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

Date: **5 November 2013**

By: **Chief Operating Officer**

Title of report: **Internal Audit Progress Report – Quarter 2 (01/07/13 – 30/09/13)**

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 2.**

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 2; and

(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 July 2013 and 30 September 2013.

3.   Summary and Key Audit Findings

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

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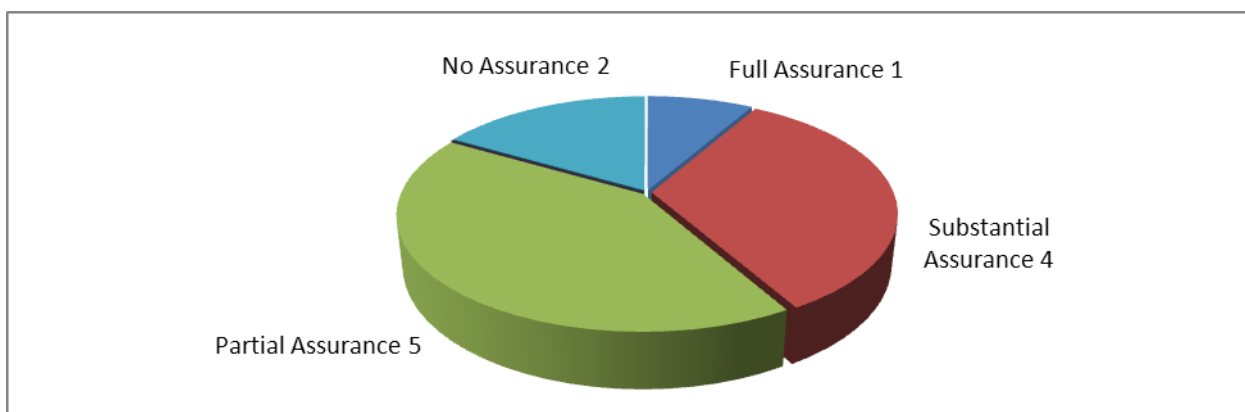
3.2   Overall, of the 12 formal audits completed, 1 resulted in a 'full assurance' opinion, 4 received 'substantial assurance', 5 received 'partial assurance' (1 of which was a school) and 2 received 'no assurance' (1 of which was a school).

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**. It is, however, important to highlight that there have been a number of reviews finalised during quarter 2 where internal control was found to be below an acceptable level and where prompt management action is required to address the identified deficiencies. These include Staff Leavers and Transfers, Deceased Client Notifications, the Lease Car Scheme and the Phoenix Centre (William Parker Sports College).

3.4   This overall conclusion has been drawn based on all audit work completed in the year to date, including recent reviews of higher risk areas, such as the Council's General Ledger and the SAP Migration to Surrey County Council, which received opinions of 'full assurance' and 'substantial assurance' respectively. The opinion also takes into account the management response to recommendations raised and the level of progress in subsequent implementation.

3.5   During quarter 2, we have continued to identify a pattern of control weaknesses within schools and as a result, have been working with colleagues within Children's Services Department and BSD Finance to help develop a range of measures aimed at improving financial governance in schools. Details of these measures are set out within Appendix D to this report, which should be read in conjunction with the Director of Children's Services progress report on the joint member reference group in relation to school governors, which is included elsewhere within the ABVCSSC papers.

3.6   Formal follow up reviews are carried out for all audits where either 'minimal' or 'no assurance' opinions have been given and for all higher risk areas receiving 'partial' assurance. In addition, arrangements are in place to monitor implementation of all individual high risk recommendations and at the time of writing this report, all recommendations had been implemented with the exception of two which have been partially implemented. 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.

KEVIN FOSTER
Chief Operating Officer

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Background Documents:
Internal Audit Strategy and Annual Plan 2013-14

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Summary of key audit findings

SAP Migration to Surrey County Council

During 2013, a project was undertaken to transition the ESCC SAP Enterprise Resource Planning System (ERP) onto the new hosting hardware platform at Surrey County Council's data centre.

