

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

Date: **1 September 2011**

By: **Director of Corporate Resources**

Title of report: **Internal Audit Progress Report – Quarter 1 (1 April 2011 – 30 June 2011)**

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 1**

RECOMMENDATIONS: Members are recommended to

(1) 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 1; and

(2) identify any new or emerging risks for consideration for inclusion in the internal audit plan.

1. Financial Appraisal

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

2. Supporting Information

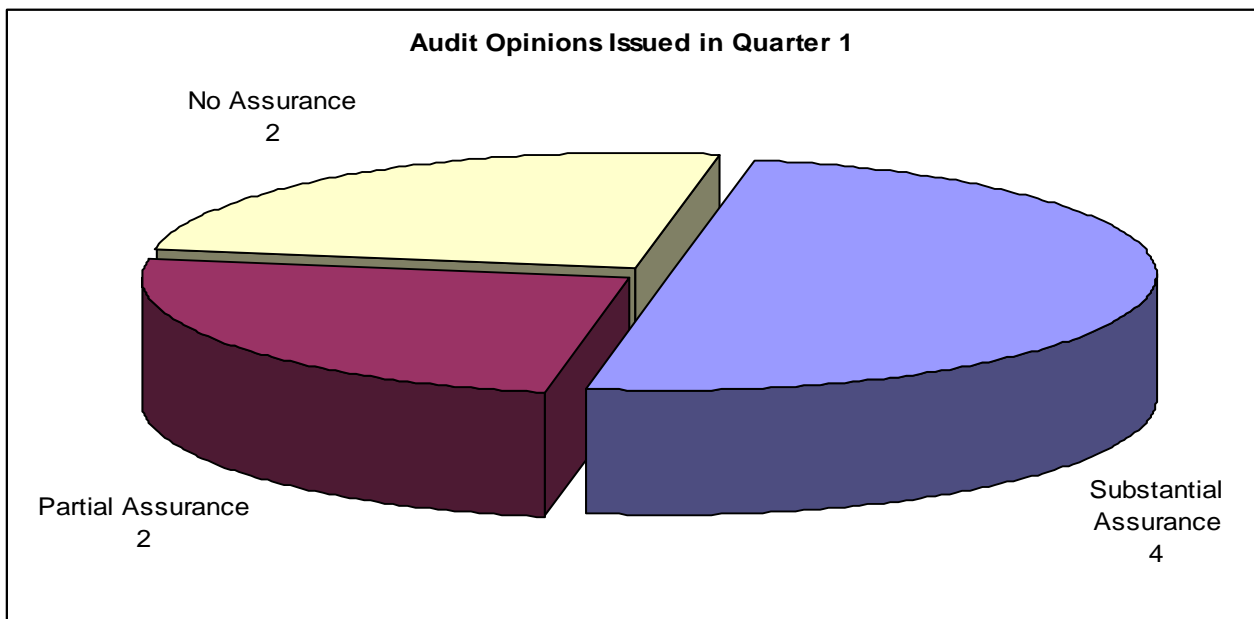
2.1 The current annual plan for internal audit is contained within the Audit & Performance Division's Internal Audit Strategy and Annual Plan 2011-12. This was prepared after consulting Chief Officers and senior managers and was endorsed by Audit and Best Value Scrutiny Committee (1 June 2011) and Cabinet (5 July 2011). 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 April 2011 and 30 June 2011.

3. Summary and Key Audit Findings

3.1 Key audit findings from final reports issued during Quarter 1 are summarised in Appendix A.

3.2 Overall, of the 8 formal audits completed, four resulted in a 'substantial assurance' opinion, two received 'partial assurance' and there were two reviews where 'no assurance' could be given (Nursery Income and Schools Recruitment and Selection).



3.2 In all instances where high risk (3 star) recommendations have been issued, implementation by management is monitored by internal audit through an action tracking process. In addition to this, formal follow up reviews will be undertaken in relation to all fundamental accounting systems, all audits with either 'minimal' or 'no assurance' and a number of the audits with 'partial assurance'. Chief Officers attention is particularly drawn to our work on:

- Nursery Income (Children's Services);
- Schools Recruitment and Selection – Themed Review (Children's Services).

