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Annual Internal Audit Report
2009 - 2010

May 2010

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1. FOREWORD

The annual audit plan for 2009 – 2010 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 outlined 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

In order to provide an opinion on the Council's internal controls, Internal Audit is required to take cognisance of the Council's main financial systems and their support systems. The main financial audit areas are:

- Payroll Systems;
- Council Tax and Non-Domestic Rates;

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- Main Accounting Systems;
- Creditor Payments Systems;
- Debtors
- Unified Benefits; and
- Asset Management.

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 advice to enable rectification of system weaknesses, improve compliance and control and reduce risk.

Internal Audit in agreement with Grant Thornton UK LLP in 2008 – 2009 adopted the CIPFA Systems Based Audit (SBA) control matrices. Adopting the CIPFA methodology enables the identification of weaknesses and risks in systems whilst evaluating the controls management have established to ensure they are working effectively and provide assurance. The introduction and use of CIPFA SBAs complements the corporate objective of introducing self assessment tools to strengthen the drive for continuous improvement.

The core financial audits undertaken in 2009 – 10 were selected using an Audit Needs Assessment methodology of risk ranking. These audits enabled Internal Audit to provide an assurance statement on the Council's overall internal control framework.

Non Core Financial Audits

The Code requires that Internal Audit not only audit financial systems controls but also other systems of management control used to ensure the Council's objectives are being properly managed. Internal audit responsibility is to review that control arrangements have been established and operate within the Council thus ensuring that the Council's core values are being addressed.

Internal Audit in complying with the Code, prepare this section of the annual audit plan incorporating high risk areas identified by Heads of Service through an operational risk exercise. In addition, regular discussions take place with departmental Directors and Heads of Service in order to afford them the opportunity to identify any specific issues that would benefit from Internal Audit review.

The non-financial section of the strategic audit plan also recognises activities that require to be reviewed on an annual basis. These include corporate governance, computer audit, risk management, business continuity and statutory performance indicators. CIPFA has developed a number of systems based audit (SBA) control matrices for non financial control areas, and these were utilised in 2009 - 2010.

Contingency and Other Areas

Within the annual audit plan contingency direct audit days are set aside for events which, by their very nature, are one off events or could not have been predicted, e.g.:

- Notification of potential 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.

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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, strategic and annual planning are also designated as other area tasks.

Internal Audit Reporting

Audit Committee

In 2009 – 2010, the Audit Committee continued to be provided with 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. Internal audit in 2009 – 2010 started to develop a reporting method that will integrate with Pyramid. Guidance from Grant Thornton UK LLP provided scope for the Audit Committee to develop its role further in terms of influence and responsibility which Internal Audit will continue to actively support. In 2009 – 2010 the Audit Committee undertook an away day to focus on its annual role and responsibilities. The result was the identification of a work and training programme for 2009 – 2010.

The Audit Committee holds quarterly meetings at which they review:

- Quarterly reports which correspond to the Audit Committee work plan.
- The annual internal audit programme in terms of audits planned and completed with the number of days expended;
- Internal Audit reports issued;
- The progress made by management in implementing External and Internal Audit report recommendations; and
- Audit Scotland and Audit Commission national reports which report on issues pertinent to Local Authorities.

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

- An annual Audit Committee report
- An annual Internal Audit report; and
- Statement of Governance and Internal Control.

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. A system of grading audit findings is provided to the auditee and resultant recommendations are set out within an action plan recording management agreement to address the point within an agreed timescale, the grading classification and evaluation criteria is set out below:

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

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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 or in other areas work jointly on large system control issues. Consultations are held on a regular and informal basis to co-ordinate work. In particular this co-ordinated approach allows External and Internal Audit the opportunity to discuss major issues and agree a way forward, thus saving time and effort. In 2009 – 2010 External and Internal Audit, worked jointly on the Council's Statutory Performance Indicator audit.

