

## **Argyll & Bute Council – 2001/02**

### **Management Report - Regularity and Governance**

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## EXECUTIVE SUMMARY

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### Introduction

As part of our final audit for the year to 31 March 2002, we undertook a review of selected aspects of a number of systems in place within the Council. We have concluded that in some areas internal control and processes require to be further developed as highlighted by the need for the Council to take remedial action during the year. This section summarises the main findings arising from our review.

### Main findings

#### *Internal Audit*

Progress against the action plan points raised in the 2000/01 report *A Job Worth Doing* has been good, although there are still some areas where improvements have yet to be realised. Since the partnership with KPMG commenced in February 2002 a risk-based audit needs assessment and a three year strategic internal audit plan have been prepared and approved by the Audit Committee. In our view the audit needs assessment employed sound methodology and the strategic plan provides an appropriate basis for internal audit to provide an objective assessment of the adequacy, reliability and effectiveness of the Council's internal control systems. We have concerns in some areas, including the independence of internal audit, the level of IT/MIS coverage, and the staffing and structure of the internal audit section.

#### *Budgetary Control – Education Department*

During 2001/02 it became apparent to Council management that budgetary control within the Education Department was not operating effectively and that there was a possibility that the Department would overspend its budget for 2001/02. In a review to examine financial control within the Education Department, KPMG outlined a number of areas where financial control systems were unreliable and commented that the process employed to prepare income and expenditure projections was not sufficiently detailed and robust. A dedicated team was put in place to revise the budgetary control system and their work is continuing.

#### *Building Maintenance DLO*

As reported in the 2001/02 annual accounts, the Building Maintenance DLO incurred a deficit of £85,000. The monitoring of management accounts by the Finance Department during the year highlighted a potential problem. The level of work had increased from the previous year and controls to ensure that individual jobs were accurately costed and ongoing cost control measures proved insufficient for a reasonable return to be achieved.

### ***Unified Benefits System***

A review of procedures relating to the processing of Housing and Council Tax Benefit claims was undertaken. We noted that procedures could be tightened to potentially reduce the amounts of benefit overpaid and reconciliations between the Unified Benefits System and financial ledger should be carried out more regularly. In addition, communication between departments could be improved with regard to benefit fraud investigation and the Benefit Procedures Manual should be updated to clarify the procedures staff should follow when processing backdated applications, dealing with applications from family or friends and investigating the non-return of review forms.

### ***Corporate Governance and Fraud and Corruption arrangements***

We found that the Council had well developed arrangements to ensure that the three fundamental principles of corporate governance, openness, integrity and accountability, are applied and also to prevent and detect fraud and corruption.

## **Conclusion**

Overall the procedures put in place by the Council appear to be operating satisfactorily. However, some procedures were put in place or enhanced during the year to meet shortcomings which controls were unable to prevent. Detailed recommendations are included within our audit findings for each area reviewed, and are summarised in the following agreed action plan.

## ACTION PLAN

Page/ Para Ref	No	Recommendation	Responsible Officer	Action	Date
		<b><i>Internal Audit</i></b>			
9/5	1	<p>Management should continue to monitor the implementation of the outstanding points in the action plan agreed following the 2000/01 report.</p> <p><i>Priority: Medium</i></p>	I. Nisbet/ A. Colligan	<p>Training is included in our partnership agreement with KPMG and will be provided by them.</p> <p>Internal Audit has adopted a consistent approach in respect of working papers and files.</p> <p>New members of staff attend a corporate induction course and are provided with an audit pack that includes the Audit manual, risk assessment and strategic plan and other documents used by Internal Audit.</p>	March 2003
10/6 10/9	2	<p>Management should ensure that the plan for 2002/03 is followed as closely as possible and levels of non-direct audit work are monitored actively.</p> <p><i>Priority: High</i></p>	I. Nisbet/ A. Colligan	The audit plan for 2002/2003 contains less days assigned to these tasks. The audit plan for 2002/2003 will be followed as closely as possible.	March 2003
10/7	3	<p>Any further input to benefit fraud investigations should be restricted to minimise the effect on the delivery of the 2002/03 plan.</p> <p><i>Priority: Medium</i></p>	I. Nisbet	A Counter Fraud Manager was appointed on the 2 <sup>nd</sup> of September 2002. This will reduce the input requirement by Internal Audit.	N/A
10/8	4	<p>Management should consider the appropriateness of the staffing structure of internal audit.</p> <p><i>Priority: Medium</i></p>	S. McGregor	The Council recently reviewed the structure of Internal Audit and entered into a partnership for Internal Audit with KPMG for a 3-year period. It is not proposed to review the structure prior to the end of the partnership.	January 2005

