

# **EAST AYRSHIRE COUNCIL**

## **GOVERNANCE & SCRUTINY COMMITTEE – 20 MAY 2011**

### **ANNUAL REPORT 2010/11**

#### **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 2011.
- 1.2 The Annual Report is primarily designed to direct your attention to matters of significance that have arisen out of the 2010/11 audit process, and offer an opinion on the adequacy and effectiveness of the systems of internal control.
- 1.3 The 2010/11 Audit Plan was presented to Governance & Scrutiny on 19 March 2010 and the Mid Year Progress Report was presented to Governance & Scrutiny on 19 November 2010.

#### **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 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. A sound control system will help safeguard assets, ensure records are reliable, promote operational efficiency and ensure adherence to policy and procedures.
- 3.2 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 PLAN ACHIEVEMENT**

- 4.1 We have achieved 100% of plan outputs for 2010/11. 42 audit reports have been issued in the year, including planned assignments, follow-up reviews and investigations. A total of 125 audit recommendations have been agreed with clients covering a range of work across all services, and these, when implemented, will help to strengthen the control environment and assist best value objectives in all of the areas examined. Performance is close to plan in all service areas and across all audit activity.

## **5 KEY OUTCOMES**

- 5.1 The primary outcomes of Internal Audit link with Community Planning objectives in a number of key areas, including sound corporate governance and internal control, performance improvements, best value and reduction in waste and fraud. During the course of this year's work Internal Audit has identified efficiencies totalling over £170k.
- 5.2 Core financial systems assignments on income control and PECOS (Council's electronic purchasing system) were completed and reported to management in the first half of 2010/11. The assignments are part of a programme of end-to-end core systems agreed with our current external auditor. Core systems assignments completed by Internal Audit over recent years have enabled our External Auditor to place reliance on this work in planning their audit of East Ayrshire Council. An audit assignment on recovery of VAT on the fuel element of mileage expenses was completed in the year, and this has identified that over £20k of additional income can be recovered annually.
- 5.3 Also completed in the current audit year were planned assignments on asset management, social work, contract coverage, contractor payments, external funding, performance indicators, location audits, year end stocktaking. Improved management of security costs and Community Association centre supervisor costs are estimated to yield annual savings of around £150k, and these now form part of the 2011/12 Budget Savings package.
- 5.4 Internal Audit has been developing self-evaluation controls toolkits to support management in promoting compliance with internal controls. The toolkit is now established in over 150 locations and work will continue until toolkits are rolled out across all locations. These should serve to further strengthen self-evaluation arrangements and systems of internal control.
- 5.5 During the year an unplanned assignment on creditor bank accounts was carried out in response to national fraud alerts. Following the audit, actions were agreed with management to further strengthen controls in this area. Internal Audit reviewed controls again in March 2011, and found that enhanced controls were in place and operating effectively. The work carried out by Finance has identified that some attempts have been made to perpetrate this fraud in East Ayrshire Council, but to date no attempt has been successful.

5.5 Internal Audit has undertaken follow-up work on a number of previous audit assignments. This work has found that 97% of recommendations had been implemented by the time of audit follow-up visit.

## **6 ANNUAL REPORT (ATTACHED)**

6.1 The attached report (Appendix 1) summarises the audit work carried out in 2010/11. The report presents an analysis of the performance of the Internal Audit section during the year ending 31 March 2011, and provides a summary of the audit assignments completed in the financial year.

6.2 The Internal Audit Annual Statement on the adequacy of Internal Control is contained within Appendix 1(a) of the annual report. Our overall opinion, based on the work carried out, is that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control systems in the year to 31 March 2011.

6.3 Action plans have been developed in consultation with Executive Directors which, when implemented, will result in a continued improvement in the overall control environment.

6.4 Audit reports are available to Elected Members via the Elected Member portal on the intranet. There may be circumstances where access to reports will be delayed until outstanding issues have been resolved.

