

Report to Audit committee
22 July 2014
Report of Head of internal audit and risk management, LGSS
Subject Annual audit report on internal audit and fraud 2013-14

Item

11

Purpose

To inform members of the head of internal audit's annual audit opinion for 2013-14 and the work of internal audit and the fraud team which supports the opinion. The report and the audit opinion within it form part of the evidence to support the council's annual governance statement 2013-14.

Recommendation

To receive the annual audit opinion and note the work of internal audit and the fraud team for 2013-14.

Corporate and service priorities

The report helps to meet the corporate priority Value for money services

Ward/s: All wards

Cabinet member: Councillor Waters – Deputy leader and resources

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Background documents

Report

Background

1. *“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes”* (Public Sector Internal Audit Standards).
2. Under the Accounts and Audit Regulations 2011, the council must undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control.
3. In 2012 the relevant internal audit standard setters adopted a common set of standards across the public sector – the *Public Sector Internal Audit Standards* (PSIAS), which came into effect on 1 April 2013.
4. The standards require that the head of internal audit presents an annual report to an authority’s audit committee, which in practice is timed to support the council’s annual governance statement.
5. The annual report is a summary of all internal audit work carried out during the year. Each individual audit report is discussed at its draft stage and agreed action plans put in place. The annual report therefore represents in summary form a considerable degree of consultation with managers during the year.
6. Internal audit work is carried out to fulfil the audit plan, endorsed by the committee at its meeting on 19 March 2013. The audit plan is derived from corporate and service risk registers as well as any inherent risks such as a susceptibility to fraud associated with an individual system. Internal audit work therefore seeks to give assurance that the risks identified in the registers and within the systems risk matrix are mitigated by a sound system of internal control.
7. This report provides members of the audit committee with:
 - the head of internal audit opinion for 2013-14;
 - an overview of the council’s risk exposure and its overall system of internal control;
 - the work undertaken by internal audit in 2013-14;
 - review the outcomes from key internal audit reports;
 - an overview of the performance of internal audit;
 - the work of the fraud team in 2013-14.

INTERNAL AUDIT REPORT FOR 2013-14

Head of Internal Audit Opinion

8. This report gives a summary of the work carried out by internal audit in the financial year 2013-14 and the results of that work. From the work undertaken during the year, my overall opinion on the Council's system of internal control is that:

Substantial assurance can be given that there is generally a sound system of internal control, designed to meet the council's objectives and that controls are generally being applied consistently. The level of assurance, therefore, has improved from 2012-13 where "adequate" (moderate) assurance was assigned.

Controls relating to key financial systems were concluded to be generally at a "Substantial" level.

9. The basis for my opinion is derived from an assessment of the range of individual opinions arising from assignments, contained within the internal audit risk-based plan that have been undertaken throughout the year. This assessment has taken account of the relative materiality of these areas and management's progress in respect of addressing control weaknesses. A summary of audit opinions is shown in the following table:

Table 1 – Summary of Audit Opinions 2013 - 14

Category	Full	Substantial	Moderate	Limited	No
Financial systems	2	5	0	0	0
Other audits	0	10	5*	1*	1
Total	2	15	5	1	1
Summary (with 12-13 comparison)	8% (4%)	63% (21%)	21% (59%)	4% (8%)	4% (8%)

* Refers to 2012-13 audits finalised in 2013-14

Review of Audit Coverage

Audit Opinion on Individual Audits

10. The committee is reminded that the following assurance opinions can be assigned for an audit:

Table 2 – Assurance Categories

Level of Assurance	Definition
Full Assurance	There is a sound system of control designed to address the relevant risks with controls being consistently applied.
Substantial Assurance	There is a sound system of control, designed to address the relevant risks, but there is evidence of non-compliance with some of the controls.
Moderate Assurance	Whilst there is a basically a sound system of control, designed to address the relevant risks, there are weaknesses in the system, that leave some risks not addressed and there is evidence of non-compliance with some of the controls.
Limited Assurance	The system of control is weak and there is evidence of non-compliance with the controls that do exist which may result in the relevant risks not being managed.
No Assurance	There is no system of internal control. Risks are not being managed.

