

AGENDA ITEM: 6 Page nos. 1-18

Meeting Audit Committee
Date 31 August 2005
Subject Preparation of Statement on Internal Control (SIC)
Report of Chief Internal Auditor
Summary The Committee is asked to note the arrangements for preparation of the 2004-5 SIC and 2005-6 SIC

Officer Contributors Chief Internal Auditor
Status (public or exempt) Public
Wards affected N/A
Enclosures Appendix A – Draft Statement on Internal Control (2004-5)
For decision by Audit Committee
Function of Council
Reason for urgency / exemption from call-in (if appropriate) N/A

Contact for further information: Michael Bradley, Chief Internal Auditor 020 8359 7151

1. RECOMMENDATIONS

- 1.1 That the committee note the attached draft Statement on Internal Control (SIC).

2. RELEVANT PREVIOUS DECISIONS

- 2.1 The Audit Committee on 9 June 2005 included in the work programme for 2005-6 a report on the preparation of the SIC.

3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS

- 3.1 The SIC is intended to be an essential feature of good corporate governance which is required to provide assurance that corporate priorities can be delivered.
- 3.2 There is a statutory requirement for the Council to publish a Statement on Internal Control annually, as detailed in paragraph 8.1 of this report.

4. RISK MANAGEMENT ISSUES

- 4.1 Failure to adequately comply with the statutory requirement to produce a meaningful SIC could result in the qualification of the Accounts. The SIC deals with the Council's risk management arrangements in detail.
- 4.2 Inability to produce a meaningful, accurate SIC could demonstrate weaknesses in management assurance processes.

5. FINANCIAL, STAFFING, ICT AND PROPERTY IMPLICATIONS

- 5.1 None

6. LEGAL ISSUES

- 6.1 None.

7. CONSTITUTIONAL POWERS

- 7.1 Constitution Part 3 Paragraph 2 details the functions of the Audit Committee including "ensuring that the Council's Statement of Internal Control....are balanced, fair, conform to accountancy standards and meet prevailing best practice".

8. BACKGROUND INFORMATION

Legislative framework

- 8.1 Regulation 4 of the Accounts and Audit Regulations (2003) requires audited bodies to conduct a review at least once a year of the effectiveness of its system of internal control and publish a statement on internal control each year with the authority's financial statements.

- 8.2 As permitted by the Chartered Institute of Public Finance and Accountancy's (CIPFA's) proper practice guidance, we have opted to produce an interim statement for 2004/5 and will produce a full statement for 2005/6.

Purpose of the SIC

- 8.3 The purpose of the SIC process is to provide a continuous review of the effectiveness of an organisation's internal control and risk management systems, so as to give assurance on their effectiveness and/or to produce a management action plan to address identified weaknesses in either process. At its most effective, the process of preparing the SIC will add value to the corporate governance and internal control framework of an organisation.

Corporate Ownership

- 8.4 CIPFA's proper practice requires the most senior officer and the most senior member to sign the SIC – they must be satisfied that the document is supported by reliable evidence and accurately reflects the internal control environment. This emphasises that the document is about all corporate controls and is not confined to financial issues.

Assurance gathering process

- 8.5 We already have processes dealing with aspects of the SIC. The SIC seeks to bring them together and evidence them. The SIC process should be able to rely on existing processes and documents. The task may simply be to research and formally recognise things currently done across the authority and to record them. This coordination of existing evidence will strengthen consistency of approach across the authority and promote corporate awareness of good practice.
- 8.6 The draft SIC for 2004-5 is attached at appendix A to this report. The statement is still in draft and may change after further consultation with senior officers and external audit. It is envisaged that this will be finalised and signed off by the Chief Executive and Leader by 15 September.

9 LIST OF BACKGROUND PAPERS

- 9.1 2002/3 Statement of Accounts;
2003/4 Statement on Internal Control;
Internal Audit Annual Report 2004/5, and
External Auditor's reports carried out between 2002/3 and 2004/5
- 9.2 Any person wishing to inspect the background papers should telephone 020 8359 7151.

