

**Agenda Item No:**

**Report to:** Audit Committee

**Date of Meeting:** 29 June 2009

**Report Title:** Audit Committee 2008/09 Report to Council

**Report By:** Tom Davies  
Chief Auditor

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### **Purpose of Report**

Report from the Audit Committee on its annual review of effectiveness of Internal Audit to Council.

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### **Recommendation(s)**

1. For approval.

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### **Reasons for Recommendations**

Regulation 6 of the Accounts and Audit Regulations 2003 was amended in 2006 to require relevant bodies to conduct an annual review of the effectiveness of its system of internal audit and for a committee of the body to consider the findings.

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## Background

### Introduction

1. Regulation 4 of the Accounts and Audit Regulations 2003 requires Local Authorities 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.
2. The Local Code of Corporate Governance (paragraph 17) adopted by Cabinet in April 2003 states:

“The Chief Auditor will report annually to the Audit Committee on the state of Corporate Governance within the Council. This report will form the basis of the Annual Statement of Assurance on Corporate Governance and Internal Control Systems”

3. This report, which follows the format recommended by the Chartered Institute of Public Finance and Accountancy, sets out the review of internal control and assurance gathering process as required by the statute and accompanying guidance.
4. In addition, Regulation 6 of the 2003 Regulations was amended in 2006 to require relevant bodies to conduct an annual review of the effectiveness of its system of internal audit and for a committee of the body to consider the findings. Proper practices in relation to internal audit for relevant bodies may be found in the “Code of Practice for internal audit in local government in the United Kingdom 2006”. We have assessed ourselves against the checklist contained therein and are mainly compliant. Last year, being the first year that we needed to produce an Annual Governance Statement, we included an action plan showing those areas where we did not consider ourselves compliant with the Code of Practice for internal audit in local government in the United Kingdom 2006. Audit had intended to complete all of those actions in accordance with the timescales shown. However, there was an unprecedented level of unforeseen injected work that took priority. Two actions have been completed and the remaining recommendations given revised target dates for completion as soon as practical. A revised improvement action plan is shown at Appendix A.

### Principal statutory obligations and organisational objectives

#### Responsibility for Statutory Obligations

5. The Council has formally established responsibilities for its statutory obligations through the Constitution that sets out individual officer and member responsibilities, delegations to officers and committees, and committee terms of reference. These records are accessible on the Council's website and through the Borough Solicitor.
6. Detailed officer responsibilities are set out in job descriptions and structure charts. Each directorate has written delegations from the Corporate Director to senior managers.

7. Directors are accountable for ensuring that responsibilities, authorities and any limits to authorities are appropriately and clearly established within their directorates. The Audit Committee receives internal and external audit reports and ensures that any non-compliance is remedied through appropriate recommendations, and where necessary, requires assurance that recommendations have been implemented.

### **Organisational objectives and priorities**

8. The multi-functional nature of the Council means that there are a vast number of mandatory and discretionary requirements and powers. Hastings Borough Council took action to identify its priority objectives resulting in a list of principles and priorities underpinning the Corporate Plan. The priority areas were then devolved through Corporate Directors to Service Managers in the form of Service Delivery Plans.
9. Cabinet adopted a Local Code of Corporate Governance in April 2003. Audit Committee Terms of Reference clearly assign responsibility for the scrutiny of corporate governance arrangements to the Audit Committee.

### **Performance against planned outcomes**

10. The Authority knows how well it is performing against its planned outcomes through a comprehensive and effective performance management system managed by a team that is independent of operating responsibilities. The performance management system monitors performance against plans, targets, and financial budgets, with quarterly reports to the Overview and Scrutiny Committees.

