

WATFORD BOROUGH COUNCIL

INTERNAL AUDIT SERVICE

ANNUAL REPORT 2007/2008

1 Introduction

The Accounts and Audit Regulations 2003, as amended in 2006, 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 Annual Governance Statement (previously the Statement on Internal Control). The Code specifies various issues which this report must cover, perhaps the most significant being to “include an opinion on the overall adequacy and effectiveness of the control environment”.

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 one of my regular progress reports. This avoids the need for a separate progress report and in this case covers the period from 1st March 2008 to 31st March 2008 (see 5.2).

This report is one of the key sources of assurance used in the production of the Annual Assurance Statement.

2 Audit Opinion

In my opinion Watford Borough Council’s control environment (the systems of governance, risk management and internal control) is adequate and operates effectively. The factors taken into account in forming this opinion are set out in sections 3 and 4 below, with more detailed comments in sections 5 and 6. The work undertaken in 2007/2008 builds on work carried out in previous years. 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.

2007/08 saw a change in the content of internal audit reports. Each audit report now contains an audit opinion on the effectiveness of controls within the system/function/activity reviewed, highlighting any significant weaknesses which could affect the Council's control environment. This provides assurance (or otherwise) to Heads of Services that controls are satisfactory and enables me to more easily formulate my overall opinion of the effectiveness of the control environment. The assurance provided in each report falls into one of the following categories:-

Full Assurance – sound controls that are consistently applied.

Qualified Assurance – basically sound controls but some inconsistent application puts some control objectives at risk.

Limited Assurance – unsatisfactory controls or their application puts some control objectives at risk.

No Assurance – fundamental failure of control.

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 qualifications should be considered for inclusion in the 2007/2008 Annual Governance Statement.

- (i) Progress continues to be made in implementing risk management arrangements but is still slow in embedding these across all council services.
Corporate and service business continuity plans have been drawn up and a programme of testing has been completed. This showed that implementation of those elements of the plans tested has been patchy across services.
- (ii) In my last report I commented on the weak arrangements for controlling changes to business information software. Since then only limited improvements have been made. Only *draft* procedures for controlling changes have been produced with no evidence of actual controls being improved. It is critical that robust controls are introduced prior to the major changes Shared Services will require.
- (iii) Work was undertaken to try to establish why there are sometimes significant monthly variations between the forecast year end figures and the actual outturn. A range of possible reasons has been identified with various potential remedial actions under consideration. This is a problem that senior management and members have been aware of.

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 2007/2008 financial year which was in accordance with the approved Audit Plan. Whilst approximately only 88% of the planned work was completed, work was carried out in all of the key areas and I am

confident that more than enough work has been completed to enable me to provide a reasoned opinion.

The work plan was designed to cover the key risks facing the council. 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.

I have been providing an audit opinion for a number of years and I have therefore also been able to take into account the improvements in controls which I have noted over this extended period.

4.2 Audit Plan

The 2007/08 Audit 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 37 reports will have been issued (32 in 2006/07) illustrating the breadth of work undertaken.

4.4 Other Factors taken into account

- 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 2006/2007 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.
- 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.

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

5 Review of Work Undertaken During the Year

In my regular progress reports to the Audit Committee throughout the year I drew attention to significant control issues which had been identified. Section 5.1 lists audits undertaken during the period April 2007 to February 2008 where key conclusions have already been reported to the Audit Committee. Section 5.2 outlines further issues found in audits undertaken during March 2008.

5.1 Previously Reported

- Performance Indicators
- Housing Strategy Statistical Appendix Return
- Housing Stock Transfer
- Software Licensing
- Housing Benefit Administration
- Housing Benefit Subsidy Claim

- Parking Control
- Creditors
- Risk Management
- Contract Monitoring
- Budget Monitoring

5.2 Work undertaken during March 2008

5.2.1 Benefit Fraud Inspectorate – Follow up audit

All recommendations that were still relevant have been implemented.

5.2.2 Treasury Management

Whilst there was no suggestion of the situation being abused, there is a key risk to the Council because of the reliance placed on one person to perform both treasury management and bank reconciliation functions, especially as the level of supervision given to that person was minimal. Action has been taken to address these issues.

5.2.3 Asset Management

The Asset Management Plan follows best practice and structural arrangements are in place for the management of property assets. The key areas for further improvement are the development of a programme of maintenance to address the maintenance backlog and of systems to monitor progress against the programme. Work is in progress on these. There is also the need to introduce an effective computerised asset register to maintain up to date information on all property.

