ANNUAL REPORT OF THE

INTERNAL AUDIT SERVICE

2012/13

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1. **INTRODUCTION**

The Annual Reporting Process

1.1 Management is responsible for the system of internal control and should set in place policies and procedures to help ensure that the system is functioning correctly. Internal Audit review, appraise and report on the effectiveness of the system of internal control. This report is the culmination of the work during the course of the year and seeks to:

- provide an opinion on the adequacy of the control environment;
- comment on the nature and extent of significant risks; and
- report the incidence of significant control failings or weaknesses.

1.2 This report is a summary of the work of the Section throughout 2012-13. As such it presents a snapshot picture of the areas at the time that they were reviewed and does not necessarily reflect the actions that have been or are being taken by Managers to address the weaknesses identified. The recommendations made will be progressing through the normal management processes.

Requirement for Internal Audit

1.3 The **role of internal audit** is to provide management with an objective assessment of whether systems and controls are working properly. It is a key part of a Council's internal control system because it measures and evaluates the adequacy and effectiveness of controls so that:

- Members and senior management can know the extent to which they can rely on the whole system; and
- Individual managers can know how reliable the systems are and the controls for which they are responsible.

1.4 The internal control system is comprised of the whole network of systems and controls established to manage the Council to ensure that its objectives are met. It includes financial and non-financial controls, and also arrangements for ensuring that the Council is to achieve value for money from its activities.

1.5 The requirement for an Internal Audit function derives from local government legislation including Section 151 of the Local Government Act 1972 which requires authorities to "make arrangements for the proper administration of their financial affairs". Proper administration includes Internal Audit. More specific requirements are detailed in the Accounts and Audit Regulations 2011, in that a relevant body must "maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control"

2. **Adequacy and Effectiveness of the internal control environment**

How Internal Control is reviewed

2.1 The Audit Manager prepares an annual risk based audit plan which takes into account the adequacy of the organisations risk management, and other assurance processes.

The plan outlines the areas that will be reviewed in terms of their priority and resources required to undertake the review.

2.2 The assessment comprises the two key elements of risk:-

(i) Impact i.e. the materiality/importance of the system in achieving the Council's objectives; and

(ii) Probability, which includes:-

- the results of previous work in the service area/system, both internal and external reviews and also takes into account the last time it was audited;

- the inherent risk, i.e. the underlying potential for fraud; and

- the nature and volume of the transactions, which includes financial materiality.

2.3 This risk based approach to audit planning results in a comprehensive range of audits that are undertaken during the course of the year to support the overall opinion on the control environment. Examples include:-

- system based reviews of all key financial systems that could have a material impact on the accounts e.g. payroll, creditors, council tax and housing benefits;

- regulatory audits of Council establishments e.g. leisure centres;

- systems based reviews of departmental systems/service areas e.g., planning, human resources, and health and safety;

- corporate reviews e.g. corporate governance arrangements and risk management, and

- a small contingency for special investigations and the provision of ad hoc advice.

Internal Audit Opinion for 2012-13 and the Annual Governance Statement (AGS)

2.4 Regulation 4 of the Accounts and Audit Regulations 2011 requires that:-

"The relevant body shall be responsible for ensuring that the financial management of the body is adequate and effective and that the body has a sound system of internal control which facilitates the effective exercise of that body's functions and which includes risk management arrangements."

"The relevant body shall conduct a review at least once in a year of the effectiveness of its system of internal control and shall publish a statement on internal control, prepared in accordance with proper practices, with any statement of accounts it is obliged to publish."

2.5 Internal Audit, along with other assurance processes of the Council, have a responsibility to provide assurance from the work they undertake during the year in respect of the internal control systems operating within the Council.

> *Based on the work undertaken during the year and the implementation by management of the audit recommendations, Internal Audit can provide **reasonable assurance** that the Council's systems of internal control were operating adequately and there were no breakdown of controls resulting in material discrepancy.*

2.6   However, no system of control can provide absolute assurance against material misstatement or loss, nor can Internal Audit give that assurance. This statement is intended to provide reasonable assurance that there is an ongoing process for identifying, evaluating and managing the key risks. These risks are reflected in the audit plan and are the subject of separate reports during the course of the year.

