

REPORT TO: **AUDIT AND RISK MANAGEMENT SUB-COMMITTEE 25/09/06**

REPORT ON: **INTERNAL AUDIT ANNUAL REPORT 2005/06**

REPORT BY: **CHIEF INTERNAL AUDITOR**

REPORT NO: **558-2006**

1. PURPOSE OF REPORT

To submit to Members of the Audit and Risk Management Sub-Committee the Internal Audit Annual Report which summarises the activities of the Council's Internal Audit Service for the 2005/06 financial year and to provide an opinion on the strength of the Council's control environment.

2. RECOMMENDATIONS

The Sub-Committee Members are asked to note the information contained within this report.

3. FINANCIAL IMPLICATIONS

None

4. LOCAL AGENDA 21 IMPLICATIONS

None

5. EQUAL OPPORTUNITIES

None

6. BACKGROUND

- 6.1. Attached at Appendix A is a report pertaining to the Council's Internal Audit Service which provides a broad summary of the work carried out and circumstances that have impacted on the service during the 2005/06 financial year. In the 2005/06 financial year the actual days available for direct audit work totalled 1,345 compared to a budget of 1,330 days.
- 6.2. In terms of the work undertaken in 2005/06, a total of 45 Internal Audit Reports have been drafted covering a wide range of systems across the Council. The majority of the Executive Summaries for these reports have been reported to the Members of the Audit and Risk Management Sub-Committee and those that are still in the process of being finalised will be submitted in due course.

MARJORY STEWART
HEAD OF FINANCE

15 September 2006

BACKGROUND PAPERS

None

INTERNAL AUDIT ANNUAL REPORT 2005/06

1 PURPOSE OF REPORT

- 1.1 To summarise the activities of the Council's Internal Audit Service for the 2005/06 financial year.

2 INTERNAL CONTROLS

- 2.1 Each local authority is accountable for the way in which it has discharged its stewardship of public funds. Stewardship is a function of management and, therefore, a responsibility placed upon elected members and officers of an authority.
- 2.2 That responsibility is discharged by the establishment of sound arrangements and systems for the planning, appraisal, authorisation and control over the use of resources, and by the preparation, maintenance and reporting of accurate and informative accounts.
- 2.3 There are a number of aspects of corporate governance which are essential prerequisites to the traditional public sector values of impartiality, openness and transparency and the highest standards of probity and propriety appropriate to the handling of public funds. These include a sound control environment, security of key financial systems and an adequate and effective internal audit function.

3 ROLE OF INTERNAL AUDIT

- 3.1 Internal audit is an independent appraisal and review function which has been set up within Dundee City Council as a service to the Audit and Risk Management Sub-Committee, Chief Executive, Depute Chief Executive (Finance), Head of Finance and all levels of management. The remit of the service is to objectively examine, evaluate and report on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources throughout the Authority's activities.
- 3.2 The existence of internal audit does not diminish the responsibility of management to establish the extent of internal control in the organisation's systems and management should not depend on internal audit as a substitute for effective controls.
- 3.3 Internal audit is independent of the activities which it audits. This is essential to ensure that the service provides unbiased judgements and impartial advice to management.
- 3.4 The role of internal audit is to understand the key risks faced by the Authority and to examine and evaluate the adequacy and effectiveness of the system of risk management and internal control as operated by the Authority. Internal Audit has unrestricted access to all activities undertaken within the organisation in order to review, appraise and report on a wide range of areas which includes system reviews, computer audit work, location audits contract audit, specific investigations and advice on systems, controls and risk.

4 AUDIT PLANNING

- 4.1 A vital element in the effective management of internal audit is planning audit work to ensure that objectives are met, priorities are established, resources are targeted and used effectively, and best value is achieved. This involves strategic and annual audit planning.