3.3 In addition to Recruitment and Selection, a number of our other recent school themed reviews have resulted in minimal or no assurance opinions. We are therefore working with Children's Services to improve the communication with schools over the findings and recommendations arising from these reviews, with a view to ensuring a greater level of future compliance.

3.4 In addition to the individual audit reports, annual reports and opinions were produced and presented during the quarter for the County Council as a whole and separately for each department. In each case the opinion was satisfactory. Internal audit also contributed to the preparation of the Council's Annual Governance Statement for 2010/11.

3.5 Whilst the number of concluded audits in quarter 1 is relatively low compared to previous years, this is primarily as a result of a reduction in the amount of work in progress carried forward from 2010/11. Although this has impacted on the volume of finalised audits, it has enabled us to progress a number of new 2011/12 reviews, many of which are near to completion. Details of all work in progress are provided at the end of Appendix A.

3.6 Chief Officers will recall that flexibility was built into the audit plan to allow resources to be directed to new and emerging risks during the year. We continue to liaise with departments to identify these but would also welcome input from COMT.

4 Performance against targets

4.1 During quarter 1 of 2011/12 we delivered 440 productive audit days, equating to 25% of the plan days, above our 90% target for the year. As explained above, the percentage of audit assignments completed to final report stage is lower than anticipated at 15%, although work in progress is high. Completed audits have been delivered in 89% of the budgeted time available, well within our target.

4.2 Performance against both of our effectiveness targets is strong with 100% of recommendations being accepted and customer satisfaction running at 88%. Both Cabinet and Audit and Best Value Scrutiny Committee, as part of their approval of the Annual Report and Opinion concluded that the Council's system of internal audit was effective.

5. Priorities for Quarter 2

5.1 Priorities for the period 1 July 2011– 30 September 2011 include:

- Commencement of the 2011/12 programme of fundamental accounting system reviews;
- Progressing the internal audit service review;
- Implementation of a revised internal audit report format;
- Developing an internal audit service offer for new academies as part of new income generation opportunities;
- Managing changes to staff at Senior Auditor level, including the induction of two new appointments.

SEAN NOLAN
Director of Corporate Resources

Contact Officers:	Duncan Savage	Tel No. 01273 482330
	Russell Banks	Tel No. 01273 481447

BACKGROUND DOCUMENTS
Internal Audit Strategy and Annual Plan 2011-12

Appendix A

Summary of key audit findings

Pension Fund – New General Ledger (Corporate Resources Directorate)

The Department for Communities and Local Government issued new regulations for the Local Government Pension Scheme which became law on 1 January 2010. Regulation 6 requires that Local Authorities set up a separate bank account so that pension funds are separate from the general funds of the administering body. Compliance with this regulation needed to be in place by 1 April 2011. To help meet this requirement East Sussex County Council (ESCC) officers identified a need to expand the current accounts structure by setting up a new 'company code' for the pension fund in the SAP system.

Pension transactions in SAP are supported by a system called Axis-E and debts are recovered using the ARMS system. The interface between Axis-E/ARMS and SAP also needed to be amended so that transactions are processed into the Pension Fund company in SAP.

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

- There has been an appropriate review and sign off of progress on the project to ensure that statutory deadlines are met;
- Appropriate officer roles and user access to the new pension fund company have been created and tested before entering the SAP production system, as have the remaining adjusted ESCC roles;
- The process for undertaking pension fund transactions has been fully tested and all tests have been recorded as satisfactory by suitable officers.
- The arrangements for posting opening balances in the new pension fund company have been recorded.

From the audit work completed during this review, we have been able to provide **substantial assurance** that adequate arrangements were in place to complete the project to implement a fully functioning pension fund company in SAP and that there is a sound system of controls.

Some minor recommendations to further improve controls were made and agreed with management.

