

ITEM NO.

Report to: **Audit Committee**
Date: **14TH June 2007**
Report of: **Gordon Fletcher, Audit Manager**
Subject: **Statement on Internal Control and Corporate Governance**

1. Purpose of Report

- 1.1. The Accounts & Audit Regulations 2003 have introduced a new requirement on local authorities to publish a Statement on Internal Control and Corporate Governance with the annual statement of accounts (to be considered on 27th June 2007 at a Special Audit Committee). In order to produce this, the District Council must have in place a framework that can give assurance that its systems of internal control are working effectively. This report sets out how this should be developed, and the implications for Internal Audit and the Audit Committee.

2. Consultation

- 2.1. In preparing this report I have consulted with the:
Director of Finance and Corporate Services - District of Easington
Head of Financial Management – District of Easington
Acting Chief Executive – East Durham Homes
Audit Commission.

3. Background

- 3.1. The Accounts and Audit Regulations 2003 have introduced a new requirement on local authorities to prepare a Statement on Internal Control and Corporate Governance (SIC) to be included with the annual statement of accounts. Where a Council is in a Group relationship with other entities and undertakes significant activities through the Group, the review of the effectiveness of the system of Internal Control should include its group activities. East Durham Homes is therefore included in this review.
- 3.2. The regulations specify that the authority should have a “sound system of internal control, which includes arrangements for the management of risk”, and that the authority “shall conduct a review at least once a year of the effectiveness of its system of internal control”. The Regulations provide that the statement should be prepared in accordance with proper practices.
- 3.3. This SIC has followed the Chartered Institute of Public Finance and Accountancy (CIPFA) guidance note on internal control and risk management, which is aimed at supporting local authorities to achieve compliance with the new requirements.
- 3.4. In order to have assurance that the system of internal control is effective, the Council is required to conduct at least an annual review, of the effectiveness of the controls, and to identify which are key in mitigating against significant risks to the achievement of the Council’s agreed objectives. The Council will need to obtain an assurance that the controls are operating effectively and identify areas where improvement is required. Based on the output of this process, the Council will be able to prepare a Statement on Internal Control that will summarise the position and any action required.

There are a number of sources of assurance that the Council can rely on to do this:

- Management
- Internal Audit
- External Audit
- Other review agencies and inspectorates, including, Health & Safety Inspectorate.

- 3.5. A copy of the Council’s SIC is included at Appendix 1 for the Committee’s information, and any Internal Controls issues are identified, and any agreed action has been recorded.

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4 Implications

4.1. Policy.

There are no policy implications

4.2. Legal

Regulation 4 of the Accounts and Audit Regulations (2003) requires audited bodies 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 (SIC) each year with the authority's financial statements.

4.3. Financial.

There are no financial implications as the work for this has been included in the Annual Audit Plan for 2007/2008.

4.4. Risk.

That the legal requirement above is not implemented.

4.5. Communications

This is to be communicated to all Departmental Senior Managers, responsible for Internal Control

4.6. Corporate implications.

4.6.1. Corporate Plan and Priorities

The SIC provides an overall framework for the Council to determine its priorities.

4.6.2. E. Government

There are no E. Government implications.

4.6.3. Procurement.

There are no Procurement implications.

4.6.4 Equality and Diversity

There are no Equality and Diversity implications.

5. Position Statement and Option Appraisal

- 5.1 The changes proposed are similar to those that have already taken place in the private sector and central government, and will ensure that local government keeps pace with best practice. The need for the Council to obtain assurances that its internal control systems are working effectively in all areas of Corporate Governance underline the role of the Audit Committee in the risk management process that is being developed. The changes has meant refocusing of the work of Internal Audit, which has extended its coverage and work closely with the risk management function in identification and testing of a new range of controls in respect of all areas of governance.

6. Recommendations

- 6.1. The Audit Committee is recommended to agree the production of the Statement on Internal Control for the District of Easington for 2006/2007.

Background Papers

Internal Control', Institute of Chartered Accountants in England & Wales, 1999. (Turnbull report)
'Corporate Governance in Local Government', CIPFA/SOLACE, 2001
'Accounts and Audit Regulations', Office of the Deputy Prime Minister, March 2003.
'Guidance on Internal Control and Risk Management in Local Authorities' CIPFA December 2003.
Code of Practice on Local Authorities Accounting in the U.K. – A statement of recommended practice (SORP), guidance notes for 2006/2007.

