

ANNUAL REPORT OF THE INTERNAL AUDIT SERVICE 2005/06

1. Introduction

In accordance with the Council's adoption of the CIPFA Code of Practice on Internal Audit this report is submitted to the Audit Sub-Committee. The areas covered are objectives, resources, management, non-audit functions, planned audits, fraud and irregularity, contract audit, computer audit, the audit plan and special investigations / assignments.

2. Strategy and Objectives

The strategy and objectives are detailed in the service plan that is submitted to committee as part of the Corporate and Service Planning process. The role and responsibilities are also included.

3. Resources

The section comprises three auditors and has been fully staffed throughout the year. The service has access to all systems and endeavours to undertake audits, with minimum disruption to services, by using computer resources and other technology.

4. Management

A long-term strategic plan is produced, using risk assessment as an evaluator to determine audit coverage. The plan is reassessed every year and an annual work plan produced. These audit plans are prepared on assessed need and based on the audit establishment.

Internal Audit operates the Managed Audit concept in conjunction with our external auditors, the Audit Commission. Managed Audit primarily concentrates on the fundamental financial systems and those core financial control systems that form the basis of the Authority's accounts. Each year joint working arrangements are agreed with the Audit Commission to enable them to rely on the work of Internal Audit.

The Audit Commission also undertakes a comprehensive annual review of Internal Audit and in the 2005/06 review adjudged the service to be satisfactory.

5. Non-Audit Functions

The section undertakes a number of routine control and administrative functions. Some of these are primarily areas in which an audit presence is considered vital but there are others that could be transferred to other sections.

In addition the Audit Manager is involved in other managerial responsibilities including corporate governance, fraud awareness, security, public interest and anti-money laundering, although this latter area is still to be developed.

6. Planned Audits

Of the systems reviewed the following are worthy of specific note:-

Fundamental Financial Systems

- a. **Payroll (value of transactions processed £9.9m)** - No major concerns arose.
- b. **Council Tax (value of transactions processed £33.3m)** - All key controls were operating in the Council Tax system, however it was recommended that certain reconciliations were undertaken more frequently.
- c. **NNDR (value of transactions processed £15.1m)** – The system has been operating effectively with only minor weaknesses that were addressed during the course of the audit.
- d. **Sundry Debtors (value of transactions processed £3.3m)** - The level of arrears has always been a concern to Internal Audit especially those debts over 12 months old. In recent years an effective recovery and write-off process has reduced this amount. Nevertheless, this year, there still remains £255K of debt over 12 months old. The process needs to address the arrears situation more promptly.
- e. **Housing Benefits (value of transactions processed £13.1m)** - This system continues to operate efficiently with performance statistics to match. The current computer system plays a big part in this function particularly within the processing routines for application assessment. The introduction of verification framework during 2005 required changes to the method and manner of such processing. Management placed reliance on the new Revenue and Benefits computer system to enable this to take place. The new system has been delayed and there is some evidence questioning the processing capability of the package. The existing system has been successfully modified to facilitate this. The importance of having a reliable and accurate benefits system cannot be overstated.
- f. **Housing Rents (value of transactions processed £8.8m)** - The new rent accounting system is now in place and after some teething problems is operating well. The system will be documented and the year-end reconciliations will be examined in detail during 2006.
- g. **Treasury Management (value of transactions processed: investments £13.7m, borrowings £1.9m)** - The Authority's borrowings have been administered in accordance with the Treasury Management Policy with no major weaknesses identified.
- h. **Cash (value of transactions processed, £129.0m)** – All the Authority's income is processed and recorded by the cash collection and posting system. There were no major weaknesses identified, however some administrative controls were recommended and these are in the process of being implemented.

Core Financial Control Systems

This section covers the three main processes of the Accounts audit namely, the Main Accounting System, the Budgeting and Budgetary Control System and the Final Accounts closedown. Internal Audit undertakes the first two audits and External Audit undertakes the Final Accounts audit. There are also some ancillary functions such as the Capital Accounting process that are integral to these major systems.

Main Accounting System - This was examined and all controls employed were reviewed.

From April 2004 the Authority implemented the *Agresso New World* financial system, which includes Ledger, Creditors, Debtors and Budgetary Control modules.

