

Decision Maker: **Audit Sub Committee**

Date: **6th June 2012**

Decision Type: Non-Urgent Non-Executive Non-Key

Title: **ANNUAL AUDIT REPORT**

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Ward: All

1. Reason for report

The annual report is for Member information and is also intended to assist the Council in meeting the accountability requirements of the Accounts and Audit Regulations. Part of the overall arrangements requires the Chief Executive and the Leader to sign an annual governance statement. This will be put before Members alongside the statutory accounts. Included in this report are highlights of the performance of the Internal Audit function, a summary of the audits undertaken and an opinion on the overall adequacy and effectiveness of the organisation's internal control environment based on this work and the Annual Governance Statement. Members should note that the schools are now included within this report but that there is an annual fraud report elsewhere on this agenda.

2. **RECOMMENDATION(S)**

Members are asked to note the report and approve the Draft Annual Governance Statement.

Corporate Policy

1. Policy Status: Existing Policy:
 2. BBB Priority: Excellent Council:
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Financial

1. Cost of proposal: Not Applicable:
 2. Ongoing costs: Recurring Cost:
 3. Budget head/performance centre: Internal Audit
 4. Total current budget for this head: £533K including £250K net benefit fraud partnership costs
 5. Source of funding: Not applicable
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Staff

1. Number of staff (current and additional): 7FTE (including 2 FTEs on sold services)
 2. If from existing staff resources, number of staff hours: 190 days per quarter
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Legal

1. Legal Requirement: Statutory Requirement Accounts and Audit Regulations 2011
 2. Call-in: Not Applicable:
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Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 160 including Chief Officers, Head Teachers and Governors
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Ward Councillor Views

1. Have Ward Councillors been asked for comments? Not Applicable
2. Summary of Ward Councillors comments: None

3. COMMENTARY

- 3.1. The annual report is for Member information and is also intended to assist the Council in meeting the accountability requirements of the Accounts and Audit Regulations 2011. Part of the overall arrangements requires the Chief Executive and the Leader to sign an annual governance statement. This will be put before Members as part of the statutory accounts. Included in this report are highlights of the performance and achievements of the Internal Audit Division, a summary of the audits undertaken and associated opinions along with a statement on the overall adequacy and effectiveness of the organisation's internal control environment based on this work.
- 3.1 Internal Audit's main objective remains as ' assisting management and Members in minimising risks, maintaining high standards and continuously improving service delivery through independent appraisal, review and advice.' We have carried this out in 2011/12 by;
- **independently reviewing, appraising and providing assurance** on the systems of control throughout the Authority
 - ascertaining the **extent of compliance** with procedures, policies, regulations and legislation
 - facilitating good practice in **managing risks**
 - **working in partnership** with the external auditors and other external providers
 - **identifying fraud** and carrying out investigations
 - **running mandatory training sessions for** officers in financial regulations, contract procedure rules and fraud awareness.
- 3.2. Key aspects of our reviews looked at the controls in place and assess these and the associated risks if these controls are not in place or are not being fully followed. Essentially internal audit has ensured that the controls operate in an orderly and efficient manner, statutory and management requirements are complied with, assets are safeguarded, completeness and accuracy of records are secured and identified weaknesses are corrected when something has gone wrong. We have also considered the balance of controls against the cost of implementation and where the controls are regarded as over burdensome this will be acknowledged.
- 3.2 The purpose of the 2011/12 Internal Audit Plan was to:
- Optimise the use of audit resources available, given that these are significantly limited
 - Identify the key risks facing the Council in achieving its objectives and determine the corresponding level of audit resources
 - Ensure effective audit coverage and a mechanism to provide Members, and senior managers with an overall opinion on the auditable areas and the overall control environment
 - Add value and support senior management in providing effective control and identifying opportunities for improvement
 - Support the Finance Director in fulfilling obligations as the Council's nominated Section 151 Officer
 - Deliver an internal audit service that meets the requirements of the Accounts & Audit Regulations and the Code of Practice.
 - Carry out major investigative work and adopt the lessons learnt by utilising these in other audits particularly in relation to cumulative spend.
- 3.3. Internal Audit has striven to satisfy our customers through our business processes which make sure we have set challenging targets and standards for all audit staff through agreed objectives. We review and appraise the achievement of these objectives throughout the year.

