

EAST AYRSHIRE COUNCIL

GOVERNANCE AND SCRUTINY COMMITTEE – 24 AUGUST 2007

ANNUAL REPORT 2006/07

Report by the Chief Auditor

1 PURPOSE OF REPORT

- 1.1 Internal Audit has completed the audit of the Council's internal control systems for the year ended 31 March 2007.
- 1.2 The Annual Report is primarily designed to direct your attention to matters of significance that have arisen out of the 2006/07 audit process, and offer an opinion on the adequacy and effectiveness of the Council's systems of internal control.

2 BACKGROUND

- 2.1 The Financial Regulations of the Council require that Internal Audit present an annual report to members, showing the activity of the Internal Audit section, progress achieved against plan, and a summary of the significant audit findings for the previous financial year.
- 2.2 The revised CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom sets out organisational and operational standards for internal audit services.

3 INTERNAL CONTROL

- 3.1 In order to ensure the proper conduct of its business, the Council has a responsibility to develop, implement and maintain systems of internal control. The framework of internal control is defined as the whole system of controls, financial and otherwise, established by management in order to carry out the business of the authority in an orderly and efficient manner.
- 3.2 A sound control system will help safeguard assets, ensure records are reliable, promote operational efficiency and ensure adherence to Council policy and procedures. Such systems of internal control can provide only reasonable assurance and not absolute assurance against loss.
- 3.3 It is primarily the responsibility of management to establish an appropriate and sound system of internal control, and to monitor the continuing effectiveness of that system. It is the responsibility of the Chief Auditor to provide an independent and objective opinion on the overall adequacy and effectiveness of the control environment and stewardship of public funds. The Chief Auditor's annual report is presented to those charged with governance and should be used to support the Council's Statement on Internal Control.

4 ANNUAL REPORT 2006/07

- 4.1 The attached report (Appendix 1) summarises the audit work carried out in 2006/07. The report presents an analysis of the performance of the Internal Audit section during the year ending 31 March 2007, and provides a summary of the significant audit assignments completed in the financial year.
- 4.2 The Internal Audit Annual Statement on the adequacy of Internal Control is contained within Appendix 1(a) of the annual report.
- 4.3 Internal Audit has put forward a range of recommendations in the areas examined and action plans have been developed in consultation with the relevant Executive Director which, when implemented, will result in a continued improvement in the overall control environment.

5 POLICY/LEGAL/FINANCIAL/RISK IMPLICATIONS

- 5.1 The Council's Financial Regulations and Standing Orders set out responsibilities for governance.
- 5.2 The Council places a high degree of importance on the need to ensure that its arrangements for corporate governance are adequate and effective and are subject to ongoing review and improvement, and to this end the Council has adopted a Local Code of Corporate Governance modelled on the CIPFA/SOLACE framework for Corporate Governance in Local Government. The Code is reviewed annually.

6 RECOMMENDATIONS

- 6.1 The Governance and Scrutiny Committee is asked to note the contents of the Annual Report 2006/07.

Colin Houston
Chief Auditor
10 August 2007
CH/GSCcover060724Augv2

LIST OF BACKGROUND PAPERS

East Ayrshire Council Financial Regulations and Standing Orders
Mid Year Progress Report 2006/07
East Ayrshire Council Local Code Of Corporate Governance
CIPFA Code of Practice for Internal Audit in Local Government in the UK

Anyone wishing further information on the content of this report should contact the Chief Auditor on Tel. No. (01560) 323836.

EAST AYRSHIRE COUNCIL

ANNUAL REPORT OF INTERNAL AUDIT 2006/07

Report by the Chief Auditor**1 PURPOSE OF REPORT**

- 1.1 This report directs attention to matters of significance that have arisen out of the 2006/07 internal audit process, and offers an independent and objective opinion on the adequacy and effectiveness of the Council's systems of internal control, and the Council's stewardship of public funds.
- 1.2 The annual assurance programme of work was set out in the 2006/07 Internal Audit Plan. The plan was presented to the Risk and Audit Scrutiny Group on 27 April 2006.
- 1.3 A mid year progress report on audit activity was presented to the Risk and Audit Scrutiny Group meeting on 23 November 2006.

2 INTERNAL CONTROL ENVIRONMENT

- 2.1 In order to ensure the proper conduct of its business, the Council has a responsibility to develop and implement systems of internal control. It should be noted that it is primarily the responsibility of management to ensure that internal controls are in place and are operating effectively.
- 2.2 A sound control environment will help to safeguard assets, ensure records are reliable, promote operational efficiency and ensure adherence to Council policy and procedures. Such systems of internal control can provide only reasonable and not absolute assurance against loss.
- 2.3 The control framework includes regular management information, financial regulations, standing orders, administrative procedures, management supervision and a system of delegation and accountability.
- 2.4 The Council's Statement on the System of Internal Financial Control is included in the annual accounts for the Council. The statement is signed by the Chief Executive and the Executive Head of Finance and Asset Management. The review of the effectiveness of the systems of internal financial control is informed by the work of management, the work of finance staff and the work of internal and external audit. The Internal Audit Annual Statement on the Adequacy of Internal Control is set out in Appendix 1(a) of this report.
- 2.5 The CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom defines organisational and operational standards for the Internal Audit Service. East Ayrshire Council endeavour to comply with all aspects of the Code.

3 AUDIT APPROACH

- 3.1 Internal Audit has an important role to play in assisting the Council to discharge its governance responsibilities. The responsibilities and duties of Internal Audit and those charged with governance of the Council are set out in the Financial Regulations of the Council.

