

AUTHORITY REPORT: INTERNAL AUDIT PROGRESS REPORT 2011/12, AUDIT PLAN 2012/13 AND PLANNED AUDIT COVERAGE TO MARCH 2017

1. Confidential Report

1.1 No

2. Recommendation:

2.1 Members are asked to:-

- a) note the audit coverage for 2011/12 as outlined in Section 6;
- b) agree the audit coverage for 2012/13 as outlined in Section 7.
- c) agree the Five Year Strategic Plan set out in Appendix A

3. Purpose

- 3.1 To advise Members of the progress of Internal Audit coverage and findings arising during 2011/12.
- 3.2 To seek Members' comments and agreement to the proposed Internal Audit Plan for 2012/13 and the five-year rolling programme attached at Appendix A.

4. Executive Summary

4.1 The report outlines Internal Audit work undertaken during 2011/12. Overall Internal Audit has reached the opinion that the Authority's core financial systems are generally sound, although areas for improvement were identified. The report also sets out the proposed areas of work for 2012/13 based on the attached five-year plan.

5. Background

- 5.1 The objective and responsibility of the Internal Audit function is to provide Members and management with an independent view and assurance concerning the robustness of the systems and procedures within ELWA and in particular for the effective management of the contract with Shanks East London Ltd (SEL), thereby safeguarding assets from fraud and wastage. Internal Audit coverage has and will continue to concentrate on reviewing systems and procedures within ELWA to ensure the effective management of the contract.
- 5.2 The Internal Audit strategy / plan was agreed on 27 June 2011. The purpose of the strategic plan is to ensure total audit coverage of the key systems / areas of activity within ELWA's unique operational environment. It is intended to fulfil this responsibility by working in conjunction with the External Auditor in keeping with the principles of "Managed Audit" advocated by the Audit Commission and aims to avoid any duplication of audit effort. Where the External Auditor can place reliance upon the work of internal audit, this can assist in minimising the number of days (and cost) of external audit work.
- 5.3 The Internal Audit function is provided by the London Borough of Redbridge (LBR) and reports directly to the Finance Director, ELWA, who is the Section 151 Officer and who subsequently reports on Audit matters to the Authority.
- 5.4 This report provides Members with:-
 - a) a brief summary of the audit coverage for 2011/12;
 - b) a list of the Audit Areas due to be undertaken during 2012/13;
 - c) Details of the proposed five-year rolling audit plan, which sets out the coverage at a strategic level for the following five years (2012/13 to 2016/17).

6. Current Position

Internal Audit Coverage During 2011/12.

6.1 The main focus of Internal Audit activity during this year has been to undertake the planned reviews of Contract Management and Financial Management involving detailed substantive checks of the Integrated Waste Management Strategy (IWMS) Contract invoices. Much of the emphasis of the audit of Contract Management was to be a review of the controls and processes following the introduction of hand-held monitoring devices, which was scheduled for 2011/12. However these hand-held devices had proved to be unreliable and not

practicable and therefore the audit concentrated upon the revised systems in place. As a result of issues raised by Newham, principally around weighbridge controls and the authorisation of vehicles, a request was received from the Finance Director to undertake an additional audit to those in the plan that looked at Recycling & Waste Disposal, concentrating specifically on the issues raised by Newham. The audit of Recycling & Waste Disposal has been finalised and draft reports have been issued and action plans are in the process of being agreed for both Contract Management and Financial Management.

- 6.2 Based upon the audit work undertaken during 2011/12, Internal Audit has reached the opinion that the Authority's core financial systems are generally sound, although areas for improvement were identified within each of the assignments undertaken that will need to be addressed before controls can be considered fully effective. There was one allegation of fraud concerning collusion between a third party contractor and Shanks however a subsequent investigation found no evidence to support this claim. As no system of control can provide absolute assurance against material misstatement or loss, nor can Internal Audit give that assurance, this statement is intended to provide reasonable assurance. The main findings of the audits undertaken during 2011/12 are set out below.