The overriding theme is the annual audit planning and work programme agreed each year. Although our aim has been to complete the 2011/12 plan, this has been subject to adjustment for unexpected levels of unplanned activity including fraud and investigative work and a shortfall in staffing resources. Internal Audit resources in 2012/13 will be significantly reduced as we now only have 4 FTE's plus an element of the Head of Audit time to service the Bromley plan.

- 3.4. Internal Audit work and outputs have been reviewed by External Audit who are able to conclude that Internal Audit were providing a satisfactory service and were able to place reliance on our work.
- 3.5. Internal Audit have completed the high risk audit reviews scheduled in 2011/12 and received positive feedback from the client departments with an overall average of over 4.2 out of 5 for the audit satisfaction surveys. Overall after allowing for a number of audits that were either postponed or cancelled due to management requests/ organisational change, we have completed 90% of the plan against the annual performance indicator requirement of 90%. This has been achieved despite the partial reduction in staff resources in 2011/12 and the substantial number of days spent on fraud and investigations. We have had no issues with audits being completed within budgeted time.
- 3.6. The performance indicator requires that 95% of the audits should be completed within two months of commencement of fieldwork whereas we have achieved in the region of 83%. There are reasons for this previously reported to this committee – waiting for information, auditee availability, work load of the auditor, findings within the audit. Following the reorganisation of Internal Audit and change in management arrangements we are reviewing aspects such as scoping of the audits, availability of the auditees and portfolio of work allocated to auditors.

3.7. **Audit activity**

Please refer to Appendix 2

Audit Activity key points in 2011/12

Planned audits- please refer to appendix 2 for audits carried out in 2011/12. This constitutes our main area of activity.

Risk Management – The risk registers play a key part in the Annual Governance process both corporate and departmental risk registers are maintained. The risks are reported through to the Audit Sub committee and the corporate risks are reported through to the Risk Management group and senior management.

Customer Service – We have received good customer feedback achieving an average score of over 4.2 out of 5 in our audit surveys.

Planning - A key part of the audit planning process was consultation with senior officers, referral to previous audit reports and use of a risk methodology assessment form.

Sold Services – the partnership with L B Greenwich for benefit fraud has continued to be highly effective both prosecuting and acting as a deterrent to public sector fraud. In addition the partnership has been extended to include some corporate anti fraud work on a needs basis. In 2011/12 we carried out 15 audits for LB Greenwich that generated £75K income. In 2011-12 we also carried out a number of responsible officer roles at academies that had generated about £7k but with 12 academies now using our services this will increase to about £19k in 2012/13.

Partnership Working – we continue to achieve closer links with other local authorities and public bodies to ensure our ability to work collaboratively. We also work with the London Audit Group and Kent Audit Group on developmental and training activities and have productive working relationships with the external auditor which helps to reduce the audit fee as they are able to place reliance on our work.

Benefits Delivered

Effective Control – our work continues to be instrumental in ensuring the Council has high standards of control and probity.

Risk Management – the Council has a robust framework for identification and management of risks, reducing likelihood of failure of service delivery.

Recommendations for Improvement-Agreed actions for improvement are recognised and implemented. All priority one recommendations are reported to Members and followed up.

Advice- professional advice is given on new initiatives and ways of working. We have installed updated financial regulations and procedures as part of the managers’ toolkit, undertaken training and awareness courses and had the revised Code of Corporate Governance adopted by the Council.

Assurances-assurance provided to management by internal audit reviews. We also play a lead role in producing and coordinating the statutory Annual Governance statement.

Efficiencies- our review activity enables us to offer advice to managers regarding opportunities to improve efficiency, examples include, data matching opportunities, identifying overpayments, identifying duplication and potential for better use of technology

Audit Efficiency – we will continue to streamline our own processes, for example, continue to use electronic working papers, also rolling out self assessment for schools and use the functionality of the integrated database capturing audit and risk issues

Fraud and Investigations- we have provided substantial input into investigations into fraud and malpractice totalling 295 days.