### **Identifying principal risks to achieving the objectives**

11. 'Risk' is any obstacle, or potential obstacle, to the achievement of the Council's priority objectives or statutory duties. The purpose of risk management is to ensure the achievement of the Council's objectives with efficient use of resources.
12. By identifying high-risk groups or areas, corporate policies and service resources can be targeted on those groups or areas.
13. The Council has a formal Risk Management Framework that was approved by Cabinet. The Framework is designed to encourage managers to 'own' the risks associated with their areas of responsibility. Managers use a corporately agreed matrix for identifying and assessing risks and controls. The Audit and Investigations service carries out Risk Reviews to verify, and if necessary challenge managers' assessments. On the basis of the findings, the Audit and Investigations Division updates the risk database and provides quarterly summaries of Risk Review findings to the Audit Committee.
14. During 2008-09, in order to ensure the identification of key risks, consideration was given to risk from both a strategic and operational perspective. Using a process of self-assessment, services assessed the strategic risks (those to service provision, statutory compliance, and reputation) and operational risks (financial, physical and contractual risks).

15. During 2008-09 Audit expedited a programme of 1:1 risk management training and in conjunction with this, has been ensuring that principal risks are identified and managed.
16. Council has approved Terms of Reference for the Audit Committee giving it a clear remit to,  
  
"Review, evaluate and approve: The effectiveness of the Council's process for assessing significant risk exposures and the measures taken by management to mitigate risks to an acceptable level"
17. Throughout 2008-09, the Audit and Investigations service has continued to develop the programme of Risk Reviews.
18. A large part of the internal audit plan is risk-driven.

### **Key controls for managing principal risks**

19. To ensure that its controls are fully up to date with the current operating environment, on 14th December 2005 Council replaced the Financial Regulations, Contracts Standing Orders, and some parts of the Financial Delegations to Chief Officers with new Financial Rules and Finance Operating Procedures. These new Rules and Procedures underwent a full review and were re-published during April 2007 and provide the framework within which Members and officers must operate and compliance will be routinely checked through audit reports to the Audit Committee.
20. In addition, the Council has these controls in place:
  - a. The Council has adopted the CIPFA Code on Treasury Management to ensure compliance with the Prudential Code
  - b. A Confidential Reporting ("Whistleblowing") Policy
  - c. A Counter-Fraud and Corruption Policy
  - d. Codes of Conduct for Members and Officers
  - e. Registers of Interests for Members and Officers
  - f. A Scheme of Delegation, including financial and budgetary responsibilities
  - g. A Corporate Risk Database that is updated on an ongoing basis
  - h. Each service produces a Service Delivery Plan and performance is monitored through quarterly Performance Reviews
  - i. A Corporate Health and Safety Policy and assessment procedures have been drawn up and formally approved
  - j. A Corporate complaints procedure operates and is administered by a dedicated officer

## Sources of assurance

21. Sources of assurance on the adequacy and effectiveness of the Council's controls over key risks include:
- a. An Audit Committee that is a fully constituted Committee of the Council
  - b. An internal Audit and Investigations Division that is independent in planning, operating, and reporting, and that reports to the Audit Committee
  - c. A Chief Finance Officer (the Deputy Chief Executive & Director of Corporate Resources) with responsibility for ensuring the proper administration of the Council's financial affairs
  - d. Processes for maintaining internal control include a framework of regular management information, Financial Rules and Finance Operating Procedures, administrative procedures (including segregation of duties), management supervision and a system of delegation and accountability
  - e. A performance management system that includes commentary on service-level risk, the setting of targets for service delivery and monitoring of performance against targets and plans
  - f. A strategic Corporate Plan setting out the Council's priorities, which cascades to operational plans at service and project level, including consideration of risks
  - g. An annual budget and quarterly reviews of actual expenditure to budget
  - h. A Local Code of Corporate Governance agreed by Cabinet
  - i. A project management system for major projects
  - j. A Risk Management Framework that was first introduced and approved by Cabinet in 2003. This was reviewed during 2006/07 and is in the process of being reviewed again having been extensively revised.
  - k. A Counter-fraud and Confidential Reporting ("Whistleblowing") Policy
  - l. Codes of Conduct for Members and Officers
  - m. A Staff Health & Safety Group that monitors insurable and public liability risks
  - n. A Corporate Risk Management Group that has been developing the risk management strategy
  - o. Risk management processes designed to ensure that Directors and Managers retain ownership of the risks and internal controls associated with their areas of responsibility. Directors and Managers are therefore an important source of assurance on the effectiveness of controls for managing risks
  - p. The Audit and Investigations service carries out audit and risk reviews of high-risk areas to provide assurance that major risks have been identified and are