Page/ Para Ref	No	Recommendation	Responsible Officer	Action	Date
10/10	5	<p>Management should consider the relatively low planned input on IT/MIS and the opportunity afforded for coaching in this area.</p> <p><i>Priority: Medium</i></p>	I. Nisbet/ A. Colligan	The days assigned are to review the IT environment and looked at IT matters from a strategic and installation level. Controls at an individual application level are addressed during the course of audit. The transfer of experience will be progressed over the remaining life of the partnership.	Ongoing
11/11	6	<p>Management should consider the relative independence of internal audit and current reporting lines.</p> <p><i>Priority: Medium</i></p>	S. McGregor	<p>Internal Audit has access to the Director of Finance, the Chief Executive and the Chairman of the Audit Committee.</p> <p>However this will be reviewed at the termination of the Internal Audit partnership with KPMG</p>	January 2005
		<b>Budgetary Control - Education Department</b>			
12/18	7	<p>Management should continue to realise improvements in the system of budgetary control and ensure that monitoring of the financial position is actively carried out on a frequent and regular basis.</p> <p><i>Priority: High</i></p>	S. MacDonald	An action plan has been prepared to address the improvements required in financial control within Education. This is a much wider issue than that identified by PWC. The action plan is currently being progressed by an augmented finance team for Education. A monitoring group of members and senior officials has been established to review progress against the action plan. The Group is reporting progress to the Strategic Policy Committee. The action plan continues until March 2003	31/03/ 2003

Page/ Para Ref	No	Recommendation	Responsible Officer	Action	Date
		<b>Building Maintenance DLO</b>			
12/21	8	<p>Management should ensure that systems provide reliable management information and that all efforts are made to reduce levels of work in progress.</p> <p style="text-align: right;"><i>Priority: High</i></p>	A.Law	<p>There has been continual pressure on DLO Management staff to use information available to them and a long-delayed computer enhancement was completed in September this year.</p> <p>Issues around reducing Work in Progress are continually re-inforced with line management and this will continue to be pressed over the remainder of this year</p>	<p>October 2002 –</p> <p>March 2003</p>
12/21	9	<p>Information presented to the Commercial Operations Board should accurately reflect the true current position and potential position of the DLO.</p> <p style="text-align: right;"><i>Priority: Medium</i></p>	A.Law	<p>This is done – previous report of 29/8/2002 and intended one of 21/11/2002</p>	Ongoing
12/22	10	<p>Management should ensure that the costing and pricing of potential work is realistic to achieve the desired rate of return.</p> <p style="text-align: right;"><i>Priority: High</i></p>	A.Law	<p>This has been actioned in terms of any <i>ad hoc</i> work bid for and the revision to the Term Maintenance Contracts has been done with the DLO seeking to pursue reward levels sufficient to allow their statutory return to be made</p>	Ongoing
13/23	11	<p>Management should continue to monitor closely the financial performance of the DLO.</p> <p style="text-align: right;"><i>Priority: High</i></p>	A.Law	<p>This is being done – monthly Management Accounts considered and copied to senior members of the Council.</p> <p>Weekly staff productivity records and overtime sheets also reviewed by line management and Head of Service</p>	Ongoing

Page/ Para Ref	No	Recommendation	Responsible Officer	Action	Date
		<b>Unified Benefits System</b>			
13/25	12	The Benefits Procedure Manual should be updated to cover the procedures to be followed by staff when processing their own benefit applications or those of relatives and friends, dealing with backdated applications and investigating the non-return of review forms.  <i>Priority: Medium</i>	J. Preston	Agreed	Feb 2003
13/26	13	For cases where review forms are not returned investigations should be performed to establish whether benefit has been overpaid.  <i>Priority: Medium</i>	J. Preston	Assess if resources can be made available for this to be carried out.	March 2003
13/27	14	The Benefits System should be reconciled with the financial ledger on a monthly basis.  <i>Priority: High</i>	J. Preston	Agreed	November 2002
13/28	15	Consideration should be given to standardising the rotation of staff duties across all area offices.  <i>Priority: Medium</i>	J. Preston	Matter will be considered	Feb 2003



