

**WATFORD BOROUGH COUNCIL**

**INTERNAL AUDIT SERVICE**

**ANNUAL REPORT 2006/2007**

**1 Introduction**

The Accounts and Audit Regulations require the Council to maintain an adequate and effective system of internal audit of its accounting records and of its systems of internal control in accordance with proper practices in relation to internal control.

Those “proper practices” are primarily the standards set out in the Chartered Institute of Public Finance and Accountancy’s (CIPFA) *Code of Practice for Internal Audit in Local Government in the United Kingdom 2006* (the Code) but also include *Statement on Internal Control: Meeting the Requirements of the Accounts and Audit regulations* (CIPFA) and *Corporate Governance in Local Government* (CIPFA/SOLACE).

Included in the Code is the requirement that the Head of Internal Audit must provide a written report to those charged with governance timed to support the Statement on Internal Control and this annual report must:

- Include an opinion on the overall adequacy and effectiveness of the control environment
- Disclose any qualifications to that opinion together with the reasons for the qualification
- Present a summary of the audit work from which the opinion is derived, including reliance placed on work by other assurance bodies
- Draw attention to any issues the Head of Internal Audit judges particularly relevant to the preparation of the Statement on Internal Control
- Compare the work actually undertaken with the work that was planned and summarise the performance of the internal audit function against its performance measures and targets
- Comment on compliance with the CIPFA standards and communicate the results of the Internal Audit quality assurance programme.

In accordance with past practice, my annual report also includes details of work undertaken by Internal Audit which has not previously been reported to the Audit Committee in my regular progress reports. This avoids the need for a separate progress report and in this case covers the period from mid-December 2006 to 31<sup>st</sup> March 2007 (see 5.2).

This report is one of the key sources of assurance used in the production of the Statement on Internal control.

**2 Audit Opinion**

In my opinion Watford Borough Council’s control environment is adequate and operates effectively. The factors taken into account in forming this opinion are set out in section 3 below, with more detailed comments in sections 5 and 6. It should be

noted that whilst it is not possible to give absolute assurance of the effectiveness of the control environment I am able to provide reasonable assurance of the overall effectiveness of controls.

Almost inevitably, given the range and complexity of services provided and the level of support services, weaknesses have and will continue to be identified within individual systems. Many of the recommendations made to remedy these weaknesses related to improvements in existing controls, recommendations for alternative or additional controls or the adoption of measures of best practice.

### **3 Qualifications to Opinion**

Whilst overall control arrangements are effective there are certain qualifications to this and I am obliged to report on them. These matters should be considered for inclusion in the 2006/2007 Statement on Internal Control (SIC). Some were raised in my last annual report.

- (i) The implementation of risk management is an area where steady progress has been made, especially at the strategic level, but more remains to be done. A corporate business continuity plan is in place although this has not been tested and an action plan to further develop business continuity arrangements has been agreed. This needs to be pursued.
- (ii) A number of control weaknesses were identified in the critical and sensitive payroll system. It is worrying to have to report that there has been an increasing number of errors resulting in under and over payments to staff. Many of these appear to be unforced. The correction of the errors has, in turn, created additional work. (See 5.2.6).

I would also draw attention to the need for procedure notes for Payroll where there is a manual in existence but which urgently requires updating. The service is provided by temporary staff whose contracts are due to expire shortly and procedures must be documented in the interests of business continuity.

It is worrying to report that this is the fourth successive year that I have had to draw attention to weaknesses in the payroll function. It is an area where urgent action is required.

- (iii) Although significant improvements have been made in project management arrangements, e.g. for major projects and in the integration of project management and service planning, there are still areas where improvement is required. For example, there is a lack of consistency in applying project management methodologies across the council and inadequate arrangements for reporting progress against specific milestones makes it difficult to assess whether projects are on target. There is a danger that proposals drafted by the Project Manager (Value for Money Programme) for progress reporting (which would address many of the issues raised during this audit) may not be progressed if other duties take precedence.

