



DRAFT

Annual Internal Audit Report

2011 - 2012

May 2012

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## **1. FOREWORD**

The annual audit plan for 2011 – 2012 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 complied 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**

Internal Audit is responsible for advising all levels of management and the Council (through its Audit Committee), on the Council’s systems of internal control. It is a review activity which continuously reinforces line management’s responsibility for effective internal controls. The existence of internal audit is not a substitute for management’s responsibility to ensure the existence of a sound framework of internal control. Internal audit supports:

- Management’s organisational objectives
- The Audit Committee’s need for overall assurance on the quality and cost effectiveness of risk management and internal controls.

Internal Audit main areas of focus are:

- Risk Management and Internal control effectiveness;
- Statutory, procedures and control compliance;
- Implementation of recommendations;
- Corporate governance;
- Systems development;
- Process improvement;
- Performance reporting; and
- Value for Money and Best Value.

## **4. INTERNAL AUDIT REPORTING RESPONSIBILITIES**

### **Section 95 Officer/Head of Strategic Finance**

Internal Audit has a responsibility to the Section 95 Officer, reporting on the effectiveness of the system of internal control operated within the Council.

### **Chief Executive**

Internal Audit has a dotted line responsibility to the Chief Executive, and holds regular monthly meetings to discuss the progress of the annual audit plan, reports issued and any areas of concern.

### **Audit Chairman**

Internal Audit has a dotted line responsibility to the Audit Chairman, and discusses on a regular basis the progress of the annual audit plan and report issues.

## **Audit Committee**

Internal Audit has a responsibility to report on the progress of the audit programme in terms of planned time against actual time, provide extract summary audit reports plus action plans from finalised audits. Another key task is to keep the Audit Committee aware of progress regarding implementation by management of agreed recommendations. This is done through maintaining the internal audit database and evidence gathering. Regular monthly reporting is undertaken by internal audit to Departmental Management Teams (DMTs) and the Strategic Management Team (SMT) with a quarterly progress reporting to the Audit Committee. At the culmination of each year's audit work an annual report is prepared by Internal Audit and presented to the Audit Committee along with the Statement of Governance and Control.

In 2011 – 2012, the Audit Committee received quarterly progress reports covering:

- The Audit Committee work plan.
- The annual internal audit plan progress updates;
- Copies of issued Internal Audit reports;
- Reports covering management implementation of External and Internal Audit report recommendations; and
- Audit Scotland and Audit Commission national reports which report on issues pertinent to Local Government.

At the culmination of the years audit work the Audit Committee prepares an annual Audit Committee report and receives an annual Internal Audit report and Statement of Governance and Internal Control.

## **External Audit**

Internal Audit has a responsibility to co-ordinate its activities with external audit. Grant Thornton had responsibility for the 2010 – 2011 accounts however, Audit Scotland are the newly appointed external auditors and have responsibility for the 2011 – 2012 accounts. The relationship operated by Internal Audit with the Council's external auditor, is one of joint working. Regular consultations were held over the course of 2011 – 2012 on an informal basis, to co-ordinate work and where appropriate develop audit programmes and methodology.

Audit Scotland will place reliance on the work of Internal Audit for the purposes of their financial statements work in 2011 – 2012. That reliance will come from the following audit work:

- Non Domestic Rates;
- Council Tax;
- Payroll;
- Creditor Payments and Purchasing;
- Debtors Accounts;
- Financial Ledger; and
- Treasury Management.

For Their wider governance and performance audit work, under our Code of Audit Practice, they plan to place reliance on the work of internal audit, from the following areas:

- Performance Management Arrangements; and
- Statutory Performance Indicators.

The reliance on internal audit work in these areas will allow Audit Scotland to direct its resources to the financial systems, performance and governance areas they have assessed as being of higher audit risk.

### **Auditee**

Internal Audit provides management with an independent and objective opinion on their control environment by taking into consideration the review of internal controls and risk and, in agreement with management recommends changes where appropriate. The audit work undertaken is reported to the auditee, either in the form of a report or a memo whichever is 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.

