

# AUDIT COMMITTEE

## Internal Audit Annual Report 2007/08

25 June 2008

### Report of Internal Audit Manager

#### PURPOSE OF REPORT

To inform the Committee of the extent and outcome of Internal Audit work during the 2007/08 financial year and to present an annual Statement of Assurance regarding the Council's internal Control Framework.

**This report is public**

#### RECOMMENDATIONS

1. That the report be noted.
2. That the Controls Assurance Statement (paragraphs 2.14 to 2.19) be accepted and considered in relation to the proposed Annual Governance Statement (presented elsewhere on this agenda).

#### 1.0 Introduction

- 1.1 The terms of reference of the Audit Committee include: *To receive the annual Internal Audit Report and Controls Assurance Statement* (the Constitution, part 3 section 8, TOR 11). The Code of Practice for Internal Audit<sup>1</sup> specifies that the Head of Internal Audit must "... provide a written report to those charged with governance timed to support the Statement on Internal Control". The report and assurance statement thus makes a significant contribution to the Council's statutory duty to undertake an annual review of the Internal Control framework and publish a Statement on Internal Control.

#### 2.0 Proposal Details

- 2.1 Internal Audit is established as a section of Financial Services, reporting functionally to the Head of Financial Services. Professionally, it operates to standards set out in the CIPFA Code of Practice for Internal Audit and operates and reports in accordance with an approved Audit Charter.

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<sup>1</sup> Code of Practice for Internal Audit in Local Government in the United Kingdom (CIPFA 2006)

## **Annual Audit Plan 2007/08**

- 2.2 Internal Audit plans and assignments are developed on a risk-based approach, seeking to identify and devote resources to the areas of greatest significance to the Council. The approved Internal Audit Plan for 2007/08 was based on the provision of 840 days of Internal Audit work. In terms of Assurance Work, the plan provided for 560 days work and the production of from 39 to 55 audit reports and assurance opinions. A summary of the final position for the year is set out in the following table.

Area of work	Resources (audit days)			Outputs (audit reports & opinions)	
	Planned	Actual	Variance	Planned	Actual
Core Financial Systems	100	101	+1	10-12 reports	15 reports
Core Management Arrangements	120	81	-39	8-10 reports	4 reports
Core Operational Systems	70	2	-68	6-8 reports	1 report
Risk Based Assurance Audits	200	208	+8	15-25 reports	19 reports
Follow-Up Reviews	70	38	-32		
<b>Sub-Total, Assurance Work</b>	<b>560</b>	<b>430</b>	<b>-130</b>	<b>39-55 reports</b>	<b>39 reports</b>
Consultancy Work	155	180	+25		
Investigations	35	85	+50		
Audit Management	45	63	+18		
Non Audit Duties	5	9	+4		
General Contingency	40	0	-40		
<b>Total</b>	<b>840</b>	<b>767</b>	<b>-73</b>		

- 2.3 Thirty-nine reports have been taken into account in informing the assurance opinion given later in this report. This total is at the lower end of the range planned for the year but represents a reasonable outcome given the number of audit days devoted to assurance work.
- 2.4 Under the category of "Core Operational Systems", a change in emphasis and approach to IT audit has meant that this work is now being delivered through Core Financial Systems audits and Risk Based Assurance Audits. This change is reflected in the proposed plan for 2008/09.

## **Explanation of Major Variances**

- 2.5 Changes in demand for audit work and variations to the approved Plan were reported to and approved by Audit Committee during the year. The most significant factors affecting the plan were:
- lost productive time for all members of the section during the year, due to the office removal from St Leonard's House to Lancaster Town Hall and time required in undertaking the Fair Pay Review process. In total, these have contributed to a loss of approximately 45 days of productive audit time.
  - initial proposals to commission external consultants to undertake a review of the Council's external funding arrangements were not pursued due to uncertainty at the time regarding the development of the new Local Area Agreement. Whilst this meant that fewer audit days were delivered (the plan provided for up to 60 days from external sources), it also produced a saving on the budget for consultancy.
  - additional workload in other areas of the plan, especially in investigations had an impact on the level of resources devoted to assurance work.

