

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

Date: **10 June 2014**

By: **Chief Operating Officer**

Title of report: **Internal Audit Services: Annual Report and Opinion 2013/14**

Purpose of report: **To give an opinion on the County Council's control environment for the year from 1 April 2013 to 31 March 2014**

---

## **RECOMMENDATIONS**

### **Members are recommended to:**

- 1. note the internal audit service's opinion on the Council's control environment;**
  - 2. consider whether there are any significant control issues that should be included in the Council's annual governance statement for 2013/14; and**
  - 3. consider whether the Council's system for internal audit has proved effective during 2013/14.**
- 

### **1. Financial Appraisal**

1.1 The work referred to in this report was carried out as part of the 2013/14 internal audit plan and was funded from the agreed service budget.

### **2. Supporting Information**

2.1 The purpose of this report is to give an opinion on the adequacy of the East Sussex County Council's control environment as a contribution to the proper, economic, efficient and effective use of resources. The report covers the audit work completed in the year from 1 April 2013 to 31 March 2014 in accordance with the Internal Audit Strategy for 2013/14.

### **3. Internal control and the role of Internal Audit**

3.1 All local authorities must make proper provision for internal audit in line with the 1972 Local Government Act (S151) and the Accounts and Audit Regulations 2011. The latter states that authorities must maintain an adequate and effective system of internal audit of its accounting records and of its system of internal controls in accordance with the proper internal audit practices.

3.2 It is a management responsibility to establish and maintain internal control systems and to ensure that resources are properly applied, risks appropriately managed and outcomes achieved.

### **4. Audit Opinion and Key Issues**

4.1 No assurance can ever be absolute; however based on the internal audit work completed, the Head of Assurance (as the Council's Head of Internal Audit) can provide reasonable assurance that East Sussex County Council has in place an adequate and effective framework of governance, risk management and internal control for the period 1 April 2013 to 31 March 2014.

4.2 The opinion, and the evidence that underpins it, is further explained in the full Internal Audit Services Annual Report and Opinion which forms Annexe A of this report. The report highlights key audit activity in the following areas:

- Completed audits where an opinion below 'partial assurance' has been given;
- Progress on implementation of high risk recommendations;
- Key financial systems;
- Schools;
- Anti Fraud and Corruption.

4.3 A summary of the major findings from audit reviews completed during quarter 4 of 2013/14 is included in Annexe B (major findings from previous quarters have already been reported).

4.4 Members will note that we are continuing to identify control weaknesses within schools. As a result, a new Schools Risk Review Group was established during the year, made up of representatives from Internal Audit, Personnel and Training, Service Finance and Standards and Learning Effectiveness, with the objective of strengthening governance across all schools, particularly through improved training for governors and staff.

## **5. Performance and Effectiveness of Internal Audit**

5.1 The Accounts and Audit Regulations 2011 require the Council to 'undertake an adequate and effective internal audit of its accounting records and of its system of internal control'. The information set out in section 6 of Annexe A should provide a sound basis for making this assessment.

5.2 This report will be presented to Cabinet on 1 July 2014.

KEVIN FOSTER  
Chief Operating Officer

Contact Officers: Russell Banks, Head of Assurance  
Tel No. 01273 481447

Background documents:  
Strategic Audit Plan 2013-14  
Internal Audit Progress Reports 2013/14

**ANNEXE A**

**INTERNAL AUDIT SERVICES  
ANNUAL REPORT AND OPINION  
2013/2014**



## **1. Internal control and the role of Internal Audit**

1.1 All local authorities must make proper provision for internal audit in line with the 1972 Local Government Act (S151) and the Accounts and Audit Regulations 2011. The full role and scope of the Council's Internal Audit Service is set out within our Internal Audit Charter and Terms of Reference, which can be found elsewhere in these papers as an appendix to the Internal Audit Strategy.

1.2 It is a management responsibility to establish and maintain internal control systems and to ensure that resources are properly applied, risks appropriately managed and outcomes achieved.

1.3 Internal Audit is not the only source of assurance for the Council. There are a range of external audit and inspection agencies, as well as processes for internal management review, which can also provide assurance and these are set out in the Council's Local Code of Corporate Governance and its Annual Governance Statement.

## **2. Delivery of the Internal Audit Plan**

2.1 The County Council's Internal Audit Strategy and Plan is updated each year based on a combination of management's assessment of risk (including that set out within the departmental and strategic risk registers) and our own risk assessment of the Council's major systems and other auditable areas. The process of producing the plan involves extensive consultation with a range of stakeholders, to ensure that their views on risks and current issues, within individual departments and corporately, are identified and considered.

2.2 In accordance with the audit plan for 2013/14, a programme of audits was carried out covering all Council departments and, in accordance with best practice, this programme was reviewed during the year and revised to reflect changes in risk and priority.

2.3 All adjustments to the audit plan were agreed with the relevant departments and reported throughout the year to Corporate Management Team (CMT) and Audit, Best Value and Community Services Scrutiny Committee (ABVCSSC) as part of our quarterly internal audit progress reports.

## **3. Audit Opinion**

3.1 No assurance can ever be absolute; however, based on the internal audit work completed, the Head of Assurance (as the Council's Head of Internal Audit) can provide reasonable assurance that East Sussex County Council has in place an adequate and effective framework of governance, risk management and internal control for the period 1 April 2013 to 31 March 2014. Audit testing has confirmed that the majority of key controls examined are working in practice, with some specific exceptions. Where improvements to control or compliance are required, we are satisfied that appropriate action has been agreed by the relevant managers within reasonable timescales.

