INTERNAL AUDIT SERVICES ANNUAL REPORT AND OPINION 2016/2017

East Sussex
County Council

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 2015. The full role and scope of the Council's Internal Audit Service is set out within our Internal Audit Charter and Terms of Reference.

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 2016/17, 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[1] 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 2016 to 31 March 2017. Audit testing has confirmed that the majority of key controls examined are working in practice, with some specific exceptions.

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[1] The use of term 'reasonable assurance' reflects that the opinion has been reached based on the work set out in paragraph 4 below and that it is not possible or practicable to audit all activities of the County Council within a single year.

3.2 Where improvements in controls are required, we have agreed appropriate remedial action with management.

4. Basis of Opinion

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

- All audit work completed during 2016/17, planned and unplanned;
- Follow up of actions from previous audits;
- Management's response to the findings and recommendations;
- Ongoing advice and liaison with management, including attendance by the Head of Assurance at monthly Statutory Officers Group meetings;
- 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 2016/17.

5. Key Issues for 2016/17

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 graphs provide a summary of the outcomes from all non-school audits and school audits finalised during 2016/17 with standard audit opinions:

Non-Schools
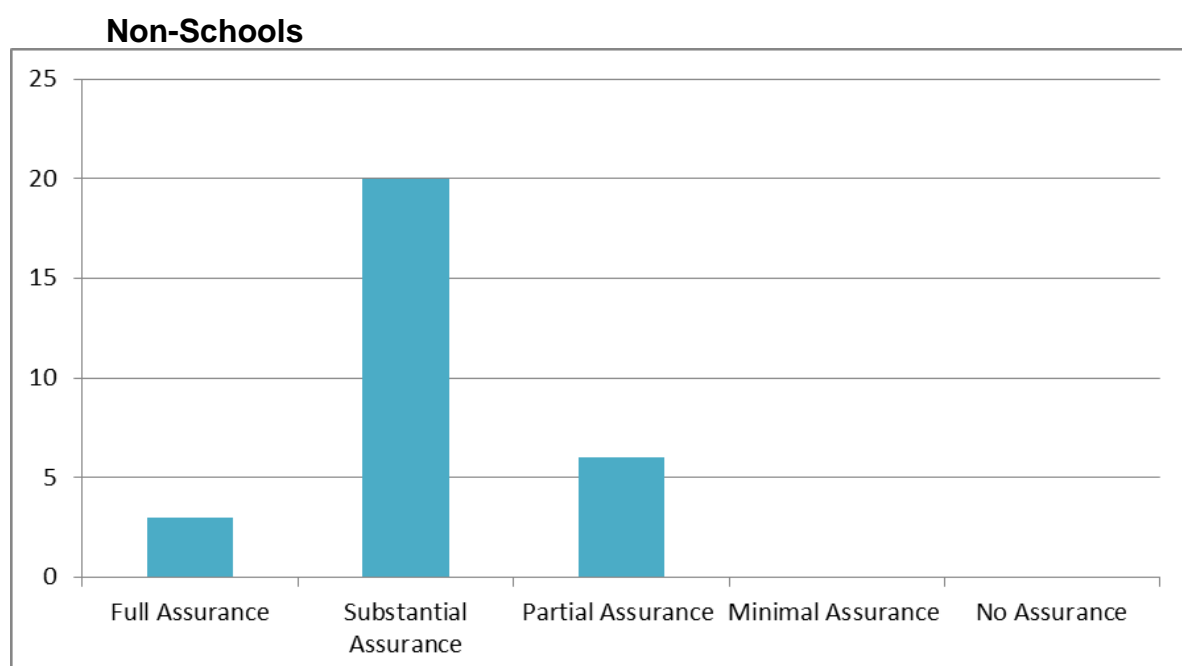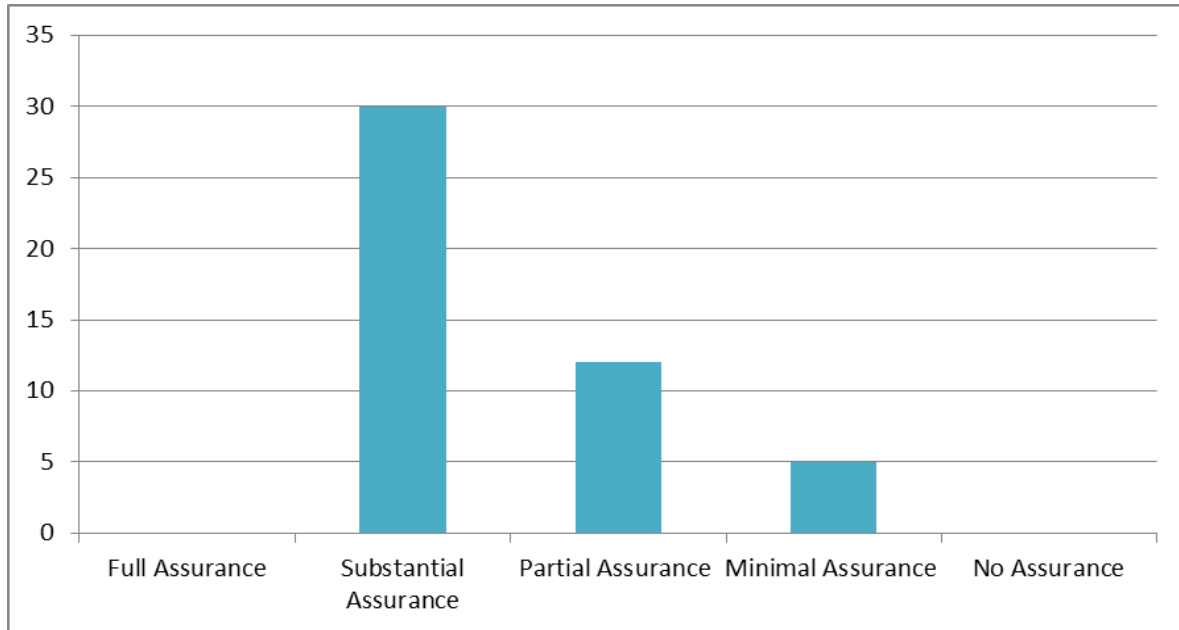
Schools