- (iv) Arrangements for controlling changes to business information software are weak. Whilst there is no evidence to suggest this has occurred, failure to properly manage change could have consequences such as partial or complete failure of software or the production of unreliable data (see 5.2.1).
- (v) The Benefit Fraud Inspectorate (BFI) reported critically on the effectiveness of measures and processes in place to prevent, deter and detect benefit fraud. The report highlighted management and performance weaknesses, including the lack of a fraud case management system, the inability to produce reliable performance information and the high caseload of fraud investigators. This report has already been discussed by the Audit Committee. It is vital that the measures set out by the Council to address the BFI's criticisms are fully implemented and performance is kept under constant review.

## **4 Basis of Opinion**

### **4.1 Work Undertaken**

My opinion on the effectiveness of the control environment is based on the work undertaken by Internal Audit during the 2006/2007 financial year which was in accordance with the approved Audit Plan. This work plan was designed to cover the key risks facing the council. More detail is included in section 5 below.

Whilst considerable progress has been made in implementing risk management processes across the council, the published risk registers were not sufficiently robust or detailed enough to enable me to base the Audit Plan solely on them. However, the procedures followed in setting up and implementing the audit work plan and the arrangements in place for reviewing the implementation of audit recommendations should provide a reasonable degree of assurance that most of the key risks have been reviewed and action taken as appropriate.

### **4.2 Audit Plan**

The 2006/07 plan was based on discussions with Heads of Services to identify their key concerns, on my knowledge of developments and weaknesses within the Council, on Internal Audit's own long-term risk assessment, on discussions with the Audit Commission and on a review of risk registers.

The draft plan was discussed with the Director of Finance and presented to the Corporate Management Board before being finally approved by the Audit Committee thus offering the opportunity for amendment in the event of any significant shortcoming.

This process should ensure that all key systems and significant risks have been taken into account.

### **4.3 Completing an Audit**

When an audit has been completed weaknesses/areas requiring improvement are reported to, and discussed with, senior management. This leads to an action plan showing measures and timescales agreed with management for the implementation of audit recommendations.

Written confirmation of implementation of these recommendations is sought from Heads of Services on a quarterly basis. Generally speaking this assurance is forthcoming although there have been occasions when I have needed to rigorously pursue responses. It has also been found that timescales have not been met. Occasional follow up visits are carried out and recommendations relating to key systems are routinely followed up during the next planned audit.

Despite the reservations expressed above, these arrangements should ensure that action is taken to remedy any issues identified during the year.

As in previous years considerable resource has been devoted to auditing the key business systems (Aptos, Radius Payroll etc). By the time all of the audits have been completed 32 reports will have been issued illustrating the breadth of work undertaken.

Once all final audit reports have been issued it is anticipated that 278 recommendations will have been made. Of these, 151 will be High priority, 103 Medium and 24 Low. This averages just over 8.5 recommendations per report.

#### **4.4 Other Factors**

- My observations arising from requests to Internal Audit for assistance, attendance at meetings, committee agendas and minutes etc
- Progress made in tackling those significant control issues raised in my last annual report and those raised in the 2005/2006 Statement on Internal Control which I am able to comment on.
- There have been no limitations placed on the scope of work undertaken by Internal Audit, on its access to records and information or on the provision of explanations as necessary.
- Internal Audit has had sufficient resource to enable it to complete its work programme, including additional funding to enable it to buy in support to cover for a vacant post.
- The absence of material changes in the Council's objectives or activities in the year under review.
- The completion of Statements of Assurance by Heads of Services confirming that they have assessed risks facing their respective services and have implemented Internal Audit recommendations. Unfortunately the value of these statements remains limited.

#### **4.5 External Assurance**

I have also taken the following into account:

- The findings of work performed by the Audit Commission
- The Use of Resources Assessment
- The Benefit Fraud Inspectorate (BFI) report *Inspection of Security* (previously reported to the Audit Committee)

- The Zurich Municipal report on risk management (previously reported to the Audit Committee)
- The work undertaken by an external provider of audit services on behalf of Internal Audit. (IT audits and other work as cover for a vacant post).

## **5 Review of Work Undertaken During the Year**

This section summarises the key conclusions arising from audits undertaken during the year. These were taken into account in formulating my opinion of the effectiveness of the control environment. Those audits covered in section 5.1 relate to key areas of work undertaken during the period April 2006 to December 2006 and have already been reported to the Audit Committee. Section 5.2 reports in greater detail on work undertaken between mid-December 2006 and March 2007.

