

INTERNAL AUDIT SERVICES
ANNUAL REPORT AND OPINION
2004/2005

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 2003. 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.

1.2 East Sussex County Council has delegated responsibility for ensuring that statutory internal audit arrangements are in place to the Deputy Chief Executive and Director of Corporate Resources. These arrangements form a key element of the County Council's framework for corporate governance. On a day to day basis the Assistant Director (Audit and Performance) serves as the County Council's Chief Internal Auditor and the Audit and Performance Division provides internal audit services to the County Council on behalf of the Deputy Chief Executive and Director of Corporate Resources.

1.3 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.

1.4 Internal audit is an assurance function that primarily provides an independent and objective opinion to the organisation on the control environment, comprising risk management, control and governance, by evaluating its effectiveness in achieving the organisation's objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources. To carry out this role the Audit and Performance Divisions Internal Audit Service (IAS) aims to:

- satisfy legal requirements and professional standards;
- examine, evaluate and report objectively on the adequacy of arrangements to secure proper economic, efficient and effective use of resources;
- assist management with its responsibility for establishing and maintaining internal control systems and for ensuring that resources are properly applied, risks are appropriately managed and outcomes are achieved;
- investigate allegations of fraud and corruption in line with the Council's Anti-Fraud and Corruption Strategy; and
- provide an annual opinion to Members and Officers on the adequacy of the Council's control environment, and regular reports on key audit findings.

2. Delivery of the Internal Audit Plan

2.1 In accordance with the 2004/05 annual audit plan, approved by the Director of Corporate Resources and endorsed by the Audit and Best Value Scrutiny Committee, a programme of audits, based on an assessment of risk, was carried out, covering all County Council departments. This programme was reviewed during the year and revised to reflect changes in risk and resources available to deliver the plan. The actual internal audit coverage across departments compared to the audit plan has been summarised in Appendix A.

2.2 As well as progress reports made during the year to both COMT and Audit and Best Value Scrutiny Committee, separate reports have been made to each departmental management team which include an opinion on that department's internal control system.

3. Audit Opinion

3.1 No assurance can ever be absolute; however this opinion seeks to provide a reasonable assurance that there are no significant weaknesses in the Council's control environment. On the basis of the audit work completed, the Council has in place a satisfactory framework of internal control which provides a reasonable assurance regarding the efficient and effective achievement of its objectives.

The level of assurance given takes into account:

- All audit work completed during 2004/05;
- Follow up of actions from previous years 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;
- The extent to which resource constraints may limit the ability to meet the full audit needs of the County Council;
- Any limitations that may have been placed on the scope of internal audit..

3.2 All audit reports produced have included a management action plan where recommendations have been made which will enhance the level of control, together with an opinion of the systems reviewed. Timescales for the implementation of recommendations have been agreed with the managers responsible for each area reviewed.

3.3 The majority of the key internal controls audited during 2004/05 were found to be in place and functioning satisfactorily. The majority of systems reports resulted in an opinion of satisfactory or good in relation to the effective operation of controls. Although reports are generally written on an exception basis, good practice, where identified has been highlighted.

4. Key Issues

CBOSS Project (Corporate Body)

4.1 During 2004/05 internal audit undertook a significant amount of work reviewing the CBOSS Project and advising on the control issues associated with SAP implementation. This work has been reported on at key stages throughout the year to the CBOSS Project Board and quarterly to COMT and the Audit & Best Value Scrutiny Committee within the Internal Audit Quarterly Progress Reports. The scope of our audit work has varied during the course of the year and has included providing an opinion to the Project Board in support of key decisions, including Blueprinting sign off, Phase 1 go-live and Phase 2 go-live.

4.2 Towards the latter half of the year, the focus of our work has shifted to concentrate on advising on queries and control issues arising from implementation and to carrying out systems based audit reviews of the SAP modules. The first of these systems reviews will be reported on during quarter 1 of 2005/06 and once they have been completed we will be able to give an assurance as to whether controls within SAP and our key financial systems are operating effectively.