- 4.2 A four year Internal Audit Strategic Plan, covering financial years 2005/06 to 2008/09, was approved by the Audit and Risk Management Sub-Committee in January 2005 (Report No. 61-2005).
- 4.3 The Internal Audit Annual Plan provides a summary of the audit reviews to be carried out during the forthcoming year. The Internal Audit Annual Plan for the 2005/06 financial year was approved by the Audit and Risk Management Sub-Committee in May 2005 (Report No. 333-2005)

5 AUDIT REPORTS

- 5.1 Each audit assignment results in an internal audit report which details the audit findings, recommendations and management responses, if appropriate. The reports essentially provide management with an action plan which assigns responsibility and details the timetable for the implementation of audit recommendations.
- 5.2 The findings and recommendations arising from the audit reviews reported upon in 2005/06 have been discussed with appropriate officers of the Council and agreed action plans have been put in place to address areas for improvement.
- 5.3 Internal Audit also undertakes follow up work to confirm that management has discharged its responsibility for implementing audit recommendations within the agreed timescale. Follow up work in respect of reports issued during 2005/06 will be reported upon in due course.

KEY EVENTS IMPACTING ON THE INTERNAL AUDIT SERVICE DURING 2005/06

6 STAFFING LEVELS WITHIN THE INTERNAL AUDIT SERVICE

- 6.1 For 2005/06 the Internal Audit Service establishment consisted of 9 posts namely that of the Chief Internal Auditor, Principal Internal Auditor, two Senior Internal Auditors and five Internal Auditors. During 2005/06 only one post remained vacant throughout the year. Whilst two members of staff were appointed during the first quarter of the financial year, one subsequently resigned and returned to work for her former employer. In order to maximise availability of resources due to vacant posts and staff absence and to assist in achieving the audit plan, two agency workers were appointed for a period of three months in March 2006.

7 PLAN ACHIEVEMENT

- 7.1 The following statistics have been collated from the internal audit management systems in relation to 2005/06 financial year:
- 81% of the actual productive days was spent on direct audit activities, with the remaining 19% being spent on support activities such as management, audit planning, training and development. This is in line with the figures for 2004/05.
 - Actual days available for audit reviews were 1,345 days against a budget of 1,330 days. This is an improvement on the figures for 2004/05 which were 1,005 and 1,185 days respectively and reflects the fact that the service was more fully staffed in the 2005/06 financial year and there was a reduction in the overall level of absences.

- Work carried out during 2005/06 included of the order of 35 major reviews and 25 areas where advice on systems control and risk was provided or specific investigations were undertaken. This compares to 30 and 27 respectively for the previous financial year.
- 45 internal audit reports have been prepared on the basis of the work undertaken and have generally been well received by departments with management agreeing to implement the vast majority of recommendations made. This compares to 43 for the previous financial year.
- In line with the requirements of the Code of Practice on Local Authority Accounting in the UK the Chief Internal Auditor is required to provide an independent opinion on the adequacy and effectiveness of the system of internal financial control. In compiling this statement, a copy of which is attached at Appendix B, the Chief Internal Auditor has taken due recognition of the audit work carried out by the Service and other pertinent information.

8 OVERALL ASSESSMENT OF CONTROLS

- 8.1 Work carried out during 2005/06 covered a wide spectrum of areas and included cash collection and receipting, debtors and debt management, ordering, receipting and creditors' payments, risk management, partnering arrangements, verification of grant claims and year end stocks and stores. There was internal audit coverage across most departments of the Council. In addition, the Council's Fraud Guidelines were reviewed for the first time since local government reorganisation and an updated version was issued.
- 8.2 The 2005/06 audit of corporate and departmental systems has identified that many of the expected controls are in place and operating satisfactorily in the areas examined. The audit work has, however, also identified scope for improvement in systems which either lack or have weaknesses in controls.
- 8.3 The Internal Audit Service has put forward a range of recommendations in the areas examined and action plans have been developed in consultation with management which, as they are implemented, should result in continued improvement in the overall control environment.

