

Meeting:	Cabinet
Date:	16 February 2006
Subject:	Internal Audit
Responsible Officer:	Myfanwy Barrett Director of Financial and Business Strategy
Contact Officer:	David Ward Group Manager Audit & Risk Management
Portfolio Holder:	Sanjay Dighe Business Connections and Performance
Key Decision:	No
Status:	Part 1

Section 1: Summary

Decision Required

To note the reference from the Audit Committee.

Reason for report

To alert Cabinet to an issue raised at the Audit Committee, in accordance with the Audit Committee's monitoring role.

Benefits

As above.

Cost of Proposals

None directly associated with noting this report.

Risks

None associated with noting this report.

Implications if recommendations rejected

Weakening of the Audit Committee's monitoring role.

Section 2: Report

2.1 Brief History

2.1.1 The Internal Audit Half Year Progress report (2005/6) was presented to the Audit Committee at its meeting on 26th January 2006.

2.1.2 The report highlighted some concerns over the lack of implementation of previous Internal Audit recommendations by management in relation to the Council's key financial systems.

2.1.3 The lack of implementation also drew comment from the Council's external auditors, in their annual audit letter.

2.1.4 The Committee considered the resources of the Internal Audit function and back office systems generally and decided to draw this to the attention of Cabinet, as per the resolutions attached at the appendix.

2.1.5 The Director of Financial and Business Strategy will follow up the concerns in consultation with the Portfolio Holder to ensure that improvements are made in 2006-07.

2.2 Options considered

2.2.1 Not applicable.

2.3 Consultation

2.3.1 None.

2.4 Financial Implications

2.4.1 This is a recommendation from the Audit Committee and deals with financial matters throughout.

2.5 Legal Implications

2.5.1 The work of Internal Audit assists the Authority to gauge its performance in line with the comprehensive assessment requirements as set out in Section 99 of the Local Government Act 2004.

2.6 Equalities Impact

2.6.1 None

2.7 Section 17 Crime and Disorder Act 1998 Considerations

2.7.1 Progress towards embedding the requirements of the Crime and Disorder Act is a specific focus of audit reviews.

Section 3: Supporting Information/Background Documents

Appendix 1 – Report of the Director of Financial and Business Strategy: Internal Audit Half Year Progress 2005/06

Appendix 2 – Reference from the Audit Committee



Meeting:	Audit Committee
Date:	26 th January 2006
Subject:	Internal Audit Half Year Progress Report 2005/06
Responsible Officer:	Myfanwy Barrett, Director of Financial and Business Strategy
Contact Officer	David Ward, Group Manager, Audit and Risk Management
Portfolio Holder:	Sanjay Dighe, Business Connections and Performance
Key Decision:	No
Status:	Part I

Section 1: Summary

This report summarises progress against the 2005/06 audit plan and key issues arising from work undertaken. It concentrates on the results from key control reviews of fundamental financial systems.

Decision Required

That the Committee considers the findings of the report and decides on any action it wishes to take in monitoring management progress with implementing improvements in the council's control environment.

Reason for Report

The Code of Practice for Internal Audit in Local Government requires regular reports on audit work undertaken to be brought to

the attention of the Audit Committee.

Benefits

Supports the role of the Audit Committee in contributing to the maintenance of an effective internal control environment.

Cost of Proposals

N/A

Risks

None associated with noting the report.

Implications if Recommendations Rejected

Weakening of the Committee's corporate governance role.

Section 2: Report

2.1 Brief History

- 2.1.1 During the first quarter of each year, the internal audit workload centres around key control reviews in relation to the council's fundamental financial systems. Thereafter, planned reviews are undertaken on a prioritised approach with regard to available resources and perceived risk.
- 2.1.2. As anticipated for 2005-06, continued staffing shortages in the audit team have had an impact on the planned work and during the early part of the year some resources were concentrated towards finalising the 2004-05 audit work.
- 2.1.3 Importantly, the key control reviews of core financial systems were fully completed within the timescales required by the council's external auditors, who rely on this work to support their findings.
- 2.1.4 An analysis of the findings from the reviews of fundamental financial systems is set out in the appendix.

Key Findings

- 2.1.5 Although there has been an overall improvement of 6% on the previous year (11% cumulative improvement over the past 2 years), there are still a significant number of expected controls only partly operating across the systems and a small number that are not operating at all.
- 2.1.6. In addition, as part of the reviews, the recommendations made by internal audit in 2003-04 were followed up within each system and only a relatively low number of these recommendations were found to be implemented (see appendix). This is expected to draw comment from the council's external auditors again and have an adverse impact on the CPA Use of Resources score.
- 2.1.7 In order to encourage managers to implement the recommendations an earlier follow-up procedure is being introduced, in December 2005.
- 2.1.8 In addition the results set out in the appendix are being circulated to Directors and managers.
- 2.1.9 The importance of implementing audit recommendations has also been stressed as part of the compulsory "Harrow Rules" training for all council managers.
- 2.1.10 The development of line management assurance, which will be a key tool to encourage more responsive action by managers, is being brought forward. The process will be piloted and implemented during the current financial year.

