



**Internal Audit Annual Report
2004 - 2005**

April 2005

INDEX

	<i>Page</i>
1. Foreword	1
2. Mission Statement	1
3. Terms of Reference	1
Objectives	1
Scope	2
4. Main Services and Reporting	2
Core Financial Audits	2
Non Financial Audits	2
Contingency Days	3
Reporting	3
Audit Committee	3
Auditees	3
5. External Audit	4
6. Statement of Internal Financial Control	5
7. Progress on Annual Audit Plan 2004 - 2005	5
Audit Opinion	7
8. Audit Analysis of 2004 - 2005	7
9. Contingency Days	7
10. Internal Audit Performance Measurement	8

Appendix 1: Assessment of Audit days 2004 – 2005 Strategic Plan

1. FOREWORD

The annual audit plan has been delivered in accordance with the CIPFA *Code of Practice for Internal Audit in Local Government in the United Kingdom* ('the Code'). This requires the Internal Audit section to provide an objective assessment of the adequacy, reliability and effectiveness of the Council's internal control system. This annual audit plan also takes into account the Internal Audit Mission Statement and Terms of Reference both of which have previously been approved by the Audit Committee.

2. 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."

3. 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;
- 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.

4. MAIN SERVICES AND REPORTING

To fulfil our responsibility the main services provided are:

CORE FINANCIAL AUDITS

Internal Audit has a responsibility to evaluate and test financial and management information systems in order to provide an opinion as to the adequacy of control within the Council. As a result of this work departmental management receive audit reports with recommendations offering suggestions and advice to enable rectification of system weaknesses and to assist them with compliance and risk control.

NON FINANCIAL AUDITS

The Code requires that internal audit not only look at financial systems but also other systems of management control used to ensure the Council's objectives are being

properly managed, and that control arrangements have been established and operated within the Council to achieve Best Value, VFM and Performance Improvement in service delivery. Internal Audit in complying with the Code, has prepared this section of the annual plan incorporating high risk areas identified by Heads of Service in a recent operational risk exercise carried out between the Corporate Services Department - Governance & Risk section, Internal Audit and its partner.

CONTINGENCY DAYS

This is audit time for unforeseen events which, by their nature, cannot be planned for, e.g.:

- notification of frauds, significant weaknesses or loss;
- consideration of controls for new or amended systems; and
- reviews of significant breakdown of internal control that cannot be accommodated within planned audits.

Clearly, the extent to which any contingency requirement will arise depends on the soundness of the Council's systems of control and the incidence of fraud or irregularity.

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 Head of Strategic Finance as Section 95 Officer to enable a statement to be placed in the Annual Accounts.

Internal Audit also reviews and documents the progress made by departmental management in implementing report recommendations made by Audit Scotland and Internal Audit. Internal Audit was concerned that the process of collecting evidence and subsequent reporting was inefficient for departments, internal audit and the Audit Committee. A new reporting system was therefore devised and was first reported to the Audit Committee in August 2004. The new system provides the Audit Committee with objective reporting on management progress with their implementation of agreed recommendations.

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 that give 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 are 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

5. 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 2004 – 2005 external and internal audit worked jointly on the Housing Benefit Grant Claim and the Council Performance Indicators.

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 2003 – 2004 Internal Audit received a favourable report and we would hope that this would continue for 2004 - 2005.

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 placed Argyll & Bute in the bottom quartile of local authorities in Scotland, Band 4. As a result the Council appointed KPMG to act as a partner to internal audit to assist and provide advice on best practice in relation to the code.

With the support of KPMG internal audit systems subsequently improved and in January 2004 Audit Scotland carried out a follow up review exercise to see whether

any improvement had taken place in respect of compliance with the Code. The results of the exercise showed that there had been a substantial improvement in Internal Audit compliance with the Code. Argyll & Bute Council was placed in Band 1.

6. INTERNAL FINANCIAL CONTROL STATEMENT (IFCS)

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 2004 - 05 it is the responsibility of Internal Audit to provide an annual overall assessment of the robustness of the internal financial control system and to provide an IFCS for the Head of Strategic Finance as Section 95 Officer.

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 2005;
- 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 IFCS 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 2004 - 2005. Internal financial control statements for Strategic Departmental Directors have also been prepared and are in the process of being signed. This will support the overall statement of control prepared by the Head of Strategic Finance for inclusion in the Council's Annual Accounts.

7. PROGRESS ON ANNUAL AUDIT PLAN 2004 – 2005

Appendix 1, lists of audits that were covered in the financial year 2004 – 05. The objective of the report is to advise members of the final status of each audit.

A total of 31 audits were planned for the financial year these were allocated into the following categories:

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

Additional to the above Internal Audit was involved in advice & assistance to management and follow up work.

Of 20 Core Financial Systems audits, in the last quarter the decision was taken amalgamate the Purchase Ordering & Certification audit with Purchasing of Equipment & Materials. Both audits are closely aligned and therefore one audit was scoped to cover the audit objectives of both. Of the remaining 19 audits 18 have been completed with final reports and agreed action plans issued. The remaining audit, Budgetary Preparation & Control is currently being progressed towards completion by KPMG. In final analysis of the financial year out of 471 planned audit days 457 have been expended as at April 2005.

