

Middlesbrough Council

Report to the Corporate Affairs Committee on the 2010 Audit

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Key findings

We have pleasure in setting out in this document our report to the Corporate Affairs Committee of Middlesbrough Council ("the Council") for the year ended 31 March 2010 for discussion at the meeting scheduled for 23 September 2010. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2010. A separate report has been issued to the Pension Fund Panel covering the audit of the Teesside Pension Fund accounts.

This summary is not intended to be exhaustive but highlights the most significant matters to which we would like to bring your attention. It should, therefore, be read in conjunction with the report and the appendices thereto.

Key findings on audit risks

The key audit risks we identified in our Audit Plan are set out below with our audit findings:

1. Valuation and completeness of the equal pay liability: the completeness of the equal pay liability and the accuracy of the calculation were both reviewed and appeared reasonable.
2. Classification of reserves and provisions in accordance with Financial Reporting Standard (FRS) 12, Provisions, Contingent Liabilities and Contingent Assets: our detailed review indicated all items are correctly classified as reserves.
3. Presumed risk of revenue recognition fraud: appropriate cut-off and recording procedures have been applied.
4. Recoverability of short term investments in the current economic climate: we reviewed the short term investments held by both the Council and the pension fund and identified no recoverability issues.
5. Valuation of fixed assets in the current economic climate: our review found the assumptions used for both revaluations and impairments to be appropriate. No further impairments were identified.
6. Valuation of community assets: satisfactory additional disclosure has been included within the accounts to explain the deviation away from the SORP.
7. Additions to revalued assets: the treatment of revaluations sampled within our testing was in line with the SORP.
8. Assets held at nominal value: our review found no significant assets held at nominal value without appropriate justification.
9. Management override of controls: no inappropriate transactions were noted or management bias identified during our testing procedures.
10. Redundancy provision: our work is ongoing but we do not anticipate any issues arising in the accounting for redundancy costs in accordance with the requirements of FRS12.
11. Pension scheme assumptions: the assumptions used by the actuary are within expected ranges and therefore appear reasonable.

More details of our findings on audit risks are given in Section 1.

Key findings (continued)

Audit status	<p>We are satisfied that the status of the audit is as expected at this stage of the timetable agreed in our audit plan. The audit is subject to the satisfactory completion of the matters set out below:</p> <ul style="list-style-type: none">• completion of testing of the housing benefit subsidy claim testing: Internal Audit carried out the testing on our behalf following the methodology determined by the Audit Commission. Issues have been identified in the quality of Internal Audit testing and as a result our own testing has been extended;• receipt of a number of bank confirmation and legal letters;• internal review and quality control procedures;• final review of the financial statements;• completion of the post balance sheet events review;• receipt of the management representation letter; and• Whole of Government accounts testing. <p>We will report to you orally in respect of any modifications to the findings or opinions contained in this report that arise on completion of these matters. On satisfactory completion of the outstanding matters, we anticipate issuing an unmodified audit opinion and value for money conclusion.</p> <p>On 13 August 2010, the Secretary of State for Communities and Local Government announced the proposed abolition of the Audit Commission. The proposed abolition will be from March 2012 and the Audit Commission has confirmed that there is no immediate change to your audit arrangements. New audit arrangements are likely to apply from the start of the 2012/13 financial year. Both we and the Audit Commission will keep you informed of further developments.</p>
Identified misstatements	<p>Audit materiality was £3,854,000 (2009: £3,953,000). We report all individual identified misstatements in excess of 5% of materiality (£192,700) and all other identified errors in aggregate. We consider identified misstatements in qualitative as well as quantitative terms.</p> <p>Subject to the completion of our testing as detailed above, there are no identified uncorrected misstatements.</p> <p>Details of the audit adjustments are included in Appendix 1.</p>
Disclosure deficiencies	<p>Management has concluded that the impact of the disclosure deficiencies, both individually and in aggregate, is not material in the context of the financial statements taken as a whole. Details of the disclosure deficiencies are included in Appendix 1.</p>

Key findings (continued)

Accounting policies and financial reporting	<p>As part of our audit, we consider the quality and acceptability of the Council's accounting policies and financial reporting. We have nothing to report in these areas.</p> <p>From 2010/11, local authorities' Statements of Accounts will be prepared under an International Financial Reporting Standards ("IFRS") - based Code of Practice on Local Authority Accounting. The Council's readiness for IFRS conversion has been assessed to be in line with expectations, but requires further work to be completed to ensure full compliance with the transition requirements.</p> <p>More detail on accounting policies and the impact of IFRS on 2010/11 is given in Section 2.</p>
Accounting and internal control systems	<p>We did not identify any significant deficiencies in the financial reporting systems that have not been covered elsewhere in this report.</p> <p>Our planning work identified that the control environment was sufficiently robust to enable us to place reliance on controls in 2009/10.</p>
Grants Certification	<p>Our scope of work includes other audit work including the certification of grant claims. The work is currently ongoing and opinions will be issued in line with our audit plan.</p>
Independence	<p>In our professional judgement we are independent within the meaning of APB Ethical Standards and the objectivity of the audit engagement partner and audit staff is not impaired. Details of our consideration of independence, including fees for non-audit services, are included in Section 4.</p>
Conclusion on arrangements for securing economy, efficiency and effectiveness in use of resources	<p>Under the Code of Audit Practice 2005 (the Code), auditors are required to include a positive conclusion in their statutory audit report as to whether they are satisfied that the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. The scope of these arrangements is defined in the Code as comprising corporate performance management arrangements and financial management arrangements. The Code criteria link directly to the key lines of enquiry (KLOE) and auditor assurances to be applied.</p> <p>For the purposes of the conclusion required by the Code, auditors are required to apply a yes/no assessment to the applicable Code criteria, i.e. the audited body either has proper arrangements in place or not.</p> <p>We have concluded that the Authority has met the applicable Code criteria.</p> <p>Further details on the evaluation against the relevant criteria are provided in Section 5.</p>

1. Key audit risks

The results of our audit work on key audit risks are set out below.

