Southend-on-Sea Borough Council

Report of Corporate Director Support Services

to

Audit Committee

on

26 September 2012

Report prepared by: Linda Everard, Head of Internal Audit

Head of Internal Audit Annual Report 2011/12

Executive Councillor – Councillor Moring

A Part 1 Public Agenda Item

1. **Purpose of Report**

1.1 To provide an opinion on the adequacy and effectiveness of the Council's system of internal control for 2011/12 based primarily upon the audit work completed during the year.

2. **Recommendation**

2.1 **The Committee accepts the Head of Internal Audit's Annual Report for 2011/12.**

3. **Audit Opinion**

3.1 The purpose of the Head of Internal Audit's Annual Report and Opinion is to contribute to the assurance available to the Council to support its annual assessment of the effectiveness of the system of internal control.

3.2 The opinion is predominantly based upon and limited to the work performed during the year on the overall adequacy and effectiveness of the Council's risk management, control and governance processes. This is outlined in the risk based audit plan agreed with the Corporate Management Team (CMT) and the Audit Committee. Internal Audit has not reviewed all risks and assurances relating to the Council's key business management, governance or service delivery processes.

HEAD OF INTERNAL AUDIT OPINION ON THE EFFECTIVENESS OF THE SYSTEM OF INTERNAL CONTROL FOR THE YEAR ENDED 31 MARCH 2012.

3.3 MY OVERALL OPINION IS THAT:

The business management arrangements established to support the delivery of the Council's objectives are generally sound although opportunities to improve some of these processes and ensure they are consistently applied, has been identified during the year.

Reliance could be placed on the control environment operated within the Council Tax, National Non Domestic Rates, Housing Benefit, Treasury Management and Housing Rents systems throughout the year. This was not the case with regards to the General Ledger, Accounts Receivable including Social Care Debt, Accounts Payable, Payroll, Cash Receipting and Banking and Income from Older People in Residential Care systems.

Insufficient risk based work was completed during the period to enable me to give an informed view on how well this element of the Council's system of internal control operated throughout the year.

3.4 THE BASIS FOR FORMING THIS OPINION IS AN ASSESSMENT OF:

- The design and operation of the underpinning business management arrangements

- The range of individual opinions arising from risk-based and other audit assignments that have been reported during the year taking into account the relative significance of these areas

- Whether management implement recommendations to mitigate identified control risks within reasonable timescales

- The impact of any issues arising from cumulative audit knowledge and other available information regarding the Council's system of internal control.

4. Supporting Commentary

BUSINESS MANAGEMENT ARRANGEMENTS

4.1 The framework for conducting the Council's business is set out in its **Local Code of Governance** (the Code, which was subject to an annual review). The version considered by the Audit Committee in March 2012, was updated to explain more cohesively the Council's principles, values and arrangements for managing itself effectively. The opportunity was also taken to:

- reintroduce the expectation that members and staff will conduct themselves in accordance with the Nolan Committee's Seven Principles of Public Life

- include for the first time, the expectation that members and officers will also conduct themselves in accordance with the Council's values.

4.2 The Council has continued to maintain a **corporate risk register** throughout the year which is periodically reported to the Corporate Management Team and the Audit Committee.

4.3 The Council updated its **Anti-Fraud and Corruption, Whistleblowing and Anti-Money Laundering** policies and strategies during the year. These now reflect the requirements of the Bribery Act 2010. A programme of work also commenced during the year to implement the strategies.

4.4 A review of the **performance management** arrangements at departmental level showed that these arrangements were sound. They are well established, focusing mainly on a selection of service delivery performance indicators, actions and the financial position covering each Head of Service area. There are regular and informative reports to senior management based on up to date information. Any performance indicators that are not on target are clearly identifiable and an explanatory narrative provided. Progress in implementing Internal Audit action plans also tends generally to be reported on a quarterly basis.

4.5 Opportunities were identified to:

- be more explicit in defining improvement actions to address any off target performance indicators

- include more regular updates on whether some of the key business management processes are being applied consistently

- provide updates on action taken to address issues identified in manager assurance statements or the annual Governance Statement.

4.6 Further consideration is being given in 2012/13 as to whether the mechanisms for gaining assurance over the operation of key business management arrangements are still sufficient and proportionate. (**Adequate**)

4.7 **Service plans and appraisals** make clear links between the corporate priorities, service objectives and individuals' objectives. There is however, potential for objectives in both these areas to more consistently follow the SMART approach (i.e. specific, measurable, achievable, relevant and resourced, time bound and timely).