Agresso was to provide the Authority with a system that undertook the majority of existing processes but offered easily accessible management information and in particular was internet web-enabled.

Internal Audit undertook an initial review in February 2005. There were certain problems identified, particularly with the co-hosting of the system with Derbyshire Dales District Council. The implementation of the Phase 2 Procurement Module also identified a number of areas within the Phase 1 implementation of the *Agresso* system. The accountancy function had also identified process problems that again are linked to our partnership arrangements.

A significant proportion of the security and control problems encountered were attributed to the way in which *Agresso* had promoted co-hosting. They established one system with two, effectively; separate companies and applied this to local authorities. Unfortunately, that assumed common approaches, working practices and account structures. Problems seem to exist at the majority of *Agresso* sites where more than one authority was in partnership. In reality each District is unique in its operation and therefore the approach was problematic, as a result a decision was made to maintain our own system. This has improved the situation at both partnering authorities as confirmed by this year's audit.

However difficulties have been experienced in agreeing the Cash Book to the general ledger, which in turn has affected the bank reconciliation process. This has occurred as a result of integrating existing systems with new systems without fully testing the outcomes. Management is addressing these issues.

Budgetary Control - The budget setting and budgetary control system has been examined, all controls proved to be operating satisfactorily.

Local Systems

DSO Housing Maintenance - the operation of the housing maintenance section of the DSO was examined, in particular, recovery of costs for certain types of work. The charges they were applying are recovered based on the use of schedules of rates. This requires that all schedule items that make up each job are charged and that the rate is set sufficient to recover all costs. It was ascertained that the rates were not set at the right level on the *Orchard* maintenance system for many of the schedule items and that certain jobs did not include all the elements of each job. Management is undertaking a review of the rates.

Members' Allowances – A system review was undertaken and it was found that the Authority did not have in place a scheme that accords with the 2003 Regulations. A scheme is being produced.

Rosliston Forestry Centre – A review was undertaken to assess the level of control exercised by management over the Centre. A number of recommendations were made which management is implementing. In addition the business plan and the proposal to extend the management contract were also examined. The financial forecasts for the Centre were seen as ambitious and not tied into the Authority's own budgets; this in itself represented a risk to the Authority and consequently the other partners.

There was a clear need to resource the Centre to an appropriate level but within the financial constraints of the partners. Therefore a more pragmatic approach has been adopted to the Business Plan financial forecasts. Providing the revised income levels materialize then the future of the centre is positive.

7. Fraud and Irregularity

Five operational areas (Benefits, Renovation Grants, Cash Collection, Credit Income, Cheques and Expense Claims) and the overall management arrangements were examined. A number of recommendations have been made but in general the Authority's anti-fraud and corruption controls are sound.

8. Contract Audit

The Contract Procedure rules now include the financial aspects of contract control previously included in the Financial Regulations. The Purchasing Code of Practice is to be revised in line with the procurement strategy.

9. Computer Audit

Annual Key Control audit checklists were completed on the system network, network management, internet/e-mail monitoring and management and security in general. The two major areas of concern raised last year were the IT Strategy and the security policy.

It is pleasing to report that, following this year's review; a new IT strategy has been implemented which incorporates the IEG elements. In addition a number of sections of the security policy have been updated in line with BS 7799 requirements as part of an ongoing programme.

10.Special Investigations

A number of investigations were undertaken during the year including one into Housing Maintenance, this dealt with void property improvements. There was concern over duplicate payments to suppliers but this was found not to be the case. However certain controls were not being adhered to and this has now been remedied. Other investigations, of a more minor nature, were carried out including cash payments, security, expenses and contracts.

11.Statement Of Internal Control (SIC) - Internal Audit Assurance Statement

The Annual Report has traditionally covered the work undertaken by the service in a particular financial year i.e. April to March. Prior to 2003 all fundamental financial systems audits, affecting the accounts, were undertaken in the year following the year of account (May-October). There has been a move, over recent years, to undertake these in the latter part of the year of account. Therefore these audits have been progressively brought forward to enable this to occur. The final accounts closure date has also been brought forward and there is now a requirement to produce an Annual Audit Assurance Statement to support the Statement of Internal Control.