Valuation and completeness of Equal Pay liability

Key findings	The completeness of the equal pay liability and the accuracy of the calculation were both reviewed and appeared reasonable.
Background	The Council has been subject to a number of equal pay claims which are still ongoing. The Council denies there has been any discrimination or breach of the right to receive equal pay and has been vigorously defending the claims brought against it. To the extent that is possible, the Council is confident that as a result of negotiations with lawyers there will be no more claims made, and expects settlement to be agreed in 2010. The Authority is aware that there is a deemed risk of understatement of liabilities in respect of these claims.
Deloitte response	The completeness of the equal pay liability and the accuracy of the calculation were reviewed for reasonableness and discussed with the Council's Legal team with no issues noted. The Council's accounting treatment for claims was reviewed against SORP guidance and found to be satisfactory. Movements within the Provision and Accrual Balances have been tested to supporting documentation.

Classification of reserves and provisions in accordance with Financial Reporting Standard (FRS) 12, Provisions, Contingent Liabilities and Contingent Assets

Key findings	Our detailed review indicated all items are correctly classified as reserves.
Background	<p>Historically the Council has had a number of earmarked reserves, some items of which had the characteristics of a provision in line with FRS 12.</p> <p>The SORP states that a provision should be established if the Authority has a present obligation as a result of a past event that binds the Authority to transfer economic benefits as a result of statutory provisions, or contractual terms or an event that, arising from the Authority's actions, creates a valid expectation amongst another party that the Authority will transfer economic benefits as a result of it accepting certain responsibilities.</p>
Deloitte response	<p>We performed a detailed review of the earmarked reserves and assessed each of the reserves against the criteria of the SORP and FRS 12.</p> <p>The review indicated all items are correctly classified as reserves.</p>

1. Key audit risks (continued)

Presumed risk of revenue recognition fraud

Key findings	Appropriate cut-off and recording procedures have been applied.
Background	International Auditing Standards (UK and Ireland) 240 “The auditor’s responsibility to consider fraud in an audit of financial statements” requires the auditors to perform certain audit procedures related specifically to fraud risk, and requires a presumption that revenue recognition is a specific risk. For Middlesbrough Council we consider that the specific revenue recognition risk relates to cut-off of grant funding.
Deloitte response	<p>We have reviewed management processes to ensure that grant income is recognised only to the extent that the Authority has met the grant conditions and therefore it is appropriate to account for the income in 2009/10.</p> <p>We have tested on a sample basis grant income received to ensure treatment of income is correct. We have also performed a review of all grant income which has been deferred to future accounting periods to ensure that deferment is appropriate. No issues have been identified.</p>

Recoverability of short term investments in the current economic climate

Key findings	We reviewed the short term investments held by both the Council and the pension fund and identified no recoverability issues.
Background	Due to the instability in the economic climate there is the possibility of banking institutions (in particular non-UK banks) coming into financial difficulty and therefore the recoverability of these investments being put at risk. A provision may be necessary to account for any loss of an investment.
Deloitte response	We reviewed the short term investments held by both the Council and the pension fund and identified no recoverability issues. Investments were agreed to bank confirmation letters. No cash deposits were held with Icelandic banks or failed institutions.

1. Key audit risks (continued)

Valuation of fixed assets in the current economic climate

Key findings	Our review found the assumptions used for both revaluations and impairments to be appropriate. No further impairments identified.
Background	The economic downturn and fall in property prices may have decreased the valuation of the Council's fixed assets. There is a risk that the Council's fixed assets may not be fairly valued at the year end and that further impairment may be necessary. All council land & buildings are valued on a rolling basis.
Deloitte response	<p>All assets that are required to be held at Market Value as per the SORP have been valued by the RICS accredited Valuation Team at both the 1st April 2009 and the 31st March 2010. All other land & buildings are valued on a rolling programme. This has led to significant revaluations in the year, both upward and downward, resulting in a net upward revaluation of £24 million.</p> <p>Furthermore an impairment review has been carried out by the Council resulting in a number of impairments being identified to a value of £9 million.</p> <p>We have reviewed the work of the valuation team and have concluded that reliance can be placed on the valuers as experts. We have also evaluated the scope and suitability of impairment review procedures and have identified no evidence for the need for further impairments. In addition, we have consulted with our own in-house valuers during the course of this work.</p>

Valuation of community assets

Key findings	Satisfactory additional disclosure has been included within the accounts to explain the deviation away from the SORP.
Background	<p>In prior years there have been a number of errors and adjustments required within Fixed Assets due to the complexity of the SORP Capital Accounting rules. There are a number of community assets held at market value which is a departure from the SORP. There are also a number of assets on the register at £nil value.</p> <p>In addition, there are grant/contribution funded assets valued at £21 million that are non-depreciable and therefore the related creditor on the balance sheet will not be written down - this has been an area of discussion in previous years due to a difference in interpretation of the SORP between Deloitte and the Council.</p>
Deloitte response	<p>The Council has disclosed the departure from the SORP regarding the valuation of the community assets at market value and the reason for this.</p> <p>The Council has adhered to the treatment recommended by Deloitte in previous years with regard to the grant/contribution funded assets. The treatment of all grants & contributions deferred will be re-reviewed by the Council in the upcoming year due to IFRS conversion.</p> <p>There are still some assets which are held at £nil value as at the year end, however as community assets, these should be held at 'historic value', but this difficult as many items were gifted to the Council. These items have not been deemed material to the financial statements.</p>

