

**READING BOROUGH COUNCIL
DIRECTOR OF CORPORATE RESOURCES**

| | | | |
|-------------------------|---|---------------------|--|
| TO: | AUDIT & GOVERNANCE COMMITTEE | | |
| DATE: | 27th September 2018 | AGENDA ITEM: | 5 |
| TITLE: | INTERNAL AUDIT QUARTERLY PROGRESS REPORT | | |
| LEAD COUNCILLOR: | COUNCILLOR BROCK | PORTFOLIO: | CORPORATE AND CONSUMER SERVICES |
| SERVICE: | FINANCE | WARDS: | N/A |
| LEAD OFFICER: | PAUL HARRINGTON | TEL: | 9372695 |
| JOB TITLE: | CHIEF AUDITOR | E-MAIL: | Paul.Harrington@reading.gov.uk |

1. PURPOSE OF THE REPORT

1.1 This report provides the Audit & Governance Committee with an update on key findings emanating from Internal Audit reports issued since the last quarterly progress report in July 2018.

1.2 The report:

- Provides assurance, commensurate with the control environment evidenced by audits conducted in the last quarter.
- Advises on significant issues where controls need to improve to effectively manage risks.
- Tracks progress on the response to audit reports and the implementation of agreed audit recommendations.





1.3 A high level summary of audits completed and the allocated opinion along with the number and type of recommendations made is as follows:

2. RECOMMENDED ACTION

2.1 The Audit & Governance Committee re requested to consider the report.

3. ASSURANCE FRAMEWORK

3.1 Where appropriate each report we issue during the year is given an overall assurance opinion. The opinion stated in the audit report provides a brief objective assessment of the current and expected level of control over the subject audited. It is a statement of the audit view based on the terms of reference agreed at the start of the audit; it is not a statement of fact. The opinion should be independent of local circumstances but should draw attention to any such problems to present a rounded picture. The audit assurance opinion framework is as follows:

| | | |
|--------------|---|---|
| Substantial |  | <p>Substantial assurance can be taken that arrangements to secure governance, risk management and internal control, within those areas under review, are suitably designed and applied effectively. Few matters require attention and are compliance or advisory in nature with low impact on residual risk exposure.</p> |
| Reasonable |  | <p>We can give reasonable assurance that arrangements to secure governance, risk management and internal control, within those areas under review, are suitably designed and applied effectively. Some matters require management attention in control design or compliance with low to moderate impact on residual risk exposure until resolved.</p> |
| Limited |  | <p>Limited assurance can be taken that arrangements to secure governance, risk management and internal control within those areas under review, are suitably designed and applied effectively. More significant matters require management attention with moderate impact on residual risk exposure until resolved.</p> |
| No assurance |  | <p>There is no assurance that arrangements to secure governance, risk management and internal control, within those areas under review, are suitably designed and applied effectively. Action is required to address the whole control framework in this area with high impact on residual risk exposure until resolved.</p> |

3.2 Grading of recommendations

3.2.1 In order to assist management in using our reports, we categorise our recommendations according to their level of priority as follows:

| Priority | Current Risk |
|---------------|---|
| High | Poor key control design or widespread non-compliance with key controls. Plus a significant risk to achievement of a system objective or evidence present of material loss, error or misstatement. |
| Medium | Minor weakness in control design or limited non-compliance with established controls. Plus some risk to achievement of a system objective |
| Low | Potential to enhance system design to improve efficiency or effectiveness of controls. These are generally issues of good practice for management consideration |

3.2.2 The assurance opinion is based upon the initial risk factor allocated to the subject under review and the number and type of recommendations we make.

3.2.3 It is management's responsibility to ensure that effective controls operate within their service areas. However, we undertake follow up work to provide independent assurance that agreed recommendations arising from audit reviews are implemented in a timely manner. We intend to follow up those audits where we have given limited or 'no' assurance.

