

CITY OF DURHAM COUNCIL

AUDIT OVERVIEW COMMITTEE

27th JUNE, 2007

REPORT OF THE DIRECTOR OF STRATEGIC RESOURCES

**STATEMENT OF INTERNAL CONTROL AND
(DRAFT) STATEMENT OF ACCOUNTS 2006-07**

A) STATEMENT OF INTERNAL CONTROL

Background Information

At the end of 2002 the Office of the Deputy Prime Minister consulted on amendments to the Accounts and Audit Regulations 1996. Statutory instrument 2003/533, the Accounts and Audit Regulations 2003, came into effect on the 1st April 2003 and the 1996 regulations were revoked.

With the introduction of the Accounts and Audit Regulations 2003, local authorities are now obliged to review the effectiveness of its system of internal control each year and are required to publish, alongside the statement of accounts a signed statement on internal control. The main purpose of the Statement of Internal Control is to improve local authority corporate governance and accountability.

In terms of internal control, the most significant changes brought about by the Accounts and Audit Regulations 2003 were:

- ◆ An explicit recognition that authorities have a corporate responsibility for their financial management and system of internal control including risk management, whilst not affecting the specific duties and responsibilities of the section 151 officer
- ◆ The need for the authority to review each year the effectiveness of its system of internal control and the requirement to publish alongside the accounts a statement on internal control
- ◆ A requirement for authorities to follow proper internal audit practices
- ◆ Bringing forward the deadlines for approval and publication of accounts in a phased way
- ◆ Extend the period for the exercise of inspection rights

The statement itself (Attached at Appendix I) is broken down into a number of categories outlining the specific evidence required to support and comply.

Further changes introduced as a result of the Accounts and Audit Regulations 2006 required that Internal Audit and the Audit Overview Committee should be subject to an annual independent review, with the results of the review becoming part of the Statement.

Statement of Internal Control Working Group

The Council's response to the requirements set out above was twofold. Firstly, a Statement of Internal Control Working Group (SOICWG) was established, consisting of representatives of all services, including the Council's Monitoring Officer, Section 151 Officer and the Head of Internal Audit.

The main function of the Group is to:-

- ◆ Establish protocols to examine and collate evidence in support of the requirements of the Act;
- ◆ Ensure that all Heads of Service and Senior Managers are aware of the need to ensure that the evidence requirements are communicated and understood by their own staff in respect of their service areas;
- ◆ Embed the need to constantly review systems of internal control within their areas of responsibility which had not been subject to audit or external inspection during the year
- ◆ Develop appropriate methods of assurance; and
- ◆ Ensure that the evidence requirements were met and that a draft statement of Internal Control is prepared in accordance with the SORP.

The Group meets on a regular basis during the year and monitors progress against an action plan developed to improve internal control and corporate / financial governance - updating the available evidence where appropriate. The Group also agrees the draft Statement of Internal Control before it is submitted to Officers Management Team and then to the Audit Overview Committee for approval.

Statement of Internal Control Software

Secondly, a functional database has been procured, which allows the Head of Internal Audit and members of the SOICWG to measure adherence to the standards by reviewing the evidence available. The software is used to produce reports and monitor action plans, showing the current situation for all standards and the level of compliance, together with linked evidence.

The Statement of Internal Control

The format and structure of the statement is prescribed in guidance contained within the Statement of Recommended Practice (SORP) and is broken down into a number of different sections. The terminology used is therefore consistent across all authorities. These are:-

- ◆ Scope of Responsibility – what the Council is responsible for;
- ◆ The purpose of the system of internal control;
- ◆ The internal control environment – the system by which the Council directs and controls its functions, including the formulation of strategy, its objectives and how it delivers services to meet those objectives;
- ◆ Review of Effectiveness – this is informed by the work of internal audit, managers, external auditors and other review agencies and inspectorates; and
- ◆ Significant Internal Control issues. – the Council must identify any areas of significant internal control, including what action is being taken to address them

The statement is compiled by the Head of Internal Audit based on a number of different criteria. The statement reflects the current position within the Council at a given time, however, should any major concerns arise between the production of the Statement and the date that the Statement is approved then this must be brought to the attention of the Head of Internal Audit and the statement amended to reflect the new position.