Internal audit has provided 1,453 audit days including fraud and sold services (1,301 days for 2010-11 that excludes fraud and sold services) to the departments through reviews, investigations and financial support and advice. As well as mainstream audit activity internal audit has spent time on investigating fraud and irregularities, managing the fraud partnership, giving advice and guidance, development of the financial regulations that is elsewhere on this agenda and updated the anti fraud and corruption protocol, attendance at departmental and corporate working groups, representing the Council at external meetings, servicing this committee, and leading and participating in data matching exercises including the National Fraud Initiative.

Summary of Audit Days provided to the departments.

	2010-11	2012-13
Departments	Audit days	Audit days
Corporate Services	458	435
Children and Young People	493	261
Adult and Community services	198	82
Environment	60	133
Recreation and Renewal	92	128
Fraud Work		144
Academies- sold services		32
RB Greenwich –sold services		238
	1,301	1,453

It should be noted that the departmental figures include 151 days spent on three major investigations.

- 3.8. All audits arising from the approved plan have resulted in a formal report to management. Each audit has agreed terms of reference and is conducted according to the CIPFA audit code of practice and Bromley's standard audit documentation guidance. All final reports are agreed with the client prior to release and are followed up systematically in the following financial year unless there are priority one recommendations which are followed up within six months. In addition, all audit reports include an opinion based on our findings.
- 3.9. Throughout the year Internal Audit have reported all priority one recommendations i.e. those that are significant and require urgent management attention. These reports are contained in the respective progress reports. The reason for the specific summary reports to Members are that all of these reports contain a recommendation which Internal Audit believe to be a risk to the service, system, function or establishment which needs to be addressed. The level of priority ones and the nature of any fundamental areas of weakness will determine the overall opinion given.
- 3.10. Over 2011/12 we issued 21 priority one recommendations –however 17 were in relation to two major investigations – one reported in the last cycle of this committee and the Executive with the other reported in part 2 of this agenda. Outside of these investigations there were 4 priority one recommendations raised in Student Exemptions (now implemented), Malware Security (now implemented), Pupil Referral Unit (currently being followed up), and Parking-Penalty Charge Notices (that appears elsewhere on this agenda). In addition there are still three P1s that have been brought forward from last year carried forward to this year (recovery of general debts; and rent accounts both of which were put back due the transfer of these sections to Liberata; and out of hours security that will be followed up in early 2012/13). The priority one list is attached to the Progress Report elsewhere on this agenda. All other priority ones brought forward from 2010/11 have been implemented- 1 in direct payments on monitoring, 1 in parking income on reconciliations, 2 at schools- salary overpayments and a lease matter, 1 in IT –disaster recovery, and 2 on the Children Centre investigation. See appendix 1 for a summary of P1 activity.
- 3.11. As a result of the Internal Audit work and in consultation with management, auditors form an overall opinion on the extent that actual controls in existence provide reasonable assurance that significant risks are being managed. They grade the control system accordingly. Full assurance is rare regarding internal control systems, because no matter how sophisticated they are, it will not be possible to prevent or detect all errors or irregularities. The opinions given are graded accordingly in the table below.

Assurance Level	Definition
Full Assurance	There is a sound system of control designed to achieve all the objectives tested.
Substantial Assurance	While there is a basically sound system and procedures in place, there are weaknesses, which put some of these objectives at risk. It is possible to give substantial assurance even in circumstances where there may be a priority one recommendation that is not considered to be a fundamental control system weakness. Fundamental control systems are considered to be crucial to the overall integrity of the system under review. Examples would include no regular bank reconciliation, non-compliance with legislation, substantial lack of documentation to support expenditure, inaccurate and untimely reporting to management, material income losses and material inaccurate data collection or recording.
Limited Assurance	Weaknesses in the system of controls and procedures are such as to put the objectives at risk. This opinion is given in circumstances where there are priority one recommendations considered to be fundamental control system weaknesses and/or several priority two recommendations relating to control and procedural weaknesses.
No Assurance	Control is generally weak leaving the systems and procedures open to significant error or abuse. There will be a number of fundamental control weaknesses highlighted.