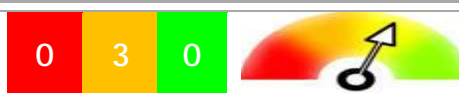
4. HIGH LEVEL SUMMARY OF AUDIT FINDINGS

4.1 Additional Payments



- 4.1.1 Additional payments cover a range of areas including acting up allowances, honoraria for undertaking a discrete project or piece of work over and above normal duties, overtime and market supplements.
- 4.1.2 The Council spent approximately £2.287m¹ on additional payments, excluding overtime, in 2017/18. In addition, c. £1.6m was paid in each of 2016/17 and 2017/18 in overtime.
- 4.1.3 The aim of the audit was to review the systems and processes which govern honoraria and additional payments, including checking that they were consistently applied, robust, appropriate and complied with HR policies.
- 4.1.4 Although HR policies are largely in place for the various types of additional payments such as acting up allowances, honoraria and market supplements, most of these policies haven't been updated for a number of years. It was noted, that there is no documented policy for the payment of a retention allowance.
- 4.1.5 Principally, the 'limited assurance' was not derived from a lack of HR rules and procedures, but from a lack of adherence to them. For example, sample testing of various additional payments identified instances where there was a lack of supporting documentation, including justification for the payment, evidence of appropriate sign off, regular review and the ongoing cost effectiveness of arrangements. We also found no regular review and any assessment of additional payments being made, showing recipients of additional payments, the amount and length of time they are being paid for.
- 4.1.6 Please refer to part 2 report on the agenda for further information.

4.3 Payment Card Industry Data Security Standard



- 4.3.1 The Payment Card Industry Data Security Standard (PCI DSS) was developed to encourage and enhance cardholder data security and facilitate the broad adoption of consistent data security measures. It provides a baseline of technical and operational requirements designed to protect account data and applies to all entities involved in payment card processing.

¹ HR informed the auditor that £637,814 was attributed to redundancy payments.

- 4.3.2 The purpose of this audit was to review the governance and operational framework for controlling the deployment, monitoring and recovery of bank approved payment card solutions. The processing of electronic payments takes place under the terms of a Merchant compliance certificate issued by the bank used by RBC, which states that the bank understand that the Council has formally undertaken to operate under PCI DSS requirements for security and data protection for all electronic payment processing.
- 4.3.3 The Council commissioned a Northgate Security Technical Design Architect² in 2017 to review payment processes and produce PCI Network flow Diagrams for a specific list of applications including Lloyd Cardnet payment card terminals. The results provided general reassurance that the Council was meeting its PCI DSS obligations. It did identify that there were a number of different business areas taking electronic payments and that these were being managed at the individual business level and not at a corporate level.
- 4.3.4 Council services and staff are provided with PCI DSS standards and guidance for using card payments securely however there is no corporate mechanism for monitoring compliance with those procedures or in ensuring that training has been completed and that terminals (PC or card machine) are being used in line with the standards. There is also a lack of central corporate oversight on the number of card machines that are in place and no formal procedures for identifying and reporting unauthorised payment activity. There is a risk that that lack of consistently applied standards leads to a failure to ensure security at a more local level by for example allowing a terminal to become compromised which could result in increased costs for electronic processing of all council payments under the merchant compliance certificate issued by the bank and in an extreme case loss of access to that electronic processing facility. These areas were addressed by the audit recommendations for greater corporate oversight and monitoring to be put in place to address the risks identified.

² Not a Qualified Security Assessor

4.4 Network Security



- 4.4.1 Cyber security is a key governance issue and is crucial to protecting digital assets. The government has rated cyber-attacks as one of the top four risks to UK national security. This audit assessed existing processes to monitor network performance, penetration testing, including intrusion detection and prevention, with a view to preventing phishing³ and hacking attacks.
- 4.4.2 Reading Borough Council is compliant with Government requirements for secure access to the Public Services Network (PSN), which means that its network security has passed the basic tests outlined in the code for accreditation. In the course of the PSN accreditation report there were issues highlighted for remedial action and these were incorporated into an action plan with Northgate, the council's ICT suppliers. These actions have been completed.
- 4.4.3 Some of the issues highlighted originated in an area shared with the transport network which is run as a separate entity outside direct oversight by the corporate ICT team and there still needs to be some work undertaken to understand the configuration of the transport ICT network to mitigate and gain insight into the outstanding risks to the council.
- 4.4.4 The remedial action report made recommendations for the hardening of the council's firewall and for plans to increase security and undertake preventative maintenance. These plans are in place but the need to keep these up to date mean the firewall will require downtime that the council is experiencing difficulty in providing. This does not mean that there is an unacceptable level of risk with the current position, but that going forward more work needs to be done to the firewall to increase the ability to meet fast evolving threats to the network.
- 4.4.5 The Council still needs to undertake some work with its staff to ensure that security patches are applied promptly on all council equipment.
- 4.4.6 The audit found that there is very little proactive monitoring of the threat environment. Without an understanding of the current threats and how that may be influenced by the activities of council staff, or external contractors, the council may not be able to mitigate the risk of network security being compromised by current or future activities. This is an essentially reactive position and it may be more prudent to understand what may be being attempted and what behaviours increase risk.

