

The Cabinet

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REPORT

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Cllr Mrs Warrander : Cabinet Member for Resources

Internal Audit Annual Report 2003/4

1. Introduction

- 1.1. Each year Internal Audit produces an annual report for Management Team and Cabinet. This reviews the performance of Internal Audit over the year, but most importantly provides an opinion on the internal control environment of the Council. The Annual Report is a requirement of the CIPFA Code of Practice for Internal Audit and has a particular significance from this year. The Annual Report will now be one of the assurance elements used to support the Statement on Internal Control, which appears elsewhere on this Agenda.

2. Levels of Assurance

- 2.1. Last year's Annual Report introduced an audit opinion on the level of assurance that could be taken for each area audited. The definitions used are as follows:

Full Assurance	The system of control is designed to achieve the system objectives and the key controls tested are effective.
Substantive Assurance	The system is basically sound but weaknesses may place the system objectives at risk.
Limited Assurance	There are weaknesses in the system of control, which place the system objectives at risk.
No Assurance	Control is weak and the system is open to the risk of abuse or error.

- 2.2. During 2003/4 these assurance levels have been incorporated into the audit reports issued. Over time it is hoped that the levels of assurance will show an improvement. Unfortunately for 2003/4 the comparison of levels awarded to those for 2002/3 is unfavourable. It should however be noted that no system audited in both 2002/3 and 2003/4 has received a lower category of assurance. The results for the 2003/4 and comparison to 2002/3 are shown in the following tables.

Audit	Level of Assurance
Financial Control Audits	
Main Accounting System	Substantive
Debtors	Substantive
Purchasing Arrangements	Limited
Creditor Payments	Substantive
Treasury Management	Limited
Housing Rents	Limited
Payroll	Limited
Asset Management	Substantive
Council Tax	Substantive
Non Domestic Rates	Substantive
Housing Benefits	Limited
Cash Collection & Banking	Substantive

Service Unit and Corporate Audits	
Grounds Maintenance & Street Cleansing	Limited
Tourism	Limited
Concessionary Travel	Limited
Housing Repairs & Maintenance	Limited
Housing Repairs – works, stores & fleet	No
Leisure Contracts	Limited
Performance Management	Substantive
Computer audit – Network Controls	Limited
Computer audit – Internet Controls	Limited

Comparison of 2003/4 to 2002/3

Category of Assurance	2002/03	2003/04
Full	0	0
Substantive	12	8
Limited	11	12
No	0	1

3. Opinion on the Internal Control Environment

3.1. Internal Audit is now required to include an opinion on the overall adequacy and effectiveness of the Council's internal control environment. The scope of a system of internal control spans the whole range of the Council's activities and includes those controls designed to ensure:

- The Council's policies are put into practice;
- The Council's values are met;
- Laws and regulations are complied with;
- Required processes are adhered to;
- Financial statements and other published information are accurate and reliable;
- Human, financial and other resources are managed efficiently and effectively, and
- High quality services are delivered efficiently and effectively.

3.2 Internal Audit's opinion on the internal control environment is derived from the audit work undertaken during 2003/4, as determined by the risk-based audit plan. On the basis of the levels of assurance given to audits during 2003/4, the Internal Audit opinion on the overall control environment is one of limited assurance. In most cases the level of assurance reflects a number of individual control failings. These are detailed further in this annual report. The majority do not, in my opinion, warrant identification in the Statement on Internal Control as significant internal control issues.

3.3 The Statement on Internal Control should disclose significant internal control issues and identify the actions being taken to address them. As a result of the work of Internal Audit there are three areas that should be identified as significant issues in the Statement on Internal Control. These are:

- Significant failure to comply with the Council's Financial and Contract Regulations in respect of purchasing and procurement.
- The absence of comprehensive, tested business continuity and disaster recovery plans.
- Stock control of housing repairs stores.

The Statement on Internal Control will need to identify how these control issues are being addressed.

4. Principal Issues Arising during 2003/4

4.1. As stated in last year's annual report the financial control audits, those directly related to the production of the Statement of Accounts, have mostly received substantive assurance ratings. Again as stated in last year's report limited ratings have been awarded to Payroll, Housing Rents and Housing Benefits. For Housing Benefits these

issues relate to reconciliations of interfaces, the management and monitoring of fraud cases and the monitoring of management information relating to overpayments. For Housing Rents the outstanding issues relate to reconciliation to the ledger, management of credit balances and the need to further improve arrears management. Whilst there remain significant issues that need to be addressed for Rents and Benefits, it is recognised that significant improvements have been made in other aspects of these systems. For payroll there remain long-standing audit recommendations that have not been addressed and in addition the most recent audit raised concerns about accuracy of data resulting from variations to pay.

