

Report to: **Audit, Best Value and Community Services Scrutiny Committee**

Date: **6 September 2013**

By: **Chief Operating Officer, Business Services Department**

Title of report: **Internal Audit Progress Report – Quarter 1 (01/04/13 – 30/06/13)**

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:

- 1. Members are recommended to consider and agree any action that should be taken in response to the issues raised in any of the audits carried out during Quarter 1;**
 - 2. Identify any new or emerging risks for consideration for inclusion in the internal audit plan.**
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1. Financial Appraisal

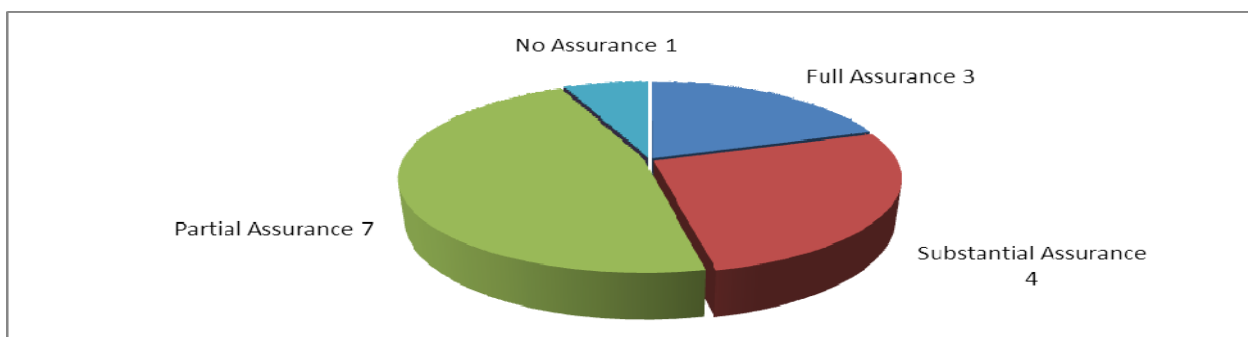
1.1 There are no direct financial implications arising from the recommendations in this report.

2. Supporting Information

2.1 The current annual plan for internal audit is contained within the Internal Audit Strategy and Annual Plan 2013-14. This was prepared after consulting Chief Officers and senior managers and was endorsed by Audit, Best Value and Community Services Scrutiny Committee (24 June 2013) and Cabinet (23 July 2013). This progress report covers work completed between 1 April 2013 and 30 June 2013, including the finalising of audits from the 2012/13 audit plan.

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 15 formal audits completed, 3 resulted in a 'full assurance' opinion, 4 received 'substantial assurance', 7 received 'partial assurance' (three of which were schools) and 1 received 'no assurance'.

3.3 Whilst the same range of internal audit opinions are issued for all audit assignments, it is necessary to also consider the level of risk associated with each area under review when drawing an opinion on the Council's overall control environment. **Taking into account these considerations, the Head of Assurance continues to be able to provide reasonable assurance that the Council has in place an effective framework of governance, risk management and internal control.**

3.4 This conclusion has been drawn based on all of our work completed in the quarter, including reviews of higher risk areas, such as HR/Payroll and Bexhill / Hastings Link Road – Financial Governance, which received opinions of full assurance and substantial assurance respectively. **Member's attention is, however, also drawn to our work on Administration of Looked After Children (LAC) Funds, where we were unable to provide any assurance over the control environment, and Information Governance and Controcc (social care payments system), over which we were only able to provide partial assurance.**

3.5 In all cases, recommendations to address the control weaknesses have been agreed with management and incorporated within a formal action plan. These will be subject to a follow up review by internal audit where either 'minimal' or 'no assurance' opinions have been given and for all higher risk areas receiving 'partial' assurance.

3.6 In addition, we have in place arrangements to monitor implementation of all high risk recommendations and at the time of writing this report, only two of these remained outstanding beyond the agreed implementation date. In both cases, the recommendations related to a school where the Council had removed the delegated budget and where CSD management are working with the school to ensure the necessary improvements are made within reasonable timescales. Further details of these recommendations are provided in Appendix B.

3.7 Members will recall that flexibility was built into the audit plan to allow resources to be directed to any new and emerging risks. We continue to liaise with departments to identify these but would also welcome input from Members. Details of those reviews added and removed from the plan so far this year are set out at the end of Appendix A.

4 Performance against targets

4.1 Progress against agreed performance targets (focussing on quality / customer satisfaction, compliance with professional standards, and cost / coverage) can be found in Appendix C. All targets have been assessed as on target (Green), including delivery of 90% of the annual audit plan by 31 March 2014.