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 UK LLP, the Council's External Auditors place reliance on the work of Internal Audit in the following areas for 2009 -10:

- Capital accounting;
- Capital contracting;
- Cash income and banking;
- Council tax and non domestic rates;
- Creditor payments;
- Debtors;
- Housing Benefit and council tax benefit;
- Asset management;
- General ledger;
- Payroll;
- Treasury management;
- Tendering procedures;
- Stocktaking;
- ICT applications; and
- Business continuity planning

6. DRAFT STATEMENT OF GOVERNANCE AND INTERNAL CONTROL 2009 – 2010

A draft joint statement covering both corporate governance and internal control has been prepared for 2009 – 2010. Internal Audit undertook a review of the evidence collected by Customer Services in support of the Code of Corporate Governance, thus ensuring that the Council has put in place appropriate management and reporting arrangements. This enabled Internal Audit to satisfy itself that the Council approach to corporate governance was adequate and effective in practice. As well as the Customer Services Department having responsibility for governance, the Director of Customer Services as Monitoring Officer is responsibility for:

- Overseeing the implementation of the Code of Corporate Governance and monitoring its operation;
- Reporting annually to the Council on compliance with the Code and any changes required to maintain it and ensure its effectiveness

Specific responsibilities are assigned to the Head of Strategic Finance as Section 95 Officer to ensure that public funds are properly accounted for. Internal Audit has therefore taken into account in preparing the draft joint statement the results of reviews of internal control that have been carried out within the Council. The assessment of the robustness of Council internal control systems 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

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internal control statements are prepared by Executive Directors regarding specific audit areas identified as requiring future attention. These departmental internal control statements are then signed and passed to Internal Audit, for analysis. All of the above therefore supports the overall assurance for internal control. The draft joint statement of governance and internal control is presented to the Strategic Management Team (SMT), Audit Committee and Executive with final sign off by the Council Leader, Chief Executive and Head of Strategic Finance. The draft joint statement is the subject of a separate report to the Audit Committee.

7. PROGRESS OF THE ANNUAL AUDIT PLAN 2009 – 2010

Strategic Audit Plan 2009 – 2010

A total of 33 audits were planned for the financial year 2009 – 2010 and these were allocated into the following categories:

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

The Annual Audit Plan for 2009 – 2010 effectively delivered by the end of April 2010. However, adjustments were made in March 2010 to the annual plan and these are reported below with reasons.

One audit from planned Non Financial Audits was deferred, Foster Care Services – Community Services. Internal Audit met with the Head of Children & Families and the decision was taken to defer to 2010 – 2011 on the grounds that new government legislation was released late and was being implemented across the service. In addition, a new service manager was due in post May 2010. It was thought prudent to carry this audit once government legislation was in place along with the new manager.

The Budgetary Preparation and Control audit from Core Financial Systems was, in agreement with external audit, reduced in terms of planned direct audit days from 40 days to 20. The decision was taken to reduce the audit planned audit days for 2009 – 2010 because presently there is a overall review being undertaken of budgetary control the results of which will be implemented in 2010 – 2011 and comfort could be derived from a KPMG audit report completed in June 2009. Payments to Voluntary Organisations audit work is complete with exit meetings to be arranged.

With regard to Special Investigations, 100 estimated direct audit days were allocated within the 2009 – 2010 audit plan however, 122 days were expended. Of the 122 days 75 days were expended for the National Fraud Initiative exercise 2008 – 2009; 30 days were allocated to a review of Performance Management; 11 days were expended on a review of the Port Askaig Development and a further 6 days were provided for Community Services.

The Other Areas section of the Annual Audit Plan saw continued involvement of Internal Audit resources being deployed in Follow Up activities both in terms of gathering from management evidence of recommendation implementation but also in preparing exception reports for the Audit Committee and Strategic Management Team (SMT). An estimated 97 direct audit days were allocated within the 2009 – 2010 audit plan, 78 were expended.

Appendix 2, lists all audits planned by Internal Audit for the financial year 2009 – 2010 inclusive of reported changes. Throughout 2009 - 2010, Internal Audit resources were under pressure due to days lost as a result of an extended period of sick leave. However, some of these days were recovered.