## **7 POLICY/LEGAL/FINANCIAL/RISK IMPLICATIONS**

7.1 The Council's Financial Regulations and Standing Orders set out responsibilities for governance. 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.

## **8 RECOMMENDATIONS**

8.1 Governance and Scrutiny is asked to note the contents of the Annual Report 2010/11.

Michela Costa-Watt & Alan Wasson

Acting Chief Auditors

May 2011

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## **LIST OF BACKGROUND PAPERS**

Annual Audit Plan 2010/11 and Mid Year Progress Report 2010/11

East Ayrshire Council Financial Regulations, Accounting Policy Bulletins, Standing Orders, Standard Circulars and 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 Acting Chief Auditors on Tel. No. (01563) 554391.

**EAST AYRSHIRE COUNCIL**

**INTERNAL AUDIT ANNUAL REPORT 2010/11**

**Report by the Chief Auditor**

**1 PURPOSE OF REPORT**

- 1.1 This report directs attention to matters of significance that have arisen out of audit work carried out in the 2010/11 audit year.

**2 INTERNAL CONTROL**

- 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. The control framework includes regular management information, financial regulations, standing orders, administrative procedures, management supervision and a system of delegation and accountability.
- 2.3 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 are set out in the Financial Regulations of the Council.
- 3.2 Audit reports are presented to Executive Directors and include agreed actions which, when implemented, will improve the control environment. Since August 2008, audit assignment reports have been available to Elected Members through the Elected Member Portal on the Council's intranet. This development is designed to further strengthen the Council's scrutiny function.
- 3.3 East Ayrshire Council, in common with all other councils, faces significant budgetary pressures, leading to refocusing of resources and redesign of existing service models. Internal Audit will contribute to this agenda, by helping services implement effective internal controls and helping services identify opportunities for greater efficiency.
- 3.4 The audit section works closely with the Council's External Auditors to ensure complementary areas of activity, and with the other Ayrshire Council audit sections and the wider internal audit community, to further strengthen the quality, efficiency and effectiveness of the audit service.

## 4 PLAN ACHIEVEMENT

- 4.1 We have achieved 100% of plan outputs for 2010/11. Performance statistics have been collated from the audit management systems for the 2010/11 audit year. The section has issued 42 outputs at the time of reporting, and includes planned assignments, follow-up reviews and investigations. A total of 125 audit recommendations have been agreed with clients covering a range of work across all services, and these, when implemented, will help to strengthen the control environment in all of the areas examined.
- 4.2 The service analysis is detailed below. Performance is close to plan in all service areas.

<b>SERVICE ANALYSIS</b>	<b>ACTUAL DAYS</b>	<b>PLAN DAYS</b>	<b>ACHIEVEMENT %</b>
FINANCE AND CORPORATE SUPPORT	<b>432</b>	<b>410</b>	<b>105</b>
EDUCATIONAL & SOCIAL SERVICES	<b>329</b>	<b>320</b>	<b>103</b>
NEIGHBOURHOOD SERVICES	<b>276</b>	<b>220</b>	<b>125</b>
<b>TOTAL AVAILABLE DAYS</b>	<b>1037</b>	<b>950</b>	<b>109</b>

- 4.3 Actual audit days achieved are 1037, and this compares to audit plan days of 950. This represents a 9% increase in available resource. In 2010/11 the financial outturn is projected to be under budget by £7k.
- 4.4 Internal Audit carry out client satisfaction surveys using post audit appraisal questionnaires. Over the past three years, 55 returned post audit appraisals have been received: 52 (95%) rated the service as good; three clients (5%) rated the service as fair; and no clients rated the service as poor.
- 4.5 Audit Scotland annual reviews of Internal Audit have consistently commented on the high quality service provided by the in-house team. Audit Scotland's 2010/11 annual assessment of the adequacy, strengths and weaknesses of the Internal Audit function, concluded that this service has appropriate resources, documentation standards and reporting procedures to allow them to place reliance on a number of assignments undertaken in 2010/11.