1. Key audit risks (continued)

Additions to revalued assets

Key findings	The treatment of revaluations sampled within our testing was in line with the SORP.
Background	Internal Audit reported, as part of the 2009/10 audit programme, some instances where capital spend has been made to revalued assets during the year, and then a revaluation carried out at year end. However the value of the addition has then been added to the revaluation even though they would have already been included in the valuation. This would result in asset values being overstated.
Deloitte response	We have reviewed the work of the Internal Audit team and considered the nature and validity of the error. From our testing of a focussed sample of assets, we concluded the treatment of revaluations to be correct as at the year end.

Assets held at nominal value

Key findings	We have concluded that the estimated effect of the depreciation of land within the building asset is not material and classification in the financial statements is appropriate.
Background	There are a number of land items on the Fixed Asset register held at nominal value. Historically Land and Buildings had been held together as one asset within the register and the valuations were carried out on the site as a whole. In preparation for the IFRS conversion, it appears some assets have now been separated out within the register to include the land and building elements separately. However since this has been carried out some of the assets have not been re-valued under the rolling scheme. Therefore the full value has been assigned to the building element and land included at nominal value until a revaluation exercise occurs.
Deloitte response	<p>A calculation has been performed based on the expected value of the land within the total asset value of the items identified. We have concluded that the estimated effect of this is unlikely to be material to the financial statements. The inclusion of land within a building asset on the register will have no other impact as they are included within the same asset class in the financial statements.</p> <p>We expect all of these assets to be revalued under the rolling programme in the next financial year.</p>

1. Key audit risks (continued)

Management override of controls

Key findings	No inappropriate transactions were noted or management bias identified during our testing procedures.
Background	Auditing Standards require the auditor to presume that there is a risk of fraud in relation to management override of controls, and to perform specific procedures to address this risk.
Deloitte response	<p>The focus of our audit procedures was to address the risk of financial reporting fraud, by reviewing in more detail areas such as accruals, provisions, accounting estimates and unusual transactions.</p> <p>In response to this risk, focussed substantive testing of these balances was performed. This involved reviewing key estimates for evidence of management bias and checking a selection of journal entries from throughout the year for appropriate accounting treatment.</p> <p>No inappropriate transactions were noted, or management bias identified, during the testing procedures.</p>

Redundancy provision

Key findings	Our work is ongoing but we do not anticipate any issues arising in the accounting for redundancy costs in accordance with the requirements of FRS12.
Background	<p>The Council has, for a number of years, been required to achieve efficiency savings as part of the VEM and local government efficiency programme. This has resulted in some rounds of voluntary redundancies and restructuring of departments and directorates.</p> <p>Furthermore, as at 31 March 2010, although the general election had not taken place, there was an expectation within the Council that further spending cuts would need to be applied. Planned reorganisations as at the balance sheet date may require a provision for costs involved.</p> <p>Additionally, given the results of the general election and emergency budget, subsequently announced, the Council may be required to make subsequent events disclosures within the accounts.</p>
Deloitte response	The Council has, like all authorities, been required to implement cost savings and efficiency programmes for a number of years. During 2009/10 a number of voluntary redundancies were agreed. The liability has been recognised within Creditors in line with the requirements of FRS12 so, subject to the receipt of a listing to support the valuation, we are satisfied that the liability has been accounted for correctly.

1. Key audit risks (continued)

Pension scheme assumptions

Key findings	The assumptions used by the actuary are within expected ranges and therefore appear reasonable.
Background	The Council participates in the Local Government Pension scheme, which is a defined benefit scheme. The liabilities of the fund are assessed by an actuary and it is actuarial values that the Council includes within their financial statements. As part of our audit of the accounts we are required to assess whether the assumptions used by the actuary are reasonable and whether the pension liabilities are materially misstated.
Deloitte response	<p>We have reviewed the assumptions made by the actuary in valuing the Council's share of the assets and liabilities of the pension fund. We have also consulted with our own in-house actuaries to determine whether the assumptions are reasonable and within expected ranges.</p> <p>Our review noted that the inflation rate selected by management to value the pension liabilities was 3.9% per annum. Our in-house actuaries have indicated that the rate is not unreasonable; however it is towards the higher (cautious) end of the range as at 31 March 2010.</p> <p>Overall our testing in the area was completed satisfactorily.</p>

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2. Accounting policies and financial reporting

Upcoming financial reporting developments

Background

From 2010/11, local authorities' Statements of Accounts will be prepared under an International Financial Reporting Standards ("IFRS") - based Code of Practice on Local Authority Accounting. This is part of a wider public sector move to international standards.

In December 2009, CIPFA published the first accounting code of practice for local authorities based on IFRS. The 2010/11 Code of Practice on Local Authority Accounting in the United Kingdom ("the Code") and the Best Value Accounting Code of Practice set out the accounting requirements for local authorities.

Potential impact

Upon adoption of the 2010/11 Code, the comparative 2009/10 figures will be required to be restated in accordance with the Code and a third balance sheet will be presented in the 2010/11 Statement of Accounts, showing the opening balance sheet at 1 April 2009 alongside the closing balance sheets as at 31 March 2010 and 31 March 2011.