The SAP ERP system provides the fundamental business application systems for the Council and any failure to successfully complete the transition could impact on the delivery of Council services and objectives, including payroll and supplier payments.

This review, focussing the technical data and SAP system transition arrangements to the new data centre, was undertaken by specialist ICT auditors from Deloitte, and covered an evaluation of controls in the following areas:

- Risk management and project governance;
- Contingency and business continuity planning;
- Implementation plans;
- System data, code migration and archiving;
- User acceptance testing procedures and results analysis;
- Go-live cutover plan and transition to business as usual.

We found the above areas to be well managed and were therefore able to provide an overall opinion of **'substantial assurance'** for the transition, with only three minor recommendations being made.

In August 2013, as a result of effective project planning and well established acceptance test procedures, the migration project successfully transitioned the SAP ERP system onto the new hosting hardware platform, with no significant problems or issues arising.

SIMS Learning Gateway Application Audit

The Schools Information Management System (SIMS) Learning Gateway provides parents with real-time, online access to timetables, attendance information, behaviour logs, homework diaries, test results and correspondence that encourages on-going communication and information sharing between the parent and the school. Whilst schools have responsibility for the type of information available through the Gateway, the Gateway itself is a separate environment which is managed by Schools ICT Services.

The following areas were reviewed as part of this audit:

- Access controls;
- Data input controls;
- Data processing and interface controls;
- Output controls;
- Management trails;
- Back-up and recovery;
- System enhancements and development;
- Support arrangements.

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Overall, we found controls relating to access and use of the SIMS Learning Gateway to be robust, resulting in an opinion of **'substantial assurance'**. Some minor recommendations for improvement were made relating to password settings, audit trails and disaster recovery arrangements, all of which have been agreed with management.

General Ledger

The review of the General Ledger is part of the programme of fundamental accounting system reviews undertaken each year. The key control objectives of which were to ensure that:

- All direct journal inputs to the General Ledger are complete, accurate and properly authorised (in accordance with Council policies);
- 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 our work, we have been able to provide **'full assurance'** over the system of controls. We found that the General Ledger continues to be appropriately managed and accurately maintained. One recommendation was restated from our 2012/13 report relating to the lack of action taken to clear a £55k debit on the Public Street Works suspense accounts. It has been agreed with management that this will be rectified in the current financial year.

Deceased Client Notifications

In 2011, we carried out a joint review with Adult Social Care (ASC) to investigate concerns that a number of care homes were incorrectly confirming that deceased clients had received services that required payment, when they had not. The review concluded that the discrepancies were as a result of poor administrative practices at the homes, rather than a deliberate attempt to defraud the County Council.

During the 2012/13 audit of ContrOCC (the system used to record contractual obligations and control payments to independent sector suppliers of care), another significant delay in a provider notifying the Council of a client's death was identified. This delay resulted in an inaccurate payment to the provider which was subsequently recovered. In addition, we identified a number of matches through the National Fraud Initiative (NFI) biennial data-matching exercise, where the Council had clients listed as alive during 2012/13, but NFI records showed they had died.

As a result, and because of the increased risk of overpayments made to providers that could potentially go undetected, we carried out further work to provide assurance on the overall effectiveness of controls within this area.

In completing this work, we found that the control framework in place at the time exposed the Council to a direct financial risk, particularly as controls to ensure the Council is notified of client deaths in a timely manner were inadequate. This resulted in an opinion of **'partial assurance'**.

The need for improvement was identified in relation to:

- Enhancing the enforcement of provider contract provisions, particularly in ensuring there is consistent practice across providers in informing ASC of the death or discharge of clients;
- Ensuring that all matches arising from the NFI are properly investigated and resolved so that potential overpayments are identified and recovered.