## 5 KEY OUTCOMES

### 5.1 Overview

- 5.1.1 The primary outcomes of Internal Audit link with Community Planning objectives in a number of key areas, including sound corporate governance and internal control, performance improvements, best value and reduction in waste and fraud. During the course of this work Internal Audit has identified efficiencies totalling over £170k, £150k of which now form part of the 2011/12 Budget Savings packages.
- 5.1.2 The annual report is designed to direct attention to matters of significance that have arisen out of the 2010/11 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.
- 5.1.3 The 2010/11 assurance programme includes assignments on the full range of audit activity, in key priority areas, including coverage of core financial systems, asset management, contractor payments, following the public pound and coverage of departmental systems. The following paragraphs provide a summary of the key outcomes.

## **5.2 Core systems - Income Control and Electronic Purchasing System**

- 5.2.1 Systems based audits continue to represent one of the main elements of planned activity. We agreed with our current external auditor at the start of their engagement that a programme of end-to-end systems reviews of core financial systems would be carried out over the term of their contract. 2010/11 is year four of a seven year programme, designed to cover all core systems areas. Since the programme started end-to-end audits of council tax, non domestic rates, debtors, creditors, four weekly payroll and the general ledger have all been completed.
- 5.2.2 A systems review in income control was completed in 2010/11. The work of the assignment examined the procedures in relation to general procedural controls, transaction controls, suspense account monitoring, cash overs/unders, security, bank reconciliations, and logical access. Sound assurance can be taken from the controls operated by the Income Control Section for most areas within the scope of this assignment. An agreed action plan is in place covering control improvements, including suspense account controls and logical access. These improvements, when implemented, will further strengthen income controls.
- 5.2.3 A systems review of PECOS, the Council's electronic purchasing system was completed in 2010/11. The work of the assignment included examination of the procedures in relation to authorisation controls, ordering, receipting, invoicing, interfaces between PECOS and Civica Financials, management of standing data and system management. Reasonable assurance can be taken from the controls operating in the majority of areas covered by the scope of this assignment. A number of the issues identified result from system limitations. An agreed action plan is in place covering a number of control improvements, including accounting policy bulletin guidance, management reporting, ordering, invoicing and logical access. These improvements, when implemented, will further strengthen PECOS controls.
- 5.2.4 Internal Audit assisted in updating the rate of VAT recovery on mileage expenses. In the course of this, Internal Audit identified an opportunity to increase the Council's recovery of VAT by over £20k per year. This has been implemented by Finance Service.
- 5.2.5 During the course of the year we have followed up on previous core systems work; general ledger, four weekly payroll and council tax collections. We found that all agreed actions had been implemented, giving an implementation score of 97% for all four assignments. We also carried out an assignment on changes to creditor bank account details in response to a national fraud alert. Further detail on this assignment can be found in Section 7 (Investigations).

## **5.3 Asset Management - Property Maintenance, PPP, Security Costs**

- 5.3.1 Internal Audit has completed a review of the Council's property maintenance contract. The purpose of the assignment is to ensure compliance with stated procedures in respect of price checking and measurement of works. Processing charges from the property maintenance contractor involves physical inspection of 100% of job lines and price check on 100% of valuation certificates. We checked prices on a sample of 50 valuation certificates. No errors were found, and we were able to conclude that price checking controls are operating correctly. We conducted physical inspections on a sample of jobs, covering £204k of invoiced charge. Our testing rejected 41% of jobs inspected. The rejected jobs had an aggregate overpayment of £12.3k (6% of the value tested). Our testing has identified that some invoices have been overpaid despite a stated control of 100% inspection. Management is investigating the issues found. An agreed action plan is in place covering a number of control improvements, including post inspection controls, contract administration and recovery of overpayments. These improvements, when implemented, will strengthen contractor payment controls.

