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Annual Internal Audit Report 2007 - 2008

June 2008

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1. FOREWORD

The annual audit plan for 2007 – 2008 has been delivered in accordance with the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom ('the Code'). As well as complying with the Code, Internal Audit has to comply with its Mission Statement and Terms of Reference, both of which have previously been approved by the Audit Committee and are covered below.

2. INTERNAL AUDIT - 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. INTERNAL AUDIT - TERMS OF REFERENCE

Objectives

- To assist the Council and its Strategic Management Team in their governance responsibilities;
- To provide assurance on the adequacy of control within the Council's systems and activities;
- 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.

Scope

The scope of Internal Audit includes the examination and evaluation of the adequacy and reliability of Council systems of internal control. To this end an annual audit plan is presented to the Audit Committee for approval with any adjustments reported throughout the year. The work of Internal Audit therefore provides assurance across all of the Council's activities.

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 the agreed annual audit plan.

4. INTERNAL AUDIT – ACTIVITY AREAS

To fulfil the above responsibilities Internal Audit undertakes the following activities based on an annual audit plan:

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

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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 Core Financial Audits

The Code requires that Internal Audit not only review 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 operate within the Council to achieve Best Value, VFM and Performance Improvement in service delivery. Internal Audit in complying with the Code, prepare this section of the annual audit plan incorporating high risk areas identified by all Heads of Service through an operational risk exercise. This exercise is supported by both the Corporate Services Department – Democratic Services and Governance section, and KPMG our Internal Audit partners.

Contingency and Other Areas

Within the annual audit plan contingency direct audit days are set aside for unforeseen events which, by their very 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 is used depends on the soundness of the Council's systems of control and the incidence of fraud or irregularity. In addition, direct audit days are provided in the annual plan for the follow up of management agreed recommendations cited in external and internal audit reports, risk management and annual planning, this is designated as other areas.

Internal Audit Reporting

Audit Committee

The Audit Committee holds quarterly meetings at which they review progress on:

- The annual audit programme in terms of audits planned and completed with the number of days expended;
- The progress made by management in implementing External and Internal Audit report recommendations; and
- National report issues that Council departments need to address such as; SWIA

At the culmination of the years audit work the Audit Committee receives:

- An Annual Internal Audit report; and
- A draft Internal Control Statement (ICS) for approval. The ICS assists the Head of Strategic Finance as Section 95 Officer, prepare a statement on control for the Annual Accounts.

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Auditees

With regard to Internal Audit reporting audit findings, Internal Audit provides management with an independent and objective opinion on the control environment by taking into consideration the review of internal controls and risk, and recommends changes where appropriate in agreement with management. The audit work undertaken is reported to the auditee, either in the form of a report or a memo whichever is the most relevant. Our reports are in a standard format and provide an opinion on controls reviewed awarding one tick (✓) for very poor control and up to 5 ticks for very good control against the specific objectives of each audit. A system of grading audit findings that have resulted in a recommendation within an action plan has been adopted in order that the significance of the findings can be ascertained. Each finding is classified as fundamental, material or minor. The definition for each classification is set out below: -

- **Fundamental.** Significant weakness in control is discovered that may give rise to loss or error;
- **Material.** A weakness is found but is not necessarily great, but the risk of error would be significantly reduced if it were rectified; and
- **Minor.** The weakness does not appear to affect the ability of the system to meet its objectives in any significant way but should be rectified.

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 coordinate work and we use external audit approved programmes to carry out our audit work. In 2007 – 2008 external and internal audit worked jointly on the Council's Statutory Performance Indicators.

On an annual basis External Audit carry out an evaluation of Internal Audit work, the outcome of which is published in their Annual Accounts report.

Grant Thornton, the Council's External Auditors will place reliance on the work of Internal Audit in the following areas:

- Payroll;
- Council tax and Non-domestic Rates;
- Creditor Payments;
- General Ledger operations;
- Cash income & banking;
- Purchasing IT and e-procurement;
- Capital;
- Unified Benefits System;
- Debtors accounts;
- Statutory Performance Indicators;
- Stocktaking;
- Payments to voluntary bodies; and
- Contract Hire and operating leases.

