

AUDIT PANEL		
Report Title	THE HEAD OF AUDIT AND RISK'S ANNUAL REPORT FOR 2009/10	
Key Decision	NO	Item No. 5
Ward	ALL	
Contributors	HEAD OF AUDIT AND RISK MANAGEMENT	
Class	Part 1	Date: 24 JUNE 2010

1 Purpose of the Report

The purpose of this report is to present the members of the Audit Panel with the Head of Audit and Risk's opinion as to the level of assurance that can be derived from the internal control and risk management frameworks in place during 2009/10.

2 Recommendation

Members are asked to note the report.

3 Head of Audit and Risk's Annual Report

The Head of Audit and Risk's annual report on the adequacy and effectiveness of internal controls and risk management for 2009/10 is attached at appendix A

4 Legal Implications

There are no legal implications arising directly from this report.

5 Financial Implications

There are no financial implications arising directly from this report.

6 Equalities Implications

There are no specific equalities implications arising directly from this report.

7 Crime and Disorder Implications

There are no specific Crime and Disorder implications arising directly from this report.

8 Environmental Implications

There are no specific environmental implications arising directly from this report.

9 Background Papers

There are no background papers reported.

If there are any queries on this report please contact the Head of Audit and Risk on 020 8314 9114.

The Head of Audit and Risks Annual Report for 2009/10 on the Adequacy and Effectiveness of Internal Control and Risk Management

Contents

Section	Title	Page
1	Introduction	2
2	Background	2
3	Opinion of the Head of Audit and Risk	3
4	Qualifications to the opinion	3
5	Internal Audit	4
	▪ Key Financial Systems	5
	▪ Risk Based Audits	6
	▪ Schools	8
6	Anti-fraud and Corruption	9
	▪ Benefit Investigations	10
	▪ Special Investigations	11
	▪ Housing Investigations	11
	▪ Fraud Prevention	11
	▪ National Fraud Initiative	12
7	Risk Management	13
8	Compliance with the CIPFA Code of Practice for Internal Audit in Local Government	13

1. Introduction

- 1.1 The Chartered Institute for Public Finance and Accountancy's Code of Practice for Internal Audit in Local Government in the United Kingdom 2006 (The CIPFA Code) established the expected professional standards for internal audit in local government. The CIPFA Code is informed by standards from other professional institutes, including the Institute of Internal Auditors (IIA) and the Government Internal Audit Standards (GIAS) issued by HM Treasury, and is the standard against which the quality of internal audit in local government is assessed.
- 1.2 The CIPFA Code sets out the requirement for reporting to officers and Members of the Audit Committee to help inform their opinions on the effectiveness of the system of internal control as well as risk management and governance arrangements.
- 1.3 This report provides the Head of Internal Audit and Risk Management's assurance opinion on the adequacy and effectiveness of the London Borough of Lewisham's internal control arrangements for the year April 2009 to March 2010.
- 1.4 The Annual Assurance Statement contributes to the annual review of internal control required by the Accounts and Audit Regulations 2006 and to the completion of the Annual Governance Statement (AGS). It is specifically timed to be considered as part of the Council's annual review of governance and internal control.

2 Background

- 2.1 The Account and Audit Regulations 2003, as amended, require the Council to maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control. The role of internal audit is to provide an independent and objective opinion on the control environment within the Council. Internal audit work is undertaken in accordance with the CIPFA Internal Audit Code of Practice for Internal Audit in Local Authorities 2006 (the code). The code sets out a number of elements to be included in an annual report from the Head of Internal Audit. These are:
 - an opinion on the overall adequacy and effectiveness of the internal control environment
 - any qualifications to the opinion
 - a summary of audit work undertaken
 - any issues particularly relevant to the Annual Governance Statement
 - a comparison of the work undertaken against the plan and performance issues
 - a comment on compliance with the CIPFA code
- 2.2 The opinion in this report is based on the work undertaken by Internal Audit¹, the Corporate Anti-fraud and Corruption Team (A-FACT)², the Insurance and Risk Management Group³ and, where relevant, external review bodies.

