



**Internal Audit Annual Report**

**2003 - 2004**

April 2004

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Appendix 2: Assessment of Audit days 2003 – 2004 Strategic Plan

## 1. MISSION STATEMENT

“To contribute to the achievement of Argyll and Bute Council’s mission and strategic objectives by providing assurance to the Council that financial and operational controls and arrangements for Best Value are functioning efficiently and effectively and that the significant risks to the organisation are being managed.”

## 2. TERMS OF REFERENCE

### Objectives

- To assist the Council and its Strategic Management Team in their governance responsibilities: that is, to support them in creating a mechanism to deliver an effective and efficient risk management and control framework; and to assist them in the corporate governance reporting process.
- To provide assurance on the adequacy of control within the Council’s systems and activities: that is to comment on and recommend appropriate changes to mechanisms put in place by management to ensure systems and activities achieve their objectives; and to bring deficiencies therein to the notice of operational management and ultimately to the Audit Committee.
- To advise management on cost effective controls for new or modified systems and activities;
- To highlight opportunities to reduce costs through greater economy and efficiency within systems and activities.
- Internal Audit areas of focus include:
  - Internal control effectiveness
  - Statutory, procedures and control compliance
  - Implementation of recommendations
  - Corporate governance
  - Systems development
  - Process improvement
  - Value for money and Best Value

Over time it is envisaged that the function will increase the proportion of performance reviews of operational systems, value for money and contribute to Best Value Audit.

### Scope

The scope of internal audit includes the examination and evaluation the adequacy and reliability of the Council’s system of internal control. Internal Audit’s work provides assurance across all of the Council’s activities regarding the extent to which management controls ensure that:

- significant risks are identified, assessed and appropriately managed;
- objectives are established and achievement against them is monitored;

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- the Council's assets are safeguarded from significant losses, including those caused by fraud, waste, inefficiency and commercially unsound practices;
- relevant laws, rules and regulations are complied with;
- operations are conducted effectively, efficiently and economically;
- operations are conducted in accordance with Council policies and procedures;
- management information systems are reliable and secure;
- systems under development are monitored, that appropriate internal controls are built in and are consistent with the organisations' needs;
- major Council projects achieve their objectives; and
- throughout the Council's activities it can demonstrate good governance.

In addition, Internal Audit may perform special reviews requested by the senior management or the Audit Committee. When plans are changed for such reviews, this is reported to the Audit Committee so that it clearly understands the implications on resources and for the assurance it requires about internal controls, and any impact on the delivery of agreed plans.

### **3. MAIN SERVICES AND REPORTING**

To fulfil our responsibility the main services provided are:

#### **CORE FINANCIAL AUDITS**

The documentation, evaluation and testing of financial and management information systems providing an opinion as to the adequacy of control and offering suggestions and advice to enable rectification of systems weaknesses and assist in the effective management of compliance and risk control.

#### **NON - CORE FINANCIAL AUDITS**

The review of specific areas of activity where management feel that an independent review by internal audit will assist them in developing and better managing issues their services face in terms of performance and best value. It is within this element of the annual audit plan that direct audit assistance is obtained from KPMG our partners who provide specialist control evaluation of hardware, software and the IT environment, offering suggestions and advice as above.

#### **SPECIAL INVESTIGATIONS**

We offer advice and assistance to all levels of management on control and risk management. Internal Audit carries out reviews of issues reported by management. The type of work done can range from advice to investigation of irregularities. The issues once investigated usually lead to the enhancement of risk management strategies or activities.

## REPORTING

### Audit Committee

At each Audit Committee throughout the year issues pertaining to the progress of the audit programme in terms of planned to actual are passed to the Audit Committee for their advice. Recommendations made by external audit are followed up and progress regarding implementation reported to the Audit Committee. At the culmination of the years audit work an annual report is prepared and presented to the Audit Committee. Our annual report provides an overall audit opinion as to the adequacy of the control environment within the Council. This has been derived from the Internal Financial Control Statement (IFCS) passed to the Section 95 Officer and Chief Executive to enable them to place their statement in the Annual Accounts.