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6. INTERNAL CONTROL STATEMENT (ICS)

It is the responsibility of Internal Audit to provide an annual overall assessment of the robustness of Council internal control systems to the Head of Strategic Finance as Section 95 Officer. The ICS is informed by a review of the findings of audit work carried out by both external and internal audit throughout the financial year. In addition departmental internal financial control statements are prepared by Strategic Directors regarding specific audit areas identified as requiring future attention. These departmental internal control statements are then signed and passed to Internal Audit. All of the above therefore supports the overall statement of control prepared for the Head of Strategic Finance.

The ICS 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 section is for any new matters arising in 2007 – 2008.

7. PROGRESS OF THE ANNUAL AUDIT PLAN 2007 – 2008

Appendix 2, lists all audits planned by Internal Audit for the financial year 2007 – 2008 inclusive of reported changes. The objective of the assessment of audit days is to advise the Audit Committee members of the final status of each audit. The annual audit plan was based on the section operating with a full staff compliment. The outcome was that the section operated throughout the year with reduced resources augmented by contract audit staff. Of 1,080 audit days planned for only 943 days were expended.

The shortfall of 137 days resulted from:

- Secondment – Internal Audit Manager to Shared Services Diagnostic team lost Direct Audit Days of 31;
- Accountant Posts – there was a shortage of 47 days from the figure in the annual plan;
- Sickness Absence - Direct Audit Days lost, 25 days more than provided for in the annual plan; and
- Vacant posts – 34 days.

Emphasis throughout the financial year was placed on achieving the audit plan. In the first quarter of the year the section came under further pressure when a member of staff had a sustained period of Sickness Absence. This resulted in the number of direct audit days expended on the remaining audits being reduced from that originally planned. The remaining audits therefore received audits focused on key control areas. This enabled the agreed audit plan to be broadly achieved and provide assurance for external audit and the preparation of the annual ICS.

A total of 33 audits were planned for the financial year 2007 – 2008 and these were allocated into the following categories:

- 18 Core Financial Systems Audits and
- 15 Non Financial Audits.

A decision was taken to combine 4 audits from the core financial section of the plan and one audit from the non-financial section to form a Major Capital Audit. The audit areas were as follows:-

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- Tendering Procedures;
- Capital Contract Audit;
- Capital Accounting;
- Treasury Management; and
- Strategic Asset Management.

This was reported to the Audit Committee on 14 December 2007. The fieldwork has been completed for this audit and reports issued. The Overview report has been issued in draft form and will be discussed at a meeting in June 2008.

Of the remaining 14 audits, 13 have been completed with final reports and action plans issued.

The final audit has not been completed due to the secondment of one of the Internal Audit Managers to the Shared Services Diagnostic Project. The audit will be completed on his return to Internal Audit.

Of the remaining 14 Non Financial Systems audits, 12 have been completed with reports and action plans issued. A draft report has been issued for another audit and Internal Audit is awaiting a response from the relevant department. Internal Audit will follow this up to ensure that the final report is issued as soon as possible. The Strategic Asset Management audit was included in the Major Capital Audit as mentioned previously.

The audit of Best Value has been deferred as there was a follow up audit on Best Value carried out by Grant Thornton, the Council's external auditors. Days allocated for this audit have been redirected to the following areas:

- Special investigations;
- External & Internal Audit follow up; and
- Risk Assessment, Strategic Plan, Annual Plans.

In 2007 – 2008 the Audit Committee was provided with more objective responses from departmental management regarding recommendations that had not been implemented within agreed deadlines. This process provided the opportunity for the Audit Committee to focus its time on areas of non implementation by management of agreed external and internal audit recommendations. The process also enabled the Audit Committee to request senior management attendance at Audit Committees in order to establish reasons for non implementation of agreed recommendations. In addition, during 2007 – 2008, the Audit Committee took advantage through the receipt of national report recommendations to request senior management attendance at the committee.

