



Decision maker:	Governance & Audit & Standards Committee
Subject:	Annual Internal Audit Report for the 2012/13 Financial Year
Date of decision:	27 th June 2013
Report by:	Chief Internal Auditor
Wards affected	All
Key decision (over £250k)	No

1. Summary

- 1.1 In 2012/13 Internal Audit raised 8 critical exceptions, 1 of these has previously been reported to this Committee but are included for information along with the remaining 7 in this report.
- 1.2 100% of the revised Annual Audit Plan has been completed. This represents 125 audits from the original plan of 140 where a total of 15 audits were deferred or removed; all of which have been reported either previously to this committee or are detailed in this report.
- 1.3 Areas of assurance are shown on Appendix A.
- 1.4 252 days of reactive work were undertaken in 2012/13, with 245 days set aside in the 2012/13 Audit Plan.
- 1.5 The Audit Plan planned coverage for 2013/14 is attached as Appendix C.
- 1.6 Due to the number of critical and high risk exceptions the Audit opinion for 2012/13 is that only limited assurance on the effectiveness of the control framework can be given with the areas of most concern highlighted in section 6 and Appendix A.

2. Purpose of report

- 2.1 This report is to give the Annual Audit Opinion on the effectiveness of the control framework, based on the Internal Audit Performance for 2012/13 to highlight areas of concern and to advise Members of the Audit Plan for 2013/14.

3. Background

- 3.1 The Annual Audit Plan for 2012/13 was drawn up in accordance with the agreed Audit Strategy approved by this Committee on 27 January 2012 and following consultation with Heads of Services, Strategic Directors and the Chair of this Committee.

3.2 The Annual Audit Plan for 2013/14 has been drawn up in accordance with the agreed Audit Strategy approved by this Committee on 24 January 2013 and following consultation with Heads of Services, Strategic Directors and the Chair of this Committee.

4. Recommendations

4.1 That Members note the Audit performance for 2012/13.

4.2 That the highlighted areas of control weakness for the 2012/13 Audit Plan are noted by Members.

4.3 Members note the Annual Audit Opinion on the effectiveness of the system of internal control for 2012/13.

4.4 Members note the Audit Plan for 2013/14.

5. Audit Plan Status 2012/13

Percentage of approved plan completed

5.1 100% of the annual audit plan has been completed. This represents 125 audits from the original plan of 140. Some of the reviews were amalgamated because of overlap and several others took longer than anticipated mainly because they were new areas which had significant issues.

5.2 Three of the Audits cannot be reported on at this time; the findings of 2 are still in dialogue with Senior Managers and 1 is subject to a court case later this year. These will be reported at a future meeting.

5.3 In total 15 audits have been deferred or removed. All of which have been reported either previously to this committee or are detailed below.

5.4 As requested by Members of the Committee a breakdown of the assurance levels on completed audits is contained in Appendix A.

5.5 Six audits have been removed from the plan:

Audit	Reason
Domiciliary Care	This audit has been deferred to 2013/14 due to the availability of key staff in Social Care.
Contracts with Special Schools outside of the City	Deferred to 2013/14 as an independent contractor is currently finalising the contract sign off with the relevant schools and the work is not scheduled for completion until the end of March 2013
Corporate Programme Management - Project Management Reviews	These three audits have been combined, deferred to 2013/14 and covered as part of an overall project assurance review programmed for 2013/14.
Tipner	
Northern Quarter	

Colas PFI	Deferred to 2013/14 to await the outcome of the best value review
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Reactive Work

- 5.6 245 days had been allowed for reactive work and investigations in 2012/13. 252 days were used.
- 5.7 The 252 reactive days were used for completion of 20 carried forward audits, 3 carried forward special investigations, 12 new special investigations, 1 unplanned item and 35 items of advice.
- 5.8 Special Investigations work undertaken in 2012/13 can be categorised as follows: Three carried forward and twelve new special investigations including:
- 4 Whistleblowing investigations
 - 10 Financial investigations
 - 1 Forensic PC Examination
- 5.9 Items of reactive work due to changes in priorities, involving an Audit Review or Internal Audit acting in a consultancy role included, amongst other things:
- The Local Enterprise Partnership (LEP) Start up Grant review

