

**Audit & Business Risk**

# **Internal Audit Annual Report and Opinion 2011/12**

**Ian Withers**

**Head of Audit & Business Risk**



**Brighton & Hove  
City Council**

# Contents

	<b>Page</b>
<b>Introduction</b>	<b>2</b>
<b>Head of Audit &amp; Business Risk's Annual Opinion</b>	<b>3</b>
<b>Internal Audit Activity</b>	<b>4</b>
<b>Performance of Internal Audit</b>	<b>7</b>
<b>Service Review</b>	<b>9</b>
<b>Service Restructure</b>	<b>9</b>
<b>Service Development</b>	<b>9</b>

## **Appendices:**

A	Definitions of Internal Audit Assurance Levels	11
B	Definitions of Priorities for Audit Recommendations	12
C	Terms of Reference for the provision of Internal Audit	13

## **Acknowledgements:**

We are grateful for the continued co-operation and support we have received from all those engaged with the audit process during 2011/12

## Introduction

### Purpose of the report

1. This report summarises the internal audit work undertaken by Audit & Business Risk during the financial year 2011/12, in particular the outcomes of audit reviews, management actions and counter fraud activities. The report includes the Head of Audit & Business Risk's Annual Opinion on the Council's control environment.

### Role of Internal Audit

2. The Council's Internal Audit function is provided by Audit & Business Risk, part of the Finance Unit, together with Deloitte & Touche Public Sector Internal Audit Lt under a co-sourced arrangement.
3. Our role is to provide independent and objective assurance on the adequacy of the council's internal control environment, comprising risk management, internal control and governance by evaluating its effectiveness as a contribution to the proper economic, efficient and effective use of resources.
4. Internal Audit is a statutory requirement for local authorities under the Accounts & Audit Regulations 2011, which states that *a local authority shall maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with proper practices*. The Council has recognised this statutory requirement in its financial regulations.
5. We continually seek to adapt and enhance our approach in order to take account of the Council's risk profile and emerging issues, to ensure our work remains focussed on the areas of highest risk and providing value added to services.
6. Internal audit work also assists the Director of Finance in the discharge of her responsibilities as the Council's Section 151 Officer.

## Head of Audit & Business Risk's Annual Audit Opinion

7. The level of assurance that the Head of Audit & Business Risk provides is based on the internal audit work carried out during the year. In assessing the level of assurance given, the following have been taken into account:
  - Internal audit work completed during 2011/12, planned and unplanned;
  - Management responses to audit reviews including effective actions to audit recommendations made;
  - Follow-up action taken following agreement and issue of final audit reports in 2011/12 and previous years;

- Assurance from individual audit reviews in the form of audit opinions;
- Other assurance work undertaken both from internal and external sources;
- Impact of significant changes to the Council's systems and operations; and
- The quality and performance of internal audit work and extent of compliance with the CIPFA Code of Practice for Internal Audit.

### Annual Audit Opinion

No assurance can ever be absolute, however based upon the internal audit work undertaken it is the Head of Audit & Business opinion that **reasonable assurance can be provided on the adequacy and effectiveness of the Council's control environment operating for the year ended 31<sup>st</sup> March 2012.** The Council's control environment comprises internal control, risk management and governance arrangements.

8. Our audit work during the year has identified weaknesses and specific control improvements required in a number of key system areas. We will continue to work closely with management in successfully implementing actions within reasonable timescales.

## Internal Audit Activity

### Annual Audit Plan

9. The Internal Annual Audit Plan for 2011/12 was agreed by the Audit Committee in April 2011 and included a total of 91 specific risk based audit reviews. The Internal Audit Plan is flexible to emerging issues and risks throughout the year and subject to change through liaison with management to ensure the best use of our audit resources. Some audit reviews have been added or deleted from the Plan, others consolidated or split into separate elements. Consequently the total number of audits undertaken during 2011/12 was 86 compared with 91 planned.
10. The total audit reviews of the final amended Annual Audit Plan were 86. A full listing of internal audit reviews is shown at Appendix A, including amendments to planned and summarised as follows:
- Deleted audit reviews from Annual Audit Plan (-4)
  - Deferred audit reviews to 2011/12 (-5)
  - Merged audit reviews with other planned (-5)
  - Additional unplanned audit reviews (+9)
11. At the time of preparing this report the position on these were as follows:
- 86 – Total number of audits per amended Annual Audit Plan
  - 58 – Final Internal Audit Reports