- 3.2 Audit plans are prepared following full consultation with the Chief Executive, Executive Head of Finance & Asset Management, and service directors. Plans take into account a range of factors, including client priorities, local and national agenda areas, risk registers and previous audit work, all with a view to identifying relevant areas for attention and with the objective of helping the Council secure continuous improvement and best value services. An element of contingency is built into the audit plan to enable resources to be deployed on investigations and advisory services.
- 3.3 Audit reports are presented to the relevant Executive Director and include recommendations and agreed actions which, when implemented, will improve the control environment.
- 3.4 Internal Audit routinely undertake follow-up work on all major audit assignments in order to assess progress on the implementation of audit recommendations. Where agreed audit recommendations have not been fully implemented by the time of the audit follow-up, the further action required has been brought to the attention of the relevant Executive Director, and the Executive Directors is asked to sign a client assurance statement confirming that any outstanding actions will be implemented, and the timescales involved.
- 3.5 As part of Internal Audit monitoring procedures, copies of all assignment reports, including follow-ups, are presented to the Chief Executive, the Executive Head of Finance & Asset Management, the Council's External Auditor and, where appropriate, to the Council Monitoring Officer.

4 AUDIT RESOURCES

- 4.1 In order for Internal Audit to deliver on its plan commitments, and discharge its responsibilities in accordance with the CIPFA Code of Practice for Internal Audit in Local Government, it must have access to the full range of knowledge, skills, qualifications and experience to deliver a modern audit service in an environment of changing priorities and emerging risks.
- 4.2 The section has an experienced team of audit staff, with a skills mix capable of providing a full range of audit services. The skills and experience mix include specialist computer audit skills, external and internal audit experience in both private and public sectors, and financial management experience. The section supports continuous professional development of all staff. There are a number of support measures in place, including in-house computer skills training, staff development through the corporate EAGER programme, and liaison with other audit sections through a number of inter-authority audit groups.
- 4.3 There was some staff turnover during the year. A qualified auditor post became vacant following a move to another area of the Council, and this post was successfully filled by an external candidate. A part-time post assistant auditor post is vacant at the present time, and the position is being kept under review.
- 4.4 The audit section works closely with the Council's External Auditors to ensure complementary areas of activity, and is developing close working relations with the other Ayrshire Council audit sections and the wider internal audit community, all with a view to further strengthening the quality, efficiency and effectiveness of the internal audit service.

5 PLAN ACHIEVEMENT

- 5.1 The annual assurance programme of work was set out in the 2006/07 Internal Audit Plan. The plan was presented to the Risk and Audit Scrutiny Group on 27 April 2006.
- 5.2 The audit plan was revised during the year. A mid year progress report on audit activity was presented to the Risk and Audit Scrutiny Group on 23 November 2006, and this report included the revisions to the audit plan. The revisions embraced cross boundary work

involving the Ayrshire councils under the shared services agenda and a request to examine further aspects of the control environment in Social Work.

5.3 The cross boundary assignments, additional work in Social Work and staff turnover had an impact on the audit plan. In order to accommodate this additional work, audit assignments in the original audit plan had to be replaced. These were the assignments on expenditure controls, tender specifications, car mileage, data matching, external funding and school response repairs.

5.4 The audit activity and service analysis is provided in the tables below:

ACTIVITY ANALYSIS	ACTUAL DAYS 2006/07	PLAN DAYS 2006/07
SYSTEMS REVIEW	526	475
COMPUTER AUDIT	84	80
CONTRACT AUDIT	127	80
AUDIT ADVISORY SERVICES	51	40
STOCKCHECKS	20	30
SPECIAL INVESTIGATIONS CONTINGENCY	77	120
PERFORMANCE INDICATORS	25	30
PERFORMANCE STUDIES	98	100
TOTAL AVAILABLE DAYS	1008	955

5.5 The allocation of time across audit activities was relatively close to plan. There was a net gain of 53 audit days. The additional time on systems reviews was linked to further work on social work control systems. 77 days were spent on investigations, and this was well within the investigation contingency.

SERVICE ANALYSIS	ACTUAL DAYS 2006/07	PLAN DAYS 2006/07
CORPORATE SUPPORT	321	275
DEVELOPMENT & PROPERTY SERVICES	175	160
EDUCATIONAL & SOCIAL SERVICES	416	390
NEIGHBOURHOOD SERVICES	96	130
TOTAL AVAILABLE DAYS	1008	955

5.6 The allocation of time across Council services was close to plan. The additional time allocated to Educational and Social Services is linked to the further work in Social Work, and in Corporate Support to the cross boundary absence management assignment.

5.7 Performance statistics have been collated from the audit management systems for the 2006/07 audit year. The section has issued 49 outputs relating to audit assignments in the year. A total of 121 audit recommendations were agreed with clients covering a range of work covering all services. The 2006/07 plan was substantially completed with 95% of planned audits delivered. 68.9% of available audit time was charged to clients against a target of 70%. 100% of post audit appraisals returned by clients rated the audit service as good.

- 5.8 The Council's External Auditor, Audit Scotland, has reviewed the arrangements for internal audit as part of their annual audit of the Council. The overall assessment is that the internal audit service is producing high quality reports backed up by excellent supporting files demonstrating a rigorous approach to the execution of the work. In terms of placing reliance on internal audit work, the lack of end to end input to core financial systems work means that they are unable to take full assurance from the work in these areas, however, in other areas such as departmental systems and the audit of statutory performance indicators, they are able to take full assurance from the work performed.

6 PLAN ASSIGNMENTS

6.1 Overview

- 6.1.1 The annual report is designed to direct attention to matters of significance that have arisen out of the 2006/07 audit process. The findings arising from all audit assignments have been discussed with appropriate officers of the Council and agreed action plans, including timetables and responsibilities, have been put in place to address all identified areas for improvement.

- 6.1.2 The 2006/07 assurance programme included assignments on the full range of audit activity, including internal controls, performance studies, computer audit, contract audit and investigations. A full listing of audit assignments completed in the 2006/07 year is presented at Appendix 1(b). In addition to the full listing of audit assignments, the following paragraphs provide a summary of the main findings arising from a selection of significant planned assignments. The selections cover major systems, departmental systems, computer audit, contract and performance studies.

