

Report to: **Audit and Best Value Scrutiny Committee**

Date: **18 November 2009**

By: **Deputy Chief Executive and Director of Corporate Resources**

Title of report: **Internal Audit Progress Report – Quarter 2 (1 July 2009 – 30 September 2009)**

Purpose of report: **To provide Members with a summary of the key audit findings, progress on delivery of the Audit Plan and the performance of the internal audit service during Quarter 2**

RECOMMENDATION: Members are recommended to consider and agree any action that should be taken in response to the issues raised as a result of the audits carried out during Quarter 2

1. Financial Appraisal

1.1 There are no direct financial implications arising from the recommendations in this report.

2. Supporting Information

2.1 The current annual plan for internal audit is contained within the Audit & Performance Division's Internal Audit Strategy and Annual Plan 2009-10. This was prepared after consulting Chief Officers and senior managers and was endorsed by Audit and Best Value Scrutiny Committee (8 July 2009) and Cabinet (28 July 2009). It is updated each year.

2.2 An annual internal audit report, which gives Members and Chief Officers an opinion on the efficiency and effectiveness of the Council's internal control environment, is prepared each year, usually in June. This progress report covers work completed between 1 July 2009 and 30 September 2009.

3. Summary and Key Audit Findings

3.1 Key audit findings from final reports issued during quarter 2 are summarised in Appendix A.

3.2 Overall, of the 13 formal audits completed, 1 resulted in a 'full assurance' audit opinion, 3 with 'substantial assurance', 3 with 'partial assurance' and 1 with 'minimal assurance' (Carepay). The remaining 5 formal audits were schools, all of which successfully passed their Financial Management Standard in Schools assessment.

3.3 In all cases where reviews result in either 'minimal' or 'no' assurance audit opinions, a formal follow up review is undertaken, either later in the year or early in the following year. In addition, follow up reviews are also carried out in relation to all fundamental accounting systems along with a number of the audits where a 'partial assurance' audit opinion has been given. In relation to work completed in quarter 2, Chief Officers' attention is particularly drawn to our work on:

- Carepay – this is a fundamental accounting system which previous Internal Audit work found to be 'weak' in terms of internal control. The recently completed review did not find that sufficient progress had been made in improving the control environment and therefore only 'minimal assurance' could be provided. A comprehensive management action plan addressing the identified weaknesses has been agreed with Children's Services and a commitment has been received to ensure controls are improved. This will be assessed by Internal Audit as part of a further review planned in quarter 4 of this year. Failure to address the recommendations

- made has the potential to impact adversely on the external auditor's opinion on the Council's accounts;
- Investigations – recent months have seen an increase in investigation activity for the team with a number of ongoing investigations, in addition to those reported on in Appendix A. Whilst so far in the year we have been able to deliver this increase in investigations work from within our contingency allocation, it is important that we continue to monitor the impact of this on planned audit work throughout the remainder of the year.

4 Performance against targets

4.1 During quarter 2 of 2009/10 we delivered 522.1 productive audit days, which, combined with the days delivered in quarter 1, equates to 49.4% of the overall plan days. We have completed 35.6% of our planned audit assignments which have been delivered in 98.4% of the budgeted time available, well within our target. Performance against both of our effectiveness targets is strong with 98.7% of recommendations being accepted and customer satisfaction running at 87%.

5. Priorities for Quarter 2

5.1 Priorities for the period 1 October 2009 – 31 December 2009 include:

- Fundamental Accounting Systems – commencement of the 2009/10 programme of reviews;
- Financial Management Standards in Schools – beginning the secondary school re-assessment work.

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BACKGROUND DOCUMENTS

Internal Audit Strategy and Annual Plan 2009-10

Appendix A

Summary of key audit findings

Pension Fund Governance & Strategy (Corporate Resources Directorate)

This review (which is part of the programme of Fundamental Accounting System reviews) was undertaken in accordance with the annual Internal Audit Plan for 2009/10 and the Pension Fund Audit Strategy.

