for 2010/11 was approved by the Audit Committee in April 2010.
8. The Internal Audit Plan identified the individual audit assignments. The activity was undertaken using a systematic risk based approach. The objectives for each activity were determined and risks in the processes that supported that activity were identified and set down in terms of reference that outlined the objectives and scope for each audit. The work was planned and performed so as to obtain all the information and explanations necessary to provide sufficient evidence in forming an overall opinion on the adequacy of the internal control framework.
9. Internal Audit reports provide an overall conclusion on the control environment for each system reviewed. A summary of the conclusions for each audit is attached as Appendix A to this report. The definitions of each conclusion are attached as Appendix B.
10. To provide quality assurance over the audit output, audit assignments are allocated to staff according to their skills and experience. Each auditor has a designated Audit Manager to perform quality reviews at four stages of the audit assignment: the audit brief (terms of reference), file review, draft report and final report stages. In addition, the Head of Internal Audit reviews all reports.
11. In addition to this annual report, the Audit Committee receive regular progress reports throughout the year.

The Internal Audit Team

12. During 2010/11 the Internal Audit Service was delivered by a team of suitably qualified auditors, supported by external contractors. Each member of the team undertakes a regular Performance Development Review (PDR) and participates in Continuing Professional Development (CPD) as appropriate.

Head of Internal Audit's Opinion on the System of Internal Control

13. The CIPFA Code of Practice on Internal Audit requires the Head of Internal Audit to provide an overall opinion on the adequacy and effectiveness of the Authority's internal control environment.

14. The Internal Audit work undertaken during the year has enabled Internal Audit to provide an objective assessment of whether systems and controls are operating effectively. In giving an audit opinion, however, it should be noted that assurance can never be absolute. However, the scope of the activity undertaken is sufficient for reasonable assurance to be placed on the work.
15. The Audit Commission, as the Council's external auditors, have reviewed the work undertaken by Internal Audit on the managed audits and have been able to place reliance on the work, and have been in agreement with the audit opinions given.
16. A summary of the work undertaken during the year, forming the basis of the audit opinion on the control environment, is shown at Appendix A of this report.
17. The opinion on the Council's System of Internal Control is that overall it continues to be adequate. In general the key controls in place are adequate and effective such that reasonable assurance can be placed on the operation of the Council's functions.
18. This conclusion is based on the following:
 - A Code of Financial Governance is in place, and is incorporated within the Constitution.
 - Financial Procedures support the Code of Financial Governance.
 - A Financial Scheme of Management is in place.
 - Procedures and processes have been documented in a number of key areas.
 - Adequate controls were found to be in place in a number of areas.
 - Progress has been made, through the IT stabilisation project in addressing the IT weaknesses that were identified during 2009/10.
 - Progress has been made in addressing many of the high risk Internal Audit recommendations made.
19. It should be noted that most audits undertaken have resulted in reports identifying areas for improvement which have been well received by managers, and actions agreed to address weaknesses in control. The implementation of these actions is tracked by Internal Audit and the progress against the implementation of high recommendations is regularly reported to the Audit Committee.
20. In arriving at the opinion the following has been taken into account:
 - The results of the audits undertaken as part of the 2010/11 plan
 - The results of follow up action in respect of previous audits
 - Whether or not any limitations have been placed on the scope of Internal Audit – of which there have been none.

21. The following key concerns were identified and these have been reflected in the Annual Governance Statement:
- Some key controls are not operating effectively in the payroll systems resulting in a limited assurance opinion. Controls in this area need to be strengthened. A comprehensive review of the payroll function is being carried out and the outcome and recommendations from that review will be reported to the Customer and Central Services Overview and Scrutiny Committee.
 - There was a lack of timely reconciliation of suspense, control accounts, bank accounts, and feeder systems for key financial systems during the year. A full reconciliation process was put in place for Quarter 3 2010/11 with a focus on clearing control, suspense and balance sheet reconciliations. This should be embedded in 2011/12.
 - A number of IT related concerns were identified, including disaster recovery, and access and security issues.
 - The Internal Audit review of shared services arrangements with Bedford Borough Council identified some control weaknesses and made recommendations designed to improve the control environment.