The statement is evidence based and relies on written assurances from managers who prepare a standardised comprehensive assurance statement on an annual basis; Internal audit's views, having carried out a number of audit assignments during the year and commented on the assurance given by each; external auditors and other review agencies and inspectorates and the assurances contained within their reports to the Council.

The draft statement is then discussed and agreed by the Statement of Internal Control Group, where some minor amendments may be carried out. The statement is then submitted to the Officers Management Team for discussion and then to Audit Overview Committee with the Statement of Accounts for approval before submission to full Council.

RECOMMENDATION

That the members of the Audit Overview Committee discuss the 2006/2007 Statement of Internal Control and that this is approved for consideration by Council on 29th June 2007

B) (DRAFT) STATEMENT OF ACCOUNTS 2006/07

Background Information

The Council's accounts are prepared on an annual basis and in accordance with recommended accounting practice, as specified in the Best Value Code of Practice on Local Authority Accounting (BVACOP) and accompanying Guidance Notes for Practitioners, issued by the Chartered Institute of Public Finance and Accountancy (C.I.P.F.A.). The Institute's guidance note on the application of Statements of Standard Accounting Practice (S.S.A.Ps.) and Financial Reporting Standards (F.R.Ss.) – set out annually in the Statement of Recommended Practice (S.O.R.P.) - dictates the mandatory form and structure of the Council's accounts, together with accounting treatment that (must) should be applied.

It is against this guidance that the Audit Commissions appointed auditor externally and independently assess the statements prepared and approved by members each year. The external audit officially starts in July each year, however, some mid-closure work on significant items is undertaken prior to approval by members in order to maximise resource availability and minimise any risk of any potential significant errors making their way into the Statements presented to members in late June.

The Audit Commission deadline for expressing an opinion on the Accounts is 30 September and within this the external auditor is required to express an opinion as to whether the accounting policies the Council has applied are appropriate to the Authority's circumstances (i.e. consistent with the S.O.R.P.) and that these have been consistently applied and adequately disclosed. A significant departure from the requirements of the S.O.R.P. could result in a qualified opinion being expressed on the accounts and even if this were to be avoided, the authority would be required to amend its accounts to reflect / adjust for the errors in the original disclosure – as was the case with the 2004/05 Accounts in relation to the bank reconciliation – prior to issue of the auditors certification / opinion on the Accounts.

Members should note that material errors in the Accounts would result in an automatic maximum score of 1 against the Use of Resources Criteria for Financial Statements. This in turn would inhibit the overall maximum score that could be obtained in that years Use of Resources Assessment and as members are aware, the Use of Resources Scores have a significant and increasing bearing on an authorities overall corporate assessment by the Audit Commission. Put simply, without an overall Use of Resources Score of 3 or more the Council has little chance of improving its overall corporate assessment of being a Fair Authority.

Changes in 2006/07 – S.O.R.P. 2006

Members will note with interest that the form and structure of local authority accounts has been subject to constant change in recent years – with more and more information having to be disclosed in the accounts every year and authorities being required to prepare Group Accounts where they have relationships with external bodies that satisfies the definitions of a Group. The City Council must statutorily prepare Group Accounts relating to its relationship with Durham Villages Regeneration Company and has done so since 2004/05.

2006/07, however, sees a considerable change in the style, format and (in some instances) the content / structure of the financial statements that must be prepared. The changes are brought about by a desire to converge local authority accounting arrangements more in line that of the private sector and for them to be “UK GAAP compliant”. That is that the accounting practices in local authorities are in line with / comparable to the Generally Accepted Accounting Practices in the private sector.

In addition to bringing the form and structure of the accounts into more of a UK GAAP compliant context, the whole aim of these changes is to try and make the statements more accessible and better understood. Members should note that, whilst these changes are applicable from 2006/07 onwards, there is a requirement to re-cast (for comparison and consistency purposes) the 2005/06 figures as part of the closedown process.

(Draft) Statement of Accounts 2006/07

The (Draft) Statement of Accounts (Attached at Appendix II) has been prepared in accordance with SORP 2006.

