

Audit Committee Meeting	Agenda Item:
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Meeting Date	25 May 2011
Report Title	Internal Audit Annual Report 2010/11
Portfolio Holder	Performance and Finance
SMT Lead	Corporate Services Director
Head of Service	Head of Audit Partnership
Lead Officer	Head of Audit Partnership
Key Decision	No
Classification	Open

Recommendations	1. That the Committee note the Head of Audit Partnership's opinion that substantial reliance can be placed on the Council's control environment in terms of the overall adequacy and effectiveness of the controls and processes which are in place to achieve the objectives of the Council.
	2. That the Committee note that the only qualification to the opinion is that it is predominantly based on just one year of internal audit work.
	3. That the Committee note that the results of the work of the Internal Audit team are the prime evidence source for 'the opinion'.
	4. That the Committee agree that the outcomes of the work and the other matters referred to in this report provide evidence of a substantial level of internal control within the Council, which supports the findings and conclusions shown in the Annual Governance Statement for 2010/11.
	5. That the Committee note the improvements in control that occur as a result of the audit process.
	6. That, as part of its consideration of this report, the Committee considers the effectiveness of the Council's internal audit service and expresses an opinion accordingly.

Purpose of Report and Executive Summary

- 1.1 The report provides details of the work of the Internal Audit Team over the financial year 2010/11 and the opinion of the Head of Internal Audit in relation to

the Council's control environment, in the context of the Annual Governance Statement.

- 1.2 The report provides an opportunity for the Committee to consider the work of Internal Audit and whether the outcomes provide evidence of:
- a) A substantial level of internal control within the organisation, and;
 - b) That an adequate and effective internal audit of the Council's accounting records and its system of internal control has been carried out in accordance with the proper practices.

2 Background

The Annual Internal Audit Report

- 2.1 The statutory Code of Practice for Internal Audit in Local Government in the United Kingdom requires that the Head of Internal Audit must provide a written report to those charged with governance, timed to support the Annual Governance Statement.
- 2.2 The Annual Governance Statement is currently being compiled and will be provided to the meeting of the Audit Committee planned for 29 June 2011.
- 2.3 The Head of Internal Audit's annual report to the organisation must:
- Include an opinion on the overall adequacy and effectiveness of the organisation's control environment
 - Disclose any qualifications to that opinion, together with the reasons for the qualification
 - Present a summary of the audit work from which the opinion is derived, including reliance placed on work by other assurance bodies
 - Draw attention to any issues the Head of Internal Audit judges particularly relevant to the preparation of the Annual Governance Statement
 - Compare the work actually undertaken with the work that was planned and summarise the performance of the internal audit function against its performance measures and targets
 - Comment on compliance with the standards (the Code of Practice) and communicate the results of the internal audit quality assurance programme.
- 2.4 The Accounts and Audit Regulations 2011 also require that the Council 'must, at least once a year, conduct a review of the effectiveness of its internal audit'. It is considered that this report provides evidence of the effectiveness of internal audit and the Committee is therefore asked to treat consideration of this report as 'the review'.

3 Proposal

The opinion on the overall adequacy and effectiveness of the Council's control environment

- 3.1 It is the opinion of the Head of Internal Audit that substantial reliance can be placed on the Council's control environment in terms of the overall adequacy and effectiveness of the controls and processes that are in place to achieve the objectives of the Council. The evidence to support the opinion is contained within this report.

Any qualifications to that opinion, together with the reasons for the qualification

- 3.2 The only qualification to the opinion is that, at this point, the opinion is predominantly based on just one year of audit work.

A summary of the audit work from which the opinion is derived

- 3.3 The opinion on the control environment is principally formed through the results of Internal Audit work during the financial year. However, the following factors have also been considered:
- The results of external audit work during the year and any concerns expressed by the External Auditor
 - The effectiveness of the Council's risk management arrangements
 - Significant control breakdowns during the financial year, whether they were found by Internal Audit or not
 - The results of any form of external inspection or assessment, and:
 - The effectiveness of senior management in resolving control weaknesses.

