



# MIDDLESBROUGH COUNCIL

STRATEGIC FINANCE

SERVICE

ANNUAL INTERNAL AUDIT  
REPORT 2007/2008

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## *Introduction*

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### *Annual Reporting*

The annual report of Internal Audit for the year commencing 1<sup>st</sup> April 2007 to 31<sup>st</sup> March 2008 presents Members of the Audit Committee with a summary of:

- Work undertaken to formulate an opinion of the overall adequacy and effectiveness of the internal control environment and any qualifications to that opinion
- Key findings
- Issues of concern relevant to the preparation of the Council's Annual Governance Statement
- Action in hand as a result of audit work undertaken during the period
- Internal audit activity, showing internal audit's performance and progress for the year ended 31<sup>st</sup> March 2008.

A key part of the Audit Committee's role is to form an overall opinion on the internal control environment and the quality of internal audit coverage.

This report conforms to the annual reporting requirements detailed in the CIPFA Code of Practice for Internal Audit in Local Government (2006).

## *Section 2*

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### *INTERNAL CONTROL AND THE ROLE OF INTERNAL AUDIT*

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#### *Internal Control*

The Council's key financial systems are managed and delivered on its behalf by Mouchel. One of Mouchel's objectives is to improve internal processes and thereby deliver 'fit for purpose' systems that support frontline services and achieve productivity gains. As a result of continuous change in processes and procedures, risks facing the Council are constantly evolving. Regular review and evaluation of these risks is therefore essential to maintain a robust and sound system of internal control. The importance of internal control is to manage risks that could have a significant affect on the Council's ability to fulfil its objectives.

It is the role of management to design, operate and monitor an appropriate system of internal control that contributes to the delivery of the Council's objectives. All employees have some responsibility for internal control as part of their accountability for achieving objectives.

#### *Role of Internal Audit*

Internal Audit provides independent, objective advice and assurance that the systems of control and risk management are adequate and effective.

A sound system of internal control should provide reasonable but not absolute assurance that the Council will not be prevented from achieving its objectives, or the orderly and legitimate delivery of services, by circumstances that may reasonably have been foreseen.

The Accounts and Audit (Amendment) (England) Regulations 2006 paragraph 4 (2) require the Council to review, at least once a year, the effectiveness of its systems of internal control and include a statement on internal control, prepared in accordance with proper practice in its annual accounts. The work of Internal Audit described in this report and the opinion based on that work contributes to the production of that statement.

## AUDIT OPINION

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### *Internal Audit's Opinion on the Effectiveness of Internal Control 2007/2008*

***On the basis of the audit work undertaken and reported upon it is the opinion of Internal Audit that the Council has a satisfactory framework of internal control to manage the achievement of its objectives. Whilst areas for improvement have been highlighted and several areas of concern raised, management have in all cases agreed to implement suggested recommendations which will improve the overall control environment. No significant weaknesses have been identified.***

In providing this opinion, it should be noted that no assurance can ever be absolute; however it seeks to provide a reasonable assurance that there are no significant weaknesses in the Council's whole system of internal controls.

The level of assurance given takes into account:

- All audit work completed in 2007/2008
- Follow up actions from previous years' audits
- Management's responses to findings and recommendations
- Effects of significant changes in the Council's systems
- The extent of resources available to deliver the audit plan
- Quality of the internal audit service's performance
- The extent to which resource constraints may limit the ability to meet the full audit needs of the Council
- Any limitations that may have been placed on the scope of Internal Audit.

All audit reports produced have included a management action plan where recommendations have been made which will enhance the level of control, together with an opinion of the systems reviewed. Timescales for the implementation of recommendations have been agreed with managers responsible for each area audited.

### *The Annual Governance Statement for 2007/08*

CIPFA guidance sets mandatory proper practice for the basic content of the required Annual Governance Statement and its approval and publication represent the end result of the annual review of internal control. The Corporate Affairs Committee is responsible for approving the

Council's Statement for signing by the Chief Executive and Mayor prior to its publication with the Council's accounts.