### **5.1 Previously Reported**

- **Performance Indicators**
- **Payroll**

See 5.2.6 below for details of further work undertaken.

- **Radius (Income System)**
- **Benefits Subsidy Claim**

A significant weakness associated with this claim involved the inability to reconcile the amount of benefit actually paid (as recorded in Aptos) to that on the claim (as extracted from Civica). I am not yet convinced that sufficient action has been taken to resolve this.

- **Benefits Administration**
- **Aptos (main accounting system)**

### **5.2 Work undertaken since mid-December 2006**

#### **5.2.1 IT Change Control**

This audit centred on a review of arrangements for controlling changes to business information software both within the Business Information Service (BIS) and individual services. Whilst there is no evidence to suggest that failure has occurred, the lack of formally adopted and enforced corporate processes for the management of changes to IT systems means that change controls across the Council have been weak. The Head of BIS has agreed to develop a change control policy which, with the recently commissioned Information Security Policy, should address the various concerns raised in the report.

### **5.2.2 Parking Control**

An audit was undertaken at the request of the Parking Control Manager who was concerned about the adequacy of income reconciliations carried out in the Parking Shop. Whilst there were procedural weaknesses and a number of errors were identified there was no evidence of any loss of income to the Council. The contractor agreed to make immediate improvements.

### **5.2.3 Creditors**

The Systems Administrator can initiate payment runs and change bank details in the supplier file. This is a significant weakness which it has not yet been possible to resolve.

### **5.2.4 IT Procurement**

IT procurement is governed by the same rules as other procurement. Most IT purchases are managed by the Head of BIS and there is an expected process to be followed that requires the production of a business case in support of purchases. There is however a lack of consistency in recording the processes followed to support decisions made. It is not always possible therefore to demonstrate that best value has been obtained. Furthermore, guidance on the involvement of BIS in developing business cases was lacking with the potential consequence that alternative cost effective solutions to business problems may not have been considered. It was also noted that the IT asset database was not up to date.

The Head of BIS has agreed a series of measures, some in conjunction with the Procurement Manager, to overcome these problems.

### **5.2.5 Project Management**

Since the Audit Commission raised concerns about the absence of a corporate approach to project management in 2005 significant improvements have been made.

There are still a number of areas where further action is required however. The Council has a Project Management Toolkit but its principles are not universally applied and not all project managers have attended the training sessions on its use. Project risk management is not being widely applied (it is proposed that this will be a requirement of the 2008 Use of Resources assessment). A lack of detailed project implementation plans and progress reporting procedures could lead to project deadlines not being met.

### **5.2.6 Payroll**

Three separate pieces of work were undertaken throughout the year. The weaknesses identified by the first audit were reported to the September meeting of the Audit Committee. Since then a follow up audit has been completed. This concluded that, despite agreement to implement all recommendations, nine out of twenty eight had not been actioned and others had only been partially completed. Included in these recommendations was the need to document procedures. This had not happened even though procedural changes had been made.

A third audit was then carried out to establish why there had been a large number of salary payments made via the Clearing House Automated Payments System (CHAPS) even though there is the facility to have two pay runs every month (other additional payments had also been made via the Bank Automated Clearance System [BACS]). There were two main reasons for this. The first was due to delays in services providing information re changes of pay details to Payroll (one of the non-implemented recommendations made in the first report was that Payroll should remind services of the need to provide such information in a timely manner). The second was due to errors made within Payroll.

#### **5.2.7 Contract Procurement and Management**

This audit looked at the awarding and managing of larger contracts. It concluded that the contract procurement guide was generally followed although it was difficult to find some tender documentation and contractors' certificates of insurance were either missing or out of date. The quality of management of the two contracts reviewed varied. The Procurement Manager has agreed to provide training to cover the general issues raised.