Other Audit Work Currently in Progress

- 2.1.11 Following the completion of the key control reviews the team is now progressing with the reviews planned for 2005-06. Work is currently underway on the following, the results from which will be reported to the Committee at the year end:-

- Emergency planning
- Housing repairs partnership review
- Budget management (Urban Living)
- Commercial rents
- Asylum seeker payments
- Grants to voluntary organisations
- Domiciliary care commissioning
- School audits
- Schools development service
- Network infrastructure
- E-Government

- Identity fraud (anti-fraud and corruption)
- Irregularity reviews

Internal Audit Team Developments

- 2.1.12. Although the internal audit team currently has 2 vacant auditor posts, the position of Senior Professional (Internal Audit) has now been filled and the post-holder joined the team on 3rd October. This is a key post which will manage the IT audits and high level reviews / investigations. This post is particularly important in respect of the new systems that will be introduced as part of the BTP.
- 2.1.13. Recruitment campaigns are underway to fill the remaining posts using a variety of methods to attract candidates. It is hoped that these will be filled by the end of the calendar year. ACIT contract staff are being utilised to achieve the planned work until the permanent posts are filled.
- 2.1.14. Since the Internal Audit and Risk Management Group is a relatively new amalgamation of skills under the new MMR structure the team has taken the opportunity to review its strategy for delivering quality services across the council with a risk-based approach.
- 2.1.15. Based on customer feedback and best practice, a wide range of potential developments have been identified by the team. These will be presented to the Committee for consideration at a future meeting in the current year, together with a new draft three-year strategic plan.

2.2 Options Considered

N/A

2.3 Consultation

The report findings have been considered by the council's senior management team.

2.4 Financial Implications

This is a report by the Director of Financial and Business Strategy and deals with financial matters throughout.

2.5 Legal Implications

Compilation of this information from internal audit assists the Authority to gauge its performance in line with the comprehensive performance assessment requirements as set out in Section 99 of the Local Government Act 2004.

2.6 Equalities Impact

N/A

Section 3: Supporting Information/Background Documents
Appendix – Audit of Core financial Systems.

AUDIT OF CORE FINANCIAL SYSTEMS

Introduction

- 1 Internal Audit undertook a key control review on the following systems as part of the agreed approach to the audit of the Authority's core financial systems for the financial year 2004/2005:
 - Non-domestic Rates (NDR)
 - Creditors

- 2 In addition follow-up reviews were undertaken on the following systems:
 - Council Tax
 - Debtors
 - Housing Benefits
 - Housing Rents
 - Payroll

- 3 The testing strategy used for the reviews was based on CIPFA Control Matrices and also agreed with the external auditors for reliance purposes. A minimum sample size of 24 (2 transactions per month) was used from 2004/2005 financial records for the full reviews and a minimum sample of 2 transactions per month from the implementation of the agreed action for follow-up reviews to confirm the application of key controls.

Overview

- 4 Overall out of a total of 65 key controls reviewed 44 (68%) were operating satisfactorily, 18 (28%) were partially operating and 3 (4%) were not operating. The position for each system reviewed is shown below (excluding Payroll as this involved a follow-up review for the second year running), figures in brackets relate to 2003/2004:

<u>SYSTEM</u>	NUMBER OF CONTROLS	FULLY OPERATING	PARTIALLY OPERATING	NOT OPERATING	OVERALL RATING
Housing Benefit	10 (10)	90% (80%)	10% (20%)	(0%)	95% (90%)
Debtors	14 (14)	86% (79%)	7 % (7%)	7% (14%)	89% (82%)
Council Tax	9 (9)	67% (56%)	33% (44%)	0% (0%)	83% (78%)
Housing Rents	10 (10)	60% (50%)	40%(50%)	0% (0%)	80% (75%)
Creditors	10 (9)	60% (44%)	40% (44%)	0% (12%)	80% (67%)
NDR	12 (12)	42% (33%)	42% (58%)	16% (9%)	63% (63%)
<u>Overall</u>	65 (64)	68 % (58%)	28% (36%)	4% (6%)	82% (76%)

- 5 For follow-up reviews it has been assumed that controls operating in 2003/2004 are still operating satisfactorily to enable comparisons to be made year on year: in all of the systems reviewed the percentage of controls fully operating increased. As a result the overall rating has improved from 76% to 82%.

Follow-up of 2003/2004 Recommendations

- 6 Recommendations made in 2003/2004, all of which were agreed by management, were followed-up as part of the 2004/2005 reviews. The position for each system reviewed is shown below:

SYSTEM	NUMBER OF RELEVANT RECS	FULLY IMPLEMENTED	PARTIALLY IMPLEMENTED	NOT IMPLEMENTED
Housing Benefit	5	40% (2)	40% (2)	20% (1)
Debtors	3	33%(1)	33%(1)	33%(1)
Council Tax	7	29% (2)	29% (2)	42% (3)
Housing Rents	13	38% (5)	31% (4)	31% (4)
Creditors	6	83% (5)	17% (1)	0% (0)
NDR	8	25% (2)	37.5%(3)	37.5% (3)
Payroll	5	40% (2)	60% (3)	0% (0)
<u>Overall</u>	47	40% (19)	34% (16)	26% (12)

- 7 For the second year running the level of implementation of recommendations is low. This was raised by the External Auditor in the 2003/2004 audit and is likely to be raised again this year. To pre-empt the situation arising again in 2005/2006 an earlier follow-up regime will be introduced in December 2005 and outstanding actions dealt with prior to the annual key control reviews.

