



INTERNAL AUDIT – ANNUAL REPORT ON PROGRESS IN 2004/5

RECOMMENDATION

- 1.1 To note the activity and performance of internal audit in 2004/5.
- 1.2 To refer the report to Scrutiny Management Commission for information.

SUPPORTING INFORMATION

- 2.1 The 2004/5 Annual Internal Audit Plan was presented to Council Cabinet on 27 April 2004. It was also referred to Scrutiny Management Commission for comment. An interim report setting out progress against the 2004/5 audit programme was brought to Cabinet on 18 January 2005.
- 2.2 The Annual Internal Audit Plan is a risk based plan designed to review the control environment of the Council, including all its operations, resources, services and responsibilities in relation to other bodies, and enable the Head of Audit and Risk Management to deliver an audit opinion. To meet this requirement for 2004/5, it was planned to cover a total of 202 audit reviews.
- 2.3 The internal audit plan is kept under review throughout the year to identify any amendments needed to reflect changing priorities and emerging risks. It is a flexible document which contains an element of contingency to accommodate assignments which could not have been reasonably foreseen at the Planning stage. Such assignments include special investigations into suspected or detected fraud, corruption or impropriety, internal control failures as well as requests for internal audit input into reviewing new systems. Emerging issues which have risk and control implications also require assessing by internal audit, and may require audit review in the current year. Any material changes to the Plan are reflected in this report (see para 2.5).
- 2.4 The Plan is ultimately determined by the available input of days. Therefore instances such as significant levels of vacancies and overruns on time budgeted for each audit assignment will effect the level of output. In such cases the Plan has to be reviewed and adjustments made, based on the risk ranking of audits. If audits need to be dropped from the planned work, then this is done based on the associated risk of the audit area. High risk audits are the main priority. In 2004/5 the number of audit reviews was reduced to 155.
- 2.5 The level of vacancies in 2004/5 was higher than anticipated. This led to a re-prioritisation of the Plan with a number of lower risk audits having to be postponed

and temporary audit resources being brought in to provide the Section with additional audit days on the key financial systems. The cost of employing temporary audit staff in 2004/5 was £46,209 and was funded from the underspend on employee costs within the existing audit budget.

- 2.6 A major piece of audit work in 2004/5 that caused a revision in the Plan was the internal fact finding investigation into the events surrounding the window replacement contract at Silverhill Primary School. This investigation concentrated on those processes surrounding the awarding of the work to the contractor by the school, the professional advice given to the school, the funding of the scheme, and the role of the Council. This evidence was used in a separate report by the Director of Education that led to suspension by the Council of the Governing Body's right to a delegated budget, amongst other actions.
- 2.7 Appendix 2 summarises the output of internal audit in 2004/5. At the end of the year, 91 audits had been completed, with a further 18 where the draft audit report had been issued, and a response from the relevant Manager was awaited. There were 17 audits where the audit review was still in progress at the end of the year. A further 28 were at the draft report review stage. One audit review was not started. Based on the degree of completion of each audit review, the Audit Section achieved the CPA target of 90% of the audit plan completed in 2004/5.
- 2.8 Internal Audit reports prioritise recommendations into 3 distinct categories of perceived weakness, fundamental, significant and merits attention. A fundamental weakness is one that requires priority attention because the associated risk to the Council would be highly likely to occur and it would also have a high impact if it were to.
- 2.9 Appendix 3 provides full details of the number of recommendations in each category by audit for all final reports issued in the year. The table below shows the difference between the number of recommendations made by Internal Audit and those accepted by Management for all completed audits.

| | Fundamental | Significant | Merits Attention |
|--------------------------|-------------|-------------|------------------|
| Recommendations Made | 0 | 189 | 157 |
| Recommendations Accepted | 0 | 177 | 147 |

There have been no fundamental weaknesses found in audit reviews in the period covered by this report.

