

Report to the Audit and Governance Committee



**Epping Forest
District Council**

Report reference: AGC-002-2012/13

Date of meeting: 21 June 2012

Portfolio: Finance and Economic Development

Subject: Internal Audit Annual Report 2011/12 and Review of the Effectiveness of the System of Internal Audit

Responsible Officer: Brian Bassington (01992 564446).

Democratic Services Officer: Gary Woodhall (01992 564470).

Recommendations/Decisions Required:

- (1) The Committee is requested to note the following report for 2011/12 and the assurance level given;**
- (2) The 2011/12 Audit Plan status report as at 31 March 2012(Appendix 2);**
- (3) To note the review of the effectiveness of the system of internal audit, undertaken by the Corporate Governance Group for 2011/12, in the context of the Council's Governance Statement; and**
- (4) To scrutinise the review and consider the effectiveness of the system of internal audit in 2011/12.**

Executive Summary:

This report is presented in support of the Internal Audit opinion on the adequacy of EFDC's internal control environment, provides a summary of the work undertaken by the Internal Audit Unit between April 2011 and March 2012 and details the overall performance against the Audit Plan for 2011/12.

The Accounts and Audit Regulations include a requirement for the Authority to carry out an annual review of the effectiveness of its system of internal audit as part of the wider review of the effectiveness of the system of governance.

This report summarises the review undertaken for 2011/12 by the Corporate Governance Group, to assist the Committee in assessing the effectiveness of the system of internal audit on behalf of the Authority.

Reasons for Proposed Decision:

Monitoring report as required by the Audit and Governance Committee Terms of Reference.

To provide the Committee with the opportunity to scrutinise the review of effectiveness.

Other Options for Action:

No other options.

Report:

Introduction

1. The Internal Audit Annual Report for 2011/12 is based on the “Code of Practice for Internal Audit in Local Government” produced by CIPFA. The work referred to in this report was carried out as part of the agreed Audit Plan for the period from 1 April 2011 to 31 March 2012.

2. The purpose of the report is to support the Internal Audit opinion on the adequacy of Epping Forest District Council’s (EFDC) internal control environment as a contribution to the proper, economic, efficient, and effective use of resources. This report provides part of the evidence that underpins the Corporate Governance Statement published in the Council’s Statutory Statement of Accounts, in line with the requirements of the Accounts and Audit Regulations 2006.

External Audit

3. The Authority’s External Auditor has a statutory responsibility to express an independent opinion on EFDC’s accounts, performance management and the financial aspects of corporate governance. The Audit Commission, who moved all principal audited bodies on to a “fee for audit” basis several years ago, appoints the External Auditor. The Audit Commission has to be confident in the processes and procedures at EFDC to produce the accounts by the statutory deadline each year, as well as being able to place reliance on the work of Internal Audit.

4. Internal and External Audit work closely together to avoid duplication of audit effort and to ensure that the Council receives comprehensive audit coverage.

The Role of Internal Audit

5. Internal Audit is provided in the context of the Council’s statutory responsibility to make arrangements for the proper administration of its financial affairs. It is an assurance function that primarily provides an independent and objective opinion to the Council on the adequacy of the control environment, as a contribution to the proper, economic, efficient and effective use of resources.

6. The main elements of the work are to:

- (a) audit and report on the core financial controls throughout the Authority;
- (b) provide advice during the development of new systems;
- (c) provide advice on financial, contractual and IT controls, including Financial Regulations and Contract Standing Orders;
- (d) review computer and network security;
- (e) investigate suspected fraud, corruption, bribery and other irregularities;
- (f) monitor the Anti-fraud strategy and participate in the National Fraud Initiative;
- (g) keep Management Board and the Corporate Governance Group informed of key issues;
- (h) liaise with the Audit Commission and their appointed External Auditors; and
- (i) report to the Audit and Governance Committee on key issues arising from audits and on the performance of the Audit team.

Performance against the Audit Plan

7. Whilst the majority of planned audits, including all of the key audits of financial systems, were completed by 31 March 2012 a small number have been rolled forward into the 2012/13 plan due primarily to the long term sickness of a member of staff who has now left the Council. The prioritisation of Audits was based on a risk evaluation and the audits that were rolled forward were considered to be of a lower priority.

