Interim Audit Report 2007-08

Derby City Council

July 2008

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1. Executive Summary

Introduction

This report summarises the findings from our interim audit, carried out in accordance with our Audit and Inspection Plan. We have considered:

- The extent to which we can place reliance on the work of Internal Audit;
- The adequacy of the governance arrangements in operation at the Council;
- The adequacy of controls over information technology;
- The adequacy of controls over the financial reporting process;
- Whether the Best Value Plan complies with statutory guidance; and
- The adequacy of arrangements for year-end closedown and the preparation of the annual accounts.

Much of our work, at this stage, has been focussed on our accounts audit responsibilities, under the Code of Audit Practice. However, where relevant, we will ensure that our findings inform our Use of Resources responsibilities, at a later stage in the audit.

Key messages for the Council

Internal Audit substantially complies with the CIPFA Code of Practice for Internal Audit and we will aim to place reliance on its systems work where this will reduce the level of our detailed final accounts testing. We have identified a number of development opportunities, which we have set out in Section Two.

The high-level governance controls and process are considered adequate with few deficiencies noted, except for risk management arrangements, where we have noted some areas for improvement. These are set out in Section Three.

Information technology controls have been assessed as generally sufficient, with no significant deficiencies or material weaknesses having been identified. Detailed recommendations can be found in Section Four.

The financial reporting process was found to be generally sound, with only a few minor recommendations concerning controls over journals being raised in Section Five.

The Best Value Performance Plan was found to meet the statutory minimum requirements and we issued an unqualified opinion on this basis.

The Council has adequate arrangements in place to ensure that the financial statements and supporting working papers are available within reporting deadlines.

Use of this report

This report is part of a continuing dialogue between the Council and us and is not, therefore, intended to cover every matter, which came to our attention. Our procedures are designed to support our audit opinion and they cannot be expected to identify all weaknesses or inefficiencies in the Council's systems and work practices.

The report is not intended for use by third parties and we do not accept responsibility for any reliance that third parties may place on it.

The Way Forward

We have discussed our findings with officers, including the Assistant Director or Resources, and agreed actions to implement the recommendations set out at Appendix A.

Acknowledgements

We would like to take this opportunity to thank the officers who have been involved in our interim audit for their assistance and co-operation.

2. Review of Internal Audit Function

The Council's Internal Audit function was reviewed against CIPFA's Standards for Internal Audit. Our review considered:

- Scope;

- Independence;

- Ethics;

- Audit Committee;

- Relationships;

- Staffing, training and continuous professional development;

- Audit strategy and planning;

- Undertaking audit work;

- Due professional care;

- Reporting; and

- Performance, quality and effectiveness.

Overall we have concluded that Internal Audit provides an independent and effective service to the Council. Areas of good practice include:

- Internal Audit's annual plan and assignments are risk-based;

- Internal Audit involves service managers in identifying risks and planning work;

- Internal Audit makes use of Quality Control Questionnaires to obtain external feedback on performance;

- Recommendations are agreed with service managers and documented in action plans and in a 'recommendation tracking' tool; and

▪ The Audit and Accounts Committee requires explanations from service managers where significant recommendations are disputed or not implemented within timescales.

We consider that Internal Audit arrangements are sufficient for us to place reliance on relevant systems work, where this will reduce the level of detailed final accounts testing.

Our work identified a number of areas where CIPFA Standards were, in our opinion, not fully met and where the Council has the opportunity to improve present arrangements. These findings are set out in detail below.

Findings and recommendations

Currently the Financial Procedure Rules do not explain how Internal Audit's resource requirements will be assessed. There is a risk that resource requirements will not be adequately considered and Internal Audit will not be sufficiently resourced to meet the annual plan and provide assurance to the Council. Internal Audit has had difficulty meeting its annual plan, with several key financial system audits incomplete at the time of our interim visit. This was largely due to the level of investigatory work undertaken by Internal Audit. Whilst a degree of involvement by Internal Audit is necessary in such investigations, the extent of such involvement can be mitigated through greater ownership and participation by service management.

Recommendation 1

The Internal Audit strategy should include an explanation of how Internal Audit's resource requirements will be assessed and/or consider alternatives to Internal Audit investigations.

CIPFA Standards dictate that the Terms of Reference for Internal Audit should include the requirement for the Head of Internal Audit to establish and maintain good working relationships and communication with members. This is not included in the current Terms of reference, in use currently.

Recommendation 2

The Council should consider updating the Terms of Reference to include the requirement that 'The Head of Internal Audit must establish and maintain good working relationships and communication with members.'

Internal Audit aim to issue reports as promptly as possible, but there are no formally agreed timescales for this.

Recommendation 3

Internal Audit should formally agree timescales for draft and final reports to be issued for each audit.

These recommendations relate to findings where we believe that the Council should implement changes in order to meet standards of good practice. We also noted some areas that the Council could consider implementing changes in order to meet standards of best practice. These findings are set out below and are not included in our Action Plan in Appendix A.

- The CIPFA Standards require the Head of Internal Audit to regularly remind Internal Audit staff of their ethical responsibilities.
- The Council could consider establishing a formal policy on the length of time that must elapse before a member of staff previously involved in operational activities can be considered sufficiently objective to be involved in the audit of those activities.