All recommendations arising from the review have been agreed in full by management, with action having already been taken in many areas.

Milton Grange Care Home

A review of Milton Grange was carried out following a number of incidents being reported to us within the last twelve months, including missing cash and an allegation of false identity against an agency worker believed to be working in the UK illegally.

As part of this review, we examined:

- Budget management;
- The identification, collection and recording of income;
- Expenditure, including petty cash and p-card transactions;
- Arrangements for identifying and managing conflicts of interest;
- Agency staff recruitment and management;
- Arrangements for the safeguarding of client property.

We found that controls in relation to budget management, the collection of client income and the management of conflicts of interest were in place and operating effectively. However, weaknesses in some areas, namely security arrangements at the home and the safe custody of cash and client valuables, resulted in an opinion of **'partial assurance'**. Recommendations for improvement in these areas have been agreed with management.

A Sussex Police investigation into the alleged false identity of an agency worker has now been concluded, with the police unable to trace the individual concerned. In this particular case, documentation had been falsified in order to circumvent the existing control framework.

Discretionary East Sussex Support Scheme (DESSS)

Funds administered by the Department of Work and Pensions (DWP) through Job Centre Plus, for Community Care Grants and Crisis Loans for living expenses, were transferred to local authorities from April 2013, as part of the Welfare Reform Act 2012. The funding for East Sussex in 2013/14 is approximately £1.2m.

During 2012/13, we provided advice and support to the DESSS Steering Group in relation to the identification and mitigation of risks and the adequacy of the control framework as new systems and processes for delivering the scheme were developed.

A Central Administrative Unit manages the overall programme within the Council, including decisions regarding whether assistance will be given to individuals. Once an individual has been assessed as having met the eligibility criteria, goods and services are provided through other organisations, including the voluntary sector. No cash payments are made.

The objective of this subsequent review was to assess and evaluate compliance with the systems in place to administer the scheme.

We found that the Central Administrative Unit has developed effective guidance and procedures for managing the overall programme and our audit testing concluded that key controls are being complied with. Decisions are well documented and are predominantly made within target timescales. We were therefore able to provide an audit opinion of **'substantial assurance'**.

We did find one weakness in the system, whereby applicants who do not receive state benefits are not always assessed for eligibility against the scheme's established financial criteria. This was accepted by management and appropriate action has been agreed to address this.

THRIVE Programme

THRIVE is a three year programme to improve the system of support for vulnerable children and young people in East Sussex running from 2012-2015. The long term aim of the programme is to ensure that we have a financially sustainable children's safeguarding system which acts in a proportionate, timely and effective way to reduce children and young people's needs.

The main purpose of this audit was to ensure that programme governance arrangements are adequate and that the programme is coordinated efficiently and effectively. The key control objectives were to ensure that:

- The programme governance arrangements are robust;
- Effective arrangements for risk identification, evaluation, mitigation, monitoring and reporting are in place;
- The proposed milestones and timetables for implementing the programmes' outcomes are achievable and are being monitored at the appropriate level.

In addition to reviewing the above areas, we also followed-up action taken against the recommendations made in our previous audit in this area, which at the time resulted in an audit opinion of partial assurance.

Overall, we are now able to provide an opinion of **'substantial assurance'** over the control environment. All of the recommendations made in our previous report relating to governance, risk management, milestone reporting and workforce development had been implemented, and we concluded that the governance arrangements of the programme are robust, with only minor recommendations being made.

Lease Car Scheme

Under the lease car scheme, the Council enters into agreements with both a leasing company and the individual staff members using the vehicle. These are normally for a period of three years. Leasing contributions are paid by staff through salary deductions and cover the rental paid by the Council to the leasing company, plus an administrative and insurance charge. Total ESCC expenditure on employees' lease cars was £521,000 in 2012/13.