- ◆ Major systems work (section 6.2)
- ◆ Departmental audits (section 6.3)
- ◆ Computer audit (section 6.4)
- ◆ Contract audit (section 6.5)
- ◆ Performance studies (section 6.6)
- ◆ Performance Indicators (section 6.7)
- ◆ Audit follow-up (section 6.8)
- ◆ Investigations (section 6.9)

6.2 Major Financial Systems Work

- 6.2.1 Internal Audit has completed an assignment to review controls in creditor payments. The audit assignment is an examination of processes and controls to prevent, detect and correct duplicate payment of supplier invoices.
- 6.2.2 The audit found that service departments submitted over 300 duplicate invoices for payment during 2005/06, from a total of 170,000 invoices passed to Finance for payment. Input controls blocked and rejected 90% of these and further post-processing checks by Finance staff take the detection rate to 97%. Common causes of error have been identified as copy invoices and pro-forma invoices. Internal Audit testing identified some undetected duplicate payments. These cases have been passed to Finance for examination and recovery.
- 6.2.3 While the focus of this assignment is duplicate payments, evidence exists of other errors in submissions by service departments including inaccurate batch totalling and wrong ledger codes.
- 6.2.4 Taking all of these factors together – invoices submitted for duplicate payment, substantial numbers of batches not pre-processed or authorised correctly, and inaccurate ledger coding - illustrates that there is scope for improvement in the pre-processing stage of invoice paying. An assessment of processes in Finance Service can lead to a reasonable level of assurance, as a significant number of errors submitted by service departments are detected and blocked by Creditors Section. There is, however, room for improvement both in the range of post-processing check to be conducted, and in collection of performance information. An agreed action plan is in place to address the areas for improvement.

- 6.2.5 Internal Audit has conducted location audits at local cash collection offices. The audits were unannounced, and involved cash counts, analysis of under/over payments and reviews of security arrangements. No major issues were found. Imprest certification arrangements were also examined, and no major issues were found.
- 6.2.6 Internal Audit has completed a range of major systems related follow-up work. Follow-up audits have been completed on authorised signatories, bank reconciliations, e-payments and employee expenses. The implementation score for finance follow-up is 91%. Assignments on Members Allowances and Expenses and Car Leasing Expenses have also been followed up in the year. The results of all audit follow-up work are reported in paragraph 6.8 of this report and in Appendix 1(b).
- 6.2.7 Reliable and informative accounts are founded upon accurate and consistent coding. Several recent audits had included recommendations on coding of invoices. This matter was brought to the attention of the executive Head of Finance and Asset Management, and an accounting policy bulletin (APB5A) has been prepared and issued to promote greater consistency and transparency in coding. Finance staff will undertake assurance testing of financial ledger transactions to identify incorrect coding and monitor compliance with the accounting policy bulletin.
- 6.2.8 In April 2006 Internal Audit completed an audit of the Council's risk management arrangements. The purpose of the assignment was to review the Council's risk management arrangements against best practice guidance and recommend actions to address areas for improvement. The audit concluded that reasonable assurance can be taken from the developing risk management framework. There have been significant developments in the Council's risk framework since the audit, including an updated risk management strategy which was approved by the corporate Governance Committee in November 2006 and the implementation of the new computerised risk register software system. Internal Audit will follow-up on this assignment in 2007/08, and use this opportunity to provide an updated assessment.

6.3 Departmental Systems Work

Foster & Adoption payments

- 6.3.1 Internal Audit has completed a review of the arrangements for foster & adoption related payments. Examination of procedural guidance on foster and adoption allowances identified a need for procedural documentation to be reviewed and updated. A number of key areas were identified where guidance was not available
- 6.3.2 This review identified that requests had been made annually to Social Work Committee for increases to foster allowances, but there had been delays in these increases being implemented. In addition, it was identified that adoption and link carer allowances had not been increased since 2004/05. During this assignment a number of issues were identified relating to the treatment of allowances paid to carers. Internal Audit has highlighted these to Social Work, and they are currently investigating in order to provide verification on the proper methods for calculating allowances.
- 6.3.3 During this review a £27k overpayment to a foster carer was identified. The overpayment covered the period February 2005 to September 2006. The investigation into the circumstances surrounding the overpayment revealed weaknesses in controls surrounding the payment of foster and adoption allowances. The process for authorising carer payments requires to be enhanced to include guidance on deadlines, notification of any discrepancies and action to be taken. The process for terminating allowance payments needed to be reviewed, to incorporate a procedure for dealing with young people who transfer from the care of Children & Families to Adult Care.
- 6.3.4 Where the Council is unable to place children with registered carers, due to unavailability of internal placements, external fostering agencies are used. Payments made to external

agencies in 2005/06 totalled £854k, and increased to £1.3m in 2006/07. No contract was in place to support this service. Social Work has begun consultation with the Council's Procurement Section with a view to establishing contractual arrangements in this area. In doing so, they will ensure full compliance in the future with the requirements of the Public Contracts (Scotland) Regulations 2006 and Council Standing Orders.

- 6.3.5 The overall assessment of the foster and adoption control environment was that key controls exist but they are not applied consistently and effectively. As a result, the control objectives are not being met. Areas for improvement have been identified which, when addressed, will improve the overall control environment.

