

EAST AYRSHIRE COUNCIL

GOVERNANCE AND SCRUTINY COMMITTEE – 19 NOVEMBER 2010

PROGRESS REPORT - INTERNAL AUDIT PLAN 2010/11

Report by the Chief Auditor

1. PURPOSE OF REPORT

- 1.1 To provide Governance and Scrutiny Committee with a mid year progress report on performance against the audit plan for 2010/11.
- 1.2 The annual assurance programme of work was presented to the Governance and Scrutiny Committee on 19 March 2010.

2. BACKGROUND

- 2.1 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. All Local Authorities should make provision for Internal Audit in accordance with the Code of Practice.
- 2.2 Internal Audit is an assurance function that provides an independent and objective opinion to the Council on the control environment, by evaluating its effectiveness. The Council's response to Internal Audit activity should lead to the strengthening of the control environment and therefore, contribute to the achievement of Council objectives.
- 2.3 Internal Audit independently report to the Chief Executive and the Governance & Scrutiny Committee.

3. PLAN ACHIEVEMENT

- 3.1 We have issued 21 reports at the time of reporting, including planned assignments, follow-up reviews and investigations. A further 7 audit assignments are in progress. Actual audit days are on budget, and we are on schedule to achieve full plan achievement, subject to no significant unplanned work emerging..
- 3.2 We are projected to be under budget by £22k for the year.
- 3.3 The attached report (Appendix 1) summarises performance and outputs in the first half of the 2010/11 audit year.

4. KEY OUTPUTS

- 4.1** The primary outcomes of Internal Audit link with Community Planning objectives in a number of key areas, including sound corporate governance, performance improvements and best value.
- 4.2** 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.
- 4.3** Also completed in the first half of the current audit year were planned assignments on asset management, external funding, performance indicators, location audits, year end stocktaking and an unplanned assignment on creditor bank accounts. The Council's response to the fraud alert on creditor bank accounts is covered in full detail in item 8 of Governance and Scrutiny business agenda.
- 4.4** Internal Audit has undertaken follow-up work on a number of previous audit assignments. This work has found that 98% of recommendations had been implemented by the time of audit follow-up visit.
- 4.5** 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.

5. FINANCIAL/RISK/POLICY/LEGAL IMPLICATIONS

- 5.1** This report is presented in accordance with the Council's Financial Regulations.

6. RECOMMENDATIONS

- 6.1** Governance and Scrutiny is asked to note the 2010/11 mid year progress report on Internal Audit plan achievement.

Colin Houston

Chief Auditor

CH/G&S covering report November 2010vf

LIST OF BACKGROUND PAPERS

Audit Plan 2010/11

CIPFA Code of Practice for Internal Audit in Local Government

East Ayrshire Community Plan

East Ayrshire Council Financial Regulations

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

EAST AYRSHIRE COUNCIL

INTERNAL AUDIT MID YEAR PROGRESS 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 first half of 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 endeavours 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. Internal
- 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 Performance statistics have been collated from the audit management systems for the 2010/11 audit year. The section has issued 21 outputs at the time of reporting, and includes planned assignments, follow-up reviews and investigations. A total of 69 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. A further 7 audit assignments are in progress at the time of reporting, and these include planned assignments, follow-ups and investigations. Actual audit days are on budget at the mid point in the year and we are on schedule to achieve full plan achievement, subject to no significant unplanned work emerging.
- 4.2 The mid year service analysis is detailed below. Performance is close to plan in all service areas at the mid point in the year.

SERVICE ANALYSIS	ACTUAL DAYS (mid year)	PLAN DAYS (full year)	ACHIEVEMENT %
FINANCE AND CORPORATE SUPPORT	211	410	51%
EDUCATIONAL & SOCIAL SERVICES	165	320	52%
NEIGHBOURHOOD SERVICES	128	220	58%
TOTAL AVAILABLE DAYS	504	950	53%

- 4.3 In 2010/11 the financial outturn is projected to be under budget by £22k. The underspend results from savings on a vacant auditor post and reduced hours working by two members of staff.
- 4.4 Internal Audit carry out client satisfaction surveys using post audit appraisal questionnaires. Forty-four returned post audit appraisals have been received over the last three years. Forty-one clients (93%) rated the service as good, three clients (7%) 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 2009/10 review of arrangements for internal audit as part of their annual audit of the Council and reported that the standard of audit work done in the last year is of the expected high quality.

5 KEY OUTCOMES

5.1 Overview

- 5.1.1 The mid year 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.
- 5.1.2 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 During the course of the year we have followed up on previous core systems work, including general ledger, council tax collections, external funding and inventories. We found that all agreed actions had been implemented, giving an implementation score of 100% 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 and Security Costs

- 5.3.1 Internal Audit has completed a review of the Council's property maintenance contract. This assignment is included in the annual audit plan for 2010/11. The purpose of the assignment is to ensure compliance with stated procedures in respect of price checking and measurement of works.
- 5.3.2 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.
- 5.3.3 Internal Audit has completed a review of security costs in Educational and Social Services (E&SS). This assignment is included in the 2010/11 annual audit plan. 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. 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 Performance Indicators

- 5.4.1 Internal Audit has completed an audit of performance indicators. This assignment is included in the annual audit plan for 2010/11. 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 31st 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.
- 5.4.2 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.

5.5 External Funding

- 5.5.1 Internal Audit has completed a review of community associations. This assignment is included in the annual audit plan for 2010/11. 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. An agreed action plan is in place covering a number of control improvements, including staffing and premises costs, service level agreements and annual accounts.
- 5.5.2 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.

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. 10 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 65 of 66 agreed actions had been fully implemented by the date of the follow-up audit visit, which is an implementation score of 98% (86% in 2009/10). Management assurance has since been received that the remaining action has now been implemented. Departmental implementation scores range between 94% and 100% of agreed actions implemented at the time of the audit follow up.

7 INVESTIGATIONS

- 7.1 Time spent on investigative work is within contingency at the mid point in the year. 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.
- 7.3 Immediately 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 is retrospectively validating all creditor bank account changes since April 2009 and has placed additional controls on all payments over £5,000. Internal Audit continues to work closely with Finance on this matter. The work carried out to date has not identified any fraudulent activity of this kind in East Ayrshire Council. The Council's response to the fraud alert is covered in full detail in item 8 of Governance and Scrutiny business agenda.
- 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 arrangements in place contravened Council established procedures in a number of areas. The audit findings are with 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 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, and it was agreed that management would investigate both matters. Investigations are on-going.

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. The key outcomes are summarised above.
- 8.2 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.
- 8.3 Actual audit days are on budget at the mid point in the year and we are on schedule to achieve full plan achievement. Performance is close to plan in all areas.

Colin Houston

Chief Auditor

November 2010

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