- 24 – Draft Internal Audit Reports (awaiting responses and agreement)
  - 4 – Audit fieldwork stage, still in progress
12. The number of audits at draft report and fieldwork stage is higher than the previous year when by June, 18 audit reviews remained at draft and 4 fieldwork. We are working with managers and giving priority to progressing all to final.
  13. Audit review remaining at fieldwork stage are nearing audit report stage but have been delayed due a number of reasons including service pressures and availability of key managers.
  14. For 2011/12 the actual direct audit days was 1,693 against planned of 1,840.
  15. During the year, we have had staff vacancies and have backfilled as far as possible, obtaining some staff resources from an external internal audit provider through a framework contract. A substantial amount of our audit time has been spent on the income systems and payroll following system control problems.

### Outcomes from Audit Reviews

16. Table 1 below contains of summary of assurance levels given in audit reports, including a comparison with the previous year 2010/11. Those not included (2) are where an assurance level is not relevant and therefore not provided.

**Table 1 – Internal Audit Reports and Assurance Levels Given**

Assurance Opinion	No. of Audit Reviews			
	2011/12		2010/11	
Full	0	0%	0	0%
Substantial	28	34%	23	25%
Reasonable	32	39%	53	57%
Limited	20	24%	15	16%
No	0	0%	0	0%
Not Included	2	3%	2	2%
Totals	82	100%	93	100%

17. The number of audit reviews giving limited assurance has increased from 16% in 2010/11 to 24% in 2011/12 and reflects a number of system control problems and issues. Specific audit reviews at final report stage, giving limited assurance are as follows:
  - Staff Overtime and Allowances
  - Income System – Cash and Cheques
  - Imprest and Petty Cash Accounts
  - Payroll/HR
  - VFM – Procurement
  - Recruitment System
  - OHMS Housing Management System Application
  - Council Transport Fuel
  - Development Control Income
  - Blue Badges
  - Residential Parking Permits

18. As part of our follow-up work we will be focussing on those audits giving limited assurance and working with management to ensure agreed actions for improvements in internal controls are implemented.
19. Table 2 below contains a summary of audit recommendations for improvements in internal controls, contained in audit reports issued for the year. Where audit recommendations are contained in final audit reports, actions will have been agreed with management for implementation. A comparison is again made with 2010/11.

**Table 2 - Audit Recommendations (Actions) Made**

No. of Audit Recommendations/Actions	2011/12		2010/11	
	No.	%	No.	%
High	40	8%	42	17%
Medium	377	76%	495	78%
Low	79	16%	96	15%
Totals	496	100%	633	100%

### Counter Fraud

20. Our work covers all corporate internal fraud and corruption which includes reactive investigations but also increasingly proactive in managing the risk of fraud.
21. During the year we received and investigated 180 fraud referrals of suspected fraud and irregularities and of these currently 81 have been closed with 91 remaining as still in progress. The number of referrals has increased from 112 in 2010/11 demonstrating a national trend of increased fraud together with greater awareness amongst staff and the general public.
22. Of the closed cases sanctions applied during 2011/12 included:
- 2 employees suspended on the grounds of suspected gross misconduct;
  - 1 employee dismissed for theft;
  - 1 employee resigning whilst under investigation;
  - 1 application to succeed a housing tenancy being refused;
  - 1 potentially illegal housing tenancy housing property being abandoned;
  - 1 potentially illegal housing property being returned to the Council for re-letting
23. The Council participates in the Audit Commission's National Fraud Initiative (NFI) a data matching exercises to identify fraud and error. We have the lead role for the Council for co-ordinating and investigating matches. During the year investigations of matches carried out resulted in savings from principally overpayments of housing benefits of £433k. This savings figure is expected to rise further during as investigations of matches are completed. Significant investigations of NFI matches included:
- 25 cases identified of housing benefit overpayment incurred by employees of the Council.
  - 2 housing benefit administration penalty sanctions being issued.