Exceptions

- 5.10 The number of exceptions raised in the final reports from the 2012/13 audit plan, in each category has been:
- 8 Critical
 - 184 High Risk
 - 35 Medium Risk
 - 12 Low Risk (Improvements)
- 5.11 An analysis of the common themes for exceptions raised under the categories noted in Appendix A is shown in the following table. As previously requested by this Committee a full breakdown of the areas of non-compliance from all 2012/13 audits is attached as Appendix B.

Assurance Area	Risk Highlighted by Audit	No of Occurrences
Compliance with Laws, Regulations, Rules, Procedures and contract conditions	Service Policies	18
	Financial Rules – Inventory	10
	Financial Rules – Income	7
	Financial Rules – Petty Cash	5
	Financial Rules – Purchase Orders	5
Monitoring & Evaluation	Monitoring/management oversight of systems	13
	Information management/	15

	incomplete information	
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5.12 The analysis shows a high number of exceptions in relation to non-compliance with Financial Rules. This is consistent with the findings from the 2011/12 Audit Plan. The analysis also shows a high number of exceptions in relation to management oversight and information management. As part of the 2013/14 Audit Plan these areas have been included for further reviews to ensure compliance throughout the Authority.

5.13 The table below is a comparison of the audit status figures, for the 2012/13 financial year and the previous two years.

	2010/11	2011/12	2012/13
% of the audit plan completed	98%	96%	100%
No. of Audits Completed for the year	169	167	125
No. of Critical exceptions	3	8	8
No. of High risk exceptions	184	198	184
No. of reactive days	379	385	252

5.14 With the achievement of the Audit Plan better assurance can be given and this includes areas not previously subject to audit. Because of this it is to be expected that there will be areas of weakness found. The assurance on Appendix A does show that, where follow ups are carried out, the weaknesses have largely been addressed which is a positive indication that the organisation is learning from the process.

6. Areas of Concern

Concerns identified since the last meeting

6.1 There are 7 new areas of concern:

6.2 Home to School Transport Budget

6.2.1 Testing confirmed that monthly budget monitoring takes place between the budget holders and accountant responsible for the control and monitoring of the home to school transport budget. Despite regular monitoring, the December 2012 Budget and Performance Monitoring Report which was sent to members forecast a £237,000.00 overspend on the assisted home to school transport budget.

6.2.2 Although work is currently being undertaken to reduce the forecast overspend it should be noted that the budget has been overspent in the previous two financial years (£45,158 in 2010/2011 and £239,895 in 2011/2012) and additional statutory provision relating to 19 to 25 year olds which come into effect from April 2014 will have a further financial impact on the budget.

- 6.2.3 Based on the testing conducted, no assurance can be given that the growths fund allocation of £101,600 for 2013/2014 and the work currently being undertaken to reduce the forecast overspend, will be sufficient to meet the requirements of this demand led budget.
- 6.2.4 **Agreed action** - Michael Lawther and Julian Wooster will liaise with Chris Ward (Head of Finance & S 151 Officer) to discuss the exception raised as a result of this review and to agree a resolution to the forecast overspend for 2013/2014.

6.3 Planning & Building Control

- 6.3.1 Testing identified that work undertaken by Building Control Surveyor is not checked.
- 6.3.2 The previous review in 2010/11 highlighted the fact that the Building Control Manager has authorisation to apply partnership discounts and to calculate fees depending on estimated costs in an attempt to secure business from private surveyors. These discounts and fees are applied to relevant cases. However, the calculations behind these figures were not evidenced in the case files so it was unclear how they have been determined.
- 6.3.3 It was agreed that a breakdown of the calculations would be attached to each file to evidence how the fee for that case was agreed but testing during this review of a sample of 4 Building Control files has confirmed that the agreed action has not been implemented.
- 6.3.4 **Agreed action** - The department is currently being restructured and at the time of the audit there was, and still is, no Building Control Manager in position. The building regulation charge calculation sheet will be reviewed to ensure that the base calculation is clearly recorded. In the interim period the calculation sheets will be spot checked by the Assistant Head of Planning Services.

