Report to:	**Audit, Best Value and Community Services Scrutiny Committee**
Date:	**28 February 2012**
By:	**Director of Corporate Resources**
Title of report:	**Internal Audit Progress Report – Quarter 3 (1 October 2011 – 31 December 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 3**

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 3;

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

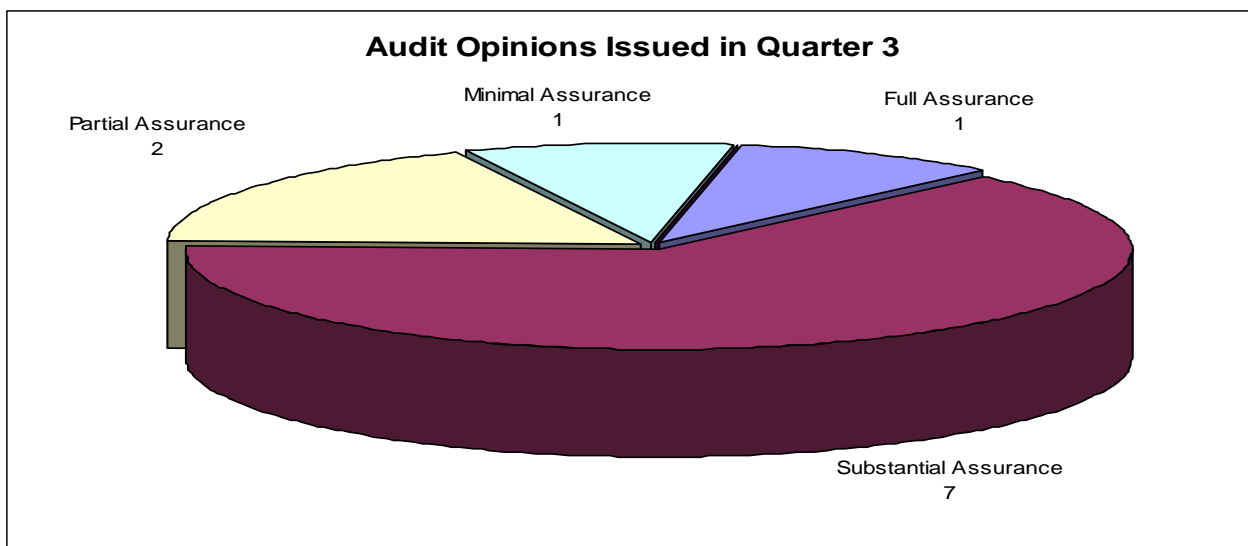## 1.   Financial Appraisal

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. This progress report covers work completed between 1 October 2011 and 31 December 2011.

3.   Summary and Key Audit Findings

3.1   The following graph provides a snapshot of all the audit opinions issued during quarter 3, with a summary of each review also provided within Appendix A.

Audit Opinions Issued in Quarter 3

Minimal Assurance
1

Full Assurance
1

Partial Assurance
2

Substantial Assurance
7

3.2   Of these reports, the review of Procurement and Contract Management in Schools resulted in an opinion of 'minimal assurance'. This is one of a number of themed reviews undertaken by internal audit in the last 2 years which have highlighted control weaknesses within schools and have now prompted a project led by Children's Services, and involving internal audit, to examine the role and relationship between the County Council and our schools. In particular, the review is seeking to ensure that risks and liabilities are properly understood in light of the greater independence available to schools and where necessary, the extent of County Council powers to influence and enforce improvements in governance and control. This work in ongoing and is due to be reported on shortly.

