

THE HIGHLAND COUNCIL

AUDIT AND SCRUTINY COMMITTEE – 12TH JUNE 2008

Agenda Item	
Report No	

Statement on Internal Control and Annual Report 2007/08

Report by Interim Head of Internal Audit and Risk Management

SUMMARY

The attached report includes an assessment of the adequacy, reliability and effectiveness of the Council's system of internal financial control and provides information for the Council's Corporate Governance Assurance Statement. This is contained within the Statement on Internal Control.

The annual report provides an overview of the Internal Audit Section's activities during 2007/08.

1. Statement on Internal Control

1.1 In order to comply with the requirements of the 2002 Code of Practice for Local Authority Accounting, a Statement on Internal Control must be produced. Section 2 of the attached report gives details relating to the Statement on Internal Control and the sources of information which inform the Statement.

1.2 On the basis of the work undertaken during the year, it is considered that the key systems operate in a sound manner and that there has been no fundamental breakdown in control resulting in material discrepancy. However as no system of control can provide absolute assurance against material loss, nor can Internal Audit give that assurance, it is the audit opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control systems for the year to 31st March 2008.

2. Annual Report 2007/08

2.1 The report gives an overview of the Section's activity during 2007/08 and provides performance information to allow comparison with previous years.

RECOMMENDATION

Members are invited to note the content of the attached report and to raise any relevant points.

Signature:

Designation: Interim Head of Internal Audit and Risk Management

Date: 28th May 2008



The Highland Council

Statement on Internal Control and Annual Report 2007/08

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1. INTRODUCTION

- 1.1 The purpose of this report is to provide an assessment of the adequacy, reliability and effectiveness of the internal control systems within the Council. This complies with the requirements of the 2002 Code of Practice for Local Authority Accounting which requires either a Statement on the System of Internal Financial Control or the wider Statement on Internal control to be included within the Council's financial statements. These statements require certain information to be addressed, including information on internal audit standards, reporting arrangements and the effectiveness of the system of internal financial control. In respect of the Highland Council a Statement on Internal Control is produced and this is provided in Section 2 of this report.

- 1.2 This report also includes an overview of the Internal Audit Section's activities for the financial year 2007/08 and also considers the issues to be faced during 2008/09.

2. STATEMENT ON INTERNAL CONTROL

2.1 Responsibilities for Internal Control

The Council's Financial Regulations require Service Directors to ensure the principles of internal control are incorporated in the working practices of their Services.

The primary objective of Internal Audit is to review, appraise and report upon the adequacy of risk management and internal controls as a contribution to the proper, economic, efficient and effective use of resources. In addition, the other objectives of the function are to:

- support the Director of Finance to discharge duties as Proper Officer in terms of Section 95 of the Local Government (Scotland) Act 1973;
- contribute to and support the Finance Service's objective of ensuring the provision of, and promoting the need for, sound financial systems;
- support the corporate Best Value process by conducting VFM (Value For Money) studies;
- provide a quality fraud and irregularity investigation service which safeguards the public pound.

2.2 Internal Control

Internal control is defined as "the whole system of checks and controls, financial or otherwise, established by management in order to provide reasonable assurance" regarding the achievement of one or more of the following objectives:

- the reliability and integrity of information;
- compliance with policies, plans, procedures, laws, regulations and contracts;
- the safeguarding of assets;
- the economical and efficient use of resources;
- the accomplishment of established objectives and goals for operations or plans.

Any system of control can only provide reasonable, and not absolute assurance that control weaknesses or irregularities do not exist, or that there is no risk of material errors, losses, fraud or breaches of laws and regulations. Accordingly the Council seeks continual improvement in the effectiveness of its systems of internal control.

2.3 Internal Audit

Internal Audit is an independent appraisal function established by the Council for the review of the internal control system as a service to the Council. It objectively examines, evaluates and reports upon the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources.

The Internal Audit Section operates in accordance with the requirements of the CIPFA Code of Practice for Internal Audit in Local Government. As required by the Code, a risk based tactical audit plan is produced each year, and submitted for information to the Audit and Scrutiny Committee.

