Herefordshire Council
Audit Service Assurance Report 2004/05

1.   Introduction

1.1   The CIPFA Code of Practice for Internal Audit In Local Government requires the Head of Internal Audit to formally submit an annual report to members. In line with good practice this Assurance Report :

- Includes an opinion on the overall adequacy and effectiveness of the organisation's internal control environment.

- Discloses any qualifications to that opinion, together with the reasons for the qualification.

- Presents a summary of the audit work undertaken to formulate the opinion.

- Draws attention to any issues the Head of Internal Audit judges particularly relevant to the preparation of the Statement on Internal Control.

- Compares the work actually undertaken with the work planned and summarises the performance of the Internal Audit function.

- Comments on the compliance with the CIPFA Code of Practice.

1.2.   In compliance with the Code of Practice, the Council now has an Audit Committee with terms of reference:

    "*To provide:*

- *Independent assurance of the adequacy of the Council's risk management framework and the associated control environment.*

- *Independent scrutiny of the Council's financial and non- financial performance to the extent it affects the Council's exposure to risk and weakens the control environment; and*

- *To oversee the reporting process".*

1.3.   The Accounts and Audit Regulations 2003 established requirements related to systems of internal control and the review and reporting of those systems. Regulation 4 of the Accounts and Audit Regulations 2003 requires that from 1st April 2003 '*The relevant body shall be responsible for ensuring that the financial management of the body is adequate and effective and that the body has a sound system of internal control which facilitates the effective exercise of that body's functions and which includes arrangements for the management of risk'.*

1.4   Herefordshire Council also 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. Cabinet approved the Statement on 14th July 2005.

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2.   Audit Approach

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   Audit Services acts as an aid to management and produces reports as a result of each of the reviews undertaken. It works in partnership with management to find solutions to any issues identified and seeks its agreement to any recommendations for improvement. Recommendations are developed with managers to produce action plans.

2.3   Audit Services is generally well received and helps management to achieve its objectives within a culture of strong stewardship.

2.4   The Audit Service would like to take this opportunity to thank all staff for their help and co-operation during audit visits.

3.   Background

3.1   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.

3.2   The Annual Plan emanates from the four-year Strategic Plan. To ensure that Directorate and Department priorities are considered, the Annual Plan is developed in consultation with Directors, Heads of Departments and Heads of Service. Both the four-year and Annual Plans have been approved by Cabinet.

3.3   Audit Services terms of reference has been formally agreed by Cabinet in the form of an Audit Charter, which outlines the independence of Audit Services and its reporting protocols.

3.4   The Audit Commission has completed its review of Audit, which involved comparing audit activity with the CIPFA Code of Practice. The review has confirmed its ability to place reliance on the work of Audit Services.

3.5   The actual cost for Internal Audit Services amounted to £418,069 compared to a budget of £445,053. In the main, the underspend was owing to a member of staff on maternity leave.

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4.   Action taken on 2003/04 key issues

4.1   There were six key issues identified in the 2003/04 Assurance report that required attention:

- **Improvement in IT security arrangements to comply with BS 7799**

     The need to provide a secure environment to support the main servers and communications equipment at Rotherwas, on which the majority of the Council's systems operate, has been recognised. The Audit review of physical security at Rotherwas identified that suitable steps were being taken to provide a high standard of protection, based upon effective physical controls and sound disciplines.

     Full protection will not be in place until the refurbishment of the server room is complete and controls relating to certain threats, such as fire detection and fighting have been fully implemented. This work is in progress.

- **Improved data collection procedures for performance indicators.**

     On 12th October 2004 the Chief Executive's Management Team approved the Performance Indicator Action Plan and Performance Indicator handbook pro-forma with the expected outcomes of:

     - Improved Leadership and Ownership.

     - Improved understanding.

     - Improved accuracy of BVPI Information.

     - Improved consistency of calculation.

     Recommendations for improved data capture and monitoring have been provided to staff responsible for the compilation of the BVPIs.

     This year's audit reviews of BVPI have shown a significant improvement in data collection and accuracy.

- **Risk Management continues to be embedded across the Council**

     Corporate, Directorate and Departmental risks have been identified and Directors and Heads of Departments are now responsible for their risk logs. They also have to ensue that all risks, both new and inherent, are regularly recorded and monitored so that they can be effectively managed.

     Regular Risk management updates are presented as part of the Corporate Performance Reports to the Chief Executive's Management Team, highlighting key risks and the measures in place to address them.