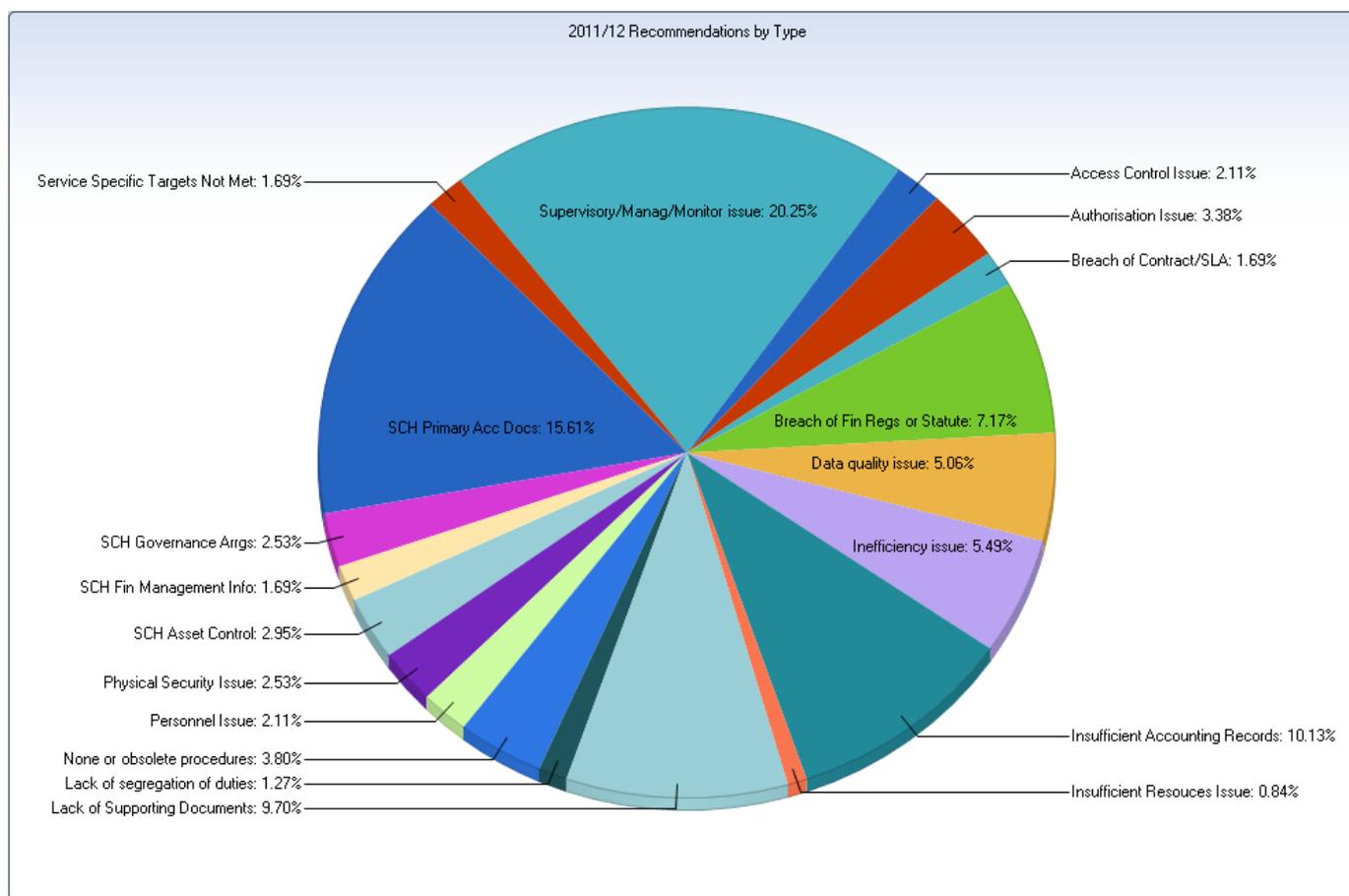
- 3.12. Where Internal Audit have provided no assurance or there has been a significant number of priority one recommendations, based on the review and testing undertaken, a full management response has been presented at the Audit Sub Committee. In addition responsible officers are called to account for the reasons for the weaknesses and giving Members assurance of their management actions agreed with Internal Audit. These actions are then followed up and reported within a six month timescale. It has been agreed that responsible officers will be required to attend the meetings where satisfactory action has not been taken.
- 3.13. Over the past year there have been three major investigations all reported to this committee. One of these was substantially completed in 2011/12- Children and Family centres with the other two in this financial year. These investigations have taken a considerable amount of time some 151 days in 2011/12 and have resulted in lessons learnt in relation to officer awareness of financial regulations and the contract procedure rules particularly cumulative spend data. As a result Internal Audit and Procurement have run mandatory training sessions on financial regulations and contract procedure rules with over 200 officers attending these sessions to date.
- 3.14. A listing of completed audits is given in appendix 2. The opinion details are given for each audit. Recommendations have been made in all reports and these are normally categorised as areas requiring immediate management attention as priority one, those that do not represent good practice as a priority two or finally suggestions for improvement at a priority three.
- 3.15. The summary of audit work undertaken resulted in 139 reports including 74 schools. Of these 50 were classified with substantial assurance, 14 with limited assurances and 1 nil assurance issued in the year. The remainder were follow up reports, investigation reports, pre academy school closure audits and work in progress audits where we do not give an opinion. Overall 274 improvement recommendations have been made in the year comprising of 21 priority ones, 216 priority twos and 37 priority threes. 85 recommendations are in respect of schools.
- 3.16. **Schools**
- 3.17. For the first time we have included schools activity within the annual report. Previously we submitted a separate annual schools report but with our scaled down activity at schools due to schools converting to academies, staffing reductions and the abolition of FMSiS a separate schools report is not warranted.
- 3.18. The internal audit coverage of Bromley's primary, secondary and special schools during 2011/12 has included a range of reviews including full school audits, follow-up reviews to assess implementation of recommendations previously made and closure audits, where schools have gained Academy status.
- 3.19. The internal audit plan for 2011/12 included internal audit reviews of 22 primary schools, 2 secondary schools and 3 special schools. Follow-up audits were carried out at 24 schools. Closure audits were carried out at 23 schools to ensure that there were no probity issues and that a transfer agreement was in place.
- 3.20. The internal audit programme reviewed controls around processes categorised as Governance Arrangements, Financial Management Information, Primary Accounting Documentation (the tests in this area include, payments, income, payroll and school meals) and Assets. We have used self assessment methodology combined with some audit testing to audit some of the primary schools. This process has proved to be a success and will be rolled forward as it not only saves on audit days but also involves input from the schools.

