

**HEREFORDSHIRE COUNCIL  
ANNUAL AUDIT ASSURANCE REPORT 2002/03**

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**1. INTRODUCTION**

- 1.1 Under the Accounts and Audit Regulations 2003, the Council has a duty to maintain an adequate and effective system of internal audit of its accounting and control systems. To ensure the Internal Audit service is adequate and effective, the Council has adopted the CIPFA Code of Practice for Internal Audit in Local Government in England and Wales. In addition, there are annual reviews of Audit Services work by the Audit Commission.
- 1.2 Herefordshire Council has an obligation to include in its Statement of Accounts a statement on the system of internal financial control. The statement should set out the framework within which financial control is managed and reviewed and the main components of the system, including arrangements for Internal Audit. This statement reports on significant identified weaknesses and the actions undertaken to rectify them.
- 1.3 The CPA results published in December 2002 identified Herefordshire Council as a 'Good' authority, which reflected the Council's achievements and its capacity for future improvements. Being a good authority allows the Council to operate with greater freedom and flexibilities.
- 1.4 The Herefordshire Council Corporate Plan sets out how the Council will direct its corporate activity to the achievement of the ambitions of the Herefordshire Plan. Audit Services ensures that Directorates and Departments achieve their objectives within a robust internal control environment.
- 1.5 Regular updates on audit work progress are sent to both Directors and Heads of Department, which enables issues at Directorate/Department level to be dealt with as they arise.
- 1.6 The Annual Audit Assurance report summarises the more important matters arising from Audit Services work for the financial year ending 31st March 2003.
- 1.7 The Audit Service would like to take this opportunity to thank all staff for their help and corporation during audit visits.

**2 INTERNAL AUDIT**

- 2.1 Internal Audit is the independent appraisal function established by management to review the internal control system as a service to the Council. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources.
- 2.2 The four-year strategic plan is based on a risk assessment evaluation, which utilises a 'Traffic Lights' Methodology, with Red being high risk, Amber being medium risk and Green being low risk. Within each risk area, consideration is also given to residual risk for specific functions or establishments based upon its last Audit opinion and current knowledge.

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- 2.3 The Annual Plan emanates from the four-year Strategic Plan. To ensure that Directorate and Departmental priorities are considered, the annual plan is developed in consultation with Directors, Heads of Departments and Heads of Service.
- 2.4 Audit Services terms of reference has been formally agreed by Cabinet in the form of an Audit Charter (Appendix I), which outlines the independence of Audit Services and its reporting protocols.
- 2.5 Although the Audit Commission has not completed its review of Audit work, the indications are that it is satisfied with the quality of and coverage of the work done.
- 2.6 The actual cost for Internal Audit Services amounted to £384,434 compared to a budget of £382,618

**3 AUDIT ACTIVITY**

**3.1 Financial Standing**

An element of the Council's financial standing is the level of assurance given by its fundamental systems. Fundamental systems are systems whose failure could cause major disruption or loss of financial control to the Council.

Fifteen fundamental systems were assessed; the outcomes are analysed in table 1 below:

<b>Table 1 Analysis of Fundamental Audit Opinions</b>					
<b>System</b>	Good	Satisfactory	Marginal	Un-satisfactory	Weak
Treasury Management	✓				
Salaries & Wages Edn		✓			
Salaries & Wages		✓			
Contract Tendering Procedures		✓			
Financial Management System			✓		
Creditors			✓		
Bank Reconciliation				✓	
Sundry Debtors		✓			
Antifraud & Corruption		✓			
NDR	✓				
Council Tax		✓			
Housing Rents		✓			
Housing Benefit		✓			
Value Added Tax		✓			
Cash and Deposit			✓		
<b>TOTAL</b>	<b>2</b>	<b>9</b>	<b>3</b>	<b>1</b>	<b>0</b>

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Assessment of the Council's main accounting process covered budgetary control, financial reporting, and accounting procedures. It was found that on the whole, the system was operating satisfactorily. However, there was a need for improved journal documentation, i.e. narrative to substantiate the journal entry. There was also a need to demonstrate regular reconciliation between feeder systems and information fed into Cedar. It should be borne in mind that the Council's financial system is very complex and the areas identified for improvement are seen as an integral part of development within the system. This will be picked up as part of the implementation of e-financials.