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Appendix 1

STATEMENT ON INTERNAL CONTROL AND CORPORATE GOVERNANCE (2006/2007)

Scope and Responsibilities

The Accountable Officer has responsibility for maintaining a sound system of internal control that supports the achievement of the organisation's policies, aims and objectives, set by the Council Members, whilst safeguarding the public funds and assets.

The system of Internal Control is designed to manage rather than eliminate the risk of failure to achieve these and therefore it can only provide reasonable and not absolute assurance of effectiveness.

The system of internal control is based on an ongoing process designed to identify the principal risks to the achievement of the organisation's policies, aims and objectives, to evaluate the nature and extent of those risks and to manage them efficiently, effectively and economically. This process has been in place for the year ending 31st March 2007, and up to the date of approval of the annual report and the accounts.

The key elements of the Council's internal control environment are:

- The District Council has adopted a constitution, which sets out how the Council operates, how decisions are made, and the procedures that are followed to ensure that these are efficient, transparent and accountable to local people. This is updated when required during the year and reported to Committee.
- The Council has adopted the Leader/Cabinet Model. The Executive Committee is responsible for delivering identifiable, accountable, corporate leadership for the Local Authority and the people it serves. The facilitation of policy and decision-making is made through the Council's Management Team, which meets on a weekly basis, and Scrutiny Committees, which assist the Council and Executive Committee in the development of its budget and the policy framework by in depth analysis of policy issues. Specific procedure rules are in place within the Constitution to govern this.
- Meetings are open to the public except where personal or confidential matters are being disclosed. In addition, senior officers of the council can make decisions under delegated authority.
- The Council publishes a Corporate and Performance Plan which contains details of key decisions to be made by the Council, its Committees and Chief officers under their delegated powers.
- The District Council has adopted a "Local Code of Corporate Governance" in accordance with the CIPFA/SOLACE Framework for Corporate Governance.
- The District Council has robust systems for identifying and evaluating all significant risks, which are developed and maintained with the pro-active participation of all those associated with planning and delivering services. A Risk Register is in place and appropriate Members and Officers have been trained in the assessment, management and monitoring of risks. All new risk implications are included with every report to Committee.
- Through reviews by external auditors, external agencies, Internal Audit, Corporate Improvement team and Best Value teams, the Council constantly seeks ways of ensuring the economical, effective and efficient use of resources, and for securing continuous improvement in the way in which its functions are exercised.
- Services are delivered by trained and experienced people. All posts have a detailed job description and person specification. Training needs are identified through the Personal Development Scheme.

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- The Council has in post a designated a qualified Monitoring Officer. It is his function to report on and to ensure compliance with established policies, procedures, laws and regulations.
- The financial management of the Council is conducted in accordance with the financial rules set out in Part 4 of the Constitution and with Financial Regulations. The Council has designated the Director of Finance and Corporate Services in accordance with Section 151 of the Local Government Act 1972.
The Council has in place a Medium Term Financial Plan for 3 years, which is updated annually, and ensures that the budgets are fully integrated and aligned to the Council's objectives through its Corporate Plan.
- 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 Council has an objective and professional relationship with external auditors and statutory inspectors, as evidenced by the Annual Audit and Inspection Letter.
- The Council has a performance management framework, which incorporates how we set, intend to deliver and review the Council's objectives at all levels. The system is driven by the Corporate and Performance Plan, which focuses attention on corporate priorities. This is cascaded through departmental service plans, individual employee appraisals and action plans. The Council's scrutiny committees monitor and scrutinise progress against targets and performance in priority areas affecting relevant service areas, and consider and approve corrective action where necessary, quarterly.
- East Durham Homes (EDH) is a contractual partner with the council with links to the Council. The governance structure is laid down in the Articles of Association and Management Agreement agreed with and issued by the District of Easington. This sets out the responsibilities of EDH and its Chief Officers.
- During 2006/2007, EDH had adopted the Council's Financial Regulations and Standing Orders, and under a service level agreement employs the Council's Internal Audit Service to carry out their audit work.

Review of Effectiveness

The District of Easington Council has responsibility for conducting, at least annually, a review of the system of internal control. The review of the effectiveness of internal control is informed by the work of the internal auditors and the senior managers within the authority who have responsibility for the development and maintenance of the internal control environment.