- 3.21. Internal audit have proactively sold services to Academies and during 2011/12 have been appointed to the role of Responsible Officer at a total of 11 schools (4 secondary and 7 primaries). We have also been asked to carry out a review of the Teacher Pension return at one Secondary school and also to carry out an internal audit at one primary school.
- 3.22. Since the abolition of the Financial Management Standard in Schools (FMSiS) the Department for Education have introduced a School Financial Value Standard (SFVS) and all Bromley schools are required to complete this by March 2013. There is no requirement for external assessment although the return should be used to inform internal audit coverage for 2013/14.
- 3.23. **Classification of recommendations**
- Typical control issues highlighted in the audit reports fall under the following broad categories;
- Organisational – the controls that provide the framework under which the system of other controls can operate effectively and efficiently.
 - Financial – the system of controls that ensures the accuracy and adequacy of financial records and also safeguards the organisation against possible financial loss due to fraud or error.
 - Operational – the system of controls that ensures the efficiency and effectiveness of operations, ensures the organisation’s objectives are met (and services delivered) and also safeguards the organisation against any reputational damage or other loss.
 - Compliance controls – the system of controls that ensure that the organisation complies with all relevant legislation, best practice guidance and internal policies with respect to the conduct of the business.
- 3.24. The classification of recommendations is shown in detail under paragraph 3.31.
- 3.25. **Annual Governance Statement-** See appendix 3
- 3.26. The system of internal control is designed to manage risk to a reasonable level rather than to eliminate risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process which is designed to identify and prioritise the risks to the achievement of Bromley’s policies, aims and objectives. It also evaluates the likelihood of those risks being realised and the impact should they be realised as well as managing them efficiently, effectively and economically. The results of 2010/11 demonstrated that the top three headings were lack of supporting documents, supervisory issues, lack of or obsolete procedures and insufficient accounting records. The main issues in 2011/12 have been lack of supporting documents, supervisory issues and insufficient accounting records. The severity of each of these needs to be seen in the context of whether it was a priority one, two or three recommendation or not but it does give a broad picture of where improvements can be made
- 3.27. The scope of internal control spans the whole range of the Council’s activities, encompassing policies, processes, tasks, behaviours and other aspects of the organisation. It is the means devised by management to promote, direct, restrain and check upon its various activities to ensure the Council is competently managed and its business is undertaken in an orderly manner in accordance with its objectives and policies. Each Chief Officer reviews the effectiveness of the system of internal control and risk management processes based on a list of key controls expected to be in place. Where measures are required to enhance the adequacy of existing internal controls actions are agreed. Because of the emphasis on risk