6.4 Credit Notes - Accounts Receivable

- 6.4.1 As part of the Accounts Receivable Audit a sample of 21 credit notes request forms were tested to ensure correct processing and authorisation. Initial testing found that for 3 of the 21 (14%) credit note request forms reviewed the 'requestor' and 'authoriser' were the same person, thereby negating any separation of duties which is a key control in preventing fraud.
- 6.4.2 To request a Credit Note a member of staff has to complete an online form, via Intralink, which is then sent directly to the Income Team shared mailbox. The request is then processed by the Income Team who will raise the credit note accordingly without making any checks regarding the authorisation as this is not part of their remit.
- 6.4.3 Testing confirmed that the person named as the authoriser does not automatically receive a copy of the request form prior to, or after its submission to the Income Team, as this process is manually driven. Therefore the current system does not offer any assurance that the credit note request has been duly authorised because the requestor is never forced to gain an authorisation. In order to confirm the authorisation the Income Team would need to contact the named authoriser for each request which they consider would be an inefficient use of resources.

- 6.4.4 A review was conducted of all credit notes processed through the Oracle system between 01/04/12 - 27/03/13. A total of 1,656 credit notes were issued during the period tested with an overall value of £5,048,866.08. Of those, 88 were selected for further review. No evidence was found of any fraud or error with the credit notes tested and all appear to have been issued for valid reasons. It is not known if there have been any issues in the past, or that there might not be any issues in the future due to the absence of preventative controls.
- 6.4.5 **Agreed action** - A new monitoring process is to be implemented to enable potential review of all credit notes raised. Monthly reports are to be produced by the Accounts Receivable team and nominated finance officers will be responsible for monitoring and verifying the validity of the credit notes raised in their area of responsibility. Evidence of the monitoring conducted will be noted on the report generated.

6.5 Legionella Management

- 6.5.1 Legionella testing undertaken by the Asset Management Service (AMS) and Housing on sites they are responsible for appear to be appropriately controlled. These areas include Council Housing, offices and a limited number of schools. The Audit review of the Port showed that testing is undertaken by the Ports Contractor MITIE on the various sites around the Port. However, there are public buildings that do not come under the auspices of the Council to undertake legionella testing and these include, for example, some schools and the Pyramid Centre
- 6.5.2 For the Port there has been no evidence provided of testing undertaken on the cold water storage tank that is used to replenish the ships. There is a potential risk that the water in this tank can be warmed by the sun to a temperature that puts it at risk of developing legionella bacteria. It is understood that a process and procedure has been put in place but no evidence has been received to ensure this area is being controlled and a critical exception was raised as a result.
- 6.5.3 Audit visits to two schools not being covered by AMS Legionella Control and outside the remit of the Council, highlighted significant gaps in the legionella process which could leave the Schools open to significant risk. AMS audit properties run by Parkwood for legionella, but not the Pyramids which is run by Southsea Community Leisure Ltd. The control of legionella across the Authority appears fragmented and leaves gaps in the process.
- 6.5.4 **Agreed action** - The Port Senior Building Surveyor has stated that "the tank mentioned is a new installation representing the first of 5 such tanks that will be used to supply water to ships, in order to satisfy the requirements of the water company for an anti-siphoning system. These tanks will be lagged and temperature gauges fitted as well as procedures for flushing before use. This, together with the rigorous testing regime that is employed in the rest of the site, will reduce the likelihood of any problem". This was due to be implemented from January 2013.
- 6.5.5 For Council's estate a Corporate Legionella Management Policy will be introduced by the Health & Safety Manager by 1st March 2013. Responsible persons in Housing / AMS / Port / Schools are to meet, share and agree a standardisation of all procedures / reporting systems / contracts for Legionella and to ensure all information is being captured in a timely manner. This will also be used to raise the profile for other bodies

to which the Council is not responsible but could offer an advisory service and all schools outside of the Council remit will be written to with advice on best practice.