## 4. Basis of Opinion

4.1 The opinion and the level of assurance given takes into account:

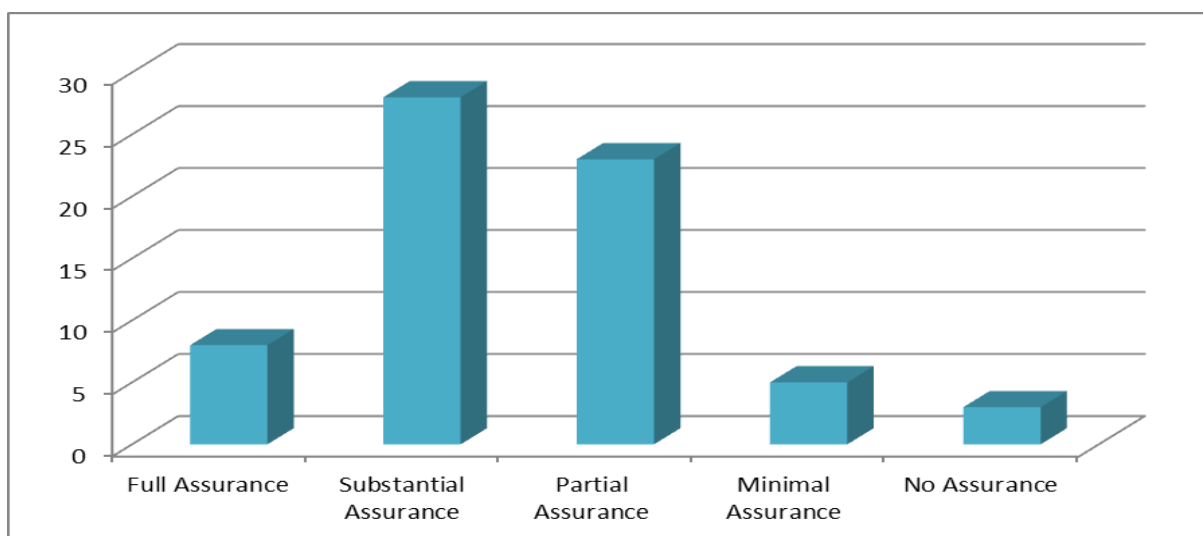
- All audit work completed during 2013/14, planned and unplanned;
- Follow up of actions from previous audits;
- Management's response to the findings and recommendations;
- Effects of significant changes in the Council's systems;
- The extent of resources available to deliver the audit plan;
- Quality of the internal audit service's performance.

4.2 No limitations have been placed on the scope of Internal Audit during 2013/14.

## 5. Key Issues for 2013/14

5.1 The overall audit opinion should be read in conjunction with the key issues set out in the following paragraphs. These issues, and the overall opinion, should be taken into account when preparing and approving the Council's Annual Governance Statement.

5.2 The internal audit plan is delivered each year through a combination of formal reviews with standard audit opinions, direct support for projects and new system initiatives, investigations, grant audits and ad hoc advice. The following chart provides a summary of the outcomes from all audits finalised during 2013/14 with standard audit opinions:



5.3 A full listing of completed audits and opinions for the year is included at Appendix B, along with an explanation of each of the assurance levels. Details of all those audits where either minimal assurance or no assurance could be provided over the control environment are set out in the following paragraphs:

- **Administration of Looked After Children's (LAC) Funds (No Assurance)** – This review involved working closely with management from Children's Services and focused on improving existing procedures around the administration of funds belonging to looked after children. The review found the control environment to be inadequate and resulted in us being unable to provide any assurance that LAC funds are properly controlled, with a high risk of theft and inappropriate use. 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.

A range of recommendations for improvement were agreed with management, many of which focussed on developing and implementing new procedures and guidance for carers. Through our ongoing action tracking we have subsequently received notification from Children's Services that these have all now been implemented. This will be confirmed as part of a formal follow up review planned for early in 2014/15.

- **Phoenix Centre (William Parker Sports College) (No Assurance)** – William Parker Sports College has a facility on site called the Phoenix Arts Centre, which is used by the college for educational purposes and is also hired by the wider community for a fee. Our audit identified weaknesses in a number of areas which increased the risk of significant financial loss and reputational damage. We also identified breaches of Financial Regulations for Schools and HMRC requirements, preventing us from providing any assurance over the control environment.

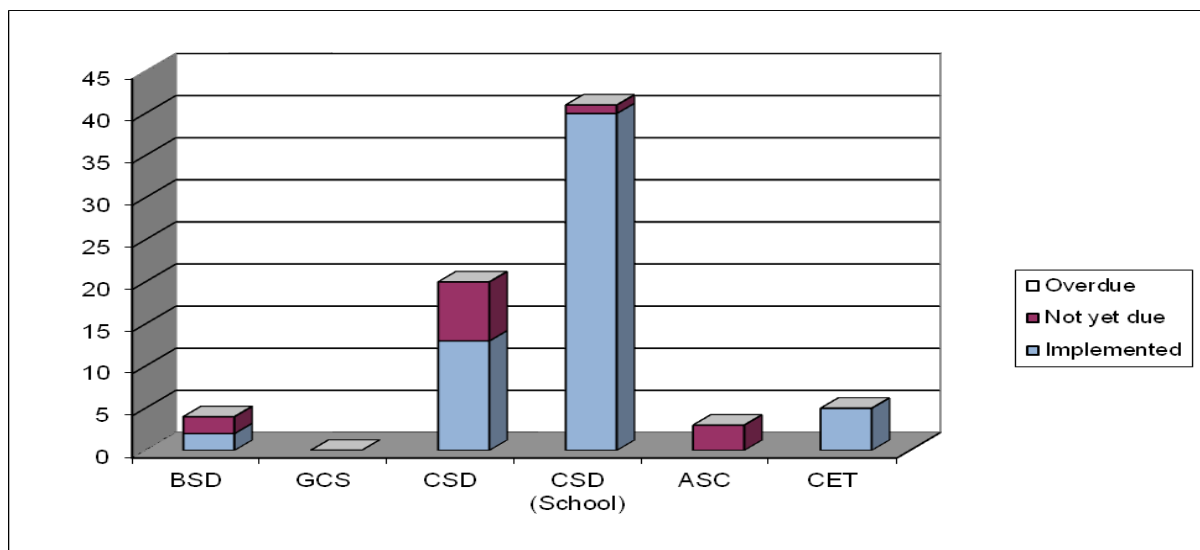
Whilst all recommendations raised as part of our review were agreed with management, the College became an Academy in September 2013 and is no longer under the control of ESCC. It is understood that the centre will be incorporated as part of the Academy and will no longer be an extended schools activity.

- **Schools Senior Leadership Salaries (Minimal Assurance)** – the purpose of this review was to assess the extent to which senior leadership team members in East Sussex schools are paid in line with pay bands recommended by the Department of Education and the Council's own model pay policy. Overall, we identified a range of issues which meant we were not able to provide anything more than minimal assurance over the control environment. These included instances where headteachers' pay was significantly above the recommended level without sufficient evidence as to the reasons for this, inadequate evidence that governing bodies had approved salary increases and, inconsistencies in the way headteachers are paid for additional duties (including Ofsted inspection work).

Working with Personnel and Training and the Standards and Learning Effectiveness Team within Children's Services, we identified a number of actions that would help to improve awareness and standards in this area. These have all been agreed and will be subject to a follow up review by Internal Audit during the coming year.

5.4 All of the remaining reviews where we have issued opinions below the level of 'partial assurance' relate to schools and these are commented on in Section 5.9 below.