11. Audit reports issued in 2013 -14, other than those relating to investigations, projects or probity (transactions) reviews, include one of the above audit opinions. Embedded assurance applies to projects / audits where auditors attended project boards or other working groups. Unless otherwise stated, all individual reports represented in this annual report are final reports and have been agreed with management, together with the accompanying action plans.

Audit assurance work

The status of 2013-14 audits is shown in Table 3 below:

Table 3 – Reports Issued 2013-14

Status	Number
2013-14 Final reports / embedded assurances completed to date	30*
Substantially complete, including at draft stage	3

* Includes 2012-13 reports finalised during 2013-14

12. Table 4 below details the assurance levels, or other description where an assurance opinion was not appropriate, of all audits undertaken in 2013-14.

Table 4 – Summary of Audit Opinions 2013-14

Service / Audit	Audit Opinion / Description
Financial systems	
Purchase cards	Substantial
Payroll	Substantial
Housing rents	Full
Housing benefits	Substantial
Treasury and cash flow management	Substantial
General ledger – journals & departmental transfers	Substantial
Budgetary control	Full
Accounts Receivable	Moderate
Corporate	
Community infrastructure levy - income arrangements	Substantial
Cash receipting replacement project	Embedded assurance
New payroll contract	Embedded assurance
Procurement guide and toolkit	Embedded assurance
Construction industry tax scheme	Substantial
Contract management in NPS	Substantial
Probity – pool cars, fuel cards, travel & subsistence	Improvements required
Business relationship management	
Remote/mobile working	Embedded assurance
GCSX/PSN compliance	Embedded assurance
Operations	
Emergency planning	Substantial
Homes & Communities Agency (HCA) arrangements	Substantial
Safety of council properties	Substantial
Garden waste scheme	No
Customers, communications and culture	
Managing customer demand	Substantial
The Halls	Substantial
Norman Centre	Substantial
Tourist Information Centre	Substantial

13. Outlined below is a summary of the audits that have been finalised during the year, including those from 2012-13, where an assurance opinion of moderate or lower has been given. These represent a summary of the findings for audits leading to:

- Red rated recommendations (action that is considered imperative to ensure that the council is not exposed to high risks); and / or
- Amber rated recommendations (action that is considered necessary to avoid exposing the council to significant risks).

14. The committee should note that the majority of these issues have previously been reported as part of the defined cycle of update reports provided to the audit committee. The purpose of this section of the report is to give assurance to the committee as to the effective progress being made to address the weaknesses identified within the individual reports.

Customer contact (general processes) – moderate assurance

15. The council has a customer contact centre based in the old cashiers area of City Hall, supported by three back office teams and the business support team. For general processes, which include cash income, there was assurance over the handling of cash, reconciliations and security measures, plus robust procedures for dealing with penalty charge notices and parking dispensations.

Three issues required recommendations. There are two separate lists of cash receipting system users, but they did not match; there was occasional hand receipting of cash or cheques outside of the secure area; and one reconciliation carried out in systems support was more appropriate for finance to carry out.

The seven recommendations due by March 2014 have all been implemented

Academy housing IT system – moderate assurance

16. There are good arrangements in place over secure hosting of the servers, a formal access request system, backup procedures, a change management system, and test environment. There was sound documentation around proposed changes by Capita, routine operational tasks in IT, and completion of work requests. 12 recommendations relating to documentation updates, access controls, program change management and the reporting of system problems were agreed and were implemented by February 2014. The implementation of one recommendation relating to the review of user access and profiles was delayed but was completed in May 2014.

Oracle financial IT system – moderate assurance

17. There are good arrangements in place over secure hosting of the servers, a formal change management system, backup procedures and interface documentation. There were good documents around changes to the financials application, receipt of information regarding leavers, completion of work requests and daily checks performed in LGSS. 11 recommendations relating to licensing, documentation updates and password standards were agreed and were implemented by December 2013. However, one recommendation regarding audit trails requires further consideration due to the potential impact on system resources. This is currently being investigated in conjunction with LGSS IT. A further recommendation regarding licences is partly complete, but is dependent on receiving further information from Oracle before being fully complete.