Towards the end of the financial year, Internal Audit commenced discussions with departments regarding a better formalised audit process where Executive Directors and Heads of Service get involved earlier in the audit process through their Departmental Management Teams (DMTs) reviewing and agreeing the audit agreement documents and audit timing prior to commencement. Thereafter for review and sign off audit reports will return to the DMTs. It is anticipated that this will enable further performance improvement for all parties.

## **5. INTERNAL AUDIT – GAINING ASSURANCE 2011 - 2012**

In compliance with the CIPFA Code of Practice for Internal Audit in Local Government, the annual plan for 2011 – 2012 provided an objective assessment of the adequacy, reliability and effectiveness of the Council's systems of operation. To do this, a database was compiled to identify and rank data using 4 broad headings:

- Materiality – an assessment of financial data;
- Risk - operational and strategic risk registers, the risk associated with a particular activity due to its very nature, and the level of sensitivity attached to a possible breakdown in the effective operation of that system;
- Control Effectiveness - an assessment based on external and internal audit report agreed recommendations, corporate governance and other external and

internal inspection reports regarding the degree of control management currently has over the inherent risks; and

- Performance Management – an assessment based on corporate and service plans and improvement plans.

All data obtained was ordered under the following audit groupings and a plan compiled:

- Financial and Control audits;
- Business systems;
- Corporate Performance; and
- Corporate/Service plans.

In addition, internal audit set aside days for contingency within the 2011 – 2012 annual audit plan for the following activities:

- Special Investigations - This is audit time for unforeseen events which, by their nature, cannot be planned for;
- Internal Audit reports on a monthly basis to both the Departmental Management Teams (DMTs) and Strategic Management Team (SMT) and on a quarterly basis to the Audit Committee, detailing management progress in implementing agreed audit report recommendations; and
- The National Fraud Initiative (NFI) is now a statutory requirement and an annual exercise.

## **6. DRAFT STATEMENT OF GOVERNANCE AND INTERNAL CONTROL 2011 – 2012**

A draft joint statement covering both corporate governance and internal control has been prepared for 2011 – 2012. Internal Audit undertook a review of the evidence collected by Customer Services – Governance and Law, 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 Executive Director of Customer Services as Monitoring Officer has the following responsibilities:

- 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 financial control that have been carried out within the Council.

The assessment of the robustness of the Councils 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 internal control statements are prepared by Executive Directors who report specific audit areas requiring future attention. These departmental internal control statements are then signed and passed to Internal Audit, for analysis.

The draft joint statement of governance and internal control is presented to the Strategic Management Team (SMT), Audit Committee and 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 2011 – 2012

A total of 35 audits were planned for the financial year 2011 – 2012 and these were allocated into the following categories:

- 15 Financial systems audits;
- 7 Business systems audits; and
- 13 Corporate performance audits.

The Annual Audit Plan for 2011 – 2012 also included a section for Corporate/Service Plan audits. These were derived through discussion with Executive Directors and Heads of Service. In 2011 – 2012, adjustments were made to the annual plan and reported to the Audit Committee on a quarterly basis.

<b>Audit Plan by section 2011 - 2012</b>	<b>April 2011</b>	<b>March 2012</b>	<b>Difference</b>
Financial Control Audits	15	15	0
Business Systems Audits	7	8	+1
Corporate Performance Audits	13	13	0
Corporate & Service Plans	0	9	+9
<b>Total</b>	<b>35</b>	<b>45</b>	<b>10</b>

As detailed above, 35 audit areas were planned at the outset of 2011 – 2012 however at the end of the financial year that had risen to 45. In addition special investigation support work was undertaken.

With regard to the 15 Financial Control Audits outlined in the audit plan, all were undertaken, with final reports issued. Of the 7 Business Systems Audits planned, 8 were eventually undertaken. One of the original 7 audits was commenced on the e-benefits system but subsequently the software agreement was cancelled by the Council and the audit stopped. A replacement audit was commenced covering information systems for a departmental service. This therefore brought the Business

system Audit total to 8 with final reports issued. There were 13 audit areas outlined in the 2011 – 2012 audit plan all areas were undertaken.