- The Council could consider establishing a policy of Internal Audit staff rotation on annually, or regularly, audited areas.

3. Review of governance arrangements

We undertook a review of entity-level controls assessing the Council's key processes and controls in the following areas:

- control by the Executive, the Audit and Accounts Committee and Management; and

- monitoring of risks to the organisation.

In general, we considered that the Council has adequate processes and controls in place. Many areas of good practice were noted, including:

- an Audit and Accounts Committee established with a proper Terms of Reference;

- the Audit and Accounts Committee have self-assessed against CIPFA's recommendations;

- the Council has procedures in place to capture and process any complaints or anonymous disclosures; and

- risk management processes ensure that key risks are identified for all business areas and are incorporated into operational business plans.

A number of opportunities for improvement were also identified which are detailed below.

Findings and recommendations

Currently the Audit and Accounts Committee does not have any members with formal financial qualifications or experience.

Recommendation 4

The Council should consider reviewing the financial skills within the membership of the Audit and Accounts Committee against the Committee's Terms of Reference with a view to providing targeted training. The Council could also consider co-opting financial expertise on to the Committee.

The Council does not have processes in place to ensure effective oversight of the Audit and Accounts Committee. The minutes of the Committee are not reviewed by the Full Council or Cabinet. Although the Audit and Accounts Committee has undertaken a self-assessment against CIPFA's standards this is not an annual process and was not elsewhere within the Council. We recognise that the current Audit and Accounts Committee is newly appointed and, as such, we will undertake a detailed review as part of our 2008-09 audit programme.

Recommendation 5

In addition to external auditors' periodic reviews of Audit and Accounts Committee arrangements, the Council should consider introducing a formal requirement for a periodic self-assessment against CIPFA Standards to review the effectiveness of the Committee. The findings should be reported outside of the Audit and Accounts Committee, within the Council's normal reporting framework.

The results of risk assessments are not reported to the Audit and Accounts Committee, the Full Council or the Cabinet.

Recommendation 6

The Council should consider reporting risk assessments from the Strategic Risk Register to the Full Council, Cabinet or Audit

and Accounts Committee.

The risk assessment process is undertaken annually, however there is no feedback loop to re-evaluate risks throughout the year. There is a risk that the Council will not identify emerging risks or ensure agreed actions to mitigate risks are followed-through.

Recommendation 7

The Council should consider periodically re-evaluating annual risk assessments to monitor progress in mitigating risks and identify any emerging risks.

The risk assessment process is intended to incorporate the identification and management of fraud risk. In practice there is little evidence of consideration of fraud within risk management plans.

Recommendation 8

The Council should ensure that proper attention is given to identify and manage fraud risks within the annual risk-assessment process.

These recommendations relate to findings where we believe that the Council should implement changes in order to meet standards of good practice. We also noted some areas that the Council could consider implementing changes in order to meet standards of best practice. These findings are set out below and are not included in our Action Plan in Appendix A.

- The Council could consider submitting the Audit and Accounts Committee minutes to the Full Council for formal adoption.

- The Council could consider monitoring the implementation of external audit recommendations through the Audit and Accounts Committee.

4. Review of information technology controls

Our information systems specialist assessed the adequacy of controls over information technology. We concluded that controls over information technology are generally sufficient, with no significant deficiencies or material weaknesses.

Our recommendations are set out in detail below.

Findings and recommendations

We noted there are no documented policies and procedures in place to manage new starters and leavers. Without formal policies and procedures, there is a risk that, as key individuals leave the organisation, critical information will be lost or access not removed. Since there is also no periodic review of user access there is an increased risk of access inappropriate with user job responsibilities or loss of segregation of duties.

Recommendation 9

We recommend consideration be given to formally documenting policies and procedures for new starters and leavers and implementing user access reviews.

In addition to this formal recommendation, we also noted one further matter that the Council could consider implementing in order to meet standards of best practice:

- Where changes have been made to Oracle Financial Management System the Council could consider retaining documentation of testing including the objective, results, conclusion and formal sign-off to evidence that controls are in place.

5. Review of financial reporting controls

We found that the Council's processes and controls for financial reporting were generally sound with only a few weaknesses identified regarding journals, the details of these findings are documented below.

Findings and recommendations

It is Council policy to allow users with authorising permissions to authorise their own journals. This means that journal transactions are entered onto the ledger without any form of review. This increases the risk of inappropriate or incorrect entries. We also found that the value of journals is not taken into consideration in the authorisation of journals. Regardless of the sums involved the authorisation route is the same.

> **Recommendation 10**
>
> The Council should consider preventing users from raising and posting their own journal entries or should establish additional controls, such as management review of journals over a set de minimus, to mitigate the risk.

The Council has encountered some difficulties in ensuring that inter-departmental journals are accepted by the receiving department. The Council has developed a temporary procedure to manage this issue, before an integrated solution is implemented, whereby its Corporate Finance section maintains a spreadsheet of recharges that receiving departments are required to update to indicate that they accept the charge. Corporate Finance then raise and authorise the journal in the usual way. However, the spreadsheet is open to finance users and anyone could mark a journal as accepted, regardless of whether they had the appropriate authority to do so.