3.   SIGNIFICANT ISSUES ARISING 2012-13

3.1   Internal Audit examined 44 systems in 2012-13. During the conduct of our audit work we have had regard to the following objectives of internal audit:

- to review and appraise the soundness, adequacy and application of the whole system of internal control;
- to ascertain the extent to which the whole system of internal control ensures compliance with established policies and procedures;
- to ascertain the extent to which the assets and interests entrusted to or funded by the Authority are properly controlled and safeguarded from losses of all kinds;
- to ascertain that management information is reliable as a basis for the production of financial, statistical and other returns;
- to ascertain the integrity and reliability of information provided to management including that used in decision making, and
- to ascertain that systems of controls are laid down and operate to achieve the most economic, efficient and effective use of resources.

3.2   Within the Audit Plan there are 10 review areas that are categorised as High Risk Business Critical Systems. These reviews are undertaken annually, full reviews of all systems are conducted every other year with key controls being examined in between. A summary of the level of assurance for each review area together with the number of recommendations made is shown in the table below;

Audit Area	Level of Assurance Given	Number of Recommendations made		
		High	Medium	Low
Payroll	Well Controlled	0	1	3
Asset Management (Capital)*	Well Controlled	0	0	0
Cash Management*	Adequately Controlled	3	2	4
Council Tax	Well Controlled	1	0	1
Creditors	Adequately Controlled	0	2	3

Audit Area	Level of Assurance Given	Number of Recommendations made		
Treasury Management	Well Controlled	0	0	1
NNDR	Well Controlled	1	0	1
General Ledger	Well Controlled	0	0	0
Housing Benefits*	Well Controlled	0	1	0
Sundry Debtors	Adequately Controlled	1	3	4

denotes systems where only key controls examined in 2012-13

3.3   A summary of the level of assurance, for all of the systems covered in 2012/13 by risk category, is given in the table below:-

Risk	Assurance			
	Full	Substantial	Limited	Little
High (A)	9	4	2	0
Medium (B)	1	26	1	0
Low (C)	0	0	1	0
	10	30	4	0

Opinions are classified as:

Full: The audit did not reveal any control weaknesses based on the samples at the time of the audit.

Substantial: The audit identified areas that required necessary action to avoid exposure to significant risk.

Limited: The audit identified areas where it was imperative to act to avoid exposure to high risks.

Little: The audit identified very little evidence of key controls being in place or a repetition of evidence that known action has not taken place to avoid exposure to high risk, i.e. as identified in previous audits. This exposes the Council to high risks that should have been managed.

3.4   Whilst there are 4 audits that have been classified as Limited Assurance most of these do not have a significant impact on the Council as a whole, many require a small number of changes to be introduced which will lead to significant improvements in the control environment. .

3.5   The main recurring themes across the audits are (figures in brackets demonstrate proportions of outstanding recommendations in these risk areas for 2012/13):

- The lack of written procedures and standards. Without these inconsistencies in working practices can develop, controls can be lost and cover in the event of absences can be haphazard. There is a need to ensure that all employees are made aware of the working practices that they should be following to ensure that they comply with the correct procedures. During 2012/13 procedure notes were found to be in place for the majority of the business critical systems, however in some instances it was found that these required updating. (23 per cent).

- The completeness and accuracy of records within service areas is important. 25 per cent of the recommendations made during 2012/13 related to issues where records had not been completed correctly, or the correct information was not found. Whilst the categorisation of recommendation accounted for 25 per cent of those made during 2012/13 none of these were categorised as high risk, the majority of these were medium or low and served to act as reminders to staff to ensure care is taken over the recording of data in relation to their particular service areas.

- Non compliance with Standing Orders and Financial Regulations was found in a number of areas particularly in relation to the lack of stock and inventory controls, there were also a few relatively minor issues in relation to compliance with contract procedures (11 per cent)

- Completion of risk assessments and ensuring that risk assessments were kept up to date is another common area where recommendations were made. 14 per cent of the recommendations outstanding at the end of the financial year related to risk assessments.

- Another key area that Internal Audit reviews as part of their work is issues of Information Security. 14 per cent of the recommendations outstanding related to this area, and included issues such as ensuring compliance with the Council's policies on Information Security Management.