- 4 blue badges cancelled as it was found that the holders had more than one issued in the UK;

24. Proactive counter fraud work undertaken during the year included:

- Continuing the close liaison with other public sector organisations for a “partnership” approach to fighting fraud examples including the UK Borders Agency, Sussex Police, NHS Counter Fraud Service, Audit Commission, National Fraud Authority and various Local Authorities.
- Close cross council working with officers from key services to combat fraud including Adult Social Care, Housing Management and Procurement.
- Further development of INCASE Intelligence software
- Further raising fraud awareness amongst staff and Members through training and briefings.
- Updating the Council’s Counter Fraud Strategy including response to the Bribery Act requirements

25. The staff resources used in respect of counter fraud for 2011/12 was 270 days an increase from 255 days in 2010/11.

26. During 2011/12 the Local Government Fraud Strategy, ‘Fighting Fraud Locally’ was developed and published by the National Fraud Authority in April of this year. The Head of Audit and Business Risk had direct input to the development as part of an expert advisory group. The Strategy contained 59 recommended actions, many are already in place but during 2012/13 we will continue to implement those appropriate.

27. The National Fraud Authority also published the latest Annual Fraud Indicator and estimated that the loss to fraud to the UK economy per annum is £73 billion of which £2.2 billion in respect specifically of local government.

### **Council’s Annual Governance Statement**

28. Our assurance work and the Head of Audit & Business Risk’s Annual Opinion above is a key part of the council’s Annual Review of Governance Arrangements and production of the Annual Governance Statement. Key issues from audit reviews, in particular those providing limited assurance have been considered and where appropriate included in the Annual Governance Statement.

### **Corporate Support**

29. We have continued to be pragmatic in providing professional support to management through proactive advice and information. This element of our work is seen as invaluable by services, particularly in areas of change management. By taking this proactive approach, often problems and risks can be avoided. Areas included projects and programme management, HR processes, Adult social care, information governance and data quality.

### Other Direct Audit Activity

30. Other direct audit activity also includes follow-up reviews on management action to implement agreed audit recommendations. These reviews are usually carried out within six months of action agreed and issue of the final report. From follow-up reviews carried out during 2011/12, the overall level of implementation of agreed actions is 86% of which 98% relates specifically to high priority recommendations.
31. We will continue to focus our resources on high and certain medium priority audit recommendations. To monitor all agreed actions, we will be reviewing the feasibility of giving access by managers to our action management software, specifically to the action tracking module.

### Performance of Internal Audit

32. The key indicator for Internal Audit performance is achievement against the Annual Audit Plan, demonstrated earlier in this report. There are however other local performance indicators used based on professional best practices and included in the agreed Annual Internal Audit Plan and our Service Business Plan. These are monitored and reported throughout the year.

#### Summary of 2011/12 performance data

33. Performance against effectiveness targets remains positive and reflects the quality of our work. The performance against agreed targets for 2011/12 is shown in Table 3 below. For comparison purposes, 2011/12 actuals are included.

### Table 3 – Actual Performance Against Targets

#### Completion of planned audits (to final or draft report)for 2011/12

<b>Purpose of the performance indicator:</b> to ensure that Audit & Business Risk provides sufficient coverage to provide an adequate and effective internal service, to provide sufficient assurance to management on the council's control environment and meet the requirements of the Section 151 Officer and External Audit.	
<b>Target: 95%</b>	<b>Achieved: 95% (2010/11 96%)</b>

(Note: Completion of planned audits for 2011/12 is at June. It is expected that all will be finalised.)