6.6 MMD

MMD Payroll

- 6.6.1 MMD (Shipping Services) Ltd is a wholly owned subsidiary of Portsmouth City Council and as part of the 2012/13 Audit Plan audits of financial systems have been carried out.
- 6.6.2 MMD uses the Sage Payroll system. Following a review of the access rights, as well as discussions with the Financial Controller, it was identified that the online banking requires only one authoriser to physically make a payment or transfer of funds. The Financial Controller post is an authoriser as well as the administrator for Sage and is therefore vulnerable to either be in a position to commit a fraud or at risk of accusations of fraud.
- 6.6.3 **Agreed actions** - The Financial Controller to be removed as an administrator of the Sage Payroll system with affect from 1st July 2013.

MMD Accounting System (Accounts Receivable)

- 6.6.4 As part of the financial audits at MMD a request was made to the Port IT Administrator for a report which showed the staff access levels to Navision, the finance and distribution system used by MMD, particularly to write off debt and approve credit memos.
- 6.6.5 The reply from the Port IT Administrator stated that no such report is available from the system and this had been confirmed with the supplier of the software. This means that MMD cannot evidence which staff have current access or what that access enables them to do.
- 6.6.6 Internal Audit are therefore unable to give any assurance that access levels to Navision are appropriately restricted to ensure financial transactions are entered and approved in accordance with MMD's policies.
- 6.6.7 **Agreed action** - The supplier of the software is unable to create this report. The IT Administrator will analyse the different security groups in Navision and detail the access rights they have. The users in each security group will then be reviewed by the Directors and amendments will be made as necessary. This is aimed to be completed by 31st July 2013.

MMD Accounts Payable

- 6.6.8 Following discussions with the Financial Controller and from confirmation with the IT Manager at the Port, it was established that all members of staff who have access to Navision have the ability to amend supplier and customer details, including bank details.

- 6.6.9 Both the Financial Controller and one of the Directors can setup a supplier, input a payment and approve the payment in Lloyds Link without reference to another party.
- 6.6.10 New supplier requests were completed for all new suppliers sampled (10) and were authorised by the Financial Controller, however there are no validity checks carried out to confirm that the details completed on the form are correct and or genuine.
- 6.6.11 **Agreed action** - To improve segregation of duties, the setting up / editing of supplier accounts will be restricted to the Management Accountant and, in their absence, by the Desktop Support Analyst. This will be achieved by blocking write access to vendor bank details in Navision to everyone else; a request has been made to our IT provider of Navision to make this change. This has been actioned.
- 6.6.12 Purchase Ledger BACS payments are created / exported from Navision by the Purchase Ledger Clerk and transactions imported into Lloyds Link are frozen so that amendments cannot be overwritten by any authorised officer without cancelling the initial entry, preventing amendments outside of Navision.
- 6.6.13 The Financial Controller checks all payments and will sample check that bank details on the forms are correct.

Previously raised areas of concern

- 6.7 The table below summarises the area of concern from the 2012/13 Audit Plan which the Committee has been made aware of.