Some specific changes to the Statement of Accounts include the following:

- fixed assets will be measured and recorded differently, particularly as a result of revaluation bases, impairment, revaluation losses and a stronger emphasis on component accounting. Specific consideration will need to be given to the capitalisation or reclassification of software and development costs;
- outstanding holiday pay will need to be accrued; and
- lease categorisation may change and leases for land and buildings will need to be separated in all cases.

Other balance sheet areas where there is likely to be an impact:

- government grants deferred; and
- other employee benefits.

Various transitional guidance is available on CIPFA's website but further guidance is still awaited.

Progress made to date

The Council is making good progress in this area and has drafted some primary statements. These have not yet been audited by Deloitte but we do expect to perform the review prior to the 2010/11 audit visit.

3. Accounting and internal control systems

In planning and performing our audit of the financial statements we considered the Council's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements. We were not engaged to perform an audit of internal control over financial reporting and, therefore, we may not have noted all matters that might have been detected had an audit of internal control over financial reporting been performed.

Financial controls

For controls considered to be 'relevant to the audit' we evaluated the design of the controls and determined whether they had been implemented ("D&I"). The controls that are determined to be relevant to the audit were those:

- where we planned to obtain assurance through operating effectiveness; and
- relating to identified risks.

We placed reliance on the Council's financial controls, in the following key business cycles:

- Expenditure;
- NNDR;
- Council tax;
- Payroll;
- Treasury.

Where possible we have placed reliance on the work performed by Internal Audit on controls within these cycles.

Our work also involved, on a sample basis, detailed testing of all significant balances. We have looked to rely on external information and confirmations where possible, and hence reduce reliance on internally prepared information.

Overall, we determined that the controls on which we planned to rely were operating effectively during the year, and we completed our audit procedures in line with those proposed in the Audit Plan.

There are no significant findings regarding the Council's system of internal financial control that we wish to bring to your attention at this stage.

General computer controls

Our general computer controls ("GCC") work covered the IT controls and environment supporting the Council's core business applications: SAP; Academy; Northgate iWorld; AXIS; and the Windows network operating system, specifically over:

- information security;
- system change control; and
- data centre and network operations.

For the purpose of our audit, we concluded that we were able to place reliance on these systems, although some additional substantive testing procedures were required due to the control weaknesses identified.

The recurring weaknesses identified in the evidencing of compliance with the controls over the AXIS Pensions system again prevent our audit from relying on this application for financial account auditing purposes.

The most significant issues noted relate to security weaknesses including, the use of shared powerful accounts, existence of an inherent system vulnerability which is attractive to hackers (i.e. the default Windows administrator account has not been renamed), the lack of monitoring of third party access to AXIS, and the lack of formal detection and review of security incidents and audit logs. Consequently, there is an increased risk that unauthorised and inappropriate access to financial systems would go undetected.

Detailed action plans are now in place and progress is being made in addressing the matters raised identified.

Details of the issues identified and our recommendations for improvement, together with management responses are included in Appendix 2.

Benefits subsidy

Our work on the housing and council tax benefits is carried out in accordance with the methodology determined by the Audit Commission. The audit is designed to provide assurance for the accounts opinion, the Value for Money (VFM) conclusion and the subsidy claim certification. The work is complex and time consuming so we agreed with the Council that Internal Audit would carry out the testing on our behalf and we would limit our work to reperformance of a sample of cases tested.

Our reperformance work has identified concerns with the quality of Internal Audit work therefore we have been unable to place reliance on it. As a result, we are required to extend our reperformance work, possibly to cover 100% of the cases in the sample, and as it will not be possible to complete this in time for our accounts opinion, carry out additional testing to gain sufficient assurance over the balances reported in the accounts. Sufficient assurance can be taken from other data quality work to support the VFM conclusion and the subsidy claim deadline falls later in the year.

Results of this work will be reported in our annual report on grant certification work.

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4. Other matters for communication

Annual Governance Statement

In June 2007 CIPFA in conjunction with the Society of Local Authority Chief Executives ("SOLACE") published 'Delivering Good Governance in Local Government: Framework'. This framework replaces the previous CIPFA/SOLACE framework 'Corporate Governance in Local Government – A Keystone for Community Governance: Framework' which was published in 2001.

The framework has introduced from 2007/08, an integrated Annual Governance Statement ("AGS"). This subsumes the requirements for the production of a Statement on Internal Control ("SIC").

The AGS covers all significant corporate systems, processes and controls, spanning the whole range of an authority's activities, including in particular those designed to ensure that:

- the authority's policies are implemented in practice;
- high quality services are delivered efficiently and effectively;
- the authority's values and ethical standards are met;
- laws and regulations are complied with;
- required processes are adhered to;
- financial statements and other published performance information are accurate and reliable; and
- human, financial, environmental and other resources are managed efficiently and effectively.

It therefore covers all of the areas previously covered by the SIC. However, it also covers performance issues - good governance is a precondition for delivering good services and poor service performance reflects a failure of governance.

Our review is directed at:

- considering the completeness of the disclosures in the governance statement and whether it complies with proper practice as specified by CIPFA; and
- identifying any inconsistencies between the disclosure and the information that we are aware of from our work on the financial statements and other work relating to the Code of Audit Practice.

We have reviewed the Council's AGS in line with the requirements above. We have concluded that the AGS includes all appropriate disclosures and is consistent with our understanding of the Council's governance arrangements and internal controls derived from our audit work.