5.2.4 Payroll

Internal Audit work in this area has been restricted to some basic transaction testing e.g. setting up new starters, processing leavers and variations to pay to enable the new interim Payroll Manager and the external consultant to concentrate on improving the operation of the payroll service. There were no errors identified in this testing. Double checking of new data input has been resumed and new reconciliation arrangements introduced. There are indications that other procedures are being tightened because mistakes made by the last Payroll Manager are being identified and corrected by the current manager (such as payment of car allowances and their treatment for tax purposes). A full audit will be carried out in 2008/09

5.2.5 Other key system audits where no significant weaknesses identified

- Bank Reconciliations
- Aptos Reconciliations
- Council Tax
- Sundry Debtors
- Radius Cash Receipting
- NNDR
- Support Service Recharges
- Accounting Issues

6 Statement on Internal Control – 2006/2007

The 2006/2007 Statement on Internal Control highlighted four significant control issues. In forming my opinion on the control environment I have taken into account progress in remedying some of these issues as identified during the course of normal audit business or during subsequent audits.

6.1 Business Continuity Plans.

See 3 (i).

6.2 Implementation Benefit Fraud Inspectorate's Recommendations

See 5.2.1.

6.3 Payroll Service.

See 5.2.4.

6.4 Arrangements for Managing Software Changes

See 3(ii).

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 2007/08 I have selected those audits which I feel may best be compared with the last two years.

The details are shown in Appendix 4 (table 1). Over the three year period there has been a drop in the numbers in both categories of recommendation (High and Medium) for selected audits. Whilst this may be taken as a broad indication of improvement over time it should be seen as no more than that.

Appendix 4 (table 2) also illustrates the total number of High, Medium and Low priority recommendations made over the last three years. Again, this is not an exact science but the table does appear to confirm the continued improvement trend.

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. 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. There have been no cases worthy of reporting to the Audit Committee.

The Anti-Fraud and Corruption Strategy and the Whistleblowing Policy have been reviewed and approved by the Audit Committee.

Internal Audit has recently issued a fraud awareness questionnaire to a cross section of staff and is currently analysing the results with the intention of taking steps to address any areas where there appears to be a lack of understanding/awareness.

10 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 fully 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 a future 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
15th May 2007

**Progress Report on Individual Audits
2007/2008**

Appendix1

| Project | Progress | Days Allocated 2007/08 | Days Taken 2007/08 |
|---|---|---------------------------------------|-----------------------------------|
| Audits Brought forward – 2006/2007 | | | |
| Payroll CHAPS | Final report 16 10 07 | - | 2 |
| Support Services Recharges | Final report 26 09 07 | - | - |
| Asset Management | Final report 20 04 07 | - | 6 |
| Budget Monitoring | Final report 20 06 07 | - | 1 |
| 2006/07 audits | | - | 9 |
| 2007/2008 Audits | | | |
| 2006/07 Performance Indicators – review calculation of 2006/07 indicators. | Final report 11 06 07 | 30 | 32 |
| Housing Strategy Statistical Appendix – review accuracy of return. | Final report 24 08 07 | | |
| Westfield Leisure Centre – restricted audit – income and expenditure controls | Completed 11 06 07 | 8 | 5.75 |
| Colosseum – review income and expenditure controls. | Final report 21 06 07 | 5 | 5 |
| Bill Everett Centre – review income and expenditure controls. | Final report 18 09 07 | 9 | 6.5 |
| Recovery of Overpaid Benefits – review of system controls. | Final report 17 09 07 | 5 | 6.5 |
| Software Licensing – check on software legality. | Final report 12 11 07 | 10 | 7.75 |
| Housing Repairs Service – follow up audit | Final report 30 07 07 | 5 | 7 |
| Building Control – review income controls. | Final report 05 11 07 | 8 | 5.75 |
| Staff Car Parking Fees – review new system controls. | Final report 18 10 07 | 5 | 3.75 |
| HB Subsidy Claim – review accuracy of claim. | Final report 11 02 08 | 26 | 32 |
| Environmental Grants – review follow up procedures. | Final report 21 09 07 | 3 | 2.25 |
| Cashiering Function – review system controls. | Final report 22 10 07 | 5 | 3.25 |
| Charter Place Market – review income controls. | Final report 12 11 07 | 5 | 2.75 |
| Housing Stock Transfer – responding to issues as they arise. | Work completed – no report issued | 20 | 5 |

