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<b>REPORT TO:</b>	<b>AUDIT SUB COMMITTEE</b>	<b>AGENDA ITEM: 8</b>
<b>DATE OF MEETING:</b>	<b>16th JUNE 2010</b>	<b>CATEGORY: RECOMMENDED</b>
<b>REPORT FROM:</b>	<b>DIRECTOR OF CORPORATE SERVICES</b>	<b>OPEN</b>
<b>MEMBERS' CONTACT POINT:</b>	<b>TONY STAMPER (595706)</b>	<b>DOC:</b>
<b>SUBJECT:</b>	<b>ANNUAL REPORT OF THE INTERNAL AUDIT SERVICE 2009/10</b>	<b>REF:</b>
<b>WARD(S) AFFECTED:</b>	<b>ALL</b>	<b>TERMS OF REFERENCE:</b>

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## **1.0 Recommendations**

- 1.1 The Committee is asked to note the annual report of the Internal Audit service attached (Appendix 1).
- 1.2 The Committee is asked to approve the Annual Internal Audit Assurance Statement.

## **2.0 Purpose of Report**

- 2.1 To provide Members with information on the work of Internal Audit over the last year.

## **3.0 Executive Summary**

- 3.1 In respect of the audit work undertaken, the annual report of the Council's Internal Audit service provides assurance that the Council's key financial systems can be relied upon and that a sound system of internal control exists.

## **4.0 Detail**

- 4.1 The Internal Audit team carries out a range of audits in accordance with the Council's Strategic Audit Plan.
- 4.2 The team works closely with the external auditors, who place a considerable degree of reliance on the work carried out by the Internal Audit team.
- 4.3 In essence, Internal Audit verifies that financial and other systems include a level of control sufficient to prevent and detect error and financial irregularity.
- 4.4 As most financial transactions are heavily computerised, this means that audit work focuses increasingly on the effectiveness of computer systems that are used to administer Council finances.

4.5 The report of the Internal Audit team at Appendix 1 explains how the team approaches its work and provides a summary of their work over the last year worthy of specific note.

4.6 It would be impossible for any audit team to look at all the Council's activities in any one year. This means that their work is prioritised, based on the perceived level of risk involved.

#### **5.0 Financial Implications**

5.1 None stemming directly from this report.

#### **6.0 Corporate Implications**

6.1 Increasing the focus on the Council's internal control environment, including audit and governance issues, will contribute to achieving the objectives within the Corporate Plan.

#### **6.2 Community Implications**

None stemming directly from this report

#### **8.0 Conclusions**

8.1 The Council's internal control framework has effective systems to safeguard both the services and finances of the Council.

#### **9.0 Background Papers**

9.1 None

## ANNUAL REPORT OF THE INTERNAL AUDIT SERVICE 2009/10

### **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 Internal Audit Service Strategy 2007-10, a supporting document of the Finance and Property Division's Service plan that is, in turn, 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, in conjunction with our external auditors, a managed audit approach which primarily concentrates on the material financial systems, these financial control systems form the basis of the Authority's accounts. Each year arrangements are agreed with the external auditors to enable them to rely on the work of Internal Audit, our current external auditors are Grant Thornton.

Since 2005 the service has been reviewed by a number of external bodies including the Audit Commission, Pritchard Stone and Price Waterhouse Coopers, all have adjudged the service to be satisfactory. Grant Thornton undertook an initial review when they were appointed and annual reviews in 2008/09 and 2009/10, their assessment also being satisfactory. Grant Thornton intend to undertake a three year review of the service against the code practice during 2010/11.

### **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, in particular internal check functions, where there are operational difficulties in maintaining separation of duties. In addition the Audit Manager is involved in other managerial responsibilities including corporate governance, fraud awareness, security and public interest issues.

## 6. Planned Audits

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

### Material Financial Systems

- a. **Creditors (value of transactions processed £31.3m)** – All key controls were operating in the Creditor system with no significant weaknesses encountered. The interim ordering system has been examined and, apart from some minor control issues dealt with during the course of the audit, found to be working well.

The introduction of electronic procurement methods has seen a move away from paper-based certification methods. At present there is a mix of the old and the new with interim and temporary systems in place with an acceptable level of control. The impending introduction of the *Agresso Invoice Manager* will result in a standardised system with clear audit trails.

- b. **Housing Benefits (value of transactions processed £19.6m)** – The Authority has been using the Academy Revenue system for over two years. This package includes the housing benefits module which administers all of the benefit payments. Separation of duties and administrator rights issues have been raised in recent audits, these are being addressed by management.

Internal Audit has audited this system twice during the year, both for 2008/09 and 2009/10 transactions as part of the rolling forward of section 151 work into the year of account.

- c. **Council Tax (value of transactions processed £40.7m)** - A review of the system controls has been undertaken, no major weaknesses were found and the day to day operation of the Council Tax function is operating well. The management control information has been examined in detail and the year end control totals for 2009/10 have been verified.

- d. **NNDR (value of transactions processed £20.8m)** – During the year a full review of the system management controls has been undertaken in which each individual control has been verified. A software update in March 2010 affected the integrity of the overall system management control information. The information was recreated from the data for final accounts purposes and the software supplier is issuing a further release to cure the problem.

