

First Annual Report from the Chair of Audit Committee to City Council

27th February 2007



**REPORT OF COUNCILLOR DAVID RADCLIFFE,
CHAIR OF AUDIT COMMITTEE**

1. Purpose of Report

To provide the first Annual Report of the work of the Audit Committee.

2. Background

2.1 The Audit Committee was established by the City Council at its meeting on 7th February 2006. This report, therefore, reflects the first year of its operation.

2.2 There is no statutory obligation for a local authority to establish an Audit Committee. However, the topic of audit committees is not new. Audit Committees have been in place in many parts of the public sector for some time, operating in different ways in different organisations. They are ever more widely recognised internationally across the public and private sectors as a core component of effective governance.

2.3 In this context, the Deputy Leader of the Council, Councillor Paul Tilsley, took the lead in recommending the setting up of an Audit Committee. This together with business transformation and the Excellence Board were seen as key drivers in improving the performance and accountability of the City Council.

2.4 The key benefits of an Audit Committee can be seen as:

- raising greater awareness on the need for internal control and the implementation of both internal and external audit recommendations.
- increasing public confidence in the objectivity and fairness of financial and other reporting.
- reinforcing the importance and independence of internal and external audit.
- providing additional assurance through a process of independent and objective review.

3. Corporate Governance

3.1 Good corporate governance requires independent, effective assurance about the adequacy of financial management and reporting together with sound management arrangements for achieving the organisation's corporate and service objectives.

- 3.2 Good practice from the wider public sector indicates that these functions are best delivered by an independent Audit Committee. In this context “independent” means independent from Executive and Scrutiny. The link with the Scrutiny function can be beneficial but the influence of the Audit Committee could be compromised by too much cross-membership. The Audit Committee also needs to retain the ability to challenge the Executive on issues and to report to it on major issues and contravention.
- 3.3 The way this has been handled is that I, as Chair of the Audit Committee, am not a Cabinet Member or a Chair of an Overview and Scrutiny Committee. No Executive Member serves on the Committee, although the Deputy Leader has a standing invitation to attend meetings as an observer. One place on the Committee is reserved for a nominee by the Co-ordinating O&S Committee. This seems to be working well.

4. Role and Remit of the Audit Committee

- 4.1 The Audit Committee’s main responsibilities include advising the Council on all matters related to corporate governance and in doing so specifically to receive and advise upon the following areas of work:

(a) The Financial Framework

- To consider whether there is an appropriate culture of risk management and related control throughout the Council;
- To approve the annual statement of internal control (SIC);
- To receive the annual Statement of Accounts, including changes in and compliance with accounting policies and practices, major judgemental areas and significant adjustments resulting from the audit;
- To identify any significant changes required to Financial Regulations and the Accounting Procedures Manual;
- To confirm the adequacy of the framework and processes for risk assessment, analysis and management within the Council, including receiving updates to the Corporate Risk Register;
- To keep under review the effective co-ordination between internal and external audit;
- To consider the budget needed to resource effective internal and external audit and other responsibilities of the Audit Committee; and
- To ensure the Audit Committee adds value to the work of the Council.

(b) External Audit and Inspection Agencies

- To note the fees and terms of engagement of the external Auditor.
- To review the planned programme of work with the external auditor.
- To consider the annual statutory audit and to advise the Executive on any response to any audit management letters, reports and investigations, including Value for Money studies and other inspection reports.
- To review whether agreed external audit or inspection recommendations have been implemented by the Executive as timetabled.
- To discuss with the external auditor any problems, reservations or issues arising from the interim or final audit or other investigations.
- To review the external auditor's independence and objectivity and annually appraise the Executive on the effectiveness and value for money of the external audit service.

(c) Corporate Governance and Internal Control Framework

- To review and advise the Executive on the embedding and maintenance of an effective system of corporate governance including internal control and risk management.
- To give an assurance to the Council that there is a sufficient and systematic review of the corporate governance, internal control and risk management arrangements within the Council.
- To review the Statement on Internal Control and make appropriate recommendations to the Council, the Executive, the Overview and Scrutiny and Regulatory Committees.
- To ensure that any significant weaknesses identified are remedied.
- To commission, if necessary, any relevant investigations into matters of particular concern relating to internal control.
- To ensure that the impact of alleged or fraudulent activity on the Council's framework of internal control is reviewed and, where necessary, to recommend changes to strengthen the control framework.
- To receive reports relating to those aspects of whistle blowing or alleged or fraudulent activity which relate to the Terms of Reference of the Audit Committee.

