

**EAST AYRSHIRE COUNCIL**

**POLICY AND RESOURCES COMMITTEE – 5 OCTOBER 2000**

**INTERNAL AUDIT – ANNUAL REPORT 1999/2000**

**Report by the Chief Auditor**

**1. PURPOSE OF REPORT**

- 1.1** To submit to Members details of the Internal Audit Annual Report 1999/2000.

**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 1999/2000**

- 3.1** The 1999/2000 Audit Plan was agreed by the Policy and Resources Committee on 23 April, 1999. The attached report (Appendix 1) summarises the audit work carried out in 1999/2000.
- 3.2** The Council's External Auditors have confirmed that the Internal Audit section achieved an acceptable level of compliance with the 1999/2000 Internal Audit Plan.
- 3.3** Internal Audit have 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. RECOMMENDATIONS**

- 4.1** Members are asked to note the contents of the Internal Audit Annual Report 1999/2000.

Colin Houston  
**Chief Auditor**

CH/P&R.2

**LIST OF BACKGROUND PAPERS**

Nil.

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

**APPENDIX 1  
EAST AYRSHIRE COUNCIL**

**INTERNAL AUDIT - ANNUAL REPORT 1999/2000**

**Report by the Chief Auditor**

**1 PURPOSE OF REPORT**

1.1 To summarise the activities and findings of Internal Audit in 1999/2000.

**2 BACKGROUND**

2.1 The Accounts Commission guidance on corporate governance stresses the need for adequate stewardship of public funds. It places this responsibility on elected members and officers.

2.2 The guidance further advises that this responsibility is only discharged where management achieves a number of aspects of corporate governance, including:

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

2.5 Internal controls are the system of controls, both financial and otherwise, which are established by management in order to:

- safeguard assets;
- ensure reliable records;
- promote operational efficiency;
- ensure adherence to Council policies and directives.

2.6 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 OVERVIEW**

3.1 This document represents the fourth 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 financial year ending 31 March 2000 and provides a synopsis of the significant audit findings arising from the work carried out in the financial year 1999/2000.

3.2 Internal Audit's principal objectives are independently to appraise, measure, evaluate and report on the adequacy and effectiveness of the Council's internal control arrangements. Internal Audit also has a role to play in assisting the Council to secure value for money and in the dissemination of best practice.

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 audits, audit probes, location audits and defalcation investigations.

#### **4 STAFFING OF INTERNAL AUDIT**

4.1 A review of departmental structures was carried out in 1998. The restructuring included the transfer of Internal Audit from the Finance Department to reporting direct to the Chief Executive. This move was one of a number of transfers designed to strengthen corporate governance within the Council. Following the recent reorganisation of Council Departments, the Chief Auditor continues to report to the Chief Executive.

4.2 During 1999/2000, the Internal Audit section had a staffing complement of 5.6 full time equivalent staff reporting to the Chief Auditor. This consisted of three senior auditors, including a computer auditor, and 2.6 assistant auditors, with 1.4 vacancies arising within establishment. In addition, there will normally be a Finance Department CIPFA trainee seconded to the section. A skillseeker was added to the section in August 1999. The Chief Auditor and the three senior audit staff are all CCAB (Consultative Committee of Accountancy Bodies) qualified accountants. Consideration is currently being given to a possible revision to the audit staffing establishment, taking advantage of the opportunity for restructuring offered by the continuing vacancies.

#### **5 AUDIT PLANNING**

5.1 The effective management of Internal Audit requires work to be carefully planned and controlled to ensure that the responsibilities of Internal Audit are properly discharged.

5.2 A strategic planning process is maintained, and the key output from this is the Annual Audit Plan. The Annual Audit Plan for 1999/2000 was prepared following full consultation with service directors, the Director of Finance and the Chief Executive and was approved by the Policy and Resources Committee on 23 April 1999.

5.3 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.

## 6 AUDIT REPORTS

- 6.1 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.
- 6.2 The findings arising from 1999/2000 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.
- 6.3 Internal Audit will undertake follow up work to assist management to discharge its responsibility for implementing audit recommendations.

## 7 PLAN ACHIEVEMENT

7.1 The following statistics have been collated from the audit management systems in relation to 1999/2000:

- Work was performed on 37 major audits and 45 other assignments;
- 25 audit reports were produced;
- 73% of all staff time was spent on direct audit activities (67% in 1998/99), with the remaining 27% on support activities such as management, performance planning, training and development;
- 1,186 audit days were produced against a plan of 1,275 days;
- 35% of direct audit time was on responsive activity which had not been able to be pre-planned (39% in 1998/99);

7.2 As would be expected, the volume of reactive audit work caused some slippage against the 1999/2000 Annual Audit Plan, However, all priority audit assignments, in particular plan work on core systems, were completed either within the year or early in 2000/2001. Plan slippage was restricted to lower priority assignments.