³ Phishing is the fraudulent attempt to obtain sensitive information such as usernames, passwords, and credit card details (and money), often for malicious reasons, by disguising as a trustworthy entity in an electronic communication.

4.5 South Reading Leisure Centre



4.5.1 South Reading Leisure Centre (SRLC) was contractually transferred back to the council in June 2017 and reopened in February 2018, having been managed as the Academy Sports Leisure Centre by the John Madejski Academy since 2007. Due to processes at SRLC not being specifically aligned to those of the Council when the transfer occurred, we were requested to review controls to ensure they are fit for purpose.

4.5.2 The audit found satisfactory controls in place to account for and monitor income at the South Reading Leisure Centre with good audit trails and supporting documentation in place. We made one recommendation to update documented processes to confirm the prescribed and authorised procedures.

4.3 Journal testing Q1



4.6.1 Throughout the 2018/19 financial year we will be performing quarterly tests on journals transactions. We validated a sample of journals from Quarter 1 of financial Year 2018-19 and found these to have been properly evidenced and supported by working papers. We will undertake further testing at the end of Q2.

4.6.2 In addition to the quarterly testing of journal transactions for this financial year, we quality assured a sample of creditor/debtor journals from year end of financial year 2017-18. These revealed a number of issues which indicated quality was lacking in some areas and these have been passed to the finance team for remedial action.

4.6.3 A number of fixed assets journals were reviewed relating to the 2016/17 financial year. These journals relate primarily to fixed assets additions, depreciation impairments, revaluations etc. All lines have been reviewed and the evidence to support them on the fixed asset register was found to be satisfactory.

4.8 School Audits

4.8.1 We have completed three school reviews this quarter as follows:

| | | | | |
|-----------------------------|---|---|---|--|
| Whitley Park Primary School | 0 | 3 | 3 | |
| Norcot Nursery School | 0 | 3 | 5 | |
| New Bridge Nursery School | 0 | 1 | 1 | |

4.8.2 There are no significant issues to report.

5. **FOLLOW UP REVIEWS**

5.1 Internal audit will look to follow up those reviews which have been assigned limited assurance. Resources permitting we envisage that the follow up review will take place between 6 - 12 months after the initial audit or after the recommendations were agreed to be implemented (if later). The following areas have been revisited to establish progress on implementing internal audit recommendations.

5.2 Right to Buy



5.2.1 The RTB scheme is considered as an area of emerging fraud risk by the CIPFA Counter Fraud Centre. With the national average value of a RTB fraud £64k per property, it lends itself to money laundering and encourages sub-letting/non-residency in order to take advantage of the scheme. If undetected it permanently deprives the Local Authority of that property for future use.

5.2.2 At our previous audit we recommended more robust measures were put in place to check residency status and to help prevent potential money laundering and fraud. Since our initial audit the verification processes have been reviewed and the service has put in place additional measures to provide more rigorous checks.

5.2.3 It is our opinion that the service has implemented some good practices as advised by DCLG RTB guidelines and is keen to develop these further.

6 AUDIT REVIEWS 2018/2019

6.2 The table below details those audit reviews in progress and the reviews planned for the next quarter. Any amendments to the plan to reflect new and emerging issues or changes in timing have been highlighted.