Delivery of the 2010/11 Internal Audit Plan

22. The operation of the key financial systems is a key part of the internal control environment. The table at Appendix A sets out the outcome of the reviews of these systems, and indicates whether the opinions are final or provisional, as some of the work is still ongoing. The opinions given during 2009/10 are included for comparison. The appendix also summarises other reviews undertaken during the year.
23. The reviews of the key financial systems (Managed Audits) help inform the Annual Governance Statement. From the review of 11 key systems for which an opinion has been determined, 7 were “adequate”, 4 were “limited” and none were “unsatisfactory”. Appendix A illustrates that the opinions given during 2010/11 remain as those for 2009/10. It should be noted that the opinion given reflects the controls in place across the whole year. Progress has been made in addressing audit recommendations made. If the control improvements are implemented this will be reflected in the audit opinions given in the future.
24. Audit work is not just limited to implementing the audit plan. Internal Audit is involved in other areas advising on systems development and using their skills to provide other general advice to service areas. Internal Audit has participated in the Purchasing Card project, providing advice on controls required, and also assisted in identifying risks within the Personalisation Programme. In addition, individual grant claims have been audited, where required.

National Fraud Initiative (NFI)

25. During 2010/11, we continued to complete work around the National Fraud Initiative (NFI). This involves supplying data to the Audit Commission for matching purposes. Work is ongoing to investigate the resulting positive matches. Work includes matches around pension payments to registered deaths, matching payrolls between authorities, and other matches including UK visas, blue badges, private residential care and Housing Benefits.

26. One of the data set matches compares individuals claiming Single Person's Council Tax Discount against the Electoral Roll. A review has been undertaken by the Head of Revenues and Benefits and as at 31st March 2011, approximately £102,000 Single Person's Discounts had been cancelled, which benefits the Council tax collection fund. Work is ongoing and the final outcomes of this review will be reported to a future committee.
27. The Procurement Team has undertaken an exercise to identify duplicate payments made to suppliers since the inception of Central Bedfordshire Council. This is also one of the NFI data sets. The exercise has resulted in a net recovery to the Council in excess of £130,000. The exercise identified a processing accuracy of 99.97%. The reasons for the duplicate payments have been examined by Procurement and Internal Audit and, where appropriate, action has been taken to improve controls. Reasons for the duplicate payments include inconsistency in the supplier name, suppliers submitting duplicate invoices but with either different invoice numbers or dates, data input error and instances where the invoice was processed both by Central Bedfordshire Council and a legacy authority.
28. The Internal Audit team has also assisted other authorities undertake their NFI enquiries by providing information to support their investigations. During 2010/11, 4 requests for information were responded to.

Anti Fraud Work and Special Investigations

29. Internal Audit has undertaken work on four investigations during the year. Three are still ongoing. As soon as these are concluded, any significant control weaknesses or fraudulent activity will be presented to the committee. Appendix C contains a brief summary of the finalised review.
30. The Anti Fraud and Confidential Reporting policies have been promoted at Corporate Induction Events throughout the year. Numerous calls have been received on the Fraud Hotline. Many of the calls received have related to fraud in other organisations and the information has been forwarded appropriately. Some calls have related to allegations of Housing Benefit Fraud and these have been forwarded to the Benefits Team for investigation. One of the calls has resulted in an investigation by Internal Audit which is ongoing.

Schools

31. Audit visits have been undertaken at 15 schools. Final reports have been issued for 3 of these, 6 draft reports have been issued, and work is ongoing to finalise the other reports. The opinions given for the finalised reviews are set out at Appendix A.
32. Work on the Financial Management Standard in Schools (FMSiS) assessments is ongoing. Although the mandatory requirement to meet the standard was abolished in October 2010, most schools requested that the assessments in progress were completed. As at the end of March 104 schools had met the standard, and 19 reviews were in progress. 8 schools to date have decided not to be assessed.

Performance Management

33. The Internal Audit Charter approved by the Audit Committee in September 2010 requires Internal Audit to report its progress on some Key Performance Indicators (KPI). Procedures to measure the indicators have been introduced during the year. Performance will be closely monitored in future to identify areas for improvement. The table below also includes the previous year's indicators, for comparative purposes.