5.3   A full listing of all completed audits and opinions for the year is included at Appendix B, along with an explanation of each of the assurance levels. Significantly, it is pleasing to report that, with the exception of schools, none of the audits completed in the period have resulted in 'minimal assurance' opinions and, there have been no 'no' assurance' opinions in either schools or non-schools.

5.4   Included with the non-schools graph above are a total of three reviews where we have revisited areas which had previously received lower levels of assurance. For one of these (Public Health Local Service Agreements), we have been able to issue a revised opinion of substantial assurance. For the other two audits (Compliance with Procurement Standing Orders and Direct Payments), the original audit opinions of partial assurance remain unchanged. In both cases, we have agreed revised action plans with management who have committed to ensuring the necessary control improvements are made. Both areas will also be subject to further follow-up work to ensure this is the case, with progress to be reported to ABVCSSC during the course of 2017/18.

5.5   As well as conducting formal follow up reviews, we have in place arrangements to track the implementation of all high risk audit recommendations issued during the year. As at 31 March 2017, of the 38 high risk recommendations issued and due by the end of the 2016/17, it is pleasing to report that all had been implemented within the agreed timescales.

5.6   At the time of producing this report, a total of 11 planned reviews remained in progress, all of which will be completed during the first quarter of 2017/18. The finalisation of these reports will result in 100% completion of the 2016/17 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. Of those completed during 2016/17, all of these, with the exception of Pensions Processes and Systems (which received partial assurance), have resulted in either full or substantial assurance being provided over the control environment.
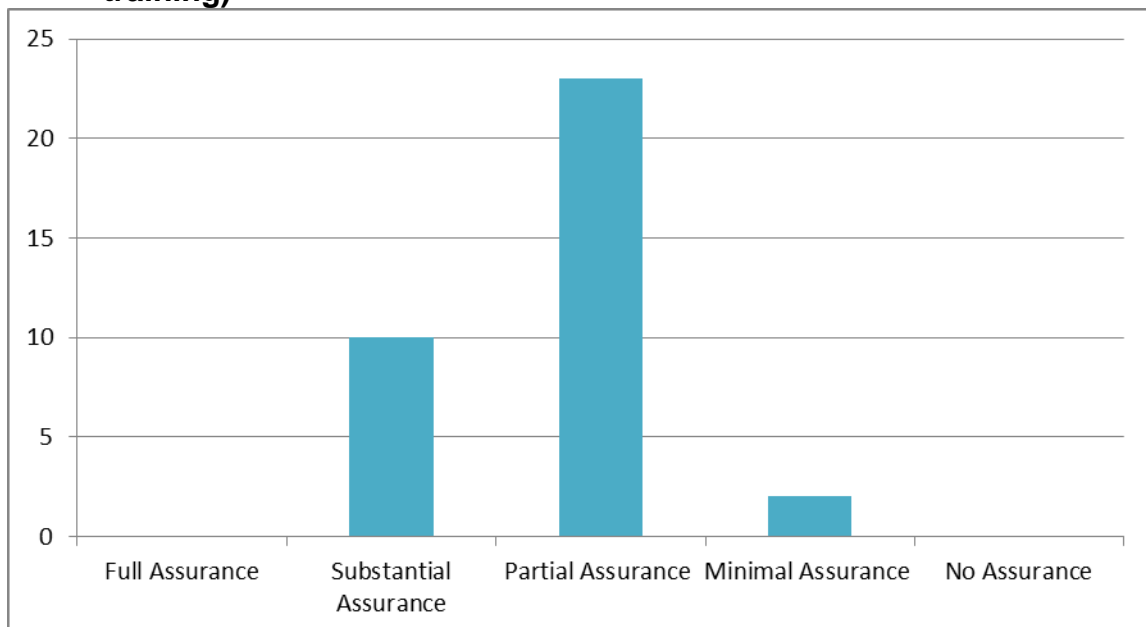
Schools

5.8   Throughout the year, we have completed a programme of assurance work in schools in accordance with our agreed Schools Internal Audit Strategy. For 2016/17, this has focussed on two main areas:

- Audits in a sample of higher risk schools and follow-ups where poorer audit opinions have been given. This work was delivered by our own Internal Audit service, and;
- A wider programme of audits of randomly selected schools, delivered through Mazars Public Sector Internal Audit.

5.9   The purpose of this wider sample of school work is to assess financial governance in more schools, not just those deemed to be higher risk, and to gauge the effectiveness of a new training programme delivered jointly by ESCC Internal Audit, Personnel, Finance and Children's Services, to governors, headteachers and school business managers. A full list of all schools audited in the year, along with the relevant audit opinions, is provided within Appendix B to this report.
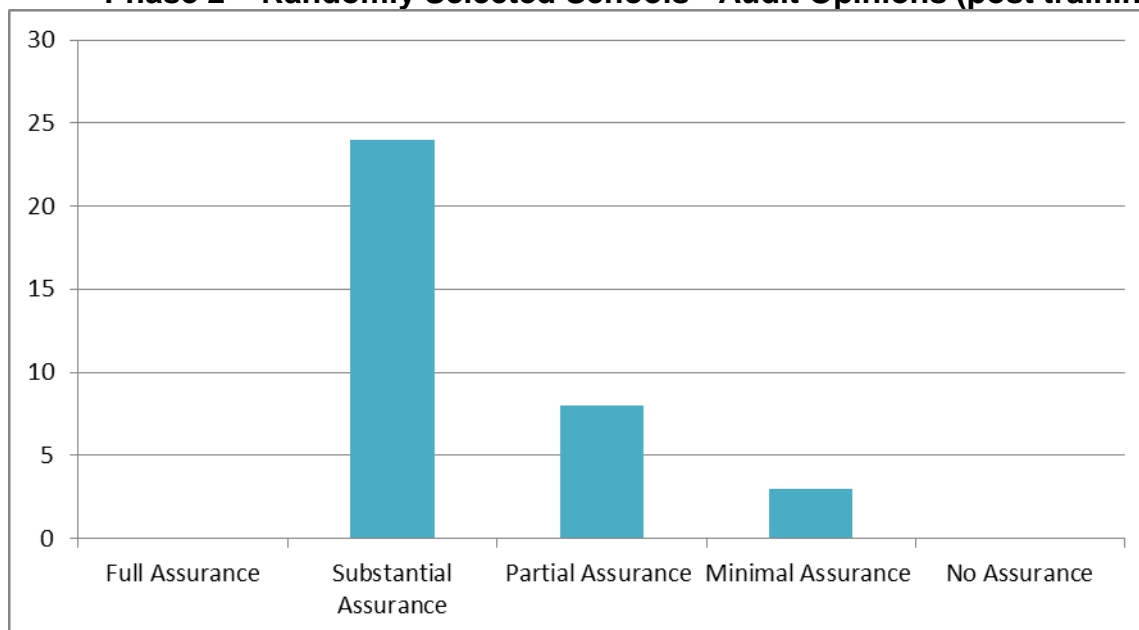
5.10   The following graphs provide a summary of audit opinions issued for those randomly selected schools prior to and after the training programme referred to above.

