



Report to Partnership Meeting of 8 February 2013

FINANCE

Statement on Internal Control 2011/12 & Audit Matters Arising

SUMMARY

This report includes an assessment of the adequacy, reliability and effectiveness of the Partnership's system of internal control and provides information for the Partnership's Governance Assurance Statement. This is contained within the Statement of Internal Control.

1. Statement of Internal Control

- 1.1 In order to comply with the requirements of the CIPFA/LASAAC Code of Practice on Local Authority Accounting, a Statement on Internal Control must be produced. Section 2 of the attached report gives details relating to the Statement on Internal Control and the sources of information which inform the Statement.
- 1.2 On the basis of the work undertaken during the year, it is considered that the key systems operate in a sound manner and that there has been no fundamental breakdown in control resulting in material discrepancy. However as no system of control can provide absolute assurance against material loss, nor can Internal Audit give that assurance, it is the audit opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Partnership's internal control systems for the year to 31 March 2012.

2. Internal Audit Matters Arising on the Statement of Internal Control

- 2.1 The detailed report and action plan are attached.
- 2.2 The report contains an audit opinion based upon the work performed in respect of the subject under review.
- 2.3 There are four audit opinions which can be provided:
 - (i) **Full Assurance:** There is a sound system of control designed to achieve the system objectives and the controls are being consistently applied.
 - (ii) **Substantial Assurance:** While there is a generally a sound system, there are areas of weakness which put some of the system objectives at risk, and/or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk.
 - (iii) **Limited Assurance:** Weaknesses in the system of controls are such as to put the system objectives at risk, and/or the level of non-compliance puts the system objectives at risk.
 - (iv) **No Assurance:** Control is generally weak, leaving the system open to significant error or abuse, and/or significant non-compliance with basic controls leaves the system open to error or abuse.

- 2.4 The opinion given is one of **Substantial Assurance**.
- 2.5 The Action Plan contains 3 recommendations, 1 Medium (important issues that officers should address and will benefit the Organisation if implemented) and 2 Low (minor issues that are not critical but officers should address). The target implementation dates are 30 April 2013, 31 October 2012 and 31 October 2013 respectively.

3. Recommendation

- 3.1 Board Members are asked to note the content of the Statement of Internal Control and the audit opinion provided, and to raise or comment on any relevant points.

Report by: Mike Mitchell
Designation: Partnership Treasurer
Date: 23 January 2013



HITRANS

Statement on Internal Control 2011/12

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1. INTRODUCTION

- 1.1 The purpose of this report is to provide an assessment of the adequacy, reliability and effectiveness of the internal control systems within the Partnership. This complies with the requirements of the CIPFA/ LASAAC Code of Practice for Local Authority Accounting in the United Kingdom which recommends that Scottish Authorities voluntarily conduct an annual review of the effectiveness of its system of internal control and include a statement reporting on the review with any Statement of Accounts. In respect of The Highlands and Islands Transport Partnership (HITRANS) a Statement on Internal Control is produced. HITRANS is the statutory regional transport partnership covering Eilean Siar, Orkney, Highland, Moray and most of the Argyll and Bute area.

2. STATEMENT ON INTERNAL CONTROL

2.1 Responsibilities for Internal Control

It is the responsibility of senior management to establish an appropriate and sound system of internal control, and to monitor the continuing effectiveness of that system.

The Head of Internal Audit & Risk Management, Highland Council, provides an annual overall assessment of the robustness of the system of internal control.

2.2 Internal Control

Internal control is defined as *"the whole system of checks and controls, financial or otherwise, established by management in order to provide reasonable assurance"* regarding the achievement of one or more of the following objectives:

- The reliability and integrity of information.
- Compliance with policies, plans, procedures, laws, regulations and contracts.
- The safeguarding of assets.
- The economical and efficient use of resources.
- The accomplishment of established objectives and goals for operations or plans.

