

Annexe A

INTERNAL AUDIT SERVICES  
ANNUAL REPORT AND OPINION  
2005/2006



## **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 2006. 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 Division's 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 2005/06 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 2005/06;
- 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 2005/06 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. The table below provides a breakdown of the audit opinions in relation to reports issued during 2005/06:

### **4. Key Issues**

4.1 The overall audit opinion should be read in conjunction with the key issues set out in the following paragraphs. These issues should also be taken into account when preparing and approving the Council's corporate assurance statement.

#### **Adults Social Care Control Environment**

4.2 During the year, Internal Audit has continued to work closely with the Adult Social Care (ASC) Department to provide both support and assurance on the action taken to improve the control environment. This was in response to a number of audits in previous years resulting in weak or unacceptable opinions and a request from the Audit and Best Value Scrutiny Committee for further assurance that internal controls within the department were being improved.

4.3 Action taken during the year by Adult Social Care has included:

- internal ASC follow up of the implementation of internal audit recommendations;
- site visits by a member of Finance staff to review operational/financial controls;
- formal meetings with key managers to review control issues;
- a review of all Staff Information Sheets to ensure guidance to staff is up to date;

- work by the CBOSS Project Officer to improve operational performance and control on SAP;
- development of an appropriate training programme for ASC staff and a manager competency self assessment process.

4.4 The Department also officially launched its Business Transformation Programme in March 2006, which is designed to fundamentally review and improve operations across the Department. Internal Audit has been fully engaged with this project and will continue to provide advice, support and challenge as the programme progresses.

4.5 In addition to the above, the work of Internal Audit has enabled us to obtain assurance that there has been an improvement in the ASC control environment and that the department has demonstrated an ongoing commitment to improve this further. This has been evidenced by:

- Development of an internal control improvement action plan by the Director and Assistant Director (Resources), progress against which has been reported to the Audit and Best Value Scrutiny Committee;
- Only one 'weak' or 'unacceptable' audit opinion was given as a result of systems audits carried out in 2005/06, compared to five in the previous year;
- No 'weak' or 'unacceptable' audit opinions were given in relation to establishment reviews (visits and self assessments), compared to two in the 2004/05;
- All follow up reviews conducted in 2005/06 have shown sufficient progress against previous audit recommendations.

4.6 Overall, the Directorate has demonstrated a positive commitment to improving its control framework and has embarked upon a challenging change agenda, including for example the Business Transformation Programme. Whilst this presents opportunities to improve the control framework it also has risks associated with it. It is essential that these risks are effectively managed and that the progress made during 2005/06 is sustained and built upon and a satisfactory control framework maintained.

## **CBOSS/SAP**

4.7 In addition to ongoing support for SAP developments, we have completed our first series of systems based audits of SAP modules. Our overall assessment is that the CBOSS Project and the implementation of SAP has provided a significantly improved control framework for our core financial and other back office systems over that in place within our previous legacy systems. Reviews of general ledger and pensions payments and contributions found that controls in place were satisfactory. However, in our reviews of Accounts Payable / Procurement, Accounts Receivable and User Authorisations we concluded that the controls in place were weak. The weaknesses identified related to both systems configuration issues and compliance with on and off SAP procedures by users in departments. It is acknowledged that a number of our reviews were started in the period immediately following systems go-live when systems had yet to achieve steady state performance. It is also clear that the implementation itself highlighted some areas of bad practice which had been present prior to implementation i.e. under previous legacy systems. Internal audit and the CBOSS Team have worked together during the year to ensure that issues identified through our work are raised promptly and acted upon. This approach has enabled prompt action to be taken during the year to resolve control weaknesses or mitigate against the risks involved.

4.8 During the final quarter of 2005/06, we undertook follow up reviews of these three systems to assess the extent to which previous audit recommendations have been

implemented. Whilst the reports from this follow up work have yet to be finalised, we can confirm that appropriate action has been taken to address the main control weaknesses and consequently a greater degree of assurance can be placed on the operation of the control framework within these systems. Full reviews of these systems will be undertaken again during 2006/07.

4.9 During the year, instances have been identified where on-SAP controls which were previously in operation have been found to no longer exist. Investigations into why this is happening are being made by management and the SAP system administration team. It is understood that the problem could be arising as a result of 'transports' to the system, i.e. where a change to one or more parts of SAP is implemented, and that such changes could be adversely affecting the control environment within SAP. This is obviously an important issue which needs to be managed to a successful conclusion and we are monitoring the situation. In addition, we are planning to carry out a review of the transport process as part of the 06/07 audit plan.

### **Pre-Employment and CRB Checks**

4.10 A review of the Pre-Employment arrangements and the processes for Criminal Records Bureau (CRB) checking within the County Council was undertaken to ensure compliance with the relevant Codes and that all relevant employees had been subject to appropriate checks. From the audit work completed and the tests carried out, Internal Audit's opinion was that the controls in place, at the time of the audit were **unacceptable**. The opinion covered both those controls operated corporately and those operated within schools.