BS: JEL
BT: CM

STATEMENT ON INTERNAL CONTROL (DRAFT 2004-5)

INTRODUCTION

The Accounts and Audit Regulations 2003 require the publication of a Statement on Internal Control (SIC) with the financial statements. Although it is published with the financial statements the SIC is a broad reflection of the whole governance of the council, and must set out the controls in place that are designed to ensure:-

- the council's policies are put into practice and that values are met;
- laws and regulations are complied with;
- required processes are adhered to;
- financial statements and other published information are accurate and reliable;
- human, financial and other resources are managed efficiently and effectively;
- services are delivered efficiently and effectively.

The SIC must be signed by the Leader and Chief Executive, after it has been approved by the council or relevant body. In considering whether to approve the SIC, the relevant body should seek to satisfy itself that it has obtained relevant and reliable evidence to support the disclosures made and should consider the reviews of the SIC by key officers within the council, including (but not exclusively) the Chief Financial Officer, Monitoring Officer and Chief Internal Auditor.

The SIC should explain the nature of control and material changes in control exercised throughout the whole accounting period. It should identify any weaknesses in control that have been identified and set out an action plan to address them. It is divided into five sections, as follows:-

- Section 1 Scope of Responsibility;
- Section 2 Purpose of the System of Internal Control;
- Section 3 Internal Control Environment;
- Section 4 Review of Effectiveness;
- Section 5 Significant Internal Control Issues.

Guidance on the production of a SIC was published by the Chartered Institute of Public Finance and Accountancy in April 2004, after the close of the financial year. An interim statement for 2003/4 was published. This statement evidences further progress towards full compliance with the process for SIC completion which will be achieved in 2005/6 by developing key indicators of internal control and documenting evidence to support the SIC.

2004/05 STATEMENT ON INTERNAL CONTROL

In line with the guidance an interim statement is being presented for 2004-5.

Section 1 – Scope of Responsibility

The council is responsible for ensuring that its business is conducted in accordance with the law and proper standards and that public money is safeguarded and properly accounted for, and used efficiently, economically and effectively. The council also has a duty under the Local Government Act 1999 to make arrangements to secure continuous improvement in the way that its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.

In discharging this overall responsibility, the council is also responsible for ensuring that there is a sound system of internal control which facilitates the effective exercise of council functions and which includes arrangements for the management of risk.

Section 2 – Purpose of the System of Internal Control

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives. It can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of council policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically.

Section 3 – Internal Control Environment

The key elements of the internal control environment are set out below.

Objectives

The council's objectives are detailed in the Community Plan, which are also reflected in the Corporate Plan. These are cascaded through service Performance Management Plans and targets for service teams and individuals. Monitoring is via the FirstStat programme, Finance and Performance Review meetings, Member Challenge events and performance management.

Policy and Decision Making

The Local Government Act 2000 and secondary guidance specify the local authority functions that are the distinct and quite separate responsibility of the council and the executive. Neither body can become involved with taking decisions on the functions of the other, with certain exceptions referred to below. The Act permits no other bodies in the formal decision-making structure other than those described below.

Council Functions

The council's functions are broadly as follows:-

- planning and enforcement;
- licensing and regulation;

- a limited number of highway matters mainly concerned with public footpaths and bridleways;
- appeals against decisions;
- staffing;
- electoral management;
- appointments to other bodies;
- some other minor functions.

These functions may be exercised by the full council meeting or be delegated to committees or officers. They cannot be delegated to an individual councillor. They are delegated to the Planning and Environment Committee and the Planning and Environment Area Sub-Committees, Appeals Committees, General Functions Committee and officers.

In addition, the full council has the power to approve the budget and statutory policy framework, but there are limitations imposed by the legislation and included in the constitution on how this can be exercised and how disagreements with the executive are to be resolved. This is the only control the council can exert over the functions of the executive. Part of each council meeting is set aside for debate on policy development, in which all councillors are able to take part. All councillors are permitted to serve on committees discharging council functions.