### Turnaround times of audit reports

<b>Purpose of the performance indicator:</b> to ensure effectiveness of audit work in terms of timeliness and service delivery to clients.	
<b>Target:</b> Issue 100% of draft reports within 10 working days of completion of audit fieldwork	<b>Achieved:</b> 94% (2010/11 97%)
<b>Target:</b> Receive 100% of client responses within 15 days of issue of draft reports.	<b>Achieved:</b> 91% (2010/11 89%)
<b>Target:</b> Issue of 100% of final audit reports within 10 days of agreement with clients	<b>Achieved:</b> 89% (2010/11 94%)

### Client satisfaction levels of at least good or very good

<b>Purpose of the performance indicator:</b> to ensure Audit & Business Risk provides a sufficient level of service in terms of quality and impact through adding value as required by its clients.	
<b>Target:</b> 92% of client satisfaction responses at least good or very good.	<b>Achieved:</b> 93% (2010/11 94%)

### Reliance by External Audit on the work of Audit & Business Risk

<b>Purpose of the performance indicator:</b> to ensure the audit coverage and quality is sufficient to meet the statutory requirements of external audit, including the International Standards of Auditing and beneficial in terms of reducing external audit fees to the City Council. Reliance is reflected in low level of external audit fees for the Council.	
<b>Target:</b> Reliance	<b>Achieved:</b> Reliance (2010/11 Reliance)

### Service Benchmarking

34. Benchmarking is accepted as a key method of comparing performance with other unitary local authorities. We continued to participate in an annual benchmarking exercise carried out by the Chartered Institute of Public Finance & Accountancy (CIPFA). The information it provides is seen as invaluable in assisting us to demonstrate value against our peers

35. Information from annual exercises has demonstrated the value of our service and we have remained consistently in the upper performance quartile. The draft report for 2011/12 was recently received and contained the following key comparisons relating to service performance and costs::
- Audit cost per £1M gross turnover for the council, £680 against an average of £984;
  - Audit days per £1m gross turnover for the council 2.17 against an average of 3.4; and
  - Direct days<sup>1</sup> per auditor 182 against an average of 175.

## Service Review

36. The Accounts and Audit Regulations 2011 (R6) requires an annual review to be carried out on the effectiveness of the system Internal Audit. This was carried out as a self assessment against the CIPFA Code of Practice for Internal Audit in Local Government. The outcome of the review against the criteria (106) contained in the Code was:
- Full Compliance 101 (95%)
  - Partial Compliance 4 (4%)
  - No Compliance 0 (0%)
  - Not applicable 1 (1%)
37. The overall conclusion is that the system of internal audit remains effective.

## Service Restructure

38. During the second half of 2011/12, an internal restructure of the service was completed to reduce costs whilst changing the staff skills mix to meet future needs and challenges facing the Council. The restructure is currently being implemented.
39. The Accounts and Audit Regulations 2011 (R6) requires an annual review to be carried out on the effectiveness of Internal Audit. This is primarily against the CIPFA Code of Practice for Internal Audit in Local Government. The outcome of the review against the criteria (106) contained in the Code was:

## Service Developments

40. The following are key service developments planned for 2012/13:
- Further implementation of New Audit Management System that will increase productivity, management information (e.g. direct Audit Committee Reports) and tracking of actions from audit reviews;
  - Greater use of flexible working to increase productivity and satisfaction of staff;

<sup>1</sup> Direct days are total days available less all leave, training and administration; therefore productive time spent carrying out audit work.

- Further developing the use of analytical software tools across the council's systems to focus audit resources on high risk areas e.g. data mining and continuous auditing
- Ensure effective quality assurance processes are in place;
  
- Review of stakeholder feedback to individual audit reviews and full survey; and
- Introduce e-learning fraud awareness training across the council to promote i fraud awareness.