- 2.10 There has been a 93.6% acceptance rate for audit's recommendations. The difference between the number of recommendations made in the draft report and those accepted for inclusion in the final report occurs where
- Management decides that they are prepared to bear the risk identified due to insufficient resources to meet the control recommended i.e. the introduction of separation of duties in a system requires additional resources
 - Management believes that it has compensating controls in place which mitigate the need for a new control

- Management are able to demonstrate limitations in the system used that prevent the suggested control from being addressed.

- 2.11 The acceptance rate is affected where audit reports are issued in final following a non-response from the auditee. There was one case in 2004/5, which was the “Going Places” audit. This issue was highlighted in the 2004/5 interim report to Cabinet in January 2005. This non-response and the delay in obtaining responses to draft audit reports led to a revised procedure being introduced to ensure that responses to draft reports were secured within 6 weeks of the draft being issued. When the interim report was considered by Scrutiny Management Commission, it recommended to Cabinet that the period of six weeks that managers were allowed in which to respond to a draft report was too long and suggested that this be reduced to four weeks. It also recommended that managers should be instructed that responding to Audit reports was mandatory. This was agreed by Council on 22 February 2005 (min 307/04).
- 2.12 The audit reviews of individual schools during the year highlighted a number of significant weaknesses. These arose in the main through weaknesses surrounding Governor’s responsibilities and where internal financial procedures were not of the required standard. It is clear from this that there is the need for further guidance and training to be provided to schools. Internal Audit works closely with the Education Service and schools in promoting improved controls within schools, where the responsibilities lie under the legal requirements of delegated budgets.
- 2.13 In the report to Cabinet on 20 July 2004 it was stated that future reports to Cabinet would outline the impact on the individual control system in operation of an exceptional number of significant weaknesses in a particular system, where these appear in combination to fundamentally compromise the internal control environment. In 2004/5, apart from school audits, Internal Audit has issued three reports following investigation reviews that have resulted in a high number of significant weaknesses. Internal Audit has assessed the impact of the high level of significant weaknesses in these areas, and concluded that in each of these cases, the internal control system has not been compromised.
- 2.14 Based on the audit work carried out in 2004/5 the overall opinion on the systems of internal control operating within the Council is that they are operating as intended. This is also backed up by the assurance gathering process undertaken in the compilation of the annual Statement on Internal Control.

Future Developments

- 2.15 The revised CPA Use of Resources framework for 2005 requires councils to provide evidence that it has an audit committee or equivalent member group, with the former being the standard for an “excellent” rating. The arguments in favour of this are that it would facilitate more extensive reporting of internal control issues to members. This would, however, require a change in the Council’s constitutional arrangements. The potential change is being viewed positively, but it is clear that the implications need to be considered in detail. A further report will therefore be brought to Cabinet in 2005 on this.

- 2.16 In 2005/6, to strengthen internal audit's opinion on the control environment operating in the Council, all audit reviews will contain an overall opinion based on the adequacy of the level of internal control in existence at the time of the audit. This will be graded as either good, satisfactory, marginal, unsatisfactory or unsound, depending on the number of controls weaknesses that are deemed "significant" or "fundamental". Any audits that receive unsatisfactory or unsound gradings will be brought to members attention in future progress reports. An Audit Committee structure would facilitate such reporting.

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| For more information contact: | Richard Boneham, Head of Audit and Risk Management, 01332 255688 |
| Background papers: | Internal Audit Annual Plan 2004/5 |
| List of appendices: | Appendix 1 – Implications Appendix 2 – Internal Audit output for 2004/5 - Summary Appendix 3 – Recommendations made in final audit reports issued in 2004/5 – By Audit |

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| IMPLICATIONS |
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Financial

1. None arising directly.

Legal

2. Under the Accounts and Audit Regulations 2003, the Council is required to 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.

Personnel

3. The Section underwent a re-structuring during 2004/5. The new structure supports a wider, flexible approach to internal audit, but has also addressed several issues within the former team based structure. The new structure operates on a pool based approach. This is designed to provide more flexibility in terms of meeting workload demands as pressures will not be confined within teams. The pool based approach addresses issues such a lack of integration between the teams and by working to one overall audit plan will provide ownership of the plan to all audit staff and enable them to “see the bigger picture”. The effect of this new working will be seen in the 2005/6 Audit Plan.