¹ The Internal Audit service was provided by RSM Tenon (formerly RSM Bentley Jennison) throughout 2009/10.

² The Anti-fraud and Corruption Team is the Council's in-house investigation service.

³ Risk management is provided by the in-house service, supported by Jardine Lloyd Thompson as the need arises.

3 Opinion of the Head of Audit and Risk

- 3.1 *"I have considered all of the work conducted by the Internal Audit service and the Anti-fraud and Corruption Team for the year ended 31st March 2010, and work undertaken post year end. This includes oversight of all internal audit reports and fraud investigations. In my opinion, **satisfactory assurance** can be placed on the adequacy and effectiveness of the controls in place in those areas reviewed by Internal Audit. Where weaknesses have been identified, these are being addressed by management. Throughout 2010/11, Internal Audit will carry out follow up reviews to assess the progress being made by managers to address the weaknesses.*
- 3.2 *I have also considered the risk management processes in operation throughout the Council. This has been assessed during 2009/10, by RSM Tenon, who have concluded that the Council has maintained its position as 'Risk Managed', the second highest level in a range of five categories. I am satisfied that the Council has an established and robust risk management process in operation which is constantly being challenged and enhanced to ensure that the processes remain fit for their intended purpose.*
- 3.3 *In addition, I was part of the team of senior officers that produced the Annual Governance Statement for the Council. I am satisfied that the content of the statement is accurate and its completion has complied with the relevant CIPFA guidance. Any issues which I have judged relevant to the preparation of the Annual Governance Statement have been included."*

4 Qualifications to the Opinion

- 4.1 The audit opinion is based largely on the work that has been undertaken during the year by the Audit and Risk Division. To make the most effective use of the available internal audit resources, the work of Internal Audit is set out in an annual internal audit plan that covers the key financial systems, schools, and the operational activities where Internal Audit and management perceive there are risks to achieving operational objectives. The work of A-FACT is predominantly derived from referrals of potential fraud and the review of output from data matching exercises. The risk management work undertaken is largely proactive and has been designed to ensure that risk management is embedded throughout the Council and appropriate action is being taken to manage risks effectively.

5 Internal audit

5.1 The work of Internal Audit is set out in an annual internal audit plan that has been agreed by the Audit Panel. The plan is designed to focus internal audit resources on the Council's fundamental systems and key operating risks, and is based upon a number of factors, including:

- the Corporate, Directorate and Service level risk registers
- the risk categories used in compiling the risk registers and Internal Audit's own assessment of risk in the operational areas
- the adequacy of the risk management, performance management and other assurance processes within the Council
- the requirements of the external auditors and their ability to place reliance on the work of Internal Audit in forming their opinion on the Council's Financial Statements
- the extent and scope of audit activity in previous years
- previous audit reports and recommendations made to strengthen controls or enhance systems
- external factors such as the Financial Management Standards in Schools (FMSiS) and grant conditions,
- the requirements of regulations and legislation
- the views of the Directorates

5.2 The 2009/10 internal audit plan was approved by the Audit Panel in March 2009. RSM Tenon provided the Council with 1165 productive audit days during 2009/10 and completed a total of 110 internal audits. Table 1 below has been included for comparison purposes and shows the productive audit days delivered and the number of audits completed by internal audit during the last three years⁴. This table shows that there has been a significant improvement in the number of audit days delivered and audits completed in the last two years, compared to 2007/08.

Year	Delivered Audit Days	Audits Completed
2009/10	1165	110
2008/09	1396	107
2007/08	1065	72

Table 1. Number of productive audit days and completed audits delivered during the last 3 years

⁴ In 2007/08 the internal audit service was provided by an in-house team of ten auditors supplemented by additional resources purchased from external suppliers, equating in total to around 11.5 full time equivalent employees. In 2008/09 and 2009/10, the internal audit service has been provided entirely by an external contractor and this equates to approximately 7 and 6 full time equivalent employees for the respective years.

5.3 Although there are some internal audit reviews yet to be completed to final report stage, the percentage of audits completed to both draft report (97%) and final report (82%) stages has significantly improved compared to last year, as can be seen from table 2 below. This improvement is particularly noticeable for the audits that have reached final report stage.

