

Report

Report subject: Internal Audit Annual Audit Report 2004/5

Report to: Audit Committee

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1 Introduction

1.1 The report covers the performance of Internal Audit during 2004/5 and provides the internal audit opinion on the council's control environment. This report was made to Management Team in May and in future years the annual report will be presented to the Audit Committee prior to consideration of the Statement on Internal Control.

2 Summary

2.1 The annual report includes the level of assurance for all of the audits undertaken by Internal Audit during 2004/5 and gives an overall opinion.

2.2 The opinion on the control framework of the council is substantive assurance. There are some gaps and areas of weakness in the application of the framework.

2.3 Five areas are identified for inclusion in the Statement on Internal Control:

- Business continuity & disaster recovery
- Risk management
- Payroll
- IT security policy & corporate standards
- Programme & project management.

2.4 Internal Audit has completed 90% of the planned audits from 2004/5. Actual audit resources were 93% of the planned resources and additional audit days were spent on some audits.

3 Audit Opinion

3.1 Internal Audit is required to provide an opinion on the overall adequacy and effectiveness of the council's internal control environment. This is based on the audit work carried out in the year. The control environment of the council covers risk management, control and governance and audit work has been carried out in each of these areas in 2004/5.

3.2 Internal Audit contributed to a review of the council's corporate governance arrangements using the

CIPFA/SOLACE framework. This followed a recommendation by the Audit Commission. The work involved a self –assessment and workshops facilitated by the Audit Commission to identify areas of strength and weakness in the council’s arrangements. The conclusion was that in many areas the council’s arrangements were robust or of a satisfactory standard. The Council approved a local code of corporate governance in February 2005 and an action plan adopted.

- 3.3 The corporate governance action plan and best practice advice on the Statement on Internal Control (SIC) lead to the approval to set up an Audit Committee. The terms of reference for the committee include corporate governance, risk management and internal control and will be a clear focus for supporting improvement. As well as the Audit Committee other steps have been taken to develop a firm basis for the SIC, including the introduction of managers’ assurance statements and a review process led by the risk management group.
- 3.4 The following table sets out the level of assurance that has been given to each of the areas audited, grouped together by theme.

Audit Area	Level of Assurance	Comment
Risk Management		
Risk Management	Substantive on policy, limited on implementation and operation	The risk management group will be taking forward the recommendations from the audit.
Control		
Cash collection & banking	Limited	
Main accounting system	Limited	
Bank reconciliation	No	Follow up audit carried out in March 2005 has now assessed the level of assurance as substantive
Debtors	Limited	
Purchasing arrangements	Limited	
Creditor payments	Substantive	
Capital expenditure	Limited	
VAT	Limited	
Payroll	Limited	
Council Tax	Substantive	
Non domestic rates	Substantive	

Housing & council tax benefits	Substantive	
Housing rents	Limited	
Five Rivers leisure centre	No	Follow up audit carried out in March 2005 has now assessed the level of assurance as limited .
Housing repairs works, stores & fleet	No	Follow up audit carried out in March 2005 has now assessed the level of assurance as limited
Service charges, sold properties	Limited	
Tourist Information Centre	Substantive	
Transport Loans	Limited	
Supporting People	Substantive	
Use of consultants	Limited	
Contract management	Limited	
IT/IS Strategy	Limited	
E-government programme management	Limited	
Business continuity and disaster recovery	Limited	
Agresso application controls	Substantive	
Paris application controls	Substantive	
Regulation of Investigatory powers	Substantive	
Capability & performance management of staff	Substantive	
Sickness Pay	No	Follow up work carried out in the audit of payroll indicated some improvement in control, although there remained control issues.

In summary the audits carried out in 2004/5 gave no assurance to four audit areas. Details of the key weaknesses are detailed in the next section. Subsequent work has been carried out on

each of these to confirm that progress has been made. The following table shows the levels of assurance given in last year's annual report. It should be noted that the audit plans cover different audit areas each year, with the exception of the principal financial control audits.

Level of assurance	2002/3	2003/4	2004/5	2004/5 updated
Full	0	0	0	0
Substantive	12	8	10	11
Limited	11	12	13	16
No	0	1	4	0
Total number of audits in year	22	21	27	27

In comparison to 2003/4 there have been three financial control audit areas where the level of assurance has declined from substantive to limited: cash & banking, main accounting system and debtors. In each case this has been the result of the implementation of new systems and time taken to ensure that appropriate controls are embedded.