Audit Area	Exception
Client Affairs	<p>The Client Affairs Team (Financial Services) takes responsibility for the finances of Social Care clients who are incapable of managing their own affairs, acting as their Deputy through an application to the Court of Protection. It was confirmed that there were no formalised procedures on how to deal with client property searches or records that need to be kept.</p> <p>Agreed Action - There is now a formalised procedure in place that covers client property searches and also a template for recording items that have been removed from clients homes.</p> <p>A copy of the procedure and template have been provided to Internal Audit and a follow up audit will review its application .</p>

7. 2013/14 Audit Plan

- 7.1 The Audit Plan planned coverage for 2013/14 has been drawn up using the Strategy noted by Members of this Committee at their 24th January 2013 meeting.
- 7.2 Meetings have been held with all Heads of Services, Strategic Directors, the Chief Executive, Director for Public Health and the Chair of the Governance & Audit & Standards Committee who have all been consulted on the areas planned and the overall Audit Plan.
- 7.3 The 2013/14 Audit Plan is attached as Appendix C to this report.

8. Annual Audit opinion

- 8.1 Due to the number of critical and high risk exceptions the Audit opinion for 2012/13 is that only limited assurance on the effectiveness of the control framework can be given with the areas of most concern highlighted in section 6 and Appendix A.
- 8.2 There are currently only three audit opinions to match the exception risk levels and these are: no assurance, limited assurance and full assurance. Where there are mainly medium or low risk exceptions the annual audit opinion would be full assurance.
- 8.3 The Audit opinion for last year was also limited assurance due to the level of critical and high risk exceptions. The number of critical exceptions and high risk exceptions has remained fairly static from 2011/12. The Audit coverage has been high for several years now and reviews undertaken on a number of areas for either the first time, or the first time in many years, so it is expected that assurance should increase.
- 8.4 Internal Audit is concerned with the overall effectiveness of the control framework and is working with Heads of Services to improve on specific areas of control weaknesses.
- 8.5 Internal Audit conforms to the new Public Sector Internal Audit Standards that have replaced the CIPFA Standards for IA UK, with the exceptions of updating the definition of Internal Audit and defining the Board and Senior Managers. Neither of which have a material impact on forming the Audit opinion. All Internal Audit work undergoes quality checks as part of the review process.
- 8.6 The Audit Charter is being updated to reflect the new standards and will be reported to the next meeting of this Committee.
- 8.7 Significant weaknesses and agreed actions will be reflected in the Annual Governance Statement. The impact of the Internal Audit work for 2012/13 may affect that years' work for External Audit. It may also inform their work for 2013/14 and where they consider there are weaknesses in control that could materially affect the accounts they may need to carry out further work to gain the necessary audit assurance required for a clean true and fair opinion, which could result in a higher fee payment from the Authority.

9. Equality impact assessment (EIA)

- 9.1 An equality impact assessment is not required as the contents of this report do not have any relevant equalities impact.

10. City Solicitor's Comments

- 10.1 The City Solicitor has considered the report and is satisfied that the recommendations are in accordance with the Council's legal requirements and the Council is fully empowered to make the decisions in this matter.
- 10.2 Where system weaknesses have been identified he is satisfied that the appropriate steps are being taken to have these addressed.

11. Head of Finance & S151 Officer Comments:

11.1 The Head of Finance and S151 Officer is in agreement with the content, evaluation and overall Annual Audit Opinion. The Head of Finance and S151 Officer will consider measures to be implemented to improve compliance with Financial Rules.

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Signed by: Lyn Graham, Chief Internal Auditor

Appendices:

Appendix A – Completed audits from 2012/13 Plan

Appendix B – Full analysis of non-compliance from 2012/13 Audit Plan

Appendix C – Audit Plan 2013/14

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

Title of document	Location
1 Accounts and Audit Regulations 2003 amended 2006 (and 2011)	Internal Audit
2 Audit Strategy 2012/13 & 2013/14 and Audit Plan 2012/13 & 2013/14	Internal Audit
3 CIPFA Code of Practice for Internal Audit UK 2006	Internal Audit
4 Previous Audit Performance Status and other Audit Reports	Internal Audit
5 Audit Charter and Terms of Reference	Internal Audit
6 Public Sector Internal Audit Standards	Internal Audit

The recommendation(s) set out above were approved/ approved as amended/ deferred/ rejected by the Governance & Audit & Standards Committee on 27th June 2013.