Further work is planned on pensions and the general ledger during 2011/12 which will test the adequacy of controls over transactions within SAP.

Putting People First (PPF) Self Directed Support Process (Adult Social Care)

The review of the Self Directed Support (SDS) process has been undertaken as part of the agreed internal audit plan of work in relation to the Putting People First (PPF) programme.

As part of the phased introduction of the PPF programme, internal audit has been providing support, advice and assurance that new systems and working practices are introduced in a controlled manner.

SDS is the process for ensuring that individuals are at the centre of the planning process, putting them in control of decisions about their support. It is the system that enables each individual to decide what they want to achieve and how to do this. The key control objectives of this review were to ensure that:

- An adequate SDS process has been developed that accurately sets out all the new procedures for individuals coming into contact with ASC;
- The key controls of the SDS Pathway are being complied with by management, ASC practitioners and operational staff.

From the audit work completed during this review, we are able to provide **partial** assurance that there is a sound system of controls in place.

The main reason for this opinion is that whilst an adequate SDS process has been developed that sets out the new procedures for individuals coming into contact with ASC, compliance by operational staff with the system needs to improve.

It is acknowledged that some of the cases selected for testing were first managed by staff around the time that SDS had just been implemented and new processes were still bedding in. The key areas of non compliance included:

- Where carers were involved, there was not always evidence that they were offered assessments of their own needs. This increases the risk of the Council being in contravention of the Carers (Equal Opportunities) Act 2004;
- Instances were found where ASC did not obtain consent from the service users to share information obtained during care assessment. This is in contravention of both the Data Protection Act and the principles of Caldicott;
- Support plans were not always fully completed and in the majority of the sample tested, there was no evidence that indicative budgets were shared with the clients;
- In half the cases tested, the required evidence could not be found that the risks to the service user and the Council were assessed appropriately;
- In 90% of the cases tested, the period between care assessment and financial assessments were considered to be excessive (longer than two months with a sample average of 4.5 months);
- Reviews are not always being undertaken within 6 weeks after the start of support and in some cases, no evidence could be found that a review had taken place within the last 12 months.

All of the recommendations arising from the review have been agreed with management and incorporated within a formal action plan. This will then be used as the basis for a subsequent follow up review later in 2011/12.

Putting People First (PPF) Budgetary Control (Adult Social Care)

The review of the budgetary control system has been undertaken as part of the agreed internal audit plan of work in relation to the Putting People First (PPF) programme.

The scope of this audit was to ensure that any changes and implications as a result of the introduction of Self Directed Support (SDS) are being effectively managed through the ASC budgetary control process.

The key control objectives for this review were to ensure that:

- ASC systems accurately record all financial data for all clients, including those assessed via the SDS pathway, and client financial information accurately reflects the correct commitments for all categories of service;
- Controls are in place to ensure the above systems provide complete and accurate financial forecasts that are routinely checked against pre-agreed and approved budgets;
- The impact of personal budget decisions on the overall ASC budget is being managed effectively to ensure ongoing affordability;
- Medium term financial plans are being developed that consider the affordability of personal budgets and the likely change in demand for services;
- Spending patterns of personal budget holders are being recorded together with their outcomes.
- The value for money of personal budgets is being evaluated.

The audit also included a review of the budget made available by the Department of Health to support the PPF change programme.

From the audit work completed, we have been able to provide **substantial assurance** over the adequacy of the control environment. We found that appropriate arrangements are in place to ensure that the financial implications associated with SDS and personal budget activities are properly considered and managed.

Adequate controls are also in place to ensure that value for money of personal budgets is being evaluated and detailed medium term financial plans are being produced that consider the future affordability of personal budgets and the likely change in future demand for ASC services.

Only one recommendation for improvement was made relating to the process of conducting support plan reviews and this has been agreed with ASC management.

Nursery Income (Children's Services)

Following a loss of cash from Rye College Nursery during 2010 (now Pugwash Nursery), an unplanned review was undertaken by internal audit which identified a range of serious weaknesses over the management and control of nursery income.

