

BABERGH DISTRICT COUNCIL

From: Head of Corporate Organisation	Report Number: M23
To: Overview and Scrutiny (Stewardship) Committee	Date of meeting: 15 May 2012

INTERNAL AUDIT ANNUAL REPORT 2011/12

1. Purpose of Report

- 1.1 To provide the Audit Manager's opinion on the overall adequacy and effectiveness of the Council's internal control environment and a summary of audit work undertaken to formulate that opinion.
- 1.2 To seek endorsement to this as part of the Committee's role as the Council's Audit Committee.

2. Recommendations

- 2.1 That the Committee notes the outcomes of internal audit work in 2011/12 and the conclusion of the Audit Manager's opinion that the Council's overall internal audit control arrangements provide an acceptable level of assurance, as detailed in Appendix A.
- 2.2 That this is reflected in the Annual Governance Statement to be submitted to the Committee for approval at its next meeting in July 2012.

The Committee is able to resolve these matters.

3. Financial Implications

- 3.1 None.

4. Risk Management

- 4.1 This report is most closely linked with the Council's Significant Business Risk No. 6 – Performance and Cost Management. Key risks are set out below:

Risk Description	Likelihood	Impact	Mitigation Measures
Internal controls within the Council may not be efficient & effective and as a result the Council may not be identifying significant weaknesses that could impact on the achievement of the Council's aims and priorities and/or lead to fraud, financial loss or inefficiency.	Low	Critical (Potentially)	Members receive and approve the internal audit work programme and receive other reports throughout the year on internal controls. The work programme is based on an assessment of risk for each system or operational area.

The risk is potentially increasing as a result of the ongoing savings and staff reductions.			External Audit reviews and reports on the work of the Internal Audit section and the current internal control arrangements.
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5. Consultations

- 5.1 This report has been agreed with the Council's Section 151 Officer.

6. Equality Analysis

- 6.1 There are no equalities implications arising from this report.

7. Shared Service / Partnership Implications

- 7.1 Following this Committee's approval of a joint Internal Audit Plan for 2011/12, it is envisaged that a combined report will be produced for both sets of Members next year when the integration process has been further embedded and more joint audits developed.

8. Key Information

- 8.1 The Accounts and Audit Regulations 2011 require every local authority to maintain an adequate and effective internal audit. The Code of Practice for Internal Audit in Local Government (UK) 2006 requires the Head of Internal Audit to provide a formal report and produce an annual audit opinion to Members on the overall adequacy and effectiveness of the Council's internal control environment, and a summary of audit work undertaken. That opinion is included within the Annual Internal Audit Report 2011/12, as detailed in Appendix A.
- 8.2 A wide number of reviews of the Council's operations were carried out last year, ranging from main financial systems to corporate and governance reviews. Each were critically evaluated and where appropriate recommendations made to further improve the internal control environment, including best practice. Internal Audit follow up all high-risk recommendations to ensure that these are dealt with in a timely manner. It is management's responsibility to ensure that agreed recommendations are implemented.
- 8.3 In terms of this and future reporting Members agreed in June 2011 (Report L25) to receive an electronic link to the full summary of the work and that a much shortened summary version would be included in this report, which draws Members attention to key issues arising. A link to the full summary of the work undertaken can be found in Appendix A, paragraph 4.8.
- 8.4 All reports issued during the year have been assessed as either 'Effective' or 'High Standard'. A key to these opinions, with their definitions, can be found in Appendix A, paragraph 4.4.
- 8.5 There continues to be steady improvement in the key controls within the financial systems, most notably within the Creditors, Debtors and Cash and Bank systems.

- 8.6 In April 2011, the administration of the Revenues and Benefit services have been undertaken by the Shared Revenues Partnership (SRP), a partnership between Babergh, Mid Suffolk and Ipswich Borough Council.
- 8.7 The SRP used existing legacy computer systems from each Council until November 2011 and moved to a single platform, Northgate, in December 2011. The external auditors for Babergh and Mid Suffolk, (PKF and the Audit Commission respectively), requested that audits were carried out on the part of the year the existing Civica systems were in use and on the data migration process to the new system. The auditing of existing systems and data migration has been carried out by Mid Suffolk's Performance and Audit Services team and the audit of Northgate will be carried out by the Ipswich Borough Council (IBC) auditors. Assurances will be sought from both Internal and External audit on the work performed by the IBC auditors. Assurances on the full year's results will reported to this Committee through the Annual Governance Statement in July 2012.
- 8.8 This opinion relies on the key financial controls being in place and the corporate governance framework operating effectively. Based on the work undertaken during the year, subject to the assurances required from the full year's SRP work, and assurances by other bodies, Internal Audit can provide reasonable assurance that the systems of internal control within these areas of the Council are operating adequately and effectively. However, Members should note that assurance cannot be absolute.
- 8.9 Looking forward, as the public sector continues through a period of severe financial constraint there will be a need to ensure that appropriate and efficient controls remain in place to maintain the governance standards within the Council, commensurate with the Council's risk appetite.
- 8.10 It is important that this Committee challenge, in their role as the Audit Committee, the work and any progress reports undertaken by Internal Audit, and also indicate whether there are any areas where the Committee may want specific feedback on.