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Background Documents
Internal Audit Strategy and Annual Plan 2013-14

Summary of key audit findings

Information Governance

Information governance is a specific subset of corporate governance and is focussed on the performance and risk management of information, including the processes, responsibilities and controls that treat information as a valuable organisational asset.

Our work in this area found that the control environment varied across the Council, with both weaknesses and good practice being identified. This has resulted in an audit opinion of '**partial assurance**'.

The key areas for improvement arising from the review included:

- The need to rationalise and standardise policies and procedures relating to information governance, avoiding duplication and inconsistency between departments;
- Improving information governance training arrangements for staff, particularly by ensuring that refresher training is provided wherever necessary;
- Ensuring that there is a consistent, Council wide, approach for information asset management, which includes an approved data classification scheme, the requirement to identify and allocate responsibility for all relevant information assets and the processes to ensure documentation is maintained as complete and accurate;
- Progressing current work to establish clear data sharing protocols and introduce an appropriate framework for the Council;
- Ensuring that there is a robust and consistent approach across all departments for security incident reporting, in accordance with the Council's Incident Reporting Policy.

A comprehensive action plan to address these and other findings has been agreed with the Council's Senior Information Risk Owner and these are being taken forward through the corporate Information Governance Group. This is an area also being monitored by the Council's Statutory Officer Group and will be subject to a follow-up review later in the year.

HR/Payroll

HR/Payroll is one of the Council's fundamental accounting systems and has been subject to a key control review during 2012/13, covering the following control objectives:

- All employees on the payroll are valid and are employed by ESCC;
- Payments are made only for allowable expenses;

- Gross payroll costs and material deductions have been properly calculated and in accordance with approved pay rates or staff contracts;
- Payroll costs have been properly accounted for in the main accounting system;
- Separation of duties is in place between those making payments and those creating and amending payroll records.

With the exception of one minor recommendation relating to out-of-pocket expenses, we were able to provide an opinion of **'full assurance'** that a sound system of controls is in place.

In addition to the HR/Payroll review, a separate internal audit has been carried out in relation to staff claims for hours worked and additional hours, including overtime. This was undertaken in response to concerns identified during the year and involved extensive testing across all Council departments. The results of this audit will be reported on in due course.

Bexhill to Hastings Link Road – Financial Governance

The County Council entered into a contract in 2009 to design and construct the Bexhill to Hastings link road, which includes Department of Transport funding of approximately £57m.

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

- Governance arrangements are robust and are likely to manage the contract effectively;
- Change control arrangements will ensure that all variations to the target cost are properly assessed and authorised;
- An adequate risk register is in place which is linked to budget contingencies and is regularly reviewed and updated;
- Financial management arrangements will ensure that accurate reports are regularly produced regarding the estimated final cost of the scheme;
- Cost control procedures will ensure that there are sufficient checks on the validity and accuracy of the contractor's actual costs.

Based on the work undertaken, we found governance arrangements to be adequate and that proposed financial reporting arrangements would be effective. As a result, we were able to provide an opinion of **'substantial assurance'**.

Some opportunities to further strengthen controls were identified in relation to:

- Formalising arrangements for the approval of variations within the project governance structure;
- Clearly specifying roles and responsibilities within the risk register;
- Clarifying details of the financial reports that are to be presented to the Project Board.

All recommendations in these areas were accepted in full by management and we understand these have all now been implemented.

Controcc

The Controcc system is used to record contractual obligations and control payments to independent sector providers of day care, home care, residential and nursing care services. Dependent on their financial circumstances, clients are required to contribute towards the cost of these services.

Controcc is one of the Council's fundamental accounting systems; the internal audit review of which is relied upon by the external auditors in forming an opinion on the Council's accounts. It is also an area highlighted within the external auditor's risk assessment as part of their 2012/13 audit plan. From April 2012 to February 2013, approximately 20,000 payments totalling £111m were made through Controcc. For the same period, £7.8m of charges were raised through the system.

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

- All payments made are accurate, timely, legitimate and properly authorised;
- Adequate interface controls exist between the source systems (ContrOCC/Abacus) and SAP;
- Access to the system is secure and data held is protected against loss or damage;
- All services provided are accurately invoiced on a timely basis;
- The financial assessment process is robust and results in an accurate and timely assessment of a client's ability to contribute towards services provided;
- Credit notes, invoice amendments and write-offs are properly authorised.

Our review found that, whilst amounts paid to providers and collected from clients were found to be correct, the need for improved clarity over roles, responsibilities and procedures was a recurrent theme. There are a number of small teams within Adult Social Care that all have some involvement with Controcc, and we found that the majority of these tend to work independently of each other, resulting in unclear lines of communication and accountability, increasing the potential risk of error or fraud.

