



Grant Thornton

Argyll and Bute Council

Interim Management Report

June 2011

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1 Executive Summary

1.1 Introduction

Argyll and Bute Council (the Council) is required to have arrangements in place to ensure propriety, regularity and best value in its stewardship of public funds. It is the responsibility of management to establish adequate systems of internal control to ensure that resources are applied to the activities intended, fraud is prevented and detected, and resources used economically, efficiently and effectively.

As part of our interim audit, we have reviewed the effectiveness of the Council's core financial systems and financial management and budgetary control arrangements. In addition, we followed up the Council's progress in implementing recommendations agreed in our prior year interim report.

1.2 Findings

Core financial systems

Our review of the core financial systems did not identify any significant control weaknesses that require reporting. This outcome confirms our assessment that the Council operates sound systems of internal financial control.

We carried out a review of the controls over IT systems and applications. Three medium risk recommendations were made to improve the security of access to the network.

The National Fraud Initiative (NFI)

We considered the Council progress in improving their participation in the NFI exercise and implementation of prior year action plan points. We noted that the Council's procedures in place for NFI have improved significantly, and at this stage, a large proportion of the matches have now been processed. We were also pleased to note that regular updates on NFI are provided to the audit committee and SMT.

We have asked the Council to consider participating in the next round of NFI process which includes the matching of electrical register data to council tax data to identify potential frauds in the claiming of single person discount for council tax purposes.

Contract management

The Council have made progress in implementing agreed action plan points in relation to our prior year reports on contract management.

There was two outstanding recommendations at the time of our audit in relation to the Argyll Air Services project, implementation of which has been delayed by the failure of the previous PSO operator, Highland Airways. The draft business plan is due to be approved at the June meeting of the Executive.

Internal audit

During our audit, we considered the extent to which the Council meets the requirements of CIPFA guidance on the role of the Head of Internal Audit. Our review found that the Council's constitution, terms of reference for the internal audit department and the internal audit manual require updating to take account of the recent changes in the internal audit department, and this is currently being actioned.

We have raised concerns that the vacancy in the audit manager position will impact on the department's ability to meet the 2011-12 audit plan. However we are aware that the Council intends to use contractors and partnership resources to meet the deficit in audit resource. We have recommended that the Council review the staffing resources available to internal audit to ensure it can meet its obligations as set out in the plan, and that there is sufficient qualified and experienced staff.

1.3 Way Forward

The findings and recommendations from our review are summarised in an Action Plan that accompanies this report. The Action Plan has been agreed with management and incorporates the management response to audit recommendations.

This report includes some specific recommendations to strengthen internal controls. It is the responsibility of management to decide the extent of the internal control system appropriate to the Council.

1.4 Acknowledgements

We would like to take this opportunity to thank Council staff who have been involved in this review for their assistance and co-operation.

This report is part of a continuing dialogue between the Council and Grant Thornton UK LLP and is not, therefore, intended to cover every matter which came to our attention. Our procedures are designed to support our audit opinion and they cannot be expected to identify all weaknesses or inefficiencies in systems and work practices.

The report is not intended for use by third parties and we do not accept responsibility for any reliance that third parties may place on it.

Grant Thornton UK LLP
June 2011

2 Financial systems

2.1 Introduction

The Council's financial statements are an essential means by which it accounts for the stewardship of resources and its financial performance in the use of those resources. As set out in our Audit Approach Memorandum, we are required to review the financial systems and controls over IT systems and applications at the Council in order to gain sufficient assurance to support our opinion on the financial statements.

2.2 Financial systems

Background

Auditing standards require that we evaluate the design effectiveness of internal controls over the financial reporting process to identify areas of weakness that could lead to material misstatement. Therefore, we will focus our control review on the high risk areas of the financial statements. As set out in our Audit Approach Memorandum, the higher risk areas we have identified for 2010-11 are:

- creditor payments
- payroll
- council tax and non-domestic rates
- fixed assets.

Findings

Our review did not highlight any performance issues with the systems covered by our control review.

2.3 IT Systems and Applications

Background

The Council's key operations rely on information technology for processing, recording and reporting transactions. Information technology is, therefore critical to the ability of the Council to operate effectively and deliver high quality services to the public. As a result, adequate controls should be in place to ensure the availability, confidentiality and integrity of data. In addition, the Council is required to comply with the provisions of the Data Protection Act 1998 to ensure the safety and security of personal data.

