

THE HIGHLAND COUNCIL

Audit and Scrutiny Committee

Date: 11th June 2009

Agenda Item	3
Report No	AS/09/09

Statement on Internal Control and Annual Report 2008/09

Report by 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 2008/09 and considers the issues to be addressed during 2009/10.

1. Statement on Internal Control

- 1.1 In order to comply with the requirements of the CIPFA/ LASSAC Code of Practice on 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 2009.

2. Annual Report 2008/09

- 2.1 The report gives an overview of the Section's activities during 2008/09 and provides performance information to allow comparison with previous years. It also considers future issues which will be addressed during the forthcoming year.

Recommendation

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

Signature:

Designation: Head of Internal Audit and Risk Management

Date: 21st May 2009

Ref:

Background Papers

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The Highland Council

Statement on Internal Control and Annual Report 2008/09

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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 CIPFA/ LASAAC Code of Practice for Local Authority Accounting in the United Kingdom (the SORP 2008) 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 2008/09 and also considers the issues to be addressed during 2009/10.

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 2009;
- 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 2008/09, a total of 126 audit recommendations were made. Of these, only 2 were classified as grade 1 and details of the specific audit concerns are detailed in Table 1 below. As these audits contain grade 1 findings, both have been scheduled for a formal follow-up review during 2009/10.

Table 1

Audit Report	Area of Concern
HA009/001 Common Good Funds	The absence of an overarching policy and guidance on administering Common Good Funds reduces the Council's ability to demonstrate good governance processes and exposes the Council to reputational risk, as a lack of direction and guidance may lead to inappropriate practices.
HK07/003 Use of Contract Suppliers	Payments had been made to suppliers where, due to the sums involved, both the EU threshold for contracts (£144,371) and Contract Standing Orders (supplies and services £25,000) had been breached. It was found that no contracts were in place despite the value of payments made. Furthermore there were occasions when the recognised contract supplier had not been used.

2.6 Action Tracking

It should be noted all of the above areas of concern have been agreed with Management who will take 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 a six-monthly basis.

2.7 Audit Opinion

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 2009.

3. OVERVIEW OF 2008/09

3.1 Performance against 2008/09 Tactical Plan

The 2008/09 tactical plan was presented to the Audit and Standards Committee on 17/04/08. Progress against the plan is reported as a standing item at each Committee meeting as part of the internal audit reviews and progress report. In addition, details are provided of any adjustments required (additions and deletions) to the tactical plan. There were a total of 51 planned audits/ activities for this year, of which 27 were not undertaken. Details of these deleted audits together with appropriate explanations were provided to Committee on 14/08/08 and 12/02/09 respectively. A significant addition to the plan was work in respect of Caithness Heat and Power, which is addressed in more detail at section 3.4 below.

The deleted audits referred to above were discussed with Directors as part of the consultation process in producing the 2009/10 tactical plan. Consequently, a number of these audits have been carried over into the 2009/10 tactical plan.

As referred to above, the reasons for the failure to complete the 2008/09 tactical plan have been reported to Committee and can be summarised as follows:

- Staff vacancies (see Section 3.2)
- Caithness Heat and Power (see Section 3.4)
- Fraud investigations (see Section 3.5)
- Provision of advice in respect of the ICT Re-procurement project has impacted upon the planned computer audits. In addition, the Computer Auditor has been appointed as a member of the Internal Quality Team.

3.2 Staffing Issues

The staffing changes from 2007/08 continued to impact upon the Section during this year. These arose due from vacancies and the associated acting up arrangements within the Section which are detailed below.

- Nigel Rose was appointed as Interim Head of Internal Audit and Risk Management from 8th April 2008. He was later appointed permanently to the post on 13/08/08.
- During these interim arrangements, Donna Sutherland, Temporary Senior Auditor became the Acting Principal Auditor as cover for Nigel Rose. Following interviews, this became permanent on 28/11/08.
- David Martin, following a period of acting up, successfully gained promotion to the permanent post of Auditor on 08/03/09.
- Jason Thurlbeck was appointed to a permanent Auditor's post, but later left the Section on 09/02/09 to take up a senior appointment with UHI.
- Laura Mackenzie, Audit Assistant left the on section on 04/01/09.

During this time, the opportunity was taken to restructure the section and this was approved by the Resources Committee on 18/02/09. This restructuring resulted in two vacancies at Auditor level.

An Auditor was due to return to the section at the end of June 2009, following a two year secondment with the Business Improvement Team. However, he has now taken up a Project Manager post with the Corporate Improvement Team, which is a three year secondment.

3.3 Audit and Scrutiny Committee

Changes to the political make up of the Council's administration, resulted in the Committee Chair changing in August 2008 from Dr David Alston (Liberal Democrat) to Mrs Jean Urquhart (SNP).

The Scrutiny Pilot Study on the Council's relationship with small businesses was completed and reported to Committee on 04/12/08. Following on from the experiences learnt from the pilot study, a framework for the performance of scrutiny reviews was produced by the Head of Internal Audit and Risk Management, and this was agreed by the Committee on 19/02/09. With regard to future scrutiny reviews, it was also agreed that support would continue to be provided from the Head of Internal Audit and Risk Management and staff from the Internal Audit Section. In addition, the clerking duties of all working group meetings are provided by a Committee Administrator.