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Resource Allocation 2009 – 2010

On 6 March 2009, the annual internal audit plan was presented and approved by the Audit Committee. This outlined an estimated direct audit day total of 1,131. This figure was reduced by the following factors:

- Internal audit manager was on long-term sick leave from the end of July to the middle of November reducing direct audit days by 85;
- Audit contractors unavailable for 16 direct audit days;
- Performance Service Improvement Framework training was required for a member of staff. This took 11 direct audit days from estimated audit days;
- There was an additional training requirement for the 2 Accounting Trainees thereby reducing the expended direct audit days by 20; and
- One audit from the Annual Audit Plan was deferred and another audit had its estimated direct audit days reduced this totalled 50 days.

In total this reduced the estimated direct audit days by 182. In order to correct the shortfall, the following actions were taken:

- One management trainee undertook 2 audits adding 30 direct audit days; and
- Two accounting trainees assisted on 2 audits adding 11 direct audit days.

This added back 41 days thus providing a total of 990 direct audit days for the plan. The table below provides the final total of direct audit days expended in 2009 –2010.

2009 - 2010	Days Deducted	Sub Total	Reported TOTAL
Original Estimated Audit Days			1,131
Foster Care Services Audit.	-30		
Budget Preparation and Control	-20	-50	1,081
Sick Leave for a Manager	-85		
Contract Auditor Unavailable	-16		
Additional Staff Training Days	-31	-132	
New Revised Estimated Audit Days			949
Management Trainee	+30		
Accounting Trainees	+11	+41	
AVAILABLE DIRECT AUDIT DAYS			990

Audit Opinion

Based on audit work carried out in 2009 – 2010 by Internal Audit, I am of the opinion that subject to the matters listed in the Statement of Governance and Internal Control being actioned, reasonable assurance can be taken that the systems of governance and internal control are operating effectively.

The review of corporate governance undertaken by internal audit has indicated that the systems for governance are operating effectively, and a Draft Joint Governance and Internal Control Statement has been produced. The Draft Statement will be presented to the Strategic Management Team (SMT), Audit Committee and Executive. With specific regard to internal control, 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.

In conclusion, the Annual Audit Plan for 2009 – 2010 was effectively completed for the end of April 2010, with finalisation of remaining draft reports imminent. The Governance Group

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accepted the assurance provided by Internal Audit and the Audit Committee is asked to accept the same assurance, based on the audit work completed in 2009 – 2010.

8. AUDIT ANALYSIS of 2009 - 2010

Apart from the reported deferment of one audit, 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;
- The Audit Committee receive final report extracts when they are issued to management for action;
- Joint audit work was completed between Internal Audit and Grant Thornton UK LLP;
- The percentage of audits carried out by qualified staff in 2009 – 2010 remained the same as in 2008-2009. This was as a result of 2 Trainees being recruited; and
- Analysis of returned client questionnaires indicated that an average approval score of 3.7 has been achieved by Internal Audit in 2009 – 2010. The highest achievable approval score is 4.

9. SERVICE REVIEW OF INTERNAL AUDIT

A report was agreed by the Audit Committee on 11 December 2009, which outlined the reasons for undertaking a service review of Internal Audit and the proposed scope and timescale of a review. On 22 January 2010, a Project Initiation Document (PID) was presented to the first meeting of the Project Board for review. Thereafter, the PID was finalised and issued to the Project Board, a copy of which was provided to the Audit Committee in March 2010.

The main purpose of the service review of internal audit is to review the performance of internal audit in order to develop a clear strategy setting out a vision for its future role, remit and structure to meet the new challenges facing the Council. Presently, an update report has been prepared for the Project Board and is also provided to the June Audit Committee. The report provides a brief overview of findings to date.

10. 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 2009 - 2010. 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 2009 - 2010

Ref	Performance Indicator	Target	Achieved 2009- 10	Comment
1.	Percentage of audit work carried out by qualified and specialist staff.	65%	63%	This percentage figure is slightly less than last year which was 65%. The percentage is influenced by the 2 Trainee Accountants.
2.	Issue of draft reports within 10 working days of work being completed.	10 days – 100%	94%	The percentage figure achieved has fallen short of the 100% target due to the issue of 2 audit reports by KPMG UK LLP after the 10 day period. However, this percentage figure is higher than that achieved in 2008 – 2009 of 82.4%.
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	3.7	Management are asked to provide an opinion on the work carried out by Internal Audit in a range 1 Disagree Strongly to 4 Agree Strongly with the audit undertaken. In 2009 – 2010 the average figure achieved was 3.7.
6.	Percentage of direct audit time	Target 81%	82%	This percentage figure has improved from last years 76%.

