

EAST AYRSHIRE COUNCIL

POLICY AND RESOURCES COMMITTEE – 4 OCTOBER 2001

INTERNAL AUDIT – ANNUAL REPORT 2000/2001

Report by the Chief Auditor

1. PURPOSE OF REPORT

- 1.1** To submit to Members details of the Internal Audit Annual Report for financial year 2000/2001.

2. BACKGROUND

- 2.1** Internal Audit annual reporting procedures require that an Annual Report on internal audit activities be presented to Council.

3. ANNUAL REPORT 2000/2001

- 3.1** The attached report (Appendix 1) summarises the audit work carried out in 2000/2001. The report presents an analysis of the performance of the Internal Audit section during the year ending 31 March 2001, and provides a synopsis of the significant audit findings arising from the work carried out in the financial year 2000/2001.
- 3.2** The Council's External Auditors have confirmed that the Internal Audit section achieved an acceptable level of compliance with the 2000/2001 Internal Audit Plan.
- 3.3** Internal Audit has put forward a range of recommendations in the areas examined and action plans have been developed in consultation with management which, when implemented, should result in an improvement in the overall control environment.

4. AUDIT SCOTLAND STUDY

- 4.1** Audit Scotland has recently prepared a national report 'A Job Worth Doing' – Raising the Standards of Internal Audit in Scottish Councils. The study was directed by the Accounts Commission in order to establish a clear picture of performance of internal audit services in all councils in Scotland, and to provide benchmarking data to support continuous improvement.

4.2 The audit study found that the internal audit service in East Ayrshire Council has well-developed procedures and performance in most areas covered by the study. The performance of councils was split into four performance bands and East Ayrshire Council is included in band one, which includes those Council's (four in total) that most fully comply with the CIPFA Code of Practice for Internal Audit in Local Government. East Ayrshire internal audit service is ranked equal first within the band one councils.

5. RECOMMENDATIONS

5.1 Members are asked to note the contents of the Internal Audit Annual Report 2000/2001.

Colin Houston
Chief Auditor

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LIST OF BACKGROUND PAPERS

A job worth doing – Raising the standard of internal audit in Scottish councils, prepared by Audit Scotland.

CIPFA Code of Practice for Internal Audit in Local Government.

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 - ANNUAL REPORT 2000/2001

Report by the Chief Auditor

1 PURPOSE OF REPORT

1.1 To summarise the activities and findings of Internal Audit in financial year 2000/2001.

2 INTERNAL CONTROLS

2.1 Each local authority is accountable for the way in which it has discharged its stewardship of public funds. Stewardship is a function of management and, therefore, a responsibility placed upon elected members and officers of an authority.

2.2 That responsibility is discharged by the establishment of sound arrangements and systems for the planning, appraisal, authorisation and control over the use of resources, and by the preparation, maintenance and reporting of accurate and informative accounts.

2.3 There are a number of aspects of corporate governance which are essential prerequisites to the traditional public sector values of impartiality, openness and transparency and the highest standards of probity and propriety appropriate to the handling of public funds. These include;

- a sound control environment;
- security of key financial systems;
- adequate and effective internal audit.

3 ROLE OF INTERNAL AUDIT

3.1 Internal Audit is an independent appraisal function established by management for the review of the internal control systems of the Council. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources. A strong internal audit function is considered important for the effectiveness of the internal control systems established.

3.2 The responsibilities and duties of Internal Audit are summarised in the Financial Regulations of the Council, which state:

"Internal Audit shall be arranged for the purpose of carrying out an examination of financial and related systems of the Council to ensure that the interests of the Council are protected."

3.3 Internal Audit carries out a range of functions, across its client group, designed to meet the above objectives. These include systems reviews, computer audit work, audit probes, location audits, contract audit, value for money studies, performance indicator work and defalcation investigations.

4 AUDIT SCOTLAND STUDY

4.1 Audit Scotland recently carried out a national study of internal audit on behalf of the Accounts Commission. Audit Scotland has undertaken this national benchmarking study to assess the performance of internal audit services in Scottish councils. Performance was assessed against the standards set by the CIPFA Code of Practice for Internal Audit in Local Government. The Commission is concerned to ensure that all councils achieve the highest standards of corporate governance and financial stewardship, and internal audit plays a key role in assessing the quality and effectiveness of the system of internal controls.

4.2 The national report on the performance of internal audit in Scottish councils was published in August 2001. The national report found that the internal audit service in East Ayrshire has well-developed procedures, performs well in most areas covered by the study and displays a number of examples of good practice. The performance of councils was benchmarked against each other and split into four performance bands. East Ayrshire Internal Audit is included in band one, and is ranked equal first among Scottish councils.