Further work in Social Work

- 6.3.6 Internal Audit has carried out further work on aspects of Social Work control systems. The assurance work provides coverage of selected aspects of children and families, community care and resources systems. This work involved testing implementation of Social Work charges, and accelerated follow-up of all recent assignments, including the taxi contract, homecare contract, and foster and adoption assignments
- 6.3.7 The updated assessment of Social Work financial control systems is drawn from this further assurance work, and the assessment of progress on implementation of agreed recommendations. Overall, the audit recommendations arising from the previous audit work had been substantially implemented. The Department has shown a commitment to work to improve the control environment, and this is demonstrated by the progress made. Further action is required in several areas, namely, care at home contract monitoring, carer payment rates, and disclosure controls around taxi drivers and escorts. These actions have been accepted by client management.
- 6.3.8 The overall assessment of the further work conducted is that implementation of the audit recommendations has strengthened the control environment in the areas examined. The 2007/08 Audit Plan includes an assignment on care home systems controls. The Executive Director of Educational & Social Services has committed to a programme of improvement actions in Social Work, including performance management, procedural guidance and structures.

Catering expenditure

- 6.3.9 Internal Audit has completed a review of Expenditure Controls around Onsite Catering expenditure for food supplies. Contracts were in place for each of the areas of food expenditure examined and these contracts had been subject to the necessary tendering procedures.
- 6.3.10 The audit identified that invoice prices were not being checked before invoices were passed for payment. 32% of invoices sampled contained prices that did not agree to those shown on the supplier contracts. In addition, 67% of invoices sampled contained non-core items for which no price schedule was available against which to check prices. None of the orders quoted the price of the goods when the order was placed. The individual invoices were signed by Catering Managers, none of whom have been approved as authorised signatories.
- 6.3.11 A number of recommendations were raised around ordering, price checking and authorisation of invoices. An agreed action plan is in place, and the audit recommendations will, when implemented, improve the control environment.

Fleet replacement

- 6.3.12 An assignment on vehicle fleet replacement arrangements was carried out. Following a formal OJEU tendering exercise, a Framework Agreement for the purchase of Council vehicles was implemented in August 2006. This agreement is effective until 2010 and requires departments to order all vehicles through Transport Services' Central Purchasing Desk.

- 6.3.13 In 2001, 64% of the Council's fleet was more than six years old. By March 2007, this had reduced to 10%. The average age of the fleet is now 2.7 years. Transport Services are increasingly working in partnership with services in decisions around the mix and size of their vehicle fleets in order that the vehicles more closely match the needs of the service. There is evidence of collaborative working in the needs assessment process, with examples of vehicles being shared across Council departments and with other local authorities. It is important that Transport Services engage with all user departments in the preparation of annual vehicle replacement plans so that further opportunities for transport efficiencies can be realised.
- 6.3.14 The Masternaut vehicle tracking system is operational in Building & Works and is being considered by other Council services. In order to ensure that maximum benefit is gained from the investment in this system it is important that services set objectives around its use, and measure progress against these objectives.
- 6.3.15 Finance conduct quarterly tendering exercises for operating leases. Operating leases with an aggregate value of £1.6m were awarded in 2005/06. Internal Audit is advised that these contracts are not required to be tendered through the OJEU process. However, Finance should consult with Procurement on the procurement options available for operating leases in order to demonstrate best value arrangements. The Council's lease advisor should not be permitted to carry out the dual role of advisor and lessor.
- 6.3.16 Reasonable assurance can be placed on the fleet replacement processes. A younger fleet should deliver maintenance and reliability benefits, and introduction of vehicle tracking should help to drive further efficiencies in the Council's transport arrangements. Finance and Procurement should consult around the operating lease arrangements.

Cashless school meals

- 6.3.17 East Ayrshire Council (EAC) installed a pilot cashless meals system at Auchinleck Academy in January 2004 in response to Principle 4 "Eliminating Stigma" included in the Scottish Executive report 'Hungry for Success'. A report to the Education Committee in November 2003 stated that the pilot would be assessed with a view to developing a framework contract, if the pilot was successful, allowing the cashless system to be extended potentially to all other schools. The cashless system has been installed in a further two secondary schools despite no formal evaluation of the pilot scheme having been reported.
- 6.3.18 There was no contract for the installation and maintenance of the cashless meals system. The total installation cost of the cashless system in the 3 academies amounted to around £53k, and maintenance costs to around £10k.
- 6.3.19 The objectives of internal control have been met in two academies, however, the control environment in the third should be strengthened.

Regularity work

- 6.3.20 Internal Audit attended the 2005/06 year end stock counts at the Building & Works stores in Kilmarnock and Lugar, and the Roads stores at Bonnyton and Gauchalland, and were satisfied that the arrangements conformed to the guidance issued by the Executive Head of Finance.
- 6.3.21 Location audit work and grant certifications completed the departmental audit work in the year.

6.4 Computer Audit

- 6.4.1 Internal Audit conducted computer audit work in a number of areas, including contributions and support for corporate projects, computer audit assignments, and computer analysis to support audit fieldwork and inform audit clients.

- 6.4.2 The section supported work on the Council's response to the NFI data matching exercise, reviewing the Council's response, assisting in analysis of results, and assisting in preparation of data submissions.
- 6.4.3 The Council is introducing an electronic procurement systems (called PECOS), and Internal Audit has reviewed security settings, and supported discussions during development. Support has also been provided to IT Services in development of security documentation. The cross-boundary review of internet and email policies began during 2006/07, and EAC's auditors have contributed to this project.
- 6.4.4 Data analysis projects have supported audit fieldwork on a number of assignments, including creditor payments, foster and adoption expenditure, and catering expenditure. Following a review of car park income in 2005/06, the client requested further information on income, and this was provided through a data analysis exercise.

