

# **Report to the Audit and Governance Committee**



**Epping Forest  
District Council**

**Report reference: AGC-009-2013/14**

**Date of meeting: 27 June 2013**

**Portfolio: Finance and Technology**

**Subject: Internal Audit Annual Report 2012/13 and Review of the Effectiveness of the System of Internal Audit.**

**Responsible Officer: Brian Bassington (01992 564446).**

**Democratic Services Officer: Gary Woodhall (01992 564470).**

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## **Recommendations/Decisions Required:**

- 1. To note the 2012/13 Audit Plan Status report as at 31 March 2013 (Appendix 2) and the assurance level given;**
- 2. To note the review of the effectiveness of the system of internal audit, undertaken by the Corporate Governance Group for 2012/13, in the context of the Council's Governance Statement; and**
- 3. To scrutinise the review and consider the effectiveness of the system of internal audit in 2012/13.**

## **Executive Summary:**

This report is presented in support of the Internal Audit opinion on the adequacy of Epping Forest District Council's (EFDC) internal control environment, provides a summary of the work undertaken by the Internal Audit Unit between April 2012 and March 2013 and details the overall performance against the Audit Plan for 2012/13.

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 2012/13 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 2012/13 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 2012 to 31 March 2013.

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 2011.

### Opinion

3. Although work continues to improve awareness of governance requirements and to promote improvement in systems, overall full assurance cannot be given as 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 2012/13 concluded that systems were generally operating satisfactorily and appropriate follow up action has been taken where required to reduce risk of error or fraud.

4. No material errors were identified from Internal Audit work carried out on the Council's major financial systems during 2012/13. Reviews of the Council's overall systems of internal control identified some weaknesses in internal controls and the timeliness of reconciliations between systems. These have been referred to in reports to the Audit and Governance Committee, and in the Council's Governance Statement.

### External Audit

5. The Authority's External Auditor has a statutory responsibility to express an independent opinion on the Council's accounts, performance management and the financial aspects of corporate governance. The External Auditors BDO (formerly PKF) are appointed by the Audit Commission, who have to be confident in the processes and procedures at the Council to produce the accounts by the statutory deadline each year, as well as being able to place reliance on the work of Internal Audit. 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

6. 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.

7. 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

8. Whilst the majority of planned audits, including all of the key audits of financial systems, were completed by 31 March 2013 a small number have been rolled forward into the 2013/14 plan due primarily to sickness within the audit team. 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.

9. During the year, 32 reports were issued to Management with the following assurance levels:

<b>Assurance Level</b>	<b>2012/13</b>	<b>2011/12</b>
Full Assurance	1	3
Substantial Assurance	29	29
Limited Assurance	2	2
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 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.

<b>Priority Level</b>	<b>Number Issued 2012/13</b>	<b>Number Issued 2011/12</b>
Priority 1 - High	6	17
Priority 2 - Medium	31	53
Priority 3 - Low	12	12

### Additional Support Provided

11. 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.

12. A summary of Contract Standing Orders which lays out the process to be followed during procurement exercises has been issued to staff in Housing Services as a pilot and minor amendments made following feedback from staff. This document is now available to all staff.

13. A module on Fraud Awareness, provided by the National Fraud Authority was loaded into the Council's e-learning system accessible through the intranet. Initially all Spending Control Officers and Authorised Signatories have received the training and the course will be rolled out to all other staff and Members over the next few months.

14. 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 2012/13;
- 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 2012/13;
- The reliance placed on the work of Internal Audit by the External Auditor; and
- Relevant information in Audit Commission and National Fraud Authority reports, such as Protecting the Public Purse and Fighting Fraud Locally.

15. 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 2012/13.

### Performance Management

16. The Internal Audit Team has local performance indicator targets to meet in 2012/13, as set out below:

	<i>Actual 2009/10</i>	<i>Actual 2010/11</i>	<i>Actual 2011/12</i>	<i>Target 2012/13</i>	<i>Actual 2012/13</i>
<i>% Planned audits completed</i>	87%	82%	82%	90%	85%
<i>% chargeable "fee" staff time</i>	69%	66%	71%	72%	69%
<i>Average cost per audit day</i>	£300	£307	£213	£245	£243
<i>% User satisfaction</i>	94%	86%	89%	85%	See note below

17. The indicators are calculated as follows:

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

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

(c) Average cost per audit day - the calculation is based on the costs in the cost centre monitoring report 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 comparator information being shared between Uttlesford, Harlow, Broxbourne and Epping Forest has resulted in a new baseline for this indicator which for 2012/13 was £245; and

(d) % User satisfaction - Recently it has been increasingly difficult to encourage clients to return the user satisfaction form with any meaningful comments. A replacement electronic form has been developed for use from April 2013 with the new audit plan.