Equalities impact

4. None directly arising.

Corporate objectives and priorities for change

5. Internal Audit contributes through its review work on the major corporate risks to the Council achieving corporate objectives and priorities. This is achieved by the audit of key systems and corporate governance issues and the associated risks. The work of Internal Audit is also relevant to the priority of ‘value for money’ .

Internal Audit Output – 2004/5

| Progress in Number of Audits | | | | | | | | | | |
|---------------------------------|--------------------|-------------------|----------------------------------|--------------|------------------|--------------------|----------------------|----------------------|-----------------------------|----------------------|
| Departments | Original Plan Jobs | Revised Plan Jobs | Increase / Decrease in Plan Jobs | Jobs Started | Jobs in Progress | Fieldwork Complete | Draft Reports Issued | Final Reports Issued | Audits Complete (No Report) | Jobs Not Yet Started |
| Contract Audit | 9 | 3 | -6 | 3 | 1 | 0 | 0 | 2 | 0 | 0 |
| Development & Cultural Services | 9 | 12 | 3 | 12 | 0 | 2 | 0 | 6 | 4 | 0 |
| Education | 40 | 24 | -16 | 24 | 3 | 4 | 5 | 8 | 4 | 0 |
| Finance | 36 | 32 | -4 | 32 | 0 | 12 | 0 | 11 | 9 | 0 |
| Corporate Governance | 11 | 5 | -6 | 5 | 0 | 3 | 1 | 0 | 1 | 0 |
| IT Audit | 24 | 22 | -2 | 22 | 5 | 1 | 0 | 4 | 12 | 0 |
| Commercial Services | 8 | 3 | -5 | 3 | 1 | 0 | 0 | 1 | 1 | 0 |
| Policy | 17 | 12 | -5 | 12 | 0 | 1 | 6 | 1 | 4 | 0 |
| Social Services | 18 | 12 | -6 | 12 | 2 | 2 | 1 | 6 | 1 | 0 |
| Corporate Services | 3 | 2 | -1 | 2 | 0 | 0 | 0 | 0 | 2 | 0 |
| External Bodies | 27 | 28 | 1 | 27 | 5 | 3 | 5 | 9 | 5 | 1 |
| TOTAL | 202 | 155 | -47 | 154 | 17 | 28 | 18 | 48 | 43 | 1 |

Notes to Appendix 2

Increase in the number of Plan Jobs

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|------------------------|--|
| External Bodies | Investigations for Derby Homes and Fire Authority |
| Development & Cultural | Internal audit input required on grant claims and also on “whistleblowing” investigation |

Decrease in the number of Plan Jobs

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|----------------------|--|
| Contract Audit | Number of audits reduced as time required for Silverhill Investigation |
| Education | Reduction in the number of school audits to meet resource shortfall |
| Corporate Governance | Change in emphasis in approach to governance audits and to reduce duplication with other reviews |
| Social Services | IDeA review and resources switched for investigations within the Department |
| Commercial Services | Lower risk audits – resources switched to higher risk areas within Council |
| Finance | Lower risk audits postponed due to resource shortfall |
| Policy | Lower risk audits postponed due to resource shortfall |