This review covered the following control objectives:

- All lease car users have a signed contract which has been approved at the appropriate levels;
- Lease car payments are deducted from the employee's salary at the correct rate;
- Any payments/refunds due during or at the end of the lease period are processed correctly;
- Accidents are reported promptly and the correct excess deductions are taken from the employee's salary; and
- Annual reimbursable mileage is monitored and changes are made to the employee's mileage band where necessary.

Our review found that the key roles and responsibilities for the lease car scheme had not been properly documented or formalised, leading to gaps in control and resulting in an audit opinion of **'partial assurance'**. The main areas for improvement from the review included:

- The need to strengthen segregation of duty and approval controls within the lease car system to reduce the risk of error or fraud;
- Improving monitoring arrangements in relation to the business mileage of lessees to ensure that ESCC only make contributions to employees who are eligible;

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- Only processing lease car applications that have been signed by the lessees to avoid invalid contracts and future disputes;
- Ensuring all lessees have undertaken the ESCC Driver Development Training programme in accordance with the requirements of the scheme, and that lessees have valid driving licences;
- The need to complete the necessary returns to HMRC to assist in ensuring that staff payroll deductions in respect of lease cars are made correctly.

We also found three instances where the contributions by lessees had been calculated incorrectly by the former Fleet Manager. Arrangements have now been put in place to avoid future repetition, with all remaining recommendations also agreed with management.

Phoenix Centre – William Parker Sports College

William Parker Sports College has a facility on site called the Phoenix Arts Centre. The facility is used by the college for educational purposes and is also hired by the wider community for a fee. There are associated costs in running the venue and it has to comply with various regulatory requirements due to its use. An Events Manager, along with an Assistant Events Manager, manage the venue and are employees of the College.

In June 2013, the Acting Head Teacher of William Parker Sports College requested that we conduct an audit of the Phoenix Arts Centre, which subsequently found an inadequate level of internal control.

Weaknesses in a number of areas increased the risk to the College of significant financial loss and reputational damage. We identified breaches of Financial Regulations for Schools and also HMRC requirements. This resulted in an opinion of **'no assurance'**.

Whilst we did not identify any instances of dishonesty as part of our testing, we found that the poor governance arrangements created an environment that increased the likelihood of this occurring and, as a result, we were unable to confirm that financial loss through error or fraud has not taken place.

Key areas for improvement included:

- Formalising governance arrangements to increase transparency in the decision-making process. We found that the Governing Body of William Parker Sports College had little oversight of the centre and its operations;
- Ensuring fees and charges for the centre are reviewed and approved periodically, and that there is clear policy in relation to the application of discounts for hirers;
- The need for key centre staff to formally declare business and/or pecuniary interests and, where these have been declared, for these to be managed appropriately to mitigate the associated risks;
- Preventing staff from storing personal business assets at the centre and from hiring equipment out to its users;
- Ensuring an adequate separation of duties exists across the centre's operations, particularly in relation to income, stock and expenditure processes;
- Paying casual staff at the centre through the College payroll as employees to ensure compliance with HMRC regulations;
- Ensuring proper stock-takes are performed to obtain assurance that the level of stock is correct, after taking into account purchases and sales.

Whilst all recommendations raised as part of our review were agreed with management, the College became an Academy in September 2013 and is no longer under the control of ESCC. It is understood that the centre will be incorporated as part of the Academy and will no longer be an extended schools activity.

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Staff Leavers and Transfers

During the period June 2012 to March 2013, there were 629 non-school staff leaving the Council and significantly more transferring between departments. The main purpose of this audit was to establish whether the processes for managing staff transfers and leavers are efficient and effective and whether adequate controls are in place to cease access to network folders, systems, Council buildings and assets once an employee has left, or transferred to a different part of the organisation.

Our review found that, whilst the process for managing assets and building access for leavers was found to be reasonable, the current arrangements for controlling access to Council network folders and IT systems were considered to be ineffective and inefficient. These weaknesses represent a clear security risk for the organisation, with potentially confidential data vulnerable to unauthorised access after employees leave or transfer roles, resulting in an audit opinion of **'partial assurance'**.