2.4 Evaluation of Control Environment

An evaluation of the control environment is informed by a number of different sources:

- the audit work undertaken by the Internal Audit Section during the year to 31st March 2008;
- the assessment of risk completed during preparation of the annual tactical plan;

- a high level review of the adequacy and effectiveness of the Council's systems of internal control as they relate to corporate governance, risk management and performance monitoring arrangements.

2.5 Areas of concern

Any areas of concern identified from an audit review will result in an audit recommendation being made which is contained within an action plan. These recommendations are given a priority grading (classified from 1 to 4, with 1 being the most serious). The grade 1 classification is given where the findings identified that a key internal control was missing for a major element of the system under review or was seriously inadequate; there was a failure to comply with the controls in place; or there was serious breach of Council policies and/ or procedures.

During 2007/08, a total of 137 audit recommendations were made. Of these, 14 were classified as grade 1 and details of the specific audit concerns are detailed in Table 1 below.

Table 1

Audit Report	Area of Concern	Audit Update	Comment/
HA27/002 Grants to Voluntary Organisations	The Corporate Governance arrangements surrounding the Council's transactions with the Voluntary Sector need to be addressed in order to ensure that Best Value is being achieved by the Council.	This is scheduled for a follow up audit review in 2008/09.	
HB10/002 Compliance with RIP(S)A	Although the Highland Council Regulation of Investigatory Powers (Scotland) Act (RIPSA) policy complies fully with the requirements of the Act, this is not adhered to in all respects. As a consequence, the Council cannot gain assurance that officers are following the legal framework set down by the Act. Furthermore it cannot be assured that RIPSA compliance work is being performed effectively and efficiently.	This is scheduled for a follow up audit review in 2008/09.	
HC19/003 Building Cleaning Contract - Client Monitoring	The contract has been in place since 2000 and still forms the basis for the provision of cleaning services. The Service therefore needs to review its arrangements for service delivery and ensure that these provide best value.	Work is ongoing in this area to carry out an options appraisal to ensure that Best Value is being obtained. Following this, Service Level Agreements or equivalent will be prepared.	

Audit Report	Area of Concern	Audit Update	Comment/
HH15/003 Private Use of Council Vehicles	<p>(1) There is currently no central record of the employees who are authorised to take vehicles home.</p> <p>(2) Analysis of the returns provided by Service management detailing all employees who currently take vehicles home, indicated that in 68% of cases the reason for the vehicle being taken home was questionable</p> <p>(3) The majority of Council vehicles do not have log books for recording basic information regarding the use of the vehicle</p>	This is scheduled for a follow up audit review in 2008/09.	
HK09/004 Debtors	<p>(1) The date of supply should be shown on the debtor invoice in order to comply with VAT regulations and for the information of the customer. It was found that this had not been completed in one third of the invoices examined.</p> <p>(2) The Finance Service procedure "Accounts Receivable – Recovery and Enforcement Timescales" has not been fully adhered to in the pursuit of outstanding debtors since the implementation of the new system.</p> <p>(3) The number and value of invoices marked as "in dispute" has significantly increased.</p>	<p>This was a follow up review of the previous report issued in May 2006. The current status is as follows:</p> <p>(1) Officers raising invoices have been reminded of the need to provide a date of supply on the invoice. The introduction of a report to highlight where the date of supply had not been completed or was beyond 14 days from the date of supply was investigated but the cost has proved prohibitive.</p> <p>(2) The procedure has been reviewed and action is taken to ensure that the pursuit of debt is up to date.</p> <p>(3) In dispute invoices are regularly monitored but there are ongoing problems.</p> <p>An audit of Debtors has recently commenced and part of the scope will be to look at these invoices, to identify why there has been such an increase and recommend solutions to the current problems.</p>	