Any system of control can only provide reasonable, and not absolute assurance that control weaknesses or irregularities do not exist, or that there is no risk of material errors, losses, fraud or breaches of laws and regulations. Accordingly the Partnership should seek continual improvement in the effectiveness of its systems of internal control.

2.3 Internal Audit

Internal Audit is an independent appraisal function established for the review of the internal control system as a service to the Highland Council. It objectively examines, evaluates and reports upon the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources. Any areas of concern together with the management agreed actions and target dates for implementation are summarised in an Action Plan within the report. It is the responsibility of management to ensure that implementation of these actions takes place as agreed. The Internal Audit Section will undertake periodic follow-up reviews to ensure that the management agreed actions have been satisfactorily implemented.

The Internal Audit Section operates in accordance with the requirements of the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom, 2006. As required by the Code, a risk based tactical audit plan for the Highland Council is produced each year, and submitted for information to the Audit and Scrutiny Committee.

2.4 Evaluation of Control Environment

Evaluation of the control environment is informed by a number of different sources:

- The audit work undertaken by the Internal Audit Section during the year to 31st March 2012. This includes both work undertaken directly for HITRANS with regard to certification of grant claims and indirectly where the Highland Council's financial systems were examined, which are also used by HITRANS. For this year, this consisted of:
 - (i) a high level review of the adequacy and effectiveness of HITRANS' system of internal control,
 - (ii) targeted testing of key controls to confirm that the main financial systems are operating as intended,
 - (iii) assurance provided by individual audits of the Council's main financial systems.
- Knowledge and audit appraisal of HITRANS' governance, risk management and performance monitoring arrangements.
- The assessment of risk completed during preparation of the Council's annual tactical plan.
- Any findings reported by the External Auditor and any other inspection agencies.

2.5 Risk Management

Risk management is a key element of Corporate Governance and to address this, a new Risk Management Strategy was produced which sets out the aims and objectives of HITRANS regarding the management of its risks in the short to medium term. The strategy was approved by the HITRANS Board in February 2011 and the Board also receives an annual update on the Risk Register, most recently in January 2012.

2.6 Review of Internal Controls and Main Financial Systems

As stated at 2.4 above, a high level review of HITRANS system of internal control was undertaken. Some minor issues have been identified which will be addressed in a separate audit report but these do not affect the audit opinion.

HITRANS uses the Council's financial systems and during the financial year 2011/12, individual audits were undertaken of the Payroll and General Ledger systems. The audit opinion provided for both these audits was **Substantial Assurance** therefore, both of these systems can be considered reliable.

The remaining financial systems (Creditors, Debtors, Income and Budgetary Control) have been subject to a review of the key controls including:

- Financial procedures and guidance issued to staff;
- Segregation of duties;
- User access levels and appropriateness;
- System backups.

A sample of transactions across all organisations which use the Council's financial systems was also selected for detailed testing to verify that the controls were operating as expected. This was verified from the testing of HITRANS transactions and no control issues were identified.