Internal control is operating effectively and the area for continuing action included within the Annual Governance Statement relates to:

- Town Centre Heritage Initiatives - Historic Lottery Fund. Internal Audit identified significant issues in the process and procedures being followed in these regeneration schemes

## Section 4

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### *Planned Coverage and Outputs 2007/2008*

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The 2007/2008 Internal Audit plan presented to the Audit Committee identified a planned requirement of 2,636 days based on resources available at the time. It became clear as the year progressed that if action were not taken, resources would fall short of those required to deliver the plan. The shortfall was predicted due to delayed appointments of new audit staff (185.5 days); a member of staff taking unpaid leave to undertake a course of study not related to the work of the Internal Audit Section (12.5 days) and special leave granted to a member of staff to enable him to represent Great Britain in an athletics competition in Japan (5 days).

The potential shortfall in resources was addressed by an increase in the use of agency staff (162 days) and additional hours worked by members of staff under the flexi-time scheme (41 days). In addition there was an overall net increase of 35 chargeable days from the 2,636 originally planned to 2,671 actually delivered.

The summary below provides the final outturn position for 2007/2008 against the original plan by activity, Directorate and other work of the Internal Audit Section. Appendix A provides a more detailed summary of the actual audit days delivered by service area.

	Original Planned Days	Actual Days Worked	Variance from Plan	% of Days Completed
Planned Audits				
Fundamental Financial Systems	473	589	116	125%
Other Corporate Financial Systems	37	59	22	159%
Code of Practice Audits	93	35	-58	38%
Children Families & Learning	457	497	40	109%
Environment & Neighbourhood Services	213	288	75	135%
Regeneration	255	241	-14	95%
Social Care	200	151	-49	76%
Central Services	103	118	15	114%
IT Audit	46	12	-34	26%
Contract Audit	50	33	-17	66%
Total Planned Audits	1927	2023	96	105%
Other Audit Work				
Contingency	121	93	-28	77%
Advice	59	70	11	119%
Other Audit Duties	439	406	-33	92%
Training	82	75	-7	91%
Total Planned & Other Audit Work	2628	2667	39	101%
External Clients	8	4	-4	50%
Total Audit Days	2636	2671	35	101%

## Comments on Audit Coverage

The overall total number of days actually delivered for planned audits exceeds the original planned days. However, this masks some variations in performance between different areas of audit activity. These are discussed below:

### ➤ **Fundamental Financial Systems**

All audits brought forward from the previous financial year (2006/2007) were completed; however several audits overran the planned number of days. This can be attributed to the fact that a different auditor was assigned to undertake the audit under the rotation policy. In other cases, delays arose from discussions with the auditee concerning implementation of recommendations. With the exception of capital accounting and payroll, audits of all the fundamental financial systems for 2007/2008 were commenced within the year and were substantially complete as at 31<sup>st</sup> March 2008.

The external auditors review the work on fundamental financial systems each year as part of their audit of the Council's 2007/2008 accounts.

### ➤ **Other Corporate Financial Systems**

Audits of the systems for payment of travel and subsistence and car allowances were carried out during 2007/2008

### ➤ **Code of Practice Audits**

During 2007/2008 the Audit Manager again fulfilled the role of key contact for the 2006 National Fraud Initiative Data Matching Exercise run by the Audit Commission. The Internal Audit Section was also responsible for investigating matches in the following areas:

- ◆ Creditors
- ◆ Payroll

The Benefit Fraud Investigation team investigated housing benefit matches and the Pensions Administration Unit investigated deceased pensioner and abatement of pension matches.

Investigations of matches identified total overpayments of £54,248 of which £28,726 is being recovered. A total of 6 fraudulent claims were identified.

The area of work not completed included reviews of individual policies and procedure e.g. financial regulations, accounting instructions, anti-fraud and corruption policy.

### ➤ **Children, Families and Learning**

During the year, the audit programme for primary schools was updated to cover all elements included in the Financial Management in Schools Standard introduced by the Government in 2006. Middlesbrough Schools use external assessors to report on their compliance with the Standard. In carrying out their assessment, the external assessors have regard to the latest Internal Audit report on the school's systems of internal control.

In 2007/2008 audits were undertaken at 14 primary schools, and 4 special schools. A follow up audit was undertaken at a secondary school.

Evidence from the audits undertaken confirmed that schools subject to audit have robust internal controls in place, which are being followed. Only three schools failed to achieve an audit opinion of full or substantial assurance. A common factor in each case was a recent change in personnel whose duties heavily involved them in the financial management of the school.

In addition to schools, the following audits were either commenced and/or completed during the year:

The number of days spent auditing Youth and Community Centres was substantially reduced, reflecting the work undertaken in previous years to improve standards.