3.3   In all instances where high risk (3 star) recommendations have been issued, implementation is monitored through an action tracking process. In addition to this, formal follow up reviews are 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'. The current position with regard to the implementation of high risk recommendations issued so far this year is:
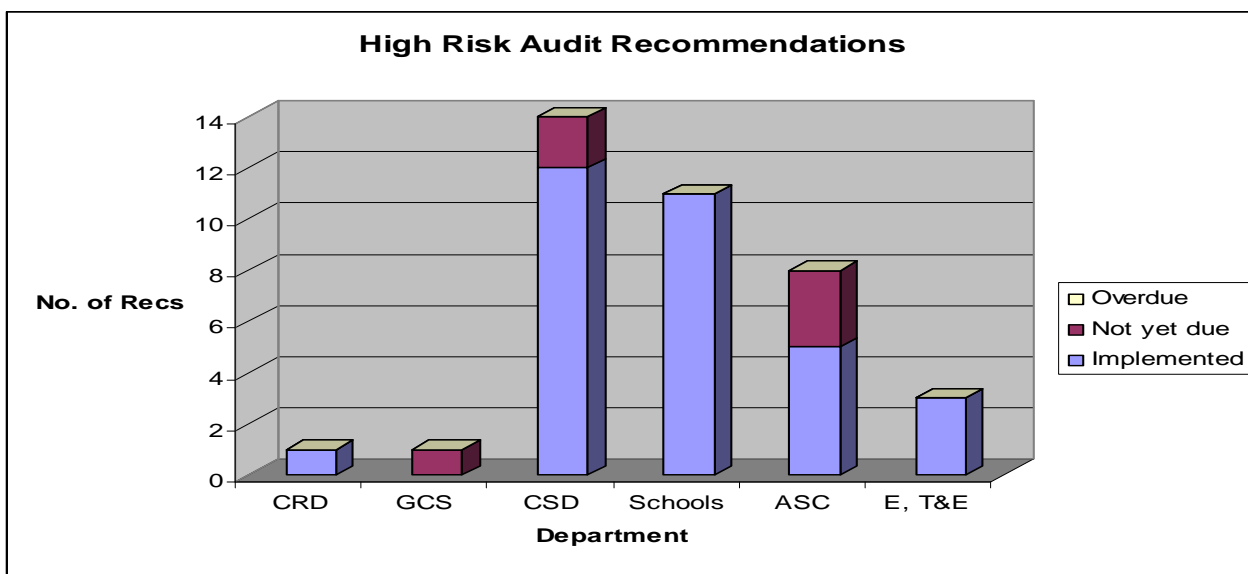
3.3   At the time of this report, all high risk recommendations, which are due to be implemented, have been actioned by departments.

3.4   Members will recall that flexibility was built into the audit plan to allow resources to be directed to new and emerging risks during the year and we continue to liaise with departments to identify these.

3   Internal Audit Performance

3.1   In response to feedback received from stakeholders as part of the current service review, we have taken the opportunity to streamline the key performance measures for internal audit, with more focus on qualitative measures. A summary of current measures is provided within Appendix B. Once agreement to the recommendations within the Service Review report has been received, revised internal audit performance measures will be developed and implemented for the new financial year.

3.2   So far this year, the feedback received from clients via customer satisfaction questionnaires completed at the conclusion of each review shows that 89.9% of clients rate all aspects of the service as satisfactory or above, and of the recommendations issued, 99.5% have been accepted by management. As at the end of December, 66.1% of the agreed audits have been finalised and we expect to meet our target by the year end.

4.   Priorities for Quarter 4

4.1   Priorities for the period 1 January 2012– 31 March 2012 include:

- Begin implementation of the recommendations from the Internal Audit Service Review (subject to agreement);
- Development of the Internal Audit Strategy and Plan for 2012/13;
- Continuation of our work to develop closer working and increased collaboration with Brighton and Hove City Council Internal Audit;
- Completion of our programme of fundamental accounting systems work.

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Director of Corporate Resources

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Local Member: All

Background Documents
Internal Audit Strategy and Annual Plan 2011-12

Appendix A

Summary of key audit findings

General Ledger (Corporate)

The review of the General Ledger (which is part of the programme of Fundamental Accounting System reviews) has been completed as part of the agreed annual audit plan for 2011/12.

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

- All direct journal inputs to the general ledger are complete, accurate and properly authorised;
- Transactions posted from feeder systems into control accounts are complete and accurate;
- Unrecognised accounts or suspense balances are reviewed and cleared on a timely basis;
- Adequate bank reconciliation procedures are in place.