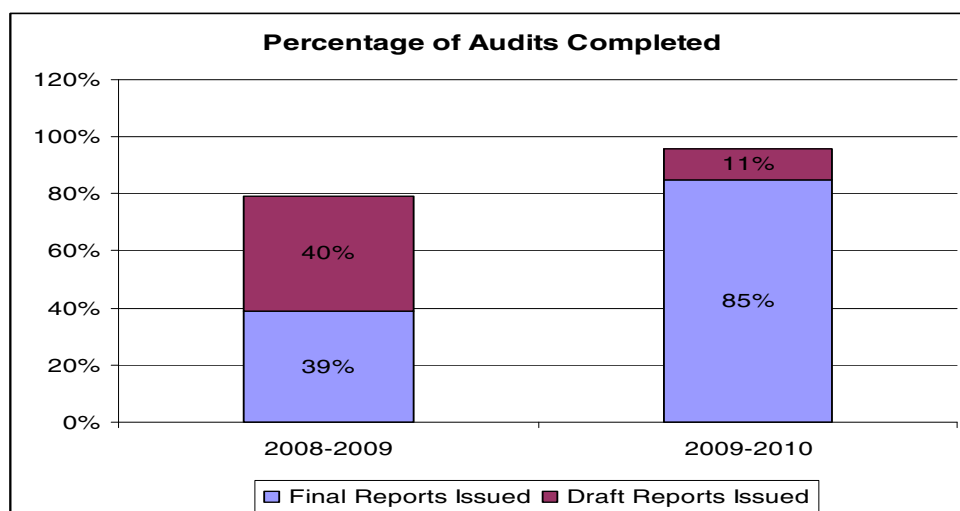


Table 2. Comparison of audits completed to draft and final report stages

5.4 For each audit where controls have been analysed, Internal Audit issues an assurance statement which indicates the level of assurance that management can place on the adequacy and effectiveness of the internal controls within the area that has been audited. For 2009/10, four levels of assurance were used. The two positive levels used were 'substantial and adequate assurance' and the two negative levels used were 'limited and no assurance'.

5.5 Key Financial Systems

The key financial systems are fundamental to the operation of the Council, so it is important that these systems have robust internal control mechanisms and operate effectively. Consequently Internal Audit tends to review these systems every year and, providing they are happy with the quality of the work, the Council's external auditors will place reliance on it. A total of thirteen key financial systems audits have been completed as part of the 2009/10 internal audit plan. A further two audits, payments to residential and domiciliary care providers and looked after children, are in progress and are approaching the draft report stage.

Table 3 below shows the assurance levels issued for each of these key financial systems for both 2009/10 and 2008/09. The direction of travel for each of these systems has also been shown. The Head of Audit and Risk can confirm that all of these key financial systems have been issued with a positive assurance level, and some 60% with substantial assurance, the highest level used by Internal Audit. The Head of Audit and Risk can also confirm that, overall, some 90% of these systems have either maintained or improved their assurance level on 2008/09.

Key Audit	08/09 Assurance Level	09/10 Assurance Level	Assurance Level Direction of Travel	
Budget Setting & Control	Adequate	Substantial	Improved	▲
Capital Programme and Expenditure	Adequate	Adequate	No change	◀▶
Cash Collection and Banking	Substantial	Substantial	No change	◀▶
Council Tax	Substantial	Substantial	No change	◀▶
Creditors	Limited	Adequate	Improved	▲
Sundry Debtors	Substantial	Adequate	Deteriorated	▼
Fixed Assets	Adequate	Adequate	No change	◀▶
Housing Benefits	Substantial	Substantial	No change	◀▶
Main Accounting System / General Ledger	Substantial	Substantial	No change	◀▶
NNDR	Substantial	Substantial	No change	◀▶
Payroll	Limited	Adequate	Improved	▲
Pensions	Substantial	Substantial	No change	◀▶
Treasury Management & Investments	Substantial	Substantial	No change	◀▶

Table 3. Internal Audit Assurance levels for the key financial systems

5.6 Risk Based Systems

A total of 44 of the planned risk based audits for 2009/10 have so far been completed to final report stage. Of these, 31 (70%) have been issued with a positive assurance level of either adequate or substantial assurance, indicating that, on the whole, the Council is managing its operational risks effectively. Of the risk based audits carried out in 2008/09 where limited assurance levels were issued, eleven of these have received follow-up reviews and in each case significant progress had been made to improve internal controls and implement the recommendations made in the previous audits. On this basis, the assurance levels for these eleven operational areas have been raised to either the adequate or substantial assurance levels.