Throughout 2007 - 2008, Internal Audit resources were under pressure due to days lost as a result of sickness absence and unfilled posts. Contract resources were brought in to assist with audit plan delivery and the recruitment of 2 Trainee Accountants which allowed the Internal Audit annual audit plan to be progressed.

Audit Opinion

Based on audit work carried out in 2007 – 2008 by Internal Audit, I am of the opinion that the Council's systems provide reasonable assurance regarding the effective and efficient achievement of the Council's objectives. Audit reports have indicated certain matters which are currently being addressed by management, and my opinion on the Council's systems is based on those recommendations being satisfactorily implemented. Additional assurance has been given in my Internal Control Statement (ICS) which is the subject of a separate report to the Audit Committee.

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In conclusion, the Annual Audit Plan for 2007 – 2008 will be completed by the end of June 2008 as remaining issues are addressed. The Audit Committee is asked to accept the assurances provided by Internal Audit, based on the audit work completed in 2007 – 2008.

8. AUDIT ANALYSIS of 2007- 2008

Apart from the deferment of one audit and the partial completion of another the planned work programme has been completed and in particular:

- Quarterly reports have been prepared for the Audit Committee advising of progress with the Annual Audit plan;
- Joint audit work was completed between Internal Audit and Grant Thornton;
- The percentage of audits carried out by qualified staff in 2007 – 2008 was above the target but was lower than 2006-2007. This was as a result of 2 Trainees being recruited.; and
- Analysis of returned client questionnaires indicated that an average approval score of 3.4 has been achieved by Internal Audit in 2007 – 2008. The highest achievable approval score is 4.

For the first time Internal Audit reports were submitted to the Audit Committee as per the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom. It was agreed at the June 2007 Audit Committee that Executive Summaries and Action Plans would be submitted to the Committee.

This was a result of a review of Internal Audit carried out by Grant Thornton, the Council's External Auditors.

The first reports were submitted to September 2007 Audit Committee.

9. INTERNAL AUDIT PERFORMANCE MEASUREMENT

Annually, Internal Audit measures the performance of its service delivery. This allows comparison to be made year-on-year and to set targets for improvement. In total there were 11 performance indicators agreed by the Audit Committee for Internal Audit to adhere to. They are set out under two headings:

- 6 **Input**; and
- 5 **Output** indicators.

The tables below set out the performance for both sets of indicators for 2007 - 2008. 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.

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INPUT PERFORMANCE MEASURES 2007 - 2008

Ref	Performance Indicator	Target	Achieved 2007-2008	Comment
1.	Percentage of audit work carried out by qualified and specialist staff.	65%	68%	This percentage figure is lower than last year's 80%. This is a result of employing 2 Trainee Accountants when attempts to recruit Accountants were unsuccessful.
2.	Issue of draft reports within 10 working days of work being completed.	10 days – 100%	91%	The percentage figure achieved has fallen short of the 100% target due to the issue of 2 draft reports after the 10 day period.
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 an action plan, prioritised recommendations, allocated responsibility and target dates for completing recommendations.	100%	As last year all of the target requirements have been 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	3.4	Management are asked to provide an opinion on the work carried out by Internal Audit and it can be reported that the level of achievement has fallen only slightly from last year's figure of 3.8. This still represents good performance for the section given the resource issues faced throughout the year.
6.	Percentage of direct audit time	Target 81%	76%	<p>The reason that the figure is below target is that time had to be spent on setting up Pyramid (Performance Management System) for Strategic Finance.</p> <p>In addition the Internal Audit Section had to move office twice in this period thus reducing the number of days for direct audit work.</p> <p>The target would have been achieved if resources did not need to be diverted to the above.</p>

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OUTPUT PERFORMANCE MEASURES 2006 - 2007