In particular, our review found that no single process is in place for managing all aspects of the staff leaver and transfer process, with separate systems in place for Personnel and Training (PAT) and ICT Services. These systems do not properly link and, in some cases, duplicate each other, increasing the potential for omission and error. As a result, our testing has identified that:

- Out of the staff who left the Council between June 2012 and March 2013, a high number of these continued to have access to the County Council's network;
- Some of these network accounts had been accessed after the employee had left. Whilst in no cases did this involve unauthorised access to any key IT application (e.g. Carefirst, SAP etc.), in some cases, the user had accessed the corporate e-mail system. These incidents are subject to on-going investigation;
- Network access permissions are not always amended when an employee transfers to a new post within the Council. In some cases, where amendments have been made, these have been based on requests from the employees concerned, without appropriate authorisation.

Finally, we found that a number of departmental systems, including cloud based systems[1], currently fall outside of the corporate arrangements for managing user access, including the processing of staff leavers and transfers. As a result, there is an increased risk that users will continue to have unauthorised access to these systems, especially where operational managers may assume that this has been ceased or amended through the corporate leaver/transfer process.

In response to the findings from this review, further analysis was undertaken in conjunction with ICT Services and PAT in order to identify the extent to which former employees may continue to have live access to the Council's network. This review involved a complete match between all current employees recorded in SAP and the list of current network users. Whilst the initial findings from this work indicate a high number of users who could not be identified as current staff, these are subject to on-going investigation by ICT Services, PAT and departmental managers, particularly with a view to excluding legitimate non staff users, such as volunteers, agency workers and contractors.

In the meantime, all recommendations for addressing the identified weaknesses have been agreed with management and urgent action is already being taken to improve the control framework. This includes the introduction of a new policy to automatically suspend all network accounts which have not been accessed within 30 days. Progress will be assessed as part of a

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[1] Systems that are hosted by external providers and accessed through web browsers, thin client and mobile apps.

formal follow up review to be carried out by internal audit either later this year or early in 2014/15.

School Audits

Cradle Hill Community Primary School (No Assurance) - Our review found that the control environment at the school was unacceptably weak. We identified breaches of Financial Regulations and Contract Standing Orders for Schools and also HMRC requirements. Other instances of incorrect financial practice meant that we were unable to provide any assurance that financial loss has occurred through error or fraud.

Key weaknesses found included:

- Poor strategic planning, with a lack of correlation between the School Improvement Plan and the budget;
- Inadequate provision of financial information to governors;
- Evidence of the incorrect treatment of a salary related payments in contravention of HMRC requirements;
- Poor accounting practice in relation to the receipt and management of grants, including unsupported expenditure;
- Incorrect and inappropriate arrangements for the payment of travel and expenses;
- Weak expenditure processes, including major purchases being commissioned without the approval of the Governing Body, as required under the school's Scheme of Delegation.

In being made aware of these issues, the Governing Body has responded positively and demonstrated a commitment to addressing the weaknesses found, with early action taken to improve controls at the school. A follow up review will also be undertaken by internal audit in due course.

Meridian Community Primary School (Partial Assurance) – Our review found a number of weaknesses in relation to the governance, payment, income and payroll arrangements at the school. In particular, there were a high number of governor vacancies during 2012/13 and governance arrangements did not include a Finance Committee. Whilst the school is not specifically required to have additional committees, this resulted in a reduced focus on financial matters, including a lack of review and approval of financial procedures. However, since completing the audit, we understand additional governors have been recruited.

Additional Audit Reviews

Through discussions with management, the following reviews have been added to the audit plan during the course of the year on the basis of risk (see 3.7 above):

- Milton Grange Care Home
- Phoenix Arts Centre, William Parker Sports College
- Deceased Client Notification
- SAP Interfaces
- Oracle Database Follow Up
- Conflicts of Interest Administration

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

High risk recommendations where implementation is overdue / unconfirmed

Action has been taken against all of the high risk recommendations due to be implemented, with the majority of these now fully in place.