Social Services Control Environment (Adult Social Services)

4.3 Within the 2003/04 we reported on a number of systems within Social Services Department where controls were not considered satisfactory. During 2004/05 further

examples of internal control weakness were identified, with the following reports all resulting in weak or unacceptable audit opinions:

- Scanning of Social Care Records
- Themed Review – Overtime / Additional Hours
- Home Care Travel
- Asylum Seekers
- Young Persons Leaving Care Scheme
- SS Petty Cash
- Home Care Block Contracting Arrangements
- Client Billing (Part III)

4.4 The adequacy of the control environment within Social Services led the Audit and Best Value Scrutiny Committee to seek further assurance that appropriate action was being taken to improve internal controls and to ensure the implementation of internal audit recommendations. Social Services DMT responded to this by formally reminding all departmental managers of their current and continued responsibility to ensure that all systems and processes operated are supported by sound financial controls. In addition they established more robust procedures to ensure that agreed Management Action Plans are implemented and the control environment enhanced, and additional short term finance capacity was made available to support this.

4.5 We are satisfied that the action taken has begun to address the weaknesses in the Social Services control environment. However, during the coming year the directorate faces risks associated with transfer of certain functions and staff to Children's Services, the restructure of the Financial Services Unit and Older Peoples Services and the revised working practices introduced as a result of SAP. It is therefore essential that these risks are effectively managed and the Adult Social Services DMT ensures that a satisfactory control environment is maintained.

Financial Governance Arrangements in Schools (Children's Services)

4.6 Following the publication of the Audit Commission report on Education Funding in July 2004, previous reports produced by OFSTED and the Audit Commission about school finances and internal audit findings over a number of years, a working group has been set up with Senior Education Management, Education Finance, Internal Audit and CfBT to review the Financial Governance arrangements in schools. The review includes planning, monitoring and resource management and the LEA's strategy for dealing with schools with large surpluses or deficits.

4.7 Initial proposals include actions to raise the awareness of governors, especially chairs of finance, of financial governance issues, including the development of a simple financial health check and a review of governor training, and a series of joint reviews of schools with high levels of balances. These actions will be underpinned by better information sharing between Education Finance, internal audit and CfBT. In addition, the school improvement service has incorporated a new question on financial governance and management in school's moderated annual self evaluation report (completed by every school), and the link adviser for each school will be discussing this question with heads and governors as part of the moderation process.

Compliance with the Council's core policy and guidance

4.8 The 2003/04 Internal Audit Annual Report commented on a number of audits and investigations that had highlighted failures to comply with the Council's Financial Regulations, Contract Standing Orders and the Code of Conduct for Employees. In response Chief Officers agreed to reinforce the culture of good governance within the Council and seek assurance that employees within their departments were aware of the

Code of Conduct, its key principles and the protection that it offers to them as well as to the County Council, and robust processes are in place to ensure compliance through the maintenance of up to date registers of interest and hospitality.

4.9 Follow up work indicates that most departments have reminded staff of the Council's requirements in these areas. However, detailed testing carried out as part of the current review of Corporate Governance indicates that there is still considerable room for improvement both in processes and compliance and a need for more consistent interpretation of the Code of Conduct itself. This document is currently under review and needs to be re-launched to ensure that staff are aware of the processes for making declarations and reporting concerns, but more importantly that they are aware of the standards of behaviour which the Council expects.

4.10 During the year a number of audits have reported on systems where controls are not satisfactory (in addition to those already highlighted in paragraph 4.3). In all these cases management have agreed to take action to strengthen the controls in place. These systems are highlighted below and will all be subject to follow up during 2004/05:

Creditors (Corporate Body)

4.11 Earlier in the year, internal audit completed a review of controls relating to the creditor payment process prior to SAP implementation. This audit found that whilst central processing controls appeared satisfactory, significant control weaknesses existed within departmental order and invoice processing. The main areas of weakness related to:

- Lack of purchase orders being raised by departments;
- Lack of evidence of proper checking of invoices;
- Evidence of invoices being processed without appropriate authorisation;
- Failure to regularly check invoices back to original orders;
- Lack of appropriate authorisation lists;
- Lack of adequate division of duty in the payment process;
- Failure to date stamp invoices upon receipt.