#### **5.2.8 Other audits where no significant weaknesses identified**

- **Bank Reconciliations**
- **Council Tax – (i) Administration and (ii) IT Application**
- **Housing Rents**
- **Recruitment**
- **Prudential Code**
- **NDR**
- **Asset Management**
- **Radius – IT Application**
- **Support service recharges**
- **Budget Monitoring**

### **6 Statement on Internal Control – 2005/2006**

The 2005/2006 Statement on Internal Control highlighted five significant control issues. In forming my opinion on the control environment I have taken into account progress identified during the course of normal audit business in remedying some of these issues. An interim progress report was made to the Audit Committee in September 2006. The latest position is reported below.

#### **6.1 Lack of Business Continuity Plans.**

An initial Corporate Business Continuity Plan and individual service plans have been published. Further work is required to finalise these and to prioritise the order in which systems need to be recovered in the event of total failure.

#### **6.2 Lack of Comprehensive procedure notes for key systems.**

See 4 (i) above.

### **6.3 Project management processes and skills are not embedded.**

See 5.25 above.

### **6.4 Lack of comprehensive monitoring leading to slippage or non-achievement of objectives.**

Corporate Management Board (CMB) has agreed a process whereby progress in implementing recommendations from internal and external audit and other review bodies are reported either to CMB or to the appropriate committee.

### **6.5 Need to develop more proactive approach to internal control in all services.**

Heads of Services are required to complete an annual assurance statement acknowledging their responsibility for risk management and internal control within their respective services. The scope of the statements has twice been outlined in writing to all Heads, reinforced by individual discussion with some Heads and a General Management Team presentation. As the quality of responses has been variable it is felt that more needs to be done by way of additional guidance.

At the time of preparing this report all statements have been received with the exception of those from BIS and HR.

## **7 Annual Improvement in the Effectiveness of the Control Environment**

I have continued the exercise which attempts to quantify improvements in the control environment by comparing the number of High and Medium priority recommendations made for key systems on a year by year basis. This is not an exact science as systems may change over time as may the objectives and parameters of individual audits. For 2006/07 I have selected those audits which I feel may best be compared with the last two years.

The details are shown in Appendix 4. Over the three year period there has been a drop in the numbers in both categories of recommendation (High and Medium). Whilst this may be taken as a broad indication of improvement over time it should be seen as no more than that. On the down side, it is disappointing to note that there have been increases for some audits, especially Benefits Administration. This last point could be due to the increased experience gained in this area by the auditor who regularly carries out the work.

## **8 Audit Report Follow up**

All audit recommendations are followed up to ensure that action has been taken, or where not, that there is an acceptable reason. All reports containing High or Medium priority recommendations are followed up on a quarterly basis with written confirmation that recommendations have been implemented sought from Heads of Services. In the case of key systems they are also checked on the next audit visit. One follow up review has been completed (Payroll).

Failure to implement recommendations will be reported to the Corporate Management Board.



## **9 Fraud Investigations/Awareness**

With the exception of benefit fraud, which is investigated by a specialist fraud team, Internal Audit is responsible for investigating suspected cases of fraud and corruption. The only case I reported to the Audit Committee was the loss of decoration vouchers from Housing Services. This was reported to the police but the matter was not resolved.

The Anti-Fraud and Corruption Strategy and the Whistleblowing Policy have been reviewed and approved by the Audit Committee. Ways of raising awareness of these are being explored and fraud awareness training is being provided by the interim Fraud Manager.

## **10 IT Audit**

Following a countywide dispute over the quality of work undertaken and lack of working papers with the previous supplier of IT audit services a new company was engaged for 2006/07. As a gesture of goodwill the old supplier was persuaded to carry out one further audit (Website Security) free of charge. The new provider has given good service.

The Head of Business Information Systems has commissioned a consultant to produce an Information Security Policy. The need for such a policy has been raised on various occasions in the past by both internal and external audit. This is now a positive step forward but the real benefits will only arise once supporting procedures are put in place.

## **11 Internal Audit - Quality Assurance**

The Internal Audit team seeks to operate in accordance with the standards laid down by CIPFA. The latest guidance (*Code of Practice – 2006*) has been published to reflect changes arising from the 2006 amendments to the Accounts and Audit Regulations and it sets out standards under the following eleven headings:

- Scope of Internal Audit
- Independence
- Ethics for Internal Auditors
- Audit Committees
- Relationships
- Staffing, Training and Continuing Professional Development
- Audit Strategy and Planning
- Undertaking Audit Work
- Due Professional Care
- Reporting
- Performance, Quality and Effectiveness.

