

**AUDIT SERVICES ANNUAL REPORT ON INTERNAL CONTROL
2008/09**

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SUMMARY: This report provides Members with assurance and an opinion on the Council's systems of internal control in 2008/09.

Recommendation:	That Members note the report and consider its contribution to the Annual Governance Statement.
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1. INTRODUCTION

1.1 The Annual Reporting Process

Management is responsible for the system of internal control and should set in place policies and procedures to help ensure that the system is functioning correctly. Internal Audit review, appraise and report on the effectiveness of financial and other management controls. This report is based on the work undertaken by internal audit in 2008/09 and seeks to:

- Provide an opinion on the adequacy of the control environment
- Comment on the nature and extent of significant risk
- Report the incidence of significant control failings or weaknesses

1.2 Requirement for Internal Audit

There is a requirement under the Accounts and Audit Regulations 2006 to maintain an adequate and effective system of internal audit of the Council's accounting records and of its system of internal control. The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Internal Audit in Local Government in the UK 2006 (Standard 10) requires that the Head of Internal Audit should provide a formal annual report to the organization, to support the Annual Governance Statement to be approved alongside the Statement of Accounts for 2008/09.

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2. REVIEW OF INTERNAL CONTROL

2.1 How Internal Control is reviewed

Internal Audit adopts a risk-based approach to audit. The risk assessment is carried out at least annually and is updated throughout the year, as audits are carried out or as circumstances change. The risk assessment is used to prioritise work in the audit plan. Factors used in the risk assessment include financial materiality, potential for fraud or theft, findings at the last audit, changes to the system or staffing and the time elapsed since the last audit.

The range of audits undertaken during the course of the year supports the overall opinion on the control environment. Details of audits undertaken were reported quarterly to the Audit Committee. A summary of the opinion on individual systems arising from the 2008/09 audits is given at Appendix A. Members are asked to note that Internal Audit was unable to carry out the annual audits, in May/June 2008, relating to Capital Accounting and the Final Accounts Process 2007/08 prior to the statutory deadline for adoption of the Accounts, as the Accounts and working papers were not available.

2.2 Opinion 2008/09

Based on the work undertaken during the year, Internal Audit has reached the opinion that key systems are operating satisfactorily and there is no fundamental breakdown of controls resulting in material error or discrepancies. Although the Beacon/TIC Cash and Banking system was rated as "Weak", the discrepancies found were all under £10, differences banked to takings recorded were both "over" and "under" and were, therefore, not material to the operation of the system. Material improvements were also put in place following the rating of the IT Arrangements for Business Continuity as "Weak". Both these audits were discussed in some depth at the Audit Committee meeting of 22 April 2009. Satisfactory arrangements were implemented to ensure the effective, efficient and economic operation of the Council's financial affairs, with the exception of the failure to meet the statutory deadline for production of an auditable Statement of Accounts for 2007/08.

However, no system of control can provide absolute assurance against material misstatement or loss, nor can Internal Audit give absolute assurance. This statement is intended to provide reasonable assurance. It should be read in conjunction with the

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internal audit report on Corporate Governance 2008/09, which reviews the wider system of internal control.

3. SIGNIFICANT ISSUES ARISING 2008/09

The following section provides a summary of the more significant issues that have been identified and reported during the year. This is by exception only.

3.1 Business Continuity

A Business Continuity exercise took place on 28 March 2008. This identified gaps in planning which needed to be addressed in 2008/09. Each service should have a business continuity plan which addresses loss of staff; loss of premises; loss of ICT facilities (computer systems, communications); or a combination of the above. Whilst services have updated their Business Continuity plans, an IT Disaster Recovery Plan has been produced (following the audit referred to in the Appendix) and a Corporate Business Continuity Plan has now clearly identified services in order of priority, arrangements (other than limited restoration of IT facilities) have not been tested in 2008/09. In particular, following the loss of key Finance staff, the Council's Business Continuity arrangements in relation to the finance function - and management of performance when these arrangements were put in place - proved to be inadequate.

3.2 Corporate Governance

Significant progress has been made in developing and updating the arrangements. However, as referred to in 3.1 above, the inadequacy of the Council's Business Continuity arrangements, following the loss of key Finance staff, resulted in failure to meet a fundamental statutory deadline to produce an auditable Statement of Accounts for 2007/08 and the need to use financial reserves to rectify the situation. The Corporate Governance arrangements, therefore, have been evaluated as weak.