(d) Internal Audit

To review and make recommendations to the Executive regarding:

- the effectiveness of internal audit;
- the internal audit function to ensure it is adequately resourced;
- the internal audit strategy, annual plan and to monitor delivery of the plan;
- the internal audit protocol;
- significant audit findings, together with the response from managers to these reports;
- any difficulties encountered by internal audit including any restrictions on the scope of activities or access to required information;
- agreed internal audit recommendations to ensure they are implemented by management as timetabled; and
- the annual report from the Assistant Director, Audit and Risk Management.

(e) Other

To consider and make recommendations to the Executive on:

- governance issues relating to the operation of the Audit Committee; and
- the proportionality, independence and appropriateness of the Council's Fraud Response Plan, the Anti-fraud and Corruption Policy and the Prosecutions and Sanctions Policy.

5. Familiarisation with Issues

- 5.1 Starting from scratch we wanted to make sure we learnt of best practice from both public and private sectors.
- 5.2 For our first meeting Steve Freer, Chief Executive of CIPFA, kindly agreed to attend to discuss with us the key considerations as he saw them and the main issues emerging from CIPFA's booklet "Audit Committees : Practical Guidance for Local Authorities". He commended the way the Committee had been set up and the independent stance from the Executive and Scrutiny that was being taken.
- 5.3 At the same meeting John Gregory, District Auditor and Relationship Manager, attended to outline the role of External Audit and their commitment to working with us. Either John or his deputy, James

Elsby, has attended each of our meetings and their active involvement is much appreciated.

- 5.4 We were advised that Leeds City Council operated a very active Audit Committee and I attended one of their meetings. Interestingly, their meeting was chaired by the Leader of the Council. In discussion after the meeting it was explained that this was intended to underline the importance which the Council attached to the Committee but they were keeping this under review. There was a wish to see first a more invigorated role being undertaken by their Scrutiny Committees.
- 5.5 We were also advised that the Peterborough and Stamford Hospital NHS Foundation Trust had a well-developed Audit Committee and together with Councillor Waddington we sat in on one of their meetings. Again, we picked up some very valuable insights but did feel that, primarily because of the difference in size in our respective authorities, there was an undue focus on issues which we would have expected officers to be charged with sorting out.
- 5.6 I have also attended the annual CIPFA one day conference on Governance, Audit and Technical Issues. Two internal training seminars have also been held.
- 5.7 I do believe that by ensuring we are familiar with good practice elsewhere we have been able to structure our own meetings for maximum benefit.

6. Statement on Internal Control

- 6.1 Good corporate governance requires independent, effective assurance about the adequacy of financial management and reporting, and the management of other processes required to achieve the organisation's corporate and service objectives. It is important that the City Council has independent assurance about the mechanisms underpinning these aspects of governance. These are specifically:
 - (a) Independent assurance of the adequacy of the control environment.
 - (b) Independent review of the financial and non-financial performance to the extent that it affects the Council's exposure to risk and weakens the control environment.
 - (c) Assurance that any issue arising from the process of drawing up, auditing and certifying the authority's annual accounts are properly dealt with and that appropriate accounting policies have been applied.

The Audit Committee has the key role in providing this independent assurance.