A particular area of concern related to the Cash and Deposit Book where there continues to be a need for improved record keeping. This need has also had an adverse effect on the reconciliation of the Council's General Account, which accounted for the unsatisfactory audit opinion for the Bank Reconciliation Audit. Current staff working with additional resources have made good progress in solving the problems identified.

Where fundamental systems have a marginal or worse opinion, it is likely that the Audit Commission will make reference to them in its management letter.

### **3.2 Systems of Internal Control**

These are systems put in place by management to ensure adherence to policies, safeguard assets, ensure relevance, reliability and integrity of information and ensures compliance with statutory requirements.

In addition to the 15 fundamental systems, 22 system audits were undertaken during the year; their audit opinion is summarised in table 2.

<b>Table 2 - Analysis of System Audit Opinions by Directorate</b>					
<b>Directorate</b>	<b>Good</b>	<b>Satisfactory</b>	<b>Marginal</b>	<b>Unsatisfactory</b>	<b>Weak</b>
Social Care and Strategic Housing			2	1	
Environment		2	5	2	1
Policy and Community		5	1		
County Treasurers			1		
Corporate			1	1	
<b>TOTAL</b>	<b>0</b>	<b>7</b>	<b>10</b>	<b>4</b>	<b>1</b>

There were two areas where major breakdowns occurred; one related to Housing Repairs where there was a need for local systems to be kept up to date with robust reconciliation between local management systems and Cedar. The overspend was £1,011,912. The County Treasurer will be presenting a full report with recommendations to the Statutory Accounts Committee.

In the other case, a potential overspend on Highways expenditure was averted by robust action by the Director of Environment, who having identified the problem, worked with Audit Services and Accountancy to put things right and at the end of the financial year expenditure was within budget.

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**3.3 The Prevention and Detection of Fraud and Corruption**

As part of its ethical framework, the Council has established a Standards Committee, and has adopted a Code of Conduct for members incorporating the mandatory requirements of the model code. In addition, members have signed a formal declaration accepting the terms of the code.

Arrangements are in place for members to monitor and test the operation of the new framework.

Table 3 highlights the main corporate documents and their availability.

<b>Table 3 Schedule of Corporate Governance Arrangements Documents</b>					
<b>Date</b>	<b>Policy/Document</b>	<b>Availability</b>			
		<b>Public</b>	<b>Partners</b>	<b>Staff</b>	<b>Members</b>
July 02	Standing Orders	✓	x	✓	✓
July 02	Financial Standing Orders and Regulations	✓	x	✓	✓
July 02	Scheme Of Delegations	✓	x	✓	✓
July 01	Whistle-Blowing Policy	✓	x	✓	✓
October 02	Anti-fraud and Corruption Policy	July 2003	x	✓	✓
April 03	Complaints Procedure	✓	x	✓	✓
July 01	Code of Conduct for Employee	✓	x	✓	✓
July 01	Standing Orders for the Regulation of Contracts	✓	x	✓	✓

With regard to availability to staff, the Anti-fraud and Corruption Policy is on the Council's Intranet; the other documents have limited circulation. In addition, the Anti-fraud and Corruption Policy is now available to the Public through the Council's Internet.

The remaining documents are available at Info Shops and Libraries, while the complaints procedure is available at all Council receptions as well.

There is a need for the Code of Conduct for Employee, the Whistle- Blowing Policy and the Standing Orders for the Regulation of Contracts to be reviewed on a regular basis.

Although Members receive training and guidance on some of the above key documents, no training is given to staff. However, induction delegates are requested to look at the Personnel Employment pack that can be found on the Council's Intranet. Procedures are being developed to ensure that staff who are not on the Intranet are able to access these key documents.

Financial Regulations will require amendment to deal with the implications of e-government.

The Council took part in the National Fraud Initiative (NFI) data matching exercise for 2002. This year there was a different format to the previous years (last NFI 2000). Better matching and filtering by the data-matching agents has led to clearer matches. More prominent this year is the Payroll and Pensions data, which is being dealt with by Audit Services.

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The large number of matches generated, (1,365), caused a significant peak in workload for the sections involved. The need to liaise with other authorities meant long delays in finalising investigations. The total number of matches leading to full investigations is quite small at 2.5% of matches (25 Benefits, 9 Audit). It is impossible to say how many will become actual cases of benefit fraud. However the Payroll checks do not appear to contain any matters of concern.