3.3 Implementation of Outstanding Audit Recommendations

In the first half of 2008/09, there was still a backlog of 2007/08 audit recommendations to be implemented, particularly due to vacancies in the Finance department. However, by the year end, significant progress had been made on the implementation of some long-standing recommendations. As at 31 March 2009, there were 44 key recommendations overdue (including 19 recommendations made in 2008/09), of which 17 related to the Accountancy section. Progress had been hindered due to late closure of the 2006/07 and 2007/08 Accounts (end of March 2009) and priority then had to be

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given to meeting the June deadline for the 2008/09 Accounts. Progress continues to be made and is reported to the Audit Committee on a quarterly basis.

4. OTHER SIGNIFICANT ISSUES

4.1 Acting S.151 Officer

Following the termination of the agency contract, pending recruitment of the permanent post holder, the Acting S.151 role was undertaken by the Audit & Fraud Prevention Manager for a period of 3 months, from 4 July to 12 October 2008. The permanent Head of Finance and Management Information Systems (the S.151 Officer) took up her post on 13 October 2008. Arrangements were subsequently put in place to maintain audit independence, as follows:-

- A register has been kept of the decisions made by Acting Head of Finance during the three month period and these are available for inspection. If they are included in any subsequent internal audit review, the audit will be taken by another member of the Audit Team and working papers reviewed by other members of the team. Arrangements have been put in place for a peer review of any such audits, to be undertaken by the Audit Manager of Allerdale Borough Council.
- During the acting up period, there was no acting Head of Audit as such. The two Audit Technical Officers were paid an honorarium to effectively act as Audit Seniors. The Acting Head of Finance undertook no audit work in this period. Indeed, very little audit work / review of audit work was undertaken in the acting up period, as they were subsequently used to support the Final Accounts process with substantive testing, supervised by the Deloitte accountant. These transactions related to 2007/08, on which system audits had already been undertaken.
- The auditing processes follow CIPFA standards and guidelines – findings are based on evidence e.g. specified tests, samples following standard sample methodology etc. All working papers are retained on system files for scrutiny by the Audit Commission and the Audit section is subject to an in-depth triennial review by the Audit Commission - arranged for May 2009. In addition, the Council must place reliance upon professional ethics and compliance with professional standards and codes of conduct of its staff.

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Corporate Team, on 11 May 2009, considered the above and concluded that the issue of independence has been managed in 2008/09. This has been fully explained in the report, elsewhere on this agenda, on the Effectiveness of the System of Internal Audit. Should a similar situation arise in the future, a full risk assessment will be undertaken and documented.

4.2 Internal Audit Coverage

Due to the circumstances described at 4.1 above, internal audit were only able to cover 66% of the Audit Plan in 2008/09. However, all the main financial systems were audited by the end of April 2009, together with 57% of the non-fundamental systems. The Audit Committee was informed of the circumstances and of the slippage as soon as this became apparent (meeting on 29/10/08). This was monitored and reported throughout the year. Following a discussion, Members agreed that the Audit Plan should not be revised but noted the audits which had to be deferred. An evaluation of the slippage has been shown at Appendix D of the separate report on the Effectiveness of the System of Internal Audit. This was considered by Corporate Team, who concluded that the impact of the slippage on the internal control environment was minimal. The outstanding work will be risk assessed and rolled forward to 2009/10, where appropriate.

5. AUDIT PERFORMANCE

5.1 Compliance with the CIPFA Code of Practice for Internal Audit

A self-assessment reviewed our compliance with the CIPFA Code of Practice issued in December 2006. Full details are reported separately on this agenda, as part of the report on the Effectiveness of the System of Internal Audit. The main issues related to the Audit & Fraud Prevention Manager acting as the S.151 Officer for a period of 3 months in 2008 and to the slippage against the audit plan. – see paragraphs 4.1 and 4.2 above.

Actions have been identified to address the issues arising in Appendix A of the report on the Effectiveness of the System of Internal Audit.

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5.2 Customer Satisfaction

As part of Internal Audit's commitment to ensuring the highest professional standards, and to ensure we are continually improving the quality of work produced, we issued an annual Customer Satisfaction Questionnaire to Management Group and to team leaders whose areas had been audited in 2008/09. 25% of questionnaires were returned. We assume that if managers had concerns about the internal audit service, they would have taken this opportunity to record this. A summary is given below:-

	Trend
• 11 felt they were sufficiently consulted on the Audit Plan [3 no response]	↑
• 2 would like extra audit services [10 would not, 2 no response]	=
• 2 rated audit services as providing excellent value for money	↓
• 5 rated audit services as providing good value for money [5 adequate, 2 no response]	↑
• 11 did not prefer audit services to be provided differently [3 no response]	↑
• 10 rated the general helpfulness of audit staff as excellent [2 good, 2 no response]	↑
• 7 rated the responsiveness of audit to managers' needs as excellent [4 good, 1 Adequate, 2 no response]	↑