As a result of this, it was agreed with Children's Services that internal audit would carry out a review of nursery income covering all five of the County Council run nurseries managed by the Children's Centre Team. During 2010/11, these nurseries received combined income of £981,322.

Our review sought to provide assurance to management on the overall effectiveness of internal controls within the nursery income system and follow up recommendations made as a result of the Rye Nursery investigation. The audit covered the following control objectives:

- Access to the ICT system(s) to record chargeable services, generate invoices, record income received, and manage outstanding debt is appropriately restricted with an appropriate audit trail of changes made.
- Adequate management reporting arrangements are in place to enable the appropriate monitoring of income and debt.
- All chargeable income due for nursery placements is identified, recorded and billed for accurately at the appropriate time.
- The receipt of income is accurately and properly recorded. Income is kept securely and banked intact as soon as possible.
- Credit control and debt recovery processes are adequate to identify non-payment of debts due and to implement recovery action where necessary. Write offs, credit notes and refunds are valid and are properly authorised.

The audit work undertaken at all five nurseries has identified a weak framework of internal control and, as a result, we have been able to provide **no assurance** that there is a sound system of controls in place for nursery income. The most significant control weaknesses have been set out below and which, when considered collectively, prevent us from being able to confirm that all income due has been received and that all income received has been accounted for correctly. Whilst there was no specific evidence of income missing as part of the review, there remains a risk that income may be lost or misappropriated, as has occurred in the past.

- Income Collection Systems - nurseries have different systems and processes to record and manage income, all of which were found to contain control weaknesses. Furthermore, many of the financial systems used have not been properly evaluated for their appropriateness in accordance with Financial Regulations;
- Nursery Charging Policy and Financial Management - No formal Nursery Charging Policy was found to exist, which has resulted in inconsistent pricing structures and approach to discounts. Nurseries do not have a common or standardised approach to financial management, based on adequately detailed financial procedures and processes, which includes clarity over roles and responsibilities. This weakness is further compounded by staff having a lack of financial expertise and experience, even though they are responsible for the day to day management and control of income and management of debt;

- Income Collection and Banking - nursery staff have developed their own working practices for recording and managing income that do not include appropriate levels of control. Control weaknesses over the reconciliation of income mean it is not possible to verify that all income due is received. A risk therefore exists that income may be lost or misappropriated without detection;
- Debt Management - payments are not always received prior to service delivery and at one nursery, there were significant levels of outstanding debt, some of which may not now be recoverable. Furthermore, no evidence was found to show that nurseries had officially written-off debts in the past, indicating that previous debts may have been written off informally, without being subject to appropriate authorisation in accordance with Financial Regulations;
- Cash Handling and Security - cash handling and security was poor in some areas, with the levels of cash held exceeding insurance limits. These concerns were reported to management during the course of this review and appropriate action is understood to have been taken. With high levels of cash being retained at the nurseries, and the need for this to be transported by staff for banking, there is an increased risk to staff personal safety, as well as financial loss.

A comprehensive management action plan addressing all of the above issues has been agreed with Children's Services Department and this will be subject to a formal follow up review by internal audit later in this financial year.

Recruitment and Selection in Schools – Themed Review (Children's Services)

The County Council has approximately 12,000 staff in schools and around 85-90% of each school's annual budget is spent on staff. Schools are responsible for their own recruitment of both teaching and non-teaching staff, although they are able to obtain various levels of advice and support from the Personnel Support Unit (PSU).

The main purpose of this audit was to review and evaluate the adequacy of internal controls relating to the recruitment and selection of staff in the County Council's schools, covering the following control objectives:

- policies, procedures and training in relation to the recruitment of school staff are adequate and comprehensive, and these comply with appropriate legislation; and
- there is adequate compliance with the Council's policies, procedures and guidance in relation to the recruitment of schools' staff.

