

BABERGH DISTRICT COUNCIL

FROM: Director of Finance

REPORT NUMBER: **K144**

TO: OVERVIEW AND SCRUTINY
(STEWARDSHIP) COMMITTEE

DATE OF MEETING: 16 November 2010

INTERIM INTERNAL AUDIT AND FRAUD REPORT 2010/11

1. PURPOSE OF REPORT

- 1.1 The purpose of this report is to inform Members of the work undertaken by the Internal Audit and Fraud Team for the period 1st April to 30th September 2010. It also provides the results from Internal Audit reviews completed for the year.
- 1.2 All reports issued for the first six months were assessed as 'Effective' (paragraph 6.11 provides a definition of each audit opinion).

2. RECOMMENDATIONS

- 2.1 That the content of the Interim Internal Audit and Fraud Team report for 2010/11 be noted and endorsed.

The Committee is able to resolve this matter

3. FINANCIAL IMPLICATIONS

- 3.1 The Internal Audit Plan for 2010/11 will be delivered with expected savings being achieved in 2010/11.

4. RISK MANAGEMENT

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

Risk Description	Likelihood	Seriousness or 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.

Risk Description	Likelihood	Seriousness or Impact	Mitigation Measures
This risk is further compounded with the need to increase savings and staff reductions.			External Audit reviews the work of the section and internal control arrangements.

5. **EQUALITY AND DIVERSITY IMPACT**

5.1 There are no equalities implications arising from this report.

6. **KEY INFORMATION**

6.1 The Accounts and Audit Regulations 2003 (as amended by the Accounts and Audit Regulations (Amendment) (England) Regulations 2006), require every local authority to maintain an adequate and effective system of internal audit. Under Standard 10 – Reporting, that in addition to the annual report, the Head of Internal Audit should make arrangements for interim reporting to the organisation in the course of the year.

6.2 This Committee has a responsibility for reviewing the Council's corporate governance arrangements, including internal control and recommending to the Strategy Committee the approval of the Annual Governance Statement. The work carried out by Internal Audit is a key source of assurance that the internal control environment is operating effectively.

6.3 Management is responsible for the systems of internal control within the Council and should have in place policies and procedures to help ensure that systems function correctly.

6.4 The audits contained in the Internal Audit Plan 2010/11 are based on an assessment of risk for each system or operational area. The assessment of risk includes elements such as the level of corporate importance, materiality, service delivery/importance and sensitivity.

6.5 A written report to management is provided at the completion of each audit review, containing a summary, findings, suggested actions and risk exposure, for management agreement and commitment to take necessary actions.

6.6 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.

6.7 It is important that this Committee challenge, in their role as the Audit Committee, the work and any progress reports undertaken by the Internal Audit and Fraud Team, and also consider whether there are any areas where the Committee may want specific feedback on.

REVIEW OF THE WORK UNDERTAKEN BY THE INTERNAL AUDIT AND FRAUD TEAM FOR THE PERIOD 1ST APRIL TO 30TH SEPTEMBER 2010

Internal Audit work

- 6.8 An overview of the work of Internal Audit for the first six months is set out in Appendix A.
- 6.9 A number of audits are currently work in progress. Several of these are near completion and are currently undergoing internal and report clearance quality review processes. These are listed under point 1.3 of Appendix A. The results of these audits will be included within the Annual Audit Report to this Committee next year.
- 6.10 All reports issued in the first half of the year have been assessed as ‘Effective’. Paragraph 6.11 below details the audit opinions and their definitions.
- 6.11 As a result of questions and scrutiny by Members, following the presentation of the Annual Internal Audit Report 2009/10 in May 2010, the audit opinions and corresponding definitions have been reviewed and changed to provide greater clarity and meaning. The audit opinions and definitions have been aligned with those used by Suffolk County Council and Mid Suffolk District Council. The table below shows the previous and new audit opinions and definitions:

