



MIDDLESBROUGH COUNCIL

STRATEGIC FINANCE

SERVICE

ANNUAL INTERNAL AUDIT
REPORT 2005/2006

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Section 1

INTRODUCTION

Annual Reporting

The annual report of Internal Audit presents Members of the Overview and Scrutiny Board 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
- 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 March 2006.

A key part of the Overview and Scrutiny Board's role in delivering the core functions of an audit committee is to form an overall opinion on the internal control environment and the quality of internal audit coverage.

Section 2

INTERNAL AUDIT ASSURANCE

Internal Control and the role of Internal Audit

The Council's key financial systems are managed and delivered on its behalf by HBS. One of HBS's objectives is to improve internal processes and thereby deliver 'fit for purpose' systems that support front line services and achieve productivity gains. As a result of continuous change in processes and procedures the 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.

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 Regulations 2003 paragraph 4(2) require the Council to review, at least once a year the effectiveness of its system 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.

Opinion 2005/06

No assurance can ever be absolute, however this opinion seeks to provide a reasonable assurance that there are no significant weaknesses in the Council's whole system of internal controls. ***On the basis of the audit work completed, the Council has in place a satisfactory framework of internal control, which provides a reasonable assurance regarding the efficient and effective achievement of its objectives. No significant weaknesses have been identified.***

The level of assurance given takes into account:

- All audit work completed in 2005/06
- Follow up of actions from previous years audits
- Management's response 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 Statement on Internal Control for 2005/06

CIPFA Guidance sets mandatory proper practice for the basic content of the required annual Statement on Internal Control and its approval and publication represent the end result of the annual review of internal control. The Corporate Affairs Committee are 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 main areas for continuing action included within the Statement on Internal Control relate to:

- Regeneration Service – Housing Bureau an Internal Audit report identifying significant issues around control processes applied to training / trainers and the appropriate type and level of checking
- Processes and procedures within the Housing Improvement Section have contributed to produce an environment where there are high risks of: fraud; grant payments exceeding the maximum amount and inability to demonstrate all building work undertaken was satisfactory
- Goods receipting control account - reconciliation procedures on this important account have been identified as an area of significant weakness.
- The following actions have been taken or are planned to be taken in 2006/07 to address the above issues
 - a) The scale of the problems resulted in a decision to close the Housing (Building) Bureau with effect from 1st April 2006. The Service has made arrangements for all trainees to complete their training. Discussions are ongoing with the relevant funding body about possible grant claw back.
 - b) Home improvement grants – the service has appointed consultants to assist with the introduction of a more robust control environment. Increased frequency of monitoring by senior managers.
 - c) New arrangements for regular reconciliation and monitoring are to be put in place by the Council's Strategic Partner. The Deputy Director of Finance will monitor the reconciliations. Improved guidance and instructions are to be issued to staff together with appropriate training to ensure orders and goods receipting are dealt with correctly.

Section 3

SUMMARY OF INTERNAL AUDIT ACTIVITY 2005/06

Audit reviews have been conducted in accordance with auditing standards contained within the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom. Audits were planned and performed to obtain all the information and explanations believed to be necessary to gain assurance as to the level of control within the Authority.

Audits completed in 2005/06 covered all aspects of the Authority. The total time delivered on audit work (2,214 days) exceeded the original plan (2,135 days). Of the 2,214 days delivered

on audit work, 455 days related to audits carried forward from the previous year. The percentage of total available time spent on audit work was 85%.

An analysis of time spent carrying out audits for different Services is shown in Appendix A

In total 94 audits were completed and final reports issued during the year. Each audit report contains an opinion on the financial controls and procedures in operation categorised as shown in Appendix B.

The following table analyses the opinions given on each of the reports:

Analysis of Audit Opinions 2005/06

Service	Opinion				Total
	Full Assurance	Substantial Assurance	Limited Assurance	No Assurance	
Key Financial Systems	-	8	5	-	13
Children Families & Learning	-	7	4	-	11
Schools	-	7	11	1	19
Environment & Neighbourhood Services	-	-	3	-	3
Regeneration	-	30	13	-	43
Social Care	-	1	3	-	4
Corporate Services	-	1	-	-	1
TOTALS	0	54	39	1	94

The single 'no assurance' opinion issued by Internal Audit was awarded as the establishment in question was facing a challenging financial environment without timely, complete and accurate financial information nor forecasting tools to ensure that it remained within budget.

Of the 39 'limited assurance' audit opinions, the following are brought to the Overview and Scrutiny board's attention:

Financial Control

More reviews of financial systems in schools and other establishments were completed in the year. In most cases the systems in place were assessed as having adequate controls or being capable of bringing about improvements to controls if the recommendations made following audits, were implemented.

Audit reviews of primary schools continue to highlight the difficulties they experience in achieving robust separation of duties. As more functions are delegated to schools and available funds increase, innovative solutions will be required to maintain robust controls.

Internal Audit identified errors in the VAT codes input to cash receipting tills at one establishment. This error has now been corrected resulting in the recovery of £1,915.53 overpaid VAT.

Performance Indicators

Significant resources were targeted at reviewing systems that generate data to produce 'Best Value Performance' and 'CPA' indicators. The data was evaluated for accuracy, validity and relevance. Discrepancies were discussed with management and appropriate actions taken to address system weaknesses and incorrect data.