The objectives of this review were to ensure that:

- the investment strategy is appropriate and is followed by the Pension Fund;
- investment strategy decisions are implemented in a timely manner and are implemented correctly;
- performance of external advisers is managed;
- Fund assets are sufficient to meet the Fund's obligations and liabilities;
- statutory reports and stakeholder reports are appropriate;
- the Fund is run in compliance with all statutory regulations; and
- those charged with governance of the Fund and the scheme can fulfil their responsibilities effectively.

From the audit work completed during this review, Internal Audit is able to provide **full assurance** that there is a sound system of controls in place, and there were no material findings to report.

Building Maintenance Follow-Up (Corporate Resources Directorate)

Internal Audit carried out a review of the Building Maintenance system during December 2007 to provide assurance to management on the adequacy of the main controls within the system. Due to the control weaknesses highlighted during the review, an audit opinion of weak was given.

It is pleasing to report that from the audit work subsequently completed during this follow up review, **substantial assurance** can now be given that there is a sound system of internal controls in place. Of the original 22 recommendations made, 18 have been implemented in full. The 4 remaining recommendations have been partially implemented with varying degrees of work undertaken on each of them as follows:

- The updated procedures for financial monitoring of building maintenance budgets and other procedures have been documented but not updated within the Quality Control Manual. This document is currently on hold pending the restructure of Property Services within CRD;
- The original recommendation of allocating specific contract rates within the building maintenance system against every item of equipment due a service was assessed as being unmanageable. However, historic SAP reports are now being used to calculate accurate commitment values for budget monitoring purposes;
- The review of the division of maintenance responsibilities between schools and Children's Services has been delayed until the Children's Services Capital Strategy Group has sufficient resources to implement the amendments. This is anticipated to be during 2010/11.

In terms of the recommendations relating to CRB checking of contractors in schools, the CRB Contractors Working Group have confirmed the final CRB checking procedures and guidance and are due to be rolling these out to all ESCC Contract Managers during November 2009. Internal Audit is therefore planning a full systems audit in this area, to commence in quarter 4.

SAP Substantive Testing (Corporate Resources Directorate)

During 2007, Internal Audit completed a review of SAP User Authorisations which identified a number of weaknesses over the process for setting up and managing user access to SAP. Since this original audit, progress has been made by management to address a number of the identified weaknesses and this was confirmed in a follow up review by Internal Audit in 2008, which provided 'partial assurance' over the control environment. Work is continuing by management to address the remaining weaknesses and during the interim, it was agreed that additional testing would be undertaken by Internal Audit, on 2008/09 transactions, to provide re-assurance that no fraudulent or erroneous transactions had occurred during the year.

This work has now been completed and, whilst some isolated examples of non-adherence to procedures were identified, the testing found no evidence of erroneous or fraudulent transactions. The non-compliance issues identified will be followed up during the forthcoming audits of fundamental accounting systems.

National Fraud Initiative (Corporate)

Internal Audit continues to support and co-ordinate the Council's response to the Audit Commission's National Fraud Initiative 2008/09, which identified a total of 2,786 filtered data matches. During quarter 2, our work has continued to focus on co-ordinating management's response to these data matches, together with the investigation of any concerns arising. This process is continuing during 2009/10 with Audit Commission monitoring progress on a regular basis. We anticipate that the bulk of the investigation work will be completed by December 2009.

ESCC Risk Management Arrangements (Corporate)

As part of the Internal Audit Plan for 2009/10, Internal Audit conducted a review of County Council risk management arrangements. The objectives of this review were to ensure that:

- County Council Members and senior management have a good understanding of risk management arrangements and expectations;
- There is effective identification of all relevant risks to the delivery of corporate, departmental, divisional and team objectives;
- Risks are effectively identified with a view to enhance the Council's ability to meet and develop business opportunities;
- Risk analysis arrangements are effective, appropriate and operate effectively;
- Risk control measures are effective, appropriate and operate effectively;
- Risk monitoring, recording and reporting arrangements operate effectively, to ensure that all risks are considered regularly and at the appropriate level in accordance with the Strategy and best practice;
- Any risks identified which have actually materialised as undesirable events are reviewed appropriately and improved mitigation measures put in place to prevent a recurrence.