Audit of Contract Management

- 6.3 Overall, we are satisfied that the systems in place are generally sound although the anticipated improvements in the consistency and documenting of inspections from the introduction of the hand-held monitoring devices did not materialise due to the problems encountered once the devices were put into full operation. The main area of the audit's focus was the inspections undertaken by ELWA and the constituent councils and the interim monitoring arrangements that had to be put in place together with the documenting of these inspections. The principal problem encountered was the councils utilising a number of officers to undertake the inspections, which would have resulted in the need for the purchase of an additional 10 devices per borough, together with the unreliability of the software and the actual physical issues of keying in the information on the small devices, which were essentially smart phones.
- 6.4 The result of the failure of the hand-held device initiative meant that monitoring processes, in the main, reverted to those previously used before the hand-helds were introduced. This has led to many of the issues, such as poor completion and inconsistencies in the inspection reports between the boroughs, arising again.
- 6.5 The service level agreements (SLA) ELWA has with each of the constituent councils set out the monitoring checks to be undertaken by the boroughs. Our review of the SLA requirements against the actual monitoring undertaken found that a number of the checks had not been carried out and that these had not been identified by ELWA as part of their own reviews when monitoring the contract. It is understood that ELWA are looking to revamp the SLAs for 2012/13 by including a base set of requirements for the boroughs' inspections but then directing the focus of the remaining resource towards monitoring of the areas the boroughs themselves would like targeted.
- 6.6 Failures to achieve the turnaround times specified within the contract performance standards and identified by Shanks continues to be the main reason for performance failures and deductions (approximately 20 per month), although it was noted that some administration penalties had also been applied. We did note however that there does not appear to be any link between the results from the inspection visits undertaken and the performance deductions as neither inspection visits carried out by the boroughs or by ELWA have resulted in any penalties being applied.
- 6.7 Regular minuted meetings are held with the boroughs and with Shanks to monitor the delivery of the IWMS contract. Shanks supplies a great deal of management information on the waste processed with the monthly invoice contained within the WasteDataFlow spreadsheet and this is used by ELWA as a key component of their contract monitoring.
- 6.8 It was our opinion that because the improvements expected from the introduction of the hand-held monitoring devices have not materialised, the boroughs' obligations regarding inspection visits were not met and were not identified as part of ELWA's monitoring processes that limited assurance is given for this review. Management have advised that it is their

intention to review monitoring and inspection procedures during 2012 to ensure that resources are targeted towards the most appropriate areas.

Audit of Financial Management

- 6.9 Our in-depth review of a sample of individual sections of invoices for the Integrated Waste Management Service contract has identified that the TIMS system is capturing the weighbridge data accurately but that some errors within the invoices had gone unnoticed and will need to be adjusted. Whilst checking procedures should be amended to ensure that such errors are prevented in future, these amounts are not considered material when reviewed in conjunction with the overall contract sum.
- 6.10 One particular area where checking routines need to be tightened up is performance deductions where some errors were noted in the calculations and it was also noted that the annual uplift had not been applied to any of the performance failures during 2011/12.
- 6.11 We checked to ensure that Shanks had identified all failures to achieve the contract turnaround times and we did not uncover any other instances but we did note a number of occasions where the turnaround time was reported as zero minutes, where explanations should have been recorded on the TIMS system.
- 6.12 Following our recommendation last year ELWA are now carrying out checks of abnormally large weights and as part of our audit we also undertook some checks of this area and we did find two instances where the vehicle tare weights had been incorrectly recorded resulting in the weight tipped being overstated and therefore ELWA being overcharged.
- 6.13 It was our opinion, based upon the areas examined during the audit, that whilst a number of errors were identified within the invoices, particularly in relation to performance failure deductions, these amounts were immaterial when viewed in conjunction with the contract sum (approximately £5m per month) as a whole and the number of tips (approximately 8,000 tips per month) and therefore substantial assurance is given for this review.

Audit of Recycling & Waste Disposal

- 6.14 This audit was undertaken at the request of the Finance Director as a result of the fraud allegation referred to in 6.2 above. Controls in place for the disposal of waste through either landfill or recycling were found to be satisfactory ensuring that tonnages were accurately reported and appropriate charges raised for both of these streams. We did note however weaknesses within the processes for authorising vehicles for the constituent councils and the arrangements with third parties using the site facilities through the IWMS contract.
- 6.15 The constituent councils authorise their own vehicles through the completion of a pro-forma and manage their own list of authorising officers, both of which are copied to Shanks. We did note however one unauthorised officer from one of the constituent councils was authorising vehicles to be removed from the list. We found that Shanks were updating TIMS with the details of the vehicles to be added and removed but that the back-up records, used when TIMS is unavailable, were not up to date. Shanks management had informed Audit that controls had been introduced to prevent vehicles remaining on the list indefinitely but our checks found that these were not being implemented at the weighbridge.
- 6.16 Observation visits were undertaken at a number of the weighbridges and these identified instances of the tonnage delivered being overstated because one of the crew members was out of the vehicle when the out-weight was captured. CCTV images were not found to be particularly clear, particularly when freeze frame and frame advance features were used, which may hamper any investigations should they need to be undertaken.
- 6.17 A small number of arrangements have existed whereby constituent councils have used the IWMS contract for processing waste collected by third parties. We noted that these arrangements had not been formalised through a written contract. The controls in place do not prevent such third parties double (or worse) counting waste that they have weighed at the weighbridge before taking it off site for processing.
- 6.18 It is our opinion that because of the weaknesses within the councils' processes for authorising vehicles and their arrangements with third parties using the site facilities through the IWMS contract, limited assurance is given for this review.