7.3 The following provides an analysis of audit time in 1999/2000 (1998/99 figures are provided for comparison).

FUNCTION	1999/2000 PLAN %	1999/2000 ACTUAL %	1998/1999 ACTUAL %
Systems Reviews	39	48	26
Computer Audit	15	9	7
Value for Money	8	1	4
Location/Probity Audits	3	3	44
Defalcation	10	25	8
Contract audit	4	-	1
Advisory Services	12	7	3
Stocks & Inventories	3	-	1
Performance Indicators	6	7	6
<b>TOTAL</b>	<b>100</b>	<b>100</b>	<b>100</b>

7.4 The Council's External Auditors have indicated that the Internal Audit section achieved an acceptable level of compliance with the 1999/2000 Internal Audit Plan.

## **8 RESULTS OF AUDIT TESTING - FINANCIAL SYSTEMS**

8.1 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.

8.2 **Payroll:** Work on the teachers' payroll was carried out during 1999/2000. The audit work was designed to test the adequacy of the controls over payments to permanent and temporary teachers. The audit work led to a number of internal control recommendations to address identified areas for improvement. These related to the need for independent cross-checking of teacher salary rate calculations, over and under payments of salary which require remedial action and teacher pay advices for some permanent staff being sent directly to the teacher's home address rather than being sent to the appropriate school for distribution.

8.3 **Cash Collection:** *Internal Audit undertook a review of the system for collection of cash during 1999/2000. A sample of cash collection offices, including the main collecting hall at John Dickie Street, Kilmarnock, the Local Office at Greenholm Street, Kilmarnock and the Dalmellington Local Office were visited during the course of this work. The audit work identified a number of areas for improvement affecting security, procedural guidance, record keeping and the checking of daily exception reports for cancellations and cash discrepancies.*

8.4 **Budgetary Control:** *The audit work was designed to report on the adequacy of controls surrounding the monitoring of General Services Revenue budgets. In 1998 an examination of the Council's budgetary control arrangements was undertaken by an external COSLA consultant which resulted in the introduction of outposted accounting teams and the establishment of a member/officer Budget Monitoring Group. The audit work concluded that most of the expected controls in the budgetary control process were in place, and implementation of recommendations in the COSLA consultant's report has strengthened the process. Recommendations were made in the areas of written procedural guidance and documentary back-up for budget adjustments.*

8.5 **Housing Benefits:** *A review of the housing benefit fraud prevention and detection systems was carried out during 1999/2000. The audit work was complementary to the work carried out by the member/officer working group which was set up in 1999 to address issues facing the benefit service. Benefit fraud has been identified by central government as an area of concern and a*

*number of initiatives have been introduced, including the establishment of a Benefit Fraud Inspectorate, verification framework, Weekly Benefit Savings and prosecution incentives, to aid the prevention and detection of benefit fraud. Considerable progress has been made to improve processes and put the service on a sound footing. The Council can anticipate external appraisal from central government via the Benefits Fraud Inspectorate and it is essential that process improvements continue to be monitored in order to consolidate the excellent work already carried out. The audit work resulted in recommendations to address general concerns including a need for detailed procedural guidance and training for staff, the adoption of the verification framework and policies covering prosecutions and penalties.*

## **9 RESULTS OF AUDIT WORK ON OTHER DEPARTMENTAL SYSTEMS**

**9.1 Review of External Funding Arrangements:** *The objective of this audit assignment was to review East Ayrshire Council's implementation of the Accounts Commission's Code of Guidance on "Funding External Bodies and Following the Public Pound". East Ayrshire Council support a number of external organisations with loans, grants and benefits in kind. The code contains guidance on purposes, financial regime, monitoring arrangements, representation, limitations and accountability. The audit conclusions are that arrangements had been put in place which secure compliance with most areas of the code of guidance. A number of audit recommendations have been made in the areas of financial appraisals, contractual agreements and monitoring arrangements in order to secure complete coverage.*

**9.2 Foster and Adoption Allowances:** *Internal Audit undertook a review of the system for awarding foster and adoption allowances in the 1999/2000 audit year. The audit included compliance testing to assess the accuracy, completeness and validity of allowances awarded. The audit findings reveal scope for strengthening the controls surrounding the calculation and payment of foster and adoption allowances. Internal control recommendations have been made in the areas of procedural guidance, checking and certification of payments and overpayments.*

**9.3 Business Unit Systems Overview:** *Internal Audit carried out a systems review of the various business units operating within East Ayrshire Council. The audit was designed to provide an overview of the controls operated in respect of cash control, payroll, recharges, purchasing, budgetary control and stores. Areas for improvement have been discussed with business unit management and internal control recommendations have been made in respect of IT systems and payroll controls.*

**9.4 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 1999/2000 year end to appraise the operation of stores controls. The main audit conclusions are that significant progress*

*has been made across a range of stores issues. Reconciliation difficulties between the Financial Management System and the Stores ledger system remain to be fully resolved; it is anticipated that procurement of a new IT system for Building & Works will address outstanding issues.*

## **10 RESULTS OF AUDIT TESTING - SPECIALIST AUDIT AREAS**

### **10.1 Computer audit**

**10.1.1 New Financial Management System (FMS):** The new FMS will replace a number of existing packages including the general ledger, budgetary control, creditor payments, debtors and cash receipting systems. The project involves the purchase of the SAP accounting system, representing a very significant investment by the Council. Benefits of the new system will include better integration of key systems, improved control of budget commitments, tighter security and more flexible reporting. Internal Audit has participated in project development, making specific input on cash receipting, procurement processes, licensing aspects and the supplier's system specification.