From the audit work completed during this review, Internal Audit is able to provide **substantial assurance** that there is a sound system of controls in place. The Strategic Risk Log is considered regularly by Chief Officers and Members and, from a review of sampled strategic risks, it was apparent that the risks were appropriate and that mitigating actions were in place.

Amongst the minor recommendations made, there remains scope to further improve the wording of some risks within the register to express more explicitly the consequences for the Authority, should they materialise.

Recommendations have been agreed with management and incorporated within a formal action plan.

Establishment Income Collection and Banking (Chief Executive's Department)

The objectives of this review were to ensure that, in respect of the Council's Libraries, Registration Offices and Traveller Sites:

- Income is appropriately managed centrally, is accounted for correctly, and all records received from establishments are accurately reconciled to the general ledger;
- All income received by establishments is collected accurately, completely and promptly;
- Cash and cheques collected by establishments are held securely and then banked regularly in a complete and secure manner.

From the audit work completed during this review, Internal Audit is able to provide **partial assurance** that there is a sound system of controls in place. The main findings related to:

- A number of weaknesses within the Traveller Team, particularly relating to lack of proper division of duties between officers responsible for collecting, securing, checking and then banking income. Issues were also identified in relation to the prompt banking of income;
- With regard to the Registration Service, the review highlighted weaknesses in the system for accounting for income received by mail;
- Inconsistencies were found at libraries in the way income is being recorded and reconciled to bank records, and delays in banking resulted in cash levels regularly exceeding insurance limits.

The recommendations arising from the review have been agreed with management and incorporated within a comprehensive action plan.

Carepay (Children's Services Department)

This review of the Carepay System (which is part of the programme of Fundamental Accounting System reviews) was undertaken in accordance with the annual Internal Audit Plan for 2008/09. The review followed up on the findings from the 2007/08 review and addressed the following control objectives:

- Access to the system is secure and in compliance with the Council's corporate standard;
- Amendments to standing data are restricted to designated staff and properly authorised;

- The payment of allowances is authorised in accordance with approved delegated authority levels and is processed at the weekly agreed rates;
- Controls on the termination/amendment of allowances are robust, minimising the level of overpayments;
- Overpayments are identified and recovered in a timely manner;
- There are robust controls over the IT environment of the Carepay system.

Internal Audit published a report in September 2008 on the Carepay System which concluded that the control environment was 'weak', primarily as a result of weaknesses over system access and administration. This subsequent review, which included a follow up on the previous audit findings, found that whilst some progress has been made by management, it is still only possible to provide **minimal assurance** over the control environment. Weaknesses were identified in relation to:

- Debt management, including arrangements for writing off debts;
- System access controls, including management of user access and password controls;
- Weaknesses in segregation of duties control for users with higher levels of access;
- Weaknesses in ICT change management processes.

A comprehensive action plan has been agreed with management to address the control weaknesses identified. In addition to this, Internal Audit has undertaken additional testing as part of the review to provide assurance that the above issues have not resulted in any inappropriate payments. This testing found that all the transactions sampled had been appropriately incurred and authorised correctly. A Carepay follow-up review will be undertaken in quarter 4 of 2009/10 to assess the extent to which improvements in the control environment have been made. As this is a fundamental accounting system, there is a risk that if sufficient progress is not made during 2009/10 to improve controls, that this may adversely impact on the external auditor's opinion on the Council's accounts.

Imprest Account Review (Children's Services)

As part of the Internal Audit Plan for 2008/09, Internal Audit conducted a review of Imprest Account management across both Adult Social Care and Children's Services, with the findings from the Adult Social Care review reported during 2008/09. The findings from the Children's Services review can now be reported, having received a formal response from management during quarter 2 of 2009/10.

Children's Services Strategic Finance is responsible for the monitoring, processing and monthly reimbursement of 83 imprest accounts across the department with an overall balance of approximately £106,000.