9. Appendices

Title	Location
(a) Appendix A – Internal Audit Annual Report 2011/12	Attached (includes a weblink to the full summary of audit reviews)

10. Background Documents

10.1 None.

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ANNUAL INTERNAL AUDIT REPORT 2011/12

1. PURPOSE OF REPORT

1.1 The CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom 2006 requires the Head of Audit to provide an annual audit report and deliver an annual audit opinion to the Council.

1.2 This report also seeks to provide:

- Background information on the role of Internal Audit;
- An overview of the work of Internal Audit and an opinion on the adequacy of the internal control environment;
- Information on the performance of Internal Audit during the year; and
- Details of all audits that have been undertaken during the year with the related audit opinion – please refer to paragraph 4.8.

2. BACKGROUND

Role of Internal Audit

2.1 Management are responsible for the systems of internal control within the Council and should set in place policies and procedures to help ensure that systems function correctly.

2.2 It is the role of Internal Audit to review, appraise and report on the adequacy, effectiveness and efficiency of financial and other management controls, including risk management and corporate governance. This is achieved by undertaking audits across the full range of the Council's functions in accordance with a risk based Audit Plan, approved annually by this Committee, which outlines assignments to be carried out and the resources required to deliver the Plan.

2.3 Internal Audit carries out the work to satisfy this legislative requirement, reporting the outcome of its work to this Committee. This Committee in its role as the Council's Audit Committee has a responsibility for reviewing the Council's corporate governance arrangements, including internal control and for scrutinising the Annual Governance Statement. The audit work carried out is therefore a key source of assurance that the internal control environment is operating efficiently and effectively.

3. REPORTING AND CONSULTATION

3.1 Members approved the 2011/12 Internal Audit Plan in March 2011. An interim Internal Audit Report was submitted to this Committee in November 2011.

3.2 A short summary of the key issues arising from audit work carried out in 2011/12 is detailed in paragraphs 4.5 to 4.7 of this report. A full summary of the work is provided by the web link provided in paragraph 4.8.

- 3.3 Auditees are given a written draft report at the end of the audit review, which gives more opportunity for consideration of matters arising, and their comments on the recommendations made are included in the final report to management.
- 3.4 As in previous years, Internal Audit would like to acknowledge the open and co-operative manner of staff that has enabled audit work to progress effectively and efficiency during the year.
- 3.5 All audit reviews were assessed as 'Effective' (10 audits) or 'High Standard' (3 audits) – refer to paragraph 4.4 for definitions. In line with Internal Audit's follow up procedure, subsequent follow up work was undertaken, allowing adequate time for the implementation of the recommendations but also taking into account the risk presented to the Council whilst the actions required remained open.

Performance of the Internal Audit Service

- 3.6 Internal Audit is committed to providing an excellent service to its customers. As part of our commitment to ensure that we maintain high professional standards and ensure that we continually improve the quality and usefulness of our work, we send a customer satisfaction survey with the issue of the final report rather than issuing an annual survey as we have in the past. The change in approach was to provide a more effective communication channel.
- 3.7 The survey similar to the annual questionnaire asks for the auditees' opinion on a range of issues and also seeks their views on how our service can be improved and developed. Of 14 customer surveys sent a total of 9 were completed and returned.
- 3.8 The results show that satisfaction with the Internal Audit service during 2011/12 remains high and that it continues to operate effectively.
- 3.9 A requirement laid down in the Accounts and Audit (England) Regulations 2011 states that "the relevant body shall, at least once a year, conduct a review of the effectiveness of its internal audit".
- 3.10 In 2011/12, a "light touch" review of Babergh's internal audit service was undertaken whereby the Audit Manager updated the self assessment against the CIPFA Code of Practice on Internal Audit. This self assessment was also subject to review by an officer within the Performance and Audit Services team from Mid Suffolk.
- 3.11 This update and independent review confirmed substantial compliance with the standards contained in the CIPFA Code of Practice. There is however, a recognition that both Councils need to combine their Audit Strategy, Terms of Reference, Audit Manual and working practices that will incorporate best practice. This will take place early in the financial year 2012/13 and the aligned Audit Strategy and Terms of Reference will be presented to this Committee for approval.