6.5 Contract Audit

- 6.5.1 Internal Audit has completed an assignment on vehicle fuel arrangements for the Council. The audit recommended that formal contract arrangements should be put in place for the provision of vehicle fuel. A contract framework is now in place for the supply of vehicle fuel in compliance with the requirements of the Public Contracts (Scotland) Regulations 2006 and Council Standing Orders.
- 6.5.2 Internal Audit has completed a review of the arrangements for the hire of vehicles within Building and Works. Audit recommendations were made around the fleet strategy for hired vehicles, authorisation of vehicle hire requisitions, migration of hired vehicles on to the framework agreement, and vehicle tracking. Significant gaps were found in the vehicle logbook arrangements within Building and Works. This represented a serious weakness in the health and safety assurance process and operating licence arrangements. This matter was immediately escalated by Internal Audit, in order to expedite action. A Council-wide instruction was issued by the Chief Executive, instructing full compliance with transport safety procedures.
- 6.5.3 Internal Audit has completed a review of contracts with external providers for care at home services. In 2005/06, £2.8 million (280,000 hours) was spent on services from external providers, and around forty percent of the care at home workload is currently outsourced. Audit recommendations were made in the areas of payment arrangements and annual rate increases. Internal Audit has highlighted the importance of robust performance monitoring of external providers. The outcome of the review of independent sector care at home purchasing arrangements was reported to the Social Work committee on 2 November 2006. The new care at home contract was tendered and came into effect on 1 April 2007.
- 6.5.4 Internal Audit has completed its programme of work on the East Ayrshire's Building Learning Communities project. The audit verified the model used to determine the VFM assessment by ensuring that the numbers used in the comparison between the Public Sector Comparator (PSC) and the PPP agreed and were consistent throughout the models. Internal Audit overall opinion is that the VFM assessment had been correctly calculated based on the information available.

6.6 Performance Studies

- 6.6.1 East Ayrshire Council Internal Audit Section has completed a review of absence management. This assignment is a cross boundary assignment involving the three Ayrshire Councils and NHS Ayrshire and Arran. The All-Ayrshire integrated services project proposed three cross boundary assignments, and East Ayrshire Council Internal Audit is acting as the lead council in the review of absence management.
- 6.6.2 The Scottish Executive's Efficient Government Initiative is a five-year programme to secure efficiency, effectiveness and productivity in Scotland's public sector. Absence

management is a key part of this agenda. Absence management is recognised by all Ayrshire Partners as a significant issue. All partners are committed to maximising attendance within the workforce.

6.6.3 The Ayrshire partners display elements of best practice in their absence management arrangements. However, some areas have been identified where improvements could be made. Best practice recommendations are made around frequency of contact with sick colleagues, return to work interviews, triggers for further action, and the role that occupational health should play, in particular in terms of prevention and early intervention.

6.6.4 In 2005/06 overall absence levels across the three Ayrshire councils were similar, and close to the Scottish Average (5.46%). NHS Ayrshire and Arran had a slightly lower absence percentage, which was equal to the average for NHS Scotland (5.23%).

6.7 Performance Indicators

6.7.1 Internal Audit has completed an audit of the 2005/06 Statutory Performance Indicators. This assignment was included in the annual audit plan for 2006/07. The overall purpose of the audit assignment is to support the External Auditors in their duty to audit the statutory performance indicators ("PIs") for the financial year ended 31 March 2006.

6.7.2 There were fifty-six performance indicators for 2005/2006 spread across all services and East Ayrshire Council reported on all indicators. Following analytical review, thirteen performance indicators were audited in detail, eight by Internal Audit and five by External Audit. All eight performance indicators tested by Internal Audit were found to be reliable. Staff from External Audit completed their review of the indicators. Several minor issues were identified, which were all resolved satisfactorily. External Audit found all indicators to be reliable, resulting in all fifty-six indicators being 'A' rated.

6.8 Audit Follow Up

6.8.1 Internal Audit routinely undertake follow-up work on all major audit assignments in order to assess progress on the implementation of audit recommendations arising from earlier audit work. 25 audits have been followed up in the year, and these revealed that agreed audit recommendations had been substantially implemented by the time of follow-up review.

6.8.2 The 25 follow-up reports included 201 audit recommendations, and the auditors found that 165 recommendations had been fully implemented by the date of the follow-up audit visit, which is a fully implemented score of 82%. A further 24 agreed recommendations had been partially implemented at the date of the audit follow-up visit, and the implementation score, using a half credit for each partially implemented action, increases the overall implementation score to 88%. There were only 9 recommendations where no action had been taken by the time of the audit follow-up, and a further 3 recommendations where the client decided to tolerate the risk.

6.8.3 Internal Audit is satisfied that there is management commitment to act where control improvement opportunities are identified, and the overall implementation score is demonstration of this commitment. Where agreed actions have not been fully implemented by the time of the audit follow-up, Executive Directors have signed Client Assurance Statements giving an assurance that the outstanding actions will be implemented and the due date for implementation. Appendix 1(b) provides a listing of all audit follow-up assignments, and the implementation score for each assignment.

6.9 Investigations

6.9.1 There were eight incidents reported to Internal Audit in the 2006/07 audit year. Investigations were made into a foster parent overpayment, two incidents involving non domestic rates, and a misappropriation of funds from a community association. Seventy-seven days from the annual contingency of one hundred and twenty days were used to investigate these matters.