2.7 Assurance from the Partnership Director

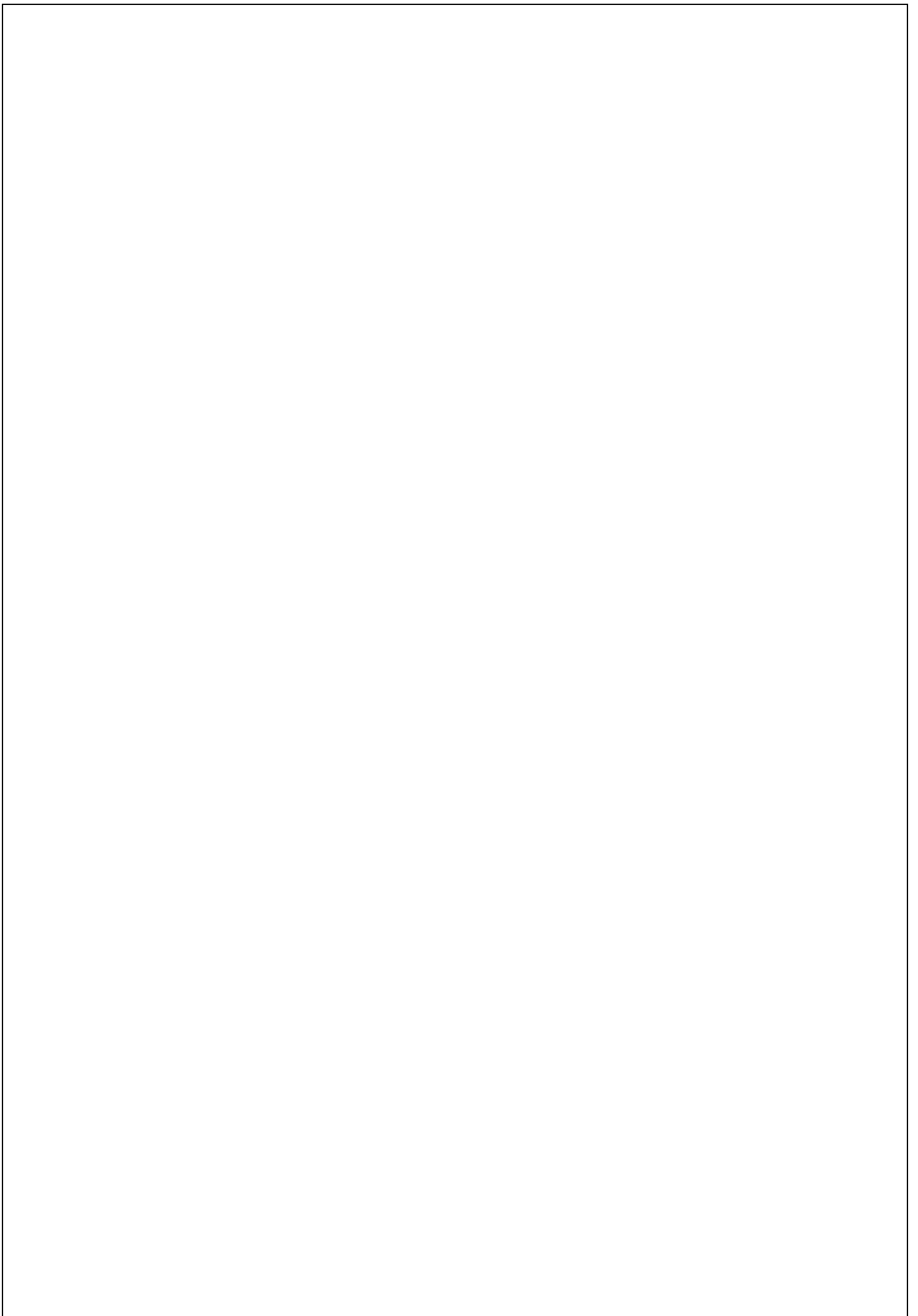
As part of the Annual Accounts process, the Partnership Director of HITRANS was asked to provide assurance that the following statements are valid:

- That Financial Monitoring Statements are regularly reviewed at management meetings.
- That Staff have been made aware of the Partnership's Financial Regulations and Contract Standing Orders.
- That Staff have been made aware of the Partnership's Code of Conduct, Information Systems Security, Fraud and Corruption and Whistle Blowing policies.
We do not have a formal Information Systems Security but follow best practice in securing the use of our IT resources.
- That HITRANS has a robust Scheme of Delegation and that Staff have been informed of their supervisory and accountability responsibilities and that their responsibilities are documented in a Job Description.
- That Segregation of Duties is an important control mechanism operation within HITRANS and where it has not been possible to operate such a control a suitable alternative is in place.
While we work closely as a team, each member of staff has clearly defined roles and responsibilities.
- That appropriate targets have been established within HITRANS to measure financial and other performance.
- That a formal system of project management, including project governance operates within HITRANS.
We follow our contract standing orders and ensure projects are delivered to the required standard through regular monitoring of progress and appropriate project management remedial action, though not through a 'separate formal system of project management' given the scale of our operations. There may be value in further formalising our project management systems during 2012/13 given our increasing involvement in multi partner EU funded projects.