4. ASSURANCE AND AN OPINION ON THE SYSTEMS OF INTERNAL CONTROL

Internal Assurance

- 4.1 Internal Audit, along with other assurance processes, have a statutory obligation under the Accounts and Audit Regulations 2011 to provide assurance from the work they undertake in respect of the internal control systems operating within the Council.

- 4.2 The system of internal control should help the Council to manage the risks which could affect the achievement of the Council's objectives rather than eliminate them completely. Internal Audit and the other assurance processes can therefore only provide within the Annual Governance Statement reasonable and not absolute assurances of adequacy and effectiveness.
- 4.3 In assessing the level of assurance that can be given to the Council for 2011/12, the following have been taken into account:
- All audits complete;
 - All necessary audit testing undertaken;
 - Audit recommendations made and remedial action consequently agreed (where applicable);
 - Audit resources available;
 - The risk assessment undertaken in preparing audit plans for Committee; and
 - External audit findings
- 4.4 All reports issued during the year have been assessed as either 'Effective' or 'High Standard'. Below are all the categories that the audit opinion is broadly based on:

Audit Opinion	Definition
High Standard	Evidence of consistent and effective control framework
Effective	Controls and procedures operate effectively in most cases but show some non-compliance
Ineffective	Controls in place are not being consistently applied – improvements are required
Audit Opinion	Definition
Poor	General control framework is weak

Key issues arising

- 4.5 Main financial systems - There continues to be steady improvement in the key controls within the financial systems, most notably within the Creditors, Debtors and Cash and Bank systems, which have been assessed with a 'High Standard' audit opinion.
- 4.6 ICT – The current process requiring officers to make entries in departmental registers of all transfers of 'PROTECTed' data is to be urgently reviewed as audit findings revealed that the registers were not being updated. An alternative solution will be developed by the IT Manager to streamline the requirement using an e-Form with required workflow included to ensure visibility by the required officers in each case. In addition, the induction process will also be reviewed to improve user understanding of information security, how it is managed and what officers should/should not do.

- 4.7 The SRP used existing legacy computer systems from each Council until November 2011 and moved to a single platform, Northgate, in December 2011. The external auditors for Babergh and Mid Suffolk, (PKF and the Audit Commission respectively), requested that audits were carried out on the part of the year the existing Civica systems were in use and on the data migration process to the new system. The auditing of existing systems and data migration has been carried out by Mid Suffolk's Performance and Audit Services team and the audit of Northgate will be carried out by the Ipswich Borough Council (IBC) auditors. Assurances will be sought from both Internal and External audit on the work performed by the IBC auditors. Assurances on the full year's results will be reported to this Committee through the Annual Governance Statement in July 2012.
- 4.8 A full summary of all the audits undertaken during 2011/12 can be found using the web link below:

<http://intranet/refdocs/finnaudit/audit/Summary%20of%20Internal%20Audit%20Reports%20issued%20during%202011-12.pdf>

External Audit

- 4.9 The External Audit Annual Governance Report and Letter for the financial year 2010/11, issued September 2011, included an unqualified opinion on the Council's Accounts and an unqualified value for money conclusion.
- 4.10 In addition, External Audit were able to place reliance on Internal Audit's work for the testing of the effectiveness of specific controls.
- 4.11 External Audit are currently reviewing the work undertaken by Internal Audit during 2011/12. Their findings will be reported within the Annual Governance Statement to be reported to this Committee in July 2012.
- 4.12 Internal Audit continue to work closely with External Audit by sharing systems documentation and feeding back any necessary amendments arising from Internal Audit work undertaken.