**3.4 Best Value Performance Indicators**

As part of the Council's ongoing quest to ensure that BVPI and Local PI are adequately supported and accurate, Audit Services, as part of its ongoing review, has completed work on nine Performance Indicators.

The table below shows the current position.

<b>Table 4 Analysis of PI Audit Opinions</b>						
	No. of Indicators	Audit Opinion				
		Good	Satisfactory	Marginal	Unsatisfactory	Weak
Corporate Health	2			2		
Social Services	3			1	2	
Housing and Council Tax Benefit	2		2			
Environmental Services	2		1	1		
<b>TOTAL</b>	<b>9</b>	<b>0</b>	<b>3</b>	<b>4</b>	<b>2</b>	<b>0</b>

Areas for improvement centred on the need for more robust data collection procedures, clear audit trails to ensure that data can be independently verified, and a clear understanding of the definition of the performance indicator.

The two performance indicators with unsatisfactory audit opinions were qualified by the Audit Commission last year and it is likely that this will happen again this year. These related to BVPI 55 – Clients receiving a review and BVPI 56 -Percentage of items of equipment less than £1,000 delivered. Management is taking action to address the issues identified for improvement.

With regards to BVPI 157 –Service delivery outcomes (e-government performance indicator), an audit assessment has identified the need for clarity with regard to responsibility for collection, presentation and monitoring of statistics related to IEG targets. The Head of Service has produced an Action Plan, which has been submitted to the Director of Policy and Community and Audit Services who will monitor its implementation.

The assessment also highlighted the need for clarity of approach regarding the challenging 15 minutes target for travelling time by Herefordshire residents to their nearest access point. There was no supporting documentation to support the calculation of the 15 minute target. The Audit Commission will require some assurance that this target will be met.

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Validation of Best Value Performance Indicators is an ongoing feature of audit work. The Council's newly developed Performance Management Framework should help to improve data collection arrangements.

**3.5 Risk Management**

There are limited corporate arrangements for the identification, assessment and management for key financial and operational risks. However, a Risk Register is being developed.

A report by the County Treasurer to the Chief Executive's Management Team highlighted the need for Directorate/Departments to identify their strategic risks, with risks being allocated to individual managers who assess the risk's likelihood of occurring and its impact. In addition, there needs to be a more formalised arrangement for the collection of risk data and the way reporting on risk is managed.

The Council is taking action to ensure that a consistent and robust approach to risk management is developed and embedded across all Council services.

A risk management review will be carried out by Audit Services as part of the 2003/4 Audit Plan.

**3.6 ICT**

Seven Audit reviews were carried out during the year; table 5 summarises the Audit opinions.

<b>Table 5 Analysis of ICT Audit Opinions</b>					
System	Good	Satisfactory	Marginal	Unsatisfactory	Weak
GAP – Analysis BS7799				✓	
E-POP Cedar E-Purchasing		✓			
Payroll System - Education			✓		
Back up and Recovery		✓			
Telephone System			✓		
Procurement IT Hardware			✓		
<b>TOTAL</b>	<b>0</b>	<b>2</b>	<b>3</b>	<b>1</b>	<b>0</b>

ICT plays a key part in the Council's drive for improvement in service delivery. To ensure a secure ICT environment, the minimum level of security is set out in BS 7799 the Code of Practice for Information Security Management.

The standard has 127 guideline objectives; a gap analysis has shown that the Council's procedures had no controls or limited controls for 93 of these guideline objectives. However, some progress is now being made by the IT Security Officer.

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**3.7 Establishment Visits**

<b>Table 6 Analysis of Establishment Audit Opinions by Directorate</b>						
<b>Directorate</b>	<b>Total</b>	<b>Good</b>	<b>Satisfactory</b>	<b>Marginal</b>	<b>UnSatisfactory</b>	<b>Weak</b>
Education	25	4	11	6	3	1
Social Care and Strategic Housing	1		1			
Policy and Community	7		1	6		
County Secretary & Solicitor	1			1		
<b>TOTAL</b>	<b>34</b>	<b>4</b>	<b>13</b>	<b>13</b>	<b>3</b>	<b>1</b>

Findings at establishments, in particular those visited for the first time, highlighted the need for up to date Accounting Guidelines, which set out the key financial and associated procedures that are good practice for establishments to have in place.