Internal Audit work

- 3.4 Twenty four audit projects were completed between April 2010 and March 2011 and are listed at Appendix I. This is 80% of the original audit plan. The list shows the control assurance for each audit. The projects completed during the first six months of the year were reported to the Committee in an Interim Report on 15 December 2010.
- 3.5 Members expressed concern at the high proportion of audit projects where limited controls assurance was found to be in place. The annual report has allowed a more balanced view to be taken and this is reflected in the annual opinion as shown above.
- 3.6 A small number of projects completed during the year did not include a control assurance assessment as it was not appropriate to the projects. This included work on the Audit Commission's National Fraud Initiative, the Annual Fraud

Report and the work that is carried out to validate the accuracy of the Interreg claim.

- 3.7 The work of the Internal Audit Team has established that for the majority (65%) of the areas examined, satisfactory controls are in place. These are summarised at Appendix III. Where weaknesses have been identified the appropriate Head of Service has agreed the action to be taken to rectify those weaknesses.
- 3.8 As a result of the follow-up process, 90% of the areas reviewed were assessed with a satisfactory level of controls assurance, with two audits awaiting a follow-up assessment at the end of the financial year.
- 3.9 The external auditors have been able to place reliance on the work of Internal Audit.

The results of external audit work during 2010/11

- 3.10 The main part of the external auditor's work relates to the Council's financial accounts. The auditors will be considering the accounts for 2010/11 shortly. Internal Audit has had meetings with the Commission's Audit Manager and Principal Auditor during 2010/11 and no issues have been raised which would give concern in relation to the Council's internal controls.
- 3.11 The external auditor's Annual Audit and Inspection Letter for 2009/10 (which was reported to the meeting of the Audit Committee on 15 December 2010), allowed considerable comfort to be drawn from his comments in relation to the financial leadership provided to the Council, the scale of efficiency savings made, data quality, governance arrangements and in the way in which the Audit Committee and the new internal audit partnership are working.
- 3.12 The District Auditor did not identify any significant weaknesses in the Council's internal control and he concluded that systems of internal control were sound. However, he makes reference to three matters that had previously been reported to the Audit Committee:
- Following a review of the Internal Audit section in March 2010, a number of recommendations were made to strengthen operational and reporting arrangements. An action plan was agreed with the new Internal Audit Partnership.
 - The incorrect calculation of termination payments to four individuals in March 2009, which resulted in overpayments being made; and
 - The need to address criticisms of the Council's staff appointment and documentation processes following an Employment Tribunal in June 2009.
- 3.13 The recommendations relating to Internal Audit related to the arrangements that were in place prior to 1 April 2010. Since that time the 'new' Audit Partnership has addressed all of the areas of concern that had been noted by the District Auditor. In relation to the termination payment and the staff appointment arrangements,

these have been reviewed and strengthened. Members will recall that the Head of Organisational Development attended the meeting of the Committee on 15 December 2010 to provide the necessary assurances. Internal Audit has since carried out further checks on these arrangements which have confirmed that improvements have been made.

The effectiveness of the Council's risk management arrangements

- 3.14 The Council has had risk management arrangements in place for some time. However, a significant amount of work has been carried out by the Internal Audit Manager during 2010/11 in order to bring the arrangements up to date and make them more effective. This has included sessions with Strategic Management Team and with Cabinet to identify the strategic risks to the delivery of the Council's priorities. In addition, training has been provided to Unit Managers and to Members.
- 3.15 Further work will be carried out during 2011/12 to develop the strategic risk register and to create operational (service) risk registers and management action plans.
- 3.16 It is considered that, although further work is required, some reliance can now be placed on the effectiveness of the Council's risk management arrangements.

Significant control breakdowns during the financial year, whether they were found by Internal Audit or not

- 3.17 There were no significant control breakdowns during 2010/11.

The results of any other form of external inspection or assessment

- 3.18 There have been no governance or control based external inspections or assessments during 2010/11, other than the normal external audit work and the review of the Audit Committee by Local Government Improvement and Development (LGID). The report arising from the LGID peer review has been considered by the Committee and a number of agreed actions will be implemented during 2011/12.