Page/ Para Ref	No	Recommendation	Responsible Officer	Action	Date
14/29	16	Consideration should be given to conducting a data matching exercise for all Council employees.  <i>Priority: Medium</i>	J. Preston	Assess feasibility with Corporate Personnel and Payroll.	Jan 2003
14/30	17	Every effort should be made to improve communication and co-ordination between departments with regard to benefit fraud investigations.  <i>Priority: Medium</i>	J. Preston/ K. MacLeod	Agreed	November 2003
14/31	18	The Council should confirm whether the requirements of the Verification Framework remain applicable to the Council.  <i>Priority: Medium</i>	J. Preston	Agreed	November 2003
14/32	19	The duties and responsibilities for the preparation of the annual benefits subsidy claim should be clearly defined.  <i>Priority: Medium</i>	B. West/D. MacVicar	Management felt that responsibility for preparation of the claim was clear. However in the light of this comment the responsibility for preparation of the claim will be re emphasised to those involved in the preparation.	March 2003

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## INTRODUCTION

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1. We conduct our audit in accordance with Audit Scotland's Code of Audit Practice, which requires us to consider the corporate governance arrangements in place as they relate to the systems of internal control. The Code makes clear that it is the responsibility of management to ensure that internal control systems are appropriate.
2. As part of our 2001/2002 audit activity, a review was undertaken of a number of the systems in place within the Council, specifically budgetary control within the Education Department, Unified Benefits and a high level review of DLOs and DSOs. We employed an approach which involved evaluating the internal control system by selecting key controls and testing that they operated satisfactorily.
3. In addition, we took the opportunity to follow up the findings of *A Job Worth Doing*, the 2001 report on raising the standard of internal audit in Scottish councils, which resulted in a detailed action plan to improve the service at Argyll & Bute Council. We also assessed the Council's corporate governance arrangements and arrangements in place to prevent and detect fraud and corruption.
4. This report summarises the findings from our review and, where appropriate, makes recommendations to address any weaknesses identified. It should be noted that communication of weaknesses does not absolve management from its responsibility for the maintenance of an adequate system of control. The Action Plan included in Section 2 of this report sets out the agreed action to be taken in response to the main recommendations, graded to show their relative priority, and the timescales within which the issues are to be addressed. The Action Plan should be read in conjunction with the relevant reference from the main findings (Section 4).
5. It should be understood that weaknesses highlighted in this report are only those that have come to our attention during normal audit work in accordance with the Code of Audit Practice and therefore are not necessarily all of the weaknesses that may exist.
6. The factual accuracy of the content of this report, and the remedial action to be taken, has been agreed in discussion with appropriate officials.
7. The co-operation and assistance afforded to audit staff during the course of the review are gratefully acknowledged.

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## MAIN FINDINGS

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### *Internal Audit*

#### **Introduction**

1. In *A Job Worth Doing*, the 2001 report on raising the standard of internal audit in Scottish councils, Argyll & Bute Council was assessed in band 4 (the lowest band) on compliance with the CIPFA Code of Practice for Internal Audit (below 50% compliance). PricewaterhouseCoopers, the Council's external auditors, produced a local report which incorporated a detailed action plan to introduce the range of improvements required. The action plan contained 27 individual recommendations.
2. Following this report the Council chose to seek a suitable partner to establish an internal audit partnership. Following a tender exercise KPMG were appointed to provide 390 days over a three year period at a cost of £225,000. As part of our 2001/02 audit we have assessed the progress made by Internal Audit since the *A Job Worth Doing* report and the commencement of the partnership with KPMG.
3. Since their appointment in February 2002, KPMG have been involved in preparing a risk-based audit needs assessment, a three year strategic internal audit plan, and annual plans for the period. KPMG also provided advice on the format of Internal Audit's annual assurance statement and proposed performance indicators for the Internal Audit service. The strategic plan reflects the results of the audit needs assessment exercise and provides a detailed schedule of assignments covering a range of systems, both financial and non-financial, operating within the Council. The annual plans include time for follow-up reviews to assess progress on implementing agreed recommendations, value for money reviews, dedicated computer audit reviews, and coverage of best value reviews and performance indicators. A contingency allowance is included also to cater for special investigations.
4. In our view, the audit needs assessment employed sound methodology and the strategic plan provides an appropriate basis for internal audit to provide an objective assessment of the adequacy, reliability and effectiveness of the Council's internal control systems.