> **Recommendation 11**
>
> If the current temporary arrangements for interdepartmental recharges are likely to continue for a significant period of time, controls should be established to prevent users outside the Corporate Finance Team from making unauthorised amendments to the master document.

6. Review of Best Value Performance Plan

We reviewed the 2007 Best Value Performance Plan to check compliance with statutory guidance and minimum content. We found that the plan was compliant and an unqualified opinion was issued on 19 December 2007.

7. Review of closedown procedures and timetable

We reviewed the annual accounts closedown schedule and guidance issued to departments and consider they are adequate to obtain the necessary information within the timescale required for the preparation of the financial statements.

One opportunity for improvement was identified and is set out below.

Finding and recommendation

We found that there were no formal arrangements in place to ensure that Derby Homes' accounts were received by the agreed deadline and in the appropriate format. Although we recognise that this has not proved to be an issue in relation to the 2007-08 accounts formalising arrangements would provide additional assurance over the timeliness of the accounts consolidation and audit processes.

Recommendation 12

The Council should consider establishing a formal consolidation schedule with Derby Homes each year to ensure that dates for submission and audit, reporting requirements and arrangements for liaison between external auditors are agreed.

Appendix A: Action Plan

	Recommendations	Priority	Management Responses	Timescales
1	The Internal Audit strategy should include an explanation of how Internal Audit's resource requirements will be assessed and/or consider alternatives to Internal Audit investigations.	Medium	Agreed.	November 2008
2	The Council should consider updating the Terms of Reference to include the requirement that "The Head of Internal Audit must establish and maintain good working relationships and communication with members.'	Low	Agreed.	November 2008
3	Internal Audit should formally agree timescales for draft and formal reports to be issued for each audit.	Low	Agreed.	Actioned
4	The Council should consider reviewing the financial skills within the membership of the Audit and Accounts Committee against the Committee's Terms of Reference with a view to providing targeted training. The Council could also consider co-opting financial expertise on to the Committee.	Medium	Agreed. We will review the skills matrix of the Audit and Accounts Committee in order to establish the gaps in their financial expertise. Following discussion with the Corporate Director – Corporate & Adult Services, we do not feel that co-opting an independent Audit & Accounts Committee member would be beneficial to the objectives of this committee. We have previously provided a training programme to members covering risk management and financial management.	31st Dec 2008

	Recommendations	Priority	Management Responses	Timescales
5	In addition to external auditors' periodic reviews of Audit and Accounts Committee arrangements, the Council should consider introducing a formal requirement for periodic self-assessment against CIPFA Standards to review the effectiveness of the Committee. The findings should be reported outside of Audit and Accounts Committee, within the Council's normal reporting framework.	Medium	Agreed.	31st Dec 2008
6	The Council should consider reporting risk assessments from the Strategic Risk Register to the Full Council, Cabinet or Audit and Accounts Committee.	High	Agreed.	Audit & Accounts Committee December 2008
7	The Council should consider periodically re-evaluating annual risk assessments to monitor progress in mitigating risks and identify any emerging risks.	High	Agreed.	November 2008

	Recommendations	Priority	Management Responses	Timescales
8	The Council should ensure that proper attention is given to identify and manage fraud risks within the annual risk-assessment process.	High	Agreed.	October 2008
9	We recommend consideration be given to formally documenting policies and procedures for new starters and leavers and implementing user access reviews.	Medium	We do have a corporate managers induction checklist, which departments are required to follow. However, this included limited information regarding access to IT systems, hence we agree that this needs updating. We are currently undertaking a council wide HR review, which will entail the establishment of the Employee Services Centre. We intend to include any revision of the induction process, including controls around access to IT systems, within the e-recruitment strand. It is expected that this will be implemented in around 12 months. In the short-term (by 1 November 2008), we intend to issue guidance to managers across the Council, reminding them of their responsibilities regarding staff access to IT systems (new starters, leavers and transfers). Responsibility for user access reviews needs to be carried periodically by the system owners.	12 Months Assistant Director (HR)

	Recommendations	Priority	Management Responses	Timescales
10	The Council should consider preventing users from raising and posting their own journal entries or should establish additional controls, such as management review of journals over a set de minimus, to mitigate the risk.	Medium	We have previously tried to introduce this control within Oracle, however this was not technically possible. We can provide evidence of manual controls in the majority of accountancy teams, where printed copies of all journals are authorised. These will be extended to the remaining teams.	October 2008
11	If the current temporary arrangements for interdepartmental recharges are likely to continue for a significant period of time, controls should be established to prevent users outside the Corporate Finance Team from making unauthorised amendments to the master document.	Medium	Agreed. However we do not expect this arrangement to continue beyond January 2009. Only accountants have access to this facility, and excludes service staff.	N/a
12	The Council should consider establishing a formal consolidation schedule with Derby Homes each year to ensure that dates for submission and audit, reporting requirements and arrangements for liaison between external auditors are agreed.	Low	Agreed.	April 2009

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