Based on the work completed as part of the review, we have been able to provide **substantial assurance** over the system of controls. Some opportunities to make further improvements were identified in relation to journal authorisation, ensuring bank reconciliation checks are properly evidenced and strengthening segregation of duty controls at Serco.

Accounts Receivable (Corporate)

The review of Accounts Receivable (which is part of the programme of Fundamental Accounting System reviews) has been completed as part of the agreed annual audit plan for 2011/12.

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

- All chargeable services provided and goods despatched are identified and billed at the correct amount;
- All income due is invoiced and correctly recorded;
- Credit control and debt recovery processes are adequate;
- Write offs, credit notes and refunds are valid and are properly authorised;
- There is adequate segregation of duties in the invoicing and receipting functions.

Based on the work completed as part of the review, we have been able to once again provide **substantial assurance** over the system of controls, with only a small number of low risk recommendations being made.

Review of Strategic Risk Management (Corporate)

The objective of this review was to assess the extent to which the organisation is effectively managing its strategic risks, as set out within the County Council's Strategic Risk Register. The audit involved examining a sample of strategic risks across all departments to provide assurance that:

- A series of comprehensive and cost-effective actions have been identified, for the mitigation of risks;
- Actions indentified for the mitigation of the risks have been implemented;
- Controls are in place to ensure that actions identified are effective in mitigating the risks as intended.

From the audit work completed during the review, we have been able to provide **substantial assurance** that effective risk management arrangements are in place across the organisation. Specifically, we found that the risk management process, whereby risks are identified, assessed, transferred, terminated, accepted or mitigated, is now well-embedded into normal management activity.

Pension Fund Processes and Systems (Corporate Resources Directorate)

The review of Pension Fund Processes and Systems (which is part of the programme of Fundamental Accounting System reviews) has been undertaken in accordance with the annual Internal Audit Plan for 2011/12 and the Pension Fund Audit Strategy.

It is pleasing to report that, from the audit work completed during the review, which covered a range of key control objectives, we have been able to provide **full assurance** that there is a sound system of controls in place.

The only recommendations arising from the review related to ensuring that returns from admitted bodies are always properly signed and that life certificates are periodically issued to pensioners based on certain risk criteria.

Procurement of Construction – Framework Agreements (Corporate Resources Directorate)

A review of the way in which the County Council uses framework agreements to procure construction contracts has been completed as part of the agreed annual audit plan for 2011/12.

Framework agreements have been developed as a result of work completed by 'Improvement and Efficiency South East' (IESE), one of nine regional partnerships established in England. The IESE frameworks can be accessed by a range of public sector bodies and are structured as follows:

- IESE Tier 1 is a Regional framework run by Hampshire County Council on behalf of Improvement and Efficiency South East covering contracts over £1m;
- IESE Tier 2 Sussex Cluster is a Sub-regional framework managed by ESCC for contracts £500k to £3m;
- IESE Tier 3 Sussex Cluster is a Sub-regional framework managed by ESCC for contracts up to £750k.

The purpose of this audit was to ensure that the IESE frameworks are being followed, providing a competitive process with the appropriate management of risk. The review sought to provide assurance on the overall effectiveness of controls within the IESE Tier 2 and Tier 3 frameworks, being those where ESCC is the lead authority.

Overall, based on the testing undertaken, we have been able to provide **partial assurance** as to the adequacy of the control environment. The main areas where there were opportunities to strengthen internal controls were:

- Increasing the level of senior officer scrutiny, when authorising the appointment of a single stand out contractor from the framework rather than making the selection via a mini competition process;
- Ensuring that formal agreements are in place between the County Council and other public sector organisations using the frameworks and strengthening controls to ensure that all fee income due to the County Council is received.

All recommendations have been agreed with management with implementation will be monitored by internal audit as part of our normal action tracking process.

On-Line Collection of Cash Receivable Health Check (Corporate Resources Directorate)

At the commencement of this review, ESCC was already providing a facility for on-line debit or credit card payments to be made via the internet for Registration Services. This solution was to be extended and enhanced subsequently as part of the "SAP invoiced and non-invoiced collections project" to allow internet payments for the settlement of outstanding invoices, as well as procurement of Council services (e.g. Schools Music Service).