- 6.2 Regulation 4 of the Accounts and Audit Regulations (2003) require audited bodies to conduct a review at least once a year of the effectiveness of its systems of internal control and publish a statement on internal control (SIC) each year with the Authority's financial statements. The purpose of the SIC process is to provide a continuous review of the effectiveness of an Authority's internal control and risk management systems, so as to give assurance upon their effectiveness and/or to produce a management action plan to address identified weaknesses in either process.
- 6.3 At our June meeting the Committee received a copy of the SIC for consideration prior to its formal approval by the Cabinet and Council Business Management Committee. The Committee heard that internal control arrangements are reviewed annually through assurance statements provided by each Strategic Director to the Chief Executive. These in turn are supported by assurances provided by Divisional Heads to the Directors and by files of evidence which each Directorate prepares as background information.
- 6.4 Significant internal control issues raised in the assurance statements and through the audit process were highlighted in the SIC. These included the need to improve social care provided to children, improving landlord services, particularly in relation to the housing repairs service and the supporting people function. The Committee intend to monitor developments and improvements in these areas.
- 6.5 We were impressed with the Statement of Internal Control as presented to us. It presented a clear and precise statement of the internal control and risk management system the Council has in place and whilst we made a few comparatively minor observations we had no hesitation in confirming:
- (a) that the system of risk management in the Authority is generally adequate in identifying risks and allows for the proper management of these risks. We would though like to see some of the risk assessment undertaken a bit earlier to provide a bit more time before the project/plan is to be implemented;
 - (b) that there seemed to be no areas of duplication or omission in the system of governance. We did note that the Council's devolution policy carried some risks here but we were conscious that the Co-ordinating O&S Committee were tracking the decisions of the Cabinet Committee Devolution on these matters and to avoid duplication we have not delved too deeply into this area at the moment.

7. External Audit

- 7.1 External audit has an essential part to play in the accountability of public money. The statutory responsibilities of the Audit Commission as external auditors to the Council are laid down in the Audit Code of Practice approved by Parliament. External audit are required to review aspects of governance and financial management as well as arrangements for securing economy, efficiency and effectiveness across the Council. The work of the Audit Committee is an integral part of the Council's governance arrangements.
- 7.2 In Birmingham, the District Auditor and team members fully support the establishment of an Audit Committee. This support is demonstrated through attendance at Committee meetings, presentation of key reports to help Members drive improvement eg the Annual Governance report, and participation in local training. Working closely with Birmingham Audit, the external audit programme ensures that statutory responsibilities are delivered without duplicating internal audit work. Reliance is placed on internal audit wherever possible.

8. Ombudsman

- 8.1 As part of the Audit Committee's remit to consider reports from external audit and inspection agencies, the Committee received the Local Government Ombudsman's Annual Report for the year 2005/06. A comparison of the volumes, trends and outcomes of complaints received by the three Ombudsmen for England to complaints against Birmingham was made. The Audit Committee's consideration of this report increases awareness of the Local Government Ombudsman's role and relationship with the Council amongst Members. This has been absent in recent years. The Annual Report of the Ombudsmen will be formally received by the Audit Committee in the future.
- 8.2 This year's Annual Report from the three Local Government Ombudsman for England stated that the number of complaints they had determined remained steady at around eighteen and a half thousand. Complaints about Birmingham also barely changed between 2004/05 and 2005/06 at around 400. However, the subject matter of complaints was reported as having changed as the three Ombudsman had seen a 25% increase in complaints about education matters. The Ombudsmen receive more complaints about housing benefit than any other subject, followed by Housing and Planning. Birmingham does not follow this trend, as Housing matters have always attracted the most complaints, followed this year by social care matters, then Planning issues. There has been no rise in education complaints in Birmingham.
- 8.3 The Annual Report also refers to the individual reports produced by the three Ombudsmen. This determination is used by them for the most serious of complaints, where Maladministration with Injustice is found.

Additionally, a significant failure in the provision of service is often found too. Last year, there were four reports issued about Birmingham cases, a high number for one year. All of these reports included a system failure in an area of service. In each case the service was reviewed by the relevant department or directorate. But as part of the Audit Committee's role, it will also receive reports from the Local Government Ombudsman concerning individual cases in future.

- 8.4 This will give the Council a formal reporting mechanism where the Local Government Ombudsman makes recommendations for service improvement based on her findings of specific failings in a particular area of service, following a complaint of mal-administration and injustice by a member of the public. The Committee may then determine that recommend that the appropriate Overview and Scrutiny Committee considers the Executive's proposals for improvement in depth. This role strengthens the Council's procedures for considering an external audit process in order to learn from mistakes to improve services.