     Cabinet has considered both corporate and significant service risks and has assured itself that sufficient mitigating actions are being undertaken to safeguard the Council's business and reputation.

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- **Improvements in relation to the Jarvis contract**

A follow-up by Audit Services on the recommendations previously made showed that good progress was made on the action taken on the sixteen recommendations made with nine fully implemented, four substantially implemented and three partially implemented. To help improve the outcomes from future reviews, external consultants are working with Audit Services to produce audit programmes tailored to partnership working. A recent report by the Audit Commission confirms that risks associated with the Jarvis contract have been identified, classified as corporate, and that control measures are in place. In addition, that risks are formally monitored by the Chief Executive's Management Team on a quarterly basis and informally on a daily basis by the partnership officers.

- **The publication of up to date Accounting Guidelines**

The Assistant County Treasurer (Accountancy and Exchequer Services) has produced the key Accounting Guidelines, which include Budgetary Control, and Journals. Guidelines on Inventory and imprest account management have been piloted and comments made included in the final documents. These four guidelines will be published by the beginning of September. The Assistant County Treasurer (Accountancy and Exchequer) has a timetable for the piloting of the remaining guidelines.

- **Improvements are needed to arrangements for the prevention and detection of fraud**

Audit Services has developed a risk-based programme of work as part of the annual operational plan. This programme includes audit reviews of car mileage, travel and subsistence and renovation grants. In addition, Audit Services has circulated anti-fraud awareness flyers to all members and staff.

Financial Regulations require the County Treasurer to be informed of any suspected or actual fraud within the Council. Anti-fraud and Corruption returns have been sent to all Directors and Heads of Departments for them to report any incidents of fraud identified. All returns relating to 20040/5 have been returned stating that none had been identified for the year. In addition, the Chief Executive's Management Team and Heads of Service have signed Declaration returns in relation to gifts and hospitality.

Once again, it is important to emphasise the Council's minimal experience of fraud and the significant faith the Council has in its staff. The key issue remains to ensure that anti-fraud and whistle-blowing policies, together with the high standards of conduct required of all staff and members, are regularly publicised and maintain a high profile.

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5.   Summary of Audit work undertaken

5.1   Fundamental systems

Fundamental systems are systems whose failure could cause major disruption or loss of financial control to the Council. The outcomes are summarised in below:

TABLE 1

SUMMARY FUNDAMENTAL AUDIT OPINIONS	
Audit Opinion	**Number**
Good	1
Satisfactory	10
Marginal	1
Unsatisfactory	0
Unsound	0
TOTAL	**12**

A marginal opinion was given to the audit review of the Council's creditor system. Whilst the processing of payments on a day-to-day basis was generally satisfactory, a number of weak controls were noted during the review with most having been raised in previous audits. It should also be noted that nine of the original nineteen recommendations have been actioned, with those not actioned all at level 2. The Assistant County Treasurer (Accountancy and Exchequer Services) has confirmed that a new manager has now been appointed and urgent action is being taken on the recommendations with a view to having them completed by the next audit visit later in the year. The areas identified for improvement in the creditors report related to duplication of creditors, identification of potential duplicate payments, correction of incorrect payments, procedures in relation to emergency payments and cheque security.

It should be noted that where a fundamental system has a marginal or worse opinion, it is likely that the Audit Commission will make reference to it in its management letter.

5.2   Non-fundamental systems

In addition to the fundamental systems that Audit reviewed, including seven non-fundamental systems, one was found to be unsound. This related to Homecare cash handling, where controls were poor and documentation did not give assurance on transactions undertaken. Recommendation have been made and the Head of Service is working with partners to put things right.

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5.3   Corporate Governance arrangements (including Anti Fraud arrangements)

As part of the Council's robust approach to 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.

The Council has established a Standards Committee in accordance with Section 53 of the Local Government Act 2000, with the role of promoting and maintaining high standards of conduct by councillors.   In fulfilling its role, the Standards Committee meet six times during the year.   The Herefordshire Council Scrutiny Committee's Annual Report for 2004/05 has been published and provides evidence of the continuing development of the scrutiny role within Herefordshire Council.

Key corporate governance documents are in place and Table 2 highlights their availability.