This ICT audit health check, conducted by specialist auditors from Deloitte, was delivered in accordance with the 2011/12 audit plan and covered the following areas:

- User Interface;
- Back-up and Recovery;
- System Maintenance;
- Back Office Access Controls;
- Input Validation;
- System Accounting;
- Interface Controls; and
- Security (PCC-DSS).

The resultant report set out the findings from this audit work and highlighted the potential improvements in the control framework, all of which were raised with the client and resolved during the course of the review.

No audit opinion was provided in this instance as only a limited assurance can be given for a system implementation health check, until such time as the system has been fully developed and tested. Further work in this area is likely to be included in future audit plans as the system is rolled out.

Wide Area Network (Corporate Resources Directorate)

The Corporate ICT Wide Area Network (WAN) Infrastructure provides the fundamental support platform for the delivery of the primary business application and communication systems. It is therefore essential that the WAN has in place adequate and appropriate controls to address the corporate ICT risks and regulatory obligations, including confidentiality, integrity and availability requirements.

This review, conducted by specialist ICT auditors from Deloitte, resulted in an audit opinion of **partial assurance** over the control environment. A range of detailed recommendations, none of which were deemed to be of a high risk nature, have been agreed with management aimed at improving:

- Monitoring of system changes and security activities across the WAN;
- Lockout controls for unauthorised access attempts;
- The use of real time alerts to detect unauthorised activity in relation to certain high risk events;
- Management of user accounts and sharing rights, particularly in relation to those with privileged access levels.

All recommendations have been agreed with ICT Services and will be subject to a follow up review during the course of 2012/13 to ensure implementation.

Real Time Telephone Monitoring (Adult Social Care)

Real Time Telephone Monitoring (RTTM) is the system used for recording and monitoring the delivery of home care services by external providers under framework agreements. The data collected by RTTM forms the basis for subsequent payments, meaning that ESCC pays service providers for the actual amount of care received by the service user and not planned time, which therefore reduces the risk of paying for care which has not been delivered.

This was the first review of RTTM since its implementation and covered the following key control objectives:

- Access to the system is secure and in compliance with the Council's Corporate standards;
- Data held is secure and protected against loss or damage;
- Payments made are accurate and correctly authorised and are only made to approved providers;
- There is adequate segregation of duties to prevent any one member of staff controlling all parts of the payment process;
- RTTM data is transferred completely and accurately between RTTM and Controcc;
- There are adequate and effective management reports within RTTM that are regularly analysed.

Based on the work undertaken as part of the review we have been able to provide **substantial assurance** over the RTTM internal control framework. Some opportunities to further strengthen controls were identified in relation to improving the monitoring of suspended payments and developing user guides and procedures to help ensure business continuity and improve the quality of management information.

Integrated Community Equipment Service (Adult Social Care)

The Integrated Community Equipment Service (ICES) has a key role in supporting people to remain at, or return home. In the period January to December 2010, the service processed over 30,000 orders, delivering over 65,000 items of equipment. The service is funded through a pooled budget (£3.5m) with East Sussex Downs and Weald Primary Care Trust (PCT) and Hastings and Rother PCT.

Following the implementation of new contractual arrangements for community equipment and minor adaptations, revised business processes have been developed by the Business Development Team in Adult Social Care (ASC).

At the request of ASC, we reviewed these new processes prior to implementation, specifically looking at arrangements for the checking of orders, deliveries and invoices to ensure payments would only be made for items of equipment that had actually been ordered and delivered. It should be noted that, as the processes had not yet gone live, no audit testing was undertaken and it is therefore likely that further audit work will required once full implementation has been achieved.

Overall, the proposals were found to be sound, although there were some areas where further consideration was needed to help ensure the ordering, receipt and payments process was adequately controlled. These were reported to ASC who are committed to strengthening processes and controls wherever necessary.

Further audit work in this area will be undertaken in the new financial year to ensure that systems are operating as expected.

CarePay (Children's Services)

CarePay is a component part of CareFirst, the client database used to record service-related activity. Since October 2004, CarePay has been used to monitor and control allowances, including those due to foster parents, providing accommodation and support for looked after children who are in the Local Authority's care, and to adoptive parents. An automatic interface exists linking CarePay with the Accounts Payable (AP) module of SAP, from where the physical payments are made.