4.11 A comprehensive management action plan, incorporating internal audit recommendations to improve the overall processes and control environment was agreed with the Director of Law and Performance. The plan set out the action which had already been taken to address the key findings from the report, both to ensure that the controls were improved and checks properly carried out in future, but also carry out retrospective checks against list 99 for all staff appointed in schools since 2002.

4.12 The Director of Law and Performance provided an update on progress to Audit and Best Value Scrutiny Committee at its March meeting, and a further update was requested for the June meeting. In view of the significance of the findings from this review, internal audit will also be undertaking a follow up review in the first quarter of 2006/07 to confirm implementation of the audit recommendations.

### **Financial Governance Arrangements in Schools**

4.13 The 2004/05 highlighted a range of actions that were taken to improve financial governance arrangements in schools. The DfES has since decided that all secondary schools must comply with its Financial Management Standard in Schools (FMSiS) by March 2007 and is consulting on the wider roll out of the standard to all schools. Internal Audit has been working closely with Children's Services Finance to put in place arrangements to implement the new standard which minimise the burden on schools but will support improvements in financial governance. Of the 17 school audits carried out during the year, 8 received weak or unacceptable opinions.

### **Compliance with the Council's core policy and guidance**

4.14 Work has progressed during the year to address the understanding of and compliance with the Council's core policy and guidance, which was identified as an area for improvement in our 2004/05 report. In particular, the Employee Code of Conduct has been

revised and re-launched along with supporting guidance, and processes to support the declaration of interests and registration of offers of gifts and hospitality have been reviewed. We plan to assess the effectiveness of these improvements as part of our corporate governance work in 2006/07.

### **Other systems given weak opinions**

4.15 During the year a number of audits have reported on systems where controls are not satisfactory (in addition to those already highlighted above). 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 2006/07:

- Debt Management – Health Authority Recharges (Adult Social Care);
- A Review of the Main Controls on Schools Surpluses and Licensed Deficits (Children’s Services);
- School Meals Income System (Children’s Services);
- Adoption Allowances (Children’s Services);
- Contract management – Payments via SAP (Children’s Services);
- CRD Property Project Management Arrangements (Corporate Body);
- Car Parking Arrangements – Hastings Borough Council (Transport & Environment).

### **Anti Fraud and Corruption**

4.16 As well as completing follow up work on the National Fraud Initiative 2004, internal audit has assessed and, where appropriate, investigated a number of potential instances of fraud and corruption. A number of these cases were allegations made under the Confidential Reporting (“whistleblowing”) Policy. Internal disciplinary processes and external criminal and civil proceedings have been pursued where appropriate. Reference to completed cases and any wider control issues identified has been made in our regular reports to COMT and Audit and Best Value Scrutiny Committee. Such investigations are often complex and lengthy and have accounted for 112.4 days of internal audit resource in 2005/06. The Council has also approved an Anti Money Laundering Policy during the year and put in place arrangements to ensure compliance with both money laundering regulations and the Proceeds of Crime Act.

### **ICT Security Arrangements**

4.17 During the year, Internal Audit undertook a major exercise, in conjunction with ICT Services, to assess the County Council’s compliance with ICT Security best practice (as defined in the Audit Commission’s “Checklist for Action” further to its 2004 survey of “IT Fraud and Abuse”). This work, which was reported to the Audit and Best Value Scrutiny Committee in March 2006, concluded that controls in place are satisfactory, with the County Council’s ICT systems being generally well protected against fraud and abuse. Some areas were identified where there was scope for improvement in control and appropriate recommendations have therefore been agreed with management.

## **5. Internal Audit Performance**

5.1 The Accounts and Audit Regulations 2006 require the Council to carry out an annual review of the effectiveness of its system of internal audit. The Audit Commission is developing detailed guidance on this process but the following paragraphs provide a sound basis for carrying out this assessment.

5.2 Performance against agreed targets is set out in Appendices A and B. In total the Internal Audit Service has delivered 2072 direct days or 97.5% of the total plan. This is the highest proportion of planned days delivered in a number of years. Direct time performance stands at 63.4% which, whilst below the overall target of 66.1%, 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 and is closer to our medium term target of 102%.

5.3 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 and SAP related audits.

5.4 The IAS has carried a number of vacancies for some time and has used agency staff to backfill where possible. We are continuing to experience difficulties in recruiting to permanent positions and will continue to make use of temporary staff whilst at the same time working with PAT colleagues to develop a recruitment strategy.

5.5 Performance against effectiveness targets continues to be positive and reflects both the quality of work completed and its focus on key areas of risk. A CPA score of 3/4 was obtained for internal control as part of the revised CPA methodology, placing it in the top 15 of 34 counties in England. In addition, the Audit and Inspection Annual Letter confirmed that the Audit Commission continues to place reliance on the work of Internal Audit, stating that 'the Council is performing well in maintaining an effective system of internal control. We concluded that Internal Audit remains effective and have been able to place reliance on its work consistently during the audit year'.