9. Links with Overview and Scrutiny Committees

- 9.1 Mention has already been made of the need for the Audit Committee to be independent of both the Executive and Scrutiny. However, whilst having separate roles there is a strong complementarity between the two and this is reflected in the Co-ordinating O&S Committee nominating a representative to serve on the Audit Committee.
- 9.2 Essentially the approach being adopted is that the Audit Committee will focus on the "bigger picture" to ensure that the overall arrangements the City Council has put in place to ensure high fiscal standards are, to coin a phrase much in use at the moment, "fit for purpose". When a failure occurs the main intent will be to ensure that there is no risk of repetition.
- 9.3 Where more detailed follow-up is required of a more forensic nature then this is where the Audit Committee will look to the relevant Overview and Scrutiny Committee to undertake that review. And vice versa when a Scrutiny Committee comes across an instance of concerning practice or behaviour which they feel might happen on a broader front then this could be something they could ask the Audit Committee to examine.

10. What the Committee has done so far

- 10.1 I do believe it to be the case that we have got the Audit Committee up and running very expeditiously. City Council gave its approval to the setting up of the Audit Committee on 7th February 2006, with the

membership confirmed by the City Council on 28th February 2006, We held our first meeting on 29th March 2006.

10.2 The Council suggested that in the first instance we should meet quarterly and that is what we have done with our subsequent meetings being on 13th June 2006, 26th September 2006 and 19th December 2006. Our agendas have been very full, covering a lot of ground, and because of that our meetings have been quite lengthy. We are, therefore, considering meeting bi-monthly in the new Municipal Year.

10.3 In the paragraphs below I outline some of the work we have undertaken.

10.4 Birmingham Audit Annual Report 2005/6

This report is the vehicle for the Assistant Director, Audit & Risk Management, to give his annual assurance opinion. Based on the delivery of the 2005/06 audit plan he was able to give a reasonable assurance – the highest level available.

The report outlined significant issues arising from audit work undertaken during the year. Progress made in embedding risk management processes across the organisation, including the revision of the Council's risk management policy statement, strategy and methodology and toolkit was highlighted. The report also detailed the work undertaken by Birmingham Audit in the area of Corporate Governance and highlighted project management as a process requiring improvement. In the area of financial control, the high level findings from reviews of the main financial systems were reported upon and found to be adequate

The report also detailed quality, performance and customer feedback information for the year. The Committee was pleased to see that in addition to retaining ISO 9001:2000 quality accreditation, Birmingham Audit were successful in obtaining the BS 7799 – 2:2002 Information Security accreditation at the first attempt. This is a unique achievement as Birmingham is the first local authority on the British Standard register.

The audit plan for 2005/06 contained 10554 days, which was delivered and involved the issue of 437 audit reports. Against a challenging completion target of 90%, set by the Audit Commission, 97% of planned assignments and 93% of unplanned audit jobs which were started during the year were completed. Customer feedback on the internal audit service showed 75% of customers rating the service as either very good or good with a further 24% rating it as adequate or better and only 1% rating it as poor.

It also contained, for Audit Committee approval, the internal audit plan for 2006/07. This was produced after consultation with the external auditors and against a background of a reduction in resources.

Finally the report contained the Data Matching Policy and Strategy documents. Data Matching is a primary driver for activities designed to help combat fraud. The Committee approved these documents and gave support to Birmingham Audit's activities and initiatives in this regard.

10.5 Fraud Report 2005/6

This report provided information on the results of non housing or council tax benefit related fraud work undertaken by Birmingham Audit during 2005/06. It included details of the number and type of fraud the City Council was experiencing. During the year a total of 343 suspicions of fraud were referred to Birmingham Audit. All referrals are subject to a risk assessment to determine whether the matter should be investigated.

The Committee were interested to hear that the biggest proportion of referrals was in respect of suspected payroll irregularity. Most of these referrals came out of the Audit Commission's National Fraud Initiative (NFI) data matching exercise and concerned either individuals with multiple employment or concerns relating to the total number of hours worked being in excess of the European Working Time Directive.

Other concerns included; the number of code of conduct issues referred to Birmingham Audit (57, more than double that referred in the previous year) external organisation irregularity, 48 investigations completed into the conduct of employees who had committed housing and council tax benefit fraud and increasing levels of computer misuse.