- 4.2. Purchasing has once again been given a limited assurance rating and this was the focus for a substantial area of work for Internal Audit in 2003/4. A joint audit was carried out with the Audit Commission and further audits were carried out by Internal Audit to firstly confirm the results of the original work and secondly to measure improvements. Work was also undertaken to monitor the action plan approved by Management Team. As stated in paragraph 3.3 this issue should be included in the Statement on Internal Control.
- 4.3. For other audits undertaken on service unit and corporate systems it was only possible to give a substantive level of assurance on one audit. Of even greater concern was the necessity to award 'No Assurance' to the Housing Repairs works, stores and fleet audit. Purchasing, stock control and management information were found to be substantially flawed. In addition there were significant weaknesses relating to management of the repairs vehicles. The audit of the Housing Repairs system itself found good performance in the delivery of repairs services to tenants, but significant weaknesses in the procurement, contract management and management information of the service.
- 4.4. Contract management issues also lay behind the limited assurance ratings given to the Grounds Maintenance & Street Cleansing audit and the audit of Leisure Contracts. For the Grounds and Street cleansing function there were also significant weaknesses in the management of budgets, resulting in an inadequate link between the actual services provided and the expenditure reported in the accounts.
- 4.5. In relation to Concessionary Travel, issues over budgetary control and forecasting were raised, together with the need for the Council to fulfil its statutory responsibilities to advertise the scheme. For Tourism the issues related to financial reporting not being reconciled to the ledger and measurement of objectives.
- 4.6. The computer audits undertaken showed that in many areas the management of the Council's network and Internet were of a good standard. The primary weaknesses related to disaster recovery arrangements and security issues. These aspects were both raised in last year's report. A follow up report was also undertaken jointly with the Audit Commission to examine progress since the report on the level of compliance with ISO17799. The report showed that overall compliance had improved to 60 per cent. However, issues relating to security policy remain to be addressed.

5. Recognising Improvements

- 5.1. As already noted there have been areas of significant progress over the last year and for some systems there has been year-on-year improvement in management and financial control. As well as recognising areas of outstanding weaknesses it is also important to recognise improvements. In particular there have been improvements in controls in the management of Council Tax and Non-domestic rates over the last two years. Housing Benefits have also addressed some significant issues, particularly in relation to management reviews, caseload management and performance management. Following the creation of a System Administrator post within Strategic Housing Services some long-outstanding issues have been addressed or improved. The Council has now adopted a new and challenging Rent Arrears policy.
- 5.2. Whilst purchasing has been under particular focus this year, the attention from the Audit Commission has been a catalyst for change. Improvements were noted in the follow up testing carried out by Internal Audit in December and action plans to address key issues have been drawn up. The real measure of improvement will be known following the 2004/5 audit of purchasing scheduled for this summer. Some progress has also been identified in the computer audits undertaken. The Joint review with the Audit commission identified improvements across a number of aspects of the ISO 17799 standard. The network review resulted in a

number of recommendations to improve security and efficiency being actioned before the final report was issued.

6. Acceptance and Implementation of Audit Recommendations

- 6.1. The level of acceptance of audit recommendations is an indicator of how relevant the audit work undertaken is. For 2003/4 the estimated percentage is 98 per cent. Some audits have not yet been finalised with clients.
- 6.2. The implementation of audit recommendations measures how effectively managers address the risks identified during the audit. Whilst many managers monitor and action audit recommendations there remains a problem with some. At the time of writing follow up reviews issued by Internal Audit are outstanding in relation to the following audits:

Audit	Assurance Level	Date of Follow up	Service Unit Response Required
Housing Benefits	Limited	September 2003	Personnel
Computer audit – Payroll	Limited	October 2003	Personnel
Concessionary Travel	Limited	January 2004	Forward Planning & Transportation

- 6.3. Internal Audit measure the number of accepted recommendations that have not been implemented. For reviews carried out on 2002/3 audits the recorded level is 21 per cent, which is a decline on the 14 Per cent recorded for 2001/2 audits. This is a snapshot since it doesn't take into account recommendations that are implemented after the date of follow up. However this does raise issues about the implementation of recommendations. Use of the performance management system is planned to help minor and track implementation of recommendations, which will give better performance information and also assist managers to monitor the outstanding issues. This also allows managers to identify any significant barriers to implementation such as resources. However managers should be encouraged to be realistic when agreeing recommendations and timescales for implementation, but also to recognise the associated risks of not addressing them.