| Audit Title | Timing | | | | Start Date | Draft Report | Final Report | Res | | | Assurance |
|--|--------|----|----|----|------------|--------------|--------------|-----|----|----|-------------|
| | Q1 | Q2 | Q3 | Q4 | | | | P1 | P2 | P3 | |
| Continuing Health Care (CHS) | ● | | | | Apr-18 | Sep-18 | | | | | |
| Delayed Transfer of Care (c/fwd) | ● | | | | Apr-18 | Jul-18 | Sep-18 | 2 | 4 | 1 | Limited |
| Entitlement & Assessment/HB Subsidy | ● | | | | | | | | | | |
| Revenue Budget Setting (Hyperion) | ● | | | | Jun-18 | | | | | | |
| Additional Payments | ● | | | | Apr-18 | Jul-18 | Sep-18 | 1 | 3 | 1 | Limited |
| PCIDSS | ● | | | | Jun-18 | Aug-18 | Sep-18 | 0 | 3 | 0 | Reasonable |
| Data Storage | ● | | | | Jun-18 | | | | | | |
| Network Infrastructure Security (c/fwd) | ● | | | | Apr-18 | Sep-18 | Sep-18 | 0 | 3 | 2 | Reasonable |
| Residents Parking | ● | | | | Jun-18 | Sep-18 | | | | | |
| Use of CCTV - Urban Traffic Control | ● | | | | | | | | | | |
| Homes for Reading | ● | | | | Jun 18 | Sep-18 | | | | | |
| Right to Buy (follow up, c/fwd) | ● | | | | Apr-18 | Jun-18 | Aug-18 | 0 | 1 | 3 | Reasonable |
| Norcot Nursery School | ● | | | | Jun-18 | Jul-18 | Jul-18 | 0 | 3 | 5 | Reasonable |
| New Bridge Nursery School | ● | | | | Jun-18 | Jul-18 | Sep-18 | 0 | 1 | 1 | Reasonable |
| Commercial Leases (Stepping Stones)* | ● | | | | May-18 | Jul-18 | | | | | |
| General Ledger Q1 Journal testing* | | ● | | | Aug 18 | Aug 18 | Aug 18 | 0 | 0 | 0 | Substantial |
| Capital Accounting (Fixed Assets) | | ● | | | Oct-18 | | | | | | |
| Bank and Cash Reconciliations (follow up) | | ● | | | | | | | | | |
| Creation of Children's Company | | ● | | | | | | | | | |
| Budgetary Control & Savings | | ● | | | | | | | | | |
| Section 106 Agreements | | ● | | | | | | | | | |
| South Reading Leisure Centre | | ● | | | Jul-18 | Sep 18 | Sep-18 | 0 | 1 | 0 | Substantial |
| LTP Capital Settlement (Grant Certification) | | ● | | | Sep-18 | Sep-18 | | | | | |
| Bus Subsidy Grant | | ● | | | Sep-18 | Sep-18 | | | | | |

| Audit Title | Timing | | | | Start Date | Draft Report | Final Report | Res | | | Assurance |
|---|--------|----|----|----|------------|--------------|--------------|-----|----|----|------------|
| | Q1 | Q2 | Q3 | Q4 | | | | P1 | P2 | P3 | |
| General Ledger Q2 Journal testing* | | ● | | | Oct-18 | | | | | | |
| Employee Gifts & Hospitality & Declarations of Interest | | | ● | | Sep-18 | | | | | | |
| Creditors (Accounts Payable) | | | ● | | | | | | | | |
| Troubled Families Grant Sign Off | | | ● | | | | | | | | |
| Direct Payments (f/up) | | | ● | | | | | | | | |
| Commissioning (Adults) | | | ● | | | | | | | | |
| Business Rates | | | ● | | | | | | | | |
| Sundry Debtors | | | ● | | | | | | | | |
| Payroll | | | ● | | | | | | | | |
| Looked After Children | | | ● | | | | | | | | |
| Commercialisation | | | ● | | Oct-18 | | | | | | |
| Redlands Primary School | | | ● | | | | | | | | |
| The Hill Primary School | | | ● | | Sep-18 | | | | | | |
| Whitley Park Primary School | | | ● | | Jun-18 | Jul-18 | Jul-18 | 0 | 3 | 3 | Reasonable |
| General Ledger Q3 Journal testing* | | | | ● | Jan-18 | | | | | | |
| Public Health Grant (f/up) | | | | ● | | | | | | | |
| MOSAIC Finance Module | | | | ● | | | | | | | |
| Foster Care (f/up) | | | | ● | | | | | | | |
| Child Exploitation & Missing Children (f/up) | | | | ● | | | | | | | |
| Housing Revenue Account | | | | ● | | | | | | | |
| Blessed Hugh Farringdon Catholic Secondary School | | | | ● | Oct-18 | | | | | | |
| Christ the King Catholic Primary School | | | | ● | | | | | | | |
| St Michael's Primary School | | | | ● | | | | | | | |