Home Improvement Grants

A review of the systems for the award, administration and monitoring of Home Improvement Grants was undertaken. The overall opinion is that no progress has been made since the last audit and that at best only a 'limited assurance' opinion can be given. Since the audit, management have taken action by bringing in consultants to assist with the implementation of a more robust control environment.

Anti-Fraud and Corruption

Internal Audit co-ordinated the Audit Commission's National Fraud Initiative on behalf of the Council. A considerable number of data matches from Pensions, Benefits, Payroll and Student Loans were investigated and the outcomes reported to the Audit Commission. In addition Internal Audit dealt with a significant number of requests from other Councils for additional information to enable them to form an opinion as to whether a match required further investigation. The results of the Council's participation in the National Fraud Initiative are:

- Action taken to recover £7,247 of overpaid pensions
- Action taken to recover £41,000 of Housing and Council Tax Benefit overpayments
- Sanctions imposed valued at £6,400
- 2 prosecutions for benefit fraud

Irregularities

Financial Regulations require managers to report all suspected irregularities to Internal Audit. In financial year 2005/06, 10 instances of irregular activity were reported and investigated either wholly or in part by the section.

Two cases were referred to the police for further investigation. One resulted in a successful prosecution with the offender receiving a six-month supervision order and ordered to repay the monies taken: £2,018. The second case has yet to appear before the courts. Analysis of the types of incidents reported to Internal Audit is shown in the following table.

Type of incident reported	Number
Allegations of financial mismanagement or misconduct	3
Theft of equipment / assets	2
Misuse of assets	1
Time recording	1
Theft misappropriation of Middlesbrough Council monies	3
Total	10

The number of reported cases has increased since last year and there has been a corresponding increase in the amount of time spent on investigations.

Recommendations to improve control of risks identified through Internal Audit activity were discussed with, and accepted by, relevant managers and will be followed up by Internal Audit.

Section 4

AUDIT PERFORMANCE

The audit plan for 2005/06 was acknowledged to be challenging. Targets for delivery of the audit plan and achieving audits within budget have not been met, although performance on the former has improved since 2004/05. The fact that the time spent on special projects and investigating irregularities exceeded budget by 157 days and time spent giving advice to services exceeded budget by 30 days had a detrimental impact in terms of meeting targets.

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

- all the key financial audits were completed to at least draft report stage with the exception of Housing Benefits, Payroll and Main Accounting System,
- more audits were undertaken at establishments, including unannounced cashing up of leisure centres
- time taken to audit the accounts of Community Councils, Youth and Community Centres and Community Centres was reduced by 36 days despite additional work in some areas.
- average time taken to audit a primary school decreased from 19 days to 12 days. Further development of audit programmes and changes in working practices is required to achieve a target time of 7 days.

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

	Actual for Year
Chargeable days per FTE employee (<i>Audit Commission benchmark = 175</i>)	185
No. of Recommendations made	760
No. of audits commenced	138
Completion of annual audit plan	64%
No. of days spent on audits carried forward from previous year	455

Middlesbrough is a member of the CIPFA/IPF Audit Benchmarking Club. Through this, information about our costs and productivity is compared against other unitary authorities. The figures for 2005/06 were not available from IPF at the time of writing this report; however cost and time analysis information for 2004/05 produced the following statistics:

	Middlesbrough	Average	Lowest	Highest
Cost per £m gross turnover	£1,064	£1,158	£605	£1,955
Cost per auditor	£38,224	£46,000	£31,857	£76,400
Cost per audit day	£224	£281	£179	£583
Audit days per auditor	169	165	112	194

Middlesbrough spends slightly less per £m gross turnover on its audit service than other, unitary councils. The below average cost per auditor and per audit day are the result of lower than average salaries and overhead costs. The number of audit days per auditor is slightly above average.

Key issues for the next year

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 in response to the additional factors that have been added to the list of mandatory requirements. 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 audit, raising awareness and assurance work.

A draft of the new Code of Practice for Internal Audit to be published in Autumn 2006, has been circulated. The new code incorporates Ethics for Internal Auditors as a standard, promotes a risk-focused approach to auditing and strengthens the requirements for monitoring the performance and effectiveness of Internal Audit.

Appendix A

OUTTURN SUMMARY

The following table summarises the internal audit coverage across all Council Services during 2005/06:

Service	Plan Days	Actual Days
Children, Families and Learning		
Life Long Learning	37	75
Standards	5	0
Inclusion	30	17
Planning & Information	22	13
Vulnerable Children	35	0
Schools	314	360
Environment & Neighbourhood		
Transport	7	25
Street Scene	52	13
Community Protection	53	14
Horticulture, Parks & Leisure Centres	42	69
Regeneration		
Middlesbrough Town Centre Company	0	0
Museums & Galleries	13	0
Library & Information	20	27
Cultural Services	18	21
Economic & Community Regeneration	40	85
Planning & Regeneration	25	61
Social Care	176	92
Corporate Centre		
Finance	37	18
Legal Services	15	0
Chief Executive's Office	0	0
Members' Office	0	3
Performance & Policy	55	75
Corporate Systems	795	894
Contract Audit	80	6
IT Audit	95	2
Advice	33	63
Contingency	100	257
Non Audit Work	36	24
Total Audit Days	2135	2214

Appendix B

DEFINITIONS OF AUDIT ASSURANCE

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 nonachievement 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 key controls. Large number of both fundamental and significant recommendations made.