



MIDDLESBROUGH COUNCIL

STRATEGIC FINANCE

SERVICE

ANNUAL INTERNAL AUDIT
REPORT 2003/2004

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INTRODUCTION

The Annual Reporting Process

The Accounts and Audit Regulations 2003 require the Council to maintain an adequate and effective Internal Audit Service in accordance with proper internal audit practices. 'Proper internal audit practices' were defined in guidance accompanying the regulations as those contained in the Code of Practice for Internal Audit in Local Government in the United Kingdom (the Code), issued by CIPFA. In that part of the Code dealing with reporting there is a requirement of the Head of Internal Audit to provide a written report to those charged with governance, which should include an opinion on the overall adequacies of the internal control environment.

Management is responsible for the system of internal control and should set in place policies and procedures to help ensure that the system is functioning correctly. On behalf of the Director of Resources, Internal Audit review, appraise and report on the efficiency, effectiveness and economy of the financial and other management controls. This report is the culmination of the work during the course of the year and seeks to:

- ❖ Provide an opinion on the adequacy of the control environment
- ❖ Comment on the nature and extent of significant risk
- ❖ Report the incidence of significant control failings or weaknesses.

Section 2

REVIEW OF INTERNAL CONTROL

How Internal Control is Reviewed

Internal Audit continues to embrace the risk assessment approach to audit planning. During the course of the year Internal Audit revised its audit risk analysis used to determine a schedule of priorities for audit attention. The model combines three key factors:

- ❖ The size of the risk or exposure
- ❖ The likelihood that the risk will materialise
- ❖ The probability of the consequences being detected if the risk does materialise

The risk analysis process draws on key indicators of risks to the organisation and attempts to ensure that audit time and resources are applied to review the more significant areas of the Council's activities. The risk based approach to audit planning results in a full range of audits that are undertaken during the course of the year to support the overall opinion on the control environment. Examples include:

- ❖ System based reviews of all fundamental systems that could have a material impact on the accounts (e.g. payroll, creditors)
- ❖ Regulatory audits of Council establishments (e.g. schools, Social Services establishments, leisure centres)
- ❖ Systems based reviews of departmental systems (e.g. school meals, home improvement grants and foster carers)
- ❖ Contract audit
- ❖ Information Technology audit
- ❖ Responsive fraud and irregularity investigations

The audit plan contains a contingency provision that is utilised during the year in response to unforeseen work demands that arise.

Opinion 2003/04

Internal Audit has concluded, based on the findings of work undertaken that there are sound systems of internal financial control in place. A number of areas for improvement have been identified and will be implemented on an agreed and phased basis subject to the level of risk.

The system of internal control can only provide reasonable and not absolute assurance regarding the achievement of policies, aims and objectives. This opinion is based on work, as approved in the Strategic Audit plan, in 2003/04 of accounting records and the system of internal control.

Section 3

SIGNIFICANT ISSUES ARISING 2003/04

The following section provides a summary of the more significant issues that have been identified and reported during the year. This is by exception only.

1 *CORPORATE PERFORMANCE INDICATORS*

A review was undertaken of the procedures to ensure that Key Performance Indicators are accurately compiled, monitored and reviewed on a timely basis. Our review concluded that the Council has devised and agreed a process for the implementation of a corporate approach to quality assurance. Although some good practice was found, approximately 41% of the 69 Performance Indicators examined did not have satisfactory supporting documentation. Further work was carried out by Internal Audit to reduce this figure to 22%. Checking of completed BVPI reports in some instances was not robust as incorrect calculations, data and results were included, despite the correct information being incorporated in supporting documentation. The Annual Audit and Inspection letter prepared by the Audit Commission stated that:

‘The Council has made significant efforts to improve the quality of collected data. Our work identified a very low error rate, which was well below the threshold for qualification’.