7. Other Areas of Audit Activity

- 7.1. During the course of 2003/4 Internal Audit contributed to the corporate development of the Council in addition to the performance of core audit work. In particular Internal Audit helped to develop the Council's Risk Management Policy and contributes to the Procurement Steering Group and the Information Management Group. The introduction of the Corporate Financial Management Information System in April 2004 also involved Internal Audit, including testing and advice on controls.
- 7.2. An expanding area for Internal Audit has been the level of requests for consultancy, help and advice. For 2003/4 this resulted in 73 days of audit time, against a budget of 35 days. Within this total there were some particular pieces of work, which should be separately noted. The following table shows a breakdown of the help & advice given, by Service Unit.

Service Unit	Topics Included	Number of Days
Best Value	Procurement & contracts	3
Community Initiatives	Five Rivers transfer	14
Corporate	Whistleblowing referral	5
Customer Services	Procurement	0.7
Democratic Services	Print Unit review, Members Travel & Subsistence	2
Development Services	PARSOL contract	3
Audit Commission	CAATS data interrogation of creditor database	2
Environmental Health &	Contracts for abandoned vehicles, parks,	3

Commercial Services	protective clothing	
External	Parish Councils, queries from other Councils	0.5
Financial Services	Purchasing, cash income, write-offs	7
Forward Planning & Transportation	Park & ride bus contract, other contracts	2
Housing Management	Contracts, rent arrears policy, stock control	5
IT Services	Disposal of IT equipment, IT standards and policies, BACS IP procurement	3
Legal & Property	Money Laundering Policy	1
Marketing ED & Tourism	Cash handling, contracts	3
Personnel	Code of conduct, whistleblowing policy, payroll queries	4
Revenue & Benefits	Cash collection matters	5
Strategic Housing Services	Rent in advance audit, contracts, petty cash floats	10

8. **Internal Audit Performance**

- 8.1. The challenge for Internal Audit was to deliver the plan, maintain the professional standards required by the CIPFA Code of Practice whilst addressing the need for significant divergence from the plan to meet the audit issues arising. At the same time there has been uncertainty and change in the management structure within the Financial Services Unit.
- 8.2. The CPA Auditor Score Judgements for Internal Audit awarded a maximum score of 4. In the Annual Audit Letter the Audit Commission confirmed that the team has met the standards required by the CIPFA Code of Practice. Of the audits planned for 2003/4 (excluding reactive and development work) Internal Audit has achieved 88 per cent of them. In 2002/3 82 per cent of planned audits were completed. In terms of delivery of audit days 527 days were provided against the plan of 521 or 101 per cent. This was achieved by use of a temporary auditor to carry out two audits. The comparative figure for 2002/3 was 92 per cent.
- 8.3. The time spent on responding to requests for help & advice has increased considerably from 25 days in 1999/2000 to 50 last year and 73 days this year. Whilst this in part is a good reflection on the service provided by Internal Audit, this also reflects the need for there to be clear areas of responsibility and policy within the Council. In particular the biggest single area is purchasing and contracts. In 2003/4 additional requests were prompted by the Audit Commission findings, but in general Service Units need assistance on procurement matters. Similarly Internal Audit receives requests relating to the retention of records, which will be redirected if a corporate policy is developed.

9. **Conclusions**

- 9.1. The performance of Internal Audit has been good in difficult circumstances and this has been recognised in the CPA score for Internal Audit.
- 9.2. The control issues identified have resulted in a qualified opinion on the overall control environment and there are some significant issues for inclusion in the Statement of Internal Control.
- 9.3. There is a growing demand for additional consultancy advice from Internal Audit that needs to be monitored and reappraised in 2004/5.

10. **Recommendations**

- 10.1. The Statement of Internal Control should include the issues relating to purchasing & procurement, stock control and business continuity and disaster recovery, together with an action plan to address them.
- 10.2. The performance of Internal Audit on the 2003/4 Audit Plan and the issues arising should be noted.

10.3. Management Team should continue to monitor the performance of Service Units in addressing the specific control issues raised and ensure that the internal control framework of the Council is robust in addressing the Council's risks.