Audit Report	Area of Concern	Audit Update	Comment/
HK11/008 General Ledger - Journal Entries and Internal Recharges	In attempting to trace a sample of internal charges back to their source, it was frequently found that the credits to the cost centre which bore the original expenditure was posted to an income subjective code, rather than the original expenditure subjective code.	This has been actioned and the Corporate Finance training module has been adjusted to explain when a credit should be posted to an income code. There were 6 Corporate Finance training sessions arranged in the second half of the financial year 2007/08 and these are ongoing.	
HL18/003 Performance Indicators	<p>The 4 Statutory Performance Indicators (SPIs) listed below were classified as unreliable as the requirements of Financial Regulations had not been met. These instruct Service Directors to establish and maintain systems and procedures to ensure that the required information is gathered, and adequate audit trails are maintained.</p> <p>(1) ASW1: Community Care Services. The Council failed to report this indicator, as occurred also in 2005/06. Despite staff being informed by the Director of Social Work Services and the Head of Operations (Community Care) to provide full and accurate information for the indicator, it had not been collected correctly.</p> <p>(2) WM5: Abandoned Vehicles. This was a new indicator for 2006/07, and clear guidance on cases which were eligible for inclusion was provided by Audit Scotland. Despite this, the figures submitted did not comply with the guidance provided.</p> <p>(3) CC6: Learning Centre and Learning Access Point Users. The SPI information was incomplete due to missing data relating to Inverness Library.</p> <p>(4) WM2: Refuse Collection Complaints. There was a lack of supporting documentation to evidence that the figures reported comply with the guidance provided by Audit Scotland.</p>	Performance Indicators are audited on an annual basis. Included within the annual audit scope is the follow up of the audit recommendations relating to the previous year's report.	

2.6 Action Tracking

It should be noted all of the above areas of concern have been agreed with Management who are responsible for taking the necessary action to address these. As part of the audit process, these are action tracked to ensure that the agreed actions have been implemented. The results of this action tracking process are reported to the Audit and Scrutiny Committee on an annual basis (see also section 3.5).

3. OVERVIEW OF 2007/08

3.1 Performance against 2007/08 Tactical Plan

The 2007/08 tactical plan was presented to the Audit and Standards Committee on 21/03/07. Progress against the plan is reported as a standing item at each Committee meeting. There were a total of 67 planned audits/ activities for this year, of which 26 were not undertaken. As part of the process of producing the 2008/09 tactical plan, any audits not undertaken the previous year are considered and where the risk score is high enough, the audit was carried forward to this year's plan. For 2008/09 this was any audit with a risk score of 170 or above, and 15 such audits were included. The remaining 11 which were not undertaken are detailed in Table 2 below.

Table 2

<i>Ref</i>	<i>Audit</i>
HA05/001	Business Improvement Team
HC31/001	Phoenix System. This IT system is due to be replaced by a new web based system.
HC41/001	School Transport
HF01/003	Accommodation Account
HF03/002	Capitalised Maintenance
HF14/003	Revenue Maintenance
HG11/001	GIRFEC. This project is still ongoing and therefore it was agreed that it was not appropriate to audit it at this time.
HK35/001	Treasury Management System
HL07/002	Information Management
HL26/001	IT Data and Software File Controls
HL31/001	IT Programme & Project Management Controls

Unless stated otherwise, the audits detailed above could not be undertaken due to other demands upon audit time such as:

- 2 fraud investigations this year which consisted of :
 - (1) The purchase of inappropriate equipment and their subsequent theft by an employee. This equipment was not required for Council purposes but instead was purchased for personal use. This former employee has since appeared in Court on this matter.
 - (2) The misuse of the School Fund and other financial irregularities by a former Head Teacher. Again this resulted in a Court case where the former Head Teacher pled guilty to fraud and embezzlement.
- Unplanned audit work. Although there is a contingency allowance for unplanned work, this proved to be insufficient.
- Systems development advice.

In considering the work of the Internal Audit section it is important to note that an audit service is also provided to the following organisations:

- Northern Constabulary;
- Highlands and Islands Fire Service;
- Assessors;
- Eden Court
- a computer audit service is provided to the three Islands; Orkney, Shetland and Comhairle nan Eilean Siar.