- 6.9.2 During the review of foster and adoption allowances a £27k overpayment to a foster carer was identified. The overpayment covered the period February 2005 to September 2006, and resulted from weak controls around the payment of foster and adoption allowances. The Executive Head of Social Work and the Head of Legal, Procurement & Regulatory Services have considered the overpayment and concluded that there is no realistic prospect of recovery.
- 6.9.3 In December 2006 Internal Audit was contacted by Finance staff to advise of a complaint received from a rate payer, regarding six alleged missing non-domestic rates payments in respect of premises in Kilmarnock. The missing payments totalled £5,799. Internal Audit was asked to investigate the alleged missing payments. Internal Audit checked finance records and girobank statements and could find no evidence to indicate that the Council received any of the alleged payments. The ratepayer was advised of the audit findings, and the case was passed to the Police.
- 6.9.4 A second incident involving an alleged payment of non-domestic rates was investigated in the year. On this occasion a receipt for £5,000 was provided by a ratepayer. Internal Audit interviewed the ratepayer and examined the receipt. Internal Audit concluded that the receipt had been altered from £500 to £5,000. The individual concerned had an arrears in non-domestic rates and an overpayment situation in council tax, and the matter was referred to Legal Services to pursue. The ratepayer subsequently withdrew her complaint, and agreed to set off an overpayment on Council Tax against arrears in non-domestic rates.
- 6.9.5 In December 2006, Internal Audit was contacted by Educational & Social Services to advise of a misappropriation of funds at a community centre run by a community association. A potential shortfall of around £16,000 was suggested. There is evidence of a shortfall between the bank balance reported to the association on the annual accounts presented and the true bank balances shown on bank statements. The bank statements show a shortfall of £12,432 at 31st January 2006, and show that this has accrued over a number of years. The additional shortfall to have accrued between February and November 2006 is estimated to be around £4,700. The total shortfall is around £17,000. The treasurer has resigned, and the case is with Strathclyde Fraud Squad.
- 6.9.6 In relation to fraud, Internal Audit completed a planned assignment on the National Fraud Initiative in 2005/06, and in 2006/07 has continued to support the Council's response to National Fraud Initiative. The National Fraud Initiative is a national data matching exercise to identify fraud and recover overpayments. The 2005/06 exercise identified 44 cases of benefit overpayment totalling £170,000, attracting over £32,000 of subsidy rewards and admin penalties. Eight cases involved employees of the Council who had not declared their earnings from the Council. The 2006/07 exercise is underway. The Council has established a single Disciplinary Panel and an Appeals Panel to deal with any disciplinary issues arising from employee fraudulent claims under the National Fraud Initiative.
- 6.9.7 A consolidated anti-fraud and anti-corruption policy is currently being prepared, and this will draw together the various policy arrangements in this area, and present a clear statement on the Council's commitment to combat fraud.

7 SUMMARY OF PERFORMANCE

- 7.1 The performance of the Internal Audit Section in the audit year, in terms of numbers of audit assignments and client coverage was close to the revised plan.
- 7.2 Internal Audit carried out a review of creditor payments, and the overall assessment of processes in Finance can lead to a reasonable level of assurance. There is scope for improvement in the pre-processing stage of invoice paying. Internal Audit has conducted regularity audit work at local cash collection offices and on imprests, and followed-up on a range of other work, including Members expenses and allowances, authorised signatories, bank reconciliations, e-payments, employee expenses, and car leasing. The overall implementation score for Finance follow-up is 85%.

- 7.3 Internal Audit has completed a review of foster and adoption payments. The overall assessment of the foster and adoption control environment was that key controls exist but they are not applied consistently and effectively. Internal Audit has carried out a range of further assurance work in Social Work, including accelerated follow-up of all recent audit assignments. Internal Audit found that the audit recommendations arising from the previous audit work had been substantially implemented (80%), and that the department has shown a commitment to work to improve the control environment, and this is demonstrated by the progress made. Further action is required in several areas, namely, care at home contract monitoring, carer payment rates, and disclosure controls around taxi drivers and escorts. These actions have been accepted by client management. The Executive Director of Educational and Social Services has committed to a programme of work designed to strengthen the control environment in Social Work.
- 7.4 Internal Audit has completed a range of other departmental work, including onsite catering expenditure controls, cashless school meals, vehicle hire and vehicle fleet replacement arrangements.
- 7.5 Internal Audit has also carried out work on a range of other activities, including computer audit, contract audit, performance indicators and performance studies, including a cross boundary assignment on absence management, and has made a number of audit recommendations designed to improve the robustness of these processes. The time spent on investigations was well within the available contingency.
- 7.6 As a result of these assignments, Internal Audit has put forward recommendations to address areas for improvement. Action plans have been developed in consultation with management to address all areas for improvement identified, which should result in continued improvement in the overall control environment.
- 7.7 Internal Audit has undertaken follow-up work on a number of previous audit assignments, with a view to establishing progress on the implementation of audit control recommendations. This work revealed that agreed actions had been substantially implemented by the time of the audit visit. Where audit recommendations have not been fully implemented the further action required has been agreed with the service and Executive Directors have provided an assurance that the outstanding actions will be implemented and the due date for implementation. Internal Audit is satisfied that there is management commitment to act where control improvement opportunities are identified, and that staff understand and accept the need for systems to be robust and reliable.
- 7.8 The Internal Audit Annual Statement on the Adequacy of Internal Control is set out in Appendix 1(a) of this report.

Colin Houston
Chief Auditor
AnnualReportGSCv1

INTERNAL AUDIT ANNUAL STATEMENT ON THE ADEQUACY OF INTERNAL CONTROL

As Chief Auditor of East Ayrshire Council, I present my annual statement on the adequacy and effectiveness of the internal control systems of the Council for the year ended 31 March 2007.

Responsibilities of management and Internal Audit in relation to internal control

It is the responsibility of the Council's senior management to establish an appropriate and sound system of internal control and to monitor the continuing effectiveness of that system. It is the responsibility of the Chief Auditor to provide an annual assessment of the robustness of the internal control systems based on the work of the Internal Audit section.

Sound internal controls

The main objectives of the Council's internal control systems are:

- to ensure adherence to management policies and directives in order to achieve the organisation's objectives;
- to safeguard assets;
- to ensure the relevance, reliability and integrity of information, so ensuring as far as possible the completeness and accuracy of records; and
- to ensure compliance with statutory requirements.

Any system of control can only ever provide reasonable and not absolute assurance that control weaknesses or irregularities do not exist or that there is no risk of material errors, losses, fraud or breach of laws or regulations. Accordingly, the Council is continually seeking to improve the effectiveness of its systems of internal control.