The key control objectives reviewed as part of this audit were to ensure that:

- All payments from imprest accounts were made in accordance with the County Council's Financial Regulations and Standard Financial Procedures;
- All roles and responsibilities were clearly defined and appropriately allocated;
- Adequate security arrangements were in place to safeguard any cash held.

The main findings of the review were that:

- There was inadequate departmental monitoring of imprest accounts, particularly in relation to challenging the types/nature of payments being made;

- Imprest accounts were not being operated in full accordance with ESCC Financial Regulations/Standard Financial Procedures. For example, payments were made (for staff travel expenses) that should have been processed through the payroll system, equipment purchases were made that should have been processed through SAP and the individual transaction limit of £25 was regularly exceeded;
- Available guidance on the use of imprest accounts did not accurately reflect current working practices;
- A large number of imprest accounts were found to be regularly overdrawn.

As a result of the findings, an audit opinion of **partial assurance** was given. All recommendations arising were agreed with Children's Services management and included in a formal action plan. This will be subject to a follow up review during 2010/11.

Financial Management Standard in Schools (FMSiS) (Children's Services)

Internal Audit has continued to carry out external assessments to ensure that schools are meeting the standards laid down by the Department for Children, Schools and Families (DCSF).

During the quarter external assessments were carried out at 5 primary schools as part of the three year programme for all schools to achieve the standard by 2010.

All of these schools passed their assessments and will receive accreditation in due course from the DCSF, which will last for three years, when the process will need to be revisited.

Internal Audit continues to work with Children's Services Finance to support the schools that have not met the standard to ensure they address the weaknesses identified and prepare for a re-assessment.

As at the end of the quarter, a total of 140 schools (71%) have been assessed by Internal Audit as meeting the Standard since the assessment process began in 2006/07. Work will continue throughout the year to complete the assessment of the remaining 29% of schools.

CONTRICC (Adult Social Care)

ContrICC is a new contract management system that is used to raise contracts (Individual Service Agreements) for Adult Social Care clients in support of care episodes agreed by operational managers following a funding approval process.

Interfaces exist between CareFirst (the client database), ContrICC and Abacus (the provider payment system), which allow contract related data to be passed between the respective systems.

At the time of the audit ContrICC held 7,245 contracts generating payments to the value of £2.4m per week.

The review covered the accuracy and integrity of the system to produce contracts, aid the management of provider details and the adequacy of controls in place to ensure that all data passed from one system to another is complete, accurate and timely.

The main findings of the audit concerned improving the administration of system access rights and processes relating to the movement/transfer of data between Carefirst, Controcc and Abacus.

Six recommendations were made, agreed with management and included in a formal action plan.

From the audit work completed during this review, Internal Audit was able to provide **substantial assurance** that there is a sound system of controls in place.

Putting People First (PPF) (Adult Social Care)

The PPF project framework continues to be developed and implemented by Adult Social Care (ASC). The role of Internal Audit is to provide support and advice on an ongoing basis as well as seeking assurance on control issues associated with new ways of working.

During the quarter, Internal Audit liaised with programme management as project plans were still being developed. In particular, internal audit provided support in the development of the Self Directed Support care pathway narratives and risk framework. Assurance was also sought that the first version of the Resource Allocation System (RAS) had been reviewed and tested for use within the Self Directed Support Pathway Demonstrator Site Project.

Business Transformation (Adult Social Care)

Internal Audit continued to provide support on the remaining elements of the Adult Social Care Business Transformation Programme, providing advice on internal control, risk and ICT issues.

During the quarter, Internal Audit work focussed on providing assurance and advice relating to the continued development and testing of system modules prior to go-live of:

- Interactive Resource Monitoring (IRM) system – this module provides management access to reports in respect of financial data (it will also be used to provide access to reports on personnel data);
- Real Time Telephone Monitoring (RTTM) – this module will provide management with data with respect to Home Care visits in order to be able to pay care providers against actual visits rather than against planned visits.

Although the financial aspect of IRM has gone live, development is continuing with respect to reporting of personnel data. ICT audit support and testing of the IRM personnel module and RTTM will continue until they go-live.