8. The number of audits carried out in 2011/12 was less than the previous year, due to 2010/11 including the audits that were contracted out to Deloitte. With the ending of that contract the audit plan was reduced due to a more focussed review of the higher risk areas, resulting in a financial saving for the Council as previously reported.

9. During the year, 34 reports were issued to Management with the following assurance levels:

Assurance Level	2011/12	2010/11
Full Assurance	3	4
Substantial Assurance	29	37
Limited Assurance	2	7
No Assurance	0	0

10. The recommendations made within the audit reports are given a priority rating of 1 to 3, with priority 1 being the highest. These priority 1 recommendations are now monitored by the Corporate Governance Group to ensure that action is taken and these actions are reported quarterly to the Audit and Governance Committee. The recommendations are included in detail as appendices to the four quarterly reports to the Audit and Governance Committee.

Priority Level	Number Issued 2011/12	Number Issued 2010/11
Priority 1 - High	17	29
Priority 2 - Medium	53	80
Priority 3 - Low	12	18

Opinion

11. Although work continues to improve awareness of governance requirements and to promote improvement in systems, overall full assurance cannot be given and risks cannot be totally minimised. On this basis, the opinion given in this report provides a reasonable level of assurance that there are no significant weaknesses in the Council's control environment as the audits carried out during 2011/12 concluded that systems were generally operating satisfactorily, and appropriate follow up action had been taken where required to reduce risk of error or fraud.

12. No material errors were identified from Internal Audit work carried out on the Council's major financial systems during 2011/12. Reviews of the Council's overall systems of internal control identified some weaknesses in the application of Financial Regulations, Contract Standing Orders and internal controls. These have been referred to in reports to the Audit and Governance Committee, and in the Council's Governance Statement.

13. To assist non financially trained managers' understanding of finance and governance issues, advice is regularly given by the Audit team and training has been provided by an external supplier supported by the Director of Finance and ICT and the Chief Internal Auditor.

14. Work continues on a summary of Contract Standing Orders which will simplify the process to

be followed during procurement exercises.

15. The level of assurance on the Council's systems of internal control that can be given by the Chief Internal Auditor takes into account:

- All audit work completed during 2011/12;
- Follow up actions from previous years audits;
- Management's response to findings and recommendations;
- The resources available to deliver the audit plan;
- The certification of Service Directors in their assurance statements;
- Internal Audit performance in 2011/12;
- The reliance placed on the work of Internal Audit by the External Auditor; and
- Relevant information in Audit Commission reports, such as Protecting the Public Purse.

16. Taking all of the available information into account, in particular the audit work completed, it is considered by the Chief Internal Auditor that the Council has in place a satisfactory framework of internal control, which provides reasonable assurance regarding the efficient and effective achievement of its objectives in 2011/12.

Performance Management

17. The Internal Audit Team has local performance indicator targets to meet in 2011/12, as set out below:

	<i>Actual 2008/09</i>	<i>Actual 2009/10</i>	<i>Actual 2010/11</i>	<i>Target 2011/12</i>	<i>Actual 2011/12</i>
<i>% Planned audits completed</i>	95%	87%	82%	90%	82%
<i>% chargeable "fee" staff time</i>	71%	69%	66%	72%	71%
<i>Average cost per audit day</i>	£309	£300	£307	£300	£213
<i>% User satisfaction</i>	85%	94%	86%	85%	89%

18. The indicators are calculated as follows:

(a) % Planned audits completed - a cumulative calculation is made each quarter based on the approved plan as amended for additional work (eg investigations) during the year;

(b) % Chargeable fee time - a calculation is made each quarter based on reports produced from Internal Audit's time recording system;

(c) Average cost per audit day - the calculation is based on the costs for each quarter divided by the number of fee earning days extracted from the time recording system. As previously reported, a reassessment of what constitutes productive time, based upon information from the CIPFA benchmarking club and comparator information currently being shared between Uttlesford, Harlow, Broxbourne and EFDC has resulted in a new baseline for this indicator. The target for 2012/13, based on the comparator information is £245; and

(d) % User satisfaction - a calculation is made each quarter based on returned client surveys for each audit giving a score on a five point scale 0 (poor) – 5 (excellent). The score is backed up by the client's comments on a range of issues related to the audit.