Appendix 3

Recommendations Made and/or Accepted in Final Audit Reports Issued in 2004/5 – By Audit

| | | | | Recommendations Made | | | Recommendations Accepted | | |
|--|---------|-------------------|-------------------|----------------------|------------------|---------------------|--------------------------|------------------|---------------------|
| Job Name | Year | Draft Report Date | Final Report Date | Funda- mental | Signif- icant | Merits Attention | Funda- mental | Signif- icant | Merits Attention |
| <u>Reports issued in Final Contract Audit</u> | | | | | | | | | |
| Investigation - Bus Realtime Information System | 2003/04 | 14-Dec-04 | 22-Feb-05 | 0 | 3 | 0 | 0 | 3 | 0 |
| <u>Development & Cultural Services</u> | | | | | | | | | |
| Recycling - Follow-up | 2003/04 | 31-Mar-04 | 05-May-04 | 0 | 2 | 4 | 0 | 2 | 3 |
| Development Control - Follow-up | 2004/05 | 26-Jul-04 | 21-Sep-04 | 0 | 0 | 1 | 0 | 0 | 1 |
| Advice - Sinfin Library Petty Cash Float | 2004/05 | 10-May-04 | 27-Jul-04 | 0 | 5 | 0 | 0 | 4 | 0 |
| Arts Development / Grants - Follow-up | 2003/04 | 22-Mar-04 | 26-Jul-04 | 0 | 1 | 3 | 0 | 1 | 3 |
| Whistleblowing Investigation - Taxi Firms | 2004/05 | 10-Feb-05 | 14-Mar-05 | 0 | 4 | 2 | 0 | 4 | 2 |
| <u>Education Service</u> | | | | | | | | | |
| St James CE (Aided) Junior School | 2003/04 | 14-May-04 | 02-Jul-04 | 0 | 6 | 5 | 0 | 6 | 5 |
| Rosehill Infant School | 2004/05 | 29-Sep-04 | 21-Oct-04 | 0 | 13 | 11 | 0 | 13 | 11 |
| St Giles Special School | 2003/04 | 27-Feb-04 | 14-Oct-04 | 0 | 10 | 13 | 0 | 10 | 13 |
| Firs Estate Primary School | 2003/04 | 15-Mar-04 | 10-May-04 | 0 | 7 | 3 | 0 | 7 | 3 |
| Markeaton Primary School | 2003/04 | 04-Feb-04 | 06-Apr-04 | 0 | 8 | 9 | 0 | 8 | 8 |
| Meadow Farm Community Primary School | 2003/04 | 31-Mar-04 | 26-May-04 | 0 | 13 | 4 | 0 | 13 | 4 |
| Asterdale Primary School | 2004/05 | 22-Nov-04 | 28-Feb-05 | 0 | 13 | 11 | 0 | 12 | 10 |
| Homefields Primary School | 2003/04 | 29-Nov-04 | 10-Feb-05 | 0 | 15 | 14 | 0 | 15 | 13 |
| <u>Finance Directorate</u> | | | | | | | | | |
| NNDR - High Level Controls & Mandatory Discretionary Relief | 2003/04 | 13-Oct-04 | 13-Oct-04 | 0 | 1 | 2 | 0 | 1 | 2 |
| Payroll / Ledger Reconciliations | 2003/04 | 12-Aug-04 | 15-Sep-04 | 0 | 1 | 3 | 0 | 1 | 3 |
| External Funding - Jobs, Education and Training - Going Places | 2003/04 | 23-Dec-03 | 13-May-04 | 0 | 4 | 0 | 0 | 0 | 0 |
| BVPI 8 (Creditor Payments) | 2003/04 | 11-Sep-03 | 07-Mar-05 | 0 | 5 | 4 | 0 | 5 | 1 |
| Council Tax (2003-04) | 2003/04 | 21-Dec-04 | 25-Jan-05 | 0 | 4 | 5 | 0 | 3 | 5 |
| Finance - Creditors Follow-up | 2003/04 | 05-Mar-04 | 07-Mar-05 | 0 | 1 | 8 | 0 | 1 | 8 |
| Finance - Debtors Follow-up | 2003/04 | 22-Jan-04 | 07-Mar-05 | 0 | 4 | 1 | 0 | 4 | 1 |
| Payroll / Ledger Reconciliations | 2003/04 | 12-Aug-04 | 15-Sep-04 | 0 | 1 | 3 | 0 | 1 | 3 |
| Car Loans - Follow-up | 2003/04 | 31-Mar-04 | 07-Mar-05 | 0 | 0 | 1 | 0 | 0 | 1 |
| NNDR - High Level Controls & Mandatory Discretionary Relief | 2003/04 | 13-Oct-04 | 13-Oct-04 | 0 | 1 | 2 | 0 | 1 | 2 |
| Advice - Sign Language Interpreters | 2004/05 | 02-Dec-04 | 11-Jan-05 | 0 | 0 | 5 | 0 | 0 | 5 |
| <u>IT Audit</u> | | | | | | | | | |
| IT Audit Investigations - System Weaknesses | 2003/04 | 12-Feb-04 | 14-Apr-04 | 0 | 1 | 5 | 0 | 1 | 5 |
| Benefits - Application Audit | 2004/05 | 02-Mar-05 | 24-Mar-05 | 0 | 4 | 5 | 0 | 4 | 4 |
| <u>Commercial Services</u> | | | | | | | | | |
| Trade Refuse Debtors | 2003/04 | 26-Jul-04 | 31-Mar-05 | 0 | 3 | 4 | 0 | 2 | 3 |
| <u>Policy Directorate</u> | | | | | | | | | |
| Derby Homes - Client Monitoring | 2003/04 | 25-Mar-04 | 22-Apr-04 | 0 | 5 | 4 | 0 | 5 | 4 |
| <u>Social Services</u> | | | | | | | | | |
| BVPI 58 (People Receiving Statement of Needs) - Follow-up | 2003/04 | 24-Mar-04 | 06-May-04 | 0 | 1 | 1 | 0 | 1 | 0 |
| Asylum Seekers - Follow-up | 2003/04 | 26-Mar-04 | 17-Jun-04 | 0 | 0 | 2 | 0 | 0 | 2 |
| Payroll - Starters, Leavers and Variations | 2003/04 | 18-Aug-04 | 30-Mar-05 | 0 | 5 | 4 | 0 | 5 | 4 |
| Investigation - Missing Monies | 2003/04 | 03-Oct-03 | 09-Jun-04 | 0 | 28 | 18 | 0 | 25 | 18 |
| Investigation - T&S Claims | 2003/04 | 10-Feb-04 | 26-Aug-04 | 0 | 12 | 0 | 0 | 12 | 0 |

