Southend-on-Sea Borough Council

Report of Corporate Director for Corporate Services

to

Audit Committee

on

19 June 2013

Report prepared by: Linda Everard, Head of Internal Audit

Head of Internal Audit Annual Report 2012/13

Executive Councillor – Councillor Moring

A Part 1 Public Agenda Item

1. Purpose of Report

1.1 To provide the rationale for and an audit opinion on the adequacy and effectiveness of the Council's system of internal control during 2012/13.

2. Recommendation

2.1 The Audit Committee:

- accepts the Head of Internal Audit's Annual Report for 2012/13

- takes account of this report when considering the Council's Annual Governance Statement.

3. Audit Opinion

3.1 The Head of Internal Audit's Annual Report and Opinion provides the Council with an independent source of evidence regarding both the design of its system of internal control and how well it has operated throughout the year.

3.2 The opinion is predominantly based upon 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.

3.3 All audit reports are agreed with the relevant Group Managers, Heads of Service and Corporate Directors before being finalised. The opinion and summary findings from audit reviews are reported to the Corporate Management Team and the Audit Committee throughout the year.

3.4 Internal Audit has not reviewed all risks and assurances relating to the Council's activities.

3.5 Head of Internal Audit Opinion for the year ended 31 March 2013

Further work is required to clarify how the Council is obtaining assurance that its governance framework is sound and operating as designed in line with the requirements of the updated CIPFA Guidance, Delivering Good Governance.

Whilst reliance could be placed throughout the year on the control environment of many of the Council's key financial systems, this was not the case with those operating on the Agresso software application although this did improve in the latter part of the financial year.

With regard to the risk-based service reviews completed this year, opportunities exist to strengthen controls in these areas.

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

- The design and operation of the underpinning corporate management and governance 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 activities

- 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

GOVERNANCE AND CORPORATE MANAGEMENT ARRANGEMENTS

4.1 The Council's governance framework for 2012/13 was set out in its Local Code of Governance (the Code) which was reviewed and challenged by the Audit Committee in March 2012.

4.2 Manager assurance statements were completed again this year by Heads of Service who have concluded that they have generally applied the Council's key business management processes throughout the year. This exercise highlighted that business continuity arrangements require further work in some areas.

4.3 A senior officer group met to consider the potential impact on the Council's current arrangements of the updated CIPFA / SOLACE Framework, Delivering Good Governance in Local Government issued during the year. Corporate Assurance Statement templates were produced which if implemented would produce some annual evidence that the Council's business management processes were update to date and being applied. Further work will be undertaken during 2013/14, to ensure the Council complies in a proportionate manner with this statutory guidance.

4.4 The Council has continued to maintain a corporate risk register throughout the year which was periodically reported to the Corporate Management Team and the Audit Committee. Further work is required in 2013/14 to update the policy, strategy and supporting guidance to help ensure good risk management is effectively and consistently applied throughout the Council in all areas of activity.

4.5   The Council updated its Anti-Fraud and Corruption, Whistleblowing and Anti-Money Laundering policies and strategies during the year. The Council assessed how well its arrangements meet the requirements of Fighting Fraud Locally, the National Fraud Strategy for Local Government and identified what actions it will take in 2013/14 to implement this fully. It has also been investigating potential frauds identified from the Audit Commission's National Fraud Initiative 2012 as well as implementing a strategy for combating housing tenancy fraud with South Essex Homes. The outcome of this work was reported periodically to Corporate Management Team and the Audit Committee.

4.6   A School's Risk Management Group met during the year to discuss the various risks relating to schools performance and to co-ordinate any support provided to them. A risk assessment was produced for the first time in the latter part of the year to support this work and inform the annual schools audit plan. This will be developed over the coming year.

4.7   The Information Commission's Office (ICO) carried out an audit of how the Council processes personal data pursuant to the Data Protection Act 1998, the policies and procedures that apply and the training of staff. There was a particular focus on:

- records management (manual and electronic)

- security of personal data

- requests for personal data and how these are processed.

4.8   ICO audit reports are graded into 4 categories, High Assurance, Reasonable Assurance, Limited Assurance and Very Limited Assurance. The Council achieved:

- an overall grading in the second highest category "Reasonable Assurance"

- a grading of "High Assurance" in the area of processing requests for personal data.

4.9   An action plan has been produced to address some areas where the opportunity to improve the arrangements was identified. The ICO will be reviewing progress made in August 2013.

4.10 In 2012/13, savings identified by services to be taken out of their own budgets were generally supported by evidence of how this was to be achieved. There was less clarity about how all cross-departmental or corporate savings were to be:

- realised when individual budgets were originally set

- taken out of individual budgets initially as the analysis supporting them was often less robust.

4.11 This was, however, resolved during the year and budgets were adjusted to reflect the cross-cutting savings identified. For 2013/14 all savings targets (including cross-cutting ones) were taken out of budgets at the start of the financial year.