Under these headings there are over one hundred separate criteria listed, many of which are further subdivided. I have carried out an initial review of Internal Audit's performance against these and whilst there are areas where Internal Audit does not comply I am satisfied that there are no material areas of non-compliance that I need to report on at this stage. In coming to this conclusion I have assessed the risk non-compliance has on the effectiveness of the control environment.

I propose to carry out a more detailed review of compliance with the standards and report separately on individual criteria to the next meeting of the Audit Committee.

Internal Audit's work is subject to review by the external auditors on an annual basis. There has been no criticism of our work over the past year.

Internal Audit has its own quality assurance controls. Standard procedures and working papers are used. For every audit I review the working papers and all versions of the audit report. Any concerns/queries are discussed with individual auditors.

Work on individual audits is carried out by auditors with the appropriate level of skill and experience.

Use is made of customer satisfaction questionnaires as a means of independent comment on our service. Any issues raised are discussed with the customer and the auditor. We try to learn from any mistakes we may make or from suggestions for improvement.

Copies of all final audit reports are circulated to CMB for comment.

We work with colleagues from other audit teams in Hertfordshire in the exchange of ideas and best practice and also help facilitate joint training sessions covering the latest developments in internal auditing. All auditors from participating authorities attend these sessions.

Barry Austin  
Audit Manager  
30<sup>th</sup> May 2007

**Progress Report on Individual Audits  
2006/2007**

**Appendix1**

<b>Project</b>	<b>Progress</b>	<b>Days Allocated 2006/07</b>	<b>Days Taken (31 3 07)</b>
<b>Audits Brought forward – 2005/2006</b>			
NNDR	Final report 14 06 06	-	3
Budgetary Control	Final report 13 06 06	-	3
Payroll – continued in 2006/07	-	-	-
CSC – Cash Handling	Final report 30 06 06	-	0.5
CSC – IT Security	Final report 13 09 06	-	1.5
Bank Reconciliations	Final report 12 06 06	-	8.5
<b>2006/2007 Audits</b>			
Performance Indicators – review of 2005/2006 KPIs	Final report 04 07 06	25	28
Repairs Service a) use of materials. b) job control. More work to follow.	a) Final report 25 07 06 b) memo 25 07 06	30	7.5
Payroll – system review, flowcharting and testing of key controls. (Continuation from 2005/06).	Final report 09 1 06	25	30
Radius (Income) – system review, flowcharting and testing of key controls.	Final report 07 09 06	25	20.25
Loss of decoration vouchers.	Final report 13 07 06	Contingency item	15
Benefit Subsidy Claim – following up issues previously raised by Audit Commission and Internal Audit and testing elements of the claim.	Final report 07 11 06	12	27.25
Sundry Debtors – system review, flowcharting and testing of key controls.	Final report 14 12 06	20	22
Benefits Administration – work as above.	Final report 24 01 07	30	31.75
Council Tax – as above (order placed with Tribal – Business Assurance Division)	Final report 23 03 07	15	15
Creditors – as above – order with Tribal.	Final report 30 03 07	15	15
Housing Rent Collection – system review, flowcharting and key control testing.	Final report 21 03 07	20	26.5
Aptos – system flowcharting and review of feeder system reconciliations.	Final report 01 02 07	10	9
IT Procurement	Final report 16 04 07	10	16.2