*10.1.2 Year 2000: Internal Audit was represented by the computer auditor on the Year 2000 corporate working group which monitored progress to prevent disruption to the Council's business as a result of the 'millennium bug' threat.*

**10.1.3 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 Internal Audit. During the 1999/2000 audit year, CAATs were used on a number of audit assignments, including systems work and special investigations.

**10.2 Value for Money:** *A three-year Value for Money Plan, covering the years 1997/98 to 1999/2000, was agreed by the Finance and Property Sub-Committee of Policy and Resources in September 1997. The plan laid out the suggested studies to be undertaken jointly by Internal Audit and relevant departments over the three year period. Between 1997/98 and 1998/99 studies on PC disposal, Social Work unit costs and income maximisation were completed. In 1999/2000 a study on business loans and grants was commenced within the Economic Development service of Development Services and the results of the study are anticipated in 2000/2001. Proposed studies on property utilisation, use of transport and risk management have been subsumed within broader council developments. In the case of the proposed study on property utilisation a member/officer working group is carrying out work in this area, a client liaison group is currently reviewing transport issues and risk management has already been subject to a root and branch review with the appointment of a council risk manager within the Finance Department. A new three year Value for Money Plan (2000/01 to*

2002/03) is being developed for consideration by the Policy and Resources Committee.

**10.3 Performance Indicators:** *Internal Audit and External Audit jointly carry out the audit of statutory performance indicators for East Ayrshire Council. The work carried out in 1999/2000 related to the 1997 Accounts Commission Direction and the 1998/99 indicators. The audit work consisted of a high level review of performance indicator data, collection systems and procedures. The audit work identified some areas for improvement and these have been included in an action plan designed to improve data collection systems and procedures. The audit identified scope for improvement in the areas of departmental checking of data prior to release and the standard of working papers. These issues are being progressed by relevant officers across the council.*

#### **10.4 Special investigations**

10.4.1 Internal Audit carried out work on 19 special investigations in the year ended 31 March 2000, representing 25% of audit time and 300 audit days. Some of these were relatively minor but at least six involved significant audit resources including misappropriation of car park income, cash collection defalcations, sub contractor usage, unauthorised use of equipment and external organisation fiscal management.

10.4.2 All departments have been made aware of the importance of immediate reporting of known or suspected defalcations to Internal Audit under the terms of the Council's Defalcation Procedures. Revised Defalcation Procedures were circulated to all Council departments during 1999/2000.

10.4.3 Corporate action was taken during the course of the year to emphasise the importance of strict adherence to Accounting Policy Bulletins, and in particular guidelines relating to cash handling have been further developed departmentally to be of specific individual relevance to the variety of circumstances which occur across council services.

### **11 OVERALL ASSESSMENT OF CONTROLS**

11.1 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.

- 11.2 During financial year 1999/2000 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.
- 11.3 Several of the defalcation investigations highlighted gaps in income monitoring procedures. It is essential that income monitoring and analysis of income trends is carried out not only to inform the budgetary control process but also to highlight at an early stage any potential financial irregularities. The 2000/2001 Audit Plan was deliberately constructed with an income theme in order that Internal Audit could offer advice and assistance in this key area.
- 11.4 The Director of Finance issued Accounting Policy Bulletin (APB) Manuals to all departments of the Council in 1998. The APBs cover basic financial controls in areas such as cash handling, creditor payments, inventories etc. This initiative is viewed as a positive step towards improving the control environment surrounding our main financial systems. There is potential for further development of the Accounting Policy Bulletin approach. The Director of Finance has confirmed that new APBs are currently being developed.
- 11.5 The lack of fully adequate procedural documentation continues to be highlighted as a common weakness both for financial systems and departmental systems. Written procedures are an essential management control to ensure that basic financial controls are operated and are operated consistently. Progress has been made in this area and it continues to be strongly advocated that complete and comprehensive systems documentation is fully established as quickly as possible. Corporate instruction has been issued to help expedite action in this area.
- 11.6 As inherited systems are replaced by new systems the opportunity should be taken to develop sound controls in addition to the functionality of new systems. It is also essential that adequate training is provided for staff and procedural guidance is made available at the implementation of new systems. Internal Audit will continue to support systems development and offer advice and assistance in the area of internal controls.
- 11.7 It is important to recognise that a great deal of positive work has been carried out across the Council to effect systems and process improvements over the course of the last year, and indeed in the period since reorganisation of local government. The 1999/2000 audit has

identified certain gaps in controls and weak controls in some of the areas examined, and identified scope for improvement.

11.8 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.

Colin Houston  
**Chief Auditor**  
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**AGENDA**