being actively managed, and that the internal control environment is adequate

- q. The Deputy Chief Executive & Director of Corporate Resources in his role as the Chief Financial Officer, provides a source of assurance that the requirements of the Local Government Act 1972 section 151 are being met
- r. The Borough Solicitor in her role as Monitoring Officer, undertakes the relevant statutory duties and provides a source of assurance that the Council's affairs are conducted in compliance with relevant legislation and Codes of Conduct
- s. External audit provides a source of assurance on the operation of internal controls in that PKF inspects internal audit work at each annual external audit

## **Evaluation of assurances and identification of gaps**

### **The Audit and Investigations Division**

- 22. On the basis of the audits reported to the Audit Committee by the Audit and Investigations Division, the audit conclusion is that during the year 2008-09, 83% of the Council's operations that were audited incorporate control systems that are 'Satisfactory' or better.
- 23. The "poor" opinion related to the Museum Extension Project. 5 recommendations were made and accepted. 4 of the 5 recommendations are now implemented and recommendation 4 that was made - The use of a formal project methodology to be further embedded in the council's working practices and training given to all appropriate staff - is in progress and in the 2009/10 Corporate Plan.
- 24. The published annual plan was not fully discharged this year. This was due mainly to work spent strengthening controls over contract management resulting from the recommendations made in PKF's Review of Missing Income report and other injected work. The work that was not completed in the 2008/09 published audit plan included one main audit that is in progress and mostly completed and four lesser assignments that were also in progress and will be completed in the early part of the current year. The audit programme included International Auditing Standards (IAS) end of year support work that covered nearly all key financial controls. There were no major issues to report.
- 25. In financial systems, the audit aims to evaluate the strength of controls for ensuring the proper administration of financial resources. In the audit of non-financial areas, the audit aims to evaluate the strength of controls for ensuring that external obligations are met and that the success criteria of the activity under review are achieved. The following table shows the audit conclusion for each of the main audits carried out in 2008-09:

Summary of Audit Conclusions		
Audit Conclusion	No of Audits	% of total audits
<b>A: Good</b> More than the key controls are in place and work effectively. While improvement may be possible, there are no significant audit concerns	3	50%
<b>B: Satisfactory</b> The key controls are in place and work effectively. Improvement is possible but there are no significant audit concerns	2	33%
<b>C: Adequate but with reservations in some areas</b> Some controls in place are adequate but there are audit concerns in some areas	0	-
<b>D: Poor</b> Controls are not adequate or not present or not adequately complied with. Improvement is essential	1	17%
<b>Total audits</b>	<b>6</b>	<b>100%</b>

26. This compares with previous years as follows:

Audit Conclusion	2006-07		2007-08		2008-09	
	No of audits	% of total	No of audits	% of total	No of audits	% of total
A: Good	0	0%	0	0%	3	50%

B,C: Satisfactory	5	100%	5	100%	2	33%
D: Poor	0	0%	0	0%	1	17%

27. The audit conclusions are defined in the service's own Internal Audit Manual. Whilst the audit plan is mainly formed on risk based selection, we have also been moving towards Risk Based Internal Auditing which should lead to greater efficiency and increased number of audits in future years.

### External Audit

28. PKF (UK) LLP are external auditors and were appointed by the Audit Commission to undertake external audit of Hastings Borough Council with effect from 1st April 2007. External audit is an important source of assurance on the adequacy of the Council's arrangements for ensuring proper arrangements for its financial affairs. During 2008-09 the Audit Committee received the following reports:

29.	Report Title	Date issued
	Annual Governance Report	Sept 2008
	Opinion on financial statements	Sept 2008
	Value for Money conclusion	Sept 2008
	Use of Resources report	Jan 2008
	Annual Audit & Inspection Letter	Mar 2009

30. PKF gave an unqualified opinion on the Council's accounts for 2007-08. In March 2009, PKF's overall Use of Resources judgement scored Hastings Borough Council as a 3 (out of a possible 4) that is performing "consistently above minimum requirements – performing well". No areas covered by the appointed auditor's judgements deteriorated and arrangements for preparing and publishing the final accounts improved.