The only area where individual audits were not defined was Corporate and Service Plans where, 200 days were allocated for Service and Corporate plan work. In the end, the service audits were determined through discussion with Executive Directors and Heads of Service. A total of 9 audits were undertaken with final reports issued. In relation to the corporate plan allocated audit days, service audits and departmental audits reduced the audit day total and this was reported throughout the financial year to the Audit Committee. By the 17<sup>th</sup> of February 2012, there were 45 audit days remaining and over the period to the end of March 2012, 29 days were expended on corporate activities. This has left 16 days not expended.

Contingency audit days were set out within the annual audit plan to cover special investigations, external and internal audit follow-up reporting of agreed recommendations, national fraud initiative work (NFI) and risk/strategic audit planning. The table below provides an overview of days expended.

<b>Audit Plan by section 2011 - 2012</b>	<b>April 2011</b>	<b>March 2012</b>	<b>Difference</b>
Special Investigations	100	33	67
External and Internal Reporting	52	62	-10
National Fraud Initiative (NFI)	25	52	-27
Risk Strategic Audit Planning	18	27	-9
<b>Total</b>	<b>195</b>	<b>174</b>	<b>21</b>

investigation work for another service was undertaken in March 2012, this resulted in 33 days being expended. There were 52 days planned for external and internal by the end March 2012, 62 days were expended. The annual audit plan provided 25 days for the NFI exercise; by the end of March 2012 the total expended was 52. The reason for the variance was down to under estimation of the support required for departmental services and management reporting. Audit Scotland published the national report which noted that Argyll & Bute had made improvements and was now one of the 85% councils fully compliant with the NFI criteria. A total of 18 audit days were planned for risk/strategic planning by the end of March 2012, the total was 27 days. This variance related to annual audit plan analysis work.

### **Resource Allocation 2011 – 2012**

As reported to Audit Committee in March 2012 a re-evaluation of the annual plan was undertaken as the year end approached. At the outset of the year the number of planned direct audit days for 2011 – 2012 was estimated to be 1,085 with 35 audit areas were outlined in the audit plan and at the end of the year 45 had been undertaken.

The annual audit plan was based on 5 full time posts and an allocation of days from contract auditor's equivalent to one full time Accountant. The total available days for direct audit work were 1,085 days after deductions for non direct audit work and public and annual leave, etc. The 5 staff estimated contribution was 865 days and contract auditors 220. In March 2012, the Internal Audit Manager retired and therefore the total of 865 days was reduced by 168 days to 697 plus 220 audit days



from contract auditors. The 1,085 audit days were reduced to 917. However, contract auditors provided 74 more days than planned which brought the total direct audit days available to 991. The table below supports the above paragraph.

<b>Audit Resource Criteria</b>	<b>Direct Audit Days</b>
Audit Days Planned March 2011	1,085
Retirement	(168)
Contract Auditors additional days to planned	74
<b>Total available days</b>	<b>991</b>

Appendix 2, details the audits undertaken by Internal Audit for the financial year 2011 – 2012 inclusive of reported changes and the direct audit days expended.

### **Audit Opinion**

Based on audit work carried out in 2011 – 2012 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 2011 – 2012 has been completed. Internal audit considers that once a final draft report has been agreed and issued to management the audit is finished. The issue of some final reports is being progressed by management. The Governance Group who oversees the governance process has 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 2011 – 2012.

## **8. INTERNAL AUDIT ANALYSIS of 2011 - 2012**

The amended audit plan has been completed and in particular:

- Quarterly reports have been prepared for the Audit Committee advising of progress with the Annual Audit Plan;
- A new presentation of progress audit External and Internal Audit Follow-up recommendation follow up for DMTs, SMT and Audit Committee has been introduced.
- A further development of interaction with departmental Executive Directors and Heads of Service has been introduced. A new process was discussed at DMTs by internal audit relating to how the audits for 2012 – 2013 will be undertaken. This has received support from management setting out

deliverables and responsibilities of those involved in the audit process

- Monthly meetings with both the Head of Strategic Finance and Chief Executive are undertaken to discuss audit reports and recommendations.
- The Audit Committee receive final internal audit report extracts after issue to management for action;
- Joint audit work was completed between Internal Audit and Grant Thornton UK LLP and with Audit Scotland;
- The Audit Scotland, National Fraud Initiative (NFI) national report May 2012 notes that Argyll and Bute is one of the councils that has improved and is within the 85% of councils who manage the NFI in a satisfactory manner; and
- Analysis of returned client questionnaires indicated that an average approval score of 3.8 has been achieved by Internal Audit in 2011 – 2012. This slightly higher than last year's 3.7 score with the highest achievable approval score being 4.