5.5 As well as conducting formal follow up reviews in all cases where an audit opinion of either 'minimal' or 'no assurance' has been given, we have in place arrangements to track the implementation of all high risk audit recommendations issued during the year. The position on these as at 31 March 2014 is shown in the following graph and, as can be seen, there are currently no high risk recommendations outstanding beyond the agreed implementation date:



5.6 At the time of producing this report, a total of 13 reviews (8 of which are schools) remained in progress, all of which will be completed during the first quarter of 2014/15. The finalisation of these reports will result in 100% completion of the 2013/14 internal audit plan.

### Key Financial Systems

5.7 Given the substantial values involved, each year a significant proportion of our time is spent reviewing the Council's key financial systems, both corporate and departmental. It is pleasing to report that of those completed during 2013/14, all of these, with the exception of Pension Fund Processes and Systems (partial assurance), resulted in either full or substantial assurance being provided over the control environment.

### Schools

5.8 Throughout the year, we have completed a programme of assurance work in schools in accordance with our agreed 'Schools Internal Audit Strategy'. Whilst all County Council schools are required to submit annual self- assessments against the national 'Schools Financial Value Standard' to Children's Services Department (CSD), an increased number of individual schools were also subject to a separate audit during the year. These were selected on the basis of risk, in consultation with CSD, and a summary of the results of this work is set out within the following table:

<b>School</b>	<b>Opinion</b>
Danehill CE Primary	Substantial Assurance
Silverdale Primary	Substantial Assurance
Claverham Community College	Substantial Assurance
Dallington CE Primary	Partial Assurance
Ringmer Primary	Partial Assurance
Telscombe Cliffs Community Primary	Partial Assurance
Meridian Community Primary	Partial Assurance
Hazel Court Special	Partial Assurance
Forest Row CE Primary	Partial Assurance
Peasmarsh CE Primary	Partial Assurance
South Malling CE Primary	Partial Assurance
Westfield Primary	Minimal Assurance
Etchingham CE Primary	Minimal Assurance
Bodiam CE Primary	Minimal Assurance
Cradle Hill Community Primary	No Assurance

5.9 In response to the control weaknesses 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 Risk Review Group made up of representatives from Internal Audit, Personnel and Training, Finance, and the Standards and Learning Effectiveness Service (which includes Governor Services). The primary aim of this group is to ensure appropriate targeted support and intervention is provided, including improved training and support for school governors and governing bodies. A separate report on the work of this group is being presented to ABVCSSC in June.

5.10 We have also significantly increased our audit coverage of schools which will continue into 2014/15. All audit reports are now circulated to each individual school governor and we also provide quarterly information bulletins to governors highlighting common themes and issues arising from our work which we recommend they seek assurance on within their own schools.

5.11 Our other assurance work in schools has included themed reviews of ‘Senior Leadership Team Salaries’ and ‘Recruitment in Schools – Follow Up’. These resulted in audit opinions of ‘minimal assurance’ and ‘substantial assurance’ respectively.

### **Anti Fraud and Corruption**

5.12 During 2013/14, we logged 22 allegations and potential issues under the Council’s Anti-Fraud and Corruption Strategy. These were identified via the Council’s confidential reporting hotline, our programme of audit work or notifications from departments. A total of 7 investigations were subsequently conducted, with the balance being referred to local management or being assessed as requiring no action. The following provides a summary of the investigation activity undertaken by Internal Audit during the past twelve months:



- Two cases, one involving Direct Payments and the other involving the alleged theft from a school, have been referred to the police and are both the subject of on-going criminal investigation;
- One investigation into inappropriate mileage claims has resulted in the dismissal of a member of staff;
- Three cases have only recently been started and were on-going investigations at the time of writing this report;
- One other case, concerning pay and hours, revealed insufficient evidence to take further action, but did identify a range of internal control improvements.

5.13 Our findings from all investigation activity are used to identify any internal control weaknesses and these are reported to management along with appropriate recommendations for improvement. The findings from investigations are also used to inform future internal audit plans.

5.14 As part of the Audit Commission's National Fraud Initiative (NFI), Internal Audit have co-ordinated the production and submission of data on behalf of the Council, covering a range of areas, including payroll, pensions, creditors, residential care clients, concessionary travel passes and residents parking permits. The results from this exercise were made available in early 2013 for further investigation and, as a result, a number of overpayments, totalling £100,335, were identified. These overpayments related to residential care clients and ESCC pensioners who had died but where payments continued to be made. With regard to private care home residents, overpayments will be recovered automatically through future payment schedules and in all other cases, financial recovery arrangements have been put in place.

5.15 The latest round of the NFI is due to commence later in 2014/15 with Internal Audit once again co-ordinating the production and submission of data on behalf of the Council.

5.16 As well as the investigation work referred to above, we continue to be proactive in the identification of potential fraud and corruption activity across the authority and in raising awareness amongst staff. This has included delivering standards of behaviour sessions at departmental induction/welcome days and internally publicising proven cases of fraud and corruption.

5.17 Whilst it is our opinion that the control environment in relation to fraud and corruption is satisfactory and the incidence of fraud is considered low for an organisation of this size and diversity, we continue to be alert to the risks of fraud. During 2013/14, we have commenced a review of the adequacy and effectiveness of our anti-fraud and corruption arrangements, with support from a new Counter Fraud Specialist, recently appointed to the team on a one year fixed term basis.

## **6. Internal Audit Performance**

6.1 Public Sector Internal Audit Standards (PSIAS) require the internal audit service to be reviewed annually against the Standards, supplemented with a full and independent external assessment at least every five years. The following paragraphs provide a summary of our performance during 2013/14, including the results of our latest internal PSIAS assessment, an update on our Quality Assurance and Improvement Programme and the year end results against our agreed targets.

### **PSIAS**

6.2 The new Standards cover the following aspects of internal audit, all of which have been assessed during 2013/14 by the Head of Assurance and subjected to preliminary external validation:

- Purpose, authority and responsibility;
- Independence and objectivity;
- Proficiency and due professional care;
- Quality assurance and improvement programme;
- Managing the internal audit activity;
- Nature of work;
- Engagement planning;
- Performing the engagement;
- Communicating results;
- Monitoring progress;
- Communicating the acceptance of risks.

6.3 The results of this work found a high level of conformance with the new Standards with only a small number of actions identified. The main areas for improvement related primarily to:

- Reviewing and updating some elements of our internal quality manual;
- Formalising some of the respective responsibilities for when audit services are provided to external clients;
- Introduction of some standard wording within our audit reports clarifying confidentiality and information sharing arrangements.

6.4 In all cases, work is already underway to address these actions, all of which are anticipated to be completed during the first quarter of 2014/15.

### **Key Service Targets**

6.5 Performance against our previously agreed service targets is set out in Appendix A. Overall, client satisfaction levels remain high, demonstrated through the results of our post audit questionnaires, discussions with key stakeholders throughout the year and annual consultation meetings with Chief Officers.