3.5 Overall Opinion and Statement on Internal control

- 3.5.1 The overall opinion on the control environment of the council is one of substantive assurance. The overall control framework established, as represented by key policies, strategies and procedures is good. There are some gaps in this overall framework, for example the absence of an IT security policy and corporate standards for application systems. The greatest area of weakness is in the application of and compliance with procedures and ensuring a culture of ownership and responsibility for them. This was also identified during the corporate governance review.
- 3.5.2 For the purpose of the Statement on Internal Control the internal audit annual report needs to identify any areas that should be included. For the 2004/5 statement it is recommended that the following should be included.

Area	Rationale
Business continuity & disaster recovery	This was included in the 2003/4 SIC and since then there has been progress through a detailed audit report and the commencement of work by the Risk Management Group. As at the date of submission of the SIC to Council satisfactory arrangements will not yet be in place.
Risk management	The extension of the risk management policy into operational risk areas and further management training to support it. Again the Risk Management Group has been tasked with taking this forward, but as at this date the work is outstanding.
Payroll	For much of 2004/5 and to date the operation of payroll has

	<p>been undertaken by only one member of permanent staff who is also responsible for the system administration and control functions of the system. There is insufficient management review and a high degree of dependence on a key individual. This is unsustainable. Recommendations have been made to Personnel and agreed, but some of the issues have been raised before and have not resulted in lasting change.</p>
IT security policy and corporate standards	<p>Whilst many practical controls are effective in the council's corporate network and in the various application systems, the council has no IT security policy and no corporate standards or guidelines by which application systems should be managed. This is an audit recommendation that has been made several times but has not yet been implemented.</p>
Programme and project management	<p>This is an area that the council has sought to improve with the introduction of a new project management framework, project management training and introduction of more effective performance management mechanisms. Recent audit work on e-government showed this to be an area of weakness however. Major IT developments are an area of particular vulnerability which if not effectively project managed can result in significant control issues, as was shown by the bank reconciliation audit. (See paragraph 3.2 below)</p>

3. Principal issues arising during 2004/5

- 3.1 The implementation of new accounting systems (Agresso) and income management and receipting systems (Paris) on 1st April 2004 had a significant impact on financial control systems. A problem with the interface between Paris and Agresso in the first few months of the year was the key factor in the limited assurance rating for cash collection & banking. This was resolved during the year. Delays in implementing effective control account reconciliations were key factors affecting the main accounting system and debtors. As part of the year-end closedown control accounts have now been addressed. As part of next year's audits the regular reconciliation of control accounts will be tested.
- 3.2 Substantial problems were experienced with the introduction of the bank reconciliation module of Agresso, principally a delay in devising an effective reconciliation process on the new system. This resulted in a significant backlog and the council's bank reconciliation was not brought up to date until February 2005. A new process has now been introduced which will need to be embedded and enhanced during 2005/6.
- 3.3 Although payroll was given a limited assurance, the same as the previous year's, overall the effectiveness of controls has reduced. This system is currently highly dependent on one member of staff and there is a lack of management review. This was clearly demonstrated by the audit of sickness payments, which audit were requested to undertake by Personnel after the discovery of a problem with long term sickness pay. This audit found significant errors in the calculation of SSP and occupational health pay due; although compensating errors meant that the net effect on pay was usually small. One overarching problem was the lack of management review. Although progress has been made following a change of staff, the audit made a substantial number of recommendations, which have yet to be implemented.
- 3.4 Taking back the management control of Five Rivers on 1st April was a significant risk and

challenge to the council. It was agreed that internal audit would carry out an early audit to help identify areas where control improvements were required. Consequently the audit was carried out when some of the inherited problems, such as the unreliability of the Clubrunner IT system were only just becoming appreciated. The lack of data integrity, together with some poor practices on accounting for income were key issues resulting in the no assurance rating. Significant steps have been taken since the issue of the report, but the recent follow up review has identified that some issues are not yet fully resolved.