As part of our 2008-09 audit, we have reviewed the design and operational effectiveness of general controls over IT systems and applications in the Council. We focused our review on the operation of the Oracle Financial Management System, the Council Tax system (iworld) and the Non Domestic Rates system (Orbis). We also reviewed the progress of implementation of the agreed action plan points from our 2009-10 audit of IT systems and applications.

Findings

Our overall conclusion is that the controls over IT systems and applications continue to operate effectively. We made four new recommendations from our audit of which three are classed as medium risk:

- the access rights of leavers should be disabled in a more timely manner
- network password settings should be encrypted to improve security and reduce the risk of unauthorised access to the network
- Oracle access rights should only be granted after being authorised by a member of staff included in the list of designated approvers.

Summary and conclusions

Financial systems continue to operate within a sound framework of financial control. There is some scope for improvement in the internal controls operating over IT systems and applications, but we have no priority 1 findings to report.

3 Governance

3.1 Introduction

Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of the organisation. The Council is responsible for putting in place arrangements for the conduct of its affairs, including compliance with applicable guidance, ensuring the legality of activities and transactions and monitoring the adequacy and effectiveness of these arrangements in practice. The Council's Audit Committee should have a role in monitoring these arrangements.

As part of our audit, we identified four specific areas risk areas relevant to governance arrangements. The work we carried out and our conclusions are documented below.

3.2 National Fraud Initiative

The National Fraud Initiative (NFI) is a nationwide data matching exercise run jointly by Audit Scotland and the Audit Commission. The NFI covers a two year cycle and for the latest cycle, 2008-09, Audit Scotland's national report has identified total cumulative frauds in the Scottish public sector of £58 million. The role of external audit in NFI is to review the Council's procedures for managing the exercise and the progress in pursuing potential frauds highlighted by the data matching exercise.

In our 2009-10 audit, we identified a number of improvements in order for the Council to improve its participation and benefit fully from the Initiative. In particular we recommended that:

- the Council should prioritise the review and processing of the highest quality data matches and ensure these are processed in a timely manner
- staff in relevant departments should be assigned responsibility to review and process the NFI matches
- the Council should consider submitting creditors data for the next NFI exercise
- the key contact should review the required access to the NFI system for the 2010-11 exercise and ensure only appropriate staff have been given access.

2010-11 Exercise

The Head of Internal Audit, as the key contact, has introduced a number of changes to the Council's procedures for participation in the Initiative, which have led to significant improvements in the ensuring the data matches are reviewed and processed in a timely manner, and also strengthening the participation of other Council departments.

One of the main improvements in the Council's participation in this year's exercise is the methodology adopted for reviewing the data matches to ensure all high quality matches are processed in a timely manner. Table 1 below highlights the Council's progress to date in processing the matches.

Table 1: Progress of NFI matches as at 18 May 2011

Area	Matches	Processed	Progress
Housing Benefit	260	77	Scheduled for completion by the end of May.
Creditors	190	212	Completed - some duplicates identified that were previously identified
Payroll	21	16	Scheduled for completion by the end of May.
Residential Care Homes	87	87	Completed- no issues noted.
Blue Badges	121	121	Completed- no issues noted.
Insurance	7	7	Completed- no issues noted.
	686	520	

Source: NFI Report to the SMT, 18 May 2011

The results of the exercise are reported to the Senior Management Team on a monthly basis. Table 1 above demonstrates that the Council has made good progress in processing matches, and expects to complete the exercise by the end of May 2011. This represents a significant improvement in the Council's level of participation in the NFI compared to prior years.

Council Tax- Single Person Discount

In May 2011, Audit Scotland wrote to all local authority chief executives to request participation in the next stage of NFI which involves matching the electoral register to council tax data to identify potential fraudulent single person discount awards. Audit Scotland is using its statutory powers as stated in Part 2A of the Public Finance and Accountability (Scotland) Act 2000 to request the electoral register from all local authorities in Scotland.

The Council already reviews potential frauds in single person discounts through a contract arrangement with a data security firm. However, the experience of the Audit Commission in England and Wales indicates that participating in the NFI exercise can lead to matches that are not otherwise identified from other means.