19. The figures for planned audits completed of 82% (target 90%) and the percentage of

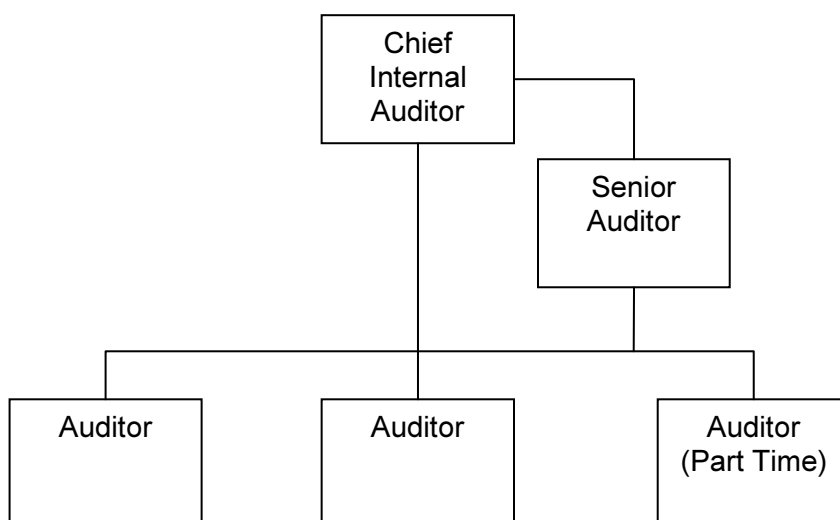
chargeable staff time of 71% (target 72%) being below target are both due to the long term sickness of the part time member of staff, who resigned in early March and study days for a member of staff studying for the Institute of Internal Auditors professional qualification, who has now passed two of the five modules and will be sitting two more in June 2012.

20. Staff have now received specialist IT audit training and are booked on a specialist procurement audit course in the first quarter of 2012/13 to enable more targeted work on areas of higher risk.

The Audit Team

21. The Team currently has an establishment of 4.4 full time equivalent (fte) Internal Auditors.

22. The establishment throughout 2011/12 is set out below:



Review of Effectiveness of Internal Audit

23. Regulation 6 of the Accounts and Audit Regulations requires the Council to maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with proper internal audit practices. In EFDC the system of internal audit consists of the work of the Internal Audit Team, although supervisory processes in all Directorates provide a control and risk management function that could be defined as contributing to the system of audit. For this purpose, however, the work of the Internal Audit Team is seen as the focus of the review of effectiveness.

24. The Council is required to carry out an annual review of the effectiveness of its system of internal audit, as part of a wider review of the effectiveness of the system of governance. It is the responsibility of the Authority to undertake the review, and not the External Auditor. The Audit and Governance Committee is the most appropriate body to oversee the review of the system of Internal Audit, as it is independent of the management of the Authority.

25. The framework for the review should demonstrate that the Internal Audit service is:

- (a) meeting its aims and objectives;
- (b) compliant with the CIPFA Code of Practice;
- (c) effective, efficient and continuously improving; and

(d) adding value and assisting the Authority in meeting its objectives.

26. The framework must also include, but not be limited to:

(a) a comprehensive set of targets to measure performance;

(b) user feedback for each individual audit and periodically for the whole service;

(c) internal quality reviews to be conducted periodically to ensure compliance with the CIPFA Code of Practice; and

(d) an action plan to implement improvements.

27. The objective of these measures is to ensure that the performance and effectiveness of the Internal Audit service improves over time, in terms of both the achievement of targets and the quality of service provided to the user.

28. Along with compliance with the Code of Practice, the review is to agree the effectiveness of the service. The outcome of the review is independent confirmation that the opinion in the annual report of the Chief Internal Auditor may be relied upon as a key source of evidence in the Governance Statement.

29. Measures of effectiveness put in place by the Chief Internal Auditor are based on existing reports and performance indicators, generally designed to measure outputs and outcomes. The key effectiveness measures are:

(a) completion of the annual audit plan (Local Performance Indicator);

(b) productive audit time as a percentage of total time (LPI);

(c) cost per audit day (LPI);

(d) achieving client service satisfaction (LPI);

(e) completion of audits within budgeted days; and

(f) finding improvements in control during each audit.