### Areas of audit concern arising from internally conducted audits

31. Under the approved risk-based audit planning strategy, risk assessments can be raised or lowered as appropriate during the course of the year when new issues come to light.

32. Although risk levels changed, there were hardly any concerns arising from internally conducted audits and those that needed to be raised have been incorporated in the 2009-10 Internal Audit Plan. The exception to this has been on Museum Extension audit report that was commissioned internally and reported to the September 2008 Audit Committee.



## Areas of audit concern arising from External Audit

33. The Audit Commission identified key areas for the Council to take action on in its Annual Audit and Inspection Letter published March 2009. One of those main areas is to:
34. Continue to report to the Audit Committee the progress made in implementing improvement plans to:
- embed risk management arrangements across all aspects of the Council's operations; and
  - ensure standing guidance for the management of contracts is fully complied with.

## Policy Implications

### Risk Management

35. This report refers to the way that the council manages its risks.

### Organisational Consequences

36. The Annual Audit and Inspection Letter 2008/09 highlighted the need to report to the Audit Committee the progress made in implementing improvement plans on further embedding risk management arrangements across all aspects of the Council's operations and evidence standing guidance for the management of contracts is complied with.
37. It is also the first year of Comprehensive Area Assessments (CAA) of which systems of internal control are a part.

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## Wards Affected

None

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## Area(s) Affected

None

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## Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues	No

Economic/Financial Implications	No
Human Rights Act	No
Organisational Consequences	Yes

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### Supporting Documents

“Code of Practice for internal audit in local government in the United Kingdom 2006”.

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### Officer to Contact

Tom Davies  
tdavies@hastings.gov.uk  
Tel: 01424 451524

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### Action Plan to improve compliance with the Cipfa Code of Audit Practice Appendix A

Adherence to standard	Comment	Responsibility	Target date
Do the ToR define Internal Audit's role in :  (a) fraud and corruption work?  (b) consultancy work?	The ToR partially defines Internal Audit's role but will look to revise and enhance it	Chief Auditor	30/09/09
Is Internal Audit independent of the activities it audits?	There is a potential procurement risk (that also exists in a number of other authorities) but this has been carefully considered and an action plan including Control Risk Self Assessment (CRSA) and a possible peer review, are still to be carried out	Deputy Chief Executive & Director Corporate Resources	31/12/09
Is there a protocol that defines the working relationship for Internal Audit with:  - management? - other internal auditors? - external auditors? - other regulators and inspectors? - elected members?	A formal protocol exists with the external auditors and an informal protocol works with each of the other parties satisfactorily but will need to define the informal ones within the audit manual	Chief Auditor	30/09/09

<p>Has the strategy been approved by the Audit Committee?</p>	<p>We have a service delivery plan, risk management strategy, audit strategy and IT audit strategy. Of these, the Service Delivery Plan is the most important and has been reviewed by senior management. The Council recognises the importance of having a detailed Audit Strategy and so a formal one will be submitted to the January 2010 Audit Committee.</p>	<p>Chief Auditor</p>	<p>12/01/10</p>
<p>Is there a defined policy for the retention of all audit documentation, both paper and electronic?</p>	<p>Completed: A document retention and destruction policy for internal audit documentation is now contained within the HBC Internal Audit Manual.</p>		<p>Completed</p>
<p>Has the Chief Auditor established appropriate escalation procedures for internal audit recommendations not implemented by the agreed date?</p>	<p>Follow-up procedures have been reviewed and incorporated within the HBC Internal Audit Manual.</p>		<p>Completed</p>