AUDIT MANAGER'S ANNUAL AUDIT OPINION

- 4.13 This opinion relies on the key financial controls being in place and the corporate governance framework operating effectively. Based on the work undertaken during the year, subject to the assurances required from the full year's SRP work, and assurances by other bodies, Internal Audit can provide reasonable assurance that the systems of internal control within these areas of the Council are operating adequately and effectively. However, Members should note that assurance can not be absolute.
- 4.14 Looking forward, as the public sector continues through a period of severe financial constraint there will be a need to ensure that appropriate and efficient controls remain in place to maintain the governance standards within the Council, commensurate with the Council's risk appetite.

5. SUMMARY OF AUDIT WORK TO FORMULATE AUDIT OPINION

Corporate Work including Advice and Guidance

5.1 There continues to be a demand for Internal Audit involvement in corporate areas of work due to the officers' skills and experience. During 2011/12 this aspect of the section's work included:

- Drafting the Annual Governance Statement for 2010/11 (AGS) as presented to this Committee in July 2011;
- Attendance at Management Team meetings and other meetings to brief senior managers in relation to risk management and audit issues; and
- Continuing to provide advice to service areas on internal controls.

Financial Governance

5.2 This work is concerned with the documentation, evaluation and testing of the effectiveness of systems on internal control within the Council's financial systems. Annual reviews of the financial systems provide assurance to the Director of Finance and External Audit that controls are operating satisfactorily.

5.3 As reported earlier there has been a steady improvement in the controls within the financial systems, most notably within the Creditors, Debtors and Cash and Bank systems, which were assessed as 'High Standard'.

5.4 Refer to the web link in paragraph 4.8 which provides a summary of the main financial systems work undertaken.

Anti-Fraud and Corruption

Introduction

5.5 The Council spends a significant amount of public money each year on essential local services. It is essential that the Council protects and preserves its ability to provide these services by ensuring that its assets are protected against all risks and loss and damage.

5.6 Excluding housing benefit, which is covered under the heading 'Benefit fraud arrangements', the Council has traditionally encountered low levels of fraud and corruption. However, the risk of loss through theft, fraud or corruption both internally and externally, is recognised nationally as a part of business life that needs to be managed effectively.

5.7 The Council is committed to ensuring that any opportunity for fraud and corruption is minimised. It adopts a culture in which all of its Members and staff can help the Council maintain a proactive attitude towards preventing fraud and corruption by reporting corrupt, dishonest or unethical behaviour.

Protecting the Public Purse

- 5.8 The Audit Commission published a report in November 2011 entitled 'Protecting the Public Purse – Fighting Fraud against Local Government', which provides useful information on the detection of fraud in local government. It considers the key fraud risks and pressures facing councils, along with identifying good practice and markers to future issues.
- 5.9 The report includes an updated fraud checklist which will be completed early in the financial year to assess the effectiveness of both Councils governance and counter fraud arrangements. The original checklist was completed by the Audit Manager during 2010 and illustrated that Babergh were already substantially complying with requirements.

Policies, procedures and awareness

- 5.10 The Council has in place an Anti-Fraud and Corruption and Whistleblowing Policy. Its purpose is to outline the Council's approach, as well as defining roles and responsibilities, for dealing with the threat of fraud and corruption, both internally and externally. This is available on both the Council's website and intranet.
- 5.11 As part of the integration process the anti-fraud and corruption arrangements of both Councils will be reviewed with the aim of producing a single policy incorporating best practice. The policy will be presented to the Council's scrutiny committees for approval later in the year.
- 5.12 The Council is committed to ensuring that any opportunity for fraud and corruption is minimised, and has in place a strong framework of processes and responsibilities which make fraud and corruption hard to perpetrate, and are likely to expose fraud and corruption at the earliest opportunity.
- 5.13 Currently the Council maintains a separate Prosecution Policy for combating benefit fraud. The public and staff are encouraged to raise concerns relating to benefits fraud through the benefit fraud telephone hotline. The Benefits Fraud Manager from the Benefit Fraud Partnership (see also paragraphs 5.16 to 5.20) is drafting an aligned revised Policy for the three partners, Babergh, Mid Suffolk and Ipswich Borough. Babergh's Audit Manager and the Head of Performance and Audit Services from Mid Suffolk have provided comments on the draft document. The Audit Manager will report back to this Committee once the Policy has been formally ratified by the host's Committee detailing any significant changes.
- 5.14 Babergh is committed to being a transparent and open Council. The Code of Recommended Practice for Local Authorities on Data Transparency published by CLG (Communities and Local Government) sets out data publishing requirements on Local Authorities, including those relating to expenditure over £500, (including supplier, costs and transaction information). This information is published on the Council's website allowing the public to view how their money is being spent.
- 5.15 Completion of national fraud and corruption surveys.