The content and purpose of each statement and the main changes in structure and format (from the Statement of Accounts 2005/06) are fully explained within the Foreword (pages 3 to 7) and Statement of Accounting Policies (pages 34 to 35 specifically).

The Directors Report (pages 8 to 22 of the Statement of Accounts) sets out in detail the initial spending plans and influencing factors in 2006/07 and contrasts this with the outturn position, providing explanation of any variances and covers the Council's General Fund; Housing Revenue Account and its Capital Programme expenditure. This section of the report also provides details of the financial strategy in terms of earmarked funds and reserves and changes to the budget framework control totals for 2007/08 where appropriate.

RECOMMENDATION

That the members of the Audit Overview Committee discuss the (Draft) Statement of Accounts 2006/07 and that this is forwarded for consideration / approval by Council on 29th June 2007.

Statement of Internal Control

1. Scope of Responsibility

The City 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 economically, efficiently and effectively. The City Council also has a duty under the Local Government Act 1999 to make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.

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

2. The purpose of the system of internal control

The system of internal control is designed to manage risk to a reasonable or acceptable 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 the City Council's 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.

3. The internal control environment.

The system of internal control refers to the system by which the City Council directs and controls its functions and relates to the community it serves. It is therefore the totality of the policies, management systems, procedures, and structures that together determine and control the way in which the City Council manages its business, formulates its strategies and objectives and sets about delivering its services to meet those objectives.

The system of internal control is based on a framework of regular management information, financial regulations, administrative procedures (including segregation of duties), management supervision, and a system of delegation and accountability. Development and maintenance of the system is undertaken by managers within the Council to facilitate its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieve the authority's objectives.

The City Council's system of internal control reflects its control environment which encompasses its organisational structure.

In particular, the system includes control activities, information and communication processes and processes for monitoring the continuing effectiveness of the system of internal control, specifically these are:-

- ♦ The Council's Constitution, which sets out how the Council operates, how decisions are made and the procedures which are followed to ensure that these are efficient, transparent and accountable. A copy of the Constitution can be found on the Council's website at www.durhamcity.gov.uk

- ◆ The Community Strategy and Local Strategic Partnerships.
- ◆ The Corporate Performance Plan, which sets out and focuses attention on corporate priorities, and in particular, the authorities “Vision”. The plan is not intended to be a comprehensive statement of everything that the Council hopes to achieve over the next three years. It outlines the significant issues and challenges affecting the district, describes the vision of the Council and sets out its main priorities for the following year and the longer term. It sets out how these important priority issues will be addressed under the City Council's aim to bring about real change through the corporate efforts of the Authority, working on its own and in partnership. The plan matches the Council's activities to the environment in which it operates and to the resources it expects to have available over the three years. It provides a focus and a framework for the planning and management of services and sets out the main aims and actions that need to be taken to achieve quality services. A copy of the Corporate Performance Plan can be found on the Council's website at www.durhamcity.gov.uk
- ◆ Supporting and underpinning the Corporate Performance Plan, is the City Council's Medium Term Financial Plan and Corporate Capital Strategy / Asset Management Plans, which set out in financial terms how resources will be allocated and used to address corporate priorities and stakeholder needs within the District. A copy of the Medium Term Financial Plan and Corporate Capital Strategy / Asset Management Plans can be found on the Council's website at www.durhamcity.gov.uk
- ◆ The Council's policy and decision making is facilitated by the establishment of a Cabinet system, supported by a scrutiny function and a standards committee. Meetings are open to the public except where personal or confidential matters are being disclosed. Senior members and officers can also make decisions under delegated powers. The Constitution contains details of decisions to be made by the Council, its committees and contains details of those powers delegated to members and officers.
- ◆ The Council has adopted a “Local Code of Corporate Governance” in accordance with the CIPFA/SOLACE Framework for Corporate Governance. The code contains appropriate reporting and monitoring procedures. A copy of the Code can be found on the Council's website at www.durhamcity.gov.uk. A Standards Committee, consisting of nine persons, including four Council members (excluding the Leader of the Council); three independent, persons who are neither councillors or officers of the Council and two Parish Council members mainly in the Council's area exists to ensure compliance with the code.
- ◆ The Council has an effective performance management framework that is driven by the Corporate Plan which focuses attention on corporate priorities. This is linked to section service plans, employee's performance development reviews (PDR) and action plans. The Council's Scrutiny Committee monitors progress against targets and performance in priority areas affecting the main service areas, and considers and approves corrective action where necessary. Performance clinics, consisting of Cabinet Members and Senior Officers, meet regularly to monitor overall performance and to review key performance indicators on a quarterly basis with regard to service and national targets.
- ◆ The Council has an inclusive culture. Weekly management team meetings are held, where the Chief Executive (Head of the Paid Service) chairs meetings of all Chief Officers and Heads of Service (including the nominated Monitoring Officer and Section 151 Officer). Corporate and service issues are disseminated from this meeting via team briefings, in accordance with the City Council's Internal Communications Strategy. Legislative updates are standing items on the Agenda and all draft Cabinet reports are considered at this meeting.