Previous Audit Opinions		Revised Audit Opinions	
Opinion	Definition	Opinion	Definition
High Standard	Full assurance can be given that there is a sound system of internal control and that controls are being consistently applied in all the areas reviewed.	High Standard	Evidence of consistent and effective control framework.
Acceptable	Significant assurance can be given that there is a generally sound system of internal control, and that controls are generally being applied consistently. However, there is weakness in the design and/or inconsistent application of control.	Effective	Controls and procedures operate effectively in most cases but show some non-compliance.
Not Fully Acceptable	Limited assurance can be given as there are weaknesses in the design, and/or inconsistent application of control.	Ineffective	Controls in place are not being consistently applied – improvements are required.

Previous Audit Opinions		Revised Audit Opinions	
Opinion	Definition	Opinion	Definition
Poor	No assurance can be given as there are weaknesses in control, and/or consistent non-compliance with controls, in the areas reviewed.	Poor	General control framework is weak.

Corporate Work including Advice and Assistance

6.12 Internal Audit continues to be actively involved in the Council's corporate work. During the first six months this aspect of the section's work has included the following:

- Prior to its abolition, significant involvement in gathering information and liaising with various staff regarding the Audit Commission's Use of Resources annual self assessment. External Audit reported in their Annual Governance Report 2009/10 that their work, to the date when the removal of the scoring of judgements was announced, recognised that the Council had made significant improvements in the year across a range of activities.
- Internal Audit drafted the Annual Governance Statement (AGS) that was presented to this Committee on 23rd June 2010 (Paper K41). To support the production of the AGS, Internal Audit carried out a detailed review of the assurance framework. The production of the AGS is a significant piece of work and was well received by both officers and by PKF, the Council's external auditors. Again, as in previous years, the message to be taken from the work undertaken on the AGS is that Babergh's governance arrangements are fundamentally sound.
- Attendance at Management Team meetings to brief senior managers in relation to the outcomes of work undertaken by the section where corporate issues are covered, e.g. Risk Management.
- Continuing to receive requests for advice and information across the Council. Areas include Housing Services – financial options to encourage tenants to complete their Housing Survey and advice around Procurement and Contract Procedure Rules. These examples demonstrate Internal Audit as a valuable part of the Council's team.

Work undertaken by the Fraud Team

6.13 In March 2010, this Committee were presented with a report (Paper J204) outlining the arrangements in place within the Council to ensure that there is a proactive corporate approach to preventing fraud and corruption, and creating a culture where fraud and corruption will not be tolerated.

6.14 The report recommended that this Committee receives an annual report on the progress and actions taken to manage the risk of fraud and corruption.

6.15 Below is a flavour of the work that has been undertaken in the first six months, which will be reported in full next year:

- Work is continuing on raising fraud awareness across the Council, e.g.
 - Issue of the second (autumn) edition of a bi-annual fraud awareness newsletter has been published to staff and Members. It has been designed to highlight areas of fraud and corruption in the workplace and to help staff and Members understand why we need to combat it effectively.
 - Alerting relevant staff of fraud bulletins and ensuring the Council's internal controls are adequate.
 - Issue of an anti-fraud and corruption survey to staff to gauge and measure awareness. Once results are received remedial action to be taken where gaps in awareness are identified.
- Completion of national fraud and corruption surveys.
- Continuation of the National Fraud Initiative (NFI) work, a national data matching exercise carried out by the Audit Commission, matching information nationally from public service databases.
- The following table is a break down of the benefit fraud cases for the first six months of the year together with the full year results for 2009/10:

CATEGORY	NUMBER	
	2009/10	Apr – Sept 2010
Total number of referrals received within the year. (All referrals are checked for relevance and a decision is made whether they are accepted as an investigation by BDC Audit & Fraud Investigation Team, referred to DWP investigators to investigate (where DWP benefit is a passport benefit to HB/CTB), referred to other LA's to investigate, referred to Benefits Admin to make enquiries, closed as information is incorrect/out of date/not relevant.	*545	*264
Number accepted for action by BDC Audit & Fraud Investigation Team.	264	131
Number of investigation cases completed by BDC Audit & Fraud Investigation Team.	234	139
Number of ongoing investigations.	62	60
Number of cautions administrated.	43	11