Action plan point 5

3.3 Contract management

Our 2009-10 audit found that the Council had made significant improvements to its contract management procedures since our original audit review in 2007-08. In particular, we noted that the Gateway process has now been implemented and embedded into the Council's working practices. In this audit year, we followed up the Council's progress in implementing the remaining recommendations from our contract management

Follow up of prior year recommendations

Table 1: Position of outstanding recommendations as at May 2011

Original report	Original recommendations outstanding	As at May 2011			
		Implemented	Not Implemented	Partially Implemented	Ongoing/Not yet due
Contract management report 2009-10	2	1	1	-	-
Contract management report 2007-08	2	1	-	-	1

We previously noted there was no formal requirement for a post completion review of significant projects under the Gateway process. The Council has now implemented this action plan point and has intergrated the requirement for post completion reviews into the Gateway process.

At the time of our audit, there was two recommendations relating to the Argyll Air Services project, which require further management action to fully implement:

- completing a post completion review of the project
- finalising the draft business plan.

We are aware that the draft business plan is due to be finalised in June 2011.

3.4 Internal audit

Background

We reviewed the Council's internal audit department against the requirements of The Code of Practice for Internal Audit in Local Government in the United Kingdom (the Code) issued by CIPFA as part of our 2007-08 audit. In addition, our 2008-09 audit, recommended that the Council carry out a review of the future strategic direction of internal audit and consider the best way of providing the service.

In June 2010, the Council appointed a 'Head of Internal Audit' (HIA) to lead the department, and this addresses one of the main areas of previous non-compliance with the Code. As part of the 2010-11 audit, we have assessed the extent to which the Council meets the requirements of CIPFA guidance on the role of the HIA

We reviewed the Council's arrangements against the 5 principles in the CIPFA guidance.

1. championing best practice in governance, objectively assessing the adequacy of governance and management of existing risks, commenting on responses to emerging risks and proposed developments
2. giving an objective and evidence based opinion on all aspects of governance, risk management and internal control
3. must be a senior manager with regular and open engagement across the organisation, particularly with the Leadership Team and with the Audit Committee
4. must lead and direct an internal audit service that is resourced to be fit for purpose
5. must be professionally qualified and suitably experienced.

We noted the following observations from our audit:

Principles 1 and 2

The appointment of the HIA addresses one of the of the most significant areas of previous non compliance with the Code of Practice for Internal Audit. Following the appointment of the HIA, the Council will be required to update its documented procedures, in particular:

- the terms of reference for internal audit
- the internal audit manual
- the Council constitution.

We are aware that the HIA is currently progressing the updating of these documents. Once completed, this will ensure the Principles outlined in the CIPFA guidance are enshrined in the Council's practices.

Principle 4

Our audit concluded that the staffing compliment of the internal audit department may not be sufficient to allow the HIA to deliver the 2011-12 plan as agreed at the March audit committee. The Table below shows the internal audit staffing position for 2011-12 as reported in the plan presented to the audit committee in March 2011:

	Direct audit days
Head of Internal Audit	123
Audit Manager	168
Senior Audit Assistant	190
Accountant	200
Trainee Accountant	184

	Direct audit days
Contract Auditors	220
TOTAL	1,085
Required days in the 2011-12 Audit Plan	1,085

Currently the Audit Manager role is vacant. The HIA plans to recruit contractor staff to fill this role in the short term. We note that the lack of an audit manager role will present operational issues for the department, mainly:

- the lack of a an officer with sufficient qualifications and experience to deputise for the HIA in their absence
- the lack of a permanent fully qualified auditor with sufficient experience to undertake the more complex areas of the plan, albeit the use of contractor staff and the partnership with KPMG will provide some cover for this area.

Management consider there to be sufficient financial resources allocated to internal audit, and we are aware that staffing levels will be reviewed in October 2011, following the completion of a review of the service.

We have noted in prior years that internal audit have not always achieved the original outturn of expected audit days per the plan. For example in the year to 31 March 2010, internal audit delivered total days of 990 versus the plan of 1,131- a variance of 141 days (12%).

We recommend that the Council reviews the operational capacity of internal audit to complete the work plan agreed by the audit committee for 2011-12 and future years.