The review examined recruitment by schools only and did not therefore include those staff employed centrally by the Children's Services Department (CSD). A sample of primary, special and secondary schools was selected for testing and this included the appointment of headteachers, teachers and support staff.

From the audit work completed, we have been able to provide **no assurance** that recruitment and selection processes in schools are fair, capable of standing up to challenge and are able to ensure the appointment of the best applicants. The main reasons for this opinion are set out below:

- Policies – whilst the County Council has a Recruitment and Selection Policy which refers to schools, this had not been made available to them. In many cases therefore, no policy framework was in place governing the recruitment process. A number of other omissions were also identified in relation to equality and diversity, increasing the risk of schools contravening legal requirements.
- Guidance - the recruitment guidance and information provided to schools is not comprehensive and it does not cover many of the essential elements of the recruitment and selection process, including short-listing applicants, interviewing and assessing candidates and documenting the decisions.
- Appointments without Selection Processes - schools do not have any guidance available setting out the circumstances when it is acceptable for appointments to be made without a full selection process. Consequently, a small number of school vacancies had not been recruited to through a competitive selection process and would not have been classed as acceptable exemptions in line with the County Council's Recruitment and Selection Policy.
- Recruitment and Selection Training – few schools staff were found to have received appropriate recruitment and selection training, despite forming part of the recruitment panel. Centrally, staff cannot be part of a recruitment panel without having first completed recruitment and selection training.
- Record Keeping - schools are not currently maintaining sufficient documentary evidence to demonstrate that they are acting in a fair, accountable and transparent way when appointing staff. Whilst schools are keeping some records of their recruitment process for the required six month period, these are not adequate to support the shortlisting and selection of the preferred candidate.
- Person Specifications - schools are not using the County Council's Person Specification templates which set out which criteria for posts are essential and which are desirable. This increases the risk of not getting the most appropriate candidate and of non compliance with the Council's policy on being 'Positive About Disabled People'. Schools were found to be unaware of the requirement to interview disabled applicants who meet all the essential criteria of a vacancy.
- Appointing Headteachers - full and detailed guidance is provided to Governors for headteacher recruitment. However, a review of the recent recruitment of four headteachers found that despite this, inadequate evidence had been maintained to support the decisions made. This included some instances where no headteacher recruitment files could be located

All recommendations arising from this review have been agreed with management from Personnel and Training and Children's Services Department. These include issuing Recruitment and Selection Policies on Czone and the production of a new Recruitment and Selection Toolkit for schools. In addition, internal audit are currently working with Children's Services to improve the communication with schools over the findings and recommendations arising from our themed reviews, with a view to ensuring a greater level of future compliance. The specific actions arising from this review will be followed up by internal audit later in 2011/12.

6th Form Funding (Children's Services)

In September 2010, the Young People's Learning Agency (YPLA) issued guidance for local authorities on gaining assurance over the funding paid in respect of local authority maintained schools with sixth forms from 1st April 2010. This assurance is provided through the Chief Financial Officer's (CFO) annual grant return, covering funds paid to the Authority by the Skills Funding Agency and YPLA in relation to the periods 1 April 2010 to 31 July 2010, and 1 August 2010 to 31 March 2011.

Whilst ESCC currently has eight secondary schools with sixth forms, we undertook a pilot review of Heathfield Community College only, in order to understand the extent of the work required. Reviews of the remaining seven schools will be completed during the next two to three years.

Although some issues were identified during the audit, these were not deemed to be material by the YPLA and therefore had no effect on the college's funding. Some improvements in the administration of the Education Maintenance Allowance paid to students were identified and agreed with the College.

School Audits (Children's Services)

Following the announcement by the Department for Education in 2010 that the Financial Management Standard in Schools (FMSiS) was no longer a mandatory requirement, our work during quarter 1 has focussed on working with those schools that wished to continue with the assessment, having already started the process, and on undertaking a separate programme of school audits. These audits form part of our overall Internal Audit Strategy for Schools and we are initially focussing on those schools that have never achieved FMSiS.