6.6 As at 31 March, 91% of the 2013/14 audit plan had been completed, in excess of our 90% target despite a high volume of unplanned and investigation work arising during the year. A small number of outstanding reviews were nearing completion at year end, with all reports due to be finalised early in quarter 1 of 2014/15. We are currently exploring opportunities to improve the benchmarking arrangements for internal audit and will report on this during 2014/15 when further information becomes available.

6.7 Internal Audit is continuing to liaise with the Council's new external auditors, KPMG, who will be undertaking their first audit on the Council's 2013/14 accounts. Whilst the approach adopted by KPMG differs from our previous external auditors, in that reliance is no longer placed directly on the work of internal audit, we are endeavouring to ensure that the Council obtains maximum value from the combined audit resources available.

6.8 In addition to this annual summary, CMT and the ABVCSSC will continue to receive performance information on Internal Audit throughout the year as part of our quarterly progress reports.

## Appendix A

### Internal Audit Performance Indicators

Measure	Source of Information	Frequency	Specific Measure / Indicator	RAG Score	Actual Performance Year End
<b>Client Satisfaction</b>					
Chief Officer/DMT	Consultation / Survey	Annual	Confirmation of satisfaction with service quality and coverage and feedback on areas of improvement.	<b>G</b>	Confirmed through Chief Officer consultations in February / March 2014, where high levels of satisfaction confirmed.
Client Managers	Satisfaction Questionnaires	Each Audit	>89%	<b>G</b>	100%
Section 151 Officer	Liaison Meetings	Quarterly	Satisfied with service quality, adequacy of audit resources and audit coverage.	<b>G</b>	Confirmed through ongoing liaison throughout the year and via approval of audit strategy and plan.
ABV&CSSC	Chairs Briefing and Formal Meetings	Quarterly / Annual	Confirmation of satisfaction with service quality and coverage and feedback on areas of improvement.	<b>G</b>	Confirmed through annual review of effectiveness and feedback from committee as part of quarterly reporting.
<b>Cost/Coverage</b>					
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	<b>G</b>	Opportunities to improve benchmarking being explored. Last results available are for 2012, these show: 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.	<b>G</b>	Ongoing via attendance at County Chief Auditors Network, Home Counties Audit Group and Sussex Audit Group.
Delivery of the Annual Audit Plan	Audits Completed	Quarterly	90% of Audit Plan Completed.	<b>G</b>	91%
<b>Professional Standards</b>					
Compliance with professional standards	Self-Assessment against new Public	Annual	Completed and implementation of any actions arising.	<b>G</b>	Self-assessment completed, improvement plan in place and being

Measure	Source of Information	Frequency	Specific Measure / Indicator	RAG Score	Actual Performance Year End
	Sector Internal Audit Standards				actioned.
External Audit Reliance	Key Financial Systems Internal Audit Activity	Annual	Reliance confirmed.	<b>G</b>	Confirmed as part of BDO Annual Governance Report

## Summary of Opinions for Internal Audit Reports Issued During 2013/14

### **Full Assurance:**

*(Explanation of assurance levels provided at the bottom of this document)*

<b>Audit Title</b>	<b>Department</b>
HR/Payroll 2012/13	BSD
Code of Conduct in Schools – Follow Up	CSD
High Weald AONB	CET
General Ledger	BSD
Pension Fund Investments	BSD
Pension Fund Governance and Strategy	BSD
Treasury Management	BSD
Contract Management - Colas	CET

### **Substantial Assurance:**

<b>Audit Title</b>	<b>Department</b>
Bexhill to Hastings Link Road – Financial Governance	CET
Bexhill to Hastings Link Road – Project Controls and Financial Governance	CET
Contracting and Procurement – A4E	ASC
SAP Migration to Surrey County Council	BSD
SIMS Learning Gateway Application	CSD
Discretionary East Sussex Support Scheme (DESSS)	ASC
THRIVE Governance	CSD
THRIVE Financial Control	CSD
Supporting People System (SPOCC)	ASC
Trapeze System	CET
Notification of Payroll Changes	BSD
Families with Multiple Problems Programme	CSD
ContrOCC 2013/14	BSD
Contract Management - Amey	BSD
Accounts Payable-Procurement	BSD
Accounts Receivable	BSD
HR/Payroll 2013/14	BSD
Pension Fund External Control Assurance	BSD
SAP Interfaces	BSD
Thin Client Technology	BSD
ICT Disaster Recovery	BSD
Contract Management - Stagecoach Hastings	CET
Peacehaven PFI Follow-Up	CSD
EXOR Follow-up	CSD
Recruitment in Schools - Follow Up	CSD
Danehill CEP School	CSD
Silverdale Primary School	CSD
Claverham Community College	CSD

**Partial Assurance:**

<b>Audit Title</b>	<b>Department</b>
Information Governance	BSD
ContrOCC 2012/13	ASC/BSD
Nursery Income and Debt – Follow-Up	CSD
Deceased Client Notifications	ASC
Milton Grange Care Home	ASC
Lease Cars	CET
Management of Staff Leavers and Transfers	BSD
Appointeeships/Deputyships	ASC
Oracle Database Follow Up	BSD
Contract Management - Churchill	CSD
Pension Fund Processes and Systems	BSD
Co-ordination Arrangements for Declaring Conflicts of Interest (Corporate)	GCS
Contract Management – Overall Report	BSD
Direct Payments	ASC
Schools' Funding Formula	CSD
Dallington CEP School	CSD
Ringmer Primary School	CSD
Telscombe Cliffs CP School	CSD
Meridian CP School	CSD
Hazel Court Special School	CSD
Forest Row CEP School	CSD
Peasmarsh CEP School	CSD
South Malling CEP School	CSD

**Minimal Assurance:**

<b>Audit Title</b>	<b>Department</b>
Contract Management - Apetito	ASC
Senior Leadership Salaries in Schools	CSD
Westfield School	CSD
Etchingham CEP School	CSD
Bodiam CEP School	CSD

**No Assurance:**

<b>Audit Title</b>	<b>Department</b>
Administration of LAC Funds	CSD
Phoenix Centre – William Parker Sports College	CSD
Cradle Hill CP School	CSD

**Other Audit Activity Undertaken During 2013/14 (including direct support for projects and new system initiatives and grant audits):**

<b>Audit Title</b>	<b>Department</b>
6th Form Funding	CSD
Galaxy Replacement	BSD
New Property Management System	BSD
Resources Consolidation	BSD
South Downs Joint Committee	CET
Contracting and Procurement Analytical Review	BSD
Social Care Information System (SCIS)	ASC
Broadband	CET
Highways Re-procurement	CET
Certification of Grant Returns	Corporate

**Internal Audit Assurance Levels:**

**Full Assurance:** There is a sound system of control designed to achieve the system objectives. Compliance with the controls is considered to be good. All major risks have been identified and are managed effectively.