5.3.2 Internal Audit has completed an assignment on Public Private Partnerships (PPP). The purpose of the assignment is to verify that indexation on invoices is correctly calculated, ensure deductions are applied by EAC where there have been contractual failures and ensure additional charges incurred are fair and correctly calculated. The annual cost of the PPP contract for 2010/11 is £8.3m. This cost is a fixed commitment by way of a monthly unitary charge and cannot be varied. Variations over and above the unitary charge represent 2.5% for deductions and 0.19% for additional charges. The high volume of core hours purchased at the contract stage means that there is a low risk of us incurring high or erroneous additional charges. Sound assurance can be taken from the controls operating in most areas within the scope of this assignment. An agreed action plan is in place covering control improvements, including written procedures and controls over deductions and authorisation levels.

5.3.3 Internal Audit has completed a review of security costs in Educational and Social Services (E&SS). We selected a sample of E&SS vacant and surplus properties. This testing found significant delays in clearing properties, declaring properties surplus and carrying out demolitions. We also found extended use of 24-hour manned security on some properties. These delays each contributed to security costs being incurred unnecessarily. Spend on the security contract totalled £800k over the last two years. We have identified a number of areas where savings could be made and have recommended that a corporate needs assessment of security requirements should be conducted, taking account of options to reduce spend on mobile patrols, manned security, security shuttering and keyholding. There is an opportunity to better align security with Risk Management Centre controls. The annual savings could be in the region of £100k. An agreed action plan is in place covering a range of improvements which, when implemented, should significantly reduce costs and contribute to the Council's efficiency drive.

#### **5.4 Procurement – Contract Coverage, Roads Contracts and Payments to Care Homes**

5.4.1 Internal Audit has completed a review of contract coverage arrangements across the Council. Internal Audit examined 180 vendor accounts with expenditure greater than £50k in the six months from April to September 2010. The total expenditure with these vendors is £49m in six months excluding VAT. Examination of contract arrangements confirmed that 176 vendors (ie 98%) had contracts either in place or currently being progressed. Four vendors were identified either where no tender exercise was carried out or the contract had expired. The total expenditure on these four vendors was £317k (excluding VAT) in six months. This represents 2% of the vendors examined, and 0.6% of the expenditure covered. These cases have been advised to Procurement for action. The objectives of internal control are being met in the majority of areas and a reasonable level of assurance can be taken from current arrangements. An agreed action plan is in place covering control improvements, including tendering, management of contract coverage, contracts register and committee reporting.

5.4.2 Internal Audit has completed an assignment in respect of Roads contractors' payments. The purpose of the assignment is to verify that payments are made in line with contracted or agreed prices, confirm that variations to contract specifications are properly authorised and paid at agreed rates. We also verified whether works are measured before payment is made and agreed measures are reflected in the invoice. Our testing included the verification of controls operating when authorising invoices. We examined a total of 19 contracts with external contractors and found examples of good practice in the way final measures were agreed with the contractor. However, the testing highlighted three examples where the engineers had accepted the final measure provided by the contractor without carrying out their own physical verification. These jobs were re-measured in the presence of Internal Audit and errors of around 5% of the values verified were found. Sound assurance can be taken in respect of the controls operating in the areas of specifications and costing of works. Contract variation and measurement controls are not always

applied consistently or effectively and can be improved. Overall, reasonable assurance can be taken in respect of the controls in place for payments to Roads contractors. An agreed action plan is in place covering control improvements, including contract specification, tendering, measurement, committee reporting, invoicing and quality assurance.

5.4.3 Internal Audit has completed a review of care home payments. The purpose of the assignment is to verify correctness of payments to care homes for a sample of service users and ensure that contracts were in place with all care homes used within East Ayrshire. The controls adopted by Resources Finance in Social Work were found to be operating effectively and there were no errors identified in the payments to care homes. We identified that there is scope to more clearly define the roles and responsibilities of Resources Finance and the Contracting & Commissioning Team in respect of care home performance reporting. Overall, sound assurance can be taken from controls operated by Resources Finance and Social Work staff in most areas covered within the scope of this assignment.