### Auditees

With regard to internal audit reporting on audits carried out, we provide management with an independent and objective opinion on the control environment by taking into consideration the review of internal controls and risk, and recommend changes where appropriate in agreement with management. The internal audit work undertaken is reported to clients, either in the form of a report or a memo whichever is the most relevant. Our reports are in a standard format which gives a pictorial view of the findings of each audit and ranks their importance in severity of control weakness. All report findings are discussed with management for their collective buy-in to our findings. Follow-up reviews are planned within the audit plan.

Set out below is the classifications used by Internal audit when reporting our findings.

Fundamental	Major observations on high level controls and other important internal controls. Significant matters relating to factors critical to the success of the objectives of the system. The weakness may therefore give rise to loss or error
Material	Observations on less important internal controls, improvements to the efficiency and effectiveness of controls which will assist in meeting the objectives of the system and items which could be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified
Minor	Minor recommendations to improve the efficiency and effectiveness of controls and one-off items subsequently corrected. The weakness does not appear to affect the ability of the system to meet its objectives in any significant way

## 4. EXTERNAL AUDIT

The relationship operated by Internal Audit with the Council's External Auditors is one of joint working where we try to either avoid areas of duplication and in other areas work jointly on large system control issues. Consultations are held on a regular and informal basis to co-ordinate work and we use Audit Scotland audit programmes to carry out our audit work. In 2003 – 2004 a joint audit was carried out between Audit Scotland and Internal Audit covering

the Council's arrangements for Asset Accounting and Asset Management. The audit identified a number of key issues and recommendations for the Council and management are currently addressing these.

On an annual basis Audit Scotland carry out an evaluation of Internal Audit work the outcome of which is published in their Annual Accounts report. For 2002 – 2003 Internal Audit received a favourable report and we would hope that this would continue for 2003 - 2004.

Audit Scotland conducted a review of all local authority internal audit provision across Scotland in the autumn of 2000 this culminated in the issue of a report in August 2001 entitled, "A job worth doing". Its assessment of internal audit compliance with the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Internal Audit in Local Government was to place Argyll and Bute in the bottom quartile of authorities in Scotland. As a result the Council appointed KPMG to act as a partner to internal audit to assist and advise on best practice.

With the support of KPMG over the last two years internal audit systems have improved and in January 2004 Audit Scotland carried out a follow up review exercise to see whether any improvement had taken place. It is anticipated that the results of the exercise will show a substantial improvement in compliance with the code has occurred. The results of the review will be published in a report around August 2004.

## **5. STATEMENT ON INTERNAL FINANCIAL CONTROL**

It is the responsibility of the Council's senior management to establish an appropriate and sound system of internal control and to monitor the continuing effectiveness of that system. For the Council's annual accounts for the financial year 2003-04 it is the responsibility of Internal Audit to provide an annual overall assessment of the robustness of the internal financial control system (IFCS) for the Chief Executive.

The main objectives of the Council's internal financial control systems are:

- To ensure adherence to management policies and directives in order to achieve the organisation's objectives;
- To safeguard assets;
- To secure the relevance, reliability and integrity of information, so ensuring as far as possible the completeness and accuracy of records; and
- To ensure compliance with statutory requirements.

Evaluation of the control environment is informed by a number of sources:

- The work undertaken by internal audit during the year to 31 March 2004;
- The assessment of needs completed during the preparation of the strategic audit plan;
- Reports issued by the Council's external auditors, Audit Scotland.
- Internal Audit knowledge of the Council's governance, risk management and performance monitoring arrangements.

The statement has 2 sections in which Internal Audit is required to give an opinion on the Council control environment. The first is on matters brought forward from last year. The

second is for any new matters arising in 2003/2004. Internal financial control statements for departmental Directors have also been prepared and signed to support the overall statement of control prepared by the Head of Strategic Finance for inclusion in the Council's Annual Accounts.

## **6. PROGRESS ON ANNUAL AUDIT PLAN 2003 – 2004**

Below is the list of audits that were scheduled for the financial year 2003 – 04. The objective of the report is to advise members of the final status of each audit.