This assurance was provided by the Partnership Director on 23/04/12 together with a number of comments detailed above in italics. There are no issues highlighted which affects the Statement on Internal Financial Control.

2.8 Audit Opinion

On the basis of the work undertaken during the year, it is considered that the key systems operate in a sound manner and that there has been no fundamental breakdown in control resulting in material discrepancy. However as no system of control can provide absolute assurance against material loss, nor can Internal Audit give that assurance, it is the audit opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the HITRANS' internal control systems for the year to 31st March 2012.



**INTERNAL AUDIT
FINAL REPORT**

HIGHLANDS & ISLANDS TRANSPORT PARTNERSHIP
MATTERS ARISING FROM THE STATEMENT OF INTERNAL
CONTROL 2011/12

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DISTRIBUTION

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Audit Scotland

REF: HP01/001

DRAFT DATE:
FINAL DATE:

18/09/12
17/10/12

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1. management summary

1.1 Introduction

In order to inform the Head of Internal Audit & Risk Management's annual Statement of Internal Control, work was undertaken to examine the systems of internal control operated within the Highlands & Islands Transport Partnership (HITRANS). This consisted of:

- (i) A high level review of HITRANS' system of internal control by way of an evidence-based checklist comprising six key areas:
 - Control environment.
 - Identification and evaluation of risk and control objectives.
 - Information and reporting.
 - Control processes.
 - Monitoring and corrective action.
 - Assessment of whether the key controls have been applied during the year.
- (ii) A review of the key controls operated within those financial systems which were not subject to a detailed audit review during the year (Creditors, Debtors, Income and Budgetary Control). The areas examined included:
 - Financial procedures and guidance issued to staff;
 - Segregation of duties;
 - User access levels and appropriateness;
 - System backups.

A sample of transactions was also selected for detailed testing to verify that the controls were operating as expected. This sample covered the Council and organisations which use some or all of the Council's financial systems (Assessor's Department, Northern Constabulary, Highland & Islands Fire & Rescue Service and HITRANS).

1.2 Main Findings

The main finding of the review was that the systems of internal control were reliable. However there were some matters identified where action could be taken by management to improve the internal controls as follows:

(i) Internal control checklist

HITRANS does not have a Code of Corporate Governance, however their annual Business Plan does cover some of the areas that would be expected to be included in the Code (standing orders, scheme of delegation, financial regulations, HR policies, equalities, and consultation with stakeholders) (Section 3.1.1).

HITRANS do not have formal Information Management or Information Systems Security Policies but the Partnership Director stated that they follow best practice in securing the use of IT resources (Section 3.1.2).

HITRANS should review their Financial Regulations and consider adopting the Highland Council's Financial Regulations 2012 (section 3.1.3).

(ii) Review of key controls

All testing of key controls was found to be satisfactory.

1.3 Conclusion

This review has concluded that the systems of internal control for HITRANS were reliable. However, as detailed in the main findings above, there are areas where controls could be further improved by the introduction of new policies and/ or

updating of existing ones. As a result, this report contains 3 recommendations, 1 of which is medium priority, with the remaining 2 being low priority. Management action has been agreed for each recommendation, with implementation of the actions due to be complete by October 2013.

1.4 Audit Opinion

The opinion is based upon, and limited to, the work performed in respect of the subject under review. Internal Audit cannot provide total assurance that control weaknesses or irregularities do not exist. It is the opinion that **Substantial Assurance** can be given in that while there is a generally a sound system, there are areas of weakness which put some of the system objectives at risk, and/ or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk. The levels of assurance and their definitions can be found at Appendix 1.

2. scope, Method and coverage

- 2.1 Details of the procedures in operation were ascertained by enquiry of officers within HITRANS and review of documents published on their website.
- 2.2 The audit testing covered the financial year 01/04/11 – 31/03/12 and the key controls examined were as follows. It should be noted that the sample sizes stated cut across all organisations.