5 OVERVIEW

5.1 This document represents the fifth annual report produced by the Internal Audit section of East Ayrshire Council. The report presents an analysis of the performance of the Internal Audit section during the year ending 31 March 2001, and provides a synopsis of the significant audit findings arising from the work carried out in the financial year 2000/2001.

6 STAFFING OF INTERNAL AUDIT

6.1 A review of the Internal Audit structure was carried out in the spring of 2001, taking advantage of the opportunity for restructuring offered by continuing vacancies. This revision has established the new posts of Audit Manager Client Services, Audit Manager Information Technology and a qualified auditor post. The Audit Manager Information Technology post was filled by the existing computer auditor and the posts of Audit Manager Client Services and auditor were filled in July. This brings the section close to full establishment. An assistant auditor post remains to be filled. In addition, there will normally be a trainee accountant from the Finance Department.

6.2 The Chief Auditor, Audit Manager Client Services, Audit Manager Information Technology and the auditor are all CCAB (Consultative Committee of Accountancy Bodies) qualified accountants.

7 AUDIT PLANNING

7.1 A vital element in the effective management of Internal Audit is planning audit work to ensure that objectives are met, priorities are established, resources are targeted and used effectively, and best value is achieved. This involves strategic and annual audit planning.

7.2 A new three year strategic planning, covering financial years 2001/2002 to 2003/2004, was approved by the Policy and Resources Committee on 14 June, 2001. The new strategic audit plan takes account of changed circumstances since the previous strategic plan was prepared in 1998, including council restructuring, new challenges and reordered priorities.

7.3 The Annual Audit Plan provides a detailed list of the specific audit assignments to be carried out during the forthcoming year. This level of detail is required for a number of reasons, including timetabling, staff allocation, and to avoid duplication of effort between internal and external audit. The 2001/2002 annual audit plan was approved by the Policy and Resources Committee on 5 April 2001.

8 AUDIT REPORTS

8.1 Each significant audit assignment results in an 'Action Plan' designed to solicit action, assign responsibility and set a timetable for the implementation of audit recommendations.

8.2 The findings arising from 2000/2001 audit assignments have been discussed with appropriate officers of the Council and agreed action plans have been put in place to address areas for improvement.

8.3 Internal Audit will undertake follow up work to assist management to discharge its responsibility for implementing audit recommendations.

9 PLAN ACHIEVEMENT

9.1 The following statistics have been collated from the audit management systems in relation to 2000/2001:

- Work was performed on 44 major audits and 34 other assignments (37 and 45 respectively in 1999/2000);
- 34 audit reports were produced (25 in 1999/2000);
- 79% of all staff time was spent on direct audit activities (73% in 1999/2000), with the remaining 21% on support activities such as management, performance planning, training and development;
- 1067 audit days were produced against a plan of 1200 days (1186 days in 1999/2000);
- 40% of direct audit time was on responsive activity which had not been able to be pre-planned (35% in 1999/2000).

9.2 The following provides an analysis of audit time by audit function in 2000/2001 (1999/2000 figures are provided for comparison).

<i>FUNCTION</i>	<i>2000/2001 PLAN %</i>	<i>2000/2001 ACTUAL %</i>	<i>1999/2000 ACTUAL %</i>
<i>Systems Reviews</i>	39	35	48
<i>Computer Audit</i>	12	14	9
<i>Value for Money</i>	8	2	1
<i>Location/Probity Audits</i>	4	5	3
<i>Defalcation</i>	16	28	25
<i>Contract audit</i>	4	4	-
<i>Advisory Services</i>	10	3	7
<i>Stocks & Inventories</i>	2	4	-
<i>Performance Indicators</i>	5	5	7
TOTAL	100	100	100

9.3 The audit section operated for part of the year with staff vacancies. The vacancies meant some slippage against the annual plan, however, all priority audit assignments, in particular plan work on core systems, were completed either within the year or early in

2001/2002. Plan slippage was restricted to lower priority assignments, and was caused by the volume of investigative work, which is notoriously difficult to predict.

9.4 The Council's External Auditors have indicated that the Internal Audit section achieved an acceptable level of compliance with the 2000/2001 Internal Audit Plan, and that they have placed reliance on the work carried out by Internal Audit in their annual review of financial systems.

10 RESULTS OF AUDIT TESTING - FINANCIAL SYSTEMS

10.1 The following summarises the audit work on financial systems. In each area, the audit concerns have been discussed with appropriate officers of the council and action plans are in place to effect the necessary improvements.