A total of 31 audits were planned these can be broken down into the following categories:

- 20 Core Financial Systems Audits and
- 11 Non Financial Systems Audits.

Additional to the above Internal Audit carried out special investigations follow up reviews and external audit work.

Of 20 Core Financial Systems audits, one audit Purchase Ordering & Certification was amalgamated with another audit for efficiency reasons. This was reported previously to the Audit Committee.

Of the 19 audits 14 have been completed with final reports issued with agreed implementation plans and 4 are presently at draft stage. The remaining audit is currently being worked on and will be completed shortly.

Of 11 Non Core Financial Systems audits, 2 audits are to be completed by KPMG, one for the Catering & Cleaning and the other for IT/MIS Strategy & Controls, it is anticipated that they will be completed by the end of May 2004. For the remaining 9 audits final reports with implementation plans have been issued for 6 with the remaining 3 at draft stage for final issue in May. The number of audit days expended up to April 2004 is given in Appendix 2. This will be updated to reflect the final position when all audits have been completed.

Throughout 2003 – 2004 internal audit resources have been tight and towards the end of the financial year an additional resource was brought in on a contract basis to assist with audit plan delivery. This allowed the internal audit plan to progress resulting in the annual audit plan being completed.

Additional to the above internal audit completed a number of special investigations. Also follow up reviews were carried out for reports issued in the previous financial year by both internal and external audit.

### **Audit Opinion**

Based on audit work carried out to date, we are of the opinion that the Council's systems provide a reasonable assurance regarding the effective and efficient achievement of the Council's objectives. We have indicated in our audit reports certain matters, which we understand are being addressed by local management; our opinion on the Council's systems is based on recommendations being satisfactorily implemented. Additional assurance has been given in an Internal Financial Control Statement (IFCS) prepared by internal audit and is the

subject of a separate report to the Audit Committee.

In conclusion, the audit plan for 2003 – 2004 will be effectively completed in May 2004. The Audit Committee is asked to accept the assurances provided by internal audit, based on the 2003 – 2004 audit work completed.

## **7. AUDIT ANALYSIS of 2003 - 2004**

Whilst there has been some slippage against the actions identified and their target dates, the bulk of the planned activity has been achieved, particularly:

- Quarterly reports are prepared for the Audit Committee advising of progress with the Annual Audit plan;
- A joint audit was carried out on a major system between Internal Audit and Audit Scotland;
- A higher percentage of audits were carried out by qualified staff in 2003 – 2004 than the previous year;
- Analysis of returned client questionnaires indicated that an average score of 3.5 has been achieved so far for all completed audits the highest achievable mark being 4;
- Regarding the implementation of internal audit report recommendations by the client it was reported that 100% of all fundamental recommendations were agreed and a 100% for major and minor recommendations against a target of 80% was also agreed; and.
- Audit Committee Internal Audit Performance Indicators and an explanation of the results achieved in 2003 – 2004 is given below in Section 9.

## **8. SPECIAL INVESTIGATIONS**

Council Standard Orders require management to report all suspected irregularities or issues requiring investigation to Internal Audit. In practice, many of these are resolved best by management investigation and action, with support and advice from Internal Audit. All advice, investigation and irregularity issues are recorded and it is possible to ascertain what control issues have occurred.

This information can then be used as part of the assessment of relative risk in the process of preparing the annual audit plan and also in advising managers across the Council of potential risks and opportunities to strengthen controls. This is done through our quarterly report that we issue to Directors and Heads of Service entitled Audit Focus.

During 2003 – 2004, 10 instances of issues and irregular activity were reported to and investigated by Internal Audit. Where required internal audit can call on external professional resources to assist with particular technical aspects of an investigation as and when required. Summarised below by directorate are the number of days expended against departments.



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<b>2003 – 2004</b>	<b>Number of Days Expended</b>
<b>Directorate</b>	
Chief Executives Unit	14
Corporate & Legal	12
Finance	14
Information Technology	0
Development & Environment	35
Transportation & Property	48
Housing & Social Work	6
Education	9
<b>Total</b>	<b>138</b>

The table below is the further breakdown of the above table indicating the type of issues that were covered.