within this process the individual departmental statements have been co-ordinated by the Risk Management Group that meets approximately every two months.

- 3.28. In conclusion, my overall opinion on the control environment based on the internal testing and reviews undertaken is that I am able to place overall reliance on the internal controls identified and where there have been significant issues highlighted provide assurance that corrective management action has been or will be taken to mitigate the risks. Over the past year there have been investigations that highlighted a number of weakness but specifically in officers' understanding of financial regulations and contract procedure rules. These are being addressed by mandatory training of any officers involved in the finances of this authority. I can confirm that action plans have been agreed for all areas of identified weakness and Internal Audit will continue to apply close scrutiny to ensure that all current priority control weaknesses are addressed by management. This assurance process constitutes part of the Annual Governance Statement which is attached to this report.
- 3.29. In summary the process used for determining the annual governance statement follows proper practice as guided by CIPFA and is a combination of assurances derived from;
- The adequacy and effectiveness of the management review processes
 - Outcomes from the formal risk assessment and evaluation (risk register)
 - Relevant self-assessments of key service areas within the directorate
 - Relevant internal audit reports and results of follow ups regarding implementation of recommendations
 - Outcomes from reviews of services by other bodies including Inspectorates, external auditors etc.
- 3.30. The Annual Governance Statement is attached as Appendix 3.

3.31. These control issues led to recommendations that were broadly categorised as follows:



Recommendation Category	% of all recommendations		
	2009-10	2010-11	2011-12
Access Control Issue	1%	1%	2%
Authorisation Issue	3%	4%	3%
Breach of Contract/SLA	1%	4%	2%
Breach of Financial Regulations or Procedures	13%	6%	7%
Data quality issue	4%	5%	5%
Inefficiency issue	4%	5%	5%
Insufficient Accounting Records	11%	12%	10%
Insufficient Resources Issue	1%	2%	1%
Lack of segregation of duties	1%	1%	1%
Lack of Supporting Documents	24%	20%	10%
None or obsolete procedures	13%	14%	4%
Personnel Issue	1%	2%	2%
Physical Security Issue	2%	4%	3%
Supervisory/Monitor issue	21%	19%	20%
Service Specific Targets not met	N/A	1%	2%
SCH Asset Control	N/A	N/A	3%
SCH Fin Management Info	N/A	N/A	2%
SCH Governance Arrangements	N/A	N/A	3%
SCH Primary Acc Docs	N/A	N/A	16%

4. POLICY IMPLICATIONS

None

5. FINANCIAL IMPLICATIONS

Some of the internal audit findings may have financial implications.

6. LEGAL IMPLICATIONS

Internal Audit is a statutory function under the requirements of the Accounts and Audit Regulations 2011.

7. PERSONNEL IMPLICATIONS

None

Non-Applicable Sections:	[List non-applicable sections here]
Background Documents: (Access via Contact Officer)	[Title of document and date]