#### **Audit Findings**

##### *Progress in implementing action plan points*

5. Progress against the action plan points has been good, although there are still some areas where improvements have yet to be realised. Appropriate training has yet to be agreed and delivered (point 3.41 in action plan), the introduction of the latest technology has still to be considered (point 3.49), and formats for files, reports and working papers have still to be finalised (point 3.43).

***Refer action plan no.1***

*2001/02 Internal Audit coverage*

6. Internal audit's work for 2001/02 was reported to the Audit Committee on 26 July 2002. The section suffered from staffing difficulties during the year and five planned reviews were deferred. We note that 279 days, some 29% of the total days delivered, were spent on three areas, namely year-end stock taking (88 days), the housing benefit grant claim (45 days) and performance indicators (146 days). Although the majority of this work was performed by more junior staff, the time spent on these areas appears excessive. The plan for 2002/03 envisages much less time being spent on such activities.

***Refer action plan no.2***

7. Historically the Internal Audit Manager has had responsibility for the Council's fraud officers and has spent a fair proportion of time managing and performing benefit fraud investigations. Such work was never part of the Internal Audit plan and there is a risk that continuing input may distract the section from delivering its core service. We understand that a fraud manager has recently been appointed, and that for the remainder of 2002/03 little input will be required from the Internal Audit Manager.

***Refer action plan no.3***

*Staffing and Organisation*

8. Internal Audit suffered from a shortage of resources during 2001/02 and two members of staff were recruited in July 2002. We note that the strategic plan is based on six full-time members of staff whilst currently one member of staff works for only three days a week. The section now comprises two internal audit managers one of whom is designated as the lead, two accountants and two audit assistants. The current structure may not be the most appropriate and there may remain a lack of clarity around lines of accountability and reporting.

***Refer action plan no.4***

*2002/03 Plan*

9. The current estimate is for 805 days direct audit work in comparison with the original estimate of 970 days. The shortfall arises from internal audit being under complement until August 2002. The plan is for coverage of those areas assessed with the lowest priority ranking in the Audit Needs Assessment to be deferred if necessary. This is a sensible approach to minimise the effect of the shortfall in planned days. However, we understand that the 970 days was based on six full-time members of staff, whilst one member of staff works for only three days a week. Therefore, a risk exists that the planned work for 2002/03 will not be completed substantially.

***Refer action plan no.2***

10. Of the 140 days that KMPG will provide, only 25 days are scheduled to be on direct audit work, being 10 days on IT/MIS strategy and controls (computer audit) and 15 days on Value For Money. The total planned for IT/MIS is 30 days. This appears to be a relatively low number of days given the reliance placed by the Council on IT systems. This is one particular area where on the job coaching and skills transfer by KPMG specialist(s) could be of benefit to the Council.

***Refer action plan no.5***

### *Independence of Internal Audit*

11. The CIPFA Code of Practice for Internal Audit sets out the importance of the independence of Internal Audit. At Argyll and Bute, Internal Audit cannot be said to be truly independent of line management. In practice, Internal Audit report to the Head of Accounting, who is responsible for many of the systems that Internal Audit will scrutinise. This may lead to an element of conflict. It may be more appropriate for Internal Audit to report directly to the Director of Finance with direct access to the Chairman of the Audit Committee.