**Substantial Assurance:** Whilst there is a sound system of control, there are a small number of weaknesses which put some of the system/service objectives at risk and/or there is evidence of non-compliance with some controls. Opportunities to strengthen controls still exist.

**Partial Assurance:** Controls are in place and to varying degrees are complied with but there are gaps in the control process, which weaken the system. There is therefore a need to introduce additional controls and/or improve compliance with existing controls to reduce the risk to the Authority.

**Minimal Assurance:** Weaknesses in the system of control and/or the level of compliance are such as to put the system objectives at risk. Controls are considered to be insufficient with the absence of at least one critical or key control. Failure to improve will lead to an increased risk of loss or damage to the Authority.

**No Assurance:** Control is generally weak or non-existent, leaving the system open to significant error or abuse and high risk to the system or service objectives. A high number of key risks remain unidentified and/or unmanaged.



## Summary of key audit findings

### **Coordination Arrangements for Declaring Conflicts of Interest and Offers of Gifts/Hospitality**

A conflict of interest arises when a person's private or personal interests are substantial enough to be able to influence, or potentially influence, a person's official responsibilities. The acceptance of gifts and/or hospitality could similarly be construed to have such a potential influence. The Council's Code of Conduct sets out the minimum standards of conduct that employees are expected to observe when carrying out their duties, including the need for all staff to complete declaration forms relating to both issues.

Our review considered the arrangements for the administration of conflict of interests and gift/hospitality declaration forms in all departments. This included meeting with each departmental co-ordinator and establishing arrangements for collating, monitoring and retaining forms. The process for referring declarations to management was also examined with a view to ensuring that best practice guidance is developed for consistent application across all departments.

In providing an opinion of '**partial assurance**', we identified improvements that were necessary to ensure all staff complete declarations and that positive declarations are up-to-date, with mitigation actions identified, accepted by employees (where appropriate) and implemented by management. Due to these necessary improvements, we were unable to provide complete assurance that all staff have declared interests as required or that positive declarations are being appropriately managed. Some areas of good practice were identified throughout the Council and these are to be used as the basis for developing a consistent framework of control.

### **Pension Fund External Control Assurance**

A detailed review of reports covering internal controls of the pension fund managers and the global custodian provides the County Council with some assurance that assets and investments are adequately safeguarded. In previous years, reliance has been placed on Internal Audit to perform this review but it has subsequently been agreed that this should be a management exercise performed by the Pensions Team.

In addition, the review process has been brought forward to mid-financial year, reducing the age of the reports and enabling a more timely review to be undertaken.

The main purpose of the audit was to ensure that adequate control assurance is provided on fund manager systems, through review of statutory reporting from the investment managers, custodians and property managers. This included establishing that the Pension Team had received and reviewed the principal sources of external assurance available and had taken appropriate action where any issues of concern were identified.

Overall, we have been able to provide ‘**substantial assurance**’ over the control framework, with only one area of improvement identified, relating to the need for reports from fund managers to be received and reviewed as soon as possible after they are published.

## **Pension Fund Processes and Systems**

In April 2013, Surrey County Council (South East Shared Services – SESS) took over the day to day management of pension fund administration from SERCO, under the terms of a new collaborative agreement with ESCC. SERCO staff transferred to Surrey, although the service continued to be run from the Uckfield site.

Our review focussed on reviewing controls over membership of the pension fund, fund contributions and the pension payroll. In addition, we also reviewed the adequacy of governance arrangements to facilitate the efficient running of the service, and the arrangements in place to minimise disruption and cost in the event of third party failure.

We found that pension processes and systems were adequately controlled and no significant issues were identified in relation to processing activities. However, we did identify some weaknesses in relation to the period of transition from SERCO to SESS, specifically that some of the key arrangements required to properly manage SESS were not in place or updated to reflect the change in service provider. As a result, we were only able to provide an audit opinion of ‘**partial assurance**’.

In summary, we found that there was a need to:

- Ensure adequate contractual arrangements between SESS and the pensions system software supplier (Heywood) were in place;
- Improve the existing SESS key performance indicators (KPI’s) and associated reporting mechanisms to help ensure the pension service is properly managed and monitored;
- Clarify roles and responsibilities between the operational teams of ESCC and SESS to ensure accountability;
- Agree and implement formal business continuity arrangements between ESCC, SESS and Heywood;
- Improve the management of access to the pension system.

A comprehensive action plan addressing the above findings was fully agreed with management and this will be followed up by Internal Audit as part of our 2014/15 programme of pension fund audit work.

## **Accounts Receivable**

The Accounts Receivable system is administered through SAP and is one of the Council’s key financial systems. The main control objectives of this audit were to ensure that:

- All income generating activities are identified and accurately invoiced to customers;

- All invoices are paid and the income is correctly identified and accounted for;
- The extent of debt is minimised and overdue accounts are followed-up promptly;
- Write offs, credit notes and refunds are valid and are properly authorised; and
- There is adequate segregation of duties in the invoicing and receipting functions.

Our review found that key controls continue to be effective in ensuring that debts are raised and income is received and recorded. We were able to provide an opinion of '**substantial assurance**' with only a small number of low risk recommendations being made.

### **Accounts Payable / Procurement**

The audit of Accounts Payable and Procurement forms part of our programme of key financial system reviews and covered the following control objectives:

- Only authorised staff can commit the organisation to expenditure by approving orders for goods and services;
- Invoices are processed only when goods have been received in the correct amount, and at the correct price;
- All expenditure incurred is accurately recorded;
- All payments are made only in respect of approved invoices for the correct amounts;
- There is adequate segregation of duties for the creation and maintenance of vendor master records, ordering, invoice receipt and payment functions.

Whilst our review covered the complete procure to pay process, there is a distinction between procurement and accounts payable functions and therefore, we have issued a separate audit opinion for each area. Specifically, we were able to provide '**substantial assurance**' over the controls within the procurement process and '**full assurance**' over the accounts payable system.

The main areas for improvement related to management and control over duplicate vendors and the use of substitutes within SAP. All recommendations have been agreed with management and will be followed up as part of our work in 2014/15.

### **HR/Payroll**

The HR/Payroll system is managed by two separate services. All recruitment and employee administration is carried out by the Personnel and Training Division (PAT) and is managed through the web based i-Grasp system and the HR module of SAP. The payroll function is managed by the Contracts and Compliance Team within Strategic Finance through shared services with Surrey County Council.