CATEGORY	NUMBER	
	2009/10	Apr – Sept 2010
(A caution is a written acceptance by the offender that they have committed the offence(s)-Conditions apply as to when they are offered as an alternative to prosecution).		
Number of administrative penalties accepted. (An Administrative Penalty is a fixed 30% fine based on the value of the overpaid benefits that has to be accepted in writing by the claimant-Conditions apply as to when they are offered as an alternative to prosecution).	3	2
Number of successful prosecutions. (Prosecution of an offender in a court of law: lower level cases usually heard in Magistrates Courts. Higher level, more complex and/or where the alleged offender elects to plead not guilty, these cases go to Crown Courts).	19	8

* Does not include NFI referrals.

- As a result of its work up to 30th September 2010, the Audit & Fraud Investigation Team had:
 - Identified over £106k (excluding NFI output) paid out in fraudulent or claimant error benefit claims (2009/10 over £148K);
 - Earned potential government subsidy totalling over £42k as a result of the Council's identification of these overpayments (2009/10 over £59k);
- Based on what has been achieved so far it is anticipated that prosecution recommendations at year end will exceed that of 2009/10 by a minimum of 50% (19 in 2009 to 29+ 2010/11). Currently 13 awaiting court actions in October/November 2010. It is anticipated that there will be more recommendations by year end and that subsequently the number of alternative sanctions (particularly cautions) will therefore reduce.

- During 2010/11 the number of cases that have been identified with larger overpayments and/or more elements of fraudulent behaviours have increased. This has resulted in a higher number of more complex cases being investigated by the Audit & Fraud Investigation Team (higher levels of prosecution cases and lower levels of alternative sanctions, such as cautions administrated, reported so far, this trend is appearing to continue through to year end and beyond) and subsequently referred for prosecution in line with the council's existing policies by the Council's legal department than last year. Ongoing review of investigative resources by the team leader has prioritised the higher level cases for work and the best use of the resources available.
- Evaluation of the Council's position now and going forward in the context of this work, alongside other matters relating to fraud, theft and corruption will require further decisions as to priorities and direction (strategies and policy). There are implications for BDC in respect of levels of work and resources required for the Audit & Fraud Investigation Team and the legal department, alongside potential increases in legal costs in taking forward more prosecutions and more complex cases to the courts, as opposed to offering alternative sanctions to prosecutions.
- In addition to this there are outline plans from the new Government to completely change the structures of HB/CTB and this will impact on the future work, location and resources of the Audit & Fraud Investigation Team. Matters are currently ongoing and a lot more detail is expected before April 2011. Decisions will need to be made during this period as to the way forward for Benefit Fraud and the other Counter Fraud/Corporate Fraud work carried out by the Audit & Fraud Investigation Team.
- Other than HB/CTB fraud and fraud identified through the National Fraud Initiative there were no other alleged irregularities reported to Internal Audit.

PERFORMANCE

Utilisation of Internal Audit Time

- 6.16 All of the Internal Audit team's resources are now procured from Suffolk County Council (SCC) through the joint working agreement. The arrangement with SCC allows greater flexibility of staff and potential to use the County's audit management software, Galileo. This is producing savings compared to the establishment budget. As noted earlier in this report, there have been, and continue to be, increasing demands placed on the section with regard to corporate work e.g. Corporate Governance and Risk Management.
- 6.17 Taking into account expected future progress against the Audit Plan, Internal Audit consider they will be able, as last year, to deliver a reliable audit opinion on the effectiveness of internal controls to this Committee in their Annual Internal Audit Report.