Executive Functions

All other functions of the local authority are the responsibility of the executive, which is the Leader and Cabinet – a total of 10 Members, which is the maximum permitted by the Act. Substitute or deputy Cabinet Members are not permitted.

Executive functions may be exercised by:-

- the Cabinet itself;
- Cabinet Committees (on which only cabinet members can vote or serve, although non-voting co-opted persons are allowed);
- individual Cabinet Members;
- Area committees (provided they are constituted on a ward basis);
- officers;
- joint arrangements with other local authorities.

The Leader is solely responsible for setting the executive delegation arrangements and limits. The executive is responsible for the preparation of the budget and the statutory policy framework for submission to the council. Otherwise, the executive is not subordinate to the council in discharging its functions and cannot be directed by the council how to discharge them.

Urgent and Emergency Decisions

Decisions taken by the decision takers set out above on both council and executive functions are subject to limitations and conditions imposed in the constitution, including financial restrictions. Some of those are relaxed for urgent decisions (e.g.

where urgent action is required but might be delayed by following the normal procedures). In an emergency (e.g. where immediate action is needed to protect life or property or to maintain a critical service) most of the restrictions are removed.

Overview and Scrutiny Committees

The functions of Overview and Scrutiny Committees are specified in the Act and are and can only be:-

- policy development and review to assist the council and the executive;
- scrutinising the decisions and performance of the executive and the council, and other public bodies in the area;
- calling-in for reconsideration key decisions taken by the executive but not yet implemented.

Key decisions are those significant in financial terms or in their effect on communities comprising two or more wards. The Constitution provides for the call-in process to be operated solely by the Cabinet Overview and Scrutiny Committee and all executive decisions taken by Members can be called in, not just key decisions. Members of the Cabinet cannot be members of Overview and Scrutiny Committees.

Compliance

Assurance on compliance with policies, procedures, laws and regulations is provided, in part, by Internal Audit, that conducts risk based audits on the highest risk areas. Other sources of assurance on compliance come from external audit, other external inspectors (e.g. OFSTED, CSCI) and from service management's own internal control arrangements.

Risk Management

There has been further progress in implementing risk management in the council in 2004-5. Combined with the further development of monitoring and reporting routines, this will provide the basis for an effective risk management process.

In February 2005, the Chief Internal Auditor was delegated responsibility for risk management by the Chief Executive. An appropriate amendment has been made to the council's constitution to reflect this. This development does not remove the primary responsibility for risk management from service managers and the Internal Audit unit will continue to review and report on risk management arrangements in their interim and annual reports. This arrangement will be reviewed towards the end of 2005-6. External Audit will increase the amount of work they do in this area as a consequence of this arrangement.

The corporate risk management group was disbanded, as it had fulfilled the requirements of its terms of reference chiefly the production of a formal Risk Management Strategy and Toolkit, which was approved by Cabinet

Heads of Service are required to establish and complete risk registers, with progress being monitored through the Finance and Performance Review process. These meetings also encompass close monitoring of draft budget reductions, to minimise the chances of unachievable savings being incorporated in the budget. This work is also taken into account by the Borough Treasurer when providing statutory advice to council on the appropriate level of balances and reserves, as now required under the Local Government Act 2003.

The Borough Treasurer is developing a corporate financial risk register in tandem with work on financial forward planning. This register will also highlight financial uncertainties and opportunities.

All reports to committees continue to include a section on risks, which contributes to Members being better informed prior to deciding on policy and making decisions and increases officer understanding and awareness of risk issues.

Heads of Service incorporate risks associated with delivering service priorities in their Performance Management Plans.

A list of corporate risks is presented to Directors' Group for evaluation and reporting to Cabinet. These are closely monitored throughout the year by officers and Cabinet.