Provision of 60 days of internal audit time has been made within the 2009/10 tactical plan to accommodate 2 scrutiny reviews. The planned reviews will scrutinise the efficiency agenda within the Council and the effectiveness of the Councils corporate parent role with regard to looked after children.

3.4 Caithness Heat and Power (CHaP)

In April 2008, the Interim Head of Internal Audit and Risk Management was asked to meet with Officials from Caithness Heat and Power, following a request from the company for further financial assistance from the Council. The undernoted issues arising from this meeting were reported to the Council on 08/05/08.

- A lack of robust financial control;
- Concerns as to the financial viability of the project;
- Legal issues;
- Technical issues.

Following this Council meeting, two members of staff from Internal Audit were appointed to an Operational Team comprised of Council officers. The work undertaken by the Team involved evaluating the situation, establishing some key financial controls and advising the CHaP Board. This support continued throughout the year but input was reduced to one member of staff from September 2008.

In February 2009, the Council was informed that Internal Audit had been given the remit to undertake an audit of the project, and this work is currently in progress.

3.5 Fraud and Irregularity Investigations

During 2008/09, the Internal Audit section was involved in 7 fraud and irregularity investigations totalling 169 days. In particular, one of the investigations has proved to be extremely time consuming and whilst ongoing, is nearing closure.

It is important to note that where fraud and irregularities have occurred, in addition to the investigation, the internal audit work also includes a "system weaknesses" review which identifies the issues which led to the problems occurring and makes recommendations to address these. Whilst the details of the investigations remain confidential and dealt with by Management, the system weakness reports are reported to Committee.

Of the 7 investigations referred to above, 3 of these are now complete. For the remainder, these are awaiting the outcome of Police investigations and/ or internal disciplinary hearings. However, the findings from these investigations do not constitute any material weaknesses in the Council's systems of internal control. On the contrary, it has been found that there are appropriate policies, procedures and systems in place, instead, the frauds and irregularities have arisen from the failure to comply with these.

This year has necessitated a particularly high number of days spent on investigations. In recognition of this and in line with best practice which has suggested that organisations are at greater risk of fraud due to the current recession, an increased number of days for investigations has been allowed for in 2009/10.

4. PERFORMANCE INDICATORS FOR 2008/09

4.1 2008/09 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

Improvement Area	Performance Indicator	2006/07	2007/08	2008/09
Human Resources	Annual training hours per member of staff (hours)	39.56	29.84	13.93
	Percentage of qualified staff (%)	71.7%	100%	100%
Productivity	Percentage of audit universe covered (%)	16.7%	23.1%	23.1%
	Actual days against planned audits (%)	74.5%	82.9%	42.8%
Quality	Percentage of recommendations accepted by management (%)	96.6%	98.5%	100%
	Customer satisfaction (%)	85.0%	83.0%	86.0%
	Number of complaints	0	0	0
Profile	New system developments involving Internal Audit (%)	100%	100%	100%
	Average time elapsed from issue of draft to final report (days)	59	58	47

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 X above.

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

This continues to show a downward trend as all members of staff hold the appropriate professional qualifications, which has shown as 100% qualified staff for the last two years. However, all staff continue to receive training to meet their Continuing Professional Development (CPD) needs and to ensure that they are aware of best practice in the profession.

(2) Actual days against planned audits

This decrease in performance is due to the number of deleted audits already referred to in Section 3.1. Despite the reduction in audits performed, it is reassuring to note that the "quality" indicators show an improvement in performance for those audits which were undertaken.

(3) Customer satisfaction

This indicator had shown a slight decline over the years, but has shown an improvement this year. This follows the implementation of a system to ensure that any negative comments are investigated and actioned.

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

This shows a marked improvement this year and thanks are expressed to all client officers who have contributed to this by providing prompt responses to draft reports.

5. THE FUTURE

5.1 Staffing

The lack of staffing resources continues to be an issue and the Section currently has three vacancies consisting of, 2 permanent and 1 two-year fixed term posts of Auditor. These posts have been advertised, and interviews will take place in June 2009.

It is essential that the days lost through vacancies are kept to a minimum in order that achievement of the tactical plan is not compromised and that there is sufficient coverage to ensure that the appropriate internal audit assurances can be provided to Management and the Council's External Auditors.

The new staffing structure will be monitored to ensure that this is working effectively and that this continues to best meet the needs of Section, and the expectations of all stakeholders.

5.2 Planned Improvements

A key requirement of the Council's Best Value regime is continuous improvement in all operations. As part of the Finance Service's Plan for 2009-11, the following improvements were identified for the Internal Audit Section:

- Review the operation of the Audit Management System (Galileo) and revise the user Manual accordingly to ensure that audits are undertaken in the most efficient way.
- Revision of the Employment Development Programme to ensure this continues to reflect the ongoing training requirements of the Section. This review will also consider the recommendations from the CIPFA guidance "The Excellent Internal Auditor."