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**REPORT TO** Council Resources Commission (Audit Committee)

**DATE:** 12 June 2006

**DEPARTMENT:** Resources

**REPORTING OFFICER:** Audit Manager (*Martin Helm*)

**SUBJECT:**

**INTERNAL AUDIT ANNUAL REPORT**

(a) Outturn 2005/06

(b) Annual Plan 2006/07

**WARD/S AFFECTED:** None

**FORWARD PLAN REF:** N/A

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**1.0 PURPOSE OF REPORT**

1.1 This report considers the key findings and conclusions arising from work undertaken by the Council's Internal Audit Section in 2005/06. It also looks forward to 2006/07.

**2.0 RECOMMENDATIONS**

2.1 That the key findings and conclusions arising from the work of the Council's Internal Audit Section completed in 2005/06 be noted.

2.2 That the Internal Audit Annual Plan for 2006/07 be endorsed.

**3.0 BACKGROUND INFORMATION**

3.1 Internal Audit is defined as:

“an assurance function that primarily provides an independent and objective opinion to the organisation on the control environment comprising risk management, control and governance by evaluating its effectiveness in achieving the organisation's objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources.”

(Code of Practice for Internal Audit in Local Government in the United Kingdom 2003.)

- 3.2 Each local authority must now conduct an annual review of the effectiveness of its system of internal audit. This is a new requirement and stems from a 2006 amendment to the Accounts and Audit Regulations 2003. This report is submitted to the Commission in its capacity as the Council's audit committee to help fulfil this new requirement. Any comments the Commission may wish to make must be considered as part of the Council's annual review of its system of internal control as set out in its Statement on Internal Control.
- 3.3 At its meeting on 12 December 2005, this Commission considered a report from the Council's District Auditor on the Review of Internal Audit. This review looked at the extent of compliance with the professional standards set out in the Code of Practice for Internal Audit. The key conclusion was that Internal Audit provides an effective service that complies with the standards as a whole. The District Auditor made a number of recommendations to improve points of practice and this report comments on the progress made on their implementation.
- 3.4 This report also summarises the findings from a survey of Internal Audit's clients that was undertaken in 2005/06.
- 3.5 The report concludes by drawing the Commission's attention to the issues which are considered to be particularly relevant to the Council's Statement on Internal Control.

#### 4.0 **OUTTURN 2005/06 – AUDIT OPINIONS**

- 4.1 Each year, Internal Audit issues a "management letter" to each department. This provides a strategic overview of the work done in the year and expresses an opinion on the levels of assurance that can be placed on that Department's systems of internal control. The letters for 2005/06 have recently been issued. The following table compares the results for 2005/06 to 2004/05. It is a little difficult to make a direct comparison because of the corporate restructure, but the table does provide an overall view.

<b>Opinion – Level of Assurance</b>		<b>2004/05</b>	<b>2005/06</b>
1.	High	-	-
2.	Medium/High	4 ↑ 1 → 1 ↓	2 ↑ 2 →
3.	Medium	1 →	-
4.	Low	-	-

The figures in the body of the table refer to the number of departments in each category. Note that for 2005/06, no opinion was given for the Department of Corporate Policy and Improvement (DCPI). The majority of the work for this Department consisted of providing support and advice in respect of the corporate initiatives. Also, the Department of Resources (DR) provide the departmental input on behalf of the DCPI for the major

financial systems (creditors, payroll, debtors etc). The respective audit opinions for these controls were therefore included in the DR's Management Letter.

The arrows indicate the direction of travel.

The categories of opinion/level of assurance have been determined in-house in consultation with departments. The criteria used to make a judgement between the categories include whether there are any significant gaps in internal controls and on the extent of compliance with the controls which should be in place.

- 4.2 The overall picture is very positive and one of further improvement. All departments are in the medium/high category whereas in 2004/05 there was one former department judged to be medium. The key internal controls for the Council's major financial systems are in place and are generally being met. No new significant issues were identified during the year.

## **5.0 OUTTURN 2005/06 COMPARED TO THE ANNUAL PLAN**

- 5.1 Appendix A attached to the report compares the approved plan to the outturn for the year. The key points from an efficiency viewpoint are:

- ◆ Total time spent on audit work was slightly more than the approved plan (948 days compared to 939)
- ◆ 91% of planned audits were completed at the year end
- ◆ 6 audits were outstanding. Of those, 4 were postponed to 2006/07 at the request of the client. The remaining 2 were ongoing at the year end but have now been completed
- ◆ In addition, there were 4 major investigations

- 5.2 The core area of work was to review the Council's major financial systems in view of the total financial value and volume of transactions. These include: benefits; main accounting; payroll; sundry debtors; ordering supplies; goods and services and paying for them; council tax and non-domestic rates. The opinions/levels of assurance for these major systems were either high (level 1) or medium/high (level 2). There were no new significant issues of internal control arising.