The review, which is part of the programme of fundamental accounting system reviews, included testing the accuracy and integrity of the system to make payments and to recover any overpayments made. The links between the respective systems were reviewed to ensure that they are effective and that all data passed from one system to another is complete, accurate and timely.

Based on the work completed as part of this review we have been able to provide **substantial assurance** over the control framework. The main area for improvement related to the need to increase the use of system generated exception and management reports in order to identify potentially unauthorised activity. All recommendations have been agreed with management and will be subject to follow up as part of the 2012/13 audit plan.

Children's Homes (Children's Services)

Following the identification of poor financial practices at a County Council children's home (previously reported within the quarter 2 progress report), a review of children's homes more generally has been undertaken as part of the 2011/12 audit plan.
The scope of this audit was to ensure that adequate and robust financial systems and controls are in place in all ESCC children's homes, covering:

- budget management;
- staff pay claims;
- receipt of income;
- petty cash;
- asset management for both ESCC and individual service users' property.

Based on the work completed as part of this review, which involved testing at four different homes across the County, we have been able to provide **substantial assurance** as to the adequacy of the control environment.

Our review found that controls in place at children's homes were generally good and it is clear that following the issues previously identified at one home, work has been undertaken by Children's Services to help ensure an adequate level of control exists across all the other homes. Some opportunities were identified to further improve the system of controls and the level of compliance with these, specifically in relation to:

- Petty cash - where there is a need to ensure all cash is properly recorded and signed for and that VAT is accounted for correctly; and,
- The inventory - where improved recording and regular checking of higher risk assets is required.

All recommendations have been agreed with Children's Services as part of a formal management action plan.

Procurement and Contract Management in Schools (Children's Services)

The themed review of procurement and contract management in schools has been completed as part of the agreed annual audit plan for 2011/12 and our Internal Audit Strategy for Schools.

The purpose of the audit was to review the guidance available to schools in relation to procurement and contract management and to assess the extent to which schools and governing bodies are complying with this. A sample of ten schools, including primary, secondary and special schools was selected for testing.

Based on audit work undertaken, we have only been able to provide **minimal assurance** over the adequacy of procurement and contracting controls within schools. Whilst we identified the need for some improvements in the guidance available to schools, the main weakness related to the low level of awareness, and therefore compliance, amongst school staff and governing bodies, with Contract Standing Orders for Schools and supporting ESCC guidance.

In most of the schools sampled that had commissioned building works, architects or other consultants had often been engaged in a manner which did not comply with Contract Standing Orders, particularly in relation to managing conflicts of interests. Our work also found that schools are placing too much reliance on these consultants, effectively relinquishing responsibility to them, without adequate safeguards to ensure financial probity.

Other key findings from the review included:

- The failure of schools and governing bodies to obtain and retain quotations in accordance with the requirements of Contract Standing Orders for Schools and therefore not being able to demonstrate that value for money is being achieved, or that contracts have been let fairly;
- Schools not maintaining registers of contracts which is contributing to poor contract management;
- Payments being made for works in advance, increasing the risk of financial loss, especially when references are not sought when using non-ESCC approved contractors;
- The failure of schools and governing bodies to properly approve expenditure in accordance with their Schemes of Delegation.

Whilst the final report on this work, and associated recommendations, have been agreed with Children's Services Department (CSD), it is currently unclear as to the extent to which the department can ensure and enforce compliance by schools and governing bodies, particularly in light of schools' increasing level of independence. This is an issue which had been raised by officers and Members following previous themed reviews in schools and is therefore something on which internal audit are working with CSD to help clarify as part of a separate project.

In the meantime, CSD have agreed to take action to implement the recommendations arising from this report, many of which relate to providing further guidance to all schools and reminding them of the need to ensure compliance with procurement regulations and policies. Follow up work will be undertaken by internal audit during 2012/13.