30. The measures referred to in the previous paragraph are monitored by Senior Management and Members via the following reporting processes:

(a) Preparation of the Annual Internal Audit Plan;

(b) Periodic monitoring reports by the Chief Internal Auditor, including:

(i) Quarterly Monitoring reports including Audit Plan progress;

(ii) Reports on significant findings;

(iii) Local performance indicators as referred to above; and

(iv) Results of customer satisfaction surveys; and

(c) Annual report and opinion of the Chief Internal Auditor.

31. The Council's Internal Audit Team issue a survey sheet after each main audit, and these are used in calculating one of the Team's local performance indicators, as well as providing feedback on

Directorates' perception of the quality of the work and professionalism of the audit staff. An overall score of between 1 (poor) and 5 (excellent) is requested from the clients and of the questionnaires returned, 54% were scored at 5, 36% at 4 and 10% at 3, from a return rate of 32% (26% 2010/11). Additional comments on the work of Internal Audit were invited, and where provided were constructive and showed a good level of understanding of the audit process.

32. The Council's External Auditors, PKF (UK) LLP, conduct a thorough review of the quality of Internal Audit's work on financial systems each year, in assessing the extent of reliance that can be placed on the work, in the context of their audit of the Council's Statutory Accounts. The Annual Governance Report 2010/11, issued by PKF in September 2011 stated:

"Where possible, we have sought to use Internal Audit's work and thereby avoided unnecessary duplication of audit effort. To ensure this approach was valid, we have undertaken the following:

- *reviewed Internal Audit's working papers and reports*
- *considered the robustness of the key financial systems on the evidence of this work*
- *re-performed Internal Audit's evaluation of controls and a sample of its testing of the effectiveness of controls, to ensure that its conclusions are soundly based.*

We were able to place reliance on Internal Audit's work for the testing of the effectiveness of specific controls."

33. The review of effectiveness does not specifically include any aspect of value for money of the Internal Audit Team. Whilst this is an important issue in itself (and is a local performance indicator for the Team), the focus of this review is on the delivery of the internal audit service to the required standard in order to produce the required outcome i.e. a reliable assurance on internal control and other governance arrangements, and the management of risks in the authority.

34. The Council's Corporate Governance Group has undertaken the review of the Council's Internal Audit Service in 2011/12 utilising the following main sources of evidence:

- (a) the annual report and opinion of the Chief Internal Auditor;
- (b) a review of the Internal Audit Service against CIPFA standards using a check list provided in the guidance and included in the CIPFA Benchmarking return;
- (c) a review of Internal Audit monitoring reports for 2011/12;
- (d) any comments from the Acting Chief Executive following consideration of individual audit report summaries;
- (e) the role of the Corporate Governance Group monitoring the work of Internal Audit and any significant internal control issues raised in their reports;
- (f) consideration of significant corporate control issues highlighted in audit reports, discussed within the Management Board;
- (g) performance by Internal Audit against local performance indicators;
- (h) the Internal Audit section of the Office of the Chief Executive Business Plan and work plans; and
- (i) Assessment by the Audit Commission appointed auditors (PKF).

Summary of Findings

35. The Internal Audit Section can demonstrate that it has a good understanding of the functions of the Council and has achieved the Council's objective to identify improvements to its control systems. The performance of the Unit has remained close to its key targets and while the actual audits achieved (82%) fell short of the target (90%) for completion of the audit plan due to sickness during the year, all fundamental financial systems were examined and reported on. The Council's External Auditors were able to place reliance on the work of Internal Audit when conducting their formal review of the Team's work as part of their review of the 2010/11 accounts.

36. The CIPFA Code of Practice checklist has been included in the CIPFA Benchmarking return as a required data set. This Good Practice Questionnaire returns an automated compliance score, of which the Internal Audit Section have scored 189 out of a maximum of 192 (98%) (last year 186). The areas of non or partial compliance will be reviewed over the coming year and action taken to address any weaknesses.

37. The work of the Audit and Governance Committee, with independent membership, makes an important contribution to the independent review of internal and external audit processes, as part of the Council's arrangements for securing further improvements in its systems of governance, including internal control. The Annual Report of the Audit and Governance Committee for 2011/12 demonstrated the range of issues addressed during the year.