## **Quality Considerations**

- 2.6 Customer satisfaction with Internal Audit work is judged through managers' responses to a post-audit satisfaction survey sent out following the completion of each assignment. The questionnaire seeks views, expressed as scores on a range from 1 to 9, on sixteen aspects of the audit, covering aspects of communication and consultation, conduct, objectivity, reporting and impact of the work. Summary results from questionnaires returned over the past 24 months are demonstrated in the chart in Appendix A.
- 2.7 The summary represents the average scores obtained from 26 returned surveys. Against a target level of 8 for all aspects of the audit, only two have not been met (albeit marginally), these being questions 15 and 16 relating to risk management outcomes from the audit. The second page of Appendix A details the responses received regarding these two questions. It can be seen that the main factor behind the lower score were two responses relating to audits of Internal Communications and Cemeteries (circled in red on the report).
- 2.8 On the Internal Communications audit, the low responses were given by the Head of Information & Customer Services. It is notable that the other responses on the same audit, provided by the Communications Manager, were much higher (the majority of risks covered in the audit fell within the Communication Manager's remit).





- 2.9 On the Cemeteries audit, whilst the response gave a maximum score on question 15 (identification and understanding of risk), a score of 3 was given on question 16 (management of risk). In this regard, the audit identified that in most risk areas, actions (some of which were long-term) were already being taken to address identified issues and the audit was able to provide a positive assurance statement.
- 2.10 Lower than average scores (highlighted in pink) have also been recorded against a number of financial systems audits. This may be explained by the fact that these systems are relatively stable and not subject to significant changes in risks.

### **Review of the Effectiveness of Internal Audit**

- 2.11 The Account & Audit Regulations 2003 (as amended in 2006) require Councils to conduct an annual review of the effectiveness of its system of internal audit and for a committee of the Council to consider the findings. This process is part of the wider annual review of the effectiveness of the system of internal control and governance. A report on this review is included within the report on the annual review of governance elsewhere on this agenda.

### **Results of Assurance Work**

- 2.12 In all cases, completed assurance audits have resulted in the production of a report and action plan, agreed by managers and submitted for consideration by the Audit Committee. In September 2007 new arrangements were introduced to provide an assurance opinion in each report and for those opinions to be updated at subsequent review points, including the formal audit follow-up review. The system uses four levels of opinion, as follows:

<b>Level of assurance</b>	<b>Image</b>	<b>Definition</b>
Substantial		The Authority can place high levels of reliance on the arrangements/controls. Best practice is demonstrated in some or all areas.
Reasonable		The Authority can place reasonable (i.e. sufficient) reliance on the arrangements/controls. Only relatively minor control weaknesses exist.
Limited		The Authority can place only limited reliance on the arrangements/controls. Significant control issues need to be resolved.
Minimal		The Authority cannot place sufficient reliance on the arrangements/controls. Substantial control weaknesses exist.

- 2.13 The Table in Appendix B sets out the assurance opinions issued from audits and follow-up reviews completed since the introduction of this approach, and any subsequent changes in assurance level.

### **Controls Assurance Statement**

- 2.14 It must be recognised that Internal Audit can be expected to provide reasonable and not absolute assurance that control weaknesses or irregularities do not exist.

- 2.15 This assurance statement is drawn from both the results of individual internal audit assignments and the results of follow-up reviews into previously completed audits, as reflected in the contents of Appendix B. In addition to the audits included in Appendix B, nine reports were issued during the earlier part of the year which have not been covered by the assurance rating approach. The results of these audits were reported to the Audit Committee on 8<sup>th</sup> January 2008, the audits concerned being:

<b>Audit Title</b>		<b>Report Date</b>
06/0643	Information Security Development	25/01/07
06/0641	Income Management	26/01/07
06/0650	Council Tax	07/02/07
06/0652	Waste Management	05/03/07
06/0635	Tourism	27/03/07
06/0661	Sundry Debtors	29/05/07
06/0664	National Fraud Initiative	29/05/07
06/0642	Building Control	29/05/07
06/0649	Payroll 2006/07	13/07/07

- 2.16 The following table summarises the assurance opinions covered in Appendix B, based on the most recent review.