IT Standards	Final report 29 03 07	15	17.25
IT application audit – Council Tax (Order placed with Tribal)	Final report 26 03 07	7	7
IT application audit – Radius (order placed with Tribal)	Final draft 26 03 07	7	7
Support Service Recharges (order placed with Tribal)	Final draft 26 03 07	6	6
Trade Waste (order placed with Tribal)	Final report 27 03 07	8	8
Combined Procurement/Contract review (order placed with Tribal)	Final report 02 04 07	15	15
Recruitment process – review to ensure robust procedures in place.	Final report 28 03 07	5	5.25
NNDR – system review, flowcharting and key control testing.	Final report 05 04 07	15	14.75
Parking Control – procedure review (at request of the Parking Services Manager)	Final report 16 03 07	5	5
Bank Reconciliations – review timeliness and accuracy	Final report 20 03 07	4	4.5
Website – review of security (order placed with Bentley Jennison).	Final report 29 03 07	4	4
Payroll – follow up audit to review implementation of recommendations and review of urgent CHAPS payments (Clearing House Automated Payment System)	Final report 24 05 07 Draft report 03 05 07	4	13
Contract audit – Leisure facilities – initial review of monitoring arrangements	No report, review completed	2	2
Prudential Code – application of the principles of the Code.	Final report 28 03 07	6	6
Fixed Asset Management	Final report 20 04 07	10	7
Budget Monitoring – review of processes	Testing approaching completion	8	6.75
Project Management	Final report 09 05 07	15	20

**Time Allocation exceeded (by more than two days)**

<b>Audit</b>	<b>Target Time per Plan</b>	<b>Actual Time</b>
2005/06 KPIs	25	28
Payroll	25	30
Benefit Subsidy Claim	12	27.25
Sundry debtors	20	22
Housing rents	20	26.5
IT Procurement	10	16.2
IT Standards	15	17.25
Payroll follow up	4	13
Project Management	15	20

Additional time per audit is due to several factors e.g. unexpected problems encountered during the audit, follow up on queries and the need to carry out unforeseen testing.

**Audits still in progress as at 31<sup>st</sup> March 2007 – further testing required.**

Fixed Asset Management  
Budget Monitoring  
Payroll – CHAPS payments

**Audits not undertaken as per Audit Plan**

Risk Management – but an independent health check review was undertaken by Zurich Municipal instead.

Housing Repairs and maintenance contracts – work was completed in both areas but not to the extent originally planned. The Repairs Service was undergoing a re-organisation and procedural changes were being introduced. It was decided that it would not be practical to complete the planned work.

**Additional Audits not included in Original Plan**

Parking Control – undertaken at the request of the Parking Control Manager who had concerns over income banking arrangements.

Payroll – review of urgent payments made via the CHAPS system.

## LOCAL PERFORMANCE MEASURES 2005/2006

## (i) Targets Based on Audit Plan

Criteria	Target pa (as per audit plan)	Actual 2005/06	Actual 2006/07	Comment
% of revised annual audit plan achieved (based on number of projects)*	90%	91.3%	89.1%	
Sickness – days per FTE	7.5	7.5	2.3	
Training – days per FTE	6.25	3.13	6.4	

\* Calculation based on audit plan as approved by the Audit Committee. It takes into account the number of completed audits, the number at preparation of final report stage, at preparation of draft report stage, at completion of fieldwork or % of testing completed. This is in accordance with practice agreed with other Hertfordshire authorities.

## (ii) Other

Criteria	Target pa	Actual 2005/06	Actual 2006/07	Comment
Final audit report issued within 10 available working days of agreement to draft report.	100%	100%	100%	
Draft reports issued within 10 days	100%	89.66%	72.22%	Target missed as the Audit Manager unable to review all drafts promptly due to working on fraud team/BFI issues.
Level of customer satisfaction	85%	94.07%	93.94%	Based on 11 returned questionnaires.
The number of “chargeable” days actual/planned	85%	90.2%	90.9%	
Completion of planned follow up work	100%	100%	100%	

Appendix 4

**Comparison of number of recommendations made for some of the business critical systems.**

System	2004/05			2005/06			2006/07		
	High	Med	Total	High	Med	Total	High	Med	Total
Council Tax	0	3	3	2	4	6	1	6	7
Housing Rents	6	11	17	10	12	22	2	2	4
Debtors	9	7	16	1	3	4	1	1	2
Creditors	5	7	12	7	5	12	5	4	9
Benefits Admin	16	0	16	10	1	11	11	7	18
NNDR	6	12	18	2	4	6	4	2	6
<b>Total</b>	<b>42</b>	<b>40</b>	<b>82</b>	<b>32</b>	<b>29</b>	<b>61</b>	<b>24</b>	<b>22</b>	<b>46</b>

The comparison only relates to those systems where the work undertaken each year does not vary significantly.