38. It is felt that the Audit Committee throughout 2011/12 has complied with the key features of an Audit Committee as expressed by CIPFA, specifically that the Committee had:

- (a) A strong Chairman displaying depth of skills and interests;
- (b) An unbiased approach to its work;
- (c) The ability to challenge the Executive when required; and
- (d) A membership that is objective, independent and knowledgeable.

39. In the opinion of the officers attending the Audit and Governance Committee, the continued support given by Members, in particular by insisting on timely and positive responses to audit recommendations, is invaluable in reinforcing the message of sound governance.

40. Having considered these issues, the Corporate Governance Group is satisfied that the Authority's system of Internal Audit was effective during 2011/12.

Resource Implications:

Within the report.

Legal and Governance Implications:

Within the report.

Safer, Cleaner and Greener Implications:

No specific implications.

Consultation Undertaken:

Corporate Governance Group.

Background Papers:

Audit files and working papers

Impact Assessments:

Risk Management

Internal Audit has a primary objective to provide an independent and objective opinion on the adequacy of the Council's control environment, including its governance and risk management arrangements. The audit reports referred to in this report assist managers to determine the adequacy and effectiveness of the arrangements in place in their services.

Equality and Diversity:

Did the initial assessment of the proposals contained in this report for relevance to the Council's general equality duties, reveal any potentially adverse equality implications? No

Where equality implications were identified through the initial assessment process, has a formal Equality Impact Assessment been undertaken? No

What equality implications were identified through the Equality Impact Assessment process?
There are no specific equalities impacts.

How have the equality implications identified through the Equality Impact Assessment been addressed in this report in order to avoid discrimination against any particular group?
There are no specific equalities impacts.

Priority Ratings

Each audit finding will generate an audit recommendation. These recommendations will be prioritised in accordance with the following criteria:

Priority 1 – Observations refer to issues that are fundamental to the system of internal control. We believe that these issues have caused or will cause a system objective not to be met and therefore require management action as a matter of urgency to avoid risk of major error, loss, fraud or damage to reputation. Failure to apply a Financial Regulation or Contract standing Order will normally be in this category.

Priority 2 – Observations refer mainly to issues that have an important effect on the system of internal control but do not require immediate management action. System objectives are unlikely to be breached as a consequence of these issues, although Internal audit suggested improvement to system design and / or more effective operation of controls would minimise the risk of system failure in this area.

Priority 3 – Observations refer to issues that would if corrected, improve internal control in general and ensure good practice, but are not vital to the overall system of internal control.

Assurance levels:

The level of assurance to be applied will be based on the auditor's assessment of the extent to which system objectives are met, with the agreement of the Chief Internal Auditor. As a guide, the following triggers will be used, taking into account the level of risk of error, loss, fraud or damage to reputation.

Overall assignment rating	Level of assurance and definition Trigger (number of individual audit recommendations)
1 Full Assurance –	There is a sound system of control designed to achieve system objectives, and the controls are being consistently applied. Priority 3s or no audit recommendations.
2 Substantial Assurance –	There is a sound system of control designed to achieve system objectives, and the controls are generally being consistently applied. However, there are some minor weaknesses in control, and/or evidence of non-compliance, which are placing some system objectives at risk. Priority 2s and 1 Priority 1 (if assessed as a low risk).
3 Limited Assurance –	There is a system of control in place designed to achieve system objectives. However, there are significant weaknesses in the application of control in a number of areas, and / or evidence of significant non-compliance, which are placing some system objectives at risk. Between 1 and four 1s and (usually) several Priority 2s.
4 No Assurance –	The system of control is weak, and / or there is evidence of significant non-compliance, which exposes the system to the risk of significant error or unauthorised activity. Five or more Priority 1s.