2 *WAIVERS OF CONTRACT PROCEDURE RULES*

Internal Audit has continued to be pro-active in offering pragmatic advice to officers on the application of Contract Standing Orders. When these rules cannot be complied with fully, advice is provided to officers on how to progress the procurement process to secure both best value and transparency. Advice is given to the Director of Resources on requests from Services for an exemption to Contract Standing Orders.

Year	Number of Requests
2000/2001	22
2001/2002	7
2002/2003	20
2003/2004	28

3 *KEY FINANCIAL SYSTEMS*

During 2003/04 the new SAP Payroll system went live. Audit work has confirmed that the new software is operating as intended. Based on the samples selected there is evidence to indicate that the fundamental controls are not working effectively, however no material

discrepancies were detected. A number of improvements are required to departmental controls to reduce the risk of illegal access and unauthorised payments.

The review of the Debtors system has concluded that controls relating to disputed debt and debt over one year old are weak. The main issues arising from the audit concerned the suspension of recovery action on 2,163 invoices with a total value of £3.4 million. Over half of the invoices were over twelve months old. Controls were not sufficiently robust to ensure that an invoice was raised for all services provided. Concerns were also expressed about the improper write-off of debt. Disappointingly six of the thirteen recommendations made in the report were raised in the previous year but had not been fully implemented. The review of the Creditors system has concluded that, in general, the systems and procedures are well established and working satisfactorily in practice. However, progress towards achieving the goal of paying undisputed invoices within 30 days is slow.

Audit coverage of the Council Tax system raised concerns about the absence of documentation to support the granting of exemptions. Of the exemptions tested, 20% did not have back up documentation. Difficulties in locating basic documentation to support individual transactions were also of concern in the Non Domestic Rating system. The Director of Resources has set up an improvement team to address the area of concern.

Audit coverage during the year also concluded that controls in the Housing & Council Tax Benefit, Treasury Management, Pension Fund Investment and Pension Fund Administration systems continue to operate satisfactorily.

4 *GENERAL AUDITS*

Schools

The majority of time was spent undertaking full scheduled audits of 11 schools.

Based on the detailed work undertaken in 2003/04 and the findings from previous years, our overall opinion is that the control environment within Middlesbrough's schools is generally adequate. Recommendations made to management during the course of the year should help to ensure improvements take place.

Social Services

A review of systems for the administration and management of bank accounts and monies held for service users identified deficiencies in the control environment. The main issues concerned bank records not being checked for accuracy, an absence of bank reconciliations and overdrawn bank accounts. Managers are taking action to redress the position.

A review of the fostering system raised concerns over the stability of the software used to calculate payments made to foster carers. The system was written by an officer who had left the Council's employment without providing documentation describing how the system worked. The absence of any technical knowledge to correct mistakes and amend parameters to reflect annual changes in rates of pay increases the risk of error and fraud. The Council's ability to make payments to foster carers is also put at risk. Management is investigating possible replacement systems.

5 *SAP FINANCIALS*

Throughout the year there has been ongoing involvement with the project to introduce the SAP Financials system as far as possible, given the resources available and requirement to complete other core elements of the audit programme. Internal Audit has worked to ensure that data was transferred to SAP Financials accurately and completely from legacy systems. The security framework has also been reviewed to ensure that users are authenticated by controls written into the software before gaining access to data. Authorisation procedures ensure that users are restricted to roles allocated to them and, by default, data within their own service areas. The activity of all users when signed on to the system is logged ensuring accountability.

6 *CONTINGENCY*

Unplanned Audits

During the year, unplanned audits were undertaken to review the high levels of expenditure at Keldholme and Langbaugh schools in the months leading up to their closure. Recommendations contained in the audit report were taken into account in the closure of Brackenhoe and Coulby Newham schools.

A review was also undertaken of the use of taxis by Social Services staff when undertaking early morning and late night working. As a result of the review management have improved procedures for authorising and monitoring the use of taxis by staff.

Non Audit Work

To accommodate the relocation of the mailroom to a more central location, the Internal Audit Section moved from the ground floor of the Civic Centre to the 4th floor Middlesbrough House. This exercise resulted in the loss of a number of chargeable days.