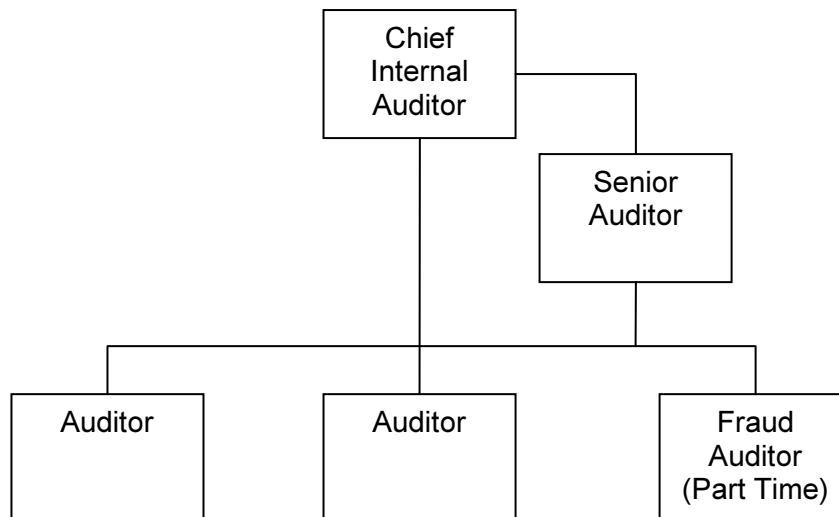
18. The figures for planned audits completed of 85% (target 90%) and the percentage of chargeable staff time of 69% (target 72%) being below target are both due to the long term

sickness of a member of staff who has now returned to full time work and study days for a member of staff studying for the Institute of Internal Auditors professional qualification, who has now qualified.

19. These indicators are monitored by the Corporate Governance Group and the Audit and Governance Committee.

### The Audit Team

20. The Team currently has an establishment of 4.4 full time equivalent (fte) Internal Auditors. The establishment throughout 2012/13 is set out below:



### Review of Effectiveness of Internal Audit

21. Regulation 6 of the Accounts and Audit Regulations 2011 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 Epping Forest, 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.

22. 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.

23. The review should demonstrate that the Internal Audit service is:

- (a) meeting its aims and objectives;
- (b) compliant with the CIPFA Code of Practice (this will be replaced by the Public Sector Internal Audit Standards (PSIAS) from April 2013);
- (c) effective, efficient and continuously improving; and
- (d) adding value and assisting the Authority in meeting its objectives.

24. 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.

25. 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.

26. The Council's External Auditors, PKF (UK) LLP (now known as BDO LLP following a merger in March 2013), 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 Audit Letter 2011/12, issued by PKF in October 2012 stated: "We were able to rely on the work of Internal Audit"

27. The Council's Corporate Governance Group has undertaken the review of the Internal Audit Service in 2012/13 utilising the following main sources of evidence:

- (i) the annual report and opinion of the Chief Internal Auditor;
- (ii) a review of the Internal Audit Service against CIPFA standards;
- (iii) a review of Internal Audit monitoring reports for 2012/13;
- (iv) any comments from the Chief Executive following consideration of individual audit report summaries;
- (v) the role of the Corporate Governance Group monitoring the work of Internal Audit and any significant internal control issues raised in their reports;
- (vi) consideration of significant corporate control issues highlighted in audit reports, discussed within the Management Board;
- (vii) performance by Internal Audit against local performance indicators;
- (viii) the Internal Audit section of the Office of the Chief Executive Business Plan and work plans; and
- (ix) assessment by the Audit Commission appointed auditors.

### Summary of Findings

28. 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 (85%) 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 2011/12 accounts.

29. 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 2012/13 demonstrated the range of issues addressed during the year.

30. 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.

31. Having considered these issues, the Corporate Governance Group is satisfied that the Authority's system of Internal Audit was effective during 2012/13.