11 Background Papers:

Internal Audit reports

12 Implications:

- **Financial:** None
- **Legal:** The Accounts and Audit Regulations 2003 require all local authorities to publish a Statement on Internal Control. Amongst the matters to be included in this will be a statement as to the effectiveness of the internal control framework and it will therefore pick up the issues covered by this report.
- **Personnel:** None
- **Community Safety:** None
- **Environmental Impact:** None
- **Council's Core Values:** Providing excellent service
- **Ward(s) Affected:** All

Appendix A

Review of Progress since the issue of Audit Reports

The level of assurance given on the completion of the audit reflects the effectiveness of internal controls in place at the time of the audit. The implementation of audit recommendations is a management responsibility but is reviewed by Internal Audit following the audit. Management Team have reviewed progress made since the audit with the responsible Service Unit Head to identify the extent of progress made. The table below identifies progress for those 2003/4 audits where limited or no assurance was given.

Audit	Level of Assurance	Comments on Progress
Purchasing Arrangements	Limited	Progress has been made to improve the procurement process with framework agreements. The importance of compliance has been emphasised to all staff by the Chief Executive. Internal Audit will carry out further work over the next few weeks to audit progress.
Treasury Management	Limited	Improvements to cash flow management have been made but changes to procedures and development of Treasury Management Practices have been deferred to later in 2004/5.
Housing Rents	Limited	Audit report was issued in April with an agreed action plan for implementation over the next few months.
Payroll	Limited	Report was issued in draft in March. The action plan is with the Head of Personnel for agreement.
Housing Benefits	Limited	Audit report was issued in May with an agreed action plan for implementation over the next few months.
Grounds Maintenance and Street Cleansing	Limited	Progress has been made in relation to recommendations on purchasing and IT licences. Recommendations linked to the specification, budgetary control and performance management are planned to be addressed along with the Best Value review of street services.
Tourism	Limited	Audit report was issued in April with an agreed action plan for implementation over the next few months.
Concessionary Travel	Limited	A report to Cabinet is planned.
Housing Repairs & Maintenance	Limited	Recommendations relating to contracts, payment of invoices and management information have been addressed. There are outstanding issues relating to reconciliations and rechargeable repairs.
Housing Repairs – works stores & fleet	No	A follow up audit on the key issues has just been completed and has again issued a no-assurance opinion. Limited progress has been made to address the purchasing issues and no progress has been made on stock control. In the longer term a corporate stock control system can be investigated but arrangements to put controls in place are now being pursued.
Leisure Contracts	Limited	Issues raised have been largely superseded by the transfer back to in-house management from 1 st April.
Computer audit – Network Controls	Limited	The majority of the recommendations have been implemented. The only area outstanding of significance is that related to business continuity and disaster recovery.
Computer audit – Internet Controls	Limited	Report was issued in draft in May. The action plan is with the Head of IT Services for agreement.

Internal Audit Performance against the Audit Plan 2003/4

	Plan (Days)	Actual (Days)	Variance (Days)
Financial Control Audit			
FINANCIAL SERVICES			
Main Accounting System	18	6.35	-11.65
Budgetary Control	18	0.20	-17.80
Bank Reconciliation	6	5.81	-0.19
Debtors	12	8.75	-3.25
Purchasing Arrangements	20	29.46	9.46
Purchasing - additional work	0	26.52	26.52
Creditor Payments	12	6.42	-5.58
Treasury Management	15	12.67	-2.33
Capital Expenditure			
Construction Industry Tax			
VAT			
STRATEGIC HOUSING SERVICES			
Housing Rents	20	29.59	9.59
PERSONNEL AND TRAINING			
Payroll	18	26.48	8.48
Officer and Member Expenses		0.10	0.10
LEGAL & PROPERTY SERVICES			
Asset Management	8	6.89	-1.11
REVENUE AND BENEFITS			
Council Tax	16	10.14	-5.86
Non Domestic Rates	12	22.09	10.09
Housing & Council Tax Benefits	25	23.82	-1.18
Benefit Verification	10	12.47	2.47
Cash Collection & Banking	10	5.07	-4.93
TOTAL FINANCIAL CONTROL AUDIT	220	232.83	12.83

SERVICE UNIT AUDIT

COMMERCIAL SERVICES

Waste Management			
Grounds Maintenance & Street	10	11.32	1.32
Cleansing			
Cleansing (PC) Contract		0.07	0.07
Vehicle workshops & Fleet			
Management			

COMMUNITY INITIATIVES

City Hall		0.03	0.03
Guildhall			
Tisbury Sports Centre			
Durrington Swimming Pool			
Sports & Arts Events, Community			
Facilities			