Trapeze/SAP Interface – Public Transport (Transport and Environment)

Trapeze is a SAP feeder system consisting of three modules that are used to manage the entire procurement to pay process in respect of Home to School Transport, Public Transport and Parental Mileage.

Two of the modules (Home to School Transport and Parental Mileage) have already successfully gone live.

The purpose of the audit work in respect of the Public Transport module was to provide assurance that the level of testing of the module's capacity to process transactions completely and accurately was appropriate and that the results of that testing were adequately documented.

From the audit work carried out there were no significant issues arising that would have prevented the module from going live.

Home to School Transport – Budget Management (Transport and Environment / Children's Services)

The transport procurement element of the Home to School Transport (HTST) service is provided by the Transport and Environment Department (T&E) whilst it is funded by Children's Services Department (CSD), which determines eligibility for the service and retains overall responsibility for financial management. The budget for 2009/10 is £11.5m.

Previous Internal Audit work in relation to the budget management of HTST was undertaken in both 2006/07 and 2007/08, the most recent of which found internal controls to be 'weak'.

This review, agreed as part of the 2009/10 Internal Audit plan, sought to give assurance to management on the overall effectiveness of internal controls in relation to the management of the HTST budget, both in terms of reviewing the implementation of previous audit recommendations and assessing the overall budget management regime in place.

A review of the audit recommendations made in May 2008 identified that progress has been made in achieving these. Improvements have been made in the budget setting process, where a budget setting model has been developed jointly between both departments and forecasting information used in budget setting is now based on data available at the beginning of the academic year to give a more accurate budget projection. Budget monitoring and reporting has also improved through the implementation of monthly budget monitoring meetings between representatives of T&E and CSD, and monthly monitoring reports being produced for management and COMT/ Cabinet.

In reviewing overall budget management, it was found that the monitoring information used in the budget setting process identified that the original budget was not likely to be sufficient to meet demand. It is important therefore that, in future years, earlier action is taken to address the likely deficit where this is identified.

In addition, there has been a significant increase in service demand so far in 2009/10 resulting in a forecast overspend of £476k as at July 2009. This is also partly due to an increase in new routes, an increase in costs relating to transport to pupil referral units and an increase in the cost of hired transport contracts. Particular focus needs to be given in the future to identifying initiatives specifically to manage demand and the cost of demand on the HTST service.

From the audit work undertaken, Internal Audit was able to provide **partial assurance** that there is a sound system of controls in place. Seven recommendations were made to improve controls and these were agreed with management and incorporated within a formal action plan. This will be subject to a further follow up review during 2010/11.

INVESTIGATIONS

Conflict of Interest Investigation (Corporate Resources Directorate)

In August 2009, Internal Audit was asked by the Assistant Director – Property to undertake an investigation into a potential conflict of interest relating to a procurement process within CRD Property. Specifically, it had become apparent to senior management that an external consultant engaged within the department had been directly involved in a procurement process involving their own employing company.

The review examined the circumstances behind the original engagement of the consultant and whether the apparent conflict of interest was of sufficient magnitude to influence adversely the award of the contract. It also evaluated the relevant procurement processes and procedures followed.

The review concluded that, whilst there was no evidence that the consultant had sought unduly to influence the tender process or that their employer had gained any commercial advantage, a clear conflict of interest had materialised. The external consultant involved should have declared the potential conflict in writing and then withdrawn from the evaluation process. Furthermore, weaknesses were also identified in the procurement process adopted and it was therefore not considered sufficiently robust to support a decision to award the contract.

As a result of the investigation, the original procurement process was re-visited to ensure it was transparent and free from challenge. Actions to address the findings made in the investigation have been agreed with the Assistant Director – Property.

Procurement of Consultants Investigation (Transport and Environment)

During the quarter, the Director of Transport and Environment requested an Internal Audit investigation into the circumstances relating to the award of a major consultancy contract within the Transport Strategy Team. As agreed with the department, the investigation sought to establish the facts surrounding the decision making process leading up to the contract award, the approval and authorisation arrangements and the extent to which proper procurement procedures had been followed.