Partnership Working

Suffolk Working Audit Partnership (SWAP)

- 6.18 Internal Audit continues to actively support and contribute to the SWAP. The 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, primarily through an extranet facility.
- 6.19 In addition, a 'Skills Inventory' and 'Centres of Excellence' are being developed. The 'Skills Inventory' will enable audit staff to contact another fellow auditor who has knowledge and experience in a particular area to talk about an audit and inform their terms of reference. The 'Centres of Excellence' are designed to identify and develop areas of specialist audit knowledge to enable auditors to provide assistance to other authorities. This will include collating and interpreting new legislation and guidance and proactively informing others of the impact, attending and delivering training where appropriate.
- 6.20 The partnership identifies common training needs and initiates joint training where necessary.

Shared Services

- 6.21 Internal Audit have been identified as one of the services that could be delivered more effectively across all Councils through a shared approach. In order to move this forward a Suffolk Internal Audit Partnership Board has been established. The Board Members meet on a regular basis and provide progress reports to the Suffolk Chief Financial Officers. Discussions are ongoing with Mid Suffolk and other Suffolk Councils to identify opportunities and options for a future joint internal audit service.
- 6.22 Babergh, Ipswich and Mid Suffolk Councils have agreed a Business Case to join their Revenues and Benefits teams with the aim of having a newly established shared service operational and delivering savings from April onwards next year. All support services including Internal Audit will be provided by the 'host' authority, i.e. Ipswich Borough Council. The Audit Plan for 2010/11 will need to be adjusted to reflect the split in work and the assurances that will be required over the control environment from the 'host' authority.
- 6.23 Benefit Fraud, including corporate fraud (as yet to be defined), is included in the agreed proposals. This area of work currently sits under Internal Audit. The level and coverage of work will need to be agreed in the event that the Benefit Fraud team, including the corporate fraud element, move into the Shared Revenues Partnership or any other partnership.

CURRENT AND FUTURE DEVELOPMENTS

- 6.24 As reported to this Committee in June 2010 (Paper K41) a revised Local Code of Corporate Governance will be reported to Members in January 2011 to bring it up to date with the recent Chartered Institute of Public Finance and Accountancy's "Statement on the Role of the Chief Financial Officer in Public Service Organisations".

6.25 With the abolition of the Comprehensive Area Assessment and the Audit Commission, the Local Government Group has set out its proposals, via a consultation paper, for a system of self improvement for councils. The consultation paper proposes a new approach that puts assessment and improvement in the hands of councils, individually and collectively. Internal Audit will need to keep abreast of these events as they will be ideally placed to provide an independent assurance to management.

7. **APPENDICES**

Appendix A – Summary of Internal Audit reports issued as at 30th September 2010.

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SUMMARY OF INTERNAL AUDIT REPORTS ISSUED AS AT 30TH SEPTEMBER 2010

1. Introduction

- 1.1 The following sections contain a brief summary of the contents of the internal audit reports issued during the first half of the financial year. Each summary provides the auditors opinion, associated risks and key messages arising from the reviews. A key to these opinions, with their definitions, can be found at the end of this Appendix, Section 2.
- 1.2 It should be noted that a significant amount of work on other areas has also been undertaken during the period which does not reflect in the issue of an audit report, including corporate and risk management work as outlined in the body of this committee report.
- 1.3 It should be noted that work on a number of other audits is substantially complete and are currently undergoing an internal quality review. These reports, listed below, will be summarised within the Annual Internal Audit Report to this Committee next year.
 - Treasury Management
 - Income Collection/Cash & Bank
 - Housing Rents
 - Payables/Creditors
 - Receivables/Debtors
 - Information Technology