Lanehead and Stainsacre Outdoor Education Centres were audited for the first time in a number of years. Although various recommendations were made to put in place additional controls and where necessary strengthen existing controls, both establishments were found to have sound financial procedures in place. Based on the work undertaken, Internal Audit was able to place substantial assurance on the control environment.

Internal Audit was asked to undertake two investigations at the Youth Justice Service. The first concerned the theft of a mobile phone; recommendations were made to tighten up controls over the issue and monitoring of usage. A further investigation into the use of fuel cards related to a breach of contract standing orders.

The audit of Pupil Referral Units was carried forward into the following financial year to enable issues arising out of free school meals to be addressed.

#### ➤ **Environment & Neighbourhood Services**

Based upon the risk-based approach adopted by Internal Audit, several system and establishment audits were commenced and/or completed in 2007/2008.

Audits of the Laboratory Service, Tees Pride 10k Road Race and Newham Grange Leisure Farm revealed a small number of weaknesses in systems of internal control; however Internal Audit was able to give an opinion of substantial assurance. In responding to the audit conducted at the Laboratory Service, the manager gave the following response:

‘My service is subject to external audit by the United Kingdom Accreditation Service (UKAS) on an annual basis and many of the systems we have derive from the quality system that we have developed to support our external accreditation. Your auditor certainly tested our systems in greater depth and breadth than our external audit and I am pleased to see that most were found to be robust. Our external audit carried out by UKAS in September was complimentary that your auditor had looked at our systems in depth and had found no major issues with regard to quality.’

When the auditor commenced the audit of the Laboratory Service he discovered outstanding debts of £116k. On completion of the audit, over £44k had been recovered as a direct result of the auditor’s actions.

Weaknesses in the systems of internal control identified in the audits of Metz Bridge Caravan Park and Pest Control meant that Internal Audit was only able to express an

opinion of limited assurance. Managers have taken action to implement the recommendations made by Internal audit.

In addition, recommendations raised in the previous year relating to: Clairville Stadium; Municipal Golf Course; Neptune Leisure Centre; Rainbow Leisure Centre and Southlands Leisure Centre were followed up. Good progress had been made in implementing Internal Audit's recommendations.

Audits of the Bus Station, Other Licensing and Car Parking are in progress or awaiting to be finalised at the year-end.

➤ **Regeneration**

Efforts continue to be made to reduce the amount of time spent in preparation and audit of accounts of Community Councils and Community Centres. For the second year running the actual time spent on this work has been reduced.

Audits were undertaken of Development and Building Control Services, Boho/Digital City and Commercial Properties. Although recommendations were made, in all cases the systems of internal control were assessed to be sufficiently robust to give an audit opinion of substantial assurance.

Audit reviews of the Housing Market Renewal Fund were undertaken quarterly. On the conclusion of each audit the Audit Manager was able to sign the verification statement of grant usage. Controls in this area were developed throughout the year and are now good. The practice adopted in Middlesbrough of quarterly audits is considered to be leading the way amongst the Teesside Authorities.

Audit work was also focused on the control environment surrounding different grant funding initiatives. It is increasingly the case that Internal Audit, and not External Audit, are required to give assurance to the funding bodies that monies have been properly accounted for and spent fairly in relation to the objectives for the funding. Specific concerns were raised by Internal Audit regarding the Teesside Heritage Initiative, such that no assurance could be placed on the control environment to prevent or detect any threat that could lead to failure to achieve key objectives, major loss due to error, fraud or impropriety / damage to reputation.

In addition, recommendations raised in previous years relating to Middlesbrough Theatre and Town Hall were followed up. Good progress had been made in implementing Internal Audit's recommendations.

➤ **Social Care**

Audit work focused on Adult Protection, Asylum Seekers and Ayresome Industries. Our reviews found a number of weaknesses in the systems of control, which resulted in recommendations being made to address these issues. The control environment operated by the Adult Protection and Asylum Seekers Services was sufficiently robust to enable the auditor to express an opinion of 'substantial assurance'. In contrast, no assurance could be placed in the control environment found at Ayresome Industries to protect the assets and ensure its continued profitability. With Ayresome Industries' position as part of the

Council now resolved, managers can concentrate on aligning activities to the standards laid down by the Council.

Audits of the Tees Community Equipment Service, Registrars and Direct Payments system were outstanding as at the 31<sup>st</sup> March 2008.

➤ **Corporate Services**

Following reviews of Members' Allowances, Performance Indicators and Local Public Service Agreements 2, Internal Audit were able to place substantial assurance on the control environment in both areas.