- ◆ In response to the Civil Contingencies Act 2004, the Council has undertaken a Business Impact Analysis to identify and prioritise the functions that it performs when delivering its business and services. This has allowed the Council to identify its business critical functions, which would need to be prioritised in an emergency or business disruption situation. From this the Council, with the support of the County Durham and Darlington Civil Contingencies Unit has developed a Business Continuity Plan outlining a number of strategy options aimed at reducing the impact of a business interruption. The Plan clearly sets out, on a building by building basis, the services and critical functions that operate within that building and the key resources required to carry out the critical functions should access to that building be denied. The City Council is in a better position to effectively respond to a business interruption as a result of this work. The Risk Management Working group has reviewed this Plan and has improved the supporting arrangements. The Council has also strengthened its Emergency Planning arrangements through participation in a series of workshops and incident response exercises, facilitated by the County Durham and Darlington Civil Contingencies Unit.
- ◆ The City Council has established a number of inter-departmental working groups to support the delivery of its strategic aims; including Corporate Strategy, Risk Management, Children and Families, Flourishing Communities, Customer Services, Community Services, Human Resources, Equalities, Internal Communication, Efficiency, Information Technology, Performance, Asset management and Capital Works.
- ◆ The City Council has designated the Director of Legal and Administration Services as Monitoring Officer. It is the function of the Monitoring Officer to ensure compliance with established policies, procedures, legislation and regulations.
- ◆ The financial management of the authority is conducted in accordance with the financial rules set out in the constitution, and in accordance with financial procedure rules and financial regulations and the SORP 2006. The Council has designated the Director of Strategic Resources as the Responsible Financial Officer in accordance with section 151 of the Local Government Act 1972. The financial governance arrangements in place are considered robust and are underpinned by the preparation of regular financial reports which indicate actual expenditure against the budgets, together with key Balance Sheet items.
- ◆ Through reviews by internal audit, external agencies, external audit, performance review and Best Value, the Council constantly seeks ways to ensure the economical, effective and efficient use of resources and for securing continuous improvement in the way in which its functions are exercised.
- ◆ The Council has developed robust systems for identifying and evaluating all significant strategic and operational risks – the Council maintains up to date strategic and operational risk registers. The Council reviewed and updated its Risk Management Strategy in 2006/07. A cross-department Risk Management Working Group, chaired by the Director of Strategic Resources, and attended by Heads of Service, senior managers and leading members, exists and operates in accordance with best practice. The management of risks has been allocated to appropriate individual officers and risks are constantly reviewed. Extensive risk management training has been carried out for all appropriate officers and members. The use of control risk self assessment forms to highlight and review business risks continue to be utilised as part of the audit process.
- ◆ The Council maintains an Internal Audit section, which operates to the standards set out in the 'Code of Practice for Internal Audit in Local Government in the UK'.
- ◆ The Head of Internal Audit prepares an annual audit strategy and risk based audit plan. This is underpinned by the Internal Audit Service Plan and Internal Audit Protocols.