Status Report at 31st March 2012

Appendix 2

AUDIT PLAN 2011/12

Audit area	Audit type	Days allocated	Completed	Risk Identifier
FINANCE AND ICT				
Finance				
Bank Reconciliation	system/follow up	15	Completed	PKF
Sundry Debtors	system/follow up	20	Completed	PKF
Creditors	system/follow up	20	Completed	PKF
Treasury Management	system/follow up	15	Completed	PKF/R26
Budgetary Control (capital and revenue)	system/follow up	10	In Progress	PKF
Risk Management and Insurance	system/follow up	15	Completed	PKF
Main Accounting and Financial Ledger	system/follow up	15	In Progress	PKF
Housing Benefits	system/follow up	25	In Progress	PKF
Council Tax	system/follow up	25	In Progress	PKF/R27/AC
National Non Domestic Rates	system/follow up	15	Completed	PKF/R27
Cash receipting and Income control	system/follow up	15	Completed	PKF
Provision for 'top up' testing	systems	15	Completed	PKF
Cash Office spot checks	verification	5	Rolled over	PKF
ICT				
Environmental controls/backup procedures	IT	10	Rolled over	PKF
Data and Network Security	IT	20	Completed	PKF
Disaster recovery/business continuity	IT	10	Rolled over	PKF/R8
TOTAL		250		
PLANNING AND ECONOMIC DEVELOPMENT				
Planning Fees	follow up	5	Completed	R27
Building Control	system	20	Rolled over	R27
TOTAL		25		
ENVIRONMENT AND STREET SCENE				
Waste Management and Recycling	follow up	20	Completed	R20
Public Health / Pest Control	system	15	Completed	R27
Car Parking	system	20	In Progress	R27
North Weald airfield	establishment	15	Completed	R27
Leisure contract	contract	15	Completed	R20
TOTAL		85		
OFFICE OF THE CHIEF EXECUTIVE				
Members Services		10	Rolled over	R
Electoral services – data quality		15	Deleted	R
TOTAL		25		
Audit area	Audit type	Days	Completed	Risk

		allocated		Identifier
HOUSING				
Housing Rent Collection and Arrears	system/follow up	25	Completed	PKF/R27
Housing Lettings	follow up	5	Rolled over	AC
Depot	system/follow up	15	Completed	
Norway House	Follow Up	15	Completed	
Bed and breakfast contract	contract	5	Completed	
Stores - Depot stock take	stocktake	5	Completed	R23
TOTAL		70		
PARTNERSHIPS AND VOLUNTARY SECTOR				
Local Area Agreements	system	15	Deleted	R22
TOTAL		15		
CORPORATE SUPPORT SERVICES				
Human Resources				
Payroll	System/follow up	25	Completed	PKF
Recruitment and Selection	Follow up	5	Rolled over	AC
Management of Sickness absence	Follow up	5	Completed	R15
Overtime and Committee Allowances	verification	10	Completed	R
Car Mileage claims	verification	10	Completed	R
Health and Safety Policy	system	5	Deleted	R
Estates/Facilities Management/Other				
Commercial Property portfolio	system/follow up	20	Completed	R9
Licensing	system	15	Completed	R27
Licensing Inforcement	Follow up	0	Completed	R27
Asset Management system	Follow up	5	Rolled over	R18
Non-HRA Repairs	verification	5	Rolled over	R2
Fleet Operations income	system	5	Rolled over	R27
Legal				
TOTAL		110		
Audit area	Audit type	Days allocated	Completed	Risk Identifier
MISCELLANEOUS				
Key and Local Performance Indicators	verification	15	Completed	R
Business Plans	verification	10	Completed	R

CONTRACTS				
Contract Compliance	System/follow up	15	Rolled over	R20
CORPORATE				
Corporate Procurement	system/follow up	15	Rolled over	AC/R2
Gifts and Hospitality (Officers)	system/follow up	10	Completed	R
Gifts and Hospitality (Members)	system/follow up	10	Completed	R
Data Protection Act	system	5	Rolled over	R18
Follow up of Priority 1 Audit recommendations	follow up	10	Completed	R23
CORPORATE MEETINGS				
Governance Statement	management review	5	Completed	AC/PKF
FRAUD AND CORRUPTION				
National Fraud Initiative (NFI)		15	In Progress	R23
TOTAL		110		
TOTAL DAYS ALLOCATED		690		
Contingency/Spot checks/Minor investigations		40		R23
Corporate/Service Advice		45		
TOTAL		775		

Risk Identifier

Key

AC

Audit Commission

PKF

External Audit

R no.

Risk No. in Corporate Register

Reputation of

R

Council