Progress on implementing risk management is monitored by the Audit and Resources Overview and Scrutiny Committee.

The council's key corporate risks were taken into account in the Corporate Plan for the year to which this statement relates and have again been identified for the first year of the subsequent version of the Corporate Plan (2005/06 – 2008/09.)

Risk Management was included in the portfolio of the Cabinet Member for Performance, Partnerships and Best Value.

Internal Audit provide a statement in all their interim and annual reports on the adequacy of risk management arrangements. Generally, they undertake an independent review of this annually. In 2004/5 they have relied on the work of external audit in this area. External Audit's final report came to the conclusion that:

'the current arrangements and processes form a good foundation for further developing risk management so that the areas for improvement identified during our review can be addressed.'

All Internal Audit reports published in 2005-6 will have a revised format that will require management to deliver the action required by the risk identified in the report i.e. Internal Audit will no longer construct recommendations in reports. However, as experts in risk and control, Internal Audit will provide advice and guidance on construction and design of controls. Internal Audit's focus will be to ensure that the identified risk has been adequately and cost-effectively addressed.

Use of Resources

Effective and efficient use of resources is achieved through a range of review processes linked to the annual service planning cycle. Best Value reviews have been conducted across a range of council services in accordance with legislative requirements. Business and service planning is well established but under constant review for improvements.

Base budget reviews are undertaken at Finance and Performance Review meetings, as part of preparing annual budget proposals to Cabinet. These meetings were convened on a bi-monthly basis for all services in 2004-5. They will be quarterly in 2005-6.

Cabinet member challenge is also undertaken on budget proposals.

All procurement activity across the council is overseen by the Strategic Procurement Team.

All Internal Audit reviews consider the use of resources as part of the scoping exercise for each review.

A self-assessment for the 2005 assessment of 'Use of Resources' will be completed in line with deadline set by the ODPM.

The 'external auditor scored judgement' gave an overall score of '3' (of a possible '4') in November 2004.

Financial Management

Financial management of the authority is organised through a wide range of processes and procedures which are being improved to deliver stronger financial control arrangements. Central to all this is Financial Regulations, which form part of the council's constitution.

Corporate financial control is also exercised through Finance and Performance Review meetings, with core membership comprising the Chief Executive, Borough Treasurer, Chief Internal Auditor, Assistant Chief Executive and Head of Human Resources. The outcome of these meetings is reported to Management Board and Cabinet Resources Committee.

Beyond this there are individual schemes of control for specific areas, e.g. Treasury Management Strategy.

A Best Value Review of Financial Management throughout the Council was carried out in 2003/04 which identified a number of actions that would improve financial management. Progress to date includes:

- Production of draft Financial Management Toolkits to be introduced to budget managers as they are trained in SAP;
- Audit of accounts for 2003/4 signed off 3 months earlier than previous year;
- Budget monitoring improved by use of standard template across all Services;
- Introduction of "Traffic light" monitors to track progress on achieving budget savings;
- Balances forecast to be £5m at 31 March 2005 having stood at £0.931 at 31 March 2004. Section 11 Notice issued following the audit of the 2002/03 accounts was lifted following the audit of the 2003/04 accounts and scrutiny of the monitoring of expenditure during 2004/05;
- Heads of Service, as an integral part of the budget preparation process for 2005/06, completed a risk assessment on all the items of budget growth or reduction,
- Financial Forward Plan presented to Council as part of budget report, and
- Capital investment proposals subjected to Option Appraisal and Capital Prioritisation by the Corporate Asset Strategy Management Group, prior to being recommended to Cabinet.

Further planned work, which is dependant upon the implementation of SAP includes:

- The transfer of roles and responsibilities between services and Corporate Finance to ensure Services take responsibility for managing their own budgets. SAP will facilitate Services undertaking some processes and being able to enquire and receive information direct from SAP.
- The completion of a new scheme of Cost Centre Management.
- The design of efficient business processes is being done through the SAP blueprint and realisation phases.
- Reduction of manual processes leading to creation of capacity for corporate finance to be proactive in supporting and advising services.