IT disaster recovery – moderate assurance

18. There are sound arrangements in place over regular exercises including IT disaster recovery (DR) testing and a recent telephony continuity exercise, provision of third party support services to assist in recovery of specific systems, the existence of an offsite facility in which some DR documentation was located and regular data backups. 11 actions were agreed relating to formalising DR and resilience arrangements between the council and LGSS, risk assessments and systems inventory, links between the corporate business continuity plan and IT DR plan, and measuring and communicating the results of testing the DR plan. Some of the actions are complete, whilst others are being addressed in conjunction with the ongoing work on business continuity management. The project to redesign the primary DR site to accommodate additional server space was due for completion in spring 2014, but has been delayed; therefore the audit follow up will be carried out in the next quarter.

Business continuity management

19. This review involved completing a scorecard to assess the level to which the council complies with BS25999-1 and best practice in business continuity management. This included work on business continuity plans, exercises and incidents, business impact analysis and resources. The review concluded that the council had scored 63% overall against the scorecard, and 17 recommendations were agreed in relation to improvements against specific areas. These have all been covered by the council's new business continuity management policy and framework, which was approved by cabinet on 25 June 2014. This will be an ongoing project, which has already commenced, with the first meeting of the business continuity steering group on 22 June 2014.

Customer contact – permit parking & controlled stationery – limited assurance

20. The review found that parking permits and other controlled stationery are held securely, but controls over issuing were weak. The main problem is that Civica, the customer contact system, is used to issue permits, but it does not have sufficient controls to prevent the issue of permits to residents who are not eligible. Also, no monitoring or reconciliations were in place. A business case has been agreed to implement the Permit Gateway Citizen system, which will address these issues, but this needs Parking Gateway Citizen to be implemented first (planned for November 2014). A stock check of permits and other stationery controlled by the customer contact team identified discrepancies which had not been investigated. 13 recommendations were made, including transferring the responsibility for stock control to the business support team. With the exception of implementing Permit Gateway Citizen all are now complete.

Accounts receivable

21. It has previously been reported that a draft report on accounts receivable resulted in a limited assurance opinion and the management response had been delayed. A response has now been received and it is likely that the final opinion will be 'moderate assurance'.

IT audit

22. In addition to the reviews referred to in paragraphs 16-18, assurances were provided in a number of areas as set out below.
23. The audit manager sits on the corporate information assurance group, which monitored progress to comply with public sector network (PSN) and payment card industry (PCI) compliance, both of which have now been achieved. The group also reviews network issues, data protection, information risk and assurance, security breaches, and information management.
24. A member of the audit team was also on the project group which successfully introduced the new ICON cash receipting system in November 2013.

Special reviews

25. During 2013-14, internal audit has continued to be responsive to requests for support from managers in the completion of unplanned reviews and special investigations. The time required to complete these reviews has been accommodated in the plan by the time set aside for special investigations and the contingency element.
26. Internal audit was not involved in any major investigations during the year. There were a small number of low-level data breaches which were reviewed by the executive head of business relationship management (as the council's senior information risk officer) and audit manager, in accordance with the council's incident response plan. No cases led to any disciplinary action, but several actions were put in place to reduce the risk of recurrence.
27. Garden waste scheme (brown bins) – no assurance. This review was requested by the head of citywide services because of concerns related to procedures and an apparent discrepancy between bins paid for to those emptied. Although there were some areas of good practice, there were control weaknesses across most areas. Nine recommendations were agreed by the head of citywide services, which were implemented in time for the main billing run in February 2014.

Follow ups

28. Internal audit reviews are followed up to ensure that recommendations have been implemented; the results of each follow up are reported to audit committee. A summary of the status of significant recommendations from audits followed up in 2013-14 is summarised in Table 5 below:

Table 5: Implementation of Audit Recommendations 2013-14

Audit Title	Red		Amber	
	Complete	Incomplete	Complete	Incomplete
Housing voids			1	
The Halls				1*
Norman Centre				1
Oracle financial IT system				
Academy housing IT system				
Emergency planning				3*
Off-street parking	1		1	
Housing benefits			4	1*
Homelessness			4	
Homes & Communities Agency			1	
Starters and leavers			5	
Contract management in citywide services	6		2	
Oracle purchasing	5		7	
Council tax			5	1
NNDR				2
Sports facilities			5	1
Care & repair			5	
TOTALS	12	0	40	3