4.8 All Heads of Service had service plans that complied with the corporate approach. Service planning at Group Manager / team level is of a less consistent quality. These plans can be more like a work plan than a business plan. This then means that teams may not consistently be able to demonstrate that their offering (i.e. the service delivered to the local community) is the right service, at the right price and quality, with the right staff resource.

4.9 Some good practice was identified in reviewing appraisals, but this element of the performance management process was not consistently being applied well. For it to be effective, appraisals need to be done well and completed in a timely manner and used effectively to identify robust training needs for individual staff.

4.10 Internal Audit will continue to work with the People and Organisational Development Team and the Policy and Partnership Team as part of the cultural change programme to explore:

- opportunities to address the above

- ways in which business planning at the service and group or team level can increasingly help the Council meet the challenges of delivering services with reducing financial resources. (**Adequate**)

4.11 Compliance with the requirements detailed in Contract Procedure Rules for the procurement of goods across Council departments is not consistent. Key concerns included lack of documentation and or evidence value for money was obtained, inadequate contractual arrangements with regular suppliers, non compliance not being properly approved and purchases being made without orders being raised.

4.12 The introduction of the new integrated financial ledger system (Agresso) in November 2011, started to address this issue in 2011/12. Further work is being undertaken in this area in 2012/13 linked to the further development of the Agresso application. This should significantly improve the controls in this area. (**Improvement Required**)

4.13 Other aspects of the Council's business management arrangements audited this year include:

- **Information management** whereby a suitable policy framework had been established. However, there needs to be more robust procedures to

proactively seek and obtain on-going evidence from services they were applying the policies consistently and effectively

- **Delivering the savings programme** where it was possible to conclude when the review was reported in September 2011 that overall, reasonable arrangements were in place to identify and then deliver the 2011/12 budget savings although the actions required to deliver them in some areas needed to be more explicitly defined. (**Adequate**)

- **Business Continuity**, whereby it was clear that there was no standard guidance on how to:

  - assess the level of evidence that should be requested from contractors, partners or suppliers prior to and during arrangements

  - build sufficient provisions into contractual or partnership arrangements.

4.14   Guidance was produced by Internal Audit for consideration, and subsequently approved for use.

4.15   As outlined in the Local Code of Governance, in order to ensure that the Council's **business management framework** is in place and operates properly throughout the year, the concept contained in the **THREE LINES OF DEFENCE**[1] model, as shown below has been adopted.
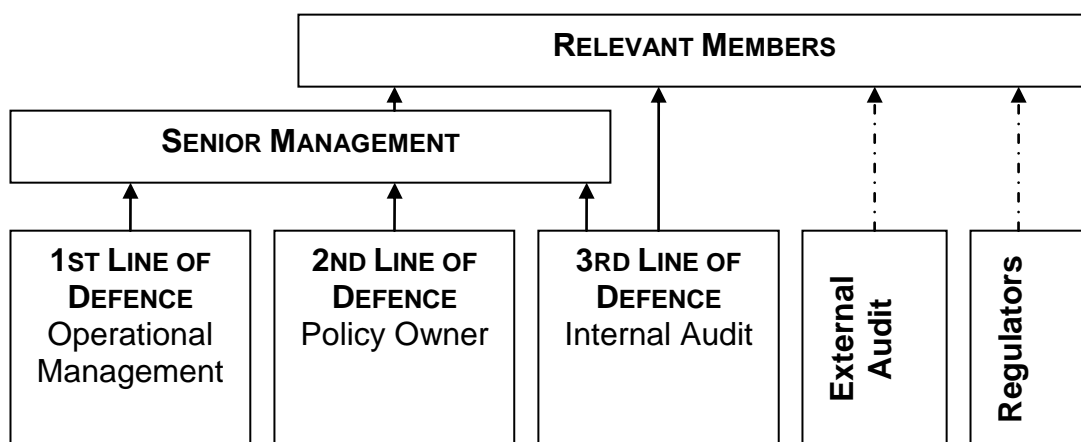
4.16   Whereby ongoing assurance of robust process application is obtained via:

- **The first line of defence** which is operational management who are **responsible** for the effective and consistent application of these key business management processes in their area of operation

- **The second line of defence** which is the business management process 'owner' or 'sponsor' who is **accountable** for the overall operation of the process. They ensure it is fit for purpose, easy for services to apply, there are cost effective arrangements in place to provide assurance this is the case and report periodically on this to senior management and members

- **The third line of defence** which is Internal Audit who provide **independent assurance** to senior management and the Audit Committee, on how effectively the first and second lines of defence have been operating.