Phase 1 - Randomly Selected Schools - Audit Opinions (prior to training)[2]

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[2] These audits were completed in 2015/16

Phase 2 – Randomly Selected Schools - Audit Opinions (post training)

5.11   These results provide a clear indication that the training programme has contributed to a significant improvement in financial control within our schools.

5.12   Other audit initiatives undertaken during the year to help improve financial governance in schools have included:

- Continuing the work of the 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 which is to ensure appropriate targeted support and intervention is provided to schools;
- Producing regular information bulletins for all school governors highlighting common themes and issues arising from audit work, encouraging Governors to increase scrutiny of the schools finances and financial position;
- Providing ad-hoc advice and guidance.

5.13   We are also currently consulting with Headteachers, Business Managers and Governors about improving the effectiveness of how we provide information and advice to them. This includes considering the offer of alternative activities, such as self-assessment tools, so that schools are able to gain assurance over their control environment between formal audits.

5.14   Finally, we completed 8 follow-up school reviews during the year where opinions of minimal or no assurance had previously been given. In all cases, clear improvements in internal control were identified.

Cultural Compliance

5.15   Cultural compliance reviews are intended to provide assurance that services are delivered effectively within teams across the Council and in compliance with appropriate policies and procedures. In particular, the reviews focus on service delivery and good management practice, budget management, expenditure, income, staff management and assets / inventory management.

5.16   In 2016/17, following a number of similar reviews in 2015/16, we completed two cultural compliance audits covering teams in BSD and CSD. It is pleasing to report that both of these received audit opinions of substantial assurance, demonstrating the existence of robust management controls in the areas sampled.

Anti-Fraud and Corruption

5.17   During 2016/17, we logged 41 allegations under the Council's Anti-Fraud and Corruption Strategy, in all cases identified through the Council's confidential reporting hotline or notifications from departments. As a result of the allegations, 11 investigations were undertaken by Internal Audit, with the remainder being referred to local management, another local authority or assessed as requiring no further action. The following provides a summary of the investigation activity undertaken by Internal Audit in the last 12 months:

- Five investigations related to the overpayment of pensions identified through the National Fraud Initiative data matching exercise (see below). Two of these resulted in the full recovery of the overpayment, totalling £6,135. For the remainder, no further action was taken as a result of either being uneconomical to pursue or due to an inability to identify next of kin, where pensioners had died.

- An investigation into the theft of income from a secondary school resulted in an employee being dismissed. Following the investigation, a range of actions were also agreed to improve controls at the school.

- An investigation into a clear conflict of interest relating to a member of staff within Children's Services, whereby the individual concerned failed to declare, or seek approval for, secondary employment which conflicted with their County Council duties. They also breached the requirements of the Data Protection Act, resulting in dismissal for gross misconduct.

- One investigation was undertaken into the theft of ICT equipment at a school. Our work found that there were insufficient records to be able to identify exactly what property was removed or to confirm formal ownership of all ICT equipment stored in the school. Consequently, it was not possible to conduct an effective investigation into the potential theft. We were, however, able to provide advice and guidance to the school on appropriate internal controls and assist with its own internal management investigation.

- An investigation into potential over-claiming of mileage identified no specific evidence of any wrong-doing. The investigation concluded, however, that there was a need to improve controls within the service, specifically around the accurate recording of journeys and deducting home to work mileage from claims. Actions for improvement were therefore agreed with management.

- Two further cases remain open at the time of writing this report.

5.18   Any internal control weaknesses identified during our investigation work are reported to management along with appropriate recommendations for improvement. This work is also used to inform future internal audit activity.