The work of Internal Audit

Internal Audit is an independent appraisal function established by the Council for the review of the internal control system as a service to the organisation. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of the Council's resources.

The Internal Audit section operates in accordance with the Chartered Institute of Public Finance and Accountancy's Code of Practice for Internal Audit in Local Government in the United Kingdom. Internal Audit activity during the year was based on the planned work programme contained in the Annual Audit Plan approved by the Risk and Audit Scrutiny Group on 27 April 2006. Audit plans are prepared following full consultation with the Chief Executive, Executive Head of Finance & Asset Management, and service directors. Plans take into account a range of factors, including client priorities, local and national agenda areas, risk registers and previous audit work, all with a view to identifying relevant areas for attention and with the objective of helping the Council secure continuous improvement and best value services.

Internal audit reports are presented to the relevant Executive Director, and include appropriate recommendations and agreed actions which, when implemented, will improve the overall control environment. As part of Internal Audit monitoring procedures, copies of all audit assignment reports, including follow-ups, are presented to the Chief Executive, the Executive Head of Finance & Asset Management, the Council's External Auditor and, where appropriate, to the Council Monitoring Officer.

Internal Audit routinely undertake follow-up work on all major audit assignments in order to assess progress on the implementation of audit recommendations. Where agreed audit recommendations have not been fully implemented by the time of the audit follow-up, the further action required has

been brought to the attention of the relevant Executive Director, and the Executive Director is asked to sign a client assurance statement confirming that any outstanding actions will be implemented, and the timescales involved.

Basis of Opinion

My evaluation of the control environment is informed by a number of sources:

- the audit work undertaken by Internal Audit during the year to 31 March 2007;
- the audit work undertaken by Internal Audit in previous audit years;
- audit follow-up work to test progress on implementation of agreed audit recommendations;
- findings/conclusions arising from work carried out by the Council's External Auditors; and
- knowledge of the Council's governance, risk management and performance monitoring framework.

Opinion

Overall, Internal Audit is of the opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control system in the year to 31 March 2007.

Internal Audit has put forward recommendations to address areas for improvement. Action plans have been developed in consultation with management to address all areas for improvement identified, which should result in continued improvement in the overall control environment.

A programme of work has been agreed with the Executive Director of Educational and Social Services to strengthen the control environment in Social Work.

Internal Audit has undertaken follow-up work on a number of previous audit assignments, with a view to establishing progress on the implementation of audit control recommendations. This work revealed that agreed actions had been substantially implemented by the time of the audit visit. Where audit recommendations have not been fully implemented the further action required has been agreed with the service.

Internal Audit is satisfied that there is management commitment to act where control improvement opportunities are identified, and that staff understand and accept the need for systems to be robust and reliable.

Colin Houston
Chief Auditor

31 May 2007

Responsibility of EXECUTIVE DIRECTOR of CORPORATE SUPPORT

Appendix 1(b)

Assignment	Findings	Report Issued
Investigation (NDR) Alleged payment of non-domestic rates.	The ratepayer withdrew her complaint, and agreed to set off an overpayment on Council Tax against arrears in non-domestic rates.	26 June 2006
Follow-up of Water Cooler assignment	4 fully and 3 partially implemented from 7 agreed actions = 79% overall implementation. Client Assurance Statement signed.	4 July 2006
Follow-up of Missing Cheque Investigation	3 of 3 agreed actions fully implemented = 100% implementation.	5 July 2006
2005/06 Statutory Performance Indicators Assignment tested the accuracy/reliability of selected PIs.	All indicators were found to be reliable, resulting in all fifty-six indicators being 'A' rated, and reported.	21 July 2006
Follow-up of Authorised Signatory assignment	5 of 6 agreed actions fully implemented = 83% implementation. No further action required on the remaining action.	1 Sept 2006
Creditor Payments Assignment reviewed duplicate payment controls.	An assessment of processes in Finance Service can lead to a reasonable level of assurance.	24 Oct 2006
Investigation (NDR) Alleged payment of non-domestic rates.	The case was passed to the Police.	30 Jan 2007
Follow-up of Members Allowances and Expenses	3 fully and 6 partially implemented from 9 agreed actions = 67% overall implementation. Client Assurance Statement signed.	14 Mar 2007
Follow-up of Employees' Expenses	11 fully implemented from 13 agreed actions = 85% implementation. No further action required on the remaining 2 actions.	9 May 2007

Assignment	Findings	Report Issued
Follow-up of Car Leasing assignment	12 fully and 3 partially implemented from 15 agreed actions = 90% overall implementation. Client Assurance Statement signed.	11 May 2007
Cash Handling in Local Offices	Objectives of internal control have been met.	21 May 2007
Follow-up of Bank reconciliations	2 of 2 agreed actions fully implemented = 100% implementation.	30 May 2007
Follow-up of E-payments	14 of 14 agreed actions fully implemented = 100% implementation.	31 May 2007
Imprest Certification	Objectives of internal control have been met.	31 May 2007

Responsibility of EXECUTIVE DIRECTOR of DEVELOPMENT & PROPERTY SERVICES

Assignment	Findings	Report Issued
Grant Claims The assignment examined the accuracy and validity of the 2006/07 grant claim for the Westrans.	The grant claim was verified.	20 June 2006
2005/06 Stocktaking Arrangements The assignment examined the adequacy of controls around the annual Roads stock checks, and followed up on previous recommendations.	Reasonable assurance can be taken from the controls being operated.	28 June 2006