The Committee also received details of pro-active anti-fraud work undertaken within Birmingham Audit. The balance between pro-active and re-active fraud investigation is continually monitored, with a view to increasing the proportion of pro-active work. However, the high volume of referrals and the associated number of investigations and subsequent use of resources has limited the extent of pro-active work undertaken. Fraud awareness training for staff in the Housing Department and the Benefit Service has been delivered.

10.6 Benefit Counter Fraud Team Annual Report 2005/6

This report detailed benefit counter fraud activity carried out during 2005/06.

The Committee was pleased to hear that in an assessment of the City Council's Benefit Service against the Housing Benefit/Council Tax Benefit Performance Standards (that form part of the overall

Comprehensive Performance Assessment) the Benefit Counter Fraud Team were rated as excellent with a maximum level 4 rating.

During the year 4,377 allegations of benefit fraud were received by Birmingham Audit. Referrals came from a number of sources including through data matches, from Benefit Service staff, from the Department of Work and Pensions (DWP) and via the fraud 'hotline'. Benefit overpayments with a value of £1,098,215 were identified and 286 sanctions were taken. The target for sanctions for 2006/07 has been set by the government at 542 cases, an increase of 90% on the number achieved in 2005/06 without any additional resources being made available. The Committee heard how better use of data matching and joint working with the DWP and neighbouring Local Authorities would be employed in working towards this target, as would a review of the organisational structure within the Benefit Counter Fraud Team and the methodologies deployed by the team to ensure that investigations are as effective as possible.

10.7 Corporate Risk Register

The Committee receives regular updates on progress being made within the City Council to embed risk management and on the content of the Corporate Risk Register. The Committee heard that the embedding of risk management continues with presentations and facilitated workshops being provided by Birmingham Audit.

The Corporate Risk Register is updated on a quarterly basis from information provided at a Directorate level detailing the management of risk within service areas. The focus of the Corporate Risk Register is to highlight both existing and emerging business issues rather than concentrating solely on financial risk or very broad strategic issues.

Using the Corporate Risk Register members of the Committee have the facility to select specific risks for more detailed examination. This assists the Committee in forming a view on how well key risks are being managed. To date this facility has already been used in respect of the Bichard report (the outcome of which is detailed further below). At the December meeting the risk of 'failing to move forward with the Library of Birmingham' project was selected and the Committee will be receiving a progress report on how this risk is being managed at its March meeting.

10.8 Bichard Recommendations

The implementation of the recommendations arising out of the Bichard Report issued following an enquiry into the murders in Soham of Jessica Chapman and Holly Wells features on the City Council's Corporate Risk Register. The Bichard Report contained 31 recommendations which have subsequently been split into 2 key areas. The first of these two areas is information and intelligence management

where the implementation of the recommendations made is the responsibility in the main of the Home Office. The second area covers safeguarding and vetting procedures and it is in this area where the City Council has responsibility to demonstrate compliance.

Given the importance of this area the Committee was keen to obtain an assurance that the City Council was adequately managing the risk of failing to comply.

At the September meeting of the Committee, a report from the Strategic Director of the Children, Young People and Families Directorate was received which updated on progress. The Committee heard that a corporate working group, with representation from each Directorate, had been formed to consider the recommendations and address the risks and implications arising from them. A detailed action plan has been developed, the implementation of which is now being overseen by the Safer Recruitment and Employment Group.

The Committee welcomed the progress already made and the comprehensive action plan for future improvement. Further progress report will come to a future meeting of the Committee.

10.9 Audit Plans

One of the responsibilities of the Audit Committee is to review the effectiveness of the Internal Audit function. Part of this responsibility includes forming a view on the adequacy of the internal audit plan. The Committee approves the annual internal audit plan and monitors Birmingham Audits delivery of it throughout the year.

Birmingham Audit's plan for 2005/06 contained 10,288 audit days, later reduced to 9401. This plan, and the subsequent reduction, was approved by the Committee.

A risk based audit plan was used to ensure that audit time available is targeted to the most important business risk areas.

The Committee, whilst approving the necessary revisions to the audit plan made it clear that they did not condone the reduction in resources for central support services such as audit

The annual external audit plan is also approved by the Committee.