* Partially complete at the time of the follow up

Other areas of non-assurance work

29. Other areas of non-assurance and consultancy work which were carried out in 2013-14 are as follows:

- National fraud initiative (see below). The audit manager (Norwich) is the key contact for each year's data matching exercises, and ensured that all data was correctly submitted and co-ordinated the proper investigation of the subsequent matches.
- Prepared the annual governance statement and supporting evidence in conjunction with heads of service.
- Completed the Audit Commission's annual fraud survey.
- Maintained the corporate risk register in conjunction with heads of service and reported to cabinet and audit committee
- Updated the council's risk management policy and risk management strategy

National Fraud Initiative (NFI) 2012-13

30. This is the main data matching exercise by the Audit Commission which occurs every two years, the results for which were received at the end of January 2013.

31. There were 74 reports, mainly covering benefits and housing, and a total of 2,677 matches, of which the Audit Commission recommended 560 as a priority for investigation.
32. The majority of matches relate to housing benefit. Staff in various service areas have made good progress in reviewing matches to identify any further action that needs to be taken – to date 91% of reports have been closed. The council's progress was rated as 'green' by the external auditors.
33. So far the exercise has uncovered one housing fraud which led to the recovery of a council property.
34. In addition, £135,370 of housing benefit overpayments has been identified. Six cases totalling £24,556 were due to fraud, resulting in one prosecution, three administrative penalties and two official cautions. 45 cases totalling £110,814 were due to either official error (19) or customer error (26). All the overpayments are recoverable by reductions in weekly benefits.
35. Finally, a duplicate creditor payment of £2993 from 2010 was identified. Following investigations by the audit manager and other council staff a full refund was received.

National Fraud Initiative (NFI) 2013-14

36. This is the council tax single person discount exercise which occurs in alternate years to the main NFI exercise (see above), but will be annually in future.
37. The results were made available in March 2014 and the 1870 matches were passed to the revenues & benefits operations manager to consider options for investigating; there is no assumption of fraud just because a match appears in the results.

Performance indicators

38. The following shows the key performance indicators in the service specification with Norwich and the results for 2013-14:

- Internal audit plan to be endorsed by CLT and audit committee by 30th June each year: The plan for 2013-14 was endorsed in March 2013 (the plan for 2012-13 was endorsed by audit committee in March 2012).
- % of internal audit plan delivered – target 100%. Actual 77%, excluding two IT audits - there was a principal auditor vacancy from April 2013 (2012-13 91%).

One planned audit (City Deal) was cancelled as it was confirmed that it was not the council's responsibility; and the Oracle upgrade/replacement was delayed until 2014-15. Three audits were substantially complete when the auditors retired – these will be finalised imminently.

The original audit plan was based on the planned restructure of the internal audit and risk service being in place from April 2013; however, this has been delayed until 2014-15, with the result that the planned resource available during 2013-14 was less than anticipated.

Actions are being taken to address the under-delivery of the audit plan and revised internal performance management arrangements will be introduced.

- % of productive time achieved by the division against the total resource days available – target 85%. Productive time was 83% (2012-13 was 82%).

Although slightly below target there was an improvement on the previous year. Further improvement will be sought under the revised performance management arrangements.

Productivity is classified as time spent working on auditing as opposed to non-audit time, which includes overheads such as administration and training.

- Draft IA reports issued within 15 days of receipt of agreed management comments: 100% (2012-13 100%).
- Final reports issued within 10 days of receipt of management comments: 100% (2012-13 100%).
- Progress reports to audit committee 6 monthly - achieved. Progress reports are presented to every audit committee, which usually meets four to five times a year (same in 2012-13).
- Although not part of the service specification, the audit manager has an appraisal target to achieve an average score of four out of five for post-audit feedback questionnaires (introduced in July 2013). The average score achieved was 4.9.

Professional Standards

39. Public Sector Internal Audit Standards (PSIAS) were adopted by the Chartered Institute of Public Finance and Accountancy (CIPFA) from April 2013. The standards are intended to promote further improvement in the professionalism, quality, consistency and effectiveness of Internal Audit across the public sector.