- 5.3 Work on Corporate Governance included rewriting the Council's Contract and Financial Procedure Rules and helping to draft the Council's new Code of Practice on Project Management. This work addressed two significant internal control issues identified in the Council's 2004/05 Statement on Internal Control. A further review of the extent of compliance with the Council's rules on the use of business unit reserves was also undertaken. The overall conclusion here was that the high level of compliance found in the first review in 2004 had been maintained.

- 5.4 On contract audit, the major areas of work included advising on the Royal Hall refurbishment scheme and providing support to help come to a conclusion on the Nidderdale Pool claim. In addition, a number of contract final accounts were audited.
- 5.5 On departmental services, 26 out of the 30 audits were completed at the year end. Examples of such audits are: land charges, licensing, collection of car park income, and the HIC box office. The general conclusion is that most key controls are in place, although there are issues of compliance in some areas. Audit recommendations were made to improve controls where appropriate. The follow-up reviews indicate that these have generally been implemented.
- 5.6 A particular piece of work was on business support to see whether the recommendations from the business support review have been implemented. In general, the structural changes are in place but the audit found that some actions to implement the identified “quick win” efficiency gains were outstanding. Action plans to implement these have been agreed with departments.
- 5.7 Internal Audit carried out a review of the income from commission made over to the Council by the private sector catering partner of the Harrogate International Centre. This was instrumental in achieving a significant amount of additional income.
- 5.8 There are two points on “non-productive time” shown in the first part of Appendix A. The increase in “administration” time is due to the completion of the job evaluation questionnaires for the Single Status/Pay and Grading Review. Secondly, although actual time on training was less than planned, all identified training needs were met.
- 5.9 As far as the economy of Internal Audit is concerned, outturn expenditure for 2005/06 was within budget. Subject to any final adjustments and audit, there was a saving of £10,700 on the Section’s net bottom-line budget for the year of £203,000.

## **6.0 REVIEW OF INTERNAL AUDIT BY THE DISTRICT AUDITOR**

- 6.1 In December 2005, the Resources Commission considered a report from the Council’s external auditor, the District Auditor, on Internal Audit. The main conclusion was that Internal Audit provides an effective service and overall complies with the professional standards set out in the Code of Practice for Internal Audit for Local Authorities in the UK.
- 6.2 The District Auditor concluded that 7 out of the 10 standards were fully met. These are: scope of internal audit; independence; audit committees or equivalent; relationships with management, other auditors and other review bodies; staffing, training and development; management of audit assignments and reporting.

6.3 The standards considered to be “mostly” met were:

<b>Standard</b>	<b>District Auditor’s Comment</b>
<b><i>Audit Strategy</i></b>	A full audit needs assessment should be carried out when the audit strategy is next updated
<b><i>Due Professional Care</i></b>	Policy on due care requires updating in the light of the revised standard
<b><i>Quality assurance</i></b>	The Internal Audit Manual requires updating

6.4 The District Auditor made 15 recommendations in his report. 14 of the recommendations have been implemented. The one outstanding is undertaking an audit needs assessment. Significant progress has been made. The next stage is to test the module included in Internal Audit’s dedicated audit planning and control software which requires support from ITD to set up a test area.

## 7.0 CLIENT SURVEY

7.1 Further evidence of the effectiveness of Internal Audit is from client surveys. In December 2005, 29 questionnaires were issued covering 25 audits completed during the first 8 months of the financial year 2005/06. 10 questions were included, allowing responses ranging from “very satisfied” to “very dissatisfied”. The response rate was high with 26 questionnaires returned (90%).

7.2 Overall, the response was extremely positive with 99% of questions scoring “very satisfied” or “satisfied” (allowing for the deduction of any who did not comment on some questions). This is a marginal improvement on the already high figure of 98% achieved in May 2005.

7.3 Appendix B attached to the report provides a summary of the results of the survey.

## 8.0 ANNUAL PLAN FOR 2006/07

8.1 Appendix C attached to the report summarises the Annual Plan for 2006/07 which has been produced on the basis of an assessment of risks. All departments have been consulted on their respective audits included in the Plan and all, except for one, have agreed to them. At the time of writing, consultation with the Department of Corporate Policy and Improvement is ongoing.

8.2 Particular points to note include:

8.2.1

### **Major Financial Systems**

The Council is in the process of implementing a number of new major financial systems or business operational systems with links to financial systems. These include:

- ◆ a new financial management system was implemented with effect from 1 April 2006. This covers placing orders for goods; works or services; processing and authorising payments to suppliers etc; raising sundry debtor accounts; income allocation and bank reconciliation
  
- ◆ a new payroll system is to be implemented with effect from 1 April 2007
  
- ◆ a new housing management system which includes rent collection to be implemented from 1 October 2007
  
- ◆ a new customer relationship management system is due to go live in mid 2006

Such major changes increase risk if only in the short-term. Therefore, a key area of work in 2006/07 must be to review the effectiveness of revised internal control arrangements put in place to support new systems, in particular the new financial

management system, and check compliance with those controls.