Performance Management

The Corporate Plan is the single improvement document for the authority. It contains all the key priorities and indicators by which achievement against corporate goals are measured. Progress against targets is monitored through a corporate performance management system based on regular meetings (FirstStat, Finance and Performance Review), regular data collection (monthly returns from service areas) and Member challenge (Overview and Scrutiny) as well as by the lead member for Policy and Performance.

CPO are currently revising performance management procedures with a view to further embedding a collaborative system based on robust data. As well as the frequency and level of service monitoring, new procedures will also consider arrangements for formally signing off actions at the appropriate level. An example of this best practice is the Chief Executive's recent agreement to receive quarterly FirstStat monitoring/action plans at Director's Group for review and sign off.

Section 4 – Review of Effectiveness

The council has responsibility for conducting, at least annually, a review of the effectiveness of the system of internal control. This review is informed by the work of Internal Audit, which reviews the development, maintenance and implementation of internal control across the council.

The work of Internal Audit on key financial systems is quality assured by the council's external auditors, who also conduct some independent reviews of internal control. Other inspectorates also examine internal control as part of their work.

The process that has been applied in maintaining and reviewing the effectiveness of the system of internal control is set out below.

Council

The constitution is reviewed annually by the Special Constitution Review Committee, informed by an Officer Constitution Group and Corporate Governance work undertaken by Internal Audit.

Executive

Cabinet periodically reviews progress on key corporate risks.

The Cabinet Member for Performance, Partnerships and Value has risk management in his portfolio.

All committee reports include a section on risk.

The Audit and Resources Overview and Scrutiny Committee conducts an annual review of the budget process. In addition it reviews the Internal Audit Annual and Interim Annual Reports and the Annual (External) Audit and Inspection Letter, in addition to other key reports from Internal and External Audit during the year.

The Cabinet Overview and Scrutiny Committee is able to review all items on the Cabinet agenda and can call-in any decision taken by the Cabinet Committee or a Cabinet Member, this exceeds the statutory requirement to have arrangements for calling-in Key Decisions.

Audit and Resources Overview and Scrutiny Committee

The terms of reference of the Audit and Resources Overview and Scrutiny Committee were as follows:-

- to ensure that the council's financial report and, in particular, the annual financial statements are balanced and fair and conform to accountancy standards;
- to reassure the council that the scope and depth of external audit work is sufficient and conducted competently;
- to satisfy the council that the internal auditors carry out a sufficient systematic review of the internal control arrangements, both operational (relating to effectiveness, efficiency and economy) and financial reporting controls;
- to consider external finance management reports;
- to scrutinise the council's annual budget process, and review the council's performance in relation to budget management;
- to assist the council in developing the three year budget strategy;
- to review the management of resources made available to the council and scrutinise financial management, property and asset acquisition and disposal and capital programme;
- to review the development of a council-wide property and asset strategy;
- to review the independence and objectivity of the external auditors and matters relating to the provision of non-audit services;
- to consider communications with the external auditors on audit planning and findings and on any material weaknesses in accounting and internal control systems and to report as appropriate to the Cabinet;
- to consider the major findings of any relevant internal investigations into control weaknesses, fraud or misconduct and management's response;

- to scrutinise the action taken by the council to fully implement a risk management system.

These were the terms of reference for this committee in 2004-5. A review of the scrutiny function has resulted in the establishment of a stand alone Audit Committee outside the scrutiny framework with a revised terms of reference which will have its first meeting in June 2005.

Internal Audit

The council's Internal Audit Service is provided predominantly by an in-house team supplemented by two external partners as follows:-

- ENPEYZ, who undertake all school audits;
- Deloitte and Touche, who provide between 150 and 250 days risk based systems audit a year.

All audit work is undertaken to the standards of the Institute of Internal Auditors and the CIPFA Code of Practice.