- ◆ The Council has also set up an Audit Overview Committee to independently monitor and review the work of internal audit, the council's risk management processes, the council's corporate governance arrangements, and the council's arrangements for seeking assurance and evidence in support of the statement of internal control. Terms of reference for the Audit Overview committee meet the standards laid down by CIPFA.
- ◆ The Council has an objective and professional relationship with their External Auditors and other statutory inspectors, as evidenced by the Annual Audit letter.
- ◆ Services are delivered by trained and experienced personnel. All posts have a detailed job description, person specification and list of competencies. Training needs are identified through personal development reviews and are corporately addressed.
- ◆ Details of key controls for all of the authorities systems have been distributed to Heads of Service. This will assist managers in determining the level of internal controls for systems under their responsibility that have not been subject to an internal audit review during the relevant period.

4. Review of Effectiveness

The City Council has responsibility for conducting, at least annually, a review of the effectiveness of its system of internal control. The review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within the authority who have responsibility for the development and maintenance of the internal control environment, and also by comments made by the external auditors and other review agencies and inspectorates.

The Council has established the following processes to achieve this aim

- ◆ Committee structure based on the Leader Cabinet model, which meets regularly to consider the plans and strategic direction of the Council. Ruling and opposition members are represented on each committee according to the rules laid down in the Council's agreed Constitution.
- ◆ The Director of Legal and Administration Services (the 'Monitoring Officer') has a duty to monitor and review the operation of the Constitution to ensure that its aims and principles are given full effect. The Constitution is regularly reviewed throughout the year, and amendments agreed by Council.
- ◆ The Council reviews the local Code of Corporate Governance on an annual basis and adopts an action plan to deal with any issues.
- ◆ Scrutiny committees review the decision making process to consider whether a decision is appropriate.
- ◆ The Standards committee promotes and maintains high standards of conduct of Councillors and co-opted Members; assisting the Councillors and co-opted Members to observe the Members' Code of Conduct;
- ◆ The Audit Overview Committee reviews the adequacy of internal controls, monitors the performance of Internal Audit, agrees the internal and external audit plan, reviews risk management arrangements, oversees corporate governance requirements, and approves the statement of internal control prior to formal consideration by Council.

- ◆ Internal audit, are responsible for monitoring the quality and effectiveness of internal control. The audit plan is developed in line with current modern best practice using a robust risk model, informed by the annual audit strategy and is approved by the Audit Overview Committee. The audit methodology is contained within the Audit manual which is largely based on the CIPFA model, and reflects the standards defined by the Code of Practice for Internal Audit in Local Government in the United Kingdom 2006, and meets the requirements of the Accounts and Audit Regulations 2003. Reports for each audit are submitted to relevant line managers and Heads of Service where appropriate. Reports include the Head of Internal Audit's independent opinion on the adequacy and effectiveness of the relevant Service's system of internal control, together with recommendations for improvements that are contained within an action plan and require agreement or rejection by line managers. Recommendations are prioritised according to risk. The process is subject to escalation where agreement cannot be reached, and includes quarterly reviews of recommendations to ensure that they are acted upon.
- ◆ The Internal audit section is subject to regular inspection by the Council's external auditors who report annually to the Council. The external auditors place great reliance on the work carried out by the section.
- ◆ The Internal audit section and the Audit Overview committee is also subject to an independent review of its activities and performance by nominated officers from the Statement of Internal Control working Group in order to meet the requirements of the Accounts and Audit Regulations 2003 (amended). A formal report has been considered by the Audit Overview Committee in this respect with the committee concluding that suitable arrangements are in place.
- ◆ Performance clinics meet quarterly to review progress on PI's. Annually internal audit reviews key performance indicators in accordance with guidance provided by the audit commission to ensure the use of the correct definition and calculation before publication of the authority's annual performance plan.
- ◆ An annual review of the Councils Corporate Governance arrangements, together with the arrangements that the Council has in place to detect and deter fraud and corruption is carried out by Internal Audit.
- ◆ Heads of Service and Directors are expected to keep under continual review the internal control processes of systems under their responsibility, particularly where such systems have not been reviewed by Internal Audit in that year. This is to ensure continued adherence to 'key' internal controls identified for all major systems and communicated to Heads of Service by Internal Audit.
- ◆ As part of this continual review, Heads of Service and Directors are also required to complete and sign an annual assurance statement outlining the key features of the systems of internal control, within their area of responsibility. This allows them to identify whether the arrangements set out are in place and operating effectively, identify problems encountered and set out action that has been taken or is proposed to address those issues.
- ◆ The risk management group annually review the risk management strategy, to ensure continued relevance to the Council. With the development of the Strategic and Operational risk registers and nomination of risks to individual officers risks are continually monitored.
- ◆ The risk management group reports on a quarterly basis to Audit Overview Committee bringing their attention to significant risks.
- ◆ The Council annually reviews its Financial Procedure rules, Contract Procedure rules and Financial Regulations.