The number of days spent reviewing requests for exemptions from Contract Standing Orders continued to increase. This is a demand led service outside the control of Internal Audit.

➤ **IT Audit**

Internal Audit coverage in this area continues to fall short of the planned number of days. The main reason for the shortfall was the departure of the senior auditor who was to take responsibility for audits in this specialist area. The work of Internal Audit concentrated on access and security of computer applications and protection of data. The total number of days reported for IT Audit is understated as all audit programmes require auditors to assess access security and back-up operations.

➤ **Contract Audit**

Although the number of days spent on the audit of contracts showed an increase on the previous year, 33 days as compared to 19 days, it was still less than the planned number of days for the year.

Audits conducted in the year included receipt and payment of contractors' claims and receipt and custody of tenders. In both cases, the audit opinion was that substantial assurance could be placed on the control environment

➤ **Contingency**

This area covers unplanned and additional audit work. Whilst there have been a number of unplanned items this year, they have been minor in nature. Internal Audit received 5 referrals in the year to investigate suspected fraud and theft matters and missing assets. One incident of theft has been dealt with through the courts resulting in a successful prosecution. Where Internal Audit has identified remedial action, management has strengthened internal controls.

No irregularity matters have come to the attention of Internal Audit that indicate a material weakness in the Authority's control environment.

➤ **Advice**

Internal Audit provides advice to Directorates to ensure that appropriate controls are incorporated at an early stage in the planning of new services or systems development. It also offers general advice on processes and procedures and interpretation of the financial and contract rules. It is important that officers are able to contact Internal Audit for advice and help.

## *AUDIT PERFORMANCE*

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During the year two experienced senior internal auditors left to take up posts outside local government. Fortunately we were able to attract an experienced auditor from another authority to fill one of the vacancies. The other vacancy was filled internally, leaving a vacant auditor post. It is at the auditor level that it has been traditionally hardest to recruit due to the level of skills and experience that we are looking for from applicants.

In addition one of the agency staff whom had been with us for some considerable time left to take up a permanent post in another area of the country. A replacement was obtained from a recruitment agency but he left after one month to take up permanent employment elsewhere. A further appointment was made however after six months this individual also left to pursue other interests. The rapid turnover of agency staff has had an impact on performance; it takes time for a new auditor to become familiar with the organisation and pick up work left partially complete by their predecessor. The recruitment process is also a drain on management time and resource.

Targets for achieving audits within budget have not been fully met although performance continues to improve. Delivery of planned audits was not assisted by the turnover of staff. In addition a number of establishments audited in the year had not received a visit from an auditor for some time due to their location for example Lanehead Outdoor Education Centre located near Conniston Water and Stainsacre Hall near Whitby.

However, there was a discernible improvement in the performance of Internal Audit, particularly:

- All the key financial audits were either completed or commenced prior to the end of the financial year, with the exception of Payroll and Capital
- Time taken to prepare and audit the accounts of Community Councils and Community Centres was reduced for the second year running
- The time taken to audit a primary school was reduced to an average of 10 days per school. This was despite additional work to identify those areas where the school did not reach the Financial Management Standard.
- Further progress has been made in the year to raise the profile of internal control and risk management by visiting establishments not subject to audit for some time.

Performance indicators to facilitate monitoring the Internal Audit Section's efficiency and effectiveness are reported below.

	2006/2007	2007/2008
Chargeable days per FTE employee (Audit Commission benchmark = 175)	172	192
No. of Recommendations raised and accepted for implementation	1,180	1049
No. of Audits commenced	131	167
Completion of annual plan	75%	80%

Middlesbrough is a member of the CIPFA/IPF Audit Benchmarking Club. Through this membership, information about our costs and productivity is compared against other unitary authorities. The figures for 2007/2008 have only just been received from IPF. The average figures quoted are estimates and subject to change but are given here for the purpose of comparison.

	Middlesbrough			Average		
	05/06	06/07	07/08	05/06	06/07	07/08
	£	£	£	£	£	£
Cost per £m gross turnover (incl. agency staff costs)	1,432	1,248	1,417	1,130	1,127	1,078
Cost per auditor	46,437	48,000	52,916	47,710	49,805	50,373
Cost per audit day	224	240	275	276	295	291
Audit days per auditor	166	172	171	170	170	169

Middlesbrough spends more per £m gross turnover on its audit service than other, unitary councils. The cost per auditor has exceeded the benchmark average for the first time since joining the club. The number of audit days provided remains above average and the cost per audit day below average.