Table 4 below has been included to give members a feel for the spread of the assurance levels issued for both the key financial and risk based audits so far completed for 2009/10 (85%) with those audits completed in for 2008/09 (100%). Overall, the percentages of audits with positive assurance level opinions is broadly similar between the two years, although it should be remembered that 15% of the 2009/10 audits have yet to reach final report stage.

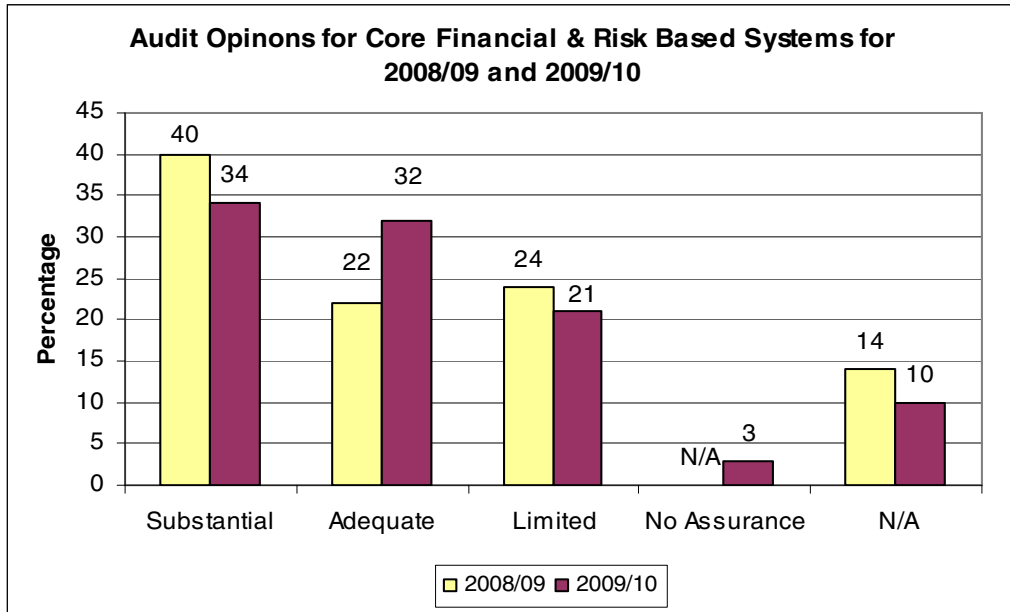


Table 4. Audit assurance levels for core financial and risk based audits completed in 2008/09 and 2009/10

Where recommendations have been made to enhance controls or address specific issues identified in the key financial systems and the risk based audits, these have been classified according to their level of significance. For 2009/10, recommendations were classified as either 'fundamental', 'significant' or 'merits attention', with 'fundamental' being the highest priority classification.

Table 5 below shows the spread of these recommendations for the key financial systems and the risk based audits that have reached final report stage. As can be seen from this table, only 6% of the recommendations so far made have been at the 'fundamental' level.