The Annual Audit Assurance Statement required for the 2005/06 year has to be produced in June and will include work undertaken in April and May 2006 relevant to the year-end core financial systems (Main Accounting, Budget setting and control, bank and feeder system reconciliations).

The Internal Audit Assurance Statement for 2005/06 can be found in Appendix 1

12.Current Year Plan (2006/07)

The current work plan, approved by the Finance and Management Committee in May 2006, has been developed from the long-term plan but has taken into consideration four factors:

- a. System evaluation of new and replacement computer systems.
- b. A revised approach to our Joint Working Arrangements with the external auditors.
- c. International Auditing Standards Documentation requirements.
- d. A shift to more Corporate Governance work.

12. Conclusion

The service had a reasonable year but the implementation of the replacement revenue systems did not materialize. The service achieved 100% of the Managed Audit (completed audits to the External auditor's satisfaction) with 77% of the planned audits and 89% of the overall plan (chargeable audit days).

The Authority's ambitious programme of system replacement has shaped recent audit plans with all major financial systems scheduled to be replaced during the period 2003-2007. Documentation requirements have affected the volume of managed audit work in the year. The joint working arrangements with our external auditors reflect this, as there is a need to verify the level of internal control for the 2005/06 final accounts process, without which we will receive a qualified opinion. As the level of internal control is unknown for new systems their risk level will initially be classed as high.

In addition our external auditor required us to meet the International Auditing Standard for documentation for all the Authority's material systems for the 2005/06 final accounts process. As a result audit coverage has concentrated on the financial systems. There is a shift to more Corporate Governance work in the 2006/07 plan

The service received the co-operation of all departments throughout the year.

Audit Manager

INTERNAL AUDIT ASSURANCE STATEMENT – 2005/2006

Statutory Requirement

The requirement for an Internal Audit function of local authorities is implied by section 151 of the Local Government Act 1972, which requires that authorities make arrangements for the proper administration of their financial affairs and ensure that one of their officers has responsibility for that role. The appointed officer, for South Derbyshire District Council, is the Director of Corporate Services. The Accounts and Audit Regulations 2003 more specifically require that 'a relevant body shall maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with the proper internal audit practices'.

System of Internal Control

The Council is responsible for ensuring that there is a sound system of internal control, which facilitates the effective exercise of the Council's functions. The control environment comprises a number of elements within its framework; a key element is the use of internal controls.

Internal controls are processes designed and implemented by management to ensure statutory requirements, policies and procedures are complied with, assets are safeguarded and records are complete and accurate.

The role of Internal Audit

This function provides an independent evaluation on the adequacy of the internal control system as a contribution to the proper, economic, efficient and effective use of resources.

Internal audit is the main means by which the Council obtains assurances that systems are operating effectively. This is achieved by reviewing systems over a period of time thereby assessing the effectiveness of the overall internal control system. A long-term strategic plan is formulated using a risk assessment methodology within the audit planning process and annual work plans are undertaken. Internal Audit operates to the standards set out in the CIPFA Code of Practice for Internal Audit in Local Government in the UK.

Internal Audit and external audit operate a joint working arrangement, known as the Managed Audit, to maximise the effectiveness of the audit process within the Council. The external auditor considers Internal Audit as a core component of the Council's internal control framework.

The Internal Audit Service is subject to regular inspection by the Council's external auditors who, in accordance with the Audit Commission's Code of Practice, place reliance on the work carried out. Internal Audit is responsible to the Head of Finance and Property Services.

Internal Audit's Assessment of the Internal Control System

The review of the effectiveness of internal control is informed by the work of Internal Audit and the senior managers within the Council who have responsibility for the development and maintenance of the internal control environment. In addition the comments made by our external auditors, inspectorates and other review agencies are also part of the overall assessment.

Internal Audit examined systems operating in a range of Council functions and Services in 2005/2006 in accordance with the annual plan. Internal Audit's observations and recommendations were discussed with relevant managers as part of the operation of the internal audit service.

In relation to work carried out by Internal Audit for the 2005/2006 financial year, I consider, that based on this work, reliance can be placed upon the Council's internal control system. The Council has implemented a number of new computer systems and these are subject to ongoing review to ensure the level of internal control is maintained.

A.J.Stamper

Audit Manager

June 2006