An annual audit plan is produced by the Chief Internal Auditor, in consultation with key stakeholders, based on a risk analysis of all of the council's auditable systems. In addition, the risks in each system are reviewed by the relevant Head of Service prior to the commencement of every audit review. The audit plan is agreed with our external auditors prior to finalisation to ensure that that plans are co-ordinated to add maximum value and avoid any duplication.

At the conclusion of each audit the recommendations are discussed with the appropriate head of service and an action plan is agreed. There is a follow-up review of every internal audit to ascertain progress being made by the head of service in addressing the agreed action plan. The Chief Internal Auditor publishes an annual report to the Management Board and Audit and Resources Overview and Scrutiny Committee.

The Chief Internal Auditor is a Chief Officer of the council, reporting to the Borough Treasurer and with direct access to the Chief Executive. The Chief Internal Auditor also reports to the Audit and Resources Overview and Scrutiny Committee on the following matters:-

- annual audit plan;
- regular progress reports on key findings and progress against the annual audit plan;
- annual report providing a final position on progress against the annual audit plan, a summary of all internal audit reviews completed, and an independent opinion of the Chief Internal Auditor on the adequacy and effectiveness of the overall control environment.

Corporate Anti Fraud Team

The Corporate Anti-Fraud Team (CAFT) is a specialist investigative unit that has been established to investigate allegations of Housing Benefit, Council Tax Benefit and general fraud within the London Borough of Barnet.

A key part of CAFT's role is to be raise fraud awareness corporately via training, publicity, enhanced intelligence gathering, effective and thorough investigation and prosecution where necessary.

Mission: CAFT's mission is to assist the council in protecting the public purse through the advancement of sound strategies, procedures and controls in the prevention, detection, investigation and deterrence of fraud and corruption.

Aims: CAFT aims to minimise fraud and loss through effective prevention and detection measures and is committed to supporting the community, employees and members in deterring fraud.

Where fraud is discovered and investigated, the Corporate Anti Fraud Team is dedicated to taking necessary action against alleged offenders and will prosecute in appropriate cases.

The council is also dedicated to reviewing all controls and systems in place and will take all reasonable steps to prevent recurrence of fraud, and to recover any funds lost through fraudulent behaviour.

Reporting: CAFT report summary findings with recommendations of all corporate fraud work to Management Board and are currently finalising arrangements for reporting to the Audit Committee. In 2005/6 CAFT will have a regular quarterly slot on the Management Board agenda.

In 2004-5 CAFT conducted successful investigations into a number of areas which has further raised the profile of anti fraud activity throughout the organisation.

All investigation reports are viewed by the Chief Internal Auditor to ensure that any risk/ control issues are identified and audit plans amended accordingly. Similarly Internal Audit discuss with CAFT any areas where they have identified control weaknesses which may have increased exposure to fraudulent activity.

In 2004-5 a serious fraud in the Cashiers office was uncovered and successfully investigated and prosecuted by CAFT. Internal Audit worked closely with CAFT on this exercise and appropriate management action was agreed to address the identified weaknesses including physical security aspects of the Cashiers office and CCTV.

CAFT will be seeking to increase the level of proactive anti-fraud work conducted in 2005/6.

CAFT's links with the Law and Probity service have been strengthened by it becoming part of this Service in July 2005.

Section 5 – Significant Internal Control Issues

When preparing the 2004-5 SIC, it is important that all the significant weaknesses in internal control are identified.

Update on Issues raised in the 2002/03 Accounts.