With regard to Non Core Financial Systems audits eleven were planned and 10 are complete with reports and agreed actions plans issued. The remaining audit, DSO Catering & Cleaning (NPDO) initially started well and KPMG were able to provide support in the initial bid process. However the further involvement that management requested of Internal Audit has consistently throughout the year been delayed due to issues regarding the progression of the NPDO. Consequently the end of the financial year was reached with neither KPMG nor Internal Audit being able to carry out any further audit work. In final analysis of the financial year out of 327 planned audit days 303 days have been expended up to April 2005.

As a result of the demand on Internal Audit resources to provide Advice & Assistance to management in 2003 – 2004, the number of Contingency days allocated in 2004 – 2005 was set at 160 days. At the end of the second quarter it became apparent that in 2004 – 2005 there had been less days required than had been experienced in 2003 – 2004. A decision was therefore taken to reduce the number of days and transfer a portion to follow up review work. This was reported to the Audit Committee on the 3rd December 2004. In the final analysis out of the 110 planned audit days 93 have been expended.

In August 2004, Internal Audit in discussion with Audit Scotland and Strategic Departmental Directors proposed to the Audit Committee that a change was required in the reporting of both external and internal audit report recommendation implementation by management. The change was accepted by the Audit Committee and now the Audit Committee is provided with more objective responses from departmental management regarding recommendations that are not implemented within agreed deadlines. There were 101 audit days set aside for Other Areas at the commencement of the financial year. At the outset of the new reporting process departments required support and 50 audit days were transferred from Contingency to cover this and to assist with risk assessment element of the Strategic Audit Plan for 2005 - 2008. This was reported to the Audit Committee on the 3rd December 2004. In the final analysis out of 151 planned audit days 159 days were expended.

Throughout 2004 – 2005, Internal Audit resources have been tight with 2 members of staff seconded over the latter 2 quarters 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 be progressed with disruption kept to a minimum.

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 2004 – 2005 will be effectively completed by the end of May 2005. The Audit Committee is asked to accept the assurances provided by Internal Audit, based on the 2004 – 2005 audit work completed.

8. AUDIT ANALYSIS of 2004 - 2005

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;
- Joint audit work was completed between Internal Audit and Audit Scotland;
- A higher percentage of audits continued to be carried out by qualified staff in 2004 – 2005;
- Analysis of returned client questionnaires indicated that an average score of 3.5 has been achieved 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 as was a 100% for major and minor recommendations.

9. CONTINGENCY DAYS

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 departmental 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.

APPENDIX 1

During 2004 – 2005, 8 instances were reported to and followed up by Internal Audit. These required advice & assistance. Internal Audit can call on external professional resources to assist with particular technical aspects on any investigation as and when required. Summarised below by directorate are the number of days expended against departments.

2004 – 2005	Number of Days Expended
Directorate	
Community Services	27
Development Services	47
Operational Services	19
Total	93

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

TYPE OF ISSUE REPORTED	C	D	O
	S	S	S
Advice & Assistance	✓	✓	✓

10. INTERNAL AUDIT PERFORMANCE MEASUREMENT

At the outset of the financial year 2004 – 2005 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 input and output performance measures for 2004 - 2005. A comment has been made for each performance indicator. Internal Audit will strive to maintain the quality standards achieved and will endeavour to make improvements.

INPUT PERFORMANCE MEASURES 2004 - 2005

Ref	Performance Indicator	Target	Achieved 2004-2005	Comment
1.	Percentage of audit work carried out by qualified and specialist staff.	65%	80%	The level of qualified staff involvement has been maintained in 2004 - 2005.
2.	Issue of draft reports within 10 working days of work being completed.	10 days – 100%	100%	Achieved.
3.	Issue of final reports within 5 working days of management responses being received.	5 days – 100%	100%	Achieved.
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 and action plan, prioritised recommendations, allocated responsibility and target dates for completing recommendations.	100%	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	3.5	The level of achievement has remained consistent with 2003 – 2004.
6.	Percentage of direct audit time	Target 81%	81%	The level of achievement has remained consistent with 2003 – 2004 at 81%.

OUTPUT PERFORMANCE MEASURES 2004 - 2005

Ref	Performance indicator	Target	Achieved 2004- 2005	Comment
1.	Audit operational plan to be submitted to the audit committee by 31 March each year.	31 March of each year (100%)	Achieved	2005 - 2008 Strategic Audit Plan including the 2005 – 2006 annual plan was presented to the Audit Committee of the 4 th of March 2005.
2.	Follow-ups to be performed within one year of the audit-taking place.	100% of recommendations followed up in following year	-	There is now a new reporting structure in place and therefore follow-ups are carried out as a routine task for the quarterly meetings of the Audit Committee.
3.	Completion of the annual plan subject to variations agreed by Audit Committee, and if appropriate, Audit Managers.	100%	100%	Individual audit assignments as in 2003 – 2004 varied in actual audit days to budget. A number of audits were either completed on time or ahead of budget whilst others took more days than had been budgeted. However in overall terms, audits have been completed within the total number of budgeted audit days set out in the annual audit plan.
4.	Recommendations accepted compared to recommendations made.	Fundamental – 100%	100%	Achieved.
		Material and minor - 100%	100%	Achieved.
5.	Internal audit costs are within budget (including in-year budget variations)	100% (Total costs within budget)	100%	Achieved.