

**Audit Committee - 29<sup>th</sup> June 2006**

**Report of the Director of Finance**

**Annual Statement of Internal Control**

**Purpose of the Report**

1. This report deals with the Statement of Internal Control [Appendix 1] that is to be published with the accounts for the financial year 2005/2006.

**Background**

2. Every local authority is required to publish a Statement of Internal Control as part of the publication of its Financial Statements.
3. The legislation requires that the Chief Executive and the Leader of the Council sign the Statement of Internal Control, but it is considered good practice to present the draft to the Audit Committee for consideration prior to it being signed.
4. The Statement of Internal Control summarises the state of the internal control environment within the Council and highlights any areas of concern. The internal control environment includes matters such as :-
  - Performance management
  - Business strategy and planning process
  - Annual budget & budgetary control
  - People strategy
  - Local code of governance (Council's Constitution)
  - Project management procedures
  - Risk management
  - Anti-Fraud and Corruption strategy
  - Ethical governance
  - Financial policies and procedures
  - Codes of conduct
  - Confidential Reporting policy
5. The aim of the various controls is to ensure that :-
  - The Council's policies are put into practice
  - The organisation's values are met

- Laws and regulations are complied with
  - Required processes are adhered to
  - Financial statements and other published information are accurate and reliable
  - Human, financial and other resources are managed efficiently and effectively
6. Dudley MBC has appropriate policies and procedures in place covering the items identified in above and the Statement of Internal Control covers significant areas whilst also highlighting any areas where there may be an adverse effect on the internal control environment.
7. In preparing the Statement of Internal Control we have reviewed the process we undertake and identified that improvements could be made to facilitate a more structured and corporate approach. Whilst the Director of Finance is required by statute and the Constitution to ensure appropriate management of the financial affairs and controls of the Council, there must be acceptance that all Members and Officers have a responsibility for internal control in it's wider sense.

It is therefore proposed that to facilitate a more structured and corporate approach to internal control a group be formed which includes a representative of each Directorate to provide a single point of contact for internal control issues. The group would be organised and supported by Audit Services.

Directorate representatives would be required to provide assurances that risks in the Corporate Risk Register have been reviewed at least quarterly and that mitigating controls are in place and working satisfactorily. They would also be required to forward details of any external reviews to Audit Services.

The group would then meet in October and April each year to prepare an interim and final Statement of Internal Control. The final Statement would be presented to the Audit Committee.

## **Finance**

8. This report has no direct financial effect.

## **Law**

9. The Account and Audit Regulations 2006 require that the relevant body shall conduct a review at least once a year of the effectiveness of its system of internal control and the findings of the review shall be considered by a committee of the relevant body. Following that consideration, they shall approve a statement on internal control, prepared in accordance with proper practices in relation to internal control.

### **Equality Impact**

10. This report does not raise any equal opportunities issues.
11. The Statement of Internal Control will help to ensure the interests of children and young people are protected, albeit they were not consulted on, or involved, with the development of the Statement.

### **Recommendations**

12. The Statement of Internal Control included at Appendix 1 to this report is accepted.
13. The Committee approve the submission of the Statement of Internal Control for signature by the Chief Executive and the Leader of the Council.
14. The Committee endorse the concept of a corporate group to assist in the preparation of the Statement of Internal Control.



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**Mike Williams**  
**Director of Finance**

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**1. SCOPE OF RESPONSIBILITY**

Dudley Metropolitan Borough 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 Council also has 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 Council must also ensure that there is a sound system of internal control that facilitates the effective exercise of the Council's functions, including 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 of failure to achieve policies, aims and objectives to a reasonable level, rather than to eliminate all risk. 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 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.

The system of internal control has been in place at Dudley Metropolitan Borough Council for the year ended 31st March 2006 and up to the date of approval of the annual report and accounts and, except for the details of significant internal control issues at section 5, accords with proper practice.

**3. THE INTERNAL CONTROL ENVIRONMENT**

The internal control environment encompasses all the processes and procedures that the Council has in place to protect itself against risks, whether financial or otherwise, and to achieve its objectives. The internal control environment consists of a whole framework of management information, financial regulations, administrative procedures (including segregation of duties), management supervision, and a system of delegation and accountability. Council members and managers are responsible for developing and maintaining the internal control environment.

The cornerstone of the internal control environment is the Council's 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. Some of these processes are required by the law, while others are a matter for the Council to determine. The

Council's Constitution also contains detailed codes and protocols, such as Contract Standing Orders (defining how contracts must be let) and Financial Regulations (setting out procedures and principles for proper financial management). The Constitution is reviewed annually.

The arrangements for establishing and monitoring the Council's objectives are also key elements in the internal control environment. The Council's most important objectives are consolidated in its published Council Plan. Recently, there has been a significant improvement in the assurance framework in that the key objectives of the Council now include formal consideration and documentation of any risks which might prevent objectives being achieved. Performance against objectives is monitored regularly, and reported to senior staff and the Cabinet quarterly, with a focus on key service indicators. The high level objectives in the above plans are supported by more detailed strategies and plans with their own monitored targets.

The Council has a legal duty to secure economy, efficiency and effectiveness in its use of resources and continuous improvement in its services. This duty is recognised in establishing the Council's policy agenda. The Council has also entered into a Local Public Service agreement with the Government that covers twelve priority targets where the Council aims to improve services faster than normal.