5.19   As part of the Cabinet Office's National Fraud Initiative (NFI), the Council is required to provide a range of data in order to carry out a data matching exercise. Data matching involves comparing computer records held by one body against other computer records held by the same or another body for the purpose of identifying potential cases of error or fraud.

5.20   Internal Audit have co-ordinated the production and submission of this data on behalf of ESCC, covering a range of areas including payroll, pensions, creditors, residential care clients, concessionary travel passes, residents parking permits and clients in receipt of direct payments. The results of this cycle of NFI became available in February 2017 and are currently being investigated by the relevant services within the Council. We have requested that these are completed by September 2017 and we will report the results in due course.

5.21   As well as the investigation work referred to above, we continue to be proactive in the identification and prevention of potential fraud and corruption activity across the Authority and in raising awareness amongst staff. During 2016/17, this has included data analysis activities along with the delivery of both targeted and general counter fraud training to teams across the Council.

5.22   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 risk of fraud. This includes working with local fraud hubs; the aim of which is to deliver a strong and co-ordinated approach to preventing, detecting and responding to fraud.

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 2016/17, 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 2016/17 by the Head of Assurance:

- 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 Standards with only a small number of actions identified. The main areas for improvement relate primarily to reviewing and updating our internal quality manual and ensuring Internal Audit staff maintain a record of their professional development and training activities. In all cases, work is continuing to address the required actions, many of which will be considered as part of our ongoing work to develop the Orbis partnership with internal audit colleagues from Surrey County Council and Brighton and Hove City Council.

Key Service Targets

6.4   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.

6.5   We have completed 92.1% of the 2016/17 audit plan, exceeding our target of 90%. As reported in 5.6 above, some outstanding reviews were nearing completion at year end, with all reports due to be finalised early in quarter 1 of 2016/17. We are currently exploring opportunities to improve the benchmarking arrangements for internal audit and will report on this in due course when further information becomes available.

6.6   Internal Audit is continuing to liaise with the Council's external auditors, KPMG, as part of which both teams are endeavouring to ensure that the Council obtains maximum value from the combined audit resources available.

6.7   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.

Internal Audit Performance Indicators

Measure	Source of Information	Frequency	Specific Measure / Indicator	RAG Score	Actual Performance Year End
Client Satisfaction					
Chief Officer/DMT	Consultation / Survey	Annual	Confirmation of satisfaction with service quality and coverage and feedback on areas of improvement.	G	Confirmed through Chief Officer consultations in December 2016 / January 2017, where high levels of satisfaction confirmed.
Client Managers	Satisfaction Questionnaires	Each Audit	>89%	G	89.7%
Section 151 Officer	Liaison Meetings	Quarterly	Satisfied with service quality, adequacy of audit resources and audit coverage.	G	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.	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	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.	G	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.	G	92.1%

Measure	Source of Information	Frequency	Specific Measure / Indicator	RAG Score	Actual Performance Year End
Professional Standards					
Compliance with professional standards	Self-Assessment against new Public Sector Internal Audit Standards	Annual	Completed and implementation of any actions arising.	G	Self-assessment completed, improvement plan in place and being actioned.
External Audit Reliance	Key Financial Systems Internal Audit Activity	Annual	Reliance confirmed.	G	Not applicable – KPMG no longer seek to place direct reliance on the work of internal audit.

Summary of Opinions for Internal Audit Reports Issued During 2016/17

Full Assurance:
(Explanation of assurance levels provided at the bottom of this document)

Audit Title	Department
Pension Fund External Control Assurance	BSD
Pension Fund Governance and Investments	BSD
Treasury Management	BSD

Substantial Assurance:

Audit Title	Department
External Funding, Grants and Loans	Corporate
Cultural Compliance Review – Facilities Management	BSD
Procure to Pay	BSD
Accounts Receivable	BSD
HR/Payroll	BSD
Orbis Integrated Budget	BSD
Cloud Computing	BSD
Cyber Security	BSD
ICT Asset Management Follow Up	BSD
Special Educational Needs and Disabilities (SEND) - Expenditure in Schools	CSD
Personal Budgets within Children's Services	CSD
Music Service Income	CSD
Troubled Families	CSD
Cultural Compliance – Looked After Children Community Family Work (Contact) Service	CSD
Controcc (15/16)	ASC
Public Health Local Service Agreements – Follow-Up	ASC
East Sussex Better Together – Programme Management	ASC
ASC Procurement	ASC
Funds Held By Trading Standards South East on Behalf of ESCC	CET
Freedom of Information, Environmental Information Regulations and Subject Access Requests (for Data Protection)	CET