***Refer action plan no.6***

### ***Budgetary Control - Education Department***

12. During 2001/02 it became apparent that budgetary control within the Education Department was not operating effectively and that there was a possibility that the Department would overspend its budget for 2001/02. The Director of Finance requested that KPMG perform a review to examine financial control within the Education Department. KPMG highlighted a number of areas where financial control systems were unreliable and commented that the process employed to prepare income and expenditure projections was not sufficiently detailed and robust. Recommendations were included in a detailed action plan to improve controls within the Education Department. In February 2002, in a follow-up report, KPMG concluded that they were unable to form a conclusion on the accuracy of the estimated projections of the year-end position.
13. One of the problems identified by KPMG was that budgetary information held in the Education Delegated Management of Resources (DMR) system and the main financial system, ORACLE, was not consistent and had not been reconciled regularly.
14. On 4 February 2002, the Education Finance Monitoring Group decided that all non-essential education expenditure should be stopped with immediate effect, in view of the uncertainty remaining on the financial outturn for the year. The Strategic Policy Committee at its meeting on 21 February 2002 transferred financial control from the Education Department to the Director of Finance.
15. The overspend on Education for 2001/02 totalled £0.691 million having been reduced by £200,000 and was achieved by reducing the Education capital budget and allowing Transportation and Property Services to transfer expenditure from revenue to capital.
16. It should be noted that the external auditors raised concerns about the budget setting and budget monitoring processes during both 1999/2000 and 2000/01. In their interim management letter for 2000/01, external audit reported that information submitted to the Education Committee was insufficient to allow an understanding of the individual factors which impact upon the variances arising. In addition, external audit commented that the budget had not been appropriately phased throughout the year which increased the complexity of departmental monitoring and variance reporting.

17. A dedicated finance team based within the Education Department was set up in November 2001 to introduce improvements in budgetary control and to progress the agreed actions in the KPMG action plan. This team has reported regularly to the Education Finance Working Group and has revised the approach to budget monitoring and reporting. It has been considered necessary to examine variances at a lower level than those examined in other departments. All Education budget holders are now required to provide explanations for variances at account code level of the lower of 5% or £5,000 (but greater than £500). This should provide greater control and also encourage budget holders to take ownership of their budgets and become fully involved in the financial monitoring process.
18. The team have completed a detailed costing exercise and revenue budget for 2002/03. This indicated that the funds required to deliver the Education Service are approximately £1.3 million more than the approved estimate. As a result the Strategic Policy Committee, on 29 August 2002, approved a savings plan totalling £1.1 million and a decision was taken to establish a core scrutiny team to undertake a thorough review of the service costs and delivery.

*Refer action plan no.7*

### ***Building Maintenance DLO***

19. As reported in the 2001/02 annual accounts, the Building Maintenance DLO incurred a deficit of £85,000. Income for the year increased by £477,000 to £3.6 million with a corresponding increase in expenditure of £583,000.
20. Management accounts for DLOs and DSOs are prepared on a monthly basis, with formal financial monitoring meetings attended by the Chief Executive and the Director of Finance being held quarterly. The Council's Commercial Operations Board oversees the activities of the DLOs and DSOs.
21. The monitoring meeting held on 30 October 2001 projected a surplus position for all DSOs and DLOs at 31 March 2002. However, the management accounts to 30 September 2001 disclosed a work in progress balance of £800,000 for building maintenance and before the meeting on 30 October, a review was instigated which revealed that a number of jobs were being disputed and that other jobs were reported as completed but had not been invoiced. Nevertheless, the Commercial Operations Board, at their meeting on 15 November 2001 were informed that all DLOs and DSOs were in a relatively healthy position as at 30 September and on target to make the necessary rate of return by the end of the financial year.

*Refer action plan no.8 and 9*

22. A review of the Building Maintenance DLO's activities identified that the deficit arose mainly from individual schemes, which are separately tendered work, where the actual volume was higher than anticipated and subsequently did not achieve a reasonable overall return. The costing system proved not to be particularly effective which led to pricing being too tight, and ongoing cost control measures were insufficiently robust. We understand that the DLO experienced internal reorganisation during the year and key staff turnover which may have contributed to the problems encountered.

*Refer action plan no.10*

23. Action has been instigated to reverse the situation including the preparation of an updated business plan. During the first three months of 2002/03 a loss of £174,000 was incurred. This deficit position may prove difficult to overturn by the end of the financial year.

*Refer action plan no.11*

### **Unified Benefits System**

#### **Introduction**

24. Our review of the Unified Benefits system covered specifically procedures relating to the processing of:
- Council Tax Benefit claims for owner occupiers (administered at Campbeltown) and for tenants processed by the Campbeltown and Dunoon offices; and
  - Housing Benefit claims.

#### **Audit Findings**

25. We noted that the Council complies with accepted good practice and has issued a revised Benefits Procedure Manual in July 2002 to all staff involved in the processing of all benefit claims. However, our review of the Manual identified that it does not cover the procedures to be followed by staff when processing their own benefit applications or those of relatives and friends, dealing with backdated applications or investigating the non-return of review forms.