The process that has been applied in maintaining and reviewing the effectiveness of the system of internal control includes the following:

- The Monitoring Officer regularly monitors and reviews how the Constitution operates to ensure that its aims and principles are given full effect.
- During 2006/2007 the Council had a Scrutiny Management Board, which comprises of the Chairs and Vice Chairs of the Council's four Scrutiny Committees, which meet immediately after the Council's Executive Committee to consider whether there are any issues in need of referral to the individual Scrutiny committees. As a significant partner the scrutiny process considers the performance of East Durham Homes.
- The Council has delegated to the Audit Committee the responsibility for reviewing the adequacy of internal controls, monitoring the performance of internal audit and agreeing to the external audit plan.

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- The Council's Management Team meet weekly to discuss strategic matters together with endorsing individual reports prior to them being considered by the Council's relevant Committees.
- The Council's Internal Audit Section undertakes the audit of the Council and EDH, the latter through a service level agreement. The audits are undertaken in accordance with the Charter Institute of Public Finance and Accountancy's (CIPFA) Internal Audit Standards with responsibility for monitoring the quality and effectiveness of the systems of internal control. A risk model is used to formulate and annually update, a three-year strategic plan, from which the annual audit plan is developed for approval by the Council's Audit Committee.

There are quarterly Internal Audit reports to Committee on the progress of the work carried out by the Audit Section, which summarises the findings and recommendations of each audit.

- The Internal Audit Section is subject to regular inspection by the Council's external auditors (Audit Commission).
- The Council reviews its Financial Regulations every year.
- The Risk Management Officer provides reports to the Management Team bringing their attention to any significant risks. The Council reviews its risks through Directorate Service plans, which inform the Corporate Plan. New risks are identified throughout the year in reports to Committee, and included on the risk register.
- The Council's Performance Management Framework is supported by a Performance Improvement team, which focuses on key performance results, trends and improvement. Performance Reports are issued every three months and are supported by Officer and Member workshops when necessary. Reports are made to:
 - Corporate Support Team
 - Management Team
 - Executive Committee
 - Scrutiny Committees.
 - Audit Committee.
- The Council was rated as Excellent in the comprehensive performance assessment. Follow up reports through the Audit Commission's Direction of Travel Statement are very positive in relation to performance management, which is now embedded within the council.

East Durham Homes (EDH)

The business of East Durham Homes is conducted through the EDH Board consisting of five district councillors, five Independents, and five tenants. The Company is a significant partner of the Council and as such needs inclusion in the SIC.

- EDH is currently undergoing another inspection by the Audit Commission's Housing Inspectorate to secure additional capital funding to improve the Council's housing stock. They are required to achieve a 2 star rating to access the funding. The previous inspection assessed the Company as fair and an action plan was produced outlining areas, which required further improvement. Some of these areas do affect the corporate governance of EDH. I.e.
 - Lack of financial information provided at Board meetings, which was required to correct a budget deficit and overspends. (This was also identified in an Internal Audit Report).
 - Risk management not fully embedded, no risk register in place.
 - Performance Management was identified as weak.

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- Some of the above issues have also been identified in the completed Directors and Managers Assurance Statements, which also stated that Service Plans for 2006/2007 were not in place. It is understood they are in place for 2007/2008.
- A service improvement plan is in place, which is currently being supported by the Council, A new Chief Executive has recently been appointed and he is due to commence his duties on the 2nd July 2007.

General

The Audit Commission reviewed the financial aspects of corporate governance at the Council, which included the work of Internal Audit. In carrying out this work the commission seeks assurances that systems of internal financial control are in place and effective. Their conclusion on the work of the Internal audit service was positive as in previous years and they did not identify any significant issues for 2006/2007.

In terms of the work carried out by Internal Audit for 2006/2007, they were of the opinion that the Council's key systems are operating soundly and there were no fundamental breakdown in controls resulting in material discrepancies. Satisfactory arrangements are in place to ensure the Council's financial affairs are conducted in an effective, efficient and economic manner.

In saying the above, systems of control cannot provide absolute assurance against material misstatement or loss, nor can Internal Audit give that assurance; this statement is intended to provide reasonable assurance. There is an ongoing process in place to identify, evaluate and manage key risks, and these are reflected in the audit plan and are subject to separate reports during the year.

Internal Control Issues

The following Internal control issue has been identified for future action:

That the actions required within the East Durham Homes Service Improvement Plan are effectively monitored to achieve a 2 star rating from the Housing Inspectorate.

**CHIEF EXECUTIVE
DATE**

**LEADER
DATE**