The 2002/03 Statement of Accounts included a Statement on Internal Financial Control (SIFC). The SIFC is now superseded by the SIC, which has a wider coverage than purely financial control, but it is important to ensure issues identified in that year have been adequately addressed. The remaining issues are:-

- Best Value Review of Corporate Financial Management - this has been completed and an improvement plan has been agreed by Cabinet. An update on the BVR action plan is included above under 'Financial Management';
- Modernising Core Systems -. The system is planned to go live on 1 August 2005. Given the opportunities this project presents and the impact if not successful, this remains a high risk area. Internal Audit involvement to date has provided satisfactory assurance statements on project management and governance. External Audit have also produced an interim report on the project and have identified the following risks:
 - Whether there is sufficient time available to complete all of the delivery tasks associated with such a major implementation project. Areas of particular concern include the delivery of UAT and data migration, change management action plans at a service level, the adoption of appropriate procedures, and the delivery of a major programme of training across the Council;
 - Whether there has been sufficient focus in the project and its execution on addressing weaknesses in the control environment identified by sources such as internal and external audit and in delivering best practice in financial stewardship recommended under the CIPFA Financial Management model;
 - Whether in the context of the above, there is sufficient time available to complete and more importantly address the outcomes of assurance reviews on the systems by the MCS project team, line management as appropriate and audit reviews. Of particular concern here are any issues arising from systems testing, internal audit reviews of both documentation and historic control weaknesses and how they will be addressed in such a tight timescale.

In addition, their review identified two specific issues that the Council will need to address following implementation of SAP:

- The need to embed improvements to the financial management and internal control regime across the Council. Whilst some progress on this can be made over the next 62 days via training and by addressing concerns from audit reviews it is a longer term issue which requires constant scrutiny and follow up; and
- The need to build upon the existing benefits realisation principles which have been set out as part of the project and to underpin them with detailed outcome based targets in areas such as the cost of processing, the quality of management and financial reporting and the degree of assurance that audit is able to give over key systems.

Update on Issues raised in the 2003/04 SIC

The internal control weaknesses that were identified in the 2003/04 SIC are detailed in the table below with an update on progress.

Issues around weak systems, in general will be addressed as part of the MCS project. As part of this process the Borough Treasurer will arrange for sound financial procedures to be set in place across the council, with clear accountability. Officers will be informed and trained on the procedures.

<u>2003-4 Issues</u>	<u>2004-5 Update</u>												
Payroll: Following the serious payroll fraud reported in 2002/3, the weaknesses which allowed the fraud to occur were revisited by Internal Audit and addressed by management within the payroll service. Further follow-up and systems work by Internal Audit has allowed them to raise the assurance level from 'none' to 'limited'. The Modernising Core Systems project offers opportunity to further raise the assurance level.	Payroll will be the subject of further Internal Audit work in 2005-6. This will be scheduled after MCS go-live.												
During 2003/04 a fraud was uncovered in building cleaning regarding 'ghost' employees that highlighted more shortcomings in the HR/Payroll systems. Following a review by the council's external auditors, these have been fully reported and a separate project team has been established to address the internal control problems.	Operation Windmill was initiated to address the internal control weaknesses which allowed this fraud to occur. The operation is ongoing and working with MCS team to ensure maximum benefit gained from the new systems.												
<p>The most recurring areas of control weakness across the council identified in the 2003/4 Internal Audit annual report are:</p> <ul style="list-style-type: none"> A lack of adequate policies and procedures – of the 87 recommendations made in this area, 17 related to weaknesses in policy arrangements. Recommendations in this area do not necessarily mean that policies and/or procedures do not exist, but that improvements or additions to existing policies and/or procedures may be 	<p>All Internal Audit recommendations are followed up as a matter of course. The 2004-5 annual audit report has shown the level of implementation of recommendations to be:</p> <table> <thead> <tr> <th>Risk Category</th> <th>No.</th> </tr> </thead> <tbody> <tr> <td>High to low/Medium to Low:</td> <td>22</td> </tr> <tr> <td>High to Medium:</td> <td>6</td> </tr> <tr> <td>Low to Low:</td> <td>4</td> </tr> <tr> <td>High to High/Medium to Medium:</td> <td>17</td> </tr> <tr> <td>Total</td> <td>49</td> </tr> </tbody> </table>	Risk Category	No.	High to low/Medium to Low:	22	High to Medium:	6	Low to Low:	4	High to High/Medium to Medium:	17	Total	49
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Total	49												