34. The indicators include both CBC audit activities and school activity.

35. **Activities for 1 April 2010 – 31 March 2011**

KPI	Definition	2010/11		2009/10	
		How we performed	Our target	How we performed	Our target
KPI01	Percentage of total audit days completed.	90%	80%	97%	80%
KPI02	Percentage of the number of planned reviews completed to final report stage.	67%	80%	51%	80%
KPI03	Percentage of audit reviews completed within the planned time budget.	59%	80%	50%	80%
KPI04	Time taken to draft reports: Percentage of reviews where the first final draft report was returned by auditee within 10 available working days of receipt of the report from the Auditor.	36%	80%	42%	80%
KPI05	Time taken to issue a final report: Percentage of reviews where the final report was issued within 10 available working days of receipt of the response agreeing to the formal report.	94%	80%	79%	80%
KPI06	Overall customer satisfaction.	85%	80%	85%	80%

36. **Analysis of indicators:**

KPI01 – During the year we delivered a total of 1,405 productive audit days against a total of 1,560 planned days for the year. This exceeds our target for the period.

KPI02 – This KPI measures final reports issued as at 31 March 2011, 67% of the planned reviews have been completed to final report stage. However, this excludes work on the second phase of the managed audits which was in progress as at 31st March. This forms a significant proportion of our work and was substantially completed as at 31 March 2011. Although the target for the year was not met, this represents an improvement on the performance in the previous year.

KPI03 – Only 59% of planned reviews have been completed within the planned time budgets. However this represents an improvement over the previous year. Internal Audit will continue to review processes to improve performance against this target.

KPI04 - This indicator measures the time taken for Internal Audit to receive a response from the auditee to the draft report. During 2010/11, only 36% of draft reports were responded to within the target set. Internal Audit will continue to work with departments to encourage a prompt response.

KPI05 - This indicator measures the time taken by Internal Audit to issue the final report upon receipt of an agreed response from the auditee. During 2010/11 Internal Audit issued 94% of final reports on target, which represents an improvement over the previous year.

KPI06 - Of the 41 questionnaires sent out, 30 have been returned to date, giving a response rate of 73%. Overall, the feedback has been very positive. The analysis indicates an overall satisfaction rate of 85%, which is consistent with the previous year.

Review of the Effectiveness of Internal audit and the Effectiveness of the Systems of Internal Control

Background (Accounts and Audit Regulations 2006)

37. All councils are required to publish an Annual Governance Statement (AGS) as part of their Statement of Accounts, in accordance with the 2006 Accounts and Audit Regulations. Assessments of the Effectiveness of Internal Audit and the Effectiveness of systems of internal control are two key aspects of the AGS. Central Bedfordshire Council has reviewed both systems for 2009/10 and the findings are incorporated into the Annual Audit opinion and subsequently into the AGS.

Review of the Effectiveness of Internal Audit.

38. As referred to in paragraph 6 above, a review of the Effectiveness of Internal Audit was undertaken by the Chair of the Audit Committee.

Review of the Effectiveness of the Systems of Internal Control

39. The Council's review of the effectiveness of the system of internal control is informed by:
- Directorate assurance based on management information, performance information, officer assurance statements and Scrutiny reports
 - the work undertaken by Internal Audit during the year
 - the work undertaken by the external auditor reported in their annual audit and inspection letter
 - other work undertaken by independent inspection bodies
39. The Head of Internal Audit has supported the Head of Legal Services (Monitoring Officer), Directors, Assistant Directors and Members to collect evidence required for the production of the AGS.
40. Directors have been requested to sign statements on the Effectiveness of Internal Control for 2010/11, confirming that during the year they were:
- Ensuring that there are arrangements in place for establishing Directorate objectives and compliance to corporate priorities;
 - Ensuring compliance to the Council's governance arrangements (Constitution, Ethical Framework, and Policies & Regulations);
 - Ensuring arrangements for sound budgetary controls;
 - Effectively monitoring and managing performance;
 - Reporting to the appropriate Member Committees;
 - Responding promptly to internal & external audits & inspections;
 - Continuously managing business risks and service continuity arrangements.
41. The work undertaken by Internal Audit on the systems of internal control disclosed that generally they were effective during 2010/11. However, some areas of concern were identified and these are summarised in paragraph 21 above, and are reflected in the Annual Governance Statement.

Conclusion and Next Steps

42. The work undertaken by Internal Audit has enabled the team to advise management of some of the control weaknesses identified at an early stage, and make recommendations designed to enhance and strengthen controls and mitigate risks.
43. The internal control environment operated adequately during 2010/11, although some areas of concern identified in the AGS must be addressed at the earliest convenience.

Appendices: Appendix A – Summary of Internal Audit Activity 2010/11 - Exempt
Appendix B – Definition of Internal Audit Opinions- Public
Appendix C - Special Investigations finalised during year - Exempt

Background Papers: None
Location of papers: N/A