**3.8 Corporate**

A review of the implementation of the Council's Staff and Review Policy identified that there was a inconsistent approach across the Council, and recommendations have been made for improvement. The Council has now developed a more streamlined version, which has been tested, and will be rolled out for the next round of staff SRDs.

**3.9 Special Investigations**

During the year, there were three unsuccessful cheque fraud attempts by the public who changed the detail on Council cheques. There was no evidence to suggest that Council staff were involved. Audit Services is liaising with the bank to see what cost effective improvements can be made to Council cheques.

**4. RECOMMENDATIONS MADE AND ACTION TAKEN**

Table 7 summarises the total number of recommendations made for each Directorate/Department.

<b>Table 7 Summary of Recommendations 2002/3</b>				
<b>Directorate/Department</b>	<b>Level 1 Recommendations</b>		<b>Level 2 Recommendations</b>	
	<b>Made</b>	<b>Accepted</b>	<b>Made</b>	<b>Accepted</b>
<b>Education</b>	102	99	282	277
<b>Environment</b>	31	30	73	71
<b>Policy and Community</b>	59	57	145	140
<b>Housing &amp; Social Care</b>	40	40	35	35
<b>County Secretary &amp; Solicitor</b>	5	5	10	10
<b>County Treasurer</b>	10	10	12	12
<b>Fundamental Systems</b>	52	52	135	135
<b>Computer Audits</b>	6	6	64	64
<b>Corporate</b>	7	7	6	6
<b>Performance Indicators</b>	60	60	0	0
<b>TOTAL</b>	<b>373</b>	<b>366</b>	<b>767</b>	<b>750</b>

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**Level 1 recommendations** are owing to statutory obligations, legal requirements, Council Policy, or major risk.

**Level 2 recommendations** are in order for sound internal control and confidence in the system to exist.

The percentage of recommendations accepted by management was 98% at level 1 and 98% at level 2. This maintains the high level of accepted recommendations as recorded last year.

**5. KEY ISSUES IDENTIFIED THAT REQUIRE ATTENTION**

- Improvement in IT security arrangements to comply with BS 7799.
- Improved data collection procedures for performance indicators.
- The Cashiers improve documentation in relation to the Cash and Deposit Book.
- Risk Management to be developed and embedded across the Council.
- The publication of up to date Accounting Guidelines.
- Regular reconciliation of local management systems to Cedar.

**6. AUDIT OPINION**

I am of the opinion that the Council's overall level of financial control continues to be satisfactory (Appendix II). However, the Council needs to continue its ongoing improvements in the areas of Risk Management, IT and Performance Management.

**R. A. Ford  
Principal Audit Manager  
July 2003**

## **AUDIT SERVICES CHARTER**

### **INTRODUCTION**

The purpose of this Charter is to establish the authority and responsibility conferred by the Council on the Audit Services Team with respect to carrying out internal audit functions.

### **STATUTORY BACKGROUND**

The need to maintain an internal audit function is implied by Section 151 of the Local Government Act 1972 under which local authorities are required to make proper arrangements for the administration of their financial affairs and to delegate responsibility for those arrangements to one of their officers. The Accounts and Audit Regulations 1996 are explicit about the requirement to maintain an internal audit function and state that local authorities shall maintain an adequate and effective system on internal audit of their accounting records and control systems.

### **THE NATURE OF AUDIT SERVICES**

The Audit Services Team is an independent and objective assurance and consulting function established by the Council to examine and evaluate its activities as a service to senior management (officers and Members as appropriate). It functions by examining the adequacy and effectiveness of internal controls.

### **INTERNAL CONTROLS**

This is the whole system of controls, both financial and otherwise, established by the Council in order to provide reasonable assurance that:

- business risks are identified, assessed and managed effectively
- operations are effective and efficient
- there are sound systems of internal financial control
- there is compliance with laws and regulations
- assets are safeguarded from unauthorised use
- proper accounting records are maintained and the financial information used for business purposes or for publication is reliable.