AUDIT	PURPOSE OF AUDIT	RISK(S)	SUMMARY OF KEY FINDINGS	AUDIT OPINION
Main Financial Systems				
Local Taxation	The objective of the audit is to ensure that the Local Taxation system operates in an efficient and effective manner. The audit reviewed the key internal controls within the system to ensure that the risk of financial loss to the Council is minimised and that legal requirements and Council regulations are complied with.	Non compliance with statutory / legislative requirements. Missed or incorrectly raised bills. Errors or fraud may occur and go undetected. Incorrect refunds may be made.	Local Taxation and NNDR Schedules of Alterations are processed on a timely basis and a regular reconciliation is undertaken afterwards to ensure that the values held by the Valuation Office agree to the Rateable Values and Bandings within the Civica system. There is documentary evidence that the new parameters for 2010/11 were entered and checked within the Civica system, and that reconciliations and live tests were carried out.	Effective

AUDIT	PURPOSE OF AUDIT	RISK(S)	SUMMARY OF KEY FINDINGS	AUDIT OPINION
		<p>Liability may not be identified.</p> <p>Loss of income to the council due to non collection or slow collection of amounts due.</p> <p>Unauthorised discounts and exemptions may be awarded.</p> <p>Changes in circumstance are not actioned.</p> <p>Unauthorised write offs.</p>	<p>Council Tax benefits are reconciled regularly.</p> <p>Processes are in place for recovery of arrears and writing off bad debts.</p> <p>The audit did identify one area of weakness with regard to visiting empty properties. This has been accepted by Management as a recognised risk. Management advise that there is a high success rate from the return of the canvass forms and that visits take place on a priority basis. The whole visiting process is to be reviewed as part of the creation of the shared revenues and benefits partnership. This area will be revisited by Internal Audit.</p>	
General Ledger	The purpose of the audit is to ensure that adequate accountancy routines exist, and they are open and transparent so as to protect the integrity of the system.	<p>The key risks associated with general ledger processes are:</p> <ul style="list-style-type: none"> • Budget may be set up incorrectly and provide inaccurate or misleading management information; • Cash and bank postings may not agree back to the bank statement that may result in non payment or loss of income; • General ledger balances may be incorrect due to inaccurate transfer of data from the feeder systems; 	<p>All direct journal inputs to the general ledger were found to be complete, accurate, and undertaken by an authorised officer;</p> <p>Transactions posted from the feeder systems are checked, validated and were found to be complete and accurate;</p> <p>Control Accounts are reconciled on a monthly basis, and checked by an independent officer;</p> <p>Unrecognised accounts or suspense accounts balances are reviewed and cleared on a timely basis.</p>	Effective

AUDIT	PURPOSE OF AUDIT	RISK(S)	SUMMARY OF KEY FINDINGS	AUDIT OPINION
		<ul style="list-style-type: none"> • Errors or irregular use of journals may occur; • Incomplete or inaccurate records may be maintained within the main financial systems; • Year-end accounts may be incorrect. 		
Payroll/HR	This audit reviewed the key controls for payroll processing, including starters and leavers, amendments, verification, reconciliation and system updates.	<p>Payroll processes may not be operated in an efficient and effective manner;</p> <p>The Council may pay its staff incorrectly;</p> <p>Failure to comply with legislation or Council requirements;</p> <p>Unauthorised transactions;</p> <p>Incorrect payroll parameters;</p> <p>Errors in processing.</p>	<p>The overall payroll controls in place with regard to starters, leavers, amendments, verification, reconciliations and system updates are effective.</p> <p>The audit identified that relevant staff need to be reminded of the requirement to initial documents to provide a management trail of checks.</p>	Effective
Corporate Audits				
Procurement & Contract Audit Review	<p>A selection of payments made to suppliers were reviewed to determine that:</p> <ul style="list-style-type: none"> • Purchases were made in accordance with the Council's Procurement and Contracts Procedure Rules; 	<p>Breach of the Council's Procurement and Contracts Procedure Rules.</p> <p>Failure to achieve value for money.</p>	From the small sample of purchases tested, it can be confirmed that, in general, the Procurement and Contracts Procedure Rules are being adhered to.	Effective