A formal report setting out the Internal Audit findings was issued to the Department in September 2009. In summary, the investigation found that key decisions resulting in the appointment of the consultant had been made without the approval of senior management and that officers had failed to follow proper procurement practices throughout some parts of the contracting process.

The absence of more detailed procedures and guidance within the Department and a lack of clarity over decision making and approval arrangements were, however, factors contributing to the issues identified. As a result of the investigation, management has agreed to review existing instructions available to staff and to ensure that the authority levels that need to be obtained are more clearly specified.

Conflict of Interest Declarations Investigation (Transport and Environment)

Corporate Governance Group arrangements for monitoring completed declarations of interest identified an issue during quarter 2 relating to two members of staff within the Transport and Environment Department. This matter was referred to Internal Audit for further investigation.

The Internal Audit activity involved background research, review of documentary evidence and interviews with a number of officers. The investigation found that the completed declarations by the two members of staff concerned had been accepted by management without proper consideration of the implications associated with the potential conflicts being declared. As a result, the County Council could have found itself open to challenge. The investigation also identified a number of procurement issues associated with the engagement of a commercial business to deliver services as part of a partnership arrangement.

The findings from the investigation were discussed in detail with senior management within the Department and the Corporate Governance Group. As a result, operational managers have been reminded of the importance of managing potential conflicts of interest effectively and the department is reviewing its arrangements for procuring services from third parties as part of externally funded projects.

Staff Mileage Investigation (Adult Social Care)

Internal Audit completed an investigation during quarter 2 relating to a member of staff within Adult Social Care who had submitted inflated claims for mileage undertaken on County Council business. The investigation obtained clear evidence of this and concluded that the individual concerned had over-claimed deliberately for personal financial gain. This conclusion was reached on the basis that none of the journeys involved had been claimed correctly, that the individual was unable to explain their actions and that clear guidance and training had previously been provided to them on the correct arrangements to follow.

A formal report was produced for management setting out these findings and the individual subsequently resigned from the County Council pending a disciplinary hearing.

Internal Audit Performance Indicators

Performance Indicator	Target	Actual Performance			
		At 30/6	At 30/9	At 31/12	At 31/03
Economy & Efficiency					
Planned days delivered (%)	90	25.5%	49.4%		
Planned audits completed = final reports issued (%) ¹	90	29.0%	35.6%		
Actual v Plan time on completed audits (%)	105	93.3%	98.4%		
Effectiveness					
External Audit reliance on internal audit	Achieved	Achieved – see Annual Governance Report			
Maintain a CPA score of at least 3 / 4 for internal control.	3/4	Results of 2009 Use of Resources Assessment expected in Quarter 3.			
Recommendations accepted (%)	90	99.5%	98.7%		
Customer feedback forms scoring 3 out of 5 or higher (%)	80	87.9%	87.0%		
Reports to Chief Officers and Members	Quarterly	Quarterly reports issued.			

¹ Excludes FMSiS Assessments

Analysis of actual days delivered against the annual internal audit plan

Service	Plan Days	Amend - ments	Revised Plan	Actual Q1	Actual Q2	Actual Q3	Actual to date	% plan delivered
East Sussex County Council:								
Corporate Body	495.0	37.5	532.5	142.9	128.2		271.1	
Computer Audit	175.0	6.0	181.0	47.4	61.3		108.7	
Children's Services	489.0	129.5	618.5	144.4	175.1		319.5	
Adult Social Care	293.0	26.5	319.5	79.5	50.4		129.9	
Transport & Environment	195.0	37.0	232.0	50.6	43.3		93.9	
Chief Executive's	173.0	9.5	182.5	59.4	45.9		105.3	
Contingency ²	250.0	-246.0	4.0	-	-		-	
Sub total – internal customers	2070.0	0.0	2070.0	524.2	504.2		1028.4	49.7%
External customers	112.0	2.0	114.0	32.6	17.9		50.5	44.3%
Total audit days	2182.0	2.0	2184.0	556.8	522.1		1078.9	49.4%

² Contingency days delivered include completion of audits carried forward from 2008/09 and unplanned work e.g. investigations, and are included in the total for the department to which the work related.