4.12 **The Audit Committee** appointed a co-opted member in the latter part of the year and has continued to be supported by relevant officers. Going forward, a review should be undertaken to ensure the Audit Committee is getting sufficient information about the design and effectiveness of the Council's governance framework, in line with the updated CIPFA guidance on Delivering Good Governance, as it is required to approve the Annual Governance Statement.

SERVICE DELIVERY RISKS

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

- 200 days being removed from the audit programme midyear due to the reduction of in house staff resources resulting from the difficulty to recruit to the team and the impact of other staffing / resourcing issues on the team

- significant additional time being required to:

  - complete the 2011/12 financial systems work which completed in the Autumn 2012. This involved documenting systems and controls for the first time as this had not been done before they went live by the services concerned

  - resource other unplanned reviews

- focussing audit resources on the financial systems work for 2012/13

4.14 The work with the **Local Safeguarding Children's Board, Serious Case Review Panel** was focused on helping to ensure that action plans arising from the latest finalised case:

- had developed the correct recommendations to mitigate the systems weaknesses identified

- were drafted to be clear on the actions required, delivery dates and required supporting evidence to demonstrate they were fully implemented.

4.15 A 'critical friend' role was undertaken to provide support and challenge to officers before and soon after the new East of England Road Works Permit Scheme was implemented in November 2012. Concerns were initially expressed about the readiness of the service to implement the new arrangements by the required date. However it was subsequently possible to conclude that the scheme's key operational arrangements were in place to assess applications, undertake required inspections work and enforce permit conditions. Discussions continue with the team with a view to further strengthening the operational arrangements and enabling an evaluation of the effectiveness of the scheme.

4.16 The IT Service Review highlighted that a generally sound ICT Strategy and steering group had been established to set direction and monitor implementation of work programmes. However it concluded that:

- overall progress in achieving strategic objectives should be more explicitly measured and reported

- there was potential opportunity to improve management of ICT-related activities by adopting a single, integrated, good practice approach throughout the Council.

4.17 The review also supported the work underway, particularly in light of previous comments, to:

- evaluate whether IT services staffing and structures were fit for the Council's business, which included looking at the current operational model of having both central and departmental IT teams

- fully implement recognised industry good practice operational and management ICT procedures within the next two years.

4.18 Work is also in progress to:

- strengthen the arrangements to ensure compliance with relevant IT project methodology dependent on the relative risk, complexity and importance of the project

- report half yearly on progress in achieving the IT Strategy's objectives, ensuring the timetable for its production enables it to be informed by the corporate and service plans and the budget.

(*Adequate Audit Opinion*)

4.19 The changes needed to the Northgate IT system to implement the **new local Council Tax reduction scheme** for 2013/14 were effectively planned, tested and applied.

(*Good Audit Opinion*)

4.20 Work planned on assessing whether the **trading companies** (excluding South Essex Homes) had appropriate arrangements in place to produce relevant year end information was curtailed. Their trading activity was not sufficiently significant to impact on the annual opinions required regarding financial accounting, governance or internal control.

FINANCIAL SYSTEMS

4.21 In 2012/13, 10 **financial systems** were:

- reviewed to evaluate whether the processes as designed included adequate and effective controls

- tested to evaluate whether the key controls identified operated consistently and effectively throughout the year where this was possible.

4.22 For *Council Tax, National Non-Domestic Rates, Housing Benefit, Treasury Management, Housing Rents and Cash Receipting and Banking, it was concluded that:*

- the design of controls within the systems were adequate or good, which means, if the controls were applied, transactions should be processed properly

- the key controls were generally working consistently, throughout the year.

(*Good or Adequate Audit Opinion*)

4.23 For *General Ledger, Accounts Receivable (General Debt), Accounts Receivable Recovery of Social Care Debt, Accounts Payable and Payroll,* it was concluded that:

- the design of controls was not satisfactory; and / or

- a number of the key controls in place were not working consistently or effectively throughout the year.

(*Improvement Required Audit Opinion*)

4.24 It should be noted that for the General Ledger, a much stronger control environment operated throughout the 2012/13 financial year. The control frameworks relating to the Accounts Receivable and Accounts Payable (general debt) systems also improved in the latter part of 2012/13. Substantive testing of a limited sample of payroll transactions did not highlight any significant concerns with data input or amendments to data.

4.25 Implementing the new integrated financial management system on the Agresso software application has been a major project for the Council. Work will continue over the next year few years to implement further modules and enhance functionality of the core applications. A lesson learnt report was produced after the core financial systems were implemented and a paper considered by the Audit Committee on how recommendations made were being implemented.

4.26 At September 2012, **Agresso's automated control framework** was not being fully utilised nor was it sufficiently robust to guarantee the integrity of key financial systems' transaction processing. As a result, the full potential of the system was not being realised and, in some areas, more time consuming manual sample checks were being undertaken by staff to compensate for this significantly reducing the level of assurance provided.