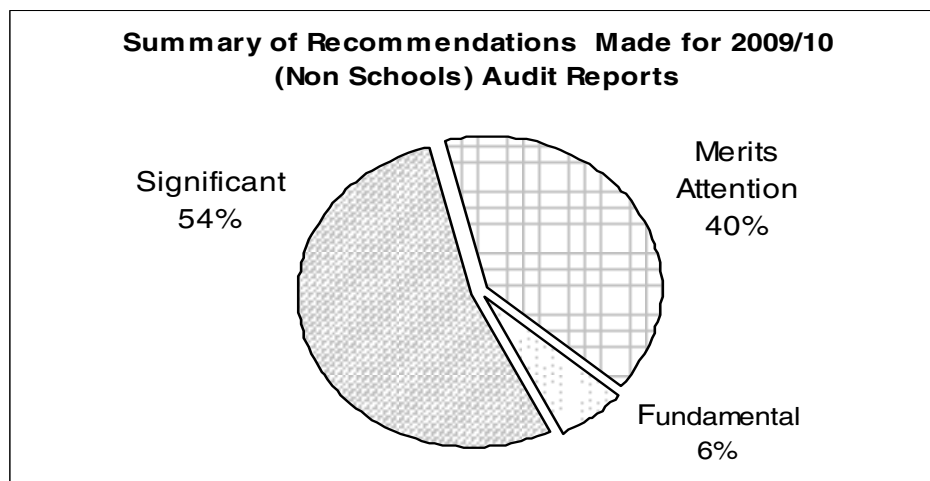


Table 5. Percentage of recommendations made for each category (non schools)

5.7 Schools

At the end of 2008/09, the Council found itself in the position where 51% of the schools that had been audited only received a limited assurance opinion. During 2009/10,

management within the Children and Young People’s Directorate have focussed much attention on improving the standard of internal control in its schools. The Head of Audit and Risk can confirm that this has been effective. As can be seen from table 6 below, in 2009/10 only 16% of the finalised school audits have received negative audit assurance levels. Of the schools that received a limited assurance level in 2008/09, sixteen have received follow-up reviews in 2009/10 and in every case significant progress had been made towards improving internal controls and implementing the recommendations made by Internal Audit. On this basis, the assurance levels for these sixteen schools have been raised to either the adequate or substantial assurance levels.

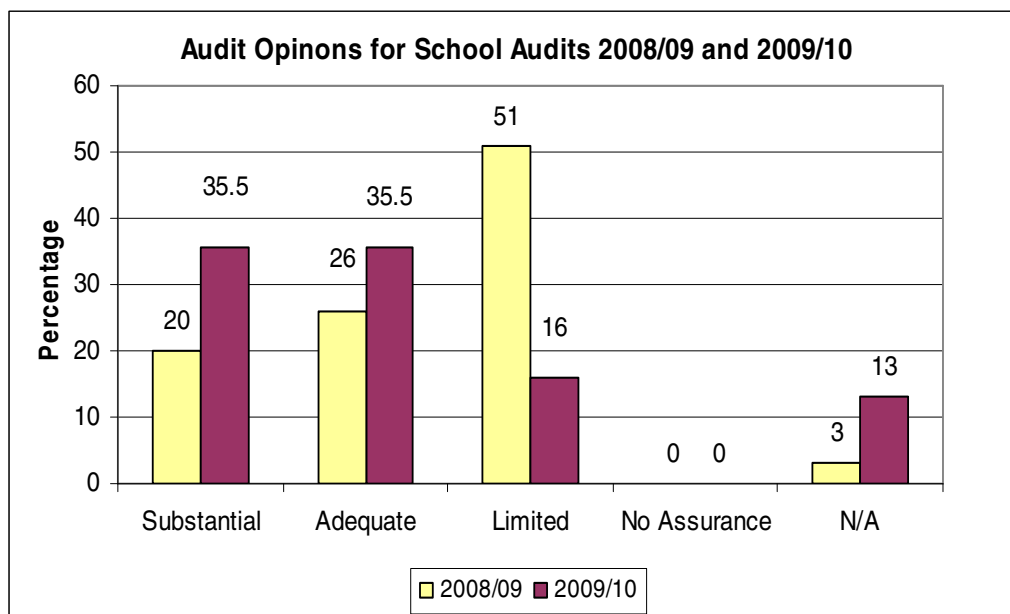


Table 6. Audit assurance levels for schools in 2008/09 and 2009/10

Where recommendations have been made to enhance controls or address specific issues identified during the school audits, they have been classified according to their level of significance. Again the recommendations were classified as either ‘fundamental’, ‘significant’ or ‘merits attention’, with ‘fundamental’ being the highest priority classification.