TABLE 2

SCHEDULE OF KEY CORPORATE GOVERNANCE ARRANGEMENTS DOCUMENTS				
Policy/Document	Availability			
	Public	Partners	Staff	Members
Standing Orders	✔	✔	✔	✔
Financial Standing Orders and Regulations	✔	✔	✔	✔
Scheme of Delegations	✔	✔	✔	✔
Whistle-Blowing Policy	✔	✔	✔	✔
Anti-fraud and Corruption Policy	✔	✔	✔	✔
Complaints Procedure	✔	✔	✔	✔
Code of Conduct for Employees	✔	✔	✔	✔
Standing Orders for the Regulation of Contracts	✔	✔	✔	✔

Owing to the importance the Council places on its partnership arrangements, which is recognised nationally, it is advisable that Council partners are reminded of the Council's key corporate governance documents.   However, it should be noted that the Audit Commission report entitled Probity in Partnerships was positive about arrangements in place.

All Directors and Heads of Service have given written assurance through a signed statement as to the operation of internal control and risk management within their Directorate/Service. In addition, all officers at Head of Service level and above have made individual declarations with regard to gifts and hospitality.

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The Council took part in the National Fraud Initiative (NFI) data matching exercise for 2004 with 1,292 (971 housing benefit and 321 non-housing benefit) matches generated for review. With regard to the non- housing benefit cases, all high priority reports (149 cases) have been subject to preliminary investigation in accordance with Audit Commission guidance. 19 potential high risk cases were identified, of which 13 cases required no further action. With regard to the remaining 6, further information has been requested from the relevant matched authorities.

Once investigations on the high risk cases have been completed, work will start on medium risk cases.

The current position with Housing Benefit cases is that 49 cases have been process so far, with 2 cases recommended for prosecution, 1 recommended for a formal caution, and with 1 formal caution already being administered. There are 16 cases still under review.

Anti-fraud awareness flyers for both members and officers have been produced and should be distributed by the end of August.

Although there is no evidence to suggest that the Council has a major issue in relation to fraud, it must continue to build on the proactive approach it has adopted.

5.4   Performance Management Framework

Performance Management is embedded across the Council, with the Head of Performance Management and Performance Leads taking a leading role. The Council's Performance Management Framework was first adopted in May 2003. Since then, significant developments and improvements have been made to elements of the framework, which has led to a revised Performance Management Framework being approved by Cabinet in June 2005.

Audit Service reviewed 12 Best Value Performance Indicators and table 3 shows the outcomes of these reviews.

TABLE 3

Summary BVPI Audit Opinions		
Audit Opinion	2004/05	2003/04
Good	0	0
Satisfactory	8	3
Marginal	3	8
Unsatisfactory	1	3
Unsound	0	0
Total	**12**	**14**

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As the table shows, there has been a strong improvement in the outcomes of BVPI's reviewed by Audit Services. The unsatisfactory audit opinion relates to BVPI 53, Intensive Home Care per 1000 population aged 65 or over, and was given because data could not be verified to a satisfactory level.

5.5 Risk Management Framework

The Council has adopted a risk management strategy that was approved by Cabinet in April 2004.

The strategy requires the Council to identify corporate and operational risks, assess risks for likelihood and impact, identifies mitigating controls and allocates responsibility for managing mitigating controls.

The Chief Executive's Management Team, on 9th November 2004 and 15th March 2005, reviewed the risks facing the Council and the mitigating actions being applied to control them. On 14th April 2005, Cabinet considered both the corporate and significant service risks and assured itself that appropriate mitigating action was being taken to safeguard the Council. Cabinet also agreed that no changes were to be made to the current Risk Management Strategy, with a further annual review in March 2006.

At operational level, services plans have to identify risks and indicate how they intend to mitigate them.

The Council has adopted the Project Management Tool, Prince 2, which means that all project and business risks must be identified as they arise, and contingency plans put in place to ensure the success of Council projects. The project issue and risk logs record such risks.

In line with good practice, reports to Cabinet and Committees include a paragraph on risk management, which highlights the associated risks.

There are clear links to the Council's Performance Management Framework with the publication of its Integrated Annual Outturn Report for 2004/05, which was approved by Cabinet on 23rd June 2005. Now that risk management is integrated into the Council's operations, there is a need to give consideration to positive risks.

5.6 ICT Protocols and Controls

A range of reviews were carried during the year and it is pleasing to note that physical security arrangements at Rotherwas were given a satisfactory audit opinion. However, this has to be contrasted with arrangements at other sites which were given an unsatisfactory opinion and recommendations have been made. A follow-up audit review will take place to see the level of progress being made in this area.