To the Members of Dundee City Council, Depute Chief Executive (Finance) and Chief Executive

As Chief Internal Auditor of Dundee City Council, I am pleased to present my annual statement on the adequacy and effectiveness of the internal control system of the Council for the year ended 31 March 2006.

Respective responsibilities of Management and Internal Audit in relation to internal control

It is the responsibility of the Council's Senior Management to determine, establish and maintain a sound system of internal control and to ensure that the organisation's resources are properly applied in a manner and on the activities intended. This includes responsibility for the prevention and detection of fraud. Senior Management are also charged with monitoring the continuing effectiveness of the internal control framework and taking action as appropriate. It is the responsibility of the Chief Internal Auditor to provide an annual overall assessment of the robustness of the internal control system. Internal Audit cannot be expected to give total assurance that control weaknesses or irregularities do not exist.

Sound internal controls

The main objectives of the Council's internal control systems are as follows:

- To ensure adherence to management policies and directives in order to achieve the organisation's objectives.
- To safeguard assets.
- To secure the relevance, reliability and integrity of information, so ensuring as far as possible the completeness and accuracy of records.
- To ensure compliance with statutory requirements.

The internal control system is designed to manage rather than eliminate the risk of failure to achieve the Council's policies, aims and objectives. A sound system of internal control reduces, but cannot eliminate, the possibility of poor judgement in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

A sound system of internal control therefore provides reasonable, but not absolute assurance that the Council will not be hindered in achieving its objectives or in the orderly and legitimate conduct of its business by circumstances which may reasonably be foreseen. A system of internal control cannot, however, provide protection with certainty against any organisation failing to meet its objectives or all material errors, losses, fraud, or breaches of laws or regulations.

The work of the Internal Audit Service

Internal Audit is an independent appraisal function established by the management of an organisation for the review of the internal control system as a service to the organisation. 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.

The Internal Audit Service operates in accordance with the Code of Practice for Internal Audit in Local Government in the United Kingdom, published by the Chartered Institute of Public Finance and Accountancy (C.I.P.F.A.), and which represents best practice. The Service undertakes an annual programme of work approved by the Audit and Risk Management Sub-Committee based on a four year strategic audit plan. The strategic audit plan is based on C.I.P.F.A.'s internal audit needs assessment and planning methodology and incorporates a formal risk assessment which is subject to

review and is amended on an periodic basis to reflect evolving risks and changes within the Council and any other factors which may effect organisational priorities.

Internal audit's reports identify system weaknesses and/or non-compliance with expected controls and such reports are brought to the attention of management and include appropriate recommendations and agreed action plans. It is management's responsibility to ensure that proper consideration is given to internal audit reports. The internal auditor is required to ensure that appropriate arrangements are made to determine whether action has been taken on internal audit recommendations or that management has understood and accepted the exposure to risk as a result of not taking action. Significant matters arising from internal audit work are reported to the Depute Chief Executive (Finance), Chief Executive and the Council's Audit and Risk Management Sub-Committee.

Basis of Opinion

My evaluation of the control environment is informed by a number of sources which include the following:

- The audit work undertaken by internal audit during the year to 31 March 2006.
- The assessment of risk completed during the review and updating of the Internal Audit Strategic Plan.
- Reports issued by Audit Scotland, the Council's External Auditors and also reports by other review agencies.
- My knowledge of the Council's governance, risk management and performance monitoring arrangements.

Limitation of Scope

The following material transactions with related parties have not been dealt with as part of the Council for the purposes of this statement:

- Dundee City Developments Limited
- Dundee Contemporary Arts Limited
- Dundee Cultural Developments Limited
- Dundee Energy Recycling Limited
- Dundee Ice Arena Limited
- Dundee Incubator Limited
- Dundee Leisure Limited
- Dovetail Enterprises (1993) Limited
- Tayside Cable Technologies Limited

Opinion

It is my opinion, based on the above, that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control system in the year to 31 March 2006.

Sallie M. Dailly

DATE 15 June 2006

**Chief Internal Auditor
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