This largely shows an improvement in Customer Satisfaction, compared to the previous year. Dissatisfaction is mainly related to wanting more audit coverage – 2 respondents would like extra audit services. Given the limited audit resources of 3 FTE staff, plus the manager who is also responsible for the Fraud section, and the requirements that have to be met for the external auditor and the CIPFA Code of Practice for Internal Audit, there is little we can do to develop more operationally-focused audits. The main emphasis is on financial and corporate governance controls. 1 complaint related to timing – unavoidable, given the delay in the audit work for 2008/09, caused by audit work supporting the closure of the Accounts.

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5.3 Performance against the approved Audit Plan 2008/09

A detailed review of audit activities has been given in the quarterly monitoring reports submitted to the Audit Committee, together with the audits that have had to be deferred. As stated at 4.1 and 4.2 above, internal audit was only able to cover 66% of the approved Audit Plan, compared to a target of 90%. However, the impact of the slippage on the control environment was minimal.

List of Appendices:

Appendix A – Opinion on controls of individual systems 2008/09

List of Background Documents: None

Officers Consulted: Corporate Team

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**APPENDIX A
SUMMARY OF THE OPINION ON INDIVIDUAL SYSTEMS AUDITED
2008/09**

**LOCAL AREA AGREEMENT ADMINISTRATION OF
GRANTS 07/08 [08/09 AUDIT REPORT]**

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	SATISFACTORY
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	HIGH

BUILDING CONTROL 07/08 [08/09 AUDIT REPORT]

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	SATISFACTORY
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE PROBABILITY	HIGH
RISK EXPOSURE IMPACT	HIGH

**RENOVATION GRANTS
[2007/08 & 1st Quarter 2008/09 transactions]**

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	SATISFACTORY
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE PROBABILITY	MEDIUM
RISK EXPOSURE IMPACT	HIGH

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BEACON MUSEUM COLLECTION

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	EXCELLENT
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE PROBABILITY	MEDIUM
RISK EXPOSURE IMPACT	HIGH

IT ARRANGEMENTS FOR BUSINESS CONTINUITY

OVERALL AUDIT OPINION	WEAK
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CONTROL DESIGN	WEAK
CONTROL EFFECTIVENESS	WEAK
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	HIGH

IT SECURITY HEALTH CHECK

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	SATISFACTORY
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	HIGH

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TRAINING EXPENSES

OVERALL AUDIT OPINION	GOOD
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CONTROL DESIGN	GOOD
CONTROL EFFECTIVENESS	GOOD
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	LOW

BEACONTIC CASH AND BANKING

OVERALL AUDIT OPINION	WEAK
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CONTROL DESIGN	SATISFACTORY
CONTROL EFFECTIVENESS	WEAK
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	LOW

CASH RECEIPTING

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	GOOD
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	HIGH

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COUNCIL TAX

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	GOOD
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	HIGH

NNDR

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	GOOD
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	HIGH

LOANS AND INVESTMENTS

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	GOOD
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	HIGH

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PAYROLL

OVERALL AUDIT OPINION	GOOD
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CONTROL DESIGN	GOOD
CONTROL EFFECTIVENESS	GOOD
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	HIGH

BENEFITS

OVERALL AUDIT OPINION	GOOD
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CONTROL DESIGN	GOOD
CONTROL EFFECTIVENESS	GOOD
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	MEDIUM

CREDITORS

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	GOOD
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	HIGH

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SUNDRY DEBTORS

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	GOOD
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE PROBABILITY	HIGH
RISK EXPOSURE IMPACT	LOW

BUDGET PROCESS

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	SATISFACTORY
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE PROBABILITY	LOW
RISK EXPOSURE IMPACT	MEDIUM

MAIN ACCOUNTING SYSTEM

OVERALL AUDIT OPINION	SATISFACTORY
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CONTROL DESIGN	GOOD
CONTROL EFFECTIVENESS	SATISFACTORY
RISK EXPOSURE - PROBABILITY	LOW
RISK EXPOSURE –IMPACT	HIGH

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CORPORATE GOVERNANCE

OVERALL AUDIT OPINION	WEAK
CONTROL DESIGN	GOOD
CONTROL EFFECTIVENESS	WEAK
RISK EXPOSURE PROBABILITY	MEDIUM
RISK EXPOSURE IMPACT	HIGH