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OUTPUT PERFORMANCE MEASURES 2009 - 2010

Ref	Performance indicator	Target	Achieved 2009- 10	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 for 2008 – 11 was presented to the Audit Committee as was the 2008 - 09 Annual Audit Plan on the 6 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	Follow-ups are carried out as a routine task for the quarterly meetings of the Audit Committee and Strategic Management Team (SMT).
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, Community Services - Foster Care and the partial completion of the core financial audit Payments to Voluntary Organisations. This has reduced the percentage achieved against plan. As in previous years individual audit assignments in 2009 – 2010 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/High – 100% Material/Medium – 100% Minor/Low – 100%	100% Achieved 100% Achieved. 100% Achieved.	A 100% was achieved across the recommendation levels.
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: 2009 -2010 Strategic Plan

AUDIT WORK SCHEDULE	Last Audited	Risk Ranking	Original Estimated Audit Days 2009-10	Revised Estimated Audit Days 2009-10	Actual Audit Days 2009-10	Balance
Core financial systems						
Complete						
Stocktaking/ Work in Progress	2008-09	2	25	25	14	11
Council Tax and Non-Domestic Rates	2008-09	2	15	15	10	5
Government & European Grants	2008-09	1	35	35	28	7
Tendering Procedures	2008-09	1	15	15	11	4
Treasury Management	2008-09	2	15	15	15	0
Debtor Accounts	2008-09	2	15	15	19	-4
Unified Benefits System	2008-09	2	15	15	21	-6
Purchasing/Creditors	2008-09	2	55	55	53	2
Car Allowances	2008-09	2	40	40	53	-13
Capital Accounting	2008-09	1	15	15	15	0
Capital Contract Management	2008-09	1	15	15	15	0
Payroll	2008-09	2	15	15	20	-5
Cash Income and Banking	2008-09	2	15	15	14	1
Asset Management	2008-09	1	15	15	10	5
Contract Hire and Operating Leases	2008-09	2	40	40	37	3
Payments to Voluntary Bodies (Following the Public Pound)	2008-09	2	40	40	18	22
General Ledger Operations	2008-09	2	15	15	19	-4
Budgetary preparation and control	2008-09	1	40	20	7	13
Section Total			440	420	379	41
Non-financial Audits						
Complete						
Business Continuity Management	-	1	30	30	30	0
Stock Control, Leisure Systems	-	2	30	30	36	-6
Performance Indicators/Single Outcome Agreement	2008-09	1	86	86	53	33
Partnership Project Funding	2007-08	3	30	30	27	4
Cleaners, Caterers & Janitorial Wages	-	1	30	30	28	2
Corporate Governance ICS	2008-09	1	30	30	29	1
ICT Applications	2008-09	2	28	28	28	0
Departmental Risk Plan Testing	2008-09	1	30	30	29	1
Single Outcome Agreement		1	30	30	25	5
New Legislation	2007-08	1	30	30	28	2
Computer Audit - Data Protection	-	2	30	30	21	9
Review of HR Activities - Health & Safety	2008-09	1	20	20	18	2
Departmental Business Continuity Plan Testing	2008-09	1	30	30	40	-10
Adult Services Assessment & Care Management	-	1	30	30	20	10
Foster Care services	-	2	30	0	-	-
Section Total			494	494	411	53
Actual Direct Audit Time			934	884	790	94
Special investigations contingency						
Council Wide - NFI			100	100	75	-22
Chief Executive's Unit – Performance Management					30	
Community Services					6	
Corporate Services					0	
Development Services					0	
Operational Services – Port Askaig Development					11	
Section Total			100	100	122	-22
Other Areas						
Follow-up External & Internal Audit Management Letter Points			77	77	64	21
Risk Assessment, Strategic Plan, Annual Plans			20	20	14	6
Section Total			97	97	78	19
TOTAL			1131	1081	990	91