Assignment	Findings	Report Issued
Vehicle Fuel Procurement Assignment examined vehicle fuel arrangements.	Reasonable assurance can be taken from the controls being operated. The audit found that there was no contract in place for fuel procurement.	15 Aug 2006
Investigation (fuel) An incident involving alleged theft of fuel was investigated.	Departmental management to interview the employee concerned.	6 Dec 2006
Follow-up of Energy Management	6 fully and 2 partially implemented from 10 agreed actions = 70% overall implementation. Client Assurance Statement signed.	14 Dec 2006
Vehicle Fleet Replacement Assignment examined vehicle fleet replacement arrangements, including operating leases.	Reasonable assurance can be placed on the fleet replacement processes. Internal Audit recommended that Finance and Procurement should consult around the operating lease arrangements, and Finance should offer advice to services around funding options.	30 Mar 2007
Grant Claims The assignment examined the accuracy and validity of the 2006/07 grant claim for the Warm Deal Programme administered by Communities Scotland.	The grant claim was verified.	11 April 2007
Follow-up of Planning and Building Standards Income	6 fully and 1 partially implemented from 7 agreed actions = 93% overall implementation. Client Assurance Statement signed.	27 April 2007

Responsibility of EXECUTIVE DIRECTOR of EDUCATIONAL & SOCIAL SERVICES

Assignment	Findings	Report Issued
Follow-up of Invoice Investigation	1 of 1 action fully implemented = 100% implementation.	20 April 2006
Volunteer Drivers Assignment examined use of volunteer drivers.	Internal Audit issued a briefing note on the use of volunteer drivers.	10 August 2006
Follow-up of Outwith Placements	9 of 9 actions fully implemented = 100% implementation.	30 Aug 2006
Review of Care at Home Contracts Assignment reviewed contracts with external providers for care at home services.	Audit recommendations were made in the areas of payment arrangements, annual rate increases, use of spot contracts, implication of TUPE regulations, and importance of robust performance monitoring of external providers.	6 Sept 2006
Review of Foster and Adoption Payments Assignment reviewed arrangements for foster & adoption related payments.	The overall assessment of the control environment was that key controls exist but they are not applied consistently and effectively. A number of audit recommendations were made around carer payment rates, payment processes and external foster placements.	11 Dec 2006
PPP The audit verified the model used to determine the VFM assessment.	Internal Audit overall opinion is that the VFM assessment had been correctly calculated based on the information available.	18 Jan 2007
Follow-up of Clothing Grants	8 fully and 1 partially implemented from 9 agreed actions = 94% overall implementation. Client Assurance Statement signed.	19 Jan 2007

Assignment	Findings	Report Issued
Investigation of Community Association	The amount misappropriated is in excess of £12k, accruing over a number of years. The matter was reported to the Police.	22 Jan 2007
James Hamilton Academy Location Audit Assessment of the key financial and administrative systems operated by the school	Key controls exist but are not applied consistently and effectively. As a result, the control objectives are not being met.	24 Jan 2007
Follow-up of Missing Income at school	5 fully and 1 partially implemented from 6 agreed actions = 92% overall implementation. Client Assurance Statement signed.	24 Jan 2007

Assignment	Findings	Report Issued
Follow-up of School Meals Income	10 of 10 recommendations fully implemented = 100% implementation.	1 Feb 2007
Follow-up of Social Work Transport	13 fully and 4 partially implemented from 21 agreed actions = 71% implementation. Control objectives not being met around disclosure checking arrangements for drivers and escorts. Client Assurance Statement signed.	6 Mar 2007
Review of Catering Controls in Onsite Services Examination of expenditure controls for Onsite food supplies.	Audit recommendations were made around ordering procedures, invoice price checking, authorised signatories and performance monitoring.	13 Mar 2007
Review of Cashless School Meals The audit team reviewed the cashless school meals system.	Key controls exist and are applied consistently and effectively relating to cash handling in two of the three secondary schools visited. Controls need to be improved in the third school visited.	4 April 2007
Follow-up of Missing Monies at Children's Unit	1 of 1 action fully implemented = 100% implementation.	5 April 2007
Follow-up of Social Work Residential Units	8 of 8 actions fully implemented = 100% implementation.	11 April 2007
Follow-up of Foster & Adoption	7 of 8 actions fully implemented = 88% implementation. Client Assurance Statement signed.	23 May 2007
Social Work Charges Assignment reviewed the implementation of revised charges across Social Work services.	The examination showed that three of the six rate changes (excluding fostering payments) were implemented on time. Action should be taken to prevent delays in future years.	24 May 2007

Assignment	Findings	Report Issued
Follow-up of Care at Home	7 fully and 2 partially implemented from 9 agreed actions = 89% overall implementation. Client Assurance Statement signed.	24 May 2007

Responsibility of EXECUTIVE DIRECTOR of NEIGHBOURHOOD SERVICES

Assignment	Findings	Report Issued
Stocktaking Arrangements 2005/06 The assignment examined the adequacy of controls around the annual stock check, and followed up on previous recommendations.	Reasonable assurance can be taken from the controls being operated.	11 May 2006

Assignment	Findings	Report Issued
Follow-up at Dick Institute	2 of 2 actions fully implemented = 100% implementation.	25 May 2006
Follow-up of Building & Works Bonus	5 of 5 actions fully implemented = 100% implementation.	21 June 2006
Follow-up Licensing Income	7 of 8 actions fully implemented = 88% implementation. Client Assurance Statement signed.	24 July 2006
Grants The assignment examined the accuracy and validity of the grant claim for the anti-social behaviour noise grant.	The grant claim was verified.	24 July 2006
Follow-up of Scaffolding Services	6 fully and 1 partially implemented from 7 agreed actions = 93% implementation. Client Assurance Statement signed.	25 July 2006
Follow-up of Housing Allocations	10 of 11 actions fully implemented = 91% implementation. Client Assurance Statement signed.	15 Aug 2006
Building & Works Vehicle Hires Assignment reviewed arrangements for the hire of vehicles within Building and Works	Gaps were found in the vehicle logbook arrangements, and recommendations were made around fleet strategy, authorisation of requisitions, use of masternaut, migration of hired vehicles onto the new framework agreement, and health and safety.	27 Oct 2006