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

- 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;
- Segregation of duties is in place between those making payments and those creating/amending payroll records; and
- All job offers are subject to completion of satisfactory pre-employment checks prior to being employed by ESCC.

Overall, we found robust controls in place in relation to both the HR and Payroll arrangements and we were able to provide an opinion of '**substantial assurance**'. This included clear segregation of duties, accurate and valid records relating to new starters, leavers and payroll changes, appropriate reconciliation and validation of the payroll system and, correct accounting for taxation and national insurance deductions. Only a small number of areas for improvement were identified and agreed with management, none of which were of a high risk nature.

## **ContrOCC**

ContrOCC is one of the Council's key financial systems and is used to record contractual obligations and control payments to independent sector suppliers of day care, home care, residential and nursing care services. Clients are required to contribute towards the cost of services depending on the outcome of a financial assessment. Contributions are raised either as bills or are offset against payments made to service providers.

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

- Payments are complete, accurate and timely and are only made to bona fide providers of care in respect of the services they have provided to ESCC care clients;
- Client contributions are properly raised in compliance with ESCC policy and are accurately accounted for in ContrOCC;
- Credit notes, changes to invoices and debt write-offs are authorised at an appropriate level.

Overall, we were able to provide an opinion of '**substantial assurance**' over the control framework. We found that providers are being paid accurately and in a timely manner. Bills are also properly raised or deductions made from provider payments where clients have been financially assessed as able to make a contribution to the cost of their own care.

We did, however, identify some areas for improvement, namely the need to:

- Strengthening controls to ensure providers notify the Council of client deaths in good time to avoid making undue payments and distressing bereaved relatives;
- Ensuring credits netted against amounts due on client invoices are separately disclosed and adequately described to avoid customer confusion, queries and complaints;
- Giving greater priority to agreeing (signing) Individual Service Agreements between ESCC and care providers for non-homecare services, where hold-ups can delay relevant payments.

All recommendations arising from the review have been agreed with management as part of a formal action plan.

## Contract Management

This audit of contract management arrangements within the Council involved the review of a sample of five major contracts across the authority, selected on the basis of risk and materiality.

At the time of the review, there were 419 active contracts listed on the Council's contracts register with a nominal total lifetime value of £1,733m. Annually, the Council spends around £125m against these contracts.

In reviewing each contract, we evaluated the adequacy and effectiveness of contract management and monitoring to ensure that:

- works and services of the required standard are delivered in accordance with the contract;
- contract payments are valid and accurate;
- changes are adequately controlled;
- continuing value for money is obtained;
- ESCC Financial Regulations, Contract Standing Orders and best practice are complied with.

Upon completion of our work, each contract sampled was reported on separately and provided with an audit opinion over the specific control environment. These are summarised in the following table:

<b>Provider Name</b>	<b>Contract</b>	<b>Audit Opinion</b>
Colas Ltd.	Maintenance of street, traffic sign and bollard lighting.	<b>Full Assurance</b>
Amey Community Ltd.	Facilities management at ESCC properties and partnering authority properties.	<b>Substantial Assurance</b>
Stagecoach Hastings	Provision of bus services.	<b>Substantial Assurance</b>
Churchill Cleaning Services	Cleaning of ESCC schools, social services and administration establishments, libraries and other buildings.	<b>Partial Assurance</b>
Apetito	Provision of meals in the community in East Sussex.	<b>Minimal Assurance</b>

In addition, we used the findings from the above to form an overall opinion of '**partial assurance**' over the Council's contract management arrangements.

Whilst we found examples of good practice, we also identified a number of areas for improvement based on common areas of weakness or patterns identified across the five contracts. These included:

- Ensuring contract planning and performance management is fully embedded within the Council and that overall ownership of contract management is clarified;
- Establishing a formal contract management framework to provide a more effective and corporate approach to managing contracts;
- Ensuring governance of individual contracts is clear and unambiguous, with defined roles and responsibilities and mechanisms for decision-making and escalation;
- Improving relationships and interaction between contract managers and the Corporate Procurement Team, particularly when planning re-procurement, contract extensions or variations, where there are clear opportunities to utilise procurement expertise;
- Applying more focus to commercial contract management where there is an opportunity to promote continuous improvement and innovation with contracts;
- Improving performance management, particularly in relation to the quality and availability of monitoring information.

Each individual report, including the overall report which summarised our findings, was discussed and agreed with management and actions to improve contract management are being taken. In the case of the Apetito contract, a formal follow up review will be carried out in the year ahead.

### **Peacehaven Schools PFI – Follow-Up**

In 2001, the Council entered into a 25-year PFI Project Agreement with Peacehaven Schools Ltd. Under the agreement, the construction of a new secondary school and the replacement/refurbishment of four primary schools (with a total capital value of £19m) were completed in 2001/02. Since then, a facilities maintenance provider has been responsible for operating and maintaining the premises (e.g. building maintenance, cleaning, catering, security, ICT services etc.) in return for unitary charge payments of currently around £5m per annum.

In 2012/13, we completed a contracting and procurement review of Peacehaven Schools PFI and were only able to provide an opinion of partial assurance. This was because governance and performance management arrangements were inadequate and there was an absence of controls for ensuring on-going service improvement and value for money.

Our subsequent follow up review, finalised in March 2014, found that significant progress had been made in addressing the issues raised in the previous audit, with many of the recommendations implemented in full. The remainder, mainly relating to ensuring adequate contract management documentation is in place, are in the process of implemented, subject to final approval of the project's Strategic Joint Board later this year. We were therefore able to provide an opinion of '**substantial assurance**' with only two further recommendations being made.

### **SAP Interfaces**

A number of automatic interfaces exist between local systems and SAP, the Council's main financial system. This review was undertaken in response to the transfer of the Councils' data centre (where SAP is hosted) from SERCO to Surrey County Council (SCC), with the objective of ensuring that:

- Controls are in place within the feeder system process to ensure all data, including payments and charges, is transferred to SAP reliably, accurately and completely;
- Staff roles and responsibilities are clearly defined and communicated in relation to the interface process;
- Controls are in place to ensure that any errors within a transfer are identified promptly, corrected, and re-transferred accurately, with the reason for failure or error investigated.

We concluded that the transfer of the data centre from SERCO to SCC did not have any major impact on the interface processes. Appropriate controls were found to be in place and operating effectively and we were able to provide an opinion of '**substantial assurance**' as a result. Specifically, we found that all data, including payments and charges, are accurately and completely transferred into SAP.

Some minor areas for improvement were identified, including the need to ensure the availability of adequate guidance for managing interfaces within existing systems and for managing new systems that interface with SAP.