10.2 **Payroll:** Internal Audit undertook a review of payroll input controls in 2000/2001. The work was designed to test the adequacy of the current controls operated by the payroll section. The total value of salaries and wages processed through the East Ayrshire Council pay office is in excess of £70m per annum. The audit work was carried out using standard audit questionnaires provided by CIPFA, interviews with payroll staff and compliance and substantive testing of payroll input documentation. The conclusion drawn from the audit work was that most of the anticipated controls appear to be operating effectively. Internal control recommendations were made to address identified areas for improvement, including completeness checks, authorisation checks and audit trails.

10.3 **Creditor payments:** This study was undertaken to report on the adequacy of the controls operated in the creditor payment system. The audit approach was to identify and compare actual controls with expected controls. Redundancy of masterfile data was tested by analysis of creditors master data using computer assisted audit techniques ("CAATs"). The CAATs were performed by obtaining downloads of all master data tables, and using two computer packages, namely Microsoft Excel and IDEA, an audit analysis program. The audit also served as a follow-up on earlier audit work in creditor payments. The overall conclusion was that most of the audit recommendations from previous audit work have been acted upon and the remaining ones are being addressed. The audit report included a number of recommendations designed to address identified areas for improvement and these covered procedural documentation, masterfile data maintenance, procedures in place to detect duplicate payments and certification controls.

10.4 **Council Tax:** This study was undertaken to test the adequacy of the controls surrounding the recovery and enforcement of council tax arrears. The study comprised an examination of the systems operated by EAC and applied compliance tests to assess the accuracy, completeness and validity of arrears collection. A new computer-based council tax administration system was introduced in 1998 to replace the systems inherited from Strathclyde Regional Council. The net council tax due for 2000/2001 was £20m. The audit included follow-up work on earlier internal and external audit assignments. The audit approach was to compare actual controls with expected controls as detailed in CIPFA control matrices. This was achieved through completion of audit questionnaires from standard CIPFA audit programmes and through interviews with Revenues staff in the Finance Department. Further audit evidence was obtained through the application of compliance tests to council tax records. The study highlighted a number of areas for improvement, including registration issues, monitoring of payment arrangements, adherence to follow-up timetables and more effective targeting of resources to improve collection performance. Internal Audit has put forward a range of recommendations in the

area of recovery and enforcement which, when implemented, should result in an improvement to the overall control environment.

10.5 Benefits: At the request of the Director of Finance Internal Audit carried out a follow-up audit on the Council's housing and council tax benefit systems. The audit assignment was designed to report on the progress made by the revenue benefits section in implementing recommendations made in previous audit work and by the member/officer working group on benefits administration. The study comprised an assessment of progress against agreed action plans and applied compliance tests to assess the effectiveness of controls operated in the administration of benefits. The audit concluded that many of the required actions had been implemented and these have strengthened the benefits control environment. Audit recommendations were made in the areas of procedural guidance, fraud recording, data matching and verification framework requirements where further action was recommended.

11 RESULTS OF AUDIT WORK ON OTHER DEPARTMENTAL SYSTEMS

11.1 The following summarises the audit work on other departmental systems. In each area, the audit concerns have been discussed with appropriate officers of the council and action plans are in place to effect the necessary improvements.

11.2 Review of Leisure Income systems: This was a planned systems audit of income collection facilities operated by the Recreation Services division of the Department of Community Services. The purpose of the review was to ensure that the controls operated within the department's income collection systems were adequate and being adhered to in practice. The systems examined included the receipt and processing of income, and posting of this income into the financial ledger. The Department of Community Services has the remit for the provision of a wide range of leisure and sporting activities, including sports halls, golf courses, football pitches etc. The day to day management supervision of these facilities falls to the Head of Leisure. Recommendations to address budgetary control, VAT liability and security issues have been implemented.

11.3 Review of Community Education Income systems: Internal Audit undertook a review of the system of income collection within the Community Education service. This work was included in the 2000/2001 audit plan for the Educational and Social Services Department. The control objectives were to ensure income is recorded completely, accurately and timeously. The controls operated were evaluated by comparing them to the expected controls. A number of internal control recommendations were made and these are in the process of being implemented.