The notes of guidance on the preparation of accounts were updated and reissued as part of a training programme for Treasurers of Community Councils and Centres.

Fraud & Corruption

The Council participated in the National Fraud Initiative 2002 managed by the Audit Commission. Data relating to employment, pensions, student applications and housing tenancies was submitted for use in the comparison of data to combat fraud involving public funds. Results of the matching were received in February. Nine instances of pension overpayments due to unreported deaths were identified and the amounts recovered. Housing Benefit matches were investigated by the Housing Benefit Fraud Investigation team who uncovered £130,000 of overpayments resulting in 11 prosecutions.

Internal Audit investigated 16 other incidents involving alleged theft of Council assets and corruption. Although many referrals are relatively minor, a small number have resulted in complicated and lengthy investigations.

Section 4

AUDIT PERFORMANCE

The Audit Commission relies on the work that Internal Audit do on key financial systems to gain assurance that the systems are operating as intended. Such assurances contribute to them being able to 'sign off' the Council's accounts and contribute to their conclusions on the financial aspects of corporate governance. Following a review of Internal Audit, the Audit Commission commented in the Annual Audit Letter that:

'Internal Audit has now completed 2003/04 reviews of all the key financial systems. We have reviewed their work and found it met CIPFA standards. There has been a steady improvement over the past two years in the quality of Internal Audit, however, as we reported last year, there continues to be scope to improve the control of Internal Audit work'.

Analysis of Issues

The Internal Audit Section consists of 15 staff delivering the equivalent of 13 full time posts.

Nine staff are professionally qualified with CIPFA or the AAT.

There were a number of changes during the year; following the resignation of one of the two Principal Auditors the opportunity was taken to re-designate the post Deputy Audit Manager. Unfortunately the successful applicant was unable to take up the post until February due to maternity leave. A post of Finance Officer was also created; however the successful applicant remained in post for just two months before deciding to return to her previous career in the hotel industry.

In addition, one of the four auditor posts could not be filled after it became vacant; nor could the other half of the Audit Clerk's position. As a result the number of days lost to vacancies: 514, was double the number planned. In addition, one of the three Senior Auditors had a long term absence.

In addition to the days lost to vacancies and sickness, there was also a significant overspend on planned audits, that is, jobs took longer than was originally envisaged and there was therefore less time to spend on planned audits. Overruns against planned time could be found on audits of the key financial systems as well as audits of operational systems managed by Services and establishments. Most of the slippage was against medium priority audits; the audits of some key financial systems were carried forward into the following year.

MEASURING THE PERFORMANCE OF INTERNAL AUDIT

The following table summarises the internal audit coverage across all Council Services during 2003/04:

Service	Plan Days	Actual Days
Education		
Life Long Learning	25	38
Standards	5	0
Inclusion	28	12
Planning & Information	27	6
Schools	204	253
Environment		
Transport	27	22
Street Scene	56	79
Planning & Development	12	2
Community Protection	70	69
Regeneration Housing & Culture		
Housing General Fund	92	63
Housing Revenue Account	107	83
Museums & Galleries	10	1
Library & Information	10	21
Cultural Services	18	0
Sport & Leisure	73	43
Neighbourhood Renewal	50	66
Social Services	215	176
Corporate Centre		
Finance	66	46
Legal Services	0	2
Chief Executive's Office	3	0
Members' Office	5	30
Performance & Policy	37	15
Corporate Systems	499	535
Contract Audit	79	13
IT Audit	65	90
Contingency	228	222
Total Audit Days	2010	1887

The performance of Internal Audit is shown by the figures shown below.

	Actual for Year
Chargeable days per FTE employee <i>(Audit Commission benchmark = 175)</i>	186
No. of Recommendations made	431
No. of audits completed	118
Completion of annual audit plan	33%
No. of days spent on audits carried forward from previous year	285