Table 7 below shows the spread of these recommendations for the schools that have reached final report stage. As can be seen from this table, only 3% of the recommendations made have been at the ‘fundamental’ level.

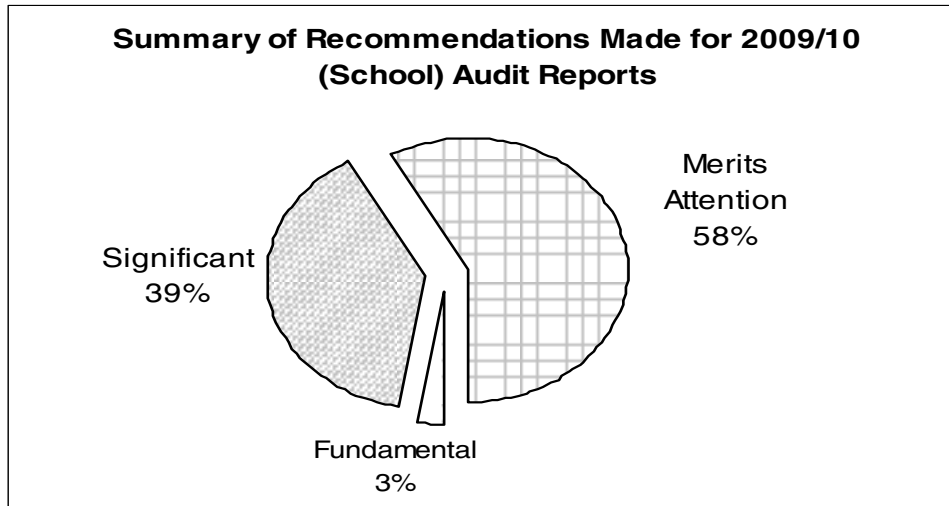


Table 7. Percentage of recommendations made for each category (schools)

6 Anti-fraud and Corruption

6.1 In addition to internal audit work, the Audit and Risk Division has responsibility for fraud investigation across the Council. Fraud investigation is carried out by the Anti-Fraud and Corruption Team (AFACT). Fraud can impact upon the Council's finances and may have implications for the systems of internal control.

Fraud affecting the Council can be split between internal fraud committed by Council staff, or external fraud, committed by third parties. In line with other large organisations in both the public and private sector, the Council suffers from both.

The anti-fraud case load of AFACT is split into four categories as follows:-

- **Housing and Council Tax Benefit investigations**
The investigation of fraudulent claims for Housing and Council Tax benefit, generally by third parties;
- **Housing Investigations**
The investigation of fraud relating to the housing stock, such as sub-letting, obtaining a property by deception, fraudulent right to buy applications and fraudulent homelessness applications, generally by third parties;
- **Special Investigations**
The investigation of all other fraud and irregularity not covered by the above two categories. Generally this tends to be internal fraud and irregularity, but also includes third party fraud for example fraud committed by contractors, misuse of disabled parking blue badges and freedom passes, and cheque fraud;
- **Fraud Prevention**
This covers preventative checks on new employees prior to commencing employment with the Council, school place applications, tracing children missing from education, fraud awareness training and the provision of information for other enforcement agencies.

6.2 Housing and Council Tax Benefit investigations

During 2009/10, the Benefit Investigations Section received a total of 548 referrals of potential benefit fraud, and they completed and closed a total of 486 cases. At the end of March 2010, the section had a further 416 open investigations in progress. The section secured a total of 143 sanctions during the year, compared to an annual performance target of 145, and identified recoverable benefit overpayments as a result of these investigations totalling some £650k.

Table 8 below shows the performance of the Benefit Investigations Section over the past four years. As can be seen from this table, the number of closed cases is broadly similar to 2006/07 and 2007/08, when the section had two more investigators than the current establishment. Although the level achieved in 2008/09 was higher, this included the initial review of the output from the National Fraud Initiative where many referrals are closed immediately after the first assessment. However, the most significant variation between the years that is apparent from the table is in the level of recoverable benefit over payments identified from completed investigations, being some 40% higher than the previous years.