11.4 School meals income review: A review of school meals income collection systems was carried out by Internal Audit during 2000/2001. The review was included in the 2000/2001 audit plan for the Educational and Social Services Department. The audit work covered the collection, banking, recording and reconciliation of school meals income. Responsibility for school meals cash collection and banking preparation lies with the catering staff within schools, who are managed by the On-Site Services Business Unit. School meals income generates around £1m annually. The audit concluded that most of the expected controls in the school meals income process are in place and appear to be operating satisfactorily. Internal Audit has put forward a range of recommendations to further strengthen the school meals income control environment and these are being implemented.

11.5 Review of cash collection procedures in Social Services: Internal Audit undertook a planned piece of work on cash collection in Social Services offices. The study comprised an examination of the cash collection systems using CIPFA control matrices. Income at Social Services offices comprises mainly of payment of home help accounts, respite care bills and returns of unused cash advances. The audit concluded that at present income levels current procedures appear to be adequate. Control recommendations were made in the areas of cash handling procedures, record-keeping and security issues and these have been implemented.

11.6 Review of Local Office procedures: The control environment surrounding the operation of one of the Council's Local Offices was examined with a view to identifying areas for improvement and making appropriate recommendations. Internal Audit made a number of recommendations to improve the overall control environment and these have been implemented, e.g. guidance on retention periods for cash collection documentation, treatment of over and under payments and reconciliation procedures.

11.7 Multi-Storey car park systems review: Internal Audit undertook a review of the system for collecting car park income at the multi-storey car park in Kilmarnock. The work was included in the 2000/2001 audit plan for the Development Services Department. The study was undertaken to report on the adequacy of controls for collecting, remitting and recording car park income. Car park income is considered to be a high risk area, based upon experience and the inherent risk associated with the volume of cash handling. Recommendations made in the areas of procedural guidance for staff, ticket and income monitoring arrangements and security measures are being implemented.

11.8 Mapping the housing repairs process: A flow diagram was produced for the Director of Homes and Technical Services of the EAC housing repairs process from the point the repair request is first reported to the Council, through to payment of the contractor's invoice. This work was used to inform the Best Value Review of the housing repairs service and will help to inform future audit work in this area.

11.9 Building & Works Stores: Over recent years considerable efforts have been made to secure improvements in Building and Works stores arrangements. During this period Internal Audit has made a number of recommendations to improve stores controls. Building and Works stores were revisited by Internal Audit at the 2000/2001 year end to appraise the operation of stores controls. The audit concluded that progress continues to be made across a range of stores issues. Internal Audit has put forward a range of recommendations covering continuous stockchecking, stores reconciliation procedures, stockholding levels and disposal of surplus/obsolete stock and these are being implemented.

12 RESULTS OF AUDIT TESTING - SPECIALIST AUDIT AREAS

12.1 Computer audit

12.1.1 Installation Review: Work on reviewing the draft corporate ICT (Information and Communication Technology) Strategy was carried out and a number of observations and comments were fed into the review process. The second release of the draft ICT Security Policy was reviewed by Internal Audit and a number of recommendations were made to

assist the review process. Internal Audit also made contributions in the areas of the IT Security User Code of Practice and e-mail monitoring procedures.

12.1.2 Computer Assisted Audit Techniques (CAATs): Computer audit relates, not only to the audit of controls around computerised systems, but also to the use of computers in performing audit tasks. This type of work is referred to as computer assisted audit techniques (CAATs). CAATs can improve the efficiency and effectiveness of the internal audit service. During the 2000/2001 audit year, CAATs were used on a number of audit assignments, including systems work, contract audit, performance indicators and special investigations.

12.2 Contract Audit: *Internal Audit undertook a review of contract tendering procedures administered by the Technical Services division of Homes and Technical Services. This was a 2000/2001 plan item. The audit assignment was designed to ensure that the controls relating to the selection of contractors for inclusion on the approved list of contractors, and those covering the invitation to tender and receipt and opening of tenders, are adequate and being adhered to in practice. CIPFA risk identifiers and internal control questionnaires were used to assess procedures. The audit work covered the award of building contracts and associated works. The audit concluded that there was scope for improvement in the areas of procedural guidance for staff, financial appraisals, technical appraisals and the timetable for review of approved contractors. An action plan to further strengthen the control environment has been produced by Internal Audit, and is being implemented.*

12.3 Value for Money: *Section 170 of the Local Government etc. (Scotland) Act 1994 imposed a statutory duty on Local Authorities to make proper arrangements for securing economy, efficiency and effectiveness in the use of resources. One means of discharging this obligation is through value for money studies. A three-year Value for Money Plan, covering the years 2000/2001 to 2002/2003, was agreed by the Policy and Resources committee in November 2000. The plan laid out the list of studies to be undertaken jointly by Internal Audit and relevant departments over the three year period. A study on 'invoicing and billing' was scheduled for year 2000/2001. The purpose of this study was to review the current procedures for the issue, collection and follow-up of debtor invoices with the aim of identifying areas where increased value for money could be achieved. The study identified scope for increased cash flow and income from more efficient billing and more effective recovery of arrears. Council services are examining each income stream to identify scope for increased efficiency in the billing process.*