*This audit was added as was not part of the original planned programme of audits

7 INVESTIGATIONS (April 2018 - June 2018)

7.2 Housing Benefit and Council Tax Support Investigations

7.1.1 For the period the Council Tax support overpayment is £2,173. The cases attracted a penalty fine value of £1,091.

7.2 Single Person Discount

7.2.1 Following a data matching exercise matching 21,106 address records against tracing and occupier lookup databases to determine the strength of residency for all individuals in a household within the borough, investigations officers are working with Council Tax reviewing the very high risk data matches (192) and high risk matches (462). From the matches investigated to date £165,880 has been identified for CTAX recovery.

7.3 Housing tenancy investigations

7.3.1 Since 1 April 2018 Investigation officers have assisted in the return to stock of 14 Council properties. At present we have 22 ongoing tenancy investigations, with 2 cases with RBC legal awaiting court outcomes.

7.3.2 It is difficult to quantify the financial implications of these types of investigations, however the RBC agreed figure of £15,000 is considered to be the average cost for retaining a family in temporary accommodation. Using this figure (14 x £15,000), to date notional savings of £210,000 have been made as a result of tenancy investigations.

7.4 Right to buy (RTB)

7.4.1 There are organisations and individuals that offer tenants money to apply to buy the home on their behalf. Money laundering is also a risk for property transactions. Money is paid by a third party who has no obvious link with the transaction. Money launderers often use front buyers to enter into transactions on their behalf. The money for a deposit or even to pay a mortgage may have come from someone other than the customer and could very well be the proceeds of crime.

7.4.2 We are working with Housing Officers to check applications against Council tax and other records and will investigate any applications that look suspicious. Improper applications can result in eviction and criminal prosecution. Since 1 April 2018 one application has been refused as a result of our investigations. This property transaction would have been entitled to the maximum of £80,900.

7.5 Social Care Fraud & Investigations

7.5.1 The team have been involved in a complex investigation relating to allegations of Direct Payment⁴ Fraud. As a result of a long investigation over almost 10 months, fraud charges have been brought against a direct payment client, suspected of Fraud and False Accounting. We estimate the fraud is likely to be over £68,000. The first hearing was held in Reading Crown Court in May 2018 where the defendant entered into a not guilty plea and is now listed for a Crown Court in December 2018.

7.6 Internal Investigations

7.6.1 Following authorised surveillance at one of the Council's leisure establishments, a now former member of staff was arrested on the suspicion of theft of cash. The matter was heard at Reading Magistrates Court on the 6th April 2018 and the defendant pleaded guilty to all charges. Full costs were awarded to the Council and the defendant has since paid £13,198.

7.7 New Homes Bonus

7.7.1 The New Homes Bonus is a grant paid by central government to local councils to reflect and incentivise housing growth in their areas. It is based on the amount of extra Council Tax revenue raised for new-build homes, conversions and long-term empty homes brought back into use.

7.7.2 Investigations officers are working with the Council's Empty Homes Officer to maximise potential income. The results of this exercise will be reported to the next meeting of the Audit & Governance Committee.

8. CONTRIBUTION TO STRATEGIC AIMS

8.1 Audit Services aims to assist in the achievement of the strategic aims of the Council set out in the Corporate Plan by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. In particular audit work is likely to contribute to the priority of remaining financially sustainable to deliver our service priorities.

9. COMMUNITY ENGAGEMENT AND INFORMATION

9.1 N/A

⁴ Direct payments are payments for people who have been assessed as needing help from social services, and who would like to arrange and pay for their own care and support services instead of receiving them directly from the Council.

10. LEGAL IMPLICATIONS

- 10.1 Legislation dictates the objectives and purpose of the internal audit service the requirement for an internal audit function is either explicit or implied in the relevant local government legislation.
- 10.2 Section 151 of the Local Government act 1972 requires every local authority to “make arrangements for the proper administration of its financial affairs” and to ensure that one of the officers has responsibility for the administration of those affairs.
- 10.3 In England, more specific requirements are detailed in the Accounts and Audit Regulations in that authorities must “maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with proper internal audit practices”.

8. FINANCIAL IMPLICATIONS

- 8.1 N/A

9. BACKGROUND PAPERS

- 9.1 N/A