Year	No. of Referrals Received	No. of Cases Closed	No. of Open Cases at Year End	No. of Sanctions Issued	No. of Sanctions Issued per Investigator	Value of Recoverable Benefit Over Payments
2007/08	469	483	554	164	18	£455,773
2008/09	561	761	354	159	23	£450,569
2009/10	548	486	416	143	20	£651,827

Table 8. Performance statistics for the Benefits Investigation Section

In 2009/10 the Benefit Investigators successfully prosecuted 13 people for benefit fraud and secured some notable convictions, many of which received local press coverage, including several cases where custodial sentences were given to the convicted fraudsters, ranging in length from eight to thirty eight months.

A-FACT continues to benefit from the support of a serving police officer from the Metropolitan Police Service who is seconded to the team. His contribution to the work of the team has been invaluable. A-FACT currently has two accredited fraud investigators with a further undergoing the training with the Metropolitan Police Service. During 2009/10 these officers were instrumental in bringing successful actions in court under the powers of the Proceeds of Crime Act, to recover assets in excess of £150k from criminals.

- 6.3 In October 2008, the investigation of housing tenancy fraud transferred to Lewisham Homes, along with two of the Council's Housing Investigators. We understand that Lewisham Homes have recovered nine properties from illegal occupants during 2009/10.

A-FACT has retained one post to undertake the more complex investigations of housing and homelessness application fraud and cash incentive scheme payments fraud against the Council. During the year to the end of March 2010, a total of 63 new cases were

passed for investigation, compared with 38 cases in 2008/09. The officer dealing with these cases completed 35 cases during the year and currently has 59 open cases under investigation. Of the 35 cases that were completed, 13 resulted in successful outcomes of either fraudulent housing applications being stopped or tenancies recovered. Two cases resulted in successful prosecutions for housing fraud.

- 6.4 During 2009/10, the Special Investigations Section received a total of 187 new referrals in relation to alleged fraud or irregularity. As can be seen from table 9 below, this figure is more than double the number of referrals received for each of the previous two years. During the year the Special Investigations Section completed a total of 168 cases, leaving 97 cases in progress at the year end.

Year	Case Load at Start of the Year	New Cases Received	Cases Closed During the Year	Case Load at End of the Year
2007/08	98	92	89	101
2008/09	101	88	109	80
2009/10	80	187	168	97

Table 9. Case load statistics for Special Investigations Section

The table 10. below shows the breakdown of the types of action taken following the conclusion of investigations for 2009/10 and the previous two years. The type of actions that fall under the 'other action' column include changes to procedures or enhancements to systems.

Year	Dismissed / removed from contract	Dismissed & Convicted	Resigned during enquiry	Other disc. Action	Job offer with-drawn	Blue badge action taken	Other action
2007/08	4	1	1	3	0	1	2
2008/09	4	1	2	1	2	3	7
2009/10	3	0	4	3	6	7	5

Table 10. Breakdown of the actions resulting from concluded investigations

- 6.5 The Special Investigations Section also carry out the pre-employment checks on new employees to the Council. The number of pre-employment questionnaires processed by AFACT during 2009/10 is below the levels for the previous two years as can be seen in the table 11 below:-

Year	Pre-employment Questionnaires Processed
2007/08	566
2008/09	553
2009/10	443

Table 11. Number of pre-employment checks undertaken

The section also handled 1275 requests for information from other enforcement agencies during 2009/10; reviewed 27 applications for school places where management believed the applicants were not living at the address stated on the application; and assisted the Education Welfare Officers on 193 occasions to trace children missing from education.

- 6.6 In 2009/10, A-FACT spent a considerable amount of time working on the output from the bi-annual National Fraud Initiative (NFI) exercise. This NFI exercise was one of the most comprehensive exercises so far facilitated by the Audit Commission and resulted in the matching of some 8,000 electronic datasets from 1,300 organisations with the view to prevent fraud in the public sector. The organisations taking part in the exercise include police authorities, local probation boards, and fire and rescue authorities, as well as the usual local authorities and NHS trust participants.