DEMOCRATIC SERVICES

Print Unit

DEVELOPMENT SERVICES

Planning Applications & Fees
Commuted Sums
Building Control Fees

ECONOMIC DEVELOPMENT & TOURISM

Tourism	7	11.89	4.89
Tourist Information Centres			

ENVIRONMENTAL HEALTH SERVICES

Licenses
Crematorium & Cemeteries

FINANCIAL SERVICES

Housing Advances
Insurance

FORWARD PLANNING AND TRANSPORTATION

Joint Transportation Strategy			
Car Parking			
Concessionary Travel	5	11.39	6.39

HOUSING MANAGEMENT

Housing Repairs & Maintenance	15	21.11	6.11
Housing Repairs works, stores & fleet	10	21.96	11.96
Service Charges - sold properties	8		-8.00

STRATEGIC HOUSING SERVICES

Private sector housing services (grants, HECA)			
Group Dwellings & Community Alarms		0.07	0.07
Homeless Housing & Leased Properties			

LEGAL & PROPERTY SERVICES

Land Charges
Property Management

TOTAL SERVICE UNIT AUDIT	55	77.84	22.84
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CORPORATE AUDIT

CONTRACT AUDIT

Use of consultants			
Tendering Arrangements		0.24	0.24
Contract Management			
Contract Final Accounts and performance benchmarking		2.50	2.50
Projects: Public Offices	8		-8.00
Projects: Other		2.57	2.57

REVENUE CONTRACTS

Waste Management - Client		0.14	0.14
Grounds Maintenance & Street Cleansing Client	15	14.39	-0.61
Leisure Contracts	10	7.36	-2.64
Facilities management		5.98	5.98

CCTV Contract

IT AUDIT (IN-HOUSE)

CFMIS implementation	40	40.03	0.03
IT/IS Strategy		0.07	0.07
IT Acquisition		0.20	0.20
Information Management		0.07	0.07
BACS Controls		1.28	1.28

ANTI FRAUD & CORRUPTION WORK

Prevention of fraud & corruption	25	14.97	-10.03
Fraud Risk Assessment	10	0.14	-9.86
National Fraud Initiatives	5	5.37	0.37
Regulation of Investigatory Powers	6	1.35	-4.65

CORPORATE AUDIT WORK

Corporate Governance Framework	15	3.34	-11.66
Internal Financial Control Statement	4	0.54	-3.46
Risk Management			
Project Management		0.47	0.47
Performance Management	15	8.72	-6.28
Corporate procurement		0.03	0.03
Community Planning			
Recruitment & selection			
Project Work - E Government	3		-3.00
Project work - SCS / EH admin systems			
Project work (Value for money)	2		-2.00
Review of Standing Orders, Financial Regulations & other	5	0.14	-4.86
Financial & Contract Training	4	1.08	-2.92
Help and Advice	35	73.34	38.34

CORPORATE PROJECT WORK

Risk Management development	10	6.52	-3.48
Procurement group	8	4.89	-3.11
Information Management Group	4	0.34	-3.66

TOTAL CORPORATE AUDIT	224	196.07	-27.93
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TOTAL AUDIT DAYS	499	506.74	7.74
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IT Audit bought in

Application and Operating Systems

Agresso - Financials	6	0	-6
Academy - Council Tax, NNDR and Benefits			
Simdell - Housing Rent Accounting and Repairs			
Team Spirit - Payroll and Personnel			
Spectrum - Cash Receipting			

Security & Control Reviews

Business Continuity

Disaster Recovery

Network Controls	12	12	0
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Internet Controls		6	6
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Email Security

System Reviews

Project Management &

Development Standards

Management Issues

IT Security Policy

Software Licensing

Anti Virus Controls

Remote Access Server

Other IT Audit Work

Help and Advice	2	0	-2
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Joint audit with Audit Commission, ISO17799 follow up	2	2	0
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Total IT Audit Days	22	20	-2
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Overall Audit Days Total	521	527	6
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APPENDIX B

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Comments

Completion of 2002/3 audit

Joint Audit with Audit Commission
Follow up work agreed with Audit
Commission and Management Team
Scope of audit reduced because of
additional testing on purchasing

Time includes completion of 2002/3 audit

Additional testing included

Includes completion of 2002/3 audit



Additional testing required on stock control
and purchasing



Beehive Park & Ride final account

Completion of 2002/3 audit

Support and testing on implementation of new IT system

Support for development of new system

Reactive work

Support for development of new policy & procedure

Reactive work - see Annual Report for breakdown



Audit deferred to 2004/5 to fit in with implementation date

Audit brought forward to substitute for
Agresso audit