<b>TYPE OF ISSUE REPORTED</b>	<b>C &amp; L</b>	<b>F I N</b>	<b>D E S</b>	<b>T P S</b>	<b>H S W</b>	<b>C. E X</b>
Irregularity	✓			✓	✓	
Advice & Assistance	✓	✓	✓	✓		✓

## 9. INTERNAL AUDIT PERFORMANCE MEASUREMENT

At the outset of the financial year 2003 – 2004 Internal Audit was tasked to measure the performance of its service delivery. This was to allow comparison to be made year-on-year and to set targets for improvement and by meeting such targets, the Audit Committee could have confidence that Internal Audit were delivering a quality service.

In total there were 11 performance indicators agreed by the Audit Committee in 2002 for Internal Audit to adhere to and were set out under two headings Input and Output:

- 6 Input indicators and
- 5 Output measures.

The tables below set out the performance measures and the performance of internal audit for the financial years 2002 – 2003 & 2003 – 2004. A comment has been made for each performance indicator. Internal Audit will strive to maintain the quality standards achieved and where appropriate make improvements.

### INPUT PERFORMANCE MEASURES AS AT 30 APRIL 2004

Ref	Performance Indicator	Target	Achieved 2003 - 2004	Comment
1.	Percentage of audit work carried out by qualified and specialist staff.	65%	<b>80%</b>	As at 30 April 2004. Qualified staff has carried out more audits this year.
2.	Issue of draft reports within 10 working days of work being completed.	10 days – 100%	<b>96%</b>	As at 30 April 2004. This target was met in overall terms. However, one audit draft report was issued over 10 working days after fieldwork had been completed. The draft report for Property Asset Management was issued late due to joint working with Audit Scotland not being taken fully into account. However this is seen as a learning curve for the future.
3.	Issue of final reports within 5 working days of management responses being received.	5 days – 100%	<b>100%</b>	As at 30 April 2004. This target was met in overall terms.
4.	Reports display: clear opinion; action plan of prioritised recommendations and management responses; a person responsible; and date for completion.	All reports (100%) state a clear conclusion/opinion, contain an action plan, prioritised recommendations, allocated responsibility and target dates for completing recommendations.	<b>100%</b>	As at 30 April 2004. All quality issues met.
5.	Management's feed back on audit planning and fieldwork.	To achieve 'average' or better in questionnaire ratings. (i.e.: a mean score of '3' or more for each question)	<b>3.5</b>	As at 30 April 2004. At this stage the current average equals that achieved last year.
6.	Percentage of time direct audit time	67% revised to 81%	<b>81%</b>	This was set through Audit Committee agreement.

**OUTPUT PERFORMANCE MEASURES AS AT 30 APRIL 2004**

<b>Ref</b>	<b>Performance indicator</b>	<b>Target</b>	<b>Achieved 2003 - 2004</b>	<b>Comment</b>
1.	Audit operational plan to be submitted to the audit committee by 31 March each year.	31 March of each year (100%)	<b>100%</b>	2003-04 Audit plan submitted to Audit Committee on 20 February 2004.
2.	Follow-ups to be performed within one year of the audit-taking place.	100% of recommendations followed up in following year	<b>94%</b>	As at 30 April 2004. In one case the follow up date was not achieved but a follow up review has now been completed.
3.	Completion of overall assignment in the annual plan (in budgeted time), subject to variations agreed by audit committee, and if appropriate, audit managers.	100%	<b>100%</b>	As at 30 April 2004. Audit Assignments were completed within the overall budgeted days.
4.	Recommendations accepted compared to recommendations made.	Fundamental – 100%	<b>100%</b>	As at 30 April 2004.
		Material and minor - 80%	<b>100%</b>	As at 30 April 2004.
5.	Internal audit costs are within budget (including in-year budget variations)	100% (Total costs within budget)	<b>100%</b>	As at 30 April 2004.