40. The objectives of the PSIAS are to:

- Define the nature of internal auditing within the UK public sector;
- Set basic principles for carrying out internal audit in the UK public sector;
- Establish a framework for providing internal audit services, which add value to the organisation, leading to improved organisational processes and operations;
- Establish the basis for the evaluation of internal audit performance and to drive improvement planning.

41. A self-assessment against the Standards concluded that Internal Audit is broadly compliant. Further details will be presented to the committee with an accompanying Audit Charter at the September meeting.

Fraud team and counter fraud activity 2013-14

42. The majority of the team's activities for 2013-14 continued to be related to benefit fraud investigations. However, 2014-15 will be the last year for reporting benefit fraud cases as, from April 2015, this work will be undertaken by the Department for Work and Pensions (DWP) and it is not yet known what impact this will have on staffing levels. There remains a number of fraud concerns outside of benefits, including council tax, business rates, housing (application, tenancy and succession), procurement and internal.

Continuing counter fraud initiatives

43. The visiting officer attached to the home options team carried-out 81 visits on behalf of the fraud team last year and continues to be an extremely useful resource. As well as conducting visits for the fraud team, he has also raised a number of concerns that have been passed on to other council departments and external government agencies. His vigilance has led to a reduction in the number of people on the council waiting list, by way of verification visits.

Liaison and joint working

44. The team continues to work and liaise with the DWP fraud and compliance teams on a regular basis. This includes invitation to joint-working, evidence gathering, interview and further action (i.e. prosecution). Joint-working led to just under 45% of the team's successful outcomes, which is consistent with previous years.
45. As well as the DWP, the team works with other government departments to tackle fraud and share concerns. These include the police, other councils, UK Border Agency and the Security Industry Authority. In the past year, the fraud team leader has been working closely with investigation staff from HM Revenue and Customs to identify better ways to share information and this includes attendance at a quarterly Police/HMRC liaison meeting.

Training

46. One member of the team is also trained as an accredited financial investigator under the Proceeds of Crime Act 2002. In the past year he has given awareness sessions to investigation officers and senior staff both internally and at other local councils.
47. Annual fraud awareness sessions were held with a number of front-line and back-of-house staff to make them aware of what the team investigates and how they can assist by raising concerns. A number of individuals followed this up by attending one-to-one sessions with the team leader to gain a better understanding of how the team operates and helping them make better quality referrals.
48. The fraud officers attended a training course on the disclosure rules under the Criminal Procedures and Investigations Act 1996, as there were some key amendments relating to prosecutions that came into force in December 2013.

Fraud team performance

49. For benefit purposes there are three types of proven fraud:

- Simple Caution is the offering of a warning for first time offenders and/or low level cases where the claimant has fully admitted the offence at interview;
- Administrative Penalty is either a 30% or 50% fine (depending on the period of the offence) and can be offered without a customer attending an interview under caution, as there is no requirement to admit an offence;
- Prosecution is used in more serious cases or where the customer has re-offended and it is in the hands of the courts what, if any, sentence to pass

50. In 2013-14 there were 898 referrals for benefit fraud, of which 511 required further investigation (641/480 in 2012-13). In context, there are approximately 18,000 claiming benefit from Norwich City Council so the number of concerns about fraud is relatively low.

51. The team achieved 40 sanctions and prosecutions (55 in 2012-13), of which 23 were NCC-led. One of the main reasons for the decrease was a reduction in benefit support until quarter four and so a number of cases were held in a backlog. The benefit needs to be reassessed and, where appropriate, recalculated before the final decision can be made on further action.

52. The total overpaid benefit identified through fraud team activity was £249,151 (£266,204 in 2012-13), of which £163,291 was from the 40 sanction and prosecution cases.

53. In addition to the above the team administered one Simple Caution for a council tax single person discount offence (one in 2012-13) and was directly responsible for the recovery of two council dwellings as a result of investigation (seven in 2012-13).

54. The accredited financial investigator has two ongoing cases for other local councils (one started in 2011-12 and one in 2012-13) and has also worked with LGSS partners across sites in the request for (financial) production orders from the courts.