

Meeting Date	23 May 2012
Report Title	Internal Audit Annual Report 2011/12
Portfolio Holder	Councillor Duncan Dewar-Whalley - Cabinet Member for 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 there is no qualification to the opinion.
	3. That the Committee note the work of the Internal Audit Team over the period April 2011 to March 2012 as shown in Appendix I and that this is the prime evidence source for the Head of Internal Audit's opinion.
	4. That the Committee agree that the outcomes of the work and the other matters referred to in this report will 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 2011/12.
	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 2011/12 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 27 June 2012.
- 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 the current report provides the necessary 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 There is no qualification to the audit opinion.

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 six audit projects were completed between April 2011 and March 2012 and are listed at Appendix I. This is 96% of the revised 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 14 December 2011.
- 3.5 A small number of projects (4) 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 and the work that is carried out to validate the accuracy of the European funded, Interreg. claim.

- 3.6 The work of the Internal Audit Team has established that for the majority (82%) of the areas examined, where an assurance assessment is applied, satisfactory controls were 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.
- 3.7 As a result of the follow-up process, 95% of the areas reviewed were subsequently assessed as providing a satisfactory level of controls assurance, with 9 audits awaiting a follow-up assessment at the end of the financial year.
- 3.8 The external auditors have been able to place reliance on the work of Internal Audit.

The results of external audit work during 2011/12

- 3.9 The main part of the external auditor's work relates to the Council's financial accounts. The auditors will be considering the accounts for 2011/12 shortly. Internal Audit has had meetings with the Commission's Audit Manager and Principal Auditor during 2011/12 and no issues have been raised at those meetings which would give concern in relation to the Council's internal controls.
- 3.10 The external auditor's Annual Audit and Inspection Letter for 2010/11 (which was reported to the meeting of the Audit Committee on 14 December 2011), and the Annual Governance Report (which was reported to the meeting of the Audit Committee on 19 September 2011), were both very positive.
- 3.11 The Annual Audit and Inspection Letter included a statement on the 'Overall conclusion from the audit' as follows:

I gave an unqualified opinion on the Council's financial statements on 20 September 2011. The Council's coped well with the new requirements of International Financial Reporting Standards, and the accounts were prepared to a high standard, with only a small number of adjustments required and improved working paper trails to support the accounts.

In relation to 'Significant weaknesses in internal control' the District Auditor commented as follows:

I identified the following weaknesses in your internal control arrangements:

- The Council's monthly bank reconciliations for 2011/12 were not up to date; and*
- As part of my IT risk assessment I identified that the Council had not completed a full disaster recovery test during 2010/11.*

I made recommendations to correct the weaknesses, and these have been accepted by officers and an action plan agreed with the Audit Committee

- 3.12 The Commission's Audit Manager has confirmed that, following an Internal Audit review of the arrangements for ICT Disaster Recovery Testing, he is satisfied that progress has been made, with testing scheduled to take place at the disaster recovery supplier's Sevenoaks site in July 2012.
- 3.13 In relation to bank reconciliation, the Chief Accountant has confirmed that external resources have been engaged in order to bring the reconciliation up to date; the process for bank reconciliation has been reviewed and a more effective and less time consuming approach has been developed, and an action plan is being implemented. All reconciliations to March 2012 are now complete. All reconciliations will be available to the external auditors in advance of their formal 'audit of accounts', which will commence in earnest in July.

The effectiveness of the Council's risk management arrangements

- 3.14 A draft strategic risk register was created during 2011/12 which identified the key risks to the delivery of the Council's priorities. Since this exercise the Council has reviewed its priorities, requiring a similar review and update of the risk register. Two 'risk refresh' sessions, involving Strategic Management Team and key Members, will be held on 25 June and 16th July 2012.
- 3.15 Individual Service Plans now contain operational risk registers which identify the risks to the delivery of each service. Action on the risks is monitored through the performance monitoring system, Covalent.
- 3.16 It is considered that, although some further work is required, 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 2011/12.

The results of any other form of external inspection or assessment

- 3.18 A Corporate Peer Challenge was commissioned from the Local Government Association during 2011/12, which sought to:
- Help to reflect on the council's recent improvement journey
 - Consider the council's current trajectory, rate of change and readiness for the future
 - Consider the council's future strategic direction and response to the Localism agenda
 - Help inform thinking on the new corporate plan

- Through all of the above, consider the core peer challenge questions relating to priority setting, leadership and governance, organisational capacity and financial planning.