4.12 As well as agreeing an action plan with the Finance Management Team covering the recommendations made from the review, we have ensured that these issues are considered as part of our ongoing CBOSS advice work and within the scope of future SAP systems audits.

External Funding / Grants (Chief Executive's)

4.13 During 2003/04, internal audit undertook an extensive exercise to examine controls in relation to the management of grants coming into the Authority and those being paid out. This involved a considerable amount of work within the Strategic Economic Development and Europe Team (SEDE) as well as testing across all County Council departments. Based on the results of our work, the internal audit opinion was that the level of control for both the grant giving and receiving process was weak. A comprehensive management action plan has been agreed with officers from both Strategic Economic Development and Europe Team and Finance. This area will be subject to a follow up during 2005/06.

Music Service (Education and Libraries)

4.14 A review of the Music Service was carried out in line with the annual plan and a large number of recommendations made. There were weaknesses relating to governance and the management control of finances and a lack of clarity of the roles and responsibilities at all levels of the service from the Management Committee down, which had contributed significantly to the Services' poor financial performance. Action had also not been taken to implement agreed recommendations from a previous audit, particularly those relating to

procurement and breaches of contract standing orders. As a result of the audit work undertaken, it was Internal Audit's opinion that the controls were unacceptable. A management action plan was drawn up and agreed by Education & Libraries management, including timescales and responsibilities for implementing the internal audit recommendations. A follow up review is planned for 2005/06.

Inter Authority Recoupment (Education and Libraries)

4.15 From the audit work completed during this review of inter authority recoupment, Internal Audit concluded that the controls in place were weak. This was due to inaccurate calculation of best estimates of recoupment expenditure resulting in material variances to annual budgets, inaccurate year-end provisions and records of expenditure not supporting amounts claimed by other LEA's, increasing the risk of inter-authority recoupment disputes. A management action plan was drawn up and agreed with Education and Libraries Department Management. A follow up review is planned for 2005/06.

School Meals Income (Education and Libraries)

4.16 This review examined the process where the corporate catering contractor is responsible for collecting money on a daily basis and banking it on behalf of the County Council. A report was issued based on the findings on the monitoring processes within the Contracts Management Team as they related to the schools in the contract and the controls were found to be unacceptable. The main weakness was a lack of effective, timely monitoring and reconciliation of the schools accounting and banking records by the Contracts Management Team. Recommendations to improve the control environment have been made and agreed in a management action plan which will be followed up during 2005/06.

Corporate Performance Indicators (Chief Executive's)

4.17 This review sampled ten Best Value Performance Indicators (BVPIs) that were assessed as high risk to the Authority. Each BVPI was examined for accuracy against the Audit Commission definitions and robustness of the audit trail from the reported figures to source documents. The main findings from this review were that two of the BVPIs had weak audit trails and six had not been calculated in accordance with the definition at the time of the review. As a result of the internal audit review these six were recalculated prior to the external audit conducted by the Audit Commission who subsequently reported that all of the indicators they reviewed fully complied with the relevant guidance. A full management action plan was agreed with the Corporate Performance Team and relevant departmental managers. This included a number of recommendations to improve the quality of BVPI data collection and reporting. Internal audit will continue to build on this BVPI audit work during 2005/06 to support improvement across the Authority in the quality and accuracy of BVPI data.

Peacehaven PFI (Education and Libraries)

4.18 A review of the Peacehaven Schools PFI payments process was undertaken to ensure payments are made in accordance with Contract Standing Orders and the contract. The processes for performance monitoring were assessed and a review of the financial management information undertaken. The audit also included a follow up of previous work undertaken in this area in September 2002. Whilst some improvements had been made to the level of controls following the previous audit, the overall audit opinion was still that of weak as there were a number of recommendations that have not yet been put in place despite being previously agreed. A new management action plan with recommendations to enhance the level of control was subsequently agreed with management and will be followed up in during 2005/06.