4. Other matters for communication (continued)

As part of our obligations under International Standards on Auditing (UK & Ireland), we are required to report to you on the matters listed below.

Independence	<p>We consider that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and the objectivity of the audit engagement partner and audit staff is not compromised.</p> <p>If the Audit and Governance Committee wishes to discuss matters relating to our independence, we would be happy to arrange this.</p>						
International Standards on Auditing (UK and Ireland)	<p>We consider that there are no additional matters in respect of those items highlighted in our publication "Briefing on audit matters" to bring to your attention that have not been raised elsewhere in this report or our audit plan.</p>						
Non-audit services	<p>We are not aware of any inconsistencies between APB Ethical Standards and the Council's policy for the supply of non audit services or of any apparent breach of that policy.</p> <p>Advisory services were provided in the year in relation to the VAT conde nast claim, the fees for which were £50,000 (2008/09 £50,000). We are satisfied that this work did not impact our independence as auditors.</p>						
Analysis of audit fees	<p>The audit fees for 2009/10 are in line with the planned fees reported in the Annual Fee Letter issued on 30 April 2009:</p> <table border="1" data-bbox="528 1283 1481 1440"> <thead> <tr> <th></th> <th>2009/10 £</th> <th>2008/09 £</th> </tr> </thead> <tbody> <tr> <td>Fees payable to the auditors for the annual audit</td> <td>274,200</td> <td>252,280</td> </tr> </tbody> </table> <p>Fees for the certification of claims and returns have not yet been agreed as work is still ongoing and fees are based on input required.</p> <p>The fee for our work on the 2009/10 VFM conclusion is included in the 2010/11 audit fee. This mismatch, which arose as a result of national guidance when UoR was introduced, needs to be addressed but this will be discussed when we receive guidance for the 2010/11 VFM conclusion work and associated fees.</p>		2009/10 £	2008/09 £	Fees payable to the auditors for the annual audit	274,200	252,280
	2009/10 £	2008/09 £					
Fees payable to the auditors for the annual audit	274,200	252,280					
Written representations	<p>A copy of the representation letter to be signed on behalf of the Council is included at Appendix 3.</p>						
Grants Certification	<p>Our scope of work includes other audit work including the certification of grant claims. The work is currently ongoing and opinions will be issued in line with our audit plan.</p>						

5. Value for money conclusion

Under the Code of Audit Practice (the Code), auditors are required to include a positive conclusion in their statutory audit report as to whether they are satisfied that the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. The scope of these arrangements is defined in the Code as comprising corporate performance management arrangements and financial management arrangements. This conclusion is given within our audit report on the Authority's accounts.

The conclusion is limited to an assessment of ten criteria specified by the Audit Commission under the Use of Resources (UoR) methodology. The UOR assessment consists of judgements against ten key lines of enquiry (KLOE) which focus on financial management but link to the strategic management of the Authority. The KLOE cover a range of topics including how financial management is integrated with strategy and corporate management, supports Council priorities and delivers value for money. Assessments are carried out annually, as part of each Council's external audit. The Commission has specified that nine of the ten KLOE will be considered for 2009/10, with the tenth, the assessment of use of natural resources, being rolled forward from the prior year.

At the end of May 2010, the Commission wrote to all chief executives to inform them that, following the government's announcement, work on CAA would cease with immediate effect and that the Commission would not be issuing new scores for the use of resources assessments.

We are still required however by the Code of Audit Practice to issue a value for money conclusion, and we have used the results of the work completed on the use of resources assessment up to the end of May to inform the 2009/10 conclusion.

For the purposes of the conclusion required by the Code, auditors are required to apply a yes/no assessment to the applicable Code criteria, i.e. the audited body either has proper arrangements in place or not.

We have concluded that the Authority has met the applicable Code criteria and anticipate signing an unqualified VFM conclusion.

6. Responsibility statement

The Audit Commission published a 'Statement of responsibilities of auditors and of audited bodies' alongside the Code of Audit Practice. The purpose of this statement is to assist auditors and audited bodies by summarising, in the context of the usual conduct of the audit, the different responsibilities of auditors and of the audited body in certain areas. The statement also highlights the limits on what the auditor can reasonably be expected to do.

Our report has been prepared on the basis of, and our work carried out in accordance with, the Code and the Statement of Responsibilities.

While our report may include suggestions for improving accounting procedures, internal controls and other aspects of your business arising out of our audit, we emphasise that our consideration of Middlesbrough Council's system of internal financial control was conducted solely for the purpose of our audit having regard to our responsibilities under Auditing Standards and the Code of Audit Practice. We make these suggestions in the context of our audit but they do not in any way modify our audit opinion, which relates to the financial statements as a whole. Equally, we would need to perform a more extensive study if you wanted us to make a comprehensive review for weaknesses in existing systems and present detailed recommendations to improve them.

We view this report as part of our service to you for use, as Members, for corporate governance purposes and it is to you alone that we owe a responsibility to its contents. We accept no duty, responsibility or liability to any other person as the report has not been prepared, and is not intended, for any purpose. It should not be made available to any other parties without our prior written consent.

If you intend to publish or distribute financial information electronically or in other documents, you are responsible for ensuring that any such publication properly presents the financial information and any report by us thereon, and for the controls over and security of the website. You are also responsible for establishing and controlling the process for electronically distributing accounts and other information.

Deloitte LLP

Chartered Accountants

Newcastle
September 2010

Appendix 1: Audit adjustments

Uncorrected misstatements

The following uncorrected misstatements were identified during the course of our audit. We will obtain written representations from the Corporate Affairs Committee confirming that after considering all these uncorrected items, both individually and in aggregate, in the context of the Statement of Accounts taken as a whole, no adjustments are required.