Lewisham received over 5,000 matches from the exercise which then had to be filtered and an assessment made as to whether the case was suitable for investigation or closed without any further action. Although the investigation of some cases is continuing, the majority of the resulting work has now been completed with the following outcomes:

- Benefit fraud – 2 prosecutions, 7 Admin Penalties, and 13 Cautions being issued;
- £245,613 of fraudulently claimed benefit identified and this in the process of being recovered;
- One immigration offender who when challenged by the team resigned their post and has subsequently disappeared;
- A duplicate payment of £83,326 had been made to a creditor. This related to a repayment of NNDR to a local business. Action is underway to recover this money.

The Audit Commission has just released its report on the results of the latest exercise and the London Borough of Lewisham is mentioned in the case studies relating to Benefit Fraud as a good example of two public sector organisations working jointly to bring about a successful prosecution.

7 Risk Management

- 7.1 The Council has been developing its approach to risk management since 2002 and has recognised that risk management could be a key tool for demonstrating to all stakeholders that its aims and objectives were being delivered in a controlled environment, and that its consideration could add value to services. During 2009/10, the Council's Internal Audit service undertook their annual risk maturity review of the Council and have confirmed that, once again, Lewisham is a strong 'risk managed'⁵ organisation. As a result, Lewisham's approach and understanding of risk is well established.
- 7.2 The Council has a clearly defined risk management strategy and policy in place. It defines the roles and responsibilities of individuals, directorates and groups, and sets out how the risk management process will be embedded.
- 7.3 A corporate approach to quantifying and describing risk is used, and these risks are reviewed on a regular basis at a strategic level by the most senior members of the Council's management team who are all members of the Internal Control Board (ICB). The ICB's non-executive Chair provides an independent and external level of challenge to the risk registers presented. Directorate level risks are considered on a regular basis, at least a quarterly, by the respective management teams, although additions and deletions to the registers are considered as and when required between such meetings.
- 7.4 Risk champions within the directorates meet quarterly at the Risk Management Working Party to discuss themes, trends and cross cutting issues around the registers maintained. The Council's Group Manager, Insurance and Risk condenses the directorate registers into the Corporate Risk Register. This judgement is reviewed by the ICB at its quarterly meetings where all directorate registers are examined.
- 7.5 The Mayor and Cabinet for the Council are appraised on risk management on a monthly basis in the management report, and this briefing clearly maps the risks identified to the Council's key priorities.

8. Compliance with the CIPFA Code of Practice for Internal Audit in Local Government

- 8.1 The CIPFA Code of Practice is a non-statutory code. However, the Accounts and Audit Regulations 2003, as amended in 2006, requires the Council to maintain an adequate and effective system of internal audit in accordance with proper internal audit practices. The guidance accompanying the Accounts and Audit Regulations specifies that proper practices are those contained within the CIPFA code. Internal Audit is, therefore, required to comply with the code.
- 8.2 The Internal Audit Team works in accordance with these standards and has a quality control mechanism which involves an internal quality review of all audit reports, and ongoing supervision and appraisal of all staff.

⁵ Risk managed is the second highest level on the Institute of Internal Auditors' 'Risk Maturity' scale, a five point scale designed to measure an organisations understanding and application of risk management.

- 8.3 The Accounts and Audit (amendment) Regulations 2006 placed a further requirement on the Council to, "at least once in each year, conduct a review of the effectiveness of its system of internal audit" and that, "the findings of the review referred ..shall be considered, as part of the consideration of the system of internal control." Some authorities have chosen to employ consultants to undertake the review, others use a peer review process whilst some rely on their audit committee. For 2009/10 Internal Audit's compliance with the standard was assessed in three ways. The first was by a self assessment approach to the effectiveness of internal audit; the second was by a peer challenge review undertaken by the London Borough of Croydon; and the third was by the Audit Commission who carried out a full triennial review of the service. All three reviews confirmed that Internal Audit complies with the requirements of the CIPFA code.
- 8.4 The work of the internal audit team has been reported to the Internal Control Board and the Audit Panel on a regular basis, together with summaries of audit work undertaken and progress on the implementation of audit recommendations.