## **9. INTERNAL AUDIT SERVICE IMPROVEMENT**

The annual audit report in June 2011 stated that the Chief Executives Unit had now commenced a support services review with the data collected by the internal audit service review integrated with the overall review. The review identified service specific work streams and team plans for internal audit which are being progressed to completion. Internal audit had 3 work streams which involved:

- Internal Audit Partnership Contract – involving 3 tasks;
- Audit Plan Review and Development – involving 2 tasks; and
- Improvements to the effectiveness of internal audit – involving 9 tasks.

The majority of these tasks have been completed.

In support of the Pyramid management reporting systems, internal audit has been assigned 13 teams actions which are performance indicators on which the service will report performance. These 13 performance indicators also feed into the indicators reported to the Audit Committee.

## **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 achieve. Following the Audit Committee Away Day in January 2012 it was decided to reduce the number of performance indicators to 10. They are set out under two headings:

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

The tables below set out the performance for both sets of indicators for 2011 - 2012. 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.

## APPENDIX 1

### INPUT PERFORMANCE MEASURES 2011 - 2012

Ref	Performance Indicator	Target	Achieved 2011 - 2012	Comment
1.	Issue of draft reports within 10 working days of work being completed.	10 days – 100%	Yes	Achieved.
2.	Issue of final reports within 5 working days of management responses being received.	5 days – 100%	Yes	Achieved.
3.	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.	Yes	Achieved.
4.	Management's feedback 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)	Yes	3.8 average score
5.	Percentage of direct audit time	Target 81%	Yes	87%

## APPENDIX 1

### OUTPUT PERFORMANCE MEASURES 2011 - 2012

Ref	Performance indicator	Target	Achieved 2011 - 2012	Comment
1.	Audit operational plan to be submitted to the audit committee by 31 March each year.	31 March of each year (100%)	Yes	Achieved.
2.	Follow-ups to be performed within one year of the audit-taking place.	100% of recommendations followed up in following year	Yes	Achieved. New 4 weekly cycle of reporting progress to DMT & SMT with quarterly summary to Audit Committee.
3.	Completion of the Annual Audit Plan subject to variations agreed by Audit Committee, and if appropriate, Audit Managers.	100%	Yes	Achieved.
4.	Recommendations accepted compared to recommendations made.	Fundamental/High – 100% Material/Medium – 100% Minor/Low – 100%	Yes	Achieved.
5.	Internal audit costs are within budget (including in-year budget variations)	Total costs were within budget.	Yes	Achieved.

## APPENDIX 2

### Assessment of Audit Days: 2011 - 2012 Annual Plan

AUDIT WORK SCHEDULE AS AT 31 March 2012	Last audited	Risk ranking	Original Estimated Audit Days 2011-12	Revised Estimated Audit Days 2011-12	Actual Audit Days 2011-12	Balance
<b>FINANCIAL CONTROL AUDITS</b>					.	
Cash Income and Banking	2010	1	20	20	19	1
Creditor Payments and Purchasing	2011	1	20	20	18	2
Stock Taking / Work in Progress	2010	2	20	20	19	1
Car Allowances and Subsistence	2011	2	20	20	19	1
Government & European Grants	2010	1	25	25	25	0
Payroll	2010	1	25	25	25	0
Debtor Accounts - Direct Payments	2011	1	20	20	18	2
Council Tax and Non-Domestic Rates	2010	1	25	25	25	0
Capital Accounting	2010	1	25	25	25	0
Treasury Management	2010	1	20	20	19	1
Contract Operating Leases	2010	2	20	20	20	0
Budgetary Preparation and Control	2011	1	25	25	25	0
General ledger operations	2011	1	20	20	19	1
Capital Contracts	2010	1	25	25	25	0
Tendering Procedures	2010	1	20	20	20	0
<b>Section Total</b>			<b>330</b>	<b>330</b>	<b>321</b>	<b>9</b>