Creditors

- Review of procedures issued to staff for the Accounts Payable system;
- Review of user and authorisation rights within the Accounts Payable system;
- A sample of 30 paid invoices were selected to ensure that:
 - an approved method of purchasing was used,
 - where a purchase order was used that it contained the right level of detail (including prices),
 - the order was approved by an appropriate officer,
 - where appropriate, the approved contract supplier was used,
 - the invoice details were matched to the order and record of goods received, and where appropriate goods were receipted in Pecos.
 - there was an appropriate segregation of duties within the ordering, receipt of goods and authorisation of invoices for payment.
- Review of the procedures for the back-up of the Accounts Payable data and the holding of this in a secure environment;
- Review of a sample of 5 BACS payment runs.

Debtors

- Review of procedures issued to staff for the Accounts Receivable system;
- Review of user and authorisation rights within the Accounts Receivable system;
- A sample of 30 paid invoices were selected to ensure that:
 - the invoice was issued within the specified timetable,
 - the invoice contains the required amount of detail,
 - the correct ledger code was used,
 - the invoice was necessary given the type of service and value involved.
 - There was an appropriate segregation of duties between the officer who raised the invoice and subsequently received the payment.
- A sample of 10 cancelled invoices were selected to ensure that:
 - An appropriate reason was given for the cancellation, and it is a legitimate cancellation,
 - Where a replacement invoice was issued, the details are cross-referenced,
 - The cancellation was approved by an appropriate officer, separate to the officer who raised the original invoice.
- A sample of 5 bad debt write-offs were selected to ensure that these were authorised and processed in accordance with HITRANS policy.
- Review of the procedures for the back-up of the Accounts Receivable data and the holding of this in a secure environment.

Income

- Review of procedures issued to staff for the collection, receipting and banking of income;
- Review of segregation of duties across cash handling, banking, central monitoring and other finance functions for the same account areas.
- Review of user and authorisation rights within the on-line banking system;
- Review of the procedures for the back-up of the General Ledger and AXIS data and the holding of this in a secure environment.

Budgetary Control

- Review of procedures issued to staff for the budgetary control system;
- A sample of 10 budget holders were selected to ensure that:
 - they are provided with regular monitoring reports,
 - the monitoring reports show actual and/ or committed expenditure and income to date, and variance against budget,
 - there is evidence of formal review by budget holders and that corrective action has been taken, where appropriate. Ensure any corrective action fits with the overall objectives and relevant rules,
- Review of the process within Oracle for the accurate collation, totalling and reporting of all authorised input and related budget information.
- A sample of 10 Committee meetings was selected to check that the relevant budget reports were provided. Where adverse variances or problems were identified checked that appropriate explanations were provided and assurance was given that action was being undertaken to address these. Also checked that the trading organisations progress in achieving prescribed financial objectives was also reported to the appropriate Committee.
- A sample of 5 Council/ Board meetings were selected to check that the overall budget position for the Council/ Board was reported. Where adverse variances or problems were identified checked that appropriate explanations were provided and assurance was given that action was being undertaken to address these.

2.3 Staff involved in the audit were:

- Partnership Director, HITRANS
- Partnership Manager, HITRANS

Thanks are extended to all of these officers for their courtesy, co-operation and assistance in this assignment.

3. Findings and Recommendations

3.1 Internal Control Checklist

3.1.1 Code of Corporate Governance

In 2008, CIPFA/SOLACE published a new corporate governance framework entitled "Delivering Good Governance in Local Government". This framework provides best practice for developing and maintaining a local Code of Corporate Governance and also provides a structure to help individual organisations with their own approach to governance. The framework is based on six core principles, each of which has a list of supporting principles and practical examples.

HITRANS does not have a Code of Corporate Governance, however their annual Business Plan does cover some of the areas that would be expected to be included in a code of corporate governance (standing orders, scheme of delegation, financial regulations, HR policies, equalities, and consultation with stakeholders).