Internal Audit has audited this system twice during the year, both for 2008/09 and 2009/10 transactions as part of the rolling forward of section 151 work into the year of account.

## 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. Bank reconciliation plays a major part in verifying the integrity of the main accounting system and is also included in this section.

**Main Accounting System** - This was examined and all system controls employed were reviewed. The trial balance facility is now a regular feature within the Agresso Accounting system. The ledger/cash book reconciliation and the bank reconciliation processes are operating well and are up to date. A new payments account cheque reconciliation process has been introduced and is an improvement on the old process. Further development of the Agresso system is included in the Corporate Services Partnering Contract.

**Budgetary Control** - The budget setting and budgetary control system has been examined; in general all controls proved to be operating satisfactorily. The assurance level for this system is generally high and no major weaknesses have been found.

**Bank Reconciliation** – The financial year 2009/10 has seen further improvements in the ledger/cash book reconciliation process and the bank to cash book reconciliation is up to date. A new payments account reconciliation procedure has been introduced and a consolidation of the two reconciliations is also now agreed on a monthly basis.

## Local Systems

**Section 106 Agreements** – The system for administering Planning Obligations was examined following a request from the Audit Sub Committee, the audit covered the control aspects of each stage of the agreement, namely planning, negotiation, payment, receipt and expenditure. The audit confirmed that the system for managing Section 106 Agreements operates with a high degree of internal control.

**Gas Safety** – the Gas Safety (Installation and Use) Regulations 1998, place duties on local housing authorities as landlords of properties to which a gas supply is available. The Regulations and their guidance are intended to make sure that landlords take all reasonable steps to undertake full safety checks of the supply and appliances within their properties. The purpose of the audit was to confirm that the Authority has such arrangements in place to meet this legislation.

The audit concluded that the Authority has established an effective control framework to ensure that all council houses with a gas supply, receive an annual safety check.

**Growth- Point Partnership** – an audit was undertaken to confirm that expenditure on Growth Point Projects in South Derbyshire for 2008/09 has been properly incurred and meets the eligibility requirements of the fund within the Derby

Housing Market Area. The audit focussed on the grant related expenditure and the level of control within the systems used to manage and monitor that expenditure. Apart from some minor issues no significant weaknesses were found and all expenditure was properly incurred and conformed to the grant conditions.

**7. Fraud and Irregularity**

Four operational areas (Debtors, Cash, NNDR and Ctax) were examined. There were no major issues raised and the Authority's anti-fraud and corruption controls in these areas are sound.

**8. Contract Audit**

A number of final accounts have been undertaken for contracts in the Housing Maintenance area. The demand for company searches and bank references has increased and the system in use is providing the Authority with low cost immediate information over the internet.

**9. Computer Audit**

Control audit checklists were completed on the system network, network management, internet/e-mail monitoring. The acceptable use policy and its application, using Websense and Sophos products, have been examined.

**10. Special Investigations**

A number of investigations have been undertaken during the year. These included Capital schemes, contract, security, subsistence, grants, cash and credit cards.

**11. Annual Governance Statement - 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. The final accounts closure date has been progressively brought forward and there is now a requirement to produce an Annual Audit Assurance Statement to support the Governance Statement.

The Annual Audit Assurance Statement required for the 2009/10 year has to be produced by June 2010 and will include work undertaken in April and May 2010 relevant to the year-end financial systems.

The Internal Audit Assurance Statement for 2009/10 can be found in Annexe A to this report.

**12. Conclusion**

The service has performed better than last year during 2009/10. The majority of the Managed Audit has been completed to the satisfaction of External Audit. The service has completed 91% of the planned days against a target of 90%.

Our external auditors required us to roll forward our section 151 work into the year of account from 2009/10, this has meant that during the year testing has been undertaken on both 2008/09 and 2009/10 transactions in many of the material financial systems. The service has managed to absorb much of this work but some audits have been carried forward in the new strategic audit plan for completion later this year.

The Authority's programme of system replacement has shaped recent audit plans. This programme is now coming to an end with only the cash receipting and posting system to be implemented. The service will be concentrating on more non-financial and VFM audit in the near future.

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

Audit Manager

## **INTERNAL AUDIT ASSURANCE STATEMENT – 2009/2010**

### **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 and the Accounts and Audit (Amendment) (England) Regulations 2006 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 within the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom. All audit work carried out is in accordance with the standards in the code and subject to a quality review process.

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 Director of Corporate Services and the Head of Finance and Property Services being the Responsible Finance Officer and Deputy for the Authority.

### **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 during 2009/10 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 this period and during April and May 2010, I consider, that based on this work, reliance can be placed upon the Council's internal control system. The Council has implemented many new computer systems over the last five years, most of which are material to the final accounts process. The controls in these systems have been extensively reviewed during 2009/10 to confirm the level of internal control is maintained. Some issues arose relating to the control data on one of the revenue systems but this was satisfactorily resolved during the course of the audit. Internal Audit has also examined more non-financial areas and no major weaknesses were found.

**A.J.Stamper**

**Audit Manager**

**June 2010**