The key area where substantial improvements are required related to disaster recovery arrangements, which was given an unsatisfactory audit opinion. It must be borne in mind that the Council has allocated additional funds to help improve arrangements, and although progress is being made, it will take time to achieve the required outcome.

A Gap Analysis comparing BS7799 on the Code of Practice for Information Security Management with the Council's arrangements showed that progress to full implementation of Information Security has been slower than anticipated. However, the Council has identified ICT, Children Services and Adult Services as high risk areas, and is currently

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working with external consultants to improve information security in these areas as a matter of urgency. Once improvements have been made in these high risk areas, a rolling programme will be instigated to cover the areas of lower risk.

5.7 Establishment Visits/Verification and Probity

The most important weaknesses are those expected where resources are stretched: lack of separation of duties; non-compliance with authorisation levels and out of date inventories. Other areas for concern in some schools were inadequate financial records and reporting. This was mostly coupled to changes in staff and unfilled posts. A less common but important concern was poor budget monitoring. In all identified problem areas, remedial action has been initiated.

5.8 Other Corporate Issues

No other corporate issues that require reporting have been identified.

5.9 Level of Recommendations agreed by Management

Currently there are two levels of recommendations made. 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 level of recommendations accepted by management was 95% (98%) at level 1 and 95% (96%) at level, which is slightly down on last year.

An improvement to recommendation reporting has been introduced for 2005/06 and entails the introduction of a new category of audit recommendation called 'Critical'. There will be recommendations where non-compliance will be a high risk to the Council and where action is required urgently or within an agreed timescale.

Critical recommendations and progress being made on them will be highlighted in future reports to the Audit Committee who will then take the opportunity to recommend further action if required.

5.10 Results of recommendations follow-up

Recommendation follow-up is featured in the Audit Plan for the year 2004/05. The outcome of the follow up work is summarised in Table 4 overleaf.

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TABLE 4

SUMMARY OF FOLLOW-UP OUTCOMES		
Status	**Number**	**Percentage**
Fully/substantially implemented	225	69
Partly implemented	65	20
Not implemented	36	11
TOTAL	326	100

As can be seen from the table, 11 percent of recommendations had not been implemented. Of the 36 not implemented 28 were level 2 recommendations. Audit follow-up action will continue in relation to the recommendations not implemented.

5.11 Statement of Internal Control

The sources of assurance to support the Statement of Internal Control have been identified and reviewed by the County Treasurer's Management Team.

There are two issues, which are judged as particularly relevant to the Council's Statement of Internal Control. The first issue relates to the overspend in Social Care and the second relates to the Council's overall disaster recovery arrangements. Both issues have been brought to Cabinet's attention and management have in place action plans to help reduce the level of risk exposure. In addition, audit reviews are planned in both areas during 2005/06.

5.12 Compliance with the Code/ Audit Performance

CIPFA issued a revised Code of Practice for Internal Audit in Local Government in 2003. Two issues were raised during its review of Audit Services in 2003/04. One related to the production of an Audit Strategy and the other Audit's Independence.

The Audit Commission has carried out its follow-up review of Audit Services for 2004/05 and its report has highlighted two areas for action. Firstly, the need for the Internal Audit work programme to provide for the timely completion of fundamental systems audits during the financial year. Secondly that action is taken to ensure full compliance with the Code of Practice standards on independence and Audit Committees.

Cabinet approved the Audit Strategy on 14th April 2005. In relation to independence, the Council now has an Audit Committee and the Principal Audit Manager reporting line will be reviewed by the new Director of Resources. The Audit programme has been structured to ensure that reviews of fundamental systems are completed by the 31s^t March 2006.

In relation to customer satisfaction, 57 satisfaction survey were sent out with 23 (40%) being returned.   There was an overall satisfaction rating of 88%, with the overall usefulness of the audit scoring 100% satisfaction. Areas for improvement related to

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timeliness/duration of audits and usefulness of initial discussions regarding scope, objectives and audit process. Members of the Chief Executive's Management Team have been sent indicative quarterly plans to circulate to their managers and Audit Assignment Briefs have to be signed off by the relevant manager. The Audit Commission continues to place reliance on the work of Audit Services.

6. **Audit Opinion**

I am of the opinion that the Council's overall level of financial control is satisfactory. However, the Council needs to continue its ongoing improvements in relation to disaster recovery and information security.

R A FORD
PRINCIPAL AUDIT MANAGER

August 2005