---

[1] Based upon general industry good practice, more specifically guidance issued by the European Confederation of Institutes of Internal Auditing "*monitoring the effectiveness of internal control, internal audits and risk management systems*" September 2010

4.17 With the demise of the Audit Commission's annual Use of Resources assessment there is a need to review whether the processes are:

- still operating effectively to provide this assurance

- proportionate to current need.

4.18 There is some evidence to suggest this may not be so for all these processes.

SERVICE DELIVERY RISKS / UNPLANNED WORK

4.19 Very little risk based work was completed during the year, mainly due to:

- 200 days being removed from the audit programme mid year due to the reduction of in house staff resources

- significant additional time required to complete the financial systems work and unplanned reviews.

4.20 It was concluded that a robust framework was in place to manage the construction of the new central library and transition to a new **Library Service**. Opportunities were identified to further strengthen the budget monitoring arrangements required to deliver the savings anticipated at a cost centre level. (**Adequate**)

4.21 The Children and Learning Directorate commission the Passenger Transport Team to provide the **Home to School Transport Service.** Although the two services had good informal working arrangements there was no formal agreement in place defining what each expected the other to deliver.

4.22 Opportunities to improve the operation of the scheme were identified as was the need to produce comprehensive procedure notes to support its operation on a day to day basis.

4.23 Both services have worked very proactively with Internal Audit to address improvement opportunities as they have arisen so good progress has already been made to strengthen this arrangement. (**Improvement Required**)

4.24 Work has continued throughout the year in a critical friend capacity, with the **Local Safeguarding Children Board**'s (LSCB) lead officer, on **serious case reviews** to:

- improve the format of the Action Plan Monitoring Statement used to identify the improvements in processes and practice around the safety of children

- give feedback on improvement opportunities available to make the actions identified for one particular case more focused (SMART)

- support the Children and Learning Department in its Ofsted best practice submission on the implementation of recommendations from serious case reviews.

4.25 It was identified from the unplanned reviews of:

- the **CCTV Maintenance Contract** that some contract management and procurement areas needed to be strengthened to ensure value for money was achieved. The arrangements for operating this service have been reviewed.

- **Print Room Contract** that it was not possible to undertake a detailed review of the initial contract letting exercise and monitoring arrangements as much of the relevant documentation was not now available. This first contract commenced on 1 June 2004. However the indications were that there was

scope to improve the manner in which the client monitoring role was undertaken / evidenced. Some opportunities to improve document management in this area were also identified. This contract has been renegotiated during this year.

FINANCIAL SYSTEMS AND FINANCIAL ISSUES ARISING THIS YEAR

4.26   This year, **financial systems** work took up a significant amount of internal audit resource, far more than initially planned. It was completed in two phases because the IT software applications used to support some systems changed during 2011/12 to Agresso, the new integrated financial ledger.

4.27   Sixteen system processes were reviewed to evaluate the adequacy and effectiveness of the system design as well as test whether the key controls identified operate consistently, where this was possible.

4.28   Separate reviews were undertaken to assess the strength of the automated control environment within the Agresso software application implemented in November 2011.

4.29   **Appendix 1** summarises the audit opinions for all the systems work completed relating to the 2011/12 financial year. It explains how audit opinions are formulated and summarises the numbers of recommendations made split between priorities 1 and 2. However in summary:

Council Tax, National Non Domestic Rates, Housing Benefit, Treasury Management and Housing Rents.

4.30   It was possible to conclude for all the processes outlined above that:

- the systems design was at least satisfactory, which means, if the process is applied, transactions should be processes as required

- the key management checks built into these systems were generally working consistently, throughout the year.

4.31   Therefore reliance could be placed on the information in the general ledger that had been posted from these systems.

General Ledger, Accounts Receivable including Social Care Debt, Accounts Payable, Payroll, Cash Receipting and Banking and Income from Older People in Residential Care.

4.32   The systems as designed did not provide sufficiently robust control actions or key management controls to provide assurance that transactions would be processed properly and consistently, throughout the year.

4.33   For a number of these systems control actions were not tested as key management controls were not consistent and or effective enough to provide sufficient assurance. Therefore testing would not have added significant value to the opinion internal audit is required to give.

4.34   I took account of the work completed by External Audit on the new payroll system for the period February and March 2012 in forming an opinion on this system.