## **5.5 Computer Audit – File Controls**

5.5.1 Internal Audit has completed computer audit assignment on file controls. This assignment has been conducted as part of the computer audit allocation in the annual audit plan for 2010/11. The purpose of the assignment is to examine physical logical and procedural controls around computer files in East Ayrshire Council, report any areas for improvement identified, and recommend actions to address areas for improvement. Examples of good practice are evident in the management of access and backups. User training in security issues is reinforced at corporate induction. Improvements have been identified, particularly the need to complete Information Security Policy, including the subsidiary document on access control, encryption of existing laptops, reviews of access logs, and minimum lengths for administration passwords. Objectives of internal control are being met in the majority of areas, and we can take reasonable assurance from current controls. An agreed action plan is in place covering control improvements, including standards and procedures, access controls, administration and backup.

## **5.6 Income collection – Cashless School Meals**

5.6.1 Internal Audit has completed a review of the cashless school meals system at St Joseph's Campus. The purpose of the assignment is to verify the implementation of the cashless school meals system and relevant procedures relating to income. Internal Audit found that income was satisfactorily banked intact but weaknesses were identified in the controls operating within this system. The major weakness was that meals income banked by the school is not reconciled to the income received by the school. It was concluded that only limited assurance could be taken from the controls currently in place. Agreed action plans are in place covering control improvements, including income recording and reconciliation.

5.6.2 Due to the weaknesses identified when undertaking the audit at St Joseph's Campus, Internal Audit completed an audit of cashless meals systems at Grange Campus, Doon Academy and Auchinleck Academy. We found no material differences between income received and income banked.

## **5.7 Performance Indicators**

5.7.1 Internal Audit has completed an audit of performance indicators. The purpose of the assignment is to support Audit Scotland, East Ayrshire Council's External Auditors, in their duty to audit the indicators for the financial year ended 31<sup>st</sup> March 2010. The performance indicators to be produced for 2009/10 are defined in the 2008 PI Directive. The 2008 PI Directive represented a significant change in approach with increased emphasis on self determination of performance measures by

councils. The number of mandatory indicators that all Scottish councils are required to use has been reduced to 25. East Ayrshire Council has decided to publish 77 indicators for 2009/10.

- 5.7.2 Each Performance Indicator file is subject to verification checks by the Best Value and Performance Section, guided by a verification checklist, which includes file format, completeness, and arithmetic accuracy checks. Files are then made available for audit. We tested five indicators and found that one required adjustment. Following this adjustment, all indicators tested were found to be reliable. Six recommendations were raised in the 2009 audit of performance indicators, and these were followed-up as part of the 2010 work. All six recommendations had been fully implemented by the time of the audit follow-up.

## **5.8 External Funding**

- 5.8.1 Internal Audit has completed a review of community associations. The audit was carried out to evaluate the arrangements between the Council and community associations, and to ensure that appropriate controls are in place and being applied correctly. Some areas for improvement were highlighted by the audit, including controls around authorisation and certification of overtime. Service level agreements are in place for Community Associations, and these include provision for the Council to charge for overtime costs above an annual allocation and for utility costs to be recharged if above reasonable amounts. Internal Audit found that arrangements for overtime and utility costs have not been formalised and no recovery of these costs is taking place. There is scope to realise a significant reduction of costs by applying the provisions in the service level agreement. The annual cost recovery is estimated to be around £50k. An agreed action plan is in place covering a number of control improvements, including staffing and premises costs, service level agreements and annual accounts.

- 5.8.2 In August 2009, Internal Audit reported on payments to an arms length body and made a number of recommendations to improve external funding controls. The improvements were accepted by management and a full action plan was put in place to ensure that the recommended improvements were fully implemented. Internal Audit has now completed a follow-up review to assess the extent of implementation of those recommendations. The follow-up was performed as a management self assessment. The follow up review found that all of the agreed actions had been fully or sufficiently implemented, giving a 100% implementation rating.