Partial Assurance:

Audit Title	Department
Property Works – Pre Contract Checking Arrangements	BSD
Pension Fund Processes and Systems (15/16)	BSD
Compliance with Procurement Standing Orders	BSD
School Partnerships and Federations	CSD
Information and ICT E-Safety in Schools	CSD
Direct Payments	CSD/ASC

Other Audit Activity Undertaken During 2016/17 (including direct support for projects and new system initiatives and grant audits):

Audit Title	Department
Annual Governance Framework	GS
East Sussex Learning Portal	GS
National Fraud Initiative – Pension Investigations	BSD
Pensions Process Integration and Altair System Merge	BSD
On-Line Staff Claims System	BSD
Accounts Payable Data Analysis	BSD
SAP Development Advice	BSD
ICT Email Fraud Risk	BSD
Homecare Process	ASC
Proactive Anti-Fraud Income Assessment (Financial Assessments)	ASC
Highways DfT Incentive Fund	CET
Highways Contract – Lessons Learnt	CET
Broadband Annual Return to BDUK	CET
Community Infrastructure Levy – Audit Position Statement	CET

Schools

Higher Risk and Follow Up Audits (Delivered in house)	Opinion
Castledown Primary School – Follow-Up	Substantial Assurance
Ocklynge Junior School – Follow-Up	Substantial Assurance
Parkside Community Primary School - Follow-Up	Substantial Assurance
Pells CE Primary School	Substantial Assurance
Priory School	Substantial Assurance
St. Mark's CE Primary School	Substantial Assurance
Northiam CE Primary School – Follow-Up	Partial Assurance
Sacred Heart Catholic Primary School – Follow-Up	Partial Assurance
St. Thomas a Becket Catholic Infant School – Follow-Up	Partial Assurance
Western Road Community Primary School – Follow-Up	Partial Assurance
Langney Primary School	Minimal Assurance
Peacehaven Community School	Minimal Assurance

Randomly Selected Schools (Completed by Mazars)	
Beckley CE Primary School	Substantial Assurance
Blackboys CE Primary School	Substantial Assurance
Burwash CE Primary School	Substantial Assurance
Chiddingly Primary School	Substantial Assurance
Crowhurst CE Primary School	Substantial Assurance
East Hoathly CE Primary School	Substantial Assurance
Fletching CE Primary School	Substantial Assurance
Framfield CE Primary School	Substantial Assurance

Randomly Selected Schools (Completed by Mazars)	
Hellingly Community Primary School	Substantial Assurance
Herstmonceux CE Primary School	Substantial Assurance
Iklesham CE Primary School	Substantial Assurance
Netherfield CE Primary School	Substantial Assurance
Ninfield CE Primary School	Substantial Assurance
Pashley Down Infant School	Substantial Assurance
Peacehaven Heights Primary School	Substantial Assurance
Punnetts Town Community Primary School	Substantial Assurance
Rotherfield Primary School	Substantial Assurance
Sandown Primary School	Substantial Assurance
St. John's CE Primary School	Substantial Assurance
St. Michael's CE Primary School, Playden	Substantial Assurance
St. Pancras Catholic Primary School	Substantial Assurance
Stone Cross School	Substantial Assurance
The Haven CE/Methodist Primary School	Substantial Assurance
Ticehurst and Flimwell CE Primary School	Substantial Assurance
Annecy Catholic Primary School	Partial Assurance
Ashdown Primary School	Partial Assurance
Bourne Primary School	Partial Assurance
Firle CE Primary School	Partial Assurance
Groombridge St. Thomas CE Primary School	Partial Assurance
St. John's Meads CE Primary School	Partial Assurance
St. Michael's Primary School, Withyham	Partial Assurance
St. Peter's CE Primary School	Partial Assurance
Harbour Primary and Nursery School	Minimal Assurance
St. Mary the Virgin CE Primary School	Minimal Assurance
Staplecross Methodist Primary School	Minimal Assurance

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.