### **Desktop Anywhere Project**

Desktop Anywhere is one of the core project developments of the Council and is an integral part of the County wide ICT strategic delivery plan. It is intended to deliver further efficiencies in service delivery by utilising a more cost effective desktop management model.

The solution is essentially based on thin client technology, where individual computers rely heavily on another computer (or server) to do most of the work. The individual computers operate as interfaces to the network server computer which does all the main work, such as saving files and processing data. The project is anticipated to deliver a range of benefits, including long term financial savings, improving access to services, providing staff with better tools and improving network security and resilience.

This review, undertaken by specialist ICT auditors from Deloitte, sought to examine controls over:

- Project governance;
- Project planning;
- Budget monitoring;
- Development design and testing;
- Proposals for measuring benefits arising from the introduction of desktop anywhere technology.

Overall, the review found controls to be adequate and an opinion of '**substantial assurance**' was provided over the control environment. The audit report did, however, make some recommendations for improvement, including ensuring adequate contingency arrangements were in place to ensure business continuity in the event of a disaster. These were all agreed in full with management.

### **ICT Disaster Recovery**

Disaster recovering planning enables the recovery of ICT systems in the event of a business disruption. Given that information and communication technology plays an increasingly important role in the delivery of Council services, the ability to recover systems in a timely manner is essential.

ESCC, with Eastbourne Borough, Rother and Wealden District Councils have entered into a Framework Agreement with ADAM Continuity Services for the provision of disaster recovery services.

The control objectives of this review were to ensure that:

- There is an established disaster recovery plan which identifies and prioritises critical business functions, locations and operations;
- The risks faced by the organisation have been fully identified, prioritised and evaluated;
- Escalation procedures are in place for the assessment and reporting of disasters;
- Emergency action procedures exist in order to prevent disasters;
- Salvage procedures are in place in order to recover items in the effected site/system as part of the recovery effort;
- There are system backup procedures for the effective recovery of business systems within the organisation;
- Temporary procedures allow business operations to continue whilst systems are under restoration;
- Financial arrangements help to ensure that disaster recovery efforts are adequately funded; and
- A disaster recovery test plan is in place to adequately test the procedures documented within the organisation's recovery plan.



Overall, we found a sound system of control to be in place and were therefore able to provide an audit opinion of '**substantial assurance**'. A small number of areas of further improvement were identified, primarily relating to ensuring business continuity plans are up-to-date and reviewed annually.

An action plan incorporating all recommendations for improvement has been agreed with management within ICT Services.

### **Bexhill to Hastings Link Road**

ESCC entered into a contract with Hochtief Vinci / Taylor Woodrow in 2009 to design and construct the Bexhill to Hastings Link Road. The total estimated cost of the scheme is £113m, of which the Department of Transport has agreed funding of £37m.

The main purpose of this audit was to examine the adequacy of project controls and the effectiveness of financial management processes.

Recognising that the project is a significant and complex activity, involving many teams of people with a high degree of diversity, we found that it is well managed for all areas examined. This included financial management, checking of contractor's claims for costs incurred, change control processes and time, quality and risk management arrangements.

We were also able to confirm that recommendations reported in our previous review of the Bexhill to Hastings Link Road had been implemented by management and were therefore able to provide an opinion of '**substantial assurance**'.

Only two minor recommendations for improvement were necessary, both of which have been agreed with management.

### **EXOR Follow-Up**

The County Council has a statutory duty to maintain the road network to ensure it is in a safe condition for the general public to use. The current contract to maintain the County's roads is with May Gurney (MG). EXOR is the system used to administer the highways management process, which includes the controlling and recording of repairs work and payments to MG.

In March 2013, we completed a review of EXOR, specifically looking at the processes for ordering works, making payments, variations and budget management. We provided an opinion of partial assurance as a result of control weaknesses in a number of areas. Due to the issues identified, a follow-up review was undertaken to assess the extent to which our recommendations had been implemented.

Our follow-up work identified that the majority of recommendations made previously had been implemented and we were able to provide a revised opinion of '**substantial assurance**' as a result. In undertaking this work, we made some additional recommendations to help strengthen controls further, particularly in relation to:

- Implementing additional mechanisms to enable more robust management reviews of Project Manager Instructions and Early Warning Notices;
- Enabling more than one employee to perform the monthly SAP interface reconciliation process;
- Enhancing procedures around the self-certification of invoices.

All recommendations were agreed in full with management.

### **Direct Payments**

The review of Direct Payments was undertaken following a recent investigation into an ASC client who was suspected of claiming a direct payment package in a fraudulent manner. The results of our investigation into this matter have been reported to Sussex Police who are continuing their enquiries.

The purpose of this subsequent review was to confirm that appropriate controls exist within the Council to ensure:

- Payments to service users are only made to eligible people who have been properly assessed and whose payments have been formally approved;
- All direct payments made are accurate, timely, appropriately authorised in accordance with Financial Regulations and supported by appropriate returns;
- All overpayments made to clients are identified and where possible recovered;
- Monitoring and control arrangements (including care assessments, financial assessments and monitoring of clients payments) are adequate, ensuring all monies provided under the direct payment scheme are being used for the purpose intended;
- Procedures and processes are in place to ensure effective 'whistleblowing' by any concerned person.

Overall, we were able to provide an opinion of '**partial assurance**' over the control environment. The main reason for this opinion is that there are a number of control weaknesses in the system that are impacting on management's ability to detect and act upon possible warning signs of fraudulent activity in a timely manner. This is mainly due to the often limited information known about clients' personal assistants (where a client manages their own payroll service) and the involvement of various different teams in the overall system, without effective communication.

Whilst we identified a number of opportunities for improvement, we also recognised that direct payments carry with them an inherent risk of fraud and misuse due to the nature of a personal budget and the client's choice over the provision of their care needs. It is, therefore, important that the Council's approach to managing direct payments remains proportionate in terms of the risks, benefits and flexibilities offered.

Our review identified the need for improvement in the following areas:

- Verification of client personal assistants where a client conducts their own payroll service;
- Making better use of limited resources by applying a risk based approach to the financial monitoring of client returns;
- Improving the liaison between Social Workers and Direct Payments Team staff, especially in relation to the potential indicators of fraud;
- Ensuring that the County Council's established debt recovery arrangements are adopted in relation to direct payments cases.

All of the recommendations arising from our work have been incorporated within an agreed management action plan, with the overall control environment expected to improve in the future through the proposed introduction of payment cards for direct payment clients.

### **THRIVE Project**

A previous review of the THRIVE programme in August 2012 resulted in an audit opinion of partial assurance, with a number of recommendations for improvement being made. Those recommendations relating to financial management were followed up in April 2013, when we were able to provide substantial assurance over the financial control environment.