## **5.9 Self Evaluation**

- 5.9.1 The Professor Lorne Crerar review of systems of regulation, audit and inspection in Scotland has delivered shared risk assessments, lighter touch external regulation and more reliance on self-evaluation. Internal Audit has been developing self-evaluation controls toolkits across services, to support management in promoting compliance with internal controls. The toolkit is now established in over 150 locations and work will continue until toolkits are rolled out across all locations and these should serve to further strengthen self-evaluation arrangements and systems of internal control. Compliance testing will be conducted into the use of these toolkits.

## **6 AUDIT FOLLOW-UP**

- 6.1 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. 17 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. We found that 111 of 114 agreed actions had been implemented by the date of the follow-up audit visit, which is an implementation score of 97% (86% in 2009/10). Management assurance has since been received that two of the

remaining actions have now been implemented, and the other action will be implemented shortly. Departmental implementation scores range between 97% and 100% of agreed actions implemented at the time of the audit follow up.

## **7 INVESTIGATIONS**

- 7.1 Time spent on investigative work in the year is 30 days over the available contingency. A selection of investigations are summarised in the following paragraphs. Audit reports covering investigations which are with the Police or where disciplinary action is pending have not been placed in the Elected Member portal.
- 7.2 In July and August 2010, Internal Audit was alerted to a major national fraud. The threat involves fraudulent alterations to creditor bank account details. The National Anti-Fraud Network (NAFN) has identified attempted payment fraud in excess of £10m. Two Scottish Councils have made payments to fraudulent bank accounts, totalling £372,000. This fraud continues to operate throughout the UK. NAFN report that two housing associations have recently fallen victim to this fraud.
- 7.3 On receipt of these fraud alerts Internal Audit contacted Finance management to alert them to the fraud risk. Internal Audit and Finance management agreed that additional controls advised by NAFN be applied immediately in the area at risk. In September, to support Finance management, Internal Audit carried out an assignment on amendments to creditor bank accounts to test compliance with the new procedures. Following the audit, actions were agreed with management to further strengthen controls in this area. To provide additional assurance, Finance retrospectively validated all creditor bank account changes since April 2009 and has placed additional controls on all payments over £5,000. Internal Audit reviewed controls again in March 2011, and found that enhanced controls were in place and operating effectively. The work carried out by Finance has identified that some attempts have been made to perpetrate this fraud in East Ayrshire Council, but to date no attempt has been successful.
- 7.4 In April 2010, Internal Audit was asked to investigate missing income involving a vending machine. We were able to establish that £1,200 was unaccounted for. Cash records were inadequate and incomplete, and the arrangements put in place contravened Council established procedures in a number of areas. The audit findings were given to management to take appropriate action.
- 7.5 In April 2010, the Council received an anonymous letter making allegations against an employee. It was alleged that the member of staff had work done to properties belonging to him and his family by Council contractors. We investigated the matter and could find no evidence to corroborate the allegations.
- 7.6 In May and July 2010, allegations were received in relation to two projects funded by the Council. The whistleblowers raised a number of management and financial concerns. The concerns were discussed with management. Internal Audit recommended that a full evaluation of one of the projects should be conducted and the matter was passed to relevant management to deal with. An investigation is still on-going with regards to the remaining project.
- 7.7 In November 2010, Internal Audit was asked to investigate a whistleblowing complaint in Leisure Services. That work is now complete and a report is with management to consider.

## **8 SUMMARY OF PERFORMANCE**

- 8.1 The 2010/11 assurance programme includes assignments on the full range of audit activity, in key priority areas, including coverage of core financial systems, asset management, contractor payments, following the public pound and coverage of departmental systems. Improved management of security costs and Community Association centre supervisor costs and increased recovery of VAT on fuel element of mileage expenses is estimated to yield savings of around £170k. The key outcomes are summarised above.
- 8.2 During the year an unplanned assignment on creditor bank accounts was carried out in response to national fraud alerts. Following the audit, actions were agreed with management to further strengthen controls in this area. The work carried out to date has not identified any fraudulent activity of this kind in East Ayrshire Council.
- 8.3 Control self evaluation toolkits are now established in over 150 locations and work will continue until toolkits are rolled out across all locations and these should serve to further strengthen self-evaluation arrangements and systems of internal control.
- 8.4 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.
- 8.5 Actual audit days were above budget at the end of the year and we completed all plan assignments in the year.