## APPENDIX 2

### Assessment of Audit Days: 2011 - 2012 Annual Plan

AUDIT WORK SCHEDULE AS AT 31 March 2012	Last audited	Risk ranking	Original Estimated Audit Days 2011-12	Revised Estimated Audit Days 2011-12	Actual Audit Days 2011-12	Balance
<b>BUSINESS SYSTEMS AUDITS</b>						
Leisure Management System	2010	3	20	20	18	2
Pyramid Performance Management	2011	2	25	25	24	1
Fleet Management	2010	3	20	20	20	0
Care First	2010	3	20	20	19	1
e-Benefits	2011	4	10	10	1	9
Planning/Building Standards	2010	3	20	20	17	3
Resource Link	2010	3	20	20	20	0
D & I ICT Systems Rationalisation	2011	2	0	10	10	0
<b>Section Total</b>			<b>135</b>	<b>145</b>	<b>129</b>	<b>16</b>

## APPENDIX 2

### Assessment of Audit Days: 2011 - 2012 Annual Plan

AUDIT WORK SCHEDULE AS AT 31 March 2012	Last audited	Risk ranking	Original Estimated Audit Days 2011-12	Revised Estimated Audit Days 2011-12	Actual Audit Days 2011-12	Balance
<b>CORPORATE PERFORMANCE AUDITS</b>						
Statutory Performance Indicators (SPIs)	2010	1	20	20	20	0
Public Service Improvement Framework (PSIF)	2010	1	20	20	20	0
Efficiency	2010	1	20	20	20	0
Governance and Accountability	2010	1	20	20	20	0
Financial Management	2010	1	20	20	20	0
Procurement	2010	1	20	20	19	1
People Management	2010	1	20	20	20	0
Risk Management	2010	1	20	20	18	2
Information Management	2010	2	10	10	10	0
Performance Management	2010	1	20	20	17	3
Community & Customer Engagement	2010	2	10	10	9	1
Asset Management	2010	1	20	20	16	4
Equality & Sustainability	2010	3	5	5	6	-1
<b>Section Total</b>			<b>225</b>	<b>225</b>	<b>215</b>	<b>10</b>



## APPENDIX 2

### Assessment of Audit Days: 2011 - 2012 Annual Plan

AUDIT WORK SCHEDULE AS AT 31 March 2012	Last audited	Risk ranking	Original Estimated Audit Days 2011-12	Revised Estimated Audit Days 2011-12	Actual Audit Days 2011-12	Balance
<b>CORPORATE/SERVICE PLANS</b>						
Development & Infrastructure - Fishing Dues/ Ports and Harbours Income	2010	1	25	25	24	1
Customer Services - Governance Statement	2010	1	10	10	10	0
Chief Executive's Unit - Procurement	2010	1	15	15	15	0
Community Services - Business Continuity	2010	1	25	25	25	0
Development & Infrastructure - Dangerous Buildings	-	1	0	25	24	1
Chief Executive's Unit - Travel & Subsistence	-	1	0	20	18	2
Customer Services - DPA	2010	1	15	15	3	12
Chief Executive's Unit - Health & Safety	2010	1	10	10	4	6
Corporate Plan	-	1	100	45	29	16
<b>Section Total</b>			<b>200</b>	<b>190</b>	<b>153</b>	<b>37</b>
<b>Overall Audit Section Total</b>			<b>890</b>	<b>890</b>	<b>818</b>	<b>73</b>
<b>Special investigations contingency</b>			<b>100</b>	<b>100</b>	<b>33</b>	<b>67</b>
<b>Other Areas</b>						
Follow-up External & Internal Audit Management Letter Points	2010		52	52	62	-10
NFI	2010		25	25	52	-27
Risk Assessment, Strategic Plan, Annual Plans	2010		18	18	27	-9
<b>Section Total</b>			<b>95</b>	<b>95</b>	<b>141</b>	<b>-46</b>
<b>TOTAL</b>			<b>1085</b>	<b>1085</b>	<b>991</b>	<b>94</b>