Ref	Performance indicator	Target	Achieved 2006- 2007	Comment
1.	Audit operational plan to be submitted to the audit committee by 31 March each year.	31 March of each year (100%)	Achieved	The Strategic Audit Plan 2008 – 2011 and the 2008-2009 Annual Audit Plan was presented to the Audit Committee on the 27 th of March 2008.
2.	Follow-ups to be performed within one year of the audit-taking place.	100% of recommendations followed up in following year	Achieved	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 Audit Plan subject to variations agreed by Audit Committee, and if appropriate, Audit Managers.	100%	94%	With the deferment of the Non-Financial Audit Chief Executive's Unit – Policy & Strategy – Best Value and the partial completion of the core financial Cash & Income Banking audit this has reduced the percentage achieved against plan. As in previous years individual audit assignments in 2007 – 2008 varied in actual audit days to plan. 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 planned direct audit days set out in the annual audit plan.
4.	Recommendations accepted compared to recommendations made.	Fundamental – 100% Material and minor - 100%	100% 100%	Achieved. Achieved.
5.	Internal audit costs are within budget (including in-year budget variations)	Total costs were within budget.	100%	Achieved.

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Assessment of Audit Days: 2007-2008 Strategic Plan

AUDIT WORK SCHEDULE	Last Audited	Risk Ranking	Original Estimated Audit Days 2007-08	Revised Estimated Audit Days 2007-08	Actual Audit Days 2007-08	Balance
Core financial systems						
Complete						
Government & European Grants	2006-07	1	30	30	17	13
Stocktaking	2006-07	2	25	25	13	12
Payments to Voluntary Bodies (Following the Public Pound)	2005-06	2	20	20	24	-4
Payroll	2006-07	2	30	30	12	18
Contract Hire and Operating Leases	2006-07	2	20	20	26	-6
Council Tax and Non- Domestic Rates	2006-07	2	30	30	20	10
Creditor Payments	2006-07	2	25	25	30	-5
Unified Benefits System	2006-07	2	30	30	32	-2
Car Allowances	2006-07	2	20	20	29	-9
Budgetary preparation & control	2006-07	1	20	20	18	2
General Ledger Operations	2006-07	2	25	25	14	11
Debtor Payments	2006-07	2	20	20	4	16
Purchasing IT e-Procurement	2006-07	2	25	25	27	-2
Draft						
Major Capital Audit	2006-07	1	120	120	165	-45
Not completed						
Cash Income & Banking	2006-07	2	30	30	15	15
Section Total			470	470	446	24
Non-financial Audits						
Complete						
All Depts – Corporate Governance	2006-07	1	20	20	15	5
All Depts – Performance Indicators	2006-07	1	50	50	46	4
Community Services – School & Public Transportation	2006-07	1	20	20	20	0
Community Services – Disclosure Scotland	N/A	2	20	20	31	-11
Community Services – Legislative Compliance	2006-07	1	20	20	18	2
Operational Services – Roads & Amenity – Waste Management	2002-03	3	20	20	18	2
Community Services – NPDO –Contract Monitoring	2006-07	1	30	30	61	-31
Corporate Services – ICT - Applications	2006-07	2	25	25	17	8
Corporate Services – Risk Management Register	2006-07	3	20	20	17	3
All Depts – Partnership Working	2006-07	1	20	20	20	0
All Depts – Business Continuity Planning	2006-07	1	20	20	20	0
Development Services – Partnership Project Funding	2006-07	1	20	20	7	13
Draft						
Community Services – Social Work	2006-07	1	20	20	20	0
Deferred						
Chief Executive's Unit – Best Value	2006-07	1	145	60	0	60
Section Total			450	365	310	55
Actual Direct Audit Time			920	835	756	79
Special investigations contingency						
Council Wide	-	-	80	125	7	4
Chief Executive's Unit					65	
Community Services					4	
Corporate Services					12	
Development Services					12	
Operational Services					21	
Section Total			80	125	121	4
Other Areas						
Follow-up External & Internal Audit Management Letter Points			60	80	48	32
Risk Assessment, Strategic Plan, Annual Plans			20	40	18	22
Section Total			80	120	66	54
TOTAL			1080	1080	943	137