Key Strengths

- 8 The systems with the highest level of controls operating satisfactorily were found to be the same as for 2003/2004, Housing Benefit (95%) and Debtors (89%) and within the Housing Benefit, Creditors, Council Tax and Housing Rents systems all key controls were either operating satisfactorily or partially.
- 9 An adequate separation of duties was found to be operating, where appropriate in all but one of the core financial systems (Creditors as per 2002/2003 & 2003/2004) and the majority are regularly reconciled to the main accounting system.

Key Weaknesses

- 10 The system with the lowest level of key controls operating satisfactorily was found to be NDR (42%). The most significant weaknesses relate to the fact that the rateable value is not reconciled to the valuation list; inspection visits were not made in all cases to confirm the granting of empty property relief, and the Revenues suspense account does not accurately reflect the number of items in suspense at any one time.

Corrective Action

- 11 A total of 35 recommendations were made to address the weaknesses identified. To assist management the recommendations are rated according to risk as follows:
- Category 1 = major issues that require action because they have significant implications for the control environment and the attainment of objectives;
 - Category 2 = issues that require action because they represent a risk to the control environment that may impact on the achievement of objectives; and
 - Category 3 = best practice where implementation will improve the control environment and increase the effectiveness of systems.

12 Of the 35 recommendations made 22 (63%) were deemed category 1 risks, 10 (28.5%) were deemed category 2 risks and 3 (8.5%) were deemed category 3 risks.

13 The current status of the individual reports is as follows:

- Housing Benefit - final issued 15/08/05, all recommendations agreed
- Debtors – final issued 26/07/05, all recommendations agreed
- Council Tax – final issued 01/08/05, all recommendations agreed
- Housing Rents – draft issued 12/07/05, awaiting management response to recommendations
- Creditors – final issued 12/08/05, all recommendations agreed
- NDR – final issued 19/09/05, all recommendations agreed
- Payroll – final issued 13/09/05, all recommendations agreed

Susan Dixon
Service Manager - Internal Audit
28 September 2005

LONDON BOROUGH OF HARROW

AUDIT COMMITTEE

16 FEBRUARY 2006

**Reference from the Meeting of the Audit Committee held on 26
January 2006: Internal Audit Half Year Progress 2005/06**

1. At the meeting of the Audit Committee on 26 January 2006, Members received a report of the Director of Financial and Business Strategy on Internal Audit Half Year Progress for 2005 to 2006. An Officer reported that managers had implemented a relatively low number of the recommendations made during the previous year by Internal Audit. Despite some improvement on the previous year, a significant number of controls were reported to be only partly operating and some not operating at all.
2. An Officer reported a shortage of resources, which could affect managers' implementation of recommended measures, and it was noted that during the last two years, external auditors had criticized the lack of implementation of audit recommendations. Following a discussion in relation to the potential reasons for managers' inadequate implementation of recommendations and measures to improve the situation, the view was expressed that a period of investment in underlying structures was necessary during a transitional period.
3. Members noted that measures were being put in place to try to encourage managers to implement the recommendations, including the introduction of an earlier follow-up procedure. Members were advised that changes would be made to future reports, in particular, to include the introduction of a section outlining performance against internal audit performance targets.
4. Regarding Internal Audit's own resources, an Officer reported that the level of resources had not affected the follow-up of audit internally, although there had been difficulties with recruitment and an internal auditor post had been left vacant due to budget constraints. The Chair expressed his concern over this and the implications it could have. The Committee was advised that the introduction of an earlier follow-up process would give managers more time to implement measures and that it was estimated that 95% of measures would be put in to practice. It was clarified that whilst there had been no incident of fraud, there had been irregularities due to controls not being robust enough. It was noted that a cost benefit analysis had not been done, and that if controls were implemented, financial resources could be increased. Members indicated that the aim of the Committee was to protect integrity and that attention should be drawn to the risks faced if non-compliance continued.

5. The Committee therefore **RESOLVED** that (1) Cabinet be requested to note:

- (i) the past failure of Harrow to implement recommended controls, primarily for resource issues in back office function;
- (ii) the impending system changes to the Business Transformation Partnership; and
- (iii) that Harrow had one of the smallest internal audit departments in London; and

(2) Cabinet be requested to consider whether additional resource should be devoted to back office functions during this period of transition.

FOR CONSIDERATION

Background Papers: Minutes of the Audit Committee on 26 January 2006 and the Report of the Director of Financial and Business Strategy: Internal Audit Half Year Progress 2005/06

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