The effectiveness of senior management in resolving control weaknesses

- 3.19 Seven reports were issued during 2010/11 relating to areas where either a limited or minimal control assurance was assessed as being in place. These are summarised at Appendix II. In all cases the responsible Head of Service completed an action plan setting out comprehensive and timely actions to address the audit recommendations.

- 3.20 Heads of Service are required to respond to every audit report where recommendations are made, by completing an action plan which sets out the action that will be taken to address the audit recommendations. The response is assessed for adequacy; to ensure that the proposed actions are sufficient and that any weakness will be addressed within a reasonable period.
- 3.21 Internal Audit carries out a follow-up to each audit to ensure that the actions have been taken in practice.
- 3.22 Nine audit follow-ups took place during 2010/11. These are shown at Appendix IV. At the end of the year there was one audit with a 'limited assurance' and one audit with a 'minimal assurance' awaiting a follow-up.
- 3.23 Based on the very positive responses received from senior management and the results of follow-up work, it is considered that senior management is effective in resolving control weaknesses.

Issues that the Head of Internal Audit judges particularly relevant to the preparation of the Annual Governance Statement

- 3.24 The opinion of the Head of Internal Audit on the internal control environment is particularly relevant to the preparation of the Annual Governance Statement. In that context the Governance Statement will need to note two audit reports where only limited or minimal controls were found to be in place, which had not been the subject of a follow-up audit at the end of the financial year.
- Development Control Enforcement – Follow up scheduled for May 2011
 - Sports Development – Follow-up scheduled for June 2011

These audit subjects will therefore be added to the Annual Governance Statement as 'outstanding control weaknesses'.

Performance of the internal audit function against its performance measures and targets

- 3.25 The internal audit function has three performance targets which are measured and reported. The targets are:
- Completion of the annual internal audit plan (90% target)
 - Percentage of chargeable time (i.e. time spent on planned audit work – the target for the operational auditors is 85%)
 - Achievement of customer care targets (85% target)

- 3.26 The target for completion of audit projects within the internal audit plan is 30 projects. This has to be achieved through the completion of twelve projects by each operational auditor. The auditor resource is 2.5 fte resulting in the target of 30.
- 3.27 In practice the number of projects completed during 2010/11 was 24, which is 80% of the target. The shortfall was almost completely the result of one auditor being unable to adapt to meet his targets or to deliver an acceptable level of output. The result being that the auditor only completed two reports from his personal target of twelve. The auditor was able to apply for early retirement and no longer works for the Council. A summary of the audits not completed during the year is shown at Appendix V.
- 3.28 Customer surveys are issued to clients following each internal audit to assess satisfaction with the audit process. In addition, an annual survey of Heads of Service is carried out in order to obtain responses on the quality of internal audit, perceptions of auditor skills and the value of audit reports. The responses for 2010/11 are still being collated.

Compliance with the CIPFA Code of Practice and the internal audit quality assurance programme

- 3.29 The Code sets out the standards that the Internal Audit team has to comply with in order to meet the statutory requirement. A copy of the code has been provided to each auditor. The Code contains a checklist which allows a self assessment of compliance with the code to be carried out.
- 3.30 On the basis of a self assessment of compliance with the code and on comments made by the external auditor, it is considered that the work of Internal Audit at Swale is in accordance with the Code of Practice.
- 3.31 A comprehensive internal audit quality assurance programme is in place to:
- Ensure that work is allocated to auditors who have the appropriate skills, experience and competence
 - Ensure that all staff are supervised appropriately throughout all audits

The supervisory process covers:

- Monitoring progress
 - Assessing quality of audit work
 - Coaching staff
- 3.32 The quality assurance programme is maintained through the ongoing review of reports and working papers by the Audit Manager and the Head of Internal Audit and through adherence by all members of the audit team to the Code of Practice.