| Job Name | Year | Draft Report Date | Final Report Date | Recommendations Made | | | Recommendations Accepted | | |
|---|---------|-------------------|-------------------|----------------------|------------------|---------------------|--------------------------|------------------|---------------------|
| | | | | Funda- mental | Signif- icant | Merits Attention | Funda- mental | Signif- icant | Merits Attention |
| Investigation - T&S Claims | 2003/04 | 15-Mar-04 | 17-May-04 | 0 | 8 | 0 | 0 | 7 | 0 |
| Total Recommendations Made – Final reports | | | | 0 | 189 | 157 | 0 | 177 | 147 |
| Final Reports issued – no recommendations | | | | | | | | | |
| Contract Audit | | | | | | | | | |
| Silverhill Primary School (Fact finding – no recommendations) | 2003/04 | | 15-Sept-04 | 0 | 0 | 0 | | | |
| Development & Cultural Services | | | | | | | | | |
| BVPI 156 (Disabled Access) – Follow Up | 2003/04 | | 02-Apr-04 | 0 | 0 | 0 | | | |
| Finance Directorate | | | | | | | | | |
| External Funding - Derby Cathedral Chapter - Cathedral Plus | 2003/04 | | 21-Mar-05 | 0 | 0 | 0 | | | |
| IT Audit | | | | | | | | | |
| Investigation – Inappropriate websites | 2004/05 | | 31-Mar-05 | 0 | 0 | 0 | | | |
| Council Tax – IDEA Tests and Samples | 2003/04 | | 24-Apr-04 | 0 | 0 | 0 | | | |

NB this table does not include final reports and recommendations made to external bodies such as Derby Homes and the Fire Authority. There were 9 final reports issued to external bodies.