- The remaining 13 per cent of recommendations were categorised in terms of business continuity (1 per cent), incomplete management information (4 per cent) staffing issues, particularly in relation to training matters (3 per cent), issues of physical security (2 per cent), separation of duties (2 per cent), and inadequate review processes (1 per cent).

3.6 In addition to the planned audits 10 special projects were carried out , these were due to various breaches of council policy, procedures and regulations. In all cases where a lack of managerial controls were found to contribute to the improper conduct of officers; a managerial report is completed which highlights the weakness and makes recommendations accordingly. The recommendations from these reports are followed up in the usual way.

3.7 Of the 10 special projects identified above, 5 were as a result of the Council's Whistleblowing Policy, and 5 from management.

3.8 In relation to main systems, recommendations arising are analysed further in the following section.

4 **ANALYSIS OF COMMON OR MATERIAL WEAKNESSES**

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Analysis of recommendations

4.1 During the period 1/4/12 to 31/3/13 a total of 503 recommendations have been made, of these 43 recommendations were outstanding as at the 31 March 2013. In total 460 recommendations have been implemented, 91%.

Recommendations are classified as:

High:	Action that is considered imperative to ensure that the authority is not exposed to high risks:
Medium:	Action that is considered necessary to avoid exposure to significant risks:
Low:	Action that is considered desirable and which should result on enhanced control or better value for money.

In this context, 'risk' may be viewed as the chance, or probability, of one or more of the association's objectives not being met. It refers both to unwanted outcomes that might arise, and to the potential failure to realise desired outcomes.

4.2 The following table shows the spilt of recommendations over high, medium and low for those that were due for implementation by the 31 March 2013:

	ALL	IMPLEMENTED	OUTSTANDING
High	88	82	6
Medium	262	240	22
Low	153	138	15
TOTAL	**503**	**460**	**43**

Target 2012/13	95%
Per Centage Implemented since April 2012	91%
Proposed target 2013/14	96%

4.3 Compliance with the agreed action plan will ensure that these risks are addressed. Management has given assurance that the action plans will be completed in accordance with the timetables specified.

Details of major findings not acted upon

Acceptance of recommendations

There were no recommendations rejected by Management during the year.

Recommendations not receiving adequate management attention

4.4 There are no high or medium risk recommendations that we consider are not receiving adequate management attention. Where appropriate outstanding high risk recommendations are reported to Audit and Risk Committee on a quarterly basis.

5 **AUDIT PERFORMANCE**

Work planned to be completed

5.1 The following table gives a summary of the results of the performance indicators since 2010/11, together with details of actual figures for 2012/13, and target for 2013/14;

Indicator	2010/11 actual	2011/12 actual	2012/13 actual	2013/14 target
Percentage of audit plan completed	93%	92%	91%	90%
Productivity of staff	76%	83%	85%	74%
Recommendations implemented	83%	88%	91%	92%
Medium to high satisfaction of the service from surveys	86%	93%	91%	90%

5.2 The table below indicates the performance against the audit plan for 2012/13, split over the 3 different risk categories for audits and for the audit plan in total.

	Planned	Actual	Actual (%)
High Risk Audits	23	23	100%
Medium Risk Audits	30	26	86%
Low Risk Audits	0	0	0
Achievement of the Audit Plan	53	49	92%

5.3 The 2012/13 audit plan as approved by Audit and Risk Committee provided for 534 days of audit work.

5.4 The level of productivity within the Section met was 85% against the target of 74% that was set at the start of the year. Each year the total resources available in Internal Audit are evaluated in terms of audit days, each day representative of 7.4 working hours. This figure is adjusted for leave, training, sickness, supervision, corporate work and a contingency allowance. The resulting sum is classed as productive days available for the year, for this reason it is not possible to achieve 100% staff productivity.

5.5 Out of 53 planned audits, 49 were completed, 92% against a target of 90%.

5.6   Completion of audits against the total plan does include some of the Audit Manager's time, since with the time being recorded direct to audit areas it is not practical to identify and remove it completely.

5.7   Satisfaction levels in terms of the service remained high at 91% this is above the set target of 85%. Any comments and feedback that is received following each audit is constantly reviewed to ensure that the service continues to meet the expectations of our customers.   During 2013/14 we are looking to implement electronic surveys through the use of Safevoice. This is a software tool recently purchased by the Council which enables communications to be delivered effectively electronically straight to the desktop.