	Credit/ (charge) to income & expenditure account £	Credit/ (charge) to statement of movement on general fund £	Increase/ (decrease) in net assets £	Increase/ (decrease) in reserves £
Total misstatements relating to current year items	-	-	-	-
Misstatements relating to prior year items				Prior year reserves
Carrying value of loans understated in previous year	-	-	(222,000)	222,000
Total misstatements	-	-	(222,000)	222,000

Recorded audit adjustments

We noted an error in our testing where a misposting resulted in both the debtors and creditors balance being overstated by £1,440,900. This had a nil balance sheet effect and was adjusted by the Council in the final accounts.

Appendix 1: Audit adjustments (continued)

Disclosure deficiencies

Auditing standards require us to highlight significant disclosure deficiencies to enable those charged with governance to evaluate the impact of those matters on the financial statements. The table below highlights those areas of disclosure that we consider require consideration by the Committee.

Disclosure	Source of disclosure requirement	Quantitative or qualitative consideration
Note 19 Valuation Information	SORP & FRS 14	The Council has presented Note 19 Valuation Information by taking a forward look at the future valuation timetable. In addition, there is no reference to the table included, and what it represents. Based on the Guidance in the SORP and FRS 14, the note should provide information for users on past revaluations rather than forward plans for revaluations, as Prior Revaluation values are the actual data in the accounts.

We noted some disclosure deficiencies during the course of the audit, all of which were correct by management for the final accounts. There were no significant deficiencies with the majority being presentational.

Appendix 2: IT audit findings

Set out below are the findings and recommendations of our 2009/10 audit which was carried out in March 2010. In addition, we followed up recommendations raised in the prior year and identified that these had not been fully actioned. We have therefore included an update on action taken or planned against the issues raised in the prior year.

Privileged access

Background

There are five business users with privileged rights to the Academy (AIM) cash system. This creates a segregation of duties conflict as this access allows the users to perform key transactions, including user administration and modification of system parameters.

The use of shared administrator level access accounts by members of the Academy team reduces accountability for the actions of individual users. In addition, the current level of access given does not enforce effective segregation of duties. There is a risk that these highly privileged accounts that can be accessed by a number of people may result in unauthorised / inappropriate activity being performed on the system. Such activity could go undetected, and, in many cases, would be untraceable to a particular user

Recommendation

Due to the powerful nature of privileged accounts, management need to restrict access to individuals with a valid business requirement, and where possible users should have unique administrator accounts in order that access and actions performed can be attributed to an individual.

Where effective segregation of duty restrictions cannot be achieved, effective monitoring controls should be established to compensate for the lack of segregation of duties.

Action taken/planned

The administration of the Academy (AIM) system will be transferred from Cashiers to the Banking team in the Finance Service, a totally separate team in a different service area, located in another building.

Timescale – September 2010

Interface monitoring

Background

Unlike other interfaces into SAP, evidence for the success or failure of the nightly interface from AXIS Pensions to SAP is not retained. Management cannot therefore gain assurance that all data has been transferred completely, accurately, and timely.

Recommendation

Retain the daily automated email from SAP stating the success or failure of the nightly AXIS data transfer

Action taken/planned

A record of all batches posted from AXIS to SAP is to be kept. SAP is to be checked on a daily basis for batches in error.

Timescale – March 2010

Appendix 2: IT audit findings (continued)

Third party governance

Background

Heywood, a third party support provider, currently have unrestricted, highly privileged access to the AXIS Pensions system during normal business hours. This access is not monitored by the Council.

Management approval of change requests submitted to Heywood are informal, with no documentation retained to evidence appropriate authorisation.

Where a third party has unmonitored, privileged access to the Council's IT systems, there is an increased risk of unauthorised or inappropriate changes being made to financial data or system configurations.

Recommendation

Where access cannot be restricted during normal business hours, implement formal procedures whereby Heywood must notify the Council of all activity.

Investigate the possibility of enabling an audit log within the AXIS system that would allow management to retrospectively monitor Heywood's access to the AXIS system.

Perform formal and regular monitoring of Heywood's performance against agreed service levels.

Document and retain management approval of all changes to the AXIS system.

Action taken/planned

When Heywood require access to the system, their consultant first must seek approval from Mouchel to access the system. This approval is confirmed by email from Mouchel. These emails are now stored as proof of permission to remote access the system.

Heywood then logon to the server using the secure access facilities provided by Mouchel IT. Access is restricted to the Pensions server by the firewall permissions. Whatever changes / fixes are then applied.

Timescale – March 2010

Security of the SAP

Background

A number of weaknesses were noted in the SAP security settings.

These weaknesses increase the risk of unauthorised access and erroneous changes being implemented into the live environment, which may result in system and data integrity issues.

Recommendation

Retain evidence of management approval for opening the production systems for direct changes.

Log the opening of the production systems.

Monitor the log report for opening of the production client and ensure that such instances are valid and authorised.

Action taken/planned

Logging has now started, and the data collected and the size will be closely monitored. Depending on the amount of data collected the SAP team might need to initialise and save reports outside the system.