5.6 In addition the Audit Commission has conducted its triennial review of internal audit which seeks to assess our compliance with the Code of Practice for Internal Audit in Local Government in the UK. This review is yet to be finalised but initial feedback is positive and no significant issues have been raised. This work follows on from internal audit's own self assessment against the Code which forms the basis of our service improvements set out in our business plan. This has included improvements to our Quality Manual and regular quality reviews of completed audit reports which themselves are used to identify improvements in our processes. One example of this has been the need to ensure greater consistency in our approach to management review of files and reports.

5.7 Five out of the 57 customer satisfaction surveys returned failed to meet our required standard, giving an overall score of 91.2% (up from 83% in 2004/05). Whilst this is an improvement on last year, it remains 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.

## Appendix A

### Actual Days delivered against the plan

The following table summarises the internal audit coverage across all County Council departments during 2005/06:

| <b>Service</b>                                          | <b>2004/05<br/>Actual<br/>Days</b> | <b>2005/06<br/>Plan<br/>Days</b> | <b>2005/06<br/>Actual<br/>Days</b> | <b>2004/05<br/>% plan<br/>days<br/>delivered</b> |
|---------------------------------------------------------|------------------------------------|----------------------------------|------------------------------------|--------------------------------------------------|
| <i>East Sussex County Council:</i>                      |                                    |                                  |                                    |                                                  |
| <i>Corporate Body</i>                                   | 444.4                              | 395.0                            | 501.7                              |                                                  |
| <i>Computer Audit</i>                                   | 352.6                              | 260.0                            | 200.0                              |                                                  |
| <i>Children's Services</i>                              | 446.0                              | 419.0                            | 447.1                              |                                                  |
| <i>Adult Social Care</i>                                | 307.1                              | 300.0                            | 288.4                              |                                                  |
| <i>Transport &amp; Environment</i>                      | 156.7                              | 165.0                            | 222.6                              |                                                  |
| <i>Chief Executives</i>                                 | 121.3                              | 200.0                            | 226.5                              |                                                  |
| <i>Contingency<sup>1</sup></i>                          | -                                  | 250.0                            | -                                  |                                                  |
| <i>Discretionary and corporate projects<sup>2</sup></i> | 44.4                               | 50.0                             | 78.3                               |                                                  |
| <i>Sub total – ESCC</i>                                 | 1872.5                             | 2039.0                           | 1964.6                             | 96.35%                                           |
|                                                         |                                    |                                  |                                    |                                                  |
| <i>External contracts<sup>3</sup></i>                   | 121.0                              | 87.0                             | 107.4                              | 123.4%                                           |
|                                                         |                                    |                                  |                                    |                                                  |
| <b>Total audit days</b>                                 | <b>1993.5</b>                      | <b>2126.0</b>                    | <b>2072.0</b>                      | <b>97.5%</b>                                     |

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

<sup>2</sup> Includes 47.3 days on West Sussex County Council investigation for which reciprocal days will be received in 06/07.

<sup>3</sup> The actual days delivered on external contracts includes additional contracted days delivered during the year (brought forward from 2004/05) and additional non contract days paid for by external customers.

## Appendix B

### Internal Audit Performance Indicators

| <b>Performance Indicator</b>                                    | <b>Target</b>    | <b>Actual 05/06</b>                                   | <b>Actual 04/05</b>                                   |
|-----------------------------------------------------------------|------------------|-------------------------------------------------------|-------------------------------------------------------|
| <b>Economy and efficiency</b>                                   |                  |                                                       |                                                       |
| <i>Planned days delivered (%)</i>                               | 100              | 97.5%                                                 | 93.6%                                                 |
| <i>Planned audits completed = final reports issued (%)</i>      | 90               | 85.1%                                                 | 80.4%                                                 |
| <i>Actual v Plan time on completed audits (%)</i>               | 102              | 103%                                                  | 104.4%                                                |
| <i>Direct time (%)</i>                                          | 66.1             | 63.4%                                                 | 70.0%                                                 |
| <b>Effectiveness</b>                                            |                  |                                                       |                                                       |
| <i>External audit reliance on internal audit</i>                | <i>Achieved</i>  | <i>Achieved</i>                                       | <i>Achieved</i>                                       |
| <i>CPA score maintained</i>                                     | <i>3/4</i>       | <i>3/4 Achieved for internal control</i>              | <i>Achieved</i>                                       |
| <i>Recommendations accepted (%)</i>                             | 90               | 98%                                                   | 98.0%                                                 |
| <i>Customer feedback forms scoring 3 out of 5 or higher (%)</i> | 95               | 91.2%                                                 | 83.0%                                                 |
| <i>Reports to Chief Officers and Members</i>                    | <i>Quarterly</i> | <i>Reports issued for every quarter during 05/06.</i> | <i>Reports issued for every quarter during 04/05.</i> |