Assurance levels

- 3.33 Internal Audit use ‘assurance levels’ or assurance statements to provide the overall audit opinion for the service or area that has been reviewed. The use of an assurance level is consistent with the requirement for managers (and Members) to consider the degree to which controls and processes can be relied upon to achieve the objectives of the reviewed activity. There are four assurance levels, as set out at Appendix VI. The consistent use of assurance levels allows a balanced view to be taken of the overall adequacy of control within the Council.
- 3.34 In the financial year 2010/11, a total of 20 audit reports included an assurance assessment for the area that had been audited (four did not). The initial assurance assessments were categorised as follows:

High	2
Substantial	11
Limited	6
Minimal	1
Not given	4
Total	24

- 3.35 The collective assurance level, which can be extracted from the audit work performed during 2010/11, provides considerable evidence to support the statutory Annual Governance Statement, with 65% of the reports having a positive assurance assessment identifying control assurance as ‘substantial’ or ‘high’ at the time of the audit.

Reporting of Internal Audit work to the Audit Committee

- 3.36 Internal Audit work is reported at six-monthly intervals. An interim report, showing the first six months work of the financial year was provided to the Audit Committee meeting in December 2010.

Mid Kent Internal Audit Partnership

- 3.37 The four-way Internal Audit Partnership between Swale, Ashford, Maidstone and Tunbridge Wells came into being on 1 April 2010. Since that time a considerable amount of work has been done in order to embed the arrangements.
- 3.38 At Swale this has meant the implementation of new working practices, a computerised audit management system (which is used by all four audit teams), a shared data site, sharing of auditors across other sites and more importantly the delivery of a more effective and professional service.

- 3.39 The partnership has provided an improved service while making significant financial savings. For Swale the savings have been £31,000 during 2010/11 compared with the previous arrangements.
- 3.40 As stated elsewhere in this report, one member of the Swale Internal Audit team was unable to meet the standard required or to achieve the necessary output. The individual chose to seek early retirement. The Strategic Management Team agreed that the post could be filled on a fixed term two-year basis.
- 3.41 Feedback on the first year of the Partnership has been very positive at all four Councils.

4 Alternative Options

- 4.1 A total of twenty four Internal Audit projects were completed during the financial year 2010/11. The work has led to improvements in control in the areas that were reviewed.
- 4.2 Although the audit work identified some areas where controls were in need of improvement, it has generally been established, through the follow-up process, that the responsible Head of Service has since taken the necessary action to address the weaknesses.
- 4.3 The matters referred to in this report and in the appendices provide evidence to support the view of the Head of Internal Audit.
- 4.4 The alternative action would be to not agree the recommendations shown at the beginning of the report. However, this would not align with the factual position set out in the report.

5 Consultation Undertaken or Proposed

- 5.1 The views set out in this report represent the independent opinion of the Head of Internal Audit. It is not appropriate to consult on that opinion.

6 Implications

Issue	Implications
Corporate Plan	The work of Internal Audit reflects the corporate plan priority of being a high performing organisation.
Financial, Resource and Property	A number of audit projects carried out in 2010/11 related to finance, resource or property.

Legal and Statutory	There is a statutory requirement for the Council to undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control (Accounts and Audit Regulations 2011)
Crime and Disorder	none identified at this stage
Risk Management and Health and Safety	Internal Audit seeks to test the adequacy of the controls which management has put in place to manage risk.
Equality and Diversity	none identified at this stage
Sustainability	none identified at this stage

7 Appendices

7.1 The following documents are to be published with this report and form part of the report

- Appendix I: Summary Report of Audit Projects completed April 2010 – March 2011
- Appendix II: Summary reports of audits assessed as providing *Limited* or *Minimal* controls assurance
- Appendix III: Summary reports of audits assessed as providing *Substantial* or *High* controls assurance
- Appendix IV: Summary Report of Audit Follow-Up assurance assessments
- Appendix V: Remainder of the 2010-11 Audit Plan not delivered during the period.
- Appendix VI: Controls assurance definitions

8 Background Papers

8.1 The Code of Practice for Internal Audit in Local Government in the United Kingdom 2006.