Other areas of improvement identified as part of our work included:

- Strengthening credit note approval processes and the monitoring of credits issued through the system;
- Improving the clarity of invoices sent to clients in respect of their care, particularly in terms of differentiating between income due and credits issued;
- Implementing robust arrangements for ensuring that providers notify the Council promptly where a client dies or leaves care, to ensure that overpayments are prevented. This is an area subject to a more detailed review by internal audit which will be reported on separately upon completion.

Based on the audit work carried out, we have been able to provide '**partial assurance**' over the control environment within Controcc. All recommendations arising from the review have been agreed with management.

Contracting and Procurement – A4e

In April 2012, the Council awarded a contract for the provision of direct payment support services in East Sussex to A4e. The contract is for a period of three years, with an option to extend for a further two, subject to satisfactory performance.

A4e work closely with the Council to provide advice and support to people who want to take more control of their personal assistance needs. They offer all kinds of help to individuals, including help with recruiting personal assistants, calculating wages and managing direct payments money on a day-to-day basis.

Payments to A4e have previously totalled approximately £3.75m per annum. Of this, approximately £300,000 per annum represents payment to A4e for the core support services they provide to clients and carers who wish to have services provided by direct payments.

The remaining £3.45m represents funds administered by A4e on behalf of clients who are in receipt of direct payments but who do not wish to have the responsibility of administering the money themselves.

Our review focussed on ensuring that all services are delivered in accordance with the contract, that all payments are valid and accurate and that all changes are adequately controlled.

Based on the work undertaken, we were able to provide an opinion of ‘**substantial assurance**’. Adequate controls were found to be in place to ensure the provision of direct payment support services in East Sussex. We also found that clear governance and performance management arrangements were in existence.

A small number of recommendations were made to improve the overall control environment, all of which have been agreed with management. These included strengthening business continuity arrangements and some aspects of performance monitoring.

Administration of Looked After Children’s (LAC) Funds

A review of the Administration of Looked After Children (LAC) funds, an area not previously reviewed by internal audit, was completed following an investigation into the alleged theft of funds from a looked after child by a staff member in 2012. This case is subject to an on-going police investigation which is being supported by ESCC staff.

Financial resources can be made available to LAC from a variety of sources, including public bodies (e.g. benefit payments), friends and relatives. As at November 2012, there were 609 children in the care of the Council, approximately 80% of which had been placed with foster carers.

Senior management recognised that there were inadequate processes and controls in relation to the administration of LAC funds and therefore agreed an independent review. In addition to identifying specific control weaknesses and providing an opinion on the overall control environment, this joint exercise with management focused on improving

existing procedures in order to give greater assurance that LAC funds are properly administered, controlled and monitored.

As expected, our review confirmed the control environment to be inadequate and this resulted in an audit opinion of '**no assurance**'. Given the weaknesses found, we were unable to provide any assurance that LAC funds are properly controlled, with a high risk of theft and inappropriate use of children's savings. In addition, we were unable to provide any assurance that funds are invested in the best interests of the children, thereby ensuring maximum returns for future use.

Specific control weaknesses included:

- An absence of formal procedures covering the administration and management of LAC savings. Although the responsibility for LAC funds is delegated to carers, this arrangement is not recognised formally in guidance for foster carers;
- Inadequate controls to account for LAC funds where children move between carers;
- Insufficient records of LAC savings accounts, with no formal processes in place to monitor savings or to review large or unusual withdrawals;
- Inadequate arrangements for ensuring that, where a child has been awarded compensation as a result of a criminal injuries claim, this is properly communicated at the point of the child leaving the County Council's care.

Working with key staff, we have reviewed and advised on changes to procedures and guidance to carers. These amendments have been welcomed and agreed with senior management and, once implemented, should significantly improve the overall control environment. All recommendations are due to be implemented by December 2013, and the majority sooner. The review will therefore be subject to a follow-up later in the year. Based on liaison with a number of other local authorities, it appears that weaknesses in the administration of LAC funds are not limited to ESCC, with a number of other Councils consulted being unable to provide details of how this area is properly controlled.

Schools' Funding Formula

In 2012, the Government published a document announcing that, as from 2013-14, changes would be made to reform the system for distributing Dedicated Schools Grant (DSG). The intention behind these reforms was to ensure fewer differences in funding of similar schools in different regions. In order to comply with the new requirements, a new funding formula model has been developed to allocate the DSG for both schools and academies.