Action plan point 6

A Action plan

No	Finding	Risk	Recommendation	Management Response	Implementation Date
IT Systems and Applications					
1	<p>Network access</p> <p>We selected a sample of 10 individuals that have left the Council since 1 April 2010. We noted that the network account for one of these leavers was still active. We understand that this leaver was not reported to the Service Desk.</p> <p>Additionally, we noted that three former members of staff have user accounts in the Northgate (payroll) application. Their access rights allow them to process payrolls in the Northgate application. One of these three leavers has an active user account on the network.</p> <p>There is a risk that the user accounts of these former members of staff could be used to gain unauthorised access to data.</p>	Medium	<p>Line Managers should be reminded about their responsibility for reporting leavers to the Service Desk.</p> <p>The Council should implement a monthly review of inactive network accounts. User accounts that have not been used for a period of time should be disabled.</p> <p>The leavers detailed in this point should have their network and application accounts disabled.</p>	<p>In the Northgate system, the system automatically disables a user if they have not been in the system for 30 days. The users IDs concerned had all been disabled in Resourcelink system but have now been end dated as well. All leavers are notified to the IT service desk via reports of leavers from the Resourcelink payroll/HR system. This is much more comprehensive than relying on notification from individual line managers. In addition, we will regularly disable network accounts which have not been used in the last 3 months. This will include people off on long term sick as well as leavers.</p>	N/A

No	Finding	Risk	Recommendation	Management Response	Implementation Date
2	<p>Password encryption</p> <p>We noted that network passwords are not stored in encrypted format. This is due to the "Store passwords using reversible encryption" setting being enabled in the password policy on the Windows network.</p> <p>There is a risk that the whole list of network passwords could be compromised in the event of a hacking attack. This could lead to unauthorised access to data or disruption in IT operations.</p>	Medium	<p>We recommend disabling the "Store passwords using reversible encryption" setting in the password policy of the Network.</p> <p>An impact analysis should be performed before disabling this setting to validate that it does not affect the performance or operation of any of the Council applications. Adequate testing should be carried out as part of this impact analysis.</p>	<p>We will, in consultation with our advisers, Exactive, attempt this change by the end of April. The change will be done out of hours to minimise disruption.</p> <p>Unfortunately it is not possible to fully test it in advance. If there are problems, then the change will be reversed.</p>	End of April 2011

No	Finding	Risk	Recommendation	Management Response	Implementation Date
3	<p>Access to the Oracle FMS application</p> <p>There is a list of designated members of staff that are the only ones that can authorise the grant of access rights to the Oracle FMS application.</p> <p>We selected a sample of 10 new users in the Oracle FMS application. It was noted that the access request for one new user was not approved by an authorised member of staff. This approval was retrospectively granted when brought to management attention.</p> <p>There is a risk that unauthorised access to the Oracle FMS application could be granted.</p>	Medium	Oracle access rights should only be granted after being authorised by a member of staff that is included in the list of designated approvers.	The setting up of a new user in Oracle with incorrect authorisation was an oversight on the part of the system administrator and this was rectified. Procedures already require appropriate authorisation and this will be adhered to.	N/A

No	Finding	Risk	Recommendation	Management Response	Implementation Date
4	<p>Software logs</p> <p>We noted that there is a software package (GFI Events Manager) that generates daily security reports for the network. However, these reports were not being checked at the time of our visit due to IT staff constraints.</p> <p>There is a risk that unauthorised activity on the network might go undetected.</p>	Low	We recommend implementing a process whereby the reports generated by the "GFI Events Manager" software tool are checked on a regular basis.	This has now been added to the daily schedule of tasks.	Immediate
NFI					
5	Audit Scotland have request that local authorities provide them with the electoral register in order to provide matches against Council Tax payments for single person discount.	Medium	The Council should consider complying with Audit Scotland's request as a part of enhancing fraud detection procedures over and above those already in place.	The electoral register will be supplied.	In line with the date supplied by Audit Scotland
Internal Audit					
6	<p>Current staffing levels in the internal audit department may not be sufficient to complete the 2011-12 audit plan, which was agreed by the audit committee.</p> <p>The Council may be able to fill some of the staffing resource gap with contractors and partnership resources. However, there</p>	<p>(Short Term: Medium)</p> <p>(Long term: High)</p>	The Council should consider if there are enough staffing resources in the internal audit department to achieve the annual plan.	The sections staffing levels have not prevented the delivery of the audit plan in previous years. The 2011 – 2012 plan will be delivered as in previous years by experienced qualified staff through close management.	Is reviewed on a monthly basis.

No	Finding	Risk	Recommendation	Management Response	Implementation Date
	is a higher risk in the longer term that there is not enough suitably qualified and experienced internal audit staff to effectively deliver internal audit services to the Council.				



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