Children Index (Children's Services)

The Children Index is an online directory used to provide a single view of children within East Sussex along with the Council's services and details of practitioner involvements. The system is designed to promote improved information sharing to enable better support for children and their families. To this end, the Children Index receives data from various feeder systems that are managed both by the County Council and by third parties.

This review, conducted by specialist ICT auditors from Deloitte, examined the following areas:

- Access Controls;
- Data Input;
- Data Processing and Interface Controls;
- Output Controls;
- Management Trails;
- Backup and Recovery;
- System Enhancements and Developments;

- Support Arrangements.

Based on the work undertaken, **substantial assurance** has been provided over the control environment. The main recommendations arising from the review, all of which have been agreed with management, focussed on strengthening business continuity by reducing reliance on key staff and improving system documentation.

Highways Maintenance Contract Extension (Transport and Environment)

We are continuing our work providing advice and challenge in relation to the Highways Maintenance Contract Extension, currently focusing on the following areas:

- project management and governance arrangements;
- risk and opportunity management;
- change management;
- asset management;
- new business processes;
- contingency arrangements;
- performance monitoring;
- ICT arrangements, including provider support.

To date, no significant issues have been identified, with progress due to be formally reported to the Project Board at their meetings in January and March 2012.

Investigations

Private Care Homes (Adult Social Care)

Amongst the results of the National Fraud Initiative 2010/11 were a number of instances where residents of private care homes (according to ESCC records) also appeared in registrar/Department of Work and Pensions records as being deceased.

As a result, a joint investigation between Adult Social Care and Internal Audit was carried out in order to establish the facts behind these cases, to identify and recover any overpayments and to establish whether any fraud had been committed against the County Council.

In all cases, any overpaid sums had been recovered from the homes, mainly through an adjustment to future contractual payments, so ESCC did not incur any financial loss. Whilst the review did not identify any evidence of fraud, it was found that this issue has arisen as a result of poor administrative practices within the homes and a lack of awareness amongst staff at the homes of the correct procedures for notifying the County Council when a service user dies. The results of this work were reported to Adult Social Care during quarter 3 and an internal control report, making recommendations to help limit future recurrence, is due to be finalised in quarter 4.

School Conflict of Interest (Children's Services)

As part of the 'Procurement and Contract Management in Schools Review' referred to above, a clear conflict of interest was identified relating to a primary school governor. Specifically, the governor concerned, who was also Chair of the School Premises Committee, was found to have been undertaking building consultancy work at the school

without ensuring that this conflict had been properly declared and without withdrawing from meetings where this work was discussed.

Internal audit investigated matter in conjunction with the Governor Services Team from Children's Services Department and found that, whilst there was no evidence of dishonesty, breaches of Contract Standing Orders and the 'Guide to the Law for School Governors' were identified.

The governor concerned has subsequently resigned from their role and the school has agreed to implement all internal audit recommendations arising from our work.

Work In Progress

The following reviews were work in progress at the end of quarter 3 and due to be reported during quarter 4:

- Development of Traded Services (CSD)
- Section 75 Pooled Budgets (CSD)
- Schools Cashless Income Collection Systems (CSD)
- Themed Review – Schools HR/Payroll (CSD)
- Early Years Education Entitlement (CSD)
- Fundamental Accounting System – Controcc (ASC)
- Highways Maintenance Contract Extension (E,T&E)
- Concessionary Fares (E,T&E)
- Enforcement Contract KPI's (E,T&E)
- Accounts Payable - Fundamental Accounting System (CRD)
- HR/Payroll - Fundamental Accounting System (G&CS/CRD)
- Wireless Network Infrastructure (CRD)
- Database Audit: Oracle (CRD)
- Public Sector Network Project (CRD).

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	47.1	69.2	
Planned audits completed = final reports issued (%)	*90*	15	46.2	66.1	
Actual v Plan time on completed audits (%)	*105*	89	97.4	93.9	
Effectiveness					
External Audit reliance on internal audit	*Achieved*	Achieved			
Recommendations accepted (%)	*90*	100	99.2	99.5	
Customer feedback forms scoring 3 out of 5 or higher (%)	*85*	88	89.5	89.9	
Reports to Chief Officers and Members	*Quarterly*	Quarterly reports issued.			