| | | | |
|--|---|----|-------|
| Housing Rents – follow up audit. | Final report 06 09 07 | 7 | 5.25 |
| Payment Card Industry Security – comparison with new industry security standards. | Final report 30 01 08 | 6 | 4.5 |
| Recruitment - follow up audit | Final report 12 11 07 | 2 | 2.5 |
| Sundry Debtors – review of system controls | Final report 31 03 08 | 15 | 16.25 |
| Risk Management – review implementation of risk management. | Final report 14 11 07 | 15 | 15 |
| Creditors – review of system controls | Final report 31 01 08 | 15 | 19 |
| Benefits Administration – review of system controls | Final report 26 03 08 | 30 | 35 |
| Corporate Governance – comparison with new standards | Work on hold. To be carried forward. | 15 | 0.5 |
| Bank Reconciliations | Final report 10 03 08 | 5 | 5 |
| Council Tax – review of system controls | Final report 31 03 08 | 15 | 19 |
| NDR – review of system controls | Draft report 08 04 08 | 15 | 16.5 |
| Budget Monitoring – review of effectiveness | Draft report 14 03 08 | 10 | 10 |
| Contract Monitoring – review of controls in Environmental Services over selected contracts | Final report 28 03 08 | 15 | 16.5 |
| Parking Control – income controls | Final report 20 01 08 | 8 | 9 |
| Radius – review of income system controls | Final report 27 03 08 | 15 | 18.5 |
| Reconciliations – data transfer between systems | Final report 27 03 08 | 25 | 31 |
| Support Service Recharges – adherence to policy for recharging. | Draft report 29 04 08 | 6 | 6.5 |
| Watford Women's Centre – performance measures review | Final report 19 02 08 | 2 | 3 |
| Fraud Awareness – issue of questionnaire an assessment of replies. | Questionnaire issued. Follow up in 08/09. | 6 | 3 |
| HB Fraud Investigation Team – review of BFI recommendations. | Final report 31 03 08 | 7 | 9.5 |

| | | | |
|---|--------------------------|----|-----|
| Asset Management – comparison with Use of resources criteria. | Draft report 24 04 08 | 15 | 7.5 |
| Treasury Management – system review. | Final report 31 03 08 | 6 | 6.5 |
| Payroll – follow up previous recommendations and basic transaction testing. | Work in progress | 20 | 7 |
| Accountancy – transaction review | Draft report 29 04 08 | 6 | 3 |

Appendix 2

Time Allocation exceeded (by more than two days)

| Audit | Target Time per Plan | Actual Time |
|--------------------------|-----------------------------|--------------------|
| HB Subsidy Claim | 26 | 32 |
| Creditors | 15 | 19 |
| Benefits Administration | 30 | 35 |
| Council Tax | 15 | 19 |
| Radius | 15 | 18.5 |
| Aptos - Reconciliations | 25 | 31 |
| Fraud Investigation Team | 7 | 9.5 |

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

Audits still in progress as at 31st March 2008.

Fixed Asset Management
Support Service Recharges
Accountancy
Payroll
NNDR
Budget Monitoring

Audits not undertaken as per Audit Plan

Two audits were not started as there was insufficient progress to justify an audit review:

Post Implementation review of Thin Client.
Review of Corporate Governance arrangements.

Westfield – closure.

Additional Audits not included in Original Plan

Environmental Grants
Payment Card Security
Staff Car Parking
Watford Women's Centre
Recruitment follow up.

LOCAL PERFORMANCE MEASURES 2007/2008

(i) Targets Based on Audit Plan

| Criteria | Target pa (as per audit plan) | Actual 2006/07 | Actual 2007/08 | Comment |
|--|-------------------------------|----------------|----------------|---|
| % of revised annual audit plan achieved (based on number of projects)* | 90% | 89.1% | 87.7% | Alternative work undertaken but not formally approved |
| Sickness – days per FTE | 7.5 | 2.3 | 5 | |
| Training – days per FTE | 6.25 | 6.4 | 2.9 | Lack of suitable courses. |

* 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 2006/07 | Actual 2007/08 | 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% | 72.22% | 80% | Audit Manager unable to review work promptly due to other pressures. |
| Level of customer satisfaction | 85% | 93.94% | 94.23% | Based on returned 9 questionnaires. |
| The number of “chargeable” days actual/planned | 85% | 90.9% | 88.94% | |
| Completion of planned follow up work | 100% | 100% | 100% | |

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

| System | 2005/06 | | | 2006/07 | | | 2007/08 | | |
|----------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| | High | Med | Total | High | Med | Total | High | Med | Total |
| Council Tax | 2 | 4 | 6 | 1 | 6 | 7 | - | 7 | 7 |
| Debtors | 1 | 3 | 4 | 1 | 1 | 2 | 1 | 2 | 3 |
| Creditors | 7 | 5 | 12 | 5 | 4 | 9 | 1 | 3 | 4 |
| Benefits Admin | 10 | 1 | 11 | 11 | 7 | 18 | 6 | 6 | 12 |
| NNDR | 2 | 4 | 6 | 4 | 2 | 6 | 2 | 2 | 4 |
| Total | 22 | 17 | 39 | 22 | 20 | 42 | 10 | 20 | 30 |

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

Comparison of Number of Recommendations Made

| Year | No. of Reports | High | Medium | Low | Total |
|---------|----------------|------|--------|-----|-------|
| 2005/06 | 39 | 188 | 112 | 7 | 307 |
| 2006/07 | 32 | 151 | 103 | 24 | 278 |
| 2007/08 | 37 | 109 | 96 | 6 | 211 |

This is purely a statistical exercise but does show a decrease in the number of recommendations made which could be an indication of an overall improvement in controls.