<b>Assurance Level (at most recent review)</b>	<b>No of Audits</b>
Substantial	0
Reasonable	20
Limited	9
Minimal	1

- 2.17 The one audit resulting in a “Minimal” assurance opinion was that relating to Income Tax and National Insurance arrangements in respect of employee benefits and expenses. Members of the Audit Committee have been advised of the circumstances surrounding this audit and measures have already been taken which will raise the level of assurance. The level of risk in this area is low and the weaknesses identified are not in themselves so significant as to warrant disclosure in the Annual Governance Statement.
- 2.18 The results set out in Appendix B demonstrate that procedures for following up audits (focusing on those not having achieved a reasonable assurance level) and reporting progress to Audit Committee are effective.

### **Financial Systems**

- 2.19 Assurance levels on the Council’s key financial systems are consistently good, with all audits included in Appendix B (with the sole exception of Housing Rents – Debit Control) showing a “reasonable” assurance level. Weaknesses in the Housing Rents system centred around the transfer and reconciliation of accounting data into the General Ledger, resulting in an overstatement of income in the 2006/07 published accounts. Measures have now been taken to remedy this situation.

With this exception, it can be taken that effective internal controls exist to ensure the accuracy and integrity of the information that the key financial systems provide and no significant control weaknesses have been identified.

## **Governance Arrangements**

- 2.20 Audits of Performance Management and Partnership Arrangements resulted in a “limited” assurance opinion. Both of these areas are key elements of the Council’s governance arrangements and the main points arising from the audits are incorporated in the governance review and Annual Governance Statement.

## **Other Audits**

- 2.21 In the assurance work undertaken, Internal Audit activity during the year did not identify any control weaknesses of such significance that they would warrant disclosure in the Council’s Annual Governance Statement. Where any control weaknesses have been identified, remedial action has been agreed and arrangements are in place to monitor the implementation of those actions and the level of assurance provided.
- 2.22 The support and proactive work undertaken by Internal Audit during 2007/08 has concentrated on a number of areas recognised by the Council as needing development, notably its arrangements for managing significant projects. In addition, Internal Audit has again been instrumental in reviewing and developing the Internal Control and Corporate Governance framework. These arrangements are key elements in the Council’s review of the Internal Control and Corporate Governance framework and the current position is reflected in the evaluation undertaken and reported elsewhere on this meeting’s agenda. Whilst Internal Audit has not produced a formal report in such areas, its views and knowledge have been fed into the evaluation process.

## **3.0 Details of Consultation**

- 3.1 No specific consultation has been undertaken in compiling this report.

## **4.0 Options and Options Analysis (including risk assessment)**

- 4.1 The proposal is that the Committee accepts Internal Audit’s assurance statement as a contribution to the overall assessment of the Internal Control and Corporate Governance Statement. No alternative options are identified.

## **5.0 Conclusion**

- 5.1 The work of Internal Audit seeks to provide assurance to the Council as to the appropriateness and effectiveness of its internal control and corporate governance arrangements. During the 2007/08 financial year, Internal Audit’s work has provided assurance in a variety of areas as well as incorporating a significant level input and contribution to the development of a number of key systems and processes.

**CONCLUSION OF IMPACT ASSESSMENT**

(including Diversity, Human Rights, Community Safety, Sustainability and Rural Proofing)

This report has no direct impact on these areas.

**FINANCIAL IMPLICATIONS**

None arising from this report.

**SECTION 151 OFFICER'S COMMENTS**

The s151 Officer has been consulted and has no further comments.

**LEGAL IMPLICATIONS**

None arising from this report

**MONITORING OFFICER'S COMMENTS**

The Monitoring Officer has been consulted and has no further comments.

**BACKGROUND PAPERS**

Internal Audit Plan 2007/08  
Internal Audit Files

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