12.4 Performance Indicators: *The Local Government Act 1992 placed a statutory duty on all councils to publish performance indicators. Since 1993 councils have had a duty to collect, record and publish defined performance indicators under the direction of the Accounts Commission. The External Auditor has a duty to satisfy himself that councils have made proper arrangements for collecting, recording and publishing performance indicator data and to test the accuracy and completeness of the data. As in previous years Internal Audit played an important role in assisting both the Council and the External Auditor in discharging these responsibilities. Internal Audit undertook selective audit work on the accuracy and completeness of the 1999/2000 performance indicators. The audit conclusions were that there had been an improvement in the accuracy and completeness of performance indicator data returned by departments for 1999/2000 and recommendations were made to address the identified areas for improvement. In February*

Internal Audit examined the preparation of housing indicator 1, measuring performance on housing response repairs, under a trial run exercise in the half year April to September 2000. The audit work identified a number of areas to address in order to achieve reliable indicator status for the 2000/2001 housing response repairs indicator and this was achieved.

*12.5 **Investigative work:** Internal Audit carried out work on 17 investigations in the year ended 31 March 2000, representing 28% of audit time and 300 audit days, at least 9 of which involved significant audit resources. The audit findings arising from this investigative work were reported to appropriate officers of the council for the purpose of disciplinary action. At the conclusion of each investigation Internal Audit have made appropriate recommendations in order to minimise the chances of any recurrence of these types of incident. Defalcation investigations are referred the Police, in accordance with the Council's Defalcation Procedures.*

13 OVERALL ASSESSMENT OF CONTROLS

13.1 It is the view of the Accounts Commission that a sound control environment is an essential prerequisite to the efficient management of any local authority, and is an important element of the culture of the organisation. Responsibility for stewardship of public funds rests firmly with the Council and its officers. The role of Internal Audit is to assist in the discharge of this responsibility with particular reference to the necessary establishment, operation and effectiveness of internal controls.

13.2 The Accounts Commission has stated that each council must arrange for a properly resourced internal audit service of good quality. They have expressed the view that it is difficult to see how stewardship responsibilities can be satisfactorily discharged in the absence of sound internal audit support.

13.3 Audit Scotland has undertaken a national benchmarking study by assessing the performance of internal audit services in all Scottish Councils, against the standards set by the CIPFA Code of Practice for Internal Audit in Local Government. The national report was published in August 2001 and this placed East Ayrshire Internal Audit in band one, which includes those Councils (four in total) who most fully comply with the CIPFA Code.

13.4 This annual audit report provides a summary of the performance of the Internal Audit Section in the audit year 2000/2001. All priority audit assignments were either completed during the audit year or shortly into the new audit year. Performance, in terms of numbers of audits and the percentage of audit time spent on direct audit activities compares favourably with the previous audit year. Staff turnover was addressed through prioritisation of work and careful management of resources.

13.5 The 2000/2001 audit plan pursued an income theme, and this is reflected in the summary of audit work in the earlier sections of this report. The audit of income systems has identified certain gaps in controls and controls requiring further strengthening in some areas examined. Internal Audit has made a number of recommendations to address the areas for improvement.

13.6 During financial year 2000/2001 significant audit resources were deployed on investigative work. Effective internal control systems will reduce the potential for defalcation and it is therefore essential that there is the fullest awareness of the importance of internal controls.

13.7 Internal Audit carried out a review of several of the Council's main financial systems in 2000/2001, including payroll, payments, council tax and benefits. Part of this work involved follow-up of audit recommendations arising from earlier pieces of audit work. In general terms the conclusion drawn from the audit work was that most of the anticipated controls were in place and operating effectively and, in terms of audit follow-up, most of the audit recommendations arising from earlier work had been implemented.

13.8 The 2000/2001 audit of departmental systems has identified that many of the expected controls are in place and operating satisfactorily in the areas examined. The audit work has, however, also revealed gaps in controls and controls requiring strengthening in some of the areas examined, and identified scope for improvement.

13.9 Internal Audit has put forward a range of recommendations in the areas examined and action plans have been developed in consultation with management which, as they are implemented, should result in continued improvement in the overall control environment.

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26 September 2001

AGENDA