3.2 Staffing Issues

This year has been difficult due to a number of staffing changes:

- David Moreton, Senior Auditor left the Section on 8th June 2007 for a 2 year secondment to the Business Improvement Team. Donna Sutherland, Auditor was appointed from within the Section to cover this post for the duration of

the secondment period. Jason Thurlbeck was recruited externally as a Temporary Auditor.

- Linda Mackay, Auditor left the Section on 24th March 2008 to take up a post with the Housing and Social Work Accounting Team.
- George Munro, Head of Internal Audit and Risk Management retired from 7th April 2008 but his last working day was on 28th March.

Following on from the secondment of the Senior Auditor, it was decided to change the operational arrangements within the Section. Previously there were two generic audit teams led by the Principal Auditor and Senior Auditor respectively. Each Team was allocated specific Services/ areas of expertise and had their own workloads. However the Principal Auditor now co-ordinates and manages the work of the whole team and is supported by the Senior Auditor in this respect. The objectives of this revised arrangement were to ensure that:

- there is greater flexibility in allocating audits to staff, thus ensuring that high risk areas are given priority.
- there is greater ability to respond to fraud/ irregularity exercises.
- staff have a more varied workload and thus achieve greater job satisfaction.
- there is a consistent approach to the conduct of audit reviews

A separate team continues to operate for computer audit due to its specialist nature but it is ensured that their work is co-ordinated with the generic audit team.

A recent review of these arrangements has shown that they are working well and the above objectives have been met.

The Section has a number of successes this year with regard to professional training:

- Lorna Forward and Laura Maclean both Audit Assistants, obtained their PIIA qualifications;
- Norma Duncan, Computer Audit Assistant, obtained the QICA qualification;
- David Martin, Audit Assistant passed his ACCA finals and is in the process of his logbook being approved in order to give him full membership of the profession.

This means that all members of the Section are qualified at least to Practitioner level.

3.3 Audit and Scrutiny Committee

The new Council in May 2007 brought about the change whereby the Audit and Standards Committee changed to the Audit and Scrutiny Committee which is chaired by a Member of the Opposition Group. The remit of this Committee makes the following references to scrutiny:

- Section 2.10: "the Committee should prepare a workplan, for the Council's approval, in relation to monitoring the performance of the Council, and funded third party organisations, against service delivery and to make recommendations to the Council on proposed actions."
- Section 2.11: "the Committee should deal with matters referred to the Committee by the Council for scrutiny purposes."

Following a report from the Head of Internal Audit and Risk Management it was agreed that the scrutiny role would be undertaken as follows

- a Working Group of 8 Members, reflecting the political balance of the Council, be established.
- initially, the Group undertake a pilot study, based on the Council's relationship with small businesses in the Highlands. This pilot study is presently ongoing.

- staff from the Internal Audit Section would provide the initial manpower for any research and advisory work for the pilot study. This has been provided by the Head of Internal Audit and Risk Management.

3.4 McClelland report

A report published in March 2006 (known as the McClelland report) proposed significant changes to the procurement landscape in Scotland. Included within this report is the recommendation that Internal Audit should carry out annual work on the procurement governance framework for all organisations in the public section.

To address this recommendation a sub-group of the Scottish Local Authorities Chief Internal Auditors Group (SLACAIG) produced a procurement audit tool kit. This uses a checklist to obtain assurances in relation to seven objectives deemed critical success factors in the procurement process, based on the recommendations of the McClelland report and best practice. George Munro was a member of the sub-group and they have recently won a prize from the CIPFA Cliff Nicolson Award for Innovation and Excellence for outstanding work in the field of audit.

The tool kit has been used recently within Highland Council and the results of this audit will be reported in due course to Committee.

3.5 Action Tracking through Galileo

Galileo, the Section's automated Audit Management System was further developed this year to use the Action Tracking facility. Previously a manual "follow up" process was used which relied upon the appropriate Auditor to trigger the follow up review.