It is best practice for a local code to be in place, as this records an organisation's approach to meeting its governance requirements. There is a risk that without these being formalised within a single document, HITRANS cannot demonstrate its commitment and approach to corporate governance.

Recommendation

Consideration should be given to developing a Code of Corporate Governance in line with the CIPFA/SOLACE guidance.

3.1.2 Information Management Policy

HITRANS do not have a formal Information Management Policy or Information Systems Security Policy, but the Partnership Director stated that they follow best practice in securing the use of IT resources. An Information Management Policy would ensure that staff are aware of their responsibilities in relation to the retention, sharing and destruction of business information, and would assist in fulfilling HITRANS' obligations in relation to Data Protection and Freedom of Information legislation. The benefits of an Information Systems Security Policy are to ensure that access to HITRANS ICT equipment is appropriately controlled, and responsibilities for preventing security breaches are clearly defined.

Recommendation

Consideration should be given to developing Information Management and Information Systems Security Policies.

3.1.3 Financial Regulations

HITRANS adopted the Highland Council's Financial Regulations dated August 2010 at the Partnership Meeting on 03/02/12. However, the Council's Regulations were subsequently revised with effect from March 2012 and whilst these are mainly minor changes, reference is made to the Bribery Act 2010, which is also relevant to HITRANS.

Recommendation

HITRANS should consider adopting the latest version of the Highland Council's Financial Regulations.

3.2 Review of Key Controls

No issues were identified from the testing of key controls with regard to the HITRANS transactions examined.

4. Action Plan

The Action Plan contains **3** recommendations as follows:

Description

Major issues that managers need to address as a matter of urgency.

Important issues that managers should address and will benefit the Organisation if implemented.

Minor issues that are not critical but managers should address.

Priority	Number
High	0
Medium	1
Low	2
Total recommendations	3

REPORT REF.	GRADE	FINDING	RECOMMENDATION	MANAGEMENT AGREED ACTION	IMPLEMENTATION	
					RESPONSIBLE OFFICER	TARGET DATE
3.1.1	Low	HITRANS does not have a Code of Corporate Governance.	Consideration should be given to developing a Code of Corporate Governance in line with the CIPFA/SOLACE guidance.	Corporate Governance is highlighted each year in the Business Plan, and updated as necessary. Interactive presentation made to Board Members on Code of Good Governance in October 2012.	Partnership Director	31/10/12
3.1.2	Medium	HITRANS do not have a formal Information Management Policy but the Partnership Director stated that they follow best practice in securing the use of IT resources.	Consideration should be given to developing Information Management and Information Systems Security Policies	HITRANS will develop formal Information Management and Information Security Policies.	Partnership Director	30/04/13

REPORT REF.	GRADE	FINDING	RECOMMENDATION	MANAGEMENT AGREED ACTION	IMPLEMENTATION	
					RESPONSIBLE OFFICER	TARGET DATE
3.1.3	Low	HITRANS adopted the Highland Council's Financial Regulations but this version has since been revised.	HITRANS should consider adopting the latest version of the Highland Council's Financial Regulations.	HITRANS review their Financial Regulations every 2 years and will ensure the next review follows on from a recent review of their Financial Regulations by The Highland Council. Any critical changes in national policy highlighted by CIPFA/ SOLACE between reviews will be dealt with through separate reports to the Partnership.	Partnership Director/ Finance Manager	31/10/13

Internal Audit Opinion

Level	Definition
Full Assurance	There is a sound system of control designed to achieve the system objectives and the controls are being consistently applied.
Substantial Assurance	While there is a generally a sound system, there are areas of weakness which put some of the system objectives at risk, and/ or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk.
Limited Assurance	Weaknesses in the system of controls are such as to put the system objectives at risk, and/ or the level of non-compliance puts the system objectives at risk.
No Assurance	Control is generally weak, leaving the system open to significant error or abuse, and/ or significant non-compliance with basic controls leaves the system open to error or abuse.