#### *Quality Assurance*

Internal Audit's aim is to provide a service that not only meets the Council's needs, but also maintains consistently high standards. This is achieved through the following internal processes:

- The Audit Plan is submitted to Members of the Audit Committee for approval of an appropriate level of assurance
- A tailored approach, using a defined methodology and audit manual are used in undertaking audit assignments
- A systematic review process ensures that all reports are reviewed by senior audit staff at each reporting stage

- The use of quality control questionnaires following the audit assignment to ascertain the clients' degree of satisfaction with the service in respect of consultation / approach, management of the audit, the audit report and any other feedback.

Questionnaires require ratings on scales of 1 to 4. Of the questionnaires returned by clients in 2007/2008, the Internal Audit Service achieved an average score of 3.3. This was above the target score of 3 and the same as the previous year.

*Key issues for 2008/2009*

Internal Audit continues to carry vacant posts and relies upon agency staff to deliver the audit plan. Efforts will continue to recruit suitably qualified and experienced staff to deliver the audit plan.

Internal Audit makes a significant contribution to the internal control 'key line of enquiry' part of the 'use of resources' category of the Council's Comprehensive Performance Assessment (CPA). The challenge is to improve the overall score. The implementation of internal control is not the responsibility of Internal Audit, as this would impact upon its independence; however it can promote improvements in controls through raising awareness and assurance work.

In order to objectively self assess the current position and performance of Internal Audit, a review will be conducted to assess compliance against the CIPFA Code of Practice for Internal Audit in Local Government 2006.

The standards and documentation of Internal Audit are to be reviewed to ensure continuing compliance with the CIPFA Code of Practice for Internal Audit in Local Government 2006.

Appendix A

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## OUTTURN SUMMARY

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The following table summarises the internal audit coverage across all Council Services during 2007/2008

Service	2006/2007		2007/2008	
	Plan Days	Actual Days	Plan Days	Actual Days
Children, Families and Learning				
Community Education	94	179	59	111
Capital & Assets	0	0	16	32
Pupil Support	68	29	43	32
Policy & Resources	43	33	47	18
School Improvement	0	0	0	0
Vulnerable Children	86	134	85	59
Schools	272	305	207	245
Environment & Neighbourhood				
Transport	25	1	34	101
Street Scene	63	87	55	0
Community Protection	92	122	76	64
Horticulture, Parks & Leisure Centres	62	165	48	123
Regeneration				
Museums & Galleries	20	42	14	1
Library & Information	13	27	0	0
Cultural Services	0	47	18	12
Economic & Community Regeneration	45	32	88	100
Planning & Regeneration	103	208	135	128
Social Care	200	68	200	151
Corporate Centre				
Finance	30	22	12	25
Legal services	36	32	21	30
Chief Executives Office	0	0	0	0
Members Office	3	0	0	0
Performance & Policy	55	41	70	63
Corporate Systems	449	543	603	683
Contract Audit	83	19	50	33
IT Audit	80	48	46	12
Advice	65	49	59	70
Contingency	135	149	121	93
Non Audit Work	37	31	30	18
Total Audit Days	2,159	2,413	2,137	2,204

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## DEFINITIONS OF AUDIT ASSURANCE

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Assurance Level	Summary Description	Detailed Definition
Full	Effective controls in operation and evidence of full compliance	No exposure to predictable risks, as key controls in place, applied consistently and effectively. No significant or fundamental recommendations made
Substantial	Controls in operation but enhancements beneficial or full compliance	Probability of some risks of error, loss, fraud impropriety or damage to reputation, which can be prevented by improvements in the control environment. Key or compensating controls present but not fully applied. Small number of significant but no fundamental recommendations made.
Limited	Enhancement of controls or the application of controls required	Authority / Service open to risks that potentially could result in the non achievement of objectives or result in error, loss, fraud, impropriety or damage to reputation. Some gaps in key controls or compensating controls or significant evidence that controls are not applied consistently or effectively. Small number of fundamental and also limited number of significant recommendations
Little / No	Enhancement of controls critical or the application of controls required	The Authority / Service is vulnerable to a significant risk that could lead to failure to achieve key objectives / major loss due to error, fraud or impropriety / damage to reputation. Evidence of significant failure in application of key controls. Large number of both fundamental and significant recommendations made.