AUDIT	PURPOSE OF AUDIT	RISK(S)	SUMMARY OF KEY FINDINGS	AUDIT OPINION
	<ul style="list-style-type: none"> • Best value is being obtained; and • Arrangements are in place to ensure that the new Local Transparency requirements (to publish payments and contract details exceeding £500) will be in place within the prescribed timescale. 		<p>The Procurement Manager is seeking opportunities for obtaining best value through collaborative work with other local authorities, including joint tenders with Mid-Suffolk District Council.</p> <p>Work has commenced to ensure that Babergh meet the Local Transparency requirements proposed by Central Government. Although the guidelines have yet to be published, Central Government are keen that councils publish these details as soon as possible. Further discussions will be required as to determine how contract information will be collected, managed, and published, and this will require a review of the current procurement regulations.</p> <p>N.B. Payments to suppliers over £500 are now reported on the Council's website. Contract information to follow.</p>	
Corporate Review of Financial Management	The purpose of the audit review was to provide an assurance on the budget management process and understanding of budget management within the Council.	<p>The Council is unaware of the current financial position.</p> <p>Inaccurate budget reporting leading to poor decision making.</p> <p>Inability to produce up to date financial information.</p> <p>Impropriety / fraud – through exploitation of e.g. inaccuracy, incompleteness of records.</p>	The audit identified that processes and systems are effective and generally work well, but there are opportunities to use audit findings proactively to increase control in some areas, (e.g. around management and responsibility, and training), to further promote the effective control and management of budgets. This will require the involvement of Heads of Service, Senior Managers, Budget Holders and the Finance Team.	Effective

AUDIT	PURPOSE OF AUDIT	RISK(S)	SUMMARY OF KEY FINDINGS	AUDIT OPINION
			It is acknowledged that since the audit work started, a positive approach is being taken by the Finance Team to address a number of the issues raised within the report.	
Member and Officer Expense Claims	The area of expenses and allowances has recently come under considerable scrutiny. The purpose of the audit was to ensure the expenses and allowances paid to officers and Members are properly authorised in accordance with approved and appropriate policies.	<p>Travel and expense claims fail to comply with the Council's policy and procedures and Inland Revenue requirements.</p> <p>Incomplete and unauthorised claim forms are processed.</p>	<p>The e-claim system is now embedded with all Members and officers having access to the system and training provided to Members to enable accurate use.</p> <p>Claims tested and reviewed were found to be correct with an improvement in authorisations received from responsible Managers clearly evident during the test period.</p> <p>Recommendations and best practice controls have been made to further enhance the processes for these claims, these focus on:</p> <ul style="list-style-type: none"> • VAT receipts • Procedure guidelines • Backdated claims • Journey details • Foreign travel. 	Effective
Business Continuity	The purpose of the audit was to review the framework arrangements in place to support the Council in the event of a significant business interruption.	<p>Key services may not be delivered to vulnerable customers.</p> <p>Services may not be restored in reasonable timescales that may affect the infra-structure of the Council.</p>	<p>Business continuity planning and arrangements are in place that meet legal requirements.</p> <p>Improvements are required in relation to business continuity arrangements with regard to Sheltered Housing Schemes.</p> <p>Improvements are required in relation to access to emergency phone numbers and the documentation held within the Business Continuity Plan.</p>	Effective

AUDIT	PURPOSE OF AUDIT	RISK(S)	SUMMARY OF KEY FINDINGS	AUDIT OPINION
			The two issues reported above were assessed by Internal Audit as being below the risk tolerance line and therefore the overall audit opinion was deemed 'Effective'.	

2. Audit Opinion

2.1 Internal Audit reaches an overall audit opinion as part of the reporting process. When determining the opinion the following is taken into account:-

1. The risk assessment,
2. The controls over the system, and
3. The results of the testing of the controls over the system.

The audit opinion is broadly classified into one of the following four categories:

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
Poor	General control framework is weak

John Snell
Acting Audit Manager
November 2010