**Appendix B****Definitions of Internal | Audit Assurance Levels**

<b>Level of Assurance</b>	<b>Definitions</b>
<b>Full</b>	There is a sound system of control designed to achieve the system and service objectives. Compliance with the controls is considered to be good. All major risks have been identified and are managed effectively.
<b>Substantial</b>	Whilst there is a basically sound system of control (i.e. key controls), there are weaknesses, which put some of the system/service objectives at risk, and/or there is evidence that the level on non-compliance with some of the controls may put some of the system objectives at risk and result in possible loss or material error. Opportunities to strengthen control still exist.
<b>Reasonable</b>	Controls are in place and to varying degrees are complied with but there are gaps in the control process, which weaken the system and result in residual risk. There is therefore a need to introduce additional controls and/or improve compliance with existing controls to reduce the risk to the Council.
<b>Limited</b>	Weaknesses in the system of control and/or the level of compliance are such as to put the system objectives at risk. Controls are considered to be insufficient with the absence of at least one critical or key control. Failure to improve control or compliance will lead to an increased risk of loss or damage to the Council. Not all major risks are identified and/or being managed effectively.
<b>No</b>	Control is generally very weak or non-existent, leaving the system open to significant error or abuse and high level of residual risk to the Council. A high number of key risks remain unidentified and/or unmanaged.

**Definitions of Priorities for Audit Recommendations**

<b>Priority</b>	<b>Assessment</b>	<b>Timescale for Implementation</b>
<b>High</b>	<p><b>Fundamental</b> There is a <b>weakness</b> in control that represents <b>immediate</b> material risk to the City Council or a service and requires urgent attention by management.</p> <p>These issues generally merit the attention of senior management.</p>	Actions to address recommendations should in a number of cases be immediate and at least within three months.
<b>Medium</b>	<p><b>Significant</b> There is weakness in control and a <b>risk</b> of material inaccuracy/loss to the City Council or a service area and requires corrective action/attention by local management within a <b>reasonable</b> period.</p>	Should be implemented within 6 months
<b>Low</b>	<p><b>Merits Attention</b> Minor matters where there is a weakness or opportunity for improvement, which does not expose the service/system under review to any significant risk, but management should consider taking action.</p>	No set time period.

## **Terms of Reference for the provision of Internal Audit Services**

### **1. Purpose**

- 1.1 The Terms of Reference is for the provision of Internal Audit Service within Brighton & Hove City Council. It is reviewed and approved on an annual basis to ensure that current needs are met.

### **2. Role and Function**

- 2.1 Internal audit is an assurance function that primarily provides an independent and objective opinion and adds value to the council on the control environment 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. The service is delivered by Audit & Business Risk within the Finance Unit.
- 2.2 The control environment comprises the systems of governance, risk management and internal control.

### **3. Reporting Lines & Relationships**

- 3.1 Audit & Business Risk provide the council's internal audit function and are part of the Finance Unit. The Head of Audit & Business Risk reports functionally to the Chief Executive, Director of Finance (Section 151 Officer), other Strategic Directors and members of the Audit Committee. Administratively the Head of Audit & Business Risk also reports to the Director of Finance.
- 3.1 The Audit Committee is responsible for approving the Internal Audit Strategy and Annual Audit Plan. The Head of Audit & Business Risk reports regularly to the Audit Committee on progress against the Annual Audit Plan and key issues arising.

### **4. Independence and Accountability**

- 4.1 Internal Audit will remain sufficiently independent of the activities that it audits to enable auditors to perform their duties in a manner, which facilitates impartial and effective professional judgements and recommendations. Internal auditors have no operational responsibility.

- 4.2 Internal Audit is involved in the determination of its priorities in consultation with those charged with governance. Internal Audit has unrestricted access to officers, members, council records and to report in its own name.
- 4.3 The existence of an internal audit function within the council does not diminish the responsibility of management to establish systems of internal control to ensure that activities are conducted in a secure, efficient and well ordered manner.

## **5. Statutory Role**

- 5.1 Internal auditing is provided as a statutory service in the context of the Accounts & Audit Regulations 2003, as amended 2006, which states that a relevant body shall maintain an adequate and effective system of internal audit of its accounting systems and its system of internal control in accordance with the proper Internal audit practices.
- 5.2 The statutory role is recognised and endorsed within the council's Financial Regulations, which provides the authority for unlimited access to officers, Members, documents and records and to require information and explanation necessary.

## **6. Consultancy and Advisory Role**

- 6.1 Audit & Business Risk also perform a consultancy or advisory role on an ad hoc basis or as part of the Annual Audit Plan, as commissioned by management. Reports from this type of work contain findings and recommendations particularly to add value to the council's services in achieving value for money in its use of resources. Any consultancy and advisory work carried out shall not jeopardise the Internal Audit independence.