4.35   Action is being taken to strengthen arrangements in these areas.

Agresso Software Application

4.36   Some concerns were identified regarding the assurance that could be obtained from the controls built into the software applications (automated controls) as:

- insufficient evidence could be obtained that these controls had been tested sufficiently prior to it going live in November 2011

- there were indications that changes to the software application were not always adequately and consistently controlled during this period and access to the live system was not sufficiently restricted.

4.37 'Process maps' setting out the automated system controls are still to be produced. There is also a need to strengthen data validation controls in some areas. Further work is going to be undertaken to confirm that current system user permissions assigned are actually appropriate to the roles staff are undertaking.

4.38 However, there was reasonable evidence that Accountancy Services had undertaken a satisfactory reconciliation exercise to provide assurance the migration of general ledger transactions was accurate and complete.

4.39 *Key themes arising from this work* included the need to:

- review and where necessary re-engineer the financial processes when implementing each of the next phase of work streams. This will ensure future processes maximise the benefits of the applications and deliver the expected objectives and required benefits. This should take into account known system issues and testing the software fully in a controlled environment before it goes live

- ensure financial processes are supported by comprehensive but proportionate procedure notes that explain how the entire system should operate

- ensure that the management reports required are available, particularly those that enable key systems reconciliations to be completed in a timely manner

- ensure that appropriate management checks are maintained and evidenced in all financial systems to provide management with on-going, timely assurance required processes are applied accurately and consistently

- ensure there is an up to date manual authorised signatory list that reflects the automated version, providing specimen signatures to support those processes that still require this.

4.40 Going forward a different approach is being taken to plan the roll out of new work streams building on the Agresso's additional functionality. A much more robust project management approach has been proposed that takes account of many of the issues raised above. Internal Audit will continue to support this project, particularly by working with services to ensure appropriate controls are built into systems at the design stage.

4.41 The Council was the victim of a fraud to divert legitimate payments owing to one of its contractors to a fraudulent bank account. Prompt action undertaken by senior management meant that only a small payment has been lost. As a result, the staff instructions in the Accounts Payable team were amended to include additional control actions covering:

- management reporting and review of all changes made to supplier details to confirm their appropriateness

- agreeing protocols with suppliers on how such changes will be made in future.

4.42 Opportunities were identified to improve arrangements and controls regarding the management of cash and low value items for sale in the Customer Services Centre.

4.43 There was a review of how petty cash claims were processed in children's social care and in particular whether appropriate supporting information was provided. Recommendations were made to strengthen the arrangements.

Schools

4.44 During 2011/12, two substantial unplanned reviews were undertaken concerning the governance and financial management arrangements in individual schools and two more are underway in 2012/13. The theme arising from this work is whether any more can be done to support schools to help:

- ensure governing bodies operate strategically, providing clear direction to their head teacher and then monitor delivery effectively

- ensure head teachers' fully understand how to discharge their core role which is to be responsible for the internal organisation, management and control of the school, and for advising on and implementing the governing body's strategic framework

- improve the governance arrangements and financial procedures operated particularly in relation to procurement and contract letting / management as well as the understanding of the principals and concept that underpin them.

4.45 In 2012/13, a joint project is being considered involving staff in the Children & Learning Department, HR, Accountancy and Internal Audit services to move this agenda forward in a proactive and supportive manner.

GRANT CLAIMS

4.46 Internal Audit is required to certify that grant monies have been used in accordance with the terms and conditions of the relevant scheme.

4.47 Two such reviews were completed this year in relation to:

- Safety and Mobility for Elderly Road Users

- Shoeburyness Youth Centre

4.48 Unqualified audit opinions were given in both cases. It was recommended that the Shoeburyness Youth Centre retained a clear agreement of centre usage with the partners that defined what is free and when additional costs would be incurred.

IMPLEMENTING AGREED RECOMMENDATIONS

4.49 Although recommendations are not always implemented by the original due date, very few are written off as no longer relevant. The corporate process for monitoring that control weaknesses identified are addressed is sound. Therefore where due dates are missed, it is generally for a valid reason and this is managed as part of the departmental performance management process.

OTHER CONSIDERATIONS

4.50 In forming my opinion, other assurance has been obtained from:

- **Manager Assurance Statements**, refer paragraph 4.50

- the annual performance assessment of the **Audit Committee** that identified it operated in line with good practice guidance during the year (refer Agenda item 6)

- the annual performance assessment of the **Internal Audit** that confirmed it operated in line with relevant professional standards throughout the year

- the annual reports provided by South Essex Homes (refer Agenda item 4).