Factors affecting the extent of our internal audit work

5.8   There are a number of issues that have affected the extent of our internal audit work during the year, they are:

- the audit technicians have continued to gain knowledge and understanding of their roles which has been evident in the completion of a high percentage of the audit plan in addition to completing a number of special projects.
- the completion of work as part of a number of special investigations that has absorbed in excess of 50 days audit time, 10% of the original available planned time.
- the Audit Manager completed a two day Fraud Loss Measurement Training course, which has provided a useful tool that can be used to identify the extent of losses as a result of fraud or error. The methodology learned from this training was applied to an area of procurement where a number of issues were identified that will enable the council to streamline areas of the business with a view to making efficiency savings. It is intended to look at this on an annual basis as part of the audit plan and review different service areas across the authority.
- The audit team has supported students from Newcastle College's Career Academy programme. During the summer we hosted 2 students on a 4 week internship, the students were studying for a BTEC in Business and Finance. The internship provide the students with valuable work experience that will hopefully assist them with their future career choices.

6.0   **NON AUDIT AREAS**

6.1   This is work undertaken by the Internal Audit Section that is not directly related to audit areas and includes administration, supporting the corporate management of the authority, professional and staff training and attendance at Staffordshire Chief Auditors Group meetings. Non-audit work in 2012/13 accounted for 180 days.

6.2   The Internal Audit Section provides support; advice and guidance to corporate initiatives, this year this has included attendance at the Corporate Governance Working Group, the Procurement Working Group, the Health and Safety Committee and the Information Security Group. In addition the Audit Manager is a member of the Resources and Support Services Departmental Management Team and also a member of the corporate Wider Management Team.

7.0   **OPERATIONAL PLANS FOR 2013/14**

7.1 Internal Audit will continue to identify ways to actively promote awareness of risks in relation to fraud and corruption in line with the national strategy 'Fighting Fraud Locally'. A fraud awareness campaign is planned for summer 2013 and this will make use of a toolkit which has been produced by the National Fraud Authority which is designed to assist local authorities to raise the profile of fraud awareness throughout their organisations. This toolkit utilises a poster campaign, an e-learning training course as well as a publicity campaign.

7.2 The contract for computer auditing will again be provided by CW Audit Services. CW Audit Services successfully won the contract to provide computer audit services for a second year.

7.3 The Section will continue to review and improve its service where appropriate. It will also ensure that adequate training is provided and the role of the Audit and Risk Committee is developed in line with best practice.

7.4 The Audit Manager will continue to mentor and coach staff within the section to ensure that the team continues to develop and improve its knowledge and experience in all aspects of audit work.

7.5 The Audit Manager will continue to raise the awareness of Information Security in order to ensure that the Authority maintains high standards in terms of the information/data that is held within the organisation, this will be increasingly important as we begin to share accommodation with external partners etc.

7.6 Internal audit will continue to support students from Newcastle College's Career Academy Programme. This involves providing a 4 week internship which is completed over the summer months by students interested in pursuing a career in finance. In addition the Audit Manger is currently mentoring one of the students from the career academy.

7.7 The Audit Manager is a member of the Staffordshire Information Governance Group; this looks at Information Governance issues across the county and in addition has developed an information sharing protocol that enables organisations to share information with partner agencies etc.

7.8 With effect from 1 April 2013 the CIPFA Code of Practice for Internal Audit in Local Government has been replaced with a new set of standards. The Public Sector Internal Audit Standards (PSIAS) have been produced by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Institute of Internal Auditors (IIA) to ensure a consistent set of standards for Internal Auditors irrespective of the sector in which they work. There have been a few changes that will be required to be undertaken in terms of working practices; however the main changes seem to be in relation to the terminology used. CIPFA have produced an application note designed to assist/clarify the standards that have been produced. This guidance note will be used during the course of 2013/14 to ensure that Internal Audit is compliant with the new standards that have been produced. As with the previous CIPFA code the Audit Manager will be required to complete a checklist to demonstrate compliance with the PSIAS and this will be used as part of the evidence for the production of the Annual Governance Statement.