Timescale – June 2010

Appendix 2: IT audit findings (continued)

Windows administrator accounts

Background	The Windows 'Administrator' account has not been renamed to something innocuous to limit the risk of attackers getting access. This is the most powerful account in the Windows network operating system used by the Council. The Administrator account is often the target for those wishing to gain unauthorised access to the system since it is delivered by default with all Windows installations.
Recommendation	Rename the default Windows administrator account to an innocuous name (e.g. an obscure or confidential value).
Action taken/planned	Work has commenced to rename Windows Administrator account. Account is used to start application services therefore cannot simply be renamed. Impact analysis is underway on approximately 220 servers. Timescale – August 2010

Logical security – password parameters

Background	Our review identified control weaknesses over the password control settings within the Northgate IWorld (revenues and benefits) privilege account and the AXIS system that are not aligned with good practice settings. Strong password settings reduce the risk that unauthorised users may access the Council's core business applications.
Recommendation	Set passwords in accordance with good practice. We acknowledge there needs to be a balance between complexity and usability. Perform a review of system security settings to understand the deviations from the Council's own security policy. Where there are functional limitations that prevent robust logical access control settings being improved within the AXIS system, implement manual controls to enforce periodic password changes and ensure that users are aware that passwords should be in line with the Council's security policy.
Action taken/planned	A new version of Heywood's Pensions Administration system is now available that satisfies these logon criteria. It is the intention to upgrade to this version in the next two years, but it does involve substantial investment to purchase the new product. An email has been sent to all systems users advising them to follow 'Best Practice' when choosing their Axis application level password. This email will be issued every six months. Timescale – May 2010

Appendix 2: IT audit findings (continued)

User access reviews

Background	<p>There is currently no formal user access rights reviews performed on a regular basis on core systems, including SAP, Academy and Windows operating system.</p> <p>A lack of formal user access reviews increases the risk of users retaining inappropriate access rights should they leave or change roles. The retention of inappropriate access rights could result in unauthorised access to the systems and a weakening of the segregation of duties control framework.</p>
Recommendation	<p>Review user profiles within core business applications (SAP and Academy) at a minimum of every six months in order to ensure that user access rights are commensurate with their roles and responsibilities and enforce the segregation of incompatible duties.</p> <p>Perform regular reviews of Windows user accounts which have not been logged in for a significant period of time to determine whether they can be removed.</p>
Action taken/planned	<p>Windows: plans are in place to implement manual procedures to identify all those who have not logged onto the network in the last year. Thereafter an automatic process will be developed to extract users who have not logged on in the last 90 days.</p> <p>SAP: customised report for identifying illegal combinations of roles will be reviewed by the Audit Manager.</p> <p>Academy: a review will be undertaken when the administration of the Academy system is transferred to the Banking team in the Finance Service. The Finance Manger will undertake an independent review every 6 months.</p> <p>Timescales – Windows: July / SAP: May / Academy: September 2010</p>

User administration

Background	<p>Whilst formal user administration procedures are in place, these procedures are not always adhered to, in particular the retention of new starter approvals and timely removal of leavers.</p> <p>Without robust user administration procedures over the leavers process there is a risk that inappropriate access to the systems may be granted. Inactive accounts can provide easy targets for intruders trying to break into IT systems. Depending on the access privileges associated with each account, these profiles may be used to gain unauthorised access to the Councils systems and information.</p>
Recommendation	<p>Re-emphasise the formal user administration procedures, particularly around the retention of approval of new starters and timely removal of users from the network and business applications.</p>
Action taken/planned	<p>All IT Staff will be reminded of existing procedures around starters & leavers.</p> <p>In addition IT Services have engaged with IBM to review an Identity Management application which could potentially consolidate starters & leavers requirements across multiple service areas.</p> <p>Timescale – August 2010</p>

Appendix 2: IT audit findings (continued)

Audit and security event logging

Background

A number of key system audit and event logs are not enabled and those which are enabled are not proactively monitored.

By not actively monitoring event logs, including unsuccessful attempts to log in or attempts to change security settings, there is a risk that unauthorised activity may be taking place which is going undetected.

Recommendation

Establish a framework that enables the monitoring and detection of any potential security breaches to allow IT to promptly investigate and resolve any breaches.

Introduce independent system monitoring measures to ensure that potential security violations and the activity of privileged users are logged, reported and reviewed.

Action taken/planned

Windows: an application called Event Tracker has been purchased which can audit unauthorised attempts to access systems on the Council network. This application is live. Further development will be scheduled to meet this recommendation in relation to the Windows Domain.

SAP: this is monitored on a weekly basis. A report is produced weekly identifying any such failed logons.

Academy: systems logs are now in place and are used as a diagnostic tool by Capita.

Axis: the Axis system has full audit log facilities which are available electronically for a rolling 6 month period. Access logon reports are produced and retained on a weekly basis, and are reviewed by the Pensions System Officer.

Timescale – Windows: August / SAP: May / Academy: June / Axis: March 2010

Appendix 2: IT audit findings (continued)

Change control

Background

Formal program change procedures are in place, however these procedures are not always being adhered to, and evidence of testing, user acceptance testing (UAT) and authorisation to go-live is not always retained.

Failure to adhere to formal change management procedures increases the risk that erroneous changes or developments may be implemented into the live environment, which may result in system and data integrity issues.

Recommendation

Define what constitutes a minor change and for all other changes, follow the formal change control procedures, in particular approval, UAT and authorisation to go-live.

Retain evidence of the testing conducted. This can then be used at a later date to help investigate subsequent problems or as a guide for future testing of the system following upgrades or development.

Action taken/planned

SAP: all transports are authorised by the Service Delivery Manager / project manager / support manager before it is transported to the live environment.

Academy: changes made by IT to Capita's payment management application implementation and configuration are now controlled through the lotus notes IT change acceptance procedure.

Axis: evidence of testing is published and retained for all major releases.