**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.

<b>Overall assignment rating</b>	<b>Level of assurance and definition Trigger (number of individual audit recommendations)</b>
<b>1 Full Assurance –</b>	There is a sound system of control designed to achieve system objectives, and the controls are being consistently applied. <b>Priority 3s or no audit recommendations.</b>
<b>2 Substantial Assurance –</b>	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. <b>Priority 2s and 1 Priority 1 (if assessed as a low risk).</b>
<b>3 Limited Assurance –</b>	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. <b>Between 1 and four 1s and (usually) several Priority 2s.</b>
<b>4 No Assurance –</b>	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. <b>Five or more Priority 1s.</b>

Approved by the Audit and Governance Committee 15 November 2010



**AUDIT PLAN 2012/13**

<b>Audit area</b>	<b>Audit type</b>	<b>Days allocated</b>	<b>Completed</b>	<b>Risk Identifier</b>
<b>FINANCE AND ICT</b>				
<b>Finance</b>				
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	reduced risk	PKF
Risk Management and Insurance	system/follow up	15	reduced risk	PKF
Main Accounting and Financial Ledger	system/follow up	15	Completed	PKF
Housing Benefits	system/follow up	25	In Progress	PKF
Council Tax	system/follow up	25	Completed	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	25	Completed	PKF
Cash Office spot checks	verification	5	reduced risk	PKF
<b>ICT</b>				
Environmental controls/backup procedures	IT	10	Completed	PKF
Disaster recovery/business continuity	IT	10	C/fwd	PKF/R8
<b>TOTAL</b>		<b>240</b>		
<b>PLANNING AND ECONOMIC DEVELOPMENT</b>				
Planning Fees	System	20		R27
Building Control	follow up	5	Completed	R27
<b>TOTAL</b>		<b>25</b>		
<b>ENVIRONMENT AND STREET SCENE</b>				
Waste Management and Recycling	follow up	20	Completed	R20
Car Parking	system	20	Completed	R27
North Weald airfield	establishment	15	C/fwd	R27
Leisure contract	contract	15	Reduced risk	R20
<b>TOTAL</b>		<b>70</b>		
<b>OFFICE OF THE CHIEF EXECUTIVE</b>				
Members Services		10	Completed	R
<b>TOTAL</b>		<b>10</b>		
<b>HOUSING</b>				
Housing Rent Collection and Arrears	system/follow up	25	In Progress	PKF/R27
Housing Lettings	follow up	5	In Progress	AC
Housing Repairs Service	system/follow up	15	C/fwd	
Housing Contracts	system	15	C/fwd	

Stores - Depot stock take	stocktake	5	Completed	R23
<b>TOTAL</b>		<b>65</b>		
<b>CORPORATE SUPPORT SERVICES</b>				
<b>Human Resources</b>				
Payroll	System/follow up	25	Completed	PKF
Recruitment and Selection	Follow up	5	Completed	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
<b>Estates/Facilities Management/Other</b>				
Commercial Property portfolio	system/follow up	20	Completed	R9
Property Management System - Asset Register	system	5	C/fwd	PKF
Fleet Operations income	system	5	Completed	R27
<b>Legal</b>				
Licensing	system	15	C/fwd	R27
Debt recovery	system	15	Completed	R27
<b>TOTAL</b>		<b>115</b>		
<b>MISCELLANEOUS</b>				
Key and Local Performance Indicators	verification	15	Completed	R
Business Plans	verification	10	Completed	R
<b>FRAUD PREVENTION &amp; DETECTION</b>				
Contracts	fraud	15	In Progress	AC/R20
Procurement	fraud	15	In Progress	AC/R2
Council Tax Discounts	fraud	15	C/fwd	AC/R23
National Fraud Initiative (NFI)	fraud	15	In Progress	R23
Data matching and analysis (IDEA software)	fraud	25	C/fwd	AC
<b>CORPORATE</b>				
Corporate Procurement	system/follow up	15	In Progress	AC/R2
Gifts and Hospitality (Members & Officers)	system/follow up	10	Completed	R
Data Protection Act	system	5	C/fwd	R18
Follow up of Priority 1 Audit recommendations	follow up	10	Completed	R23
Governance Statement	management review	5	Completed	AC/PKF
<b>TOTAL</b>		<b>155</b>		
<b>TOTAL DAYS ALLOCATED</b>				
Contingency/Spot checks/Minor investigations		<b>40</b>		R23
Corporate/Service Advice		<b>55</b>		
<b>TOTAL</b>		<b>775</b>		

<b>Key</b>	<b>Risk Identifier</b>
AC	Audit Commission
PKF	External Audit
R no.	Risk No. in Corporate Register
R	Reputation of Council