- ◆ The Council has effective governance arrangements in place for its joint venture company Durham Villages Regeneration Company (DVRC). There is cross-party “Executive” membership of the DVRC board drawn from the Cabinet. The Chief Executive is also appointed to the DVRC Board and Board meetings are held on a quarterly basis. The DVRC Board approves an annual business plan and receives regular monitoring reports, which includes financial performance information. The Council receives an audited copy of the Companies annual accounts, which is incorporated in the Council’s Statement of Accounts as part of the Group Accounts statement. Council Officers are signatories to the Companies bank account with all payments being approved by them. As part of the articles of association the Company has an open book arrangement. This gives the Council’s internal and external auditors the ability to inspect the company’s records at any time.

In summary, the system of internal control in place at the City Council for the year ended 31st March 2007 and up to the date of approval of the annual report and accounts and, except for the details of internal control issues at section 5 accords with proper practice.

We have been advised on the implications of the result of the review of the effectiveness of the system of internal control by the Authority, the executive, the Audit Overview Committee, the Councils Scrutiny Committees and the risk management group, and a plan to address weaknesses and ensure continuous improvement of the system is in place.

5. Significant Internal Control Issues

The City Council has not identified any significant internal control issues in its 2006/07 Statement of Internal Control.

The following actions have been taken during 2006/07 to strengthen and improve the Councils systems of internal control in meeting this challenge. The Council has also strengthened and embedded policies, procedures and systems (many introduced in 2005/06) including:-

- ◆ The development of a partnership toolkit and a partnership register. The Council will continue to develop its governance arrangements for partnerships during 2007/08
- ◆ The further development of procurement arrangements including the establishment of an options appraisal/market testing framework.
- ◆ The standardisation and improvements to the Corporate Report format in terms of Cabinet Reports
- ◆ The further embedding of the business planning framework, including improvements in the clarification of the links between Service and Corporate aims
- ◆ The development and embedding of operational Risk Registers for all services via a Corporate Database of all risks
- ◆ The development of internal communication arrangements, via regular staff newsletters and the SharePoint Intranet System;
- ◆ The strengthening of Internal Audit arrangements so that it continues to meet best practice
- ◆ The review of the Debt management Strategy and the introduction of a comprehensive set of performance indicators to manage the effectiveness of the recovery action taken.

- ◆ The development and implementation of new computer systems in many services such as Customer Services and Housing
- ◆ The introduction of new governance arrangements for the management of the Council's Housing stock.
- ◆ The introduction of Business Improvement and Business process re-engineering techniques such as "Lean Review"
- ◆ Further improvements in financial systems and processes such as the preparation of Revenue and Capital Budgets and the production of the Statement of Accounts (including working papers)– as recognised in the Use of Resources assessment scores
- ◆ The continual development, improvement and embedding of equality and diversity.
- ◆ The strengthening of arrangements to promote value for money, including the creation of the efficiency register.
- ◆ The further development of measures to embed environmental sustainability within the Council.

However, the Council will continue to effectively monitor its systems of internal control and will take all of the necessary action required to maintain and further improve these standards.

We are satisfied that these actions will address the need for improvements that have been identified and will review their implementation and operation as part of our next annual review.

Signature of the Leader of City of Durham Council	Date
	29 th June 2007

Signature of the Mayor of City of Durham Council	Date
	29 th June 2007

Signature of the Chief Executive	Date
	29 th June 2007

Signature of the Director of Strategic Resources	Date
	29 th June 2007