Effective financial management is an essential aspect of the Council's internal control environment. This is achieved in particular through :-

- Comprehensive revenue and capital budgeting and reporting systems
- A medium term financial planning process
- Regular reporting and monitoring of actual performance against forecast;

The Council is responsible for ensuring that risks that could frustrate the achievement of its objectives are properly managed and controlled. Part of this involves ensuring compliance with the Council's own policies and procedures and also with laws and regulations. The Council's Constitution sets out the responsibilities of members and senior managers for this, particularly the responsibilities of the three statutory posts :-

- The Head of the Paid Service (Chief Executive) must ensure that the Council is properly organised and staffed
- The Monitoring Officer (Director of Law and Property) must ensure the lawfulness and fairness of decision-making
- The Chief Finance Officer (Director of Finance) must ensure the lawfulness and financial prudence of decision-making. The Director of Finance is also responsible for the proper administration of the Council's financial affairs.

There is also a statutory requirement for the Council to have an adequate and effective internal audit function, a responsibility delegated to the Director of Finance. Internal Audit operates in accordance with the Code of Practice for Internal Audit in Local Government in the United Kingdom and is under the

day-to-day control of the Head of Audit Services who acts independently. Internal Audit's primary role is to independently review and report on whether risks facing the Council are effectively managed and controlled. It has a rolling programme of audits that, over a period of years, is intended to review all areas of major risk within the Council. The priority of different areas of the programme is determined by Internal Audit's own assessment of risks and controls.

In the course of 2005/06, to further improve the internal control system, the Council continued to "embed" a formal system of risk management into its management processes. Senior managers in all Directorates have been involved in identifying risks and controls, and evaluating the importance of risks and the effectiveness of controls on a common basis. The corporate risk register and action plans are reviewed on a regular basis and reported to Corporate Board, Cabinet and the Audit Committee. Audit Services have also carried out a number of reviews on risk management to ensure consistent identification of risks and controls together with ensuring the risk register is regularly reviewed.

The Council has an Audit Committee with a remit to oversee the effective operation of both the internal and external audit function, and to ensure that appropriate action is taken in relation to audit recommendations. There are also six Select Committees that carry out a programme of reviews of Council services and decisions. Finally External Audit conduct annual audits of the Council and external inspectorates perform a number of reviews of Council services. All of these bodies contribute to the Council's internal control environment, as well as contributing to the review of the adequacy and effectiveness of that environment.

#### **4. REVIEW OF EFFECTIVENESS**

The Council has responsibility for conducting, at least annually, a review of the effectiveness of the 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 auditor and other review agencies and inspectorates in their annual audit letter and other reports.

During 2005/06 Audit Services carried out approximately 200 planned audit reviews as part of their four-year strategic plan. The findings were reported to relevant line managers and senior management, and appropriate action agreed.

The Audit Committee receives an annual report summarising the performance of Internal Audit in the previous financial year. The Committee also receives a series of reports setting out the results of Audit Services work in each of the Council's Directorates. These reports detail the higher importance findings, any unimplemented recommendations, and management feedback about the action they have taken. The Committee also receives more detailed reports on

other areas where they consider it necessary. The Director of Finance will, under the Anti-Fraud and Corruption Strategy, report major losses, resulting from fraud and corruption, to the Audit Committee. No such reports were made during 2005/2006.

When the Audit Commission have completed their external audit for 2005/06, their Annual Audit Letter will be presented to the Audit Committee and the Cabinet.

During 2005/2006 the Audit Commission carried out no service specific external inspections, but they did start carrying out a review of how the Council had dealt with two pieces of significant legislation concerning Children's Services and Licensing. The main inspection relevant to internal control concerned the Comprehensive Performance Assessment review of the "Use of Resources" which covers the following areas :-

- Financial reporting
- Financial management
- Financial standing
- Internal control
- Value for money

The Audit Commission assessment was that we had achieved a 3 star rating.

The Accounts and Audit Regulations 2006 have introduced a requirement for an annual review of the effectiveness of its system of internal audit, and that the results of the review should be included in the Statement of Internal Control. The Audit Commission is currently carrying out this review.

A number of other external bodies carried out reviews during the year, including the Adult Learning Inspectorate, Ofsted and the Commission for Social Care Inspection. The findings of their reports were also considered.

The Council's six Select Committees also carried out an extensive programme of reviews of the Council's activities and decisions, and they report their work and findings to the Council.

In carrying out its review of the internal control system, the Council has considered the evidence provided by all of the sources referred to above and has not identified any serious deficiencies in the internal control system that would warrant mention in Section 5 of this report.

## 5. SIGNIFICANT INTERNAL CONTROL ISSUES

Whilst the review of evidence has not identified any significant control issues it is considered appropriate to provide an update on some issues.

One of the significant risks facing the Council this year was the replacement of all major financial systems. The risks were reviewed and mitigating controls were identified, including good project management. The replacement has largely been completed and no significant problems were encountered.

In the 2004/05 Statement of Internal Control mention was made of the significant progress that had been made in the implementation of formal risk management, but acknowledged that further work was required to more fully engage members in the process. The Audit Commission recently facilitated a successful seminar involving Members of the Audit Committee and the Cabinet to identify corporate and cross-cutting risks, and to endorse the risk management process.

A training seminar to promote fraud awareness as part of the Anti-Fraud and Corruption Strategy has been developed and it is proposed that this is rolled out to Directorates starting with the Directorate of the Urban Environment in May 2006. Consideration is also going to be given to the possibility of providing an on line tutorial on fraud.

The Code of Corporate Governance has been in place for some time but is still considered relevant. It will however be reviewed during 2006 when revised standard guidance is issued by CIPFA.

Councillor D. Caunt  
Leader of the Council

A. Sparke  
Chief Executive