Two recommendations arising from the audit of the Administration of Looked After Children (LAC) Funds have been partially implemented. We understand from management that staff have researched and devised an appropriate system to support the recommendations, and that these will be fully embedded early in the new year. The recommendations relate to the adoption of amendments to existing procedures and the maintenance of a central record of savings held by LAC. We will continue to monitor progress against these and liaise with management to obtain confirmation that all appropriate action has been taken.

Internal Audit Performance Indicators

Measure	Source of Information	Frequency	Specific Measure / Indicator	RAG Score	Actual Performance
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 and on-going liaison. 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 as part of quarterly reporting.
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	45.9%
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.	G	Last confirmed in Annual Audit Letter November 2012 with continued reliance for 12/13 Accounts.

Increased Support for Schools

Introduction

As a result of continued weaknesses in school governance and financial management, Internal Audit has been working together with Children's Services and BSD Finance to develop a range of mechanisms and activities to help improve financial governance in schools. Establishing good governance in schools is important to the Council in order to limit the risk of:

- schools getting into financial difficulty;
- costs associated with disciplinary procedures which fall under the Council's normal processes, where the Council would suffer financial loss if an award is made in favour of a school employee;
- reputational damage, either in relation to an individual school or a general perception of standards in East Sussex;
- depressed pupil attainment levels and the risk of an Ofsted category of concern.
- costs associated with harm to an employee or pupil with regard to their safety, e.g. on school premises or trips;
- costs associated with failure to make adequate provision for special educational needs.

During 2012, the Audit, Best Value and Community Services Scrutiny Committee (ABVCSSC) formed a joint member reference group with the Children's Services Scrutiny Committee aimed at reviewing the main responsibilities of the Council in relation to schools. The work of this group focussed on understanding the risks to the authority and how it could influence school governors to ensure appropriate decision-making. A progress report on this work is included elsewhere in the ABVCSSC papers. The actions outlined below have taken into consideration the recommendations from the joint member reference group in order to provide a co-ordinated approach to improving governance in schools.

Council Activity

Throughout the authority, a number of different teams are involved in providing support to schools, including, Standards Learning and Effectiveness (SLES), BSD Finance, Personnel and Training and Internal Audit. In recognition of the need to ensure that this support is properly co-ordinated and to improve the use of information and intelligence about individual schools, a new joint liaison group has been formed.

This group will meet periodically throughout the year with the objective of strengthening governance across all schools, as well as using a risk based approach to provide an early warning of potential issues at individual schools, with a view to providing more targeted support and intervention. One of the key activities of the group is to review the Council's financial training offer for schools, incorporating:

- An assessment of who has, and has not, previously undertaken training;
- Identifying and plugging any gaps in previous training programmes;
- Developing more targeted training based on areas of common weakness, for example, internal audit findings, Schools Financial Value Standards returns, budget plans and surpluses/deficits.

In addition to this, Internal Audit will continue to deliver the Schools' Audit Strategy, covering:

- Audits of individual schools, selected on a risk basis (the number of these visits has been increased for 2013/14 in response to a continued pattern of poor internal control);
- Themed reviews focussing on common areas of weakness;

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- Follow-up reviews to assess progress against agreed recommendations;
- Action tracking for all high priority recommendations;
- Issuing regular internal audit bulletins directly to governors, outlining common weaknesses and prompts for governors when considering financial matters;
- Specific audit training sessions for governors, including an offer to provide briefings for governing bodies at the conclusion of audit visits;
- Use of the results from school audits to inform the topics for future themed reviews;
- Continued ad hoc advice and support to schools.

The effectiveness of these measures will be assessed on an on-going basis through the joint liaison group.