Northgate: all software releases are placed into the test system and thoroughly checked, and documented for future reference as to the testing undertaken, prior to installation into the live system. Evidence of all items checked are retained, with any upgrade only being installed once approved by the user.

Timescale – SAP: May / Academy: June / Axis: March / Northgate: March 2010

Appendix 3 Draft management representation letter

We ask that the Committee notes the format of the letter below, and recommends the Chief Financial Officer can sign the letter on behalf of the Council.

Deloitte LLP
1 Trinity Gardens
Newcastle upon Tyne
NE1 2HF

Our Ref: DPW/CC/AA

Middlesbrough Council – Audit of the annual accounts for the year ended 31 March 2010

This representation letter is provided in connection with your audit of the financial statements of Middlesbrough Council (“the Council”) for the year ended 31 March 2010 for the purpose of expressing an opinion as to whether the financial statements and consolidated accounts present a true and fair view the financial position of the Council and Group as of 31 March 2010 and the results of its operations, other recognised gains and losses and its cash flows for the year then ended in accordance with the applicable accounting framework.

We acknowledge our responsibilities for preparing financial statements for the Council and Group which present a true and fair view and for making accurate representations to you.

We confirm, to the best of our knowledge and belief, the following representations.

1. All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Council have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of all Council and relevant committee meetings, have been made available to you.
2. We acknowledge our responsibilities for the design, implementation and operation of internal control to prevent and detect fraud and error.
3. We have disclosed to you all the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
4. We are not aware of any significant facts relating to any frauds or suspected frauds affecting the Council involving:
 - Management;
 - Members of the Council;
 - Employees who have significant roles in internal control; or
 - Others where the fraud could have a material effect on the financial statements.
5. We have disclosed to you our knowledge of any allegations of fraud, or suspected fraud, affecting the Council’s financial statements communicated by employees, former employees, analysts, regulators or others.
6. We are not aware of any actual or possible instances of non-compliance with laws and regulations, the effects of which should be considered when preparing financial statements.
7. We have considered the uncorrected misstatements and disclosure deficiencies detailed in the report to the Corporate Affairs Committee. We believe that no adjustment is required to be made in respect of any of these items as they are individually and in aggregate immaterial having regard to the financial statements taken as a whole.

Appendix 3: Draft management representation letter (continued)

8. Where required, the value at which assets and liabilities are recorded in the balance sheet is, in the opinion of the Members, the fair value. We are responsible for the reasonableness of any significant assumptions underlying the valuation, including consideration of whether they appropriately reflect our intent and ability to carry out specific courses of action on behalf of the Council. Any significant changes in those values since the balance sheet date have been disclosed to you.
9. We confirm the completeness of the information provided regarding the identification of related parties, and the adequacy of related party disclosures in the financial statements. We have made enquiries of any key managers or other individuals who are in a position to influence, or who are accountable for the stewardship of the Council and confirm that we have disclosed in the financial statements all transactions relevant to the Council and we are not aware of any other such matters required to be disclosed in the financial statements, whether under FRS8 "Related party disclosures" or other requirements.
10. We have considered all claims against the Council and on the basis of legal advice. No other claims in connection with litigation have been or are expected to be received.
11. No other legal claims have been received or are expected to be received that would have a material impact on the annual accounts.
12. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the financial statements.
13. We confirm that we are of the opinion that the Council is a going concern, that we have disclosed to you all relevant information of which we are aware and which relates to our opinion, and that all relevant facts are disclosed in the financial statements.
14. There have been no irregularities involving members or employees who have a significant role in the accounting and internal control systems or that could have a material effect on the financial statements.
15. The financial statements are free from material misstatement.
16. There have been no events since the balance sheet date which require adjustment of or a disclosure in the financial statements or notes thereto. Should further material events occur, which may necessitate revision of the figures included in the annual accounts or inclusion of a note thereto, we will advise you accordingly.
17. The Council has satisfactory title to all assets and there are no liens or encumbrances on the Council's assets.
18. We confirm we have properly recorded the bank balances for all school bank accounts in the financial statements.
19. We have evaluated the adequacy of self-insurance arrangements and consider it to be adequate.
20. We confirm that where income is for a specific activity, it has been recorded in the correct period.
21. We recognise that we are responsible for ensuring that the statement of accounts as published on the website properly presents the financial information and your auditors report and for the controls over, and security of, the website. We also recognise that we are responsible for establishing and controlling the process for electronically distributing annual reports and other information.

Appendix 3: Draft management representation letter (continued)

22. We confirm that:

- all retirement benefits and schemes, including UK, foreign, funded or unfunded, approved or unapproved, contractual or implicit have been identified and properly accounted for;
- all settlements and curtailments have been identified and properly accounted for;
- all events which relate to the determination of pension liabilities have been brought to the actuary's attention;
- the actuarial assumptions underlying the valuation of the scheme liabilities accord with the Members' best estimates of the future events that will affect the cost of retirement benefits and are consistent with our knowledge of the business; and
- the actuary's calculations have been based on complete and up to date member data as far as appropriate regarding the adopted methodology.

The amounts included in the financial statements derived from the work of the actuary are appropriate.

23. All known material liabilities have been properly included in the annual accounts and all material contingent liabilities have been disclosed.

We confirm that the above representations are made on the basis of adequate enquiries of management and staff (and where appropriate, inspection of evidence) sufficient to satisfy ourselves that we can properly make each of the above representations to you.

Yours faithfully

Chief Financial officer, Signed on behalf of Middlesbrough Council

Date _____

DRAFT

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