Of the schools we have reviewed so far this year, one has successfully achieved the FMSiS, one has received a **partial assurance** audit opinion, whilst the third received **substantial assurance**. Reviews of another six schools are continuing, with the outcome of these due to be reported in quarter 2.

Helenswood School – Follow Up (Children's Services)

Internal Audit carried out a review of the key financial and administrative activities of Helenswood School during March 2010, following concerns identified as part of a previous investigation and the subsequent suspension of the school's FMSiS accreditation. The aim of the audit was to examine the management framework of the school, verify the accuracy of financial data and evaluate the systems of financial administration.

Due to the control weaknesses highlighted and the no assurance audit opinion previously given, a follow-up review has been undertaken to assess the implementation of the original recommendations contained within the management action plan.

The school's financial position at 31st March 2010 was a small overspend of £9,238 on an annual budget of £4,943,131. The school had a licensed deficit of £67,125 for the 2010/11 financial year and has predicted recovery within one year, with a balanced budget in 2011/12.

From the audit work completed during the follow up review of key financial and administrative activities and the testing carried, we are now able to provide **substantial assurance** that there is a sound system of financial controls in place.

The school has addressed most of the recommendations from the March 2010 audit report; reducing the number of remaining recommendations from 45 to 8, all of which have been re-stated and agreed with the school.

National Fraud Initiative

Internal Audit is co-ordinating the Council's response to the NFI 2010/11, which has identified a total of 7,207 filtered data matches, across a number of subject areas. Whilst a data match does not always indicate an error or a fraud, the matches include potential duplicate payments, multiple insurance claims, and employees on more than one public sector payroll. They also cover cases where pensions appear to be paid and other services appear to be provided in respect of stakeholders who are deceased according to the records of the Department of Work and Pensions.

Of the total matches, 6,431 cases have been examined to date. This has resulted in the pursuit of £24,000 that has been overpaid to ESCC pensioners, together with an ongoing exercise to ensure that private residential care homes are being reimbursed for the correct number of residents and for the correct periods. Enquiries are continuing into the remaining matches and, where issues of concern are identified, these are subject to a separate investigation.

Work In Progress

The following reviews were work in progress at the end of quarter 1 and due to be reported during quarter 2:

- Risk Management;
- SAP User Authorisations;
- CRB Checking of Contractors;
- Children's Homes Follow Up;
- Integrated Waste Services Management Contract – Recycling Data Flow;
- Procurement of Construction – Framework Agreements;
- Redeployment;
- Use of Consultants – Follow up;
- Traveller Sites – Control of Income;
- Development of Traded Services;
- Spray Watersports and Exceat;
- Direct Payments Contract Management and Follow Up;
- ASC Claims for Additional Hours – Follow Up.

Appendix B

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			
Planned audits completed = final reports issued (%)	90	15			
Actual v Plan time on completed audits (%)	105	89			
Effectiveness					
External Audit reliance on internal audit	Achieved	Achieved			
Recommendations accepted (%)	90	100			
Customer feedback forms scoring 3 out of 5 or higher (%)	85	88			
Reports to Chief Officers and Members	Quarterly	Quarterly reports issued.			

Appendix C
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	400	12.0	412.0	100.3			100.3	
Computer Audit	108	0.0	108.0	4.7			4.7	
Children's Services	387	59.5	446.5	153.7			153.7	
Adult Social Care	242	25.0	267.0	64.7			64.7	
Economy, Transport & Environment	205	5.5	210.5	40.5			40.5	
Governance & Community Services	117	10.5	127.5	35.2			35.2	
Contingency ¹	200	-112.5	87.5	-			-	
Sub total – internal customers	1,659	0.0	1,659	399.1			399.1	24.1%
External customers	102	25.0	127	40.8			40.8	32.1%
Total audit days	1,761	25.0	1,786	439.9			439.9	24.6%

¹ Contingency days delivered include completion of audits carried forward from 2010/11 and unplanned work e.g. investigations, and are included in the total for the department to which the work related.