### **THE ROLE OF AUDIT SERVICES**

The role of the Audit Services Team is to understand the key risks to which the Council is exposed and to contribute to the improvement of the internal control environment - it is not a substitute for it. The Audit Services Team is therefore not directly responsible for the ensuring that adequate and effective internal controls are established to manage the key risks – that responsibility lies with senior management.

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**VALUES OF AUDIT SERVICES**

The Council expects the Audit Services Team to carry out their function in accordance with the following operational values: -

- To be client focused at all times
- To offer constructive comments and practical solutions
- To be proactive in approach
- To adopt a professional attitude to all tasks
- To be responsive to requests for advice.

**AIM OF AUDIT SERVICES**

The Audit Services Team aims to add value by contributing towards the improvement of the Council's activities by promoting effective control at reasonable cost in relation to the identified risks.

**OBJECTIVES OF AUDIT SERVICES**

The objectives of the Audit Services Team are: -

1. To assist the Council in the accomplishment of its objectives by bringing a systematic and disciplined approach to the evaluation and improvement of risk management, corporate governance and internal control processes.
2. To assist the Council in the effective discharge of its functions by providing independent analysis, appraisal, advice and recommendations on the activities subject to internal audit review.
3. To review, appraise and report on the adequacy and effectiveness of the systems of financial and internal control.
4. To review, appraise and report on the relevance, integrity and reliability of financial and other management information.
5. To review, appraise and report on the level of compliance with the policies, plans, procedures, statutory requirements and regulations that could have a significant impact on the Council's activities.
6. To review, appraise and report on the arrangements for protecting assets from loss resulting from theft, fraud, fire or misuse and, as appropriate, verifying their existence.
7. To review and appraise the economy, efficiency and effectiveness with which resources are deployed and recommend improvements in procedures and systems that will reduce wastage, extravagance and fraud.
8. To review service delivery arrangements and projects to ascertain whether the activities are being carried out as planned and the results are consistent with the Council's established policies.

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9. To maintain a programme of development, review and assessment of the Council's risk management processes in order to provide assurance on their integrity.
10. To carry out any ad hoc appraisals, inspections, investigations, examinations or reviews requested by senior management or the political executive.
11. To act as the liaison with the Council's external auditors and coordinate audit effort with the District Auditor in order to avoid duplication of effort and increase audit coverage.
12. To develop shared audit protocol with colleagues in partner organisations in order to avoid duplication of effort and maximise internal audit coverage.
13. To maintain technical competence through continuing education and active participation in professional activities.
14. To adhere to the code of ethics, standards and guidelines of the relevant professional institutes and the Auditing Practices Board.
15. To utilise the resources designated for use by the Audit Services Team to maximise the efficiency and effectiveness of the internal audit function.
16. To serve on internal working groups as appointed by senior management.

**INDEPENDENCE OF AUDIT SERVICES**

The Audit Services Team reports administratively to the County Treasurer through the Assistant County Treasurer responsible for Financial Policy and Audit Services. The County Treasurer is the Council's Responsible Financial Officer under the terms of Section 151 of the Local Government Act 1972.

The Principal Audit Manager is responsible for the day to day management of the Audit Services Team and reports to the Assistant County Treasurer – Financial Policy and Audit Services. The Principal Audit Manager has the freedom to report to any level of management (officers and Members as appropriate) on audit findings without censure.

The Principal Audit Manager has no executive or managerial powers, functions or duties except for those relating to the management of the Audit Services Team and is not involved in the day to day management of the Council.

**AUTHORITY OF AUDIT SERVICES**

This Charter and the Council's Standing Orders and Financial Regulations confirm the authority conferred on the Audit Services Team by the Council.

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The Principal Audit Manager and his internal auditors have the authority to: -

- decide on the nature, scope and timing of audits
- access the books, documents, accounts, property, vouchers, records, correspondence and other data of the Council that are necessary to the proper performance of internal audit duties
- enter any of the Council's premises
- have discussion with the Council's line managers and other employees
- request any officer to provide the information and explanations needed to be able to form an opinion on the adequacy of and compliance with the internal control system.

The Council's officers are required to assist the Audit Services Team in the performance of its audit duties and to respond promptly to any requests for information, explanation, discussion, entry to premises or access to documents.

**SCOPE OF AUDIT SERVICES**

The risk of financial loss is not the sole concern of the Audit Services Team. The scope of audit activity encompasses the whole range of internal controls employed by the Council – both financial and non-financial.