The main purpose of this subsequent review was to follow up on our previous non-financial recommendations in order to ensure that the programme governance arrangements are robust and that the programme is being co-ordinated effectively and efficiently. Our review covered the following control objectives:

- 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.

Overall, we were able to see that clear improvements had been made and that appropriate action had been taken to address our previous recommendations. Therefore, based on the work carried out, we have been able to provide a revised audit opinion of '**substantial assurance**'.

### **School Audits**

#### **School's Senior Leadership Salaries (Themed Review)**

Teachers' pay scales are set nationally by the Department for Education which provides annual guidance on how maintained schools should comply with statutory requirements for teachers pay and conditions. One of the key requirements is that Headteachers should be paid within a band that corresponds to the size of the school. These bands are known as the Individual School Range (ISR).

In order to help ensure that all the necessary conditions and requirements are adhered to, the Council issues a model pay policy to schools on an annual basis, which all schools are advised to adopt.

To assess the extent to which senior staff in East Sussex schools are paid in line with the appropriate guidelines, we examined a sample of senior leadership team salaries, discretionary and other salary related payments across a sample of schools.

Due to the level of non-compliance with a number of key controls, we were only able to provide an audit opinion of '**minimal assurance**'. Given that Ofsted are currently reviewing performance management in schools and, as part of this, are comparing patterns of pay progression to the quality of teaching and learning, a failure to have in place robust pay and reward structures could lead to reputational damage to both the Council and schools.

In the course of our work, we found:

- Instances where Headteachers' pay was more than the top of the ISR, sometimes by as much as 50%, without sufficient evidence to support the reasons for these payments;
- A lack of evidence that salary increases were properly approved by Governing Bodies;
- Inconsistencies in the way Headteacher's pay is processed (by ESCC Personnel) when they assume a temporary Executive Headteacher or Local Leader of Education role;
- Inconsistencies in the way senior staff are paid for the different roles and responsibilities they perform outside of their normal day-to-day activities, including Ofsted inspections.

Working with Personnel and Training and the Standards and Learning Effectiveness Team within Children's Services, we identified a number of actions that would help to improve awareness and standards in this area. These have all been agreed and are due to be implemented by May 2014.

### **Recruitment and Selection in Schools – Follow-Up (Themed Review)**

The County Council has approximately 12,000 staff in schools, with around 85-90% of each school's annual budget being spent on staff costs. 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) within ESCC.

In 2011, we completed a review of recruitment and selection in schools. This identified a poor system of internal control and we provided an opinion of no assurance as a result of weaknesses in a number of areas. Consequently, a follow-up review was undertaken during 2013/14 to assess the extent to which our previous recommendations had been implemented.

In completing the follow-up, we identified that significant progress had been made since the previous audit to improve the quality and availability of recruitment information for schools. We were therefore able to provide an opinion of ‘**substantial assurance**’ over the control environment, with only a small number of further improvements being recommended, the majority of which were of a low risk nature.

During the quarter, we have continued to conduct visits to schools in the County, with the individual schools selected in conjunction with Children’s Services Department on the basis of risk. We have also completed two themed reviews, both of which have been summarised above. In all cases, recommendations arising from our work have been formally agreed with school management, with copies of all audit reports now sent directly to all members of each school’s governing body.

### Individual School Audits

The following school audits have been completed in the quarter:

School	Opinion	Key Findings
Claverham Community College	Substantial Assurance	Sound control environment, with some areas where controls could be further strengthened
Peasmarsh CEP School	Partial Assurance	Improvements necessary in relation to: <ul style="list-style-type: none"> <li>governance arrangements (including the need to clearly record decisions made and to formally approve the award of contracts);</li> <li>the financial planning process, including the need for a budgeted three-year development plan;</li> <li>the payments process, including ensuring that orders are raised at the time of ordering and in advance of the invoice being received, and that all invoices are certified in advance of being paid; and</li> <li>the school fund accounts needing to be formally approved by the Governing Body.</li> </ul>
South Malling CEP School	Partial Assurance	We identified a number of areas for improvement, especially in relation to: <ul style="list-style-type: none"> <li>formally declaring conflicts of interests and properly managing these;</li> <li>ensuring letting agreements are in place and all income in respect of lettings is collected;</li> <li>raising orders for goods and services purchased by the school;</li> <li>ensuring that contractors have adequate and current public liability in place prior to work commencing; and</li> <li>carrying-out an annual inventory check.</li> </ul>

School	Opinion	Key Findings
Forest Row CEP Primary School	Partial Assurance	<p>Areas for improvement included the need for:</p> <ul style="list-style-type: none"> <li>• the Governing Body to clearly record key decisions;</li> <li>• all staff to have access to the school's whistleblowing policy;</li> <li>• a three-year School Development Plan approved by the Governing Body;</li> <li>• independent checking of reconciliations;</li> <li>• invoices to be raised for all lettings in the school; and</li> <li>• an adequate separation of duties within the payroll process.</li> </ul>
Westfield School	Minimal Assurance	<p>Particular control weaknesses included:</p> <ul style="list-style-type: none"> <li>• Conflicts of interests not fully declared and appropriately managed, including the certification of payments to a family member;</li> <li>• Staff not having adequate access to the school's whistleblowing policy;</li> <li>• Local financial procedures not adequately covering income processes and controls;</li> <li>• The staffing structure at the school not formally approved by the Governing Body;</li> <li>• No independent checking of reconciliations;</li> <li>• Large value contracts approved by the Headteacher rather than the Governing Body, as required with the Scheme of Delegation;</li> <li>• Charges for income not being reviewed and approved by the Governing Body; and</li> <li>• An inadequate separation of duties in the payroll system.</li> </ul>

### **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:

- Milton Grange Care Home;
- Phoenix Arts Centre, William Parker Sports College;
- Deceased Client Notifications;
- SAP Interfaces;
- Oracle Database Follow Up;
- Conflicts of Interest Administration;
- EXOR Follow-Up;
- Direct Payments Internal Control.

The following audits, originally scheduled for 2013/14, have been removed from the plan, primarily because they are either project work which has not progressed sufficiently, or to allow resources to be focussed on emerging higher risk areas and unplanned investigations. Where appropriate, the work has been rescheduled for delivery within the 2014/15 audit plan. In all cases, these changes have been agreed with both the Chief Finance Officer and senior departmental managers:

- Mental Health Budget Management;
- Integration with the NHS;
- Commissioning Arrangements;
- Capital Programme Project Management;
- Children's Centres – Governance and Financial Management;
- New Property Management System;
- Agile.