The main purpose of this audit was to review a number of aspects of the new funding formula model (in the form of a spreadsheet) developed within the Council, including its integrity and security. Our work was limited to manual testing of outputs on a sample of schools only and no testing was undertaken to verify the accuracy and validity of the source data used to populate the model.

Based on the work completed, we provided an audit opinion of '**partial assurance**'. There was little security in place to protect the live model or to prevent unauthorised amendment of data or formulae, which could potentially impact on future funding

allocations to schools. In addition, procedures in relation to the formula funding process had not been established or documented which could lead to inconsistencies in managing and updating the model, and inaccurate allocations.

All recommendations arising from this review have been agreed with management, with all due to be implemented by the end of June 2013.

For 2014/15, the Council is considering the use of the Department for Education's recommended model, the 'Authority Proforma Tool' (APT), which is anticipated to provide a greater level of control.

Nursery Income and Debt – Follow-Up Report

An audit review of Nursery Income was completed in July 2011 which identified a weak framework of internal control and meant that we were unable to provide any assurance over the control environment.

In view of the significant weaknesses identified, we have now completed a follow-up review to assess the extent to which our original recommendations have been implemented. Overall, we found that, whilst we are now able to provide '**partial assurance**' over the control environment with some progress having been made, there were still a number of medium risk internal control weaknesses which had not been addressed. Areas where further action is still required included:

- Improving the maintenance of attendance registers for children to ensure the completeness and accuracy of all charges;
- Strengthening controls over the accounting and invoicing for additional nursery hours and meals for children, in order to ensure the Council receives all income due;
- Ensuring appropriate separation of duties between staff invoicing clients and those receiving monies;
- Improving and standardising debt recovery procedures across nurseries.

All recommendations arising from this review were agreed by management as part of a comprehensive action plan, the majority of which are due to be implemented by the end of July 2013.

Code of Conduct in Schools – Follow-Up Report

The Scheme for Financing Schools states that Governing Bodies are responsible for ensuring that all new employees are provided with a copy of the Code of Conduct for Employees. The Scheme is not prescriptive about the content of a Code of Conduct as it is a delegated function of each school's Governing Body to determine this locally.

In 2010, we completed a 'Code of Conduct in Schools' review; the main purpose of which was to assess whether schools had adopted suitable codes and that declarations of potential conflicts of interests had been made and were being appropriately managed, particularly in relation to the procurement of goods and services and the recruitment and employment of staff. Our work in this area resulted in an opinion of 'minimal assurance', mainly because there was no clear and explicit Code of Conduct for school employees and as a result, inconsistencies arose between schools in declaring business interests.

As part of this subsequent follow up review, we have been able to establish that the County Council's Code of Conduct for Employees has now been amended to incorporate school based staff and that this has been communicated to all schools for them to adopt locally.

As a result, are now able to provide an opinion of '**full assurance**' over the control framework, with further work to be undertaken in the future to assess the extent to which individual schools have adopted and applied the policy.

School Audits

During the quarter we have continued to conduct visits to a number of schools in the County, with the individual schools selected in conjunction with Children's Services Department on the basis of risk.

Dallington C of E Primary School (Partial Assurance) – our work found an inadequate separation of duties within the payments and payroll process, and income procedures were found to be weak. In addition, orders for goods, works or services are not always raised in accordance with the school's Scheme of Delegation and the School Fund has not been audited and presented to the Governing Body for a number of years.

Ringmer Primary School (Partial Assurance) – our review of this school found a number of weaknesses in relation to the governance of the school. In particular, key policies and procedures are at risk of becoming out-of-date as a result of not being updated and reviewed regularly by the Governing Body. In addition, whilst a whistleblowing policy is in place, staff are not aware of the procedures to be followed where fraud and corruption is suspected. We also found that staff and governors have not completed annual declarations of interest and there was evidence that some potential conflicts had not been declared. There are currently inadequate links between the School Development Plan and the school's annual budget.

Telscombe Cliffs Community Primary School (Partial Assurance) – key audit findings in relation to this school included contracts not being approved in accordance with the school's Scheme of Delegation. We also found an instance of non-compliance with Financial Regulations, where a payment in advance had been made. Other weaknesses included a lack of independent review of bank and other accounting reconciliations, and an inadequate separation of duties in relation to the payroll process.

Danehill C of E Primary School (Substantial Assurance) – we found a sound system of control at this school. Some minor recommendations were made for improvement and agreed with school management.

Silverdale Primary School (Substantial Assurance) – our review found there to be evidence of good financial management and a sound control environment at the school. A few areas were, however, identified where controls could be strengthened, specifically in relation to ensuring a separation of duties is in place within the payments and payroll processes.