<p>required;</p> <ul style="list-style-type: none"> • lack of monitoring and administrative controls over the reliability and integrity of data; • inadequate monitoring of management information to ensure objectives are achieved; • inadequate monitoring of resources. 	
<p>Key systems - the 2003/04 Annual Audit Letter identified improvements that needed to be made to key systems for internal control and key systems for producing the accounts. An action plan for addressing these weaknesses has been agreed with the External Auditor.</p>	<p>Progress against the agreed action plan has been included in the external auditor's management letter for 2004-5</p> <p>The details of the recommendations in the letter are being reviewed by the MCS team to ensure that identified weaknesses are considered in the re-engineering of processes.</p>
<p>Best Value Performance Indicators: -</p> <p>The annual external audit of the 2003/04 Best Value Performance Indicators (BVPIs) has resulted in 25 reservations and 34 amendments. This was a substantial increase from 2002/3. In the light of this the council is working toward the implementation of more rigorous information management.</p> <p>The position for 2004-5 is ... <i>(to be inserted when final report received from External Auditor)</i></p>	<p>This remains an area of weakness. Further action has been planned to address. MCS will provide a significant opportunity to address some of the weaknesses</p> <p>As part of the ongoing process of improving data integrity the following actions have been put in place across the organisation: -</p> <ul style="list-style-type: none"> • CPO work with performance lead officers to raise awareness and understanding of data reliability and evidence • a central review of submitted audit sheets to verify compliance with statutory requirements; • 6 monthly collation of BVPI data, and • all BVPI lead officers are expected to complete planning sheets for all BVPIs by April of each year.

	Internal Audit have included further review of this area in 2005-6 and will seek to work closely with CPO and external audit to ensure that weaknesses are effectively addressed.
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New Issues - General Internal Control Weaknesses/ Issues that need to be addressed in 2005/06

HR weaknesses – A comprehensive project has been initiated by the Director of Resources which is being delivered by the Head of CAFT. The objectives of the project are:

- To conduct a rigorous assessment on the HR/Payroll procedures in the recruitment and payment of LBB staff.
- To review any revised/new process at draft stage for risk/control issues.
- To develop specific fraud awareness training for all HR/Payroll staff.
- To complete the NFI data-match reports with accurate findings.
- To complete the exercise within the specified timeline.

BVPIs – The Corporate Performance Office will continue to assist services to review and improve the data gathering and reporting processes around BVPIs to ensure that the identified weaknesses are effectively addressed.

Internal Audit annual report 2004-5

The most recurring areas of control weakness across the council identified in the 2003/4 Internal Audit annual report are:

- Either no or inadequate policies and procedures (26 instances out of a total 159 recommendations made).
- Recommendations in this area do not necessarily mean that policies and/or procedures do not exist but that improvements or additions to existing policies and/or procedures may be required.
- Inadequate monitoring of management information to ensure objectives are achieved (17/159) and
- Lack of monitoring and administrative controls over the reliability and integrity of data (15/159)

External Audit Reports 2004-5

In 2004-5, external audit issued reports on the following:

- BVPIs
- Grants certification
- Risk Management

- Contract Management
- HR and Payroll
- Community Care (as was)

Recommendations have been agreed and action plans drawn up to monitor implementation

SIC 2005-6

The process for production of the annual SIC can be improved. External Audit will present to a special Management Board meeting on the significance and requirements of the SIC.

Processes to ensure that all services effectively contribute to the process, probably via a 'mini-SIC' mechanism are being considered. We envisage that the mini-SIC or 'Management Assurance report' will link together work on risk management and assurances obtained from all other sources. Ultimately, this will feed into the annual statement prepared on behalf of the Chief Executive and Leader for the Annual Accounts, and will provide supporting documentation for internal and external audit.

Leo Boland
Chief Executive

Brian Salinger
Leader of the Council