5. Internal Audit Performance

5.1 Performance against agreed targets is set out in Appendices A and B. In total the Internal Audit Service has delivered 1993.5 direct days or 93.6% of the total plan. This exceeds the estimate of 90% reported at quarter 3. Direct time performance stands at 70.0% which is below the overall target of 71.3%; however this still represents a real achievement in the light of higher than expected sickness absence levels, including long term absence, during the year. Actual v. planned time on completed jobs has improved in relation to last year but further improvement is needed to meet our medium term target of 102%.

5.2 During the year, the audit plan has been reviewed against available resources in order to ensure the highest risk areas were given priority, including increasing the resource assigned to the CBOSS Project.

5.3 The IAS has carried a number of vacancies for some time and has used agency staff to backfill where possible. In addition, a number of new appointments have been made during the latter part of the year, including an internal promotion to the new position of Principal Audit Manager.

5.4 Performance against effectiveness targets continues to be positive and reflects both the quality of work completed and its focus on key areas of risk. CPA scores of 4/4 were maintained for the IAS and prevention and detection of fraud and corruption. In addition the Audit and Inspection Annual Letter confirmed that the Audit Commission continues to place reliance on the work of Internal Audit and commented that "The quality of Internal Audit work remains high and a particularly demanding workload was delivered over the past 12 months. The section has provided advice and support to some key corporate projects, providing assurance to Members that action is being taken to mitigate the risks identified by the work of Internal Auditors."

5.5 Seven out of the 41 customer satisfaction surveys returned failed to meet our required standard, giving an overall score of 83% which is below our target. In each case we followed up the survey with the customer concerned to establish the reason for the score and made improvements to our service where appropriate. We will be reviewing our processes for following up customer feedback during 2005/06.

Appendix A

Actual Days delivered against the plan

The following table summarises the internal audit coverage across all County Council departments during 2004/05:

Service	2003/04 Actual Days	2004/05 Plan Days	2004/05 Actual Days	2004/05 % plan days delivered
<i>East Sussex County Council:</i>				
<i>Corporate Body</i>	439.4	443.0	444.4	
<i>Computer Audit</i>	332.2	260.0	352.6	
<i>Education & Libraries</i>	510.2	394.0	446.0	
<i>Social Services</i>	363.1	300.0	307.1	
<i>Transport & Environment</i>	170.6	175.0	156.7	
<i>Legal & Community Services</i>	32.2	-	-	
<i>Chief Executives</i>	51.0	125.0	121.3	
<i>Contingency¹</i>	-	275.0	-	
<i>Discretionary and corporate projects</i>	41.6	50.0	44.4	
<i>Sub total – internal customers</i>	1940.3	2022.0	1872.5	92.6%
<i>External customers</i>	106.7	107.0	121.0	113.1%
Total audit days	2047.0	2129.0	1993.5	93.6%

¹ Contingency days delivered are included in the total for the department to which the work related.

Internal Audit Performance Indicators

<i>Performance Indicator</i>	<i>Target</i>	<i>Actual</i>
<i>Economy and efficiency</i>		
<i>Planned days delivered (%)</i>	100	93.6%
<i>Planned audits completed = final reports issued (%)</i>	90	80.4%
<i>Actual v Plan time on completed audits (%)</i>	102	104.4%
<i>Direct time (%)</i>	71.3	70.0%
<i>Effectiveness</i>		
<i>External audit reliance on internal audit</i>	<i>Achieved</i>	<i>Achieved</i>
<i>CPA score maintained</i>	4/4	4/4 Achieved
<i>Recommendations accepted (%)</i>	90	98%
<i>Customer feedback forms scoring 3 out of 5 or higher (%)</i>	95	83%
<i>Reports to Chief Officers and Members</i>	<i>Quarterly</i>	<i>Reports issued for every quarter during 04/05.</i>
<i>Results of internal quality reviews</i>	<i>Quality Reviews in place</i>	<i>Quality review programme introduced during 04/05.</i>