Benefit fraud arrangements

- 5.16 Local Authorities have a duty to safeguard public funds and take responsible steps to ensure that Housing & Council Tax benefit payments are made to the right people at the right time.
- 5.17 The Benefit Fraud Partnership is based at Ipswich Borough Council and was formed in April 2011. The partnership is made up from existing investigators from Babergh, Mid Suffolk and Ipswich Borough Council.
- 5.18 The team receives referrals from many sources including the public (through the Fraud Hotline and by letter), the Department of Works and Pensions (DWP), the Housing Benefit Matching Service (HBMS), National Fraud Initiative (NFI), the SRP, Customer Service Teams and others.
- 5.19 From April 2013 it is planned that the Welfare Reform Bill will result in Benefit Fraud investigations being conducted in accordance with the priorities, policies and processes operating within the Department of Work and Pensions. Members of this Committee will be advised of the changes and the impact this has on investigations.
- 5.20 Given that this has been a year of transition and embedding the team have still identified over £86k of overpayments attributed to fraud. This compares to £94k identified in the previous year (Note: these figures do not include NFI referrals).

National Fraud Initiative (NFI)

- 5.21 The NFI is a rolling programme of electronic data extraction, data matching, review of and investigation of matched reports and reporting on outcomes. The extracted Babergh data is matched with other data from within public sector organisations to highlight potentially fraudulent activity.
- 5.22 From 2008, the Audit Commission has conducted the NFI exercise under the statutory powers given to it under the Serious Crimes Act 2007. All mandatory participants, including Babergh District Council must provide data, with failure to do so a criminal offence.
- 5.23 Internal Audit takes a leading role in co-ordinating this exercise, the current round commenced in October 2010. The submitted data has been matched with data from other bodies and central government organisations and work has been ongoing to investigate potential errors and fraud.
- 5.24 As at the end of March 2012, 836 matches have been reviewed and there are currently 137 matches under investigation, which relate to benefit cases. 699 matches have been cleared with frauds and errors having been identified again relating to benefit cases. Over £38k has been recovered in overpayments of benefits.
- 5.25 In August 2010, the Department for Communities and Local Government announced plans to put in place new arrangements for auditing England's local public bodies. No decision has yet been made regarding whether the NFI will remain under the Audit Commission or whether this will be transferred to another body. However, due to its success, it is almost certain to continue in the future in some form.

5.26 Participants in the NFI exercise have already been alerted of the next bi-annual exercise 2012/13 in order to make preparations to extract data in a timely manner in order to meet the required deadline in October 2012.

Internal Audit

5.27 Fraud and corruption risks are identified as part of the annual audit planning process, with the annual joint Internal Audit Plan with Mid Suffolk including resources to undertake special irregularity investigative work, co-ordination of the NFI data matching exercise, and proactive anti-fraud and corruption work.

5.28 In addition, the Internal Audit section work in partnership with other Suffolk Councils through the Suffolk Working Audit Partnership (SWAP). This partnership allows local authorities in Suffolk to share resources, knowledge and experience regarding internal audit issues in order to identify and promote the adoption of best practice. For example, Interim Head of Audit Services at Suffolk County Council holds the Chartered Institute of Public Finance and Accountancy (CIPFA's) Advanced Certificate in Investigative Practice and acts as the partnership's 'Centre of Excellence' on fraud matters.

Reported corporate fraud cases during 2011/12

5.29 Other than benefit fraud identified by the Benefit Fraud Partnership and through the NFI exercise, as mentioned earlier, there was only one reported case of fraud reported to Internal Audit. This involved Babergh being subjected to five separate but related attempts of cheque fraud.

5.30 Four of the five cheques were stopped, however, one cheque was paid in the sum of £8,622.09. The cheque was presented to our bankers, bearing a copied signature of the Director of Finance and our logo. Otherwise the counterfeit cheque was not in the same format as our cheque documents.

5.31 There are a host of security features on our cheque stationery including a hologram, special inks, watermarks and backgrounds as well as hidden text to indicate if a cheque has been photocopied. One of the counterfeit cheques was spotted by a counter clerk at another bank when it was presented over the counter and it was due to this diligence that alerted us to the problem.

5.32 A review of our respective procedures identified areas for improvement. As a result the Council's bankers agreed to make good the loss caused by the counterfeit cheque.