Manager Assurance Statements

4.51 For some years there has been a requirement for local authorities to:

- set out their governance arrangements in a Local Code of Governance

- publish an annual statement on the effectiveness of the framework via an Annual Governance Statement.

4.52 Current good practice guidance, as set out in Chartered Institute of Public Finance and Accountancy (CIPFA) / Society of Local Authority Chief Executives and Senior Managers (SOLACE) publication: Delivering Good Governance in Local Government suggests that councils should:

- seek regular assurance that its systems of internal control are functioning effectively, which is achieved mainly through the work of the Audit Committee

- undertake an annual assessment of performance.

4.53 This requires consideration of annual reports from various sources including South Essex Homes as it is a wholly owned subsidiary of the Council (refer agenda item 4). A key element of the Council's annual assessment of performance is the production of Manager Assurance Statements by Group Managers, Heads of Service and Corporate Directors. A summary of these assessments is attached at **Appendix 2**.

4.54 This year, the approach adopted was to ask managers to assess whether they had fully met, substantially met or not met the aim of each key business management process. The Manager Assurance Statement was designed so that it set out:

- the aim of the key business management process

- the assurance required

- the types of evidence that provide the assurance the aim of the process have been met.

4.55 Responses were received from all services.

4.56 ***Management concluded through this annual assessment that the key business management processes have operated well throughout the Council's services although as would be expected, some opportunities for improvement were identified.***

4.57 The main themes arising from the Manager Assurance Statements were as follows:

- all of the key business management processes are assessed as either substantially or fully met

- there is potential to move from substantially met to fully met for the following key business management processes for some of the services:

  - Business planning and strategy (by making sure all service plans are supported by comprehensive and up to date operational strategies)

- Business continuity (by making sure all plans are regularly tested and results analysed and acted on where appropriate to implement improvements)

- Performance management of services and people (by making sure all staff have a timely appraisal).

4.58 The only issue identified from this source that should be included in the annual Governance Statement is that relating to business continuity. A corporate project is underway to address this.

5. Issues for inclusion in the Annual Governance Statement

5.1 From the information available to support my opinion, the main issues that should be considered for inclusion in the Council's Annual Governance Statement are that:

- further work is required to ensure systems designed to process key financial transactions are robust and fit for purpose

- more focus is given to business re-engineering and system design before the implementation of any significant financial systems in future

- proper processes are still in place to ensure that all business management policy owners and senior management get in year assurance that the governance framework is being consistently applied by all services

- all business continuity plans are up to date, tested and communicated to staff.

6. Corporate Implications

6.1 Contribution to Council's Aims and Priorities

Audit work contributes to the delivery of all Council Aims and Priorities

6.2 Financial Implications

The Audit Plan was delivered within the approved resource budget.

6.3 Legal Implications

The Accounts and Audit (England) Regulations 2011 require councils to have an adequate and effective system of internal audit. This is now defined as compliance with proper professional practice i.e. the CIPFA, Code of Practice for Internal Audit in Local Government in the United Kingdom 2006 (the Code).

The Code also requires the Head of Internal Audit to deliver an independent and objective annual opinion on the Council's control environment. This report discharges this duty.

6.4 People and Property Implications

People issues that were relevant to delivering the Audit Plan were raised in the quarterly progress reports.

6.5 Consultation

All terms of reference and draft reports were discussed and agreed with the relevant Corporate Directors and Heads of Service before being finalised. This annual report has also been presented to and discussed with senior management.

6.6 Equalities Impact Assessment

The relevance of equality and diversity was considered during the initial planning stage of every audit before the Terms of Reference were agreed.

6.7   Risk Assessment

Failure to operate a robust assurance process (which incorporates the internal audit function) increases the risk that there are inadequacies in the internal control framework which may impact of the Council's ability to deliver its corporate objectives.

6.8   Value for Money

Opportunities to improve value for money in the delivery of services were identified during some reviews and recommendations made as appropriate.

Internal Audit also considered whether it provided a value for money service annually through its Terms of Reference, Strategy and Performance Indicators.

6.9   Community Safety Implications and Environmental Impact

These issues were only considered if relevant to a specific audit review.

7.   Background Papers

- Audit Committee, Summary Audit Progress Reports
- The Accounts and Audit (England) Regulations 2011
- CIPFA, Code of Practice for Internal Audit in Local Government in the United Kingdom 2006
- CIPFA: The Role of the Head of Internal Audit in Public Service Organisations 2010

8.   Appendices

- **Appendix 1: Financial Systems, Summary of Audit Opinions 2011/12**
- **Appendix 2: Manager Assurance Statements 2011/12**