10.10 Use of Internet Policy

The Committee have taken a particular interest in IT related issues and have considered a number of internal audit reports in this area. A particular concern discussed initially at the June meeting of the Committee related to staff misuse of the internet. Regular updates on

progress to tackle this issue have been received, including, at the December meeting, a proposed revised Internet Use Policy and Code of Practice. The Committee was also told about work being undertaken to introduce new monitoring and control software to ensure implementation of the policy and compliance with it.

The Committee took assurance from Service Birmingham that controls and procedures were much improved and we will continue to monitor this area.

10.11 Statement of Accounts

The Audit Committee has a responsibility to receive and advise upon the annual Statement of Accounts. At the September meeting, the Committee received the Council's Statement of Accounts for 2005/06 for consideration. The Financial Controller presented the accounts and answered a number of detailed questions asked by members on a variety of issues.

10.12 Data Matching

The Audit Committee approved a Data Matching Policy and Strategy at its June meeting. The process will harness the power of new technology to improve security of data and reduce fraud. At the December meeting a report updating on progress in implementing the policy and strategy was received. In addition the report discussed data matching undertaken by the Housing Benefit Matching Service and as part of the bi-annual National Fraud Initiative.

11. **Some Early Successes**

11.1 Whilst we wanted to lay the groundwork for ensuring that the Audit Committee is able to make a measured contribution to the corporate governance of the City Council we also wanted to try to have some early successes. I would outline 5 such successes I believe we have had.

- (a) Having an immediate impact in providing an impetus for managers to tackle identified control weaknesses; an example being early action taken by Service Birmingham in relation to recommendations made in a number of IT related internal audit reports. We received prompt responses to our concerns and took assurance from Service Birmingham that controls were much improved and systems operating in a more efficient and secure way.
- (b) Agreeing a mechanism to deliver a new requirement coming out of the Account and Audit Regulations (Amendments) 2006 in

relation to conducting an annual review of the effectiveness of systems of internal audit.

- (c) Supporting and promoting improved corporate governance – an example being highlighting to all Strategic Directors the benefit of Control Risk Self Assessment as an effective management tool.
- (d) Getting agreed as a budget pressure the need to put back into the Internal Audit budget some of the money that has been taken out over recent years.
- (e) And by our very existence, our terms of reference and the business we have transacted contributing to the improved score in the City Council externally assessed “Use of Resources” assessment.

12. Looking Forward

- 12.1 I believe that the Audit Committee has made a good start getting up and running quickly and looking at some substantial and important issues. I am grateful to both Members of the Committee and the officers who support us for the diligent way in which we have worked together. I am also very grateful to the District Auditor personally but also to his staff for their strong support to the Committee’s work.
- 12.2 Our focus has been to ensure that whilst aware of the detail we did not get bogged down in minutiae but rather sought to see the wood for the trees. We seek to do this by receiving the overall risk register and the list of all internal audit reports undertaken but then through the familiar “traffic signalling” of red for high risk, amber for medium risk and green for low risk identify particular issues that we want more assurance on. Two examples here are our consideration of progress of the City Council’s action plan following the Richard Report and confirmation of the arrangements put in place for the allocation of NRF funded rubbish skips.
- 12.3 Knowing of some earlier representations from the Co-ordinating O&S Committee, we took an early view that the resources available to Internal Audit were in danger of being reduced to such a level as to compromise some key parts of the Council’s service. We, therefore, also made representations about this and are pleased that it is now proposed to reinstate some of the funding that had recently been lost. We will now take a keen interest in making sure that this extra resource is applied for maximum benefit.
- 12.4 I hope we have rapidly displaced any notion that an Audit Committee is just about looking through lines and lines of figures and wanting to make sure that these figures add up. Whilst I would want to assure

City Council that we will remain vigilant on this, we also want to ensure an understanding that the Committee is essentially about ensuring good risk assessment arrangements and good governance procedures. As the District Auditor expressed it to us, he would like to see the Audit Committee become synonymous with “the place where matters of good corporate governance are discussed.”

MOTION:

That the report of the Chair of the Audit Committee be received.