The report from the Local Government Association includes many positive comments about the management and governance of the Council and particularly highlights the improvements that have occurred over the last few years. The report therefore provides positive assurance in relation to the adequacy of the Council's control environment. The report has been published on the website at <http://www.swale.gov.uk/peer-review/>

The effectiveness of senior management in resolving control weaknesses

- 3.19 Four reports were issued during 2010/11 relating to areas where a limited control assurance was assessed as being in place. There were no 'minimal' assurance assessments. 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 Twenty two 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 none 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 must to note any material audit report where only limited controls were found to be in place, where weaknesses were still outstanding at the 31 March 2012. In the event, only one audit falls into this category. This is the audit on IT Disaster Recovery. In this instance, the report

was issued at the end of the year (March) and had not, therefore, been the subject of a follow-up audit at the end of the financial year.

This audit subject should therefore be added to the Annual Governance Statement as an 'outstanding control weakness' at 31 March 2012.

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 each of 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, for 2011/12 was initially 30 projects. This had to be achieved through the completion of twelve projects by each operational auditor. The auditor resource for 2011/12 was 2.5 fte. However, due to periods when the post of Senior Auditor was vacant, the target was reduced to 27.
- 3.27 In practice the number of projects completed during 2011/12 was 26, which is 96% of the target. Bearing in mind the difficulties that were experienced with the former Senior Auditor, this level of output is very creditable. The Senior Auditor left the Council's employment at the end of January 2012. The post has very recently been filled. The new post holder was previously employed by Maidstone Borough Council and has an excellent track record.
- 3.28 The Auditor productivity target was achieved during the year with the remaining time allocated to administrative tasks, staff briefings, team/partnership meetings etc.
- 3.29 Customer surveys are issued to clients following each internal audit to assess satisfaction with the audit process. Fourteen surveys were returned by clients during the year, all recording satisfaction with the way that the audit was carried out. In addition, an annual survey of Chief Executives, Directors and Heads of Service is carried out in order to obtain responses on the quality of internal audit service, perceptions of auditor skills and the value of audit reports. Seven responses were received from Swale Heads of Service, and all confirmed that they were either satisfied or very satisfied with the audit service received during the year. Similarly, the Chief Executive and Directors responses confirmed that they were satisfied or very satisfied. The comments received from the surveys are carefully considered and lead to improvements in the audit service.

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

- 3.30 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.
- 3.31 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.
- 3.32 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
- 3.33 The quality assurance programme is maintained through the ongoing review of reports and working papers by the Audit Manager and the Head of Audit Partnership and through adherence by all members of the audit team to the Code of Practice.

Assurance levels

- 3.34 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.
- 3.35 In the financial year 2011/12, a total of 22 audit reports included an assurance assessment for the area that had been audited (4 did not). The initial assurance assessments were categorised as follows:

Control Assurance	2011/12	Previous year
High	1	2
Substantial	17	11
Limited	4	6
Minimal	0	1
Not given	4	4
Total	26	24

- 3.36 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 82% 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

- 3.37 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 2011.

Mid Kent Audit Partnership

- 3.38 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.
- 3.39 The financial year 2011/12 was seen as a period of consolidation for the partnership, with audit systems and processes being made consistent across the four partner Council sites.
- 3.40 The partnership has provided an improved service while making significant financial savings. For Swale the savings have been £31,000 during 2011/12 compared with the previous arrangements. During 2012/13 a further annual saving of £28,000 will be made following the deletion of the 0.5 FTE post, which has previously been filled through the use of audit contractors.
- 3.41 Two Shared Service audits were completed by Maidstone team auditors working at Swale during the year - Payroll operations and Legal Services time recording systems. The audits did not require resource input from the Swale team but included audit testing of both partner's data and systems of control. This sharing of auditor resource across the partnership is a significant benefit to the four partnership Councils in terms of delivering efficiencies, resilience and providing additional skills.
- 3.42 Feedback on the first two years of the Partnership has been very positive at all four Councils. However, in order to ensure that the partnership continues to adapt

to the requirements and expectations of the four client councils, the Head of Audit Partnership will be reviewing the current structure and function of the partnership shortly, with a report to the joint officer Internal Audit Management Board in July 2012.

4 Alternative Options

- 4.1 A total of twenty six Internal Audit projects were completed during the financial year 2011/12. 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 been confirmed, 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 20101– March 2012
- 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: Controls assurance definitions

8 Background Papers

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