Michela Costa-Watt & Alan Wasson  
Acting Chief Auditors  
May 2011  
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## **INTERNAL AUDIT ANNUAL STATEMENT ON THE ADEQUACY OF INTERNAL CONTROL**

As Acting Chief Auditors of East Ayrshire Council, we present our annual statement on the adequacy and effectiveness of the internal control systems of the Council for the year ended 31 March 2011.

### **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.

### **Internal controls**

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

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

The system of internal control cannot provide 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.

### **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 Governance and Scrutiny Group on 19 March 2010. Audit plans are prepared following full consultation with the Chief Executive, the Proper Officer and Executive Directors.

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 audit assignment reports, including follow-ups, are presented to the Chief Executive, the Executive Director of Finance and Corporate Support, the Council's External Auditor and, where appropriate, to the Council Monitoring Officer. Copies of audit reports are also made available to Elected Members via the Council's intranet.

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 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**

Our 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 2011;
- the audit work undertaken by Internal Audit in previous audit years;
- audit follow-up work to assess implementation of agreed actions;
- findings/conclusions arising from work carried out by the Council's External Auditors; and
- knowledge of the Council's governance, risk management and performance framework.

## **Opinion**

We have carried out a range of audit assignments in 2010/11. End to end core systems reviews have been completed in PECOS and income control, computer audit assignments have been carried out in systems management and ICT policy support, and assignments in asset management, contractor payments, following the public pound and departmental systems have all been completed. The agreed actions arising from all of this work will, when implemented, further strengthen the framework of controls.

In July and August 2010, Internal Audit was alerted to a major national fraud. The threat involved fraudulent alterations to creditor bank account details. Immediately on receipt of these fraud alerts Internal Audit contacted Finance management to make them aware of the fraud risk. Internal Audit and Finance management agreed that additional controls advised by NAFN be applied immediately in the area at risk. In September, to support Finance management, Internal Audit carried out an assignment on amendments to creditor bank accounts to test compliance with the new procedures. Following the audit, actions were agreed with management to further strengthen controls in this area. Internal Audit reviewed controls again in March 2011, and found that enhanced controls were in place and operating effectively.

In the Chief Auditor's last annual statement, he reported that an audit investigation into payments to an arm's length organisation had identified some compliance issues with our following the public pound procedures and that Internal Audit had made a number of recommendations to address improvement areas identified during the investigative work. The improvements were accepted by management and a full action plan was put in place to ensure that the recommended improvements were fully implemented. Internal Audit has now completed a follow-up review to assess the extent of implementation of those recommendations. The follow-up review found that all of the agreed actions had been fully or sufficiently implemented.

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.

The Professor Lorne Crerar review of systems of regulation, audit and inspection in Scotland has delivered shared risk assessments, lighter touch external regulation and more reliance on self-evaluation. The scrutiny bodies operating in East Ayrshire Council (including Audit Scotland and HMIE) have collaborated to put in place an Assurance and Improvement Plan (AIP) that sets out planned scrutiny activity for the period 2010-2013. The AIP is based on the local area network's shared risk assessment of the Council and the scrutiny is proportionate to the assessed risks. Internal Audit has been developing self-evaluation controls toolkits across services, to support management in promoting compliance with internal controls. The toolkit is now established in over 150 locations and work will continue until toolkits are rolled out across all locations and these should serve to further strengthen self-evaluation arrangements and systems of internal control. Compliance testing will be conducted into the use of these toolkits.

Our overall opinion, based on the work carried out, is that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control system in the year to 31 March 2011. The objectives of internal control have been substantially met.

Acting Chief Auditors

May 2011

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