In response to the control weaknesses which we continue to identify across schools, we are working with colleagues in Children's Services and BSD Finance to agree a range of activities to help improve school financial governance. These include the creation of a

schools intelligence sharing group to ensure appropriate targeted support and intervention and improved training and support for school governors and governing bodies.

High Weald Area of Outstanding Natural Beauty (AONB)

The High Weald AONB is constituted as a Joint Committee and required to be audited under the Audit Commission Act 1998. Each year, an Annual Return for Small Bodies is completed as required by the Audit Commission. To support the completion of the annual return, a review of the effectiveness of internal controls in relation to the financial system, including the use of ESCC's main accounting system, was conducted and we were able to provide a '**full assurance**' opinion, without the need to make any formal recommendations for improvement.

South Downs Joint Committee

Although the South Downs Joint Committee ceased to operate at the end of 2010/11 with the creation of the South Downs National Park Authority, the process to finalise its financial affairs continued into 2012/13. As a result, a short piece of work was carried out in support of the Annual Return for Small Bodies. No issues of concern were identified.

Investigations

Inappropriate Use of Email

During the quarter, an internal audit investigation was undertaken in relation to the inappropriate use of the County Council's e-mail system by a member of staff. Our investigation found that the individual concerned had been engaged in receiving and sending large volumes of non-work related, inappropriate and offensive e-mails over a significant period of time. These actions represented a clear breach of the Council's Email Use Policy and resulted in the member of staff being dismissed following a disciplinary investigation.

The Council has in place robust internet and email access and usage policies and all staff continue to be periodically reminded of these.

Additional Audit Reviews

Through discussions with management, the following reviews have been added to the audit plan as emerging risks (see 3.7 above). The outcome of these audits will be reported on in quarter 2:

- Milton Grange Care Home
- Phoenix Arts Centre, William Parker Sports College
- Deceased Client Notification
- SAP Interfaces

Currently, no scheduled audits have been removed from the audit plan.

High risk recommendations where implementation is overdue

Overdue Recommendations:

Northiam C of E Primary School

Both of the high risk recommendations overdue at the time of this report relate to Northiam C of E Primary School where the Council has suspended the delegated budget. In both cases, CSD management are working with the school to ensure the recommendations are appropriately addressed within reasonable timescales.

One of the recommendations relates to the repayment of funds to the school budget share which had been incorrectly paid into the school fund. The recommendation has not yet been implemented due to complications with the relevant bank in changing cheque signatories on the school fund account. This is currently being resolved and it is envisaged that the recommendation will be addressed by September 2013.

The second recommendation relates to the need to prepare the school fund accounts and have them audited. It is our understanding that the accounts have now been prepared and that a suitable person has been identified to conduct the audit. Again, this recommendation is anticipated to be implemented in September 2013.

Internal Audit Performance Indicators

Measure	Source of Information	Frequency	Specific Measure / Indicator	RAG Score	Actual Performance Year End
Client Satisfaction					
Chief Officer/DMT	Consultation / Survey	Annual	Confirmation of satisfaction with service quality and coverage and feedback on areas of improvement.	G	Confirmed as part of audit planning process. Improvement actions built into business plan.
Client Managers	Satisfaction Questionnaires	Each Audit	>89%	G	100%
Section 151 Officer and other Client Assistant Directors	Liaison Meetings	Quarterly	Satisfied with service quality, adequacy of audit resources and audit coverage.	G	Confirmed through on-going liaison.
ABV&CSSC	Chairs Briefing and Formal Meetings	Quarterly / Annual	Confirmation of satisfaction with service quality and coverage and feedback on areas of improvement.	G	Confirmed through annual review of effectiveness and feedback from committee.
Cost/Coverage					
CIPFA Benchmarking	Benchmarking Report and Supporting Analysis Tools	Annual	1. Cost per Audit Day; 2. Cost per £m Turnover; equal to or below all authority benchmark average	G	1. £316 against average of £325 2. £559 against average of £1,004
Local and National Audit Liaison Groups	Feedback and Points of Practice	Quarterly	Identification and application of best practice.	G	Ongoing via attendance at CCAN, HCCIAG and SAG.
Delivery of the Annual Audit Plan	Audits Completed	Quarterly	90% of audit plan completed.	G	22.6%
Professional Standards					
Compliance with professional standards	Self-Assessment against new Public Sector Internal Audit Standards	Annual	Completed and implementation of any actions arising.	N/A	To be confirmed – self assessment due later in year.
External Audit Reliance	Fundamental Accounting Systems Internal Audit Activity	Annual	Reliance confirmed.	N/A	To be confirmed – due later in year.