In addition, this area also includes work on benefits. This also is a key area as the Council pays over £20 million in benefit payments each year. At the time of writing, consultations are ongoing with benefits management to finalise a programme of work for 2006/07.

## 8.2.2

### **Corporate Governance**

- ◆ On risk management arrangements, the objective will be to determine how far these are embedded by looking at arrangements in departments to monitor risks and to assess the effectiveness of mitigating actions. The intention is also to look at arrangements at the centre. This will help to make a judgement on the impact of the actions taken in the context of the comment made by the District Auditor in the recent Use of Resources Statement and in previous Statements on Internal Control
  
- ◆ This area will also review the arrangements for measuring, validating and reporting efficiency gains included in the Council's Annual Efficiency Statements. As these are signed by the Leader of the Council and the Chief Executive, this will provide an important means of assurance
  
- ◆ Further work on corporate governance will be subject to consultation with the lead department, Corporate Policy and Improvement.

## 8.2.3

### **Anti-Fraud and Corruption Work**

The Plan now includes a specific section on this work to provide added focus and in response to comments made by the District Auditor in his Review of Internal Audit. Work here includes gifts and hospitality, outside interests, and travel and subsistence claims. This will support the Chief Executive's initiative to re-launch the Council's Whistleblowing Policy.

In addition, the intention is to commission a further piece of work in this area possibly from external resources utilising the savings from 2005/06. At the time of writing, discussions are ongoing with the Audit Commission.

8.2.4

#### **Contract Audit**

This includes giving advice on the Royal Hall refurbishment scheme. Other areas of work will be auditing contract final accounts and reviewing compliance with EU Regulations.

8.2.5

#### **Computer Audit**

A programme of work has been agreed with the Head of ITD. Areas of work will include reviewing management controls, looking at the financial management of IT and advising on the development of the ICT Strategy and User Policy.

8.2.6

#### **Departmental Services**

This provides for 37 separate audits. Examples include Debt

Recovery, Refuse Collection, the Hydro, Concessionary Fares and Building Control. The objective here is to ensure that key controls are in place proportionate to risk and that these are being complied with.

8.3

In terms of internal audit resources, the section is currently fully staffed. Temporary arrangements are in place to provide cover for an officer on maternity leave.

9.0

## **CONCLUSIONS – ISSUES FOR THE STATEMENT ON INTERNAL CONTROL**

9.1

The key point arising from the work completed in 2005/06 is that the overall position on internal financial controls is very positive. There has been further improvement over 2004/05. The key controls for the major financial systems are in place and are generally being met. The audits undertaken in the year did not identify any new significant issues.

9.2

Particular internal control issues for 2006/07 include:

- ◆ the increased risk, if only for the short term, arising from the implementation of the new financial management system. The risk is that key internal controls to support the new system either are not in place or are not working
  
- ◆ the embedding of improved risk management

arrangements and practices throughout the Council

- ◆ the increased focus on anti-fraud and corruption arrangements through the work of Internal Audit and the re-launch of the Council's Whistleblowing Arrangements
  
- ◆ no list would be complete without mentioning the Royal Hall

### 9.3

Following an amendment to the Accounts and Audit Regulations, the Council must now undertake a review of the effectiveness of its system of internal audit and consider the findings of this review as part of the consideration of the system of internal control. The Commission is free to make any comments it so wishes. In so doing, the Commission may wish to take into account the following evidence:

- |               |   |
|---------------|---|
| economy       | - saving of £10,700 in the net bottom-line budget for 2005/06   |
| efficiency    | - 91% of planned audits completed at the year end. In addition, 4 major investigations were completed   |
| effectiveness | - independent conclusion from the District Auditor that Internal Audit provides an effective service and overall meets professional standards |
|               | - very positive results from the latest client satisfaction survey  |

**Background Papers:**

**OFFICER CONTACT:** Please contact Martin Helm if you require any further information on the contents of this report. The officer can be contacted at Council Offices, Crescent Gardens, Harrogate HG1 2SG by telephone on 01423 556114 or by email martin.helm@harrogate.gov.uk

**SUSTAINABILITY ASSESSMENT/POLICY CONSIDERATIONS**

		Implications are		
		Positive	Neutral	Negative
A	Economy		✓	
B	Environment		✓	
C	Social Equity			
(i)	General		✓	
(ii)	Customer Care/People with Disabilities		✓	
(iii)	Health Implications		✓	
D	Crime and Disorder Implications		✓	

If all comments lie within the shaded areas, the proposal is sustainable.