*Refer action plan no.12*

26. Housing and Council Tax Benefit claimants not returning review forms are not followed up after a reminder is sent out. Benefit is withdrawn from the review date and no attempt is made to determine when entitlement to the benefit ceased in these instances. Therefore no steps are taken to assess the amount of the potential overpayment.

*Refer action plan no.13*

27. The Benefits System is only reconciled with the financial ledger on a yearly basis at the financial year end. This increases the risk that material errors remain unidentified throughout the year.

*Refer action plan no.14*

28. Our review noted that the Oban area office has a workload rotation list for members of staff. Audit enquiry noted that staff feel that the benefits of such a system includes the identification of training needs, an increase in staff motivation and a reduction in the backlog of work in some areas of responsibility. Other area offices do not have such a system in place, with the workload in the Dunoon and Helensburgh area offices being split alphabetically. We understand that this may be creating difficulties where the workload is not split evenly amongst staff. We identified that no work rota exists in the Helensburgh office.

*Refer action plan no.15*

29. Although a data matching exercise was carried out by the Council in consultation with the Department of Work and Pensions (DWP) in 2000/2001 for manual and cleaning staff, no such exercise has been carried out for all other Council employees to identify staff who may be fraudulently claiming benefits.

***Refer action plan no.16***

30. With regard to benefit fraud investigation procedures, audit enquiry identified the following:

- the poor quality of information on some referral forms meant that fraud officers were unable to proceed further with the investigation. There appears to be a breakdown of communication between fraud officers, verification officers and benefits staff; and
- the documentation used by Fraud Officers when investigating cases of alleged fraud, e.g. documentation of interviews, may not be legally sufficient if a case were to be sent to the Procurator Fiscal for prosecution.

***Refer action plan no.17***

31. The Verification Framework control sheet records the information required to be submitted by benefit claimants as evidence of their entitlement to benefit and to meet the requirements of the Verification Framework. Audit testing identified that this form was located in most of the files checked at the Oban area office for the claim prior to the current claim. However, we noted that benefits staff at the Helensburgh area office no longer use this form. The Benefits Manager is of the belief that the rules for the Verification Framework have been relaxed and it may be no longer mandatory requirement to provide this type of evidence.

***Refer action plan no.18***

32. The Internal Audit report on the Unified Benefits System issued in February 2002 stated that the officer responsible for completing the annual benefits subsidy claim was unsure of his precise responsibilities and duties with regard to the preparation of the claim. The report recommended that the Internal Audit Manager prepare a paper which clearly specifies various duties and responsibilities for the preparation and checking of the subsidy claim. Audit enquiry noted that Internal Audit Manager did not understand why he was the responsible officer for preparing such a paper, and as such the recommendation remains outstanding.

***Refer action plan no.19***

### ***Corporate Governance***

33. We performed an overview of the Council's corporate governance arrangements using a standard checklist approach. We are pleased to note that most of the elements necessary to ensure that the Council applies the three fundamental principles of corporate governance, openness, integrity and accountability, are in place. These include:

- Codes of Conduct for Councillors and for Employees;
- A Scheme of Administration and Delegations; and
- A risk management policy and strategy in place and Risk Management Group prepare annual report.



### ***Fraud and Corruption***

34. The Council has the responsibility to establish arrangements to prevent and detect fraud and corruption. As part of this year's audit we considered the adequacy of these arrangements using a standard checklist approach. Overall we found a number of good practices including the following:

- An “anti-fraud and anti-corruption” strategy which advises and guides members and staff on the Council’s approach to the serious issues of fraud and corruption;
- A “fraud response plan” which outlines the procedures for reporting suspected fraud or corruption and how the Council will deal with such complaints;
- A “whistle blowing” policy that is consistent with the provisions of the Public Interest Disclosure Act 1998; and
- In relation to housing and council tax benefit, the Council has documented procedures for the prevention and detection of fraud and for the investigation of fraudulent claims.

## CONCLUSION

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1. We have highlighted a number of areas where the Council has reacted and taken steps to improve control and oversight. We judge the action taken to be generally appropriate and have recommended that planned improvements are continued. The matters which we have raised in this report are designed to add to the existing system of internal control.