- 3.5 The audit work on housing repairs was a follow up to the previous year's audit, which had given it a no assurance rating. Unfortunately it was not possible to improve on this when the work was carried out in early 2004/5. A more recent review has just been carried out and the key weaknesses on accounting for stock and purchasing have been addressed, although there remain issues of data integrity and controls over the IT system.
- 3.6 Two key areas of IT audit undertaken were the IT/IS Strategy and E-government programme management. Both of these audits were given a limited assurance rating. Existing programme management arrangements and controls were found to be inadequate, although an action plan to implement new arrangements was being developed at the time of the audit. With the IS/IT strategy there were draft proposals for a new strategy at the time of the audit but there remained some areas of weakness. In particular there the draft strategy did not cover the issues of risk management and corporate standards and the wider issue of IT governance. A revised strategy has now been published which addressed these wider issues.
- 3.7 Business continuity and disaster recovery were audited following their inclusion in the SIC last year. The audit found that the arrangements were out of date and were not reflective of corporate priorities and risks. The risk management group are now taking forward the audit recommendations.
- 3.8 Purchasing arrangements have been a key area for audit in the last two years and once again a limited assurance rating has been given. Some improvements were noted but overall there remains scope to make significant improvements in the purchasing process through contracts, framework arrangements and by the implementation of e-procurement processes. This will be an area of significant development in 2005/6 with the establishment of a new procurement team and implementation of phase II of Agresso. The audit of the use of consultants also found problems with little use or awareness of the best practice contained in the protocol on the use of consultants.
- 3.9 There have also been some identified improvements in controls and maintenance of effective performance. Housing and council tax benefits received a substantive rating for the first time, reflecting a number of improvements. There remain a number of issues, a consequence of the considerable external changes that shape the system. The council tax and non-domestic rating systems have maintained their substantive ratings and indeed were close to receiving full assurance. The audit of risk management was able to give a substantive assurance on the policy and action is planned to address the operational application of the risk management policy. This should help to ensure that there is a clear link to the Statement on Internal Control in the future.

4. Monitoring of Internal Audit Recommendations

- 4.1 Internal Audit carry out a follow up review of audit recommendations, which involves a certification on progress by the responsible Service Unit Head. This is normally sent out between three and six months after the date of the final report depending on the timescales in the action plan. Internal audit monitor the implementation of agreed recommendations as an indication of the improvement to the control environment. The number of agreed

recommendations made in 2003/4 that had not been implemented was 23%, identical to that measured the previous year in relation to 2002/3. This indicates that there has been no improvement.

- 4.2 Whilst most follow up reviews are responded to promptly by Service Unit Heads, there remain difficulties in receiving responses on some. The following table shows elapsed time from sending out the review and receiving the response.

Follow up reviews carried out from 2004 to date

Up to 1 month	1 to 2 months	2 to 3 months	3 to 4 months	4 to 7 months	8 to 15 months
18 responses	2 responses	0	3 responses	0	5 responses

- 4.3 Both the delay in replying to follow up reviews and the level of non-implementation of recommendations that have been agreed indicates that there is an issue that needs to be addressed. The discussion between internal audit and the responsible manager that takes place at the draft report stage is the opportunity to give practical consideration to the recommendations and to weigh the risks of not taking action. Once commitment to the implementation of the recommendation is given then there should be a responsibility to take it forward and to respond to the follow up review. It had been hoped that the inclusion of major audit recommendations on the performance management system would support managers in monitoring these actions, as well as facilitate reporting by internal audit.

- 4.4 Internal Audit are introducing a new approach for 2005/6. As part of the audit report Internal Audit will continue to identify control weaknesses and risks. Normally Internal Audit would then propose a recommendation to the responsible service manager. It is now proposed that having identified risks managers should be asked to undertake their own risk assessment and suggest actions to manage the risk. This approach should allow greater consistency with the council's risk management approach and encourage greater ownership of decisions on controls. Internal Audit will support managers by giving advice and suggestions where required. We will also give a view on whether the proposed actions will materially affect the level of assurance given.

5. Internal Audit Performance

- 5.1 Internal audit monitors its performance using a number of indicators. These are shown below with comparisons to previous years.

Indicator	2002/3	2003/4	2004/5
Percentage of audit time against plan	92	101	96
Percentage of planned audits completed	82	88	90
Percentage of recommendations agreed	92	97	95
Issue of draft report within 3 months of start of audit (percentage)	68	86	87

- 5.2 Although the actual audit days of 585 are 96 % of planned audit days, the actual gross internal audit resource was 93% of that planned. This reflects an improvement in efficiency from the

audit team.

- 5.3 There were some significant variations in actual audit days against planned audit days. In particular where additional or follow up audit work was required where there was no assurance given. This, together with the additional time spent on help and advice to service units, is the key reason why some audits were not completed during the year. Overall the completion of 90% of planned audits is a good performance in the circumstances, but not one we are complacent about. Internal Audit's aim is to improve this area year on year. Appendix A provides detailed performance data.

6. Conclusions

- 6.1 As a result of the audit work undertaken, there are five areas that should be included in the Statement on Internal Control for 2004/5. These should be considered by Management Team and the Audit Committee prior to submission of the statement to Council with the Statement of Accounts.
- 6.2 There has been good performance by internal audit but there is scope to improve the effectiveness of internal audit by addressing the area of the agreement and implementation of management action following audit work.

7 Recommendation

- 7.1 It is recommended that the Audit Committee note the performance of Internal Audit for 2004/5.