7. Internal Audit Coverage for 2012/13

- 7.1 The annual plan is structured to react to changing circumstances while considering the strategic implications / risk management issues for the Authority. The annual audit plan is formulated from discussions with the Finance Director / Section 151 Officer and the Managing Director and is based on an annual risk assessment process so that identified concerns are assessed and evaluated to determine the impact on the Authority. The risk assessment process takes into consideration the risks identified in the Authority's risk register, but also considers other factors such as previous audit findings, materiality, volume and value of transactions, complexity and stability of systems, contract compliance and level of irregularities. This ensures the plan is responsive to the needs of the Authority. Based on Internal Audit's previous work, foremost amongst those aspects, which need to be regularly reviewed, are the arrangements for the management and monitoring of the Integrated Waste Management Contract.
- 7.2 To enable Internal Audit to target its resources most effectively, coverage has been set at a more strategic level and forms part of a rolling five-year plan, a copy of which is attached at Appendix A.
- 7.3 The main area of focus for 2012/13 will be an audit of risk assessment and business continuity planning. The financial management audits, which involve the detailed checks of the IWMS invoices, are now planned as an annual review and this will be the subject of our second review and this time it will include the annual reconciliation.
- 7.4 It is also intended to continue to carry out follow up work to ensure that actions agreed by management have been implemented and to seek explanations where recommendations have not been implemented in the appropriate time scales. Internal Audit will annually report to the Authority on the progress made by management on the implementation of high risk recommendations.
- 7.5 As stated in paragraph 6.2 above, it is proposed that the updated rolling five-year plan be adopted for future audit coverage with the areas for review set at a higher, strategic level. This plan is attached for Members approval. The updated plan will enable greater flexibility and mean that Internal Audit will be able to respond to changing priorities and the concerns of Members and Management. Like the previous plan this has been risked assessed and enables internal audit resources to be targeted accordingly.

8. Performance and Effectiveness of Internal Audit

- 8.1 The requirements of the Accounts & Audit Regulations 2011 provide the necessary assurance to Members and Management as to the adequacy of the Internal Audit function. It is important that the effectiveness of the work of Internal Audit is monitored and reported, to do this a range of performance criteria is closely monitored by the Chief Auditor throughout the year. It is also essential that Internal Audit obtain the views of ELWA regarding the service it delivers and the value it adds to ELWA's business objectives. Another important measure of the effectiveness of Internal Audit is the reliance that can be placed on its work by the External Auditors. It is encouraging that the External Auditors continue to place reliance on Internal Audit's work.
- 8.2 As the Authority's Section 151 Officer I have undertaken a review of the Internal Audit process and its effectiveness. This has included regular briefings to me by the Chief Auditor / Audit Manager and the External Auditor. My view based upon my experience of the Internal Audit Section's advice and performance, external guidance on Internal Audit and the feedback received, is that the Authority has a sound and robust system of Internal Audit, which continues to adapt and respond to the changing needs of the Authority.

9. Conclusions

- 9.1 Based upon the audit work undertaken during 2011/12 Internal Audit has reached the opinion that the Authority's overall control framework is generally sound and the core financial systems continue to operate effectively and there are no fundamental breakdowns in control resulting in material discrepancy. This view is re-enforced by the Authority's External Auditors.

9.2 I feel confident that through this process and the assurances received, notably from Internal Audit, External Audit and other sources, I will be well placed to provide an opinion as to the overall adequacy and effectiveness of the Authority's internal control environment to Members and Management.

10. Relevant officer:

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11. Appendices attached:

Appendix A: Five Year Strategic Plan

12. Background papers:

12.1 Internal audit reports on:-

- a) Contract Management 2011/12
- b) Financial Management 2011/12
- c) Recycling and Waste Disposal 2011/12

13. Legal considerations:

13.1 None

14. Financial considerations:

14.1 This report requests that Members consider and agree the Internal Audit outturn for 2011/12, the 2012/13 Audit Plan and the planned audit coverage to March 2017. Findings from the progress report for 2011/12 will support the production of the Authority's Annual Governance Statement, which is an integral part of the Authority financial statements.

14.2 The Internal Audit Plan and Strategy was agreed on the 27 June 2011 and it was this programme of work that was considered essential in ensuring an appropriate level of audit coverage in key financial systems and areas of activity.

15. Performance management considerations:

15.1 None.

16. Risk management considerations:

16.1 The decision to agree the audit coverage for 2012/13 as outlined in Section 7 should help ensure ELWA's strategic and operational risks are identified and appropriate control strategies implemented to mitigate these risks.

17. Equalities considerations:

17.1 None.

18. Follow-up reports:

18.1 None.

19. Websites and e-mail links for further information:

19.1 Eastlondonwaste.gov.uk

20. Glossary:

CCTV – Closed-circuit Television

Constituent Councils – London Boroughs of Barking & Dagenham, Havering, Newham and Redbridge

ELWA – East London Waste Authority

IWMS - Integrated Waste Management Strategy

LBR – London Borough of Redbridge

SEL – Shanks east.london

21. Approved by management board

21.1 23 April 2012

22. Confidentiality:

22.1 None.