The scope of the audit function is, therefore, sufficiently comprehensive to meet the Council's needs. It extends to cover all areas of the Council and its controlled entities and may involve working with colleagues in partner organisations.

**AUDIT PROTOCOL**

The Audit Services Team is required to observe the following protocol in carrying out their internal function: -

- Provide advance notice to the manager of each service area to be audited. An annual audit plan will be established after securing input from the Heads of Service and approval of the plan by the Chief Executive's Management Team and Cabinet. The Annual Audit Plan will also be reported to the Strategic Monitoring Committee.
- Conduct a preparatory meeting with the manager of the service being audited to discuss the nature of the audit, the length of engagement and the coordination of the review around operational constraints. The detail of the audit programme will be reviewed at that meeting with the service manager in order to ensure proper and thorough audit coverage.
- Conduct interim meetings with the service manager as appropriate to discuss progress with the review and findings as they arise.
- Preparation of a written draft internal audit report following the conclusion of the audit.

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- Conduct a final meeting with the service manager to discuss the draft report and confirm the accuracy of the audit findings and the appropriateness of the audit recommendations.
- Agreed amendments to the draft report will be reflected in the final report along with the service manager's response to the recommendations. Final copies of the report will be distributed as appropriate.
- The Head of Service is responsible for making sure that the action plan included in the final report is implemented.

## **AUDIT REPORTING**

### **The Audit Plan**

A four-year strategic plan providing for the review of significant Council activities will be prepared for approval by the Chief Executive's Management Team and the Cabinet prior to the start of each financial year. It will also be reported to the Strategic Monitoring Committee. The strategic plan will be based on an assessment of the risk pertaining to the achievement of the Council's objectives.

### **Mid-Year Assurance Report**

The mid-year assurance report will identify the key internal control issues the Principal Audit Manager has identified or continues to be concerned about as a result of routine audit work. The report will provide summary information on special investigations and completed audit assignments and will be presented to CXMT for its comment before it is presented to Cabinet and Strategic Monitoring Committee.

### **Annual Audit Report**

The first year of the strategic plan forms the basis of the annual operational plan for the Audit Services Team. An annual report on progress against that plan is required for the Chief Executive's Management Team and Cabinet before the end of June following the end of the relevant financial year. The annual report will also be presented to the Strategic Monitoring Committee.

### **Audit Assignment Reports**

The Audit Services Team are required to submit timely reports on all audit assignments in accordance with the procedures and guidelines set out in the Audit Manual.

## **AUDIT STANDARDS**

The Council requires Audit Services Team to follow the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom (published in November 2000).

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**DETECTING AND DETERRING FRAUD**

Deterrence of fraud is a responsibility of management. The Audit Services Team is responsible for examining and evaluating the adequacy and effectiveness of actions taken by management to fulfill this obligation.

The Audit Services Team shall be trained to recognise the potential indicators of fraudulent activity. If sufficient control weaknesses are detected, the Audit Services Team will carry out additional tests in order to confirm or otherwise an acceptable level of propriety and probity.

The Audit Services Team will not, and cannot, however, be as skilled in the detection of fraud as individuals whose sole purpose is to detect and investigate fraud – the remit of the internal audit function is much wider than prevention of fraud as set out in this Charter. Service managers must also be clear that auditing procedures alone, no matter how professionally they are carried out, cannot guarantee that fraud will be detected.

The Audit Services Team will assist in the investigation of fraud in order to:

- Determine if controls need to be implemented or strengthened.
- Design audit tests to help disclose the existence of similar frauds in the future.
- Meet the internal auditor's responsibility to be able to recognise fraud.

A written report will be issued at the conclusion of each investigation. It will include all findings, conclusions, recommendations and corrective action to be taken.

March 2002

AUDIT OPINION

Quantification and Classification of Internal Control Levels

Control Level	Definition
<b>Good</b>	A few minor recommendations (if any).
<b>Satisfactory</b>	Minimal Risk- a few areas identified where changes would be beneficial.
<b>Marginal</b>	A number of areas have been identified for improvement.
<b>Unsatisfactory</b>	Unacceptable risks identified, changes should be made
<b>Weak</b>	Major risks identified, fundamental improvements are required.