The process within Galileo allows all recommendations and agreed actions to be followed up (action tracked) to ensure that these have been action by Management as previously agreed. A member of staff has been assigned responsibility for action tracking to ensure that these are undertaken in a timely manner and that all recommendations are tracked appropriately. There is a reporting facility within Galileo to monitor the progress of the action tracking and the system provides a database of all audit recommendations which was not previously available under the manual systems. This allows a record of all audit recommendations to be built up over time with trends and themes established. For example this can highlight where there are the same issues crossing a number of different Services or if the same issues continue to emerge in the same Service.

4. PERFORMANCE INDICATORS FOR 2007/08

4.1 2007/08 Performance Indicators and comparison with previous years

Performance Indicators play an important role in the measurement of efficiency and the following indicators were developed based upon benchmarked best practice.

Table 3

Improvement Area	Performance Indicator	2005/06	2006/07	2007/08
Human Resources	Annual training hours per member of staff (hours)	74.75	39.56	29.84
	Percentage of qualified staff (%)	71.7%	71.7%	100%
Productivity	Percentage of audit universe covered (%)	20.4%	16.7%	23.1%
	Actual days against planned audits (%)	81.1%	74.5%	82.9%
Quality	Percentage of recommendations accepted by management (%)	99.5%	96.6%	98.5%
	Customer satisfaction (%)	91.5%	85.0%	83.0%
	Number of complaints	0	0	0
Profile	New system developments involving Internal Audit (%)	N/A	100%	100%
	Average time elapsed from issue of draft to final report (days)	60	59	58

4.2 Comments

Overall the Performance Indicators show an improvement in performance which accords with the Section's aim of continuous improvement in our operations. The following comments are provided upon the information contained in Table 3 above.

(1) Annual training hours per member of staff/ Percentage of qualified staff

The annual training hours figure has decreased steadily as members of staff have completed their professional training. The high level of support provided by the Finance Service has allowed this, and this is the first year in which the Section can boast of all staff holding an appropriate professional qualification.

(2) Customer satisfaction

This PI shows a slight decline over the years. A system has now been established to ensure that any negative comments are investigated and actioned.

(3) Average time elapsed from issue of draft to final report

This is showing a gradual decrease each year but still falls short of the 30 day target. For those final reports issued during this year, 53% were issued after the target dates. This is an area which remains under constant review with action taken to resolve any issues where there are problems in agreeing the final report and the corresponding action plan.

5. THE FUTURE

5.1 Staffing

The 2008/09 Tactical Plan was approved by the Audit and Scrutiny Committee on 17th April 2008. The report accompanying the plan highlighted the staffing situation whereby the Section was carrying two vacancies and consequently the available resources were less than normal. Consequently the number of planned audit reviews is less than previous years. Action has been taken to address the staffing issue with the Head of Internal Audit and Risk Management post in the process of being advertised. Recent interviews have resulted in Jason Thurlbeck being appointed on a permanent basis to the post of Auditor and David Martin being appointed Acting Auditor which will continue until the Senior Auditor returns from secondment. Therefore this has created the post of temporary Audit Assistant and arrangements are under way to fill this post.

5.2 Galileo

An arrangement is in place with Comhairle nan Eilean Siar who use Galileo for the purposes of using the same working practices and sharing of common information such as audit work programmes. An approach has been made by two other Councils investigating a similar arrangement under the "shared services agenda". Discussions were recently held and the system has been demonstrated to both Councils. It is envisaged that the use of Galileo within the Internal Audit Section will continue to provide many benefits including:

- a greater consistency of working practices.
- enhanced reporting of information.
- fuller access to working papers and work programmes and sharing of information between staff.

5.3 Best Value

In view of the fact that staff have undergone a change of working with regard to the arrangements referred to at section 3.2 above, and in view of the learning curve associated with the introduction of Galileo, the Section's annual Best Value review was not undertaken during 2007/08. However, it is envisaged that a formal review will be undertaken during the coming year.

5.4 Systems Development

It is important that Internal Audit are approached to act in an advisory role with regard to ensuring that appropriate system controls are included in the design stage of any project. This is therefore an important element of future work, and it is important to note that staff from the Section are consulted in this respect.