4.27 It was recommended that the main focus initially should be on improving change management controls and configuring the system to robustly validate all data input. The findings from this review impacted on the audit opinion given on these financial systems.

(*Improvement Required Audit Opinion*)

4.28 Subsequently action was taken to significantly improve the arrangements for dealing with changes made to the Agresso software application which included:

- creating a Change Advisory Board and framework for managing changes to the software application

- introducing independent management checks to ensure all changes were actioned through the approved change management process.

4.29 Officers have also reported that:

- action has been taken to:

  - restrict access to the data import and archive folders on the server to authorised personnel only

  - stop the Agresso developer from implementing changes directly into the live environment, without the need for an independent person to test it first or promote the change to the live system

  - reactivate the system audit trail function, which identifies changes made, who made them and when

  - restrict those who have the ability to switch off the audit trail function to nominated senior staff only.

- work is still underway to:

  - produce flowcharts for all Agresso modules detailing the internal, automatically applied controls

  - find out whether the application can be configured so that it:

    - validates bank account details and addresses although in the interim adequate management checks are in place

    - prevents staff with permissions to amend employee records from being able to access their own records although in the meantime, appropriate management checks are in place to verify editing of records.

- the annual data cleansing exercise will be undertaken to purge and merge customer and supplier records as part of the 2012/13 financial accounts closedown process.

4.30 The design and operation of these controls is being currently being audited.

4.31 Working as a critical friend, it was identified during the year that action was required to strengthen the project governance arrangements in relation to the **Agresso implementation project**. The main areas requiring attention were:

- developing project plans at a local level for each of phase of the Agresso project

- producing an overall resource plan that addresses all individual project requirements and identifies interdependences between projects

- producing a project risk register and then review and update it on a weekly basis

- producing and agreeing job descriptions for all primary project related roles.

4.32 Work is in hand to address the first of these items and Officers have advised the other three have now been completed.

4.33 The **Adult Community College's** current financial management arrangements were adequate but needed to be formalised to ensure the required checks / tasks are understood by all relevant staff and consistently undertaken. These arrangements also need to include greater separation of duties and independent oversight of work done.

4.34 The college still needs to demonstrate how it complies with the Council's Financial Regulations and applicable finance-related policies as required by the Scheme of Delegation between itself and the Council.

4.35 There is an opportunity to improve budget monitoring and reporting to include more forward-looking information.

(*Improvement Required Audit Opinion*)

4.36 Three substantial reviews were undertaken at separate **schools** that had some impact on this audit year. The main themes arising from these reviews were that:

- the financial management arrangements and operational practices needed to be improved significantly

- governors were not effectively discharging their role.

4.37 As a result of the lessons learnt from this work, the approach to auditing schools was fundamentally reviewed and is being implemented from 2013/14.

4.38 During 2012/13 two of these schools had an audit to give a 'baseline' assessment of the design of its key financial management and governance controls. One had a full audit that assessed the design and also tested the operation of key financial management and governance controls. They have concluded that there is still a need to improve these arrangements.

4.39 A thematic review of schools' purchasing and procurement arrangements is in progress.

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

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

- Safety and Mobility for Elderly Road Users
- Local Transport Grant

4.42   Unqualified audit opinions were given in both cases.

5.   Internal Audit Performance

5.1   There is sufficient evidence to demonstrate that:

- professional standards as set out in the CIPFA, Code of Practice for Internal Audit in Local Government in the United Kingdom 2006 (the Code) have been adhered to
- many of the elements of the CIPFA: The Role of the Head of Internal Audit in Public Service Organisations 2010 were met
- the team delivered on the majority of its performance targets, despite having to deal with resourcing issues during the year which resulted in an overall reduction in work delivered.

5.2   Some opportunities have been identified to further strengthen the team's operating arrangements and an action plan has been produced to address them.

6.   Issues for the Annual Governance Statement

6.1   From the work completed this year and other information that has come to my attention, the main governance or internal control issues identified relate to:

- the need for the Council to satisfy itself that it receives sufficient in year and end of year evidence that its governance arrangements are fit for purpose and comply with the updated statutory guidance as set out in CIPFA's Delivering Good Governance Framework
- the weaknesses identified in the:
  - design and or operation of the key financial systems run on the Agresso software application throughout the financial year
  - change management arrangements operated with regard to the Agresso software application for the first half of the financial year.

6.2   Consideration should be given as to the implications of these matters for the Council's Governance Statement.

7.   Corporate Implications

7.1   Contribution to Council's Aims and Priorities

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

7.2   Financial Implications

The Audit Plan was delivered within the approved resource budget.

7.3   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.

7.4 People and Property Implications

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

7.5 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.

7.6 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.

7.7 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.

7.8 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.

7.9 Community Safety Implications and Environmental Impact

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

8. 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

9. Appendices

- **None**