## **7. Internal Audit Standards**

- 7.1 There is a statutory requirement for Audit & Business Risk to work in accordance with the 'proper audit practices'. These are effectively the CIPFA Code of Practice for Internal Audit in Local Government that accompanies the Accounts & Audit Regulations 2003 (as amended 2006).

## **8. Internal audit Scope**

- 8.1 The scope for Audit & Business Risk is 'the control environment comprising risk management, control and governance'. This means that the scope of Audit & Business Risk includes all of the council's operations, resources, services and responsibilities in relation to associated partner organisations. The priorities for Audit & Business Risk will be determined by a process of risk assessment.

## **9 Internal Audit Skills and Resources**

- 9.1 Audit & Business Risk will ensure as far as possible that it appropriately staffed in terms of numbers, skills and experience. The Head of Audit & Business Risk is responsible for appointing of staff and will ensure these are made in order to achieve the appropriate mix of qualifications, experience and skills.
- 9.2 The Head of Audit & Business Risk is responsible for ensuring that the resources of Audit & Business Risk are sufficient to meet its responsibilities and achieve its objectives. If a situation arose whereby he concluded that resources were insufficient, he must formally report this to the Director of Finance (Section 151 Officer) and the Audit Committee.
- 9.3 Where necessary to provide an adequate, effective and professional service the Head of Audit & Business Risk will outsource internal audit work to supplement internal resources but will ensure quality is not compromised.
- 9.4 If Internal auditors are appointed from operational roles elsewhere within the council, they do not undertake an audit in that area directly within one year unless by prior agreement.
- 9.5 In line with the CIPFA Statement on the Role of the Head of Internal Audit (2010), the Head of Audit & Business Risk is a professional qualified CIPFA Accountant. In addition there is a high mix of professionally qualified staff throughout the Internal Audit Team to meet delivery requirements of the service.

## **10. Fraud and Corruption**

- 10.1 Managing the risk of fraud and corruption is the responsibility of management. Internal audit reviews alone, even when performed with due professional care, cannot guarantee that fraud or corruption will be detected. Audit & Business Risk will, however be alert in all their work to risks and exposures that could allow fraud or corruption.
- 10.2 The Head of Audit & Business Risk has lead responsibility for corporate counter fraud activities including proactive initiatives, maintaining and developing an effective framework, and advising management.

## 11. Reporting Accountabilities

- 11.1 The majority of audit reviews include a formal audit report being produced and issued to management. The primary purpose of the audit report is:
- To provide an opinion on the effectiveness of the control framework operating for the mitigation of risks;
  - To make practical audit recommendations and agree management actions;
  - To prompt management action to implement audit recommendations for change leading to improvements in control and where applicable value for money and performance and;
  - To provide a formal record of points arising from an audit review and agreement with management.
- 11.2 Management are expected to implement all agreed recommendations within a reasonable timeframe. Each internal audit will be followed up normally within six months of issue, in order to ascertain whether agreed actions have been implemented effectively.
- 11.3 The Head of Audit & Business Risk reports regularly to the Audit Committee on progress made against the Annual Audit Plan and the summarised outcomes of individual audits.
- 11.4 The Head of Audit & Business Risk provides an Annual Internal Audit Report to the Audit Committee that includes an opinion on the adequacy and effectiveness of the control environment.

## 12. Responsibilities

- 12.1 In meeting its responsibilities, the activities of Audit & Business Risk will be conducted in accordance with the council's objectives, established policies and procedures. In addition, internal auditors comply with the Code of Practice for Internal Audit in Local Government (CIPFA).
- 12.2 Audit & Business Risk will co-ordinate effectively with the Audit Commission (as the council's appointed external auditors) for optimal audit coverage and to ensure that appropriate reliance can be placed on internal audit work.
- 12.3 Audit & Business Risk will work the internal audit functions of the council's partner organisations to ensure the robustness of controls and risk management arrangements, to protect the council's interests.

