

AUDIT COMMITTEE

28 SEPTEMBER 2010

OUTCOMES OF AUDIT ACTIVITY

Report from: Internal Audit

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Summary

To advise Members of the outcomes of Internal Audit activity completed since the last meeting of the Audit Committee.

1. Budget and Policy Framework

- 1.1 Following the Council's decision to establish this committee, it is within the remit of this committee to take decisions regarding accounts and audit issues.

2. Background

- 2.1 This report contains the outcome of Internal Audit's work since the last report to this committee.
- 2.2 Generally, Internal Audit reports identify areas where improvement in the control process should be made. However, there is no standard within the internal audit profession of grading the overall control environment. Furthermore, even where recommendations are prioritised, the recipient of the report has no indication of how well the overall control process is operating.
- 2.3 To address this, Medway Council's Internal Audit has introduced a grading system so that managers have a clear understanding of the operation of the control environment in their area. The audit opinion is set at one of four levels and is formed on completion of the audit testing and evaluation stage but **before** management implement any of the recommendations.
- 2.4 All audit reports containing recommendations designed to improve the control process are presented with an action plan, which has been agreed with management and specifies the action to be taken, by whom and when. This agreed management action plan is incorporated in the issued final audit report.

- 2.5 During 2009/10, the audit opinion definitions were revised to improve managers' understanding of them. Also, the opportunity was taken to revise the audit report format to direct managers more clearly to the key risk areas and to assist them, we introduced a clearer priority ranking system for audit recommendations. The revised definitions are shown at Annex A.
- 2.6 Where control is assessed at the lowest level, ("Uncontrolled"), follow up work will be undertaken within six months.
- 2.7 This report details work completed since the last report to Members. The format of the annexes is as follows: -
- Annex A Definition of audit opinions and recommendation priorities
 - Annex B Schedule of completed audit work showing the audit opinion provided and Directorates covered
 - Annex C Summary information on completed audits (Please note that details of 2 audits are set out in an exempt appendix).
- 2.8 In addition to the work set out on the following annexes, Internal Audit has also responded to requests to provide advice on control issues to managers.

3. Risk Management, Financial and Legal implications

- 3.1 There are no risk management, financial or legal implications arising from this report.

4. Recommendations

- 4.1 Members are asked to note the outcome of Internal Audit's work.

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Background papers

None.

DEFINITIONS OF AUDIT OPINIONS

Opinion	Risk Based	Compliance	Value for Money
Good	Effective controls are in place to mitigate risks reviewed as part of the audit, maximising the likelihood of achieving service objectives and value for money and protecting the Authority against loss.	Key controls exist and compliance is consistent and effective.	Objectives are being achieved efficiently, effectively and economically.
Satisfactory	Key controls exist to mitigate the risks reviewed as part of the audit effectively. However, instances of failure to comply with the control process were identified and there are opportunities to strengthen the control system and/or improve value for money.	Key controls exist but there may be some inconsistency in compliance.	Objectives are largely being achieved efficiently, effectively and economically, but areas for further improvement.
Insufficient	Controls are in place to mitigate identified risks and they are complied with to varying degrees. However, there are one or more gaps in the control process that leave the system exposed to significant residual risk. Action is required to mitigate material risks.	Key controls exist but they are not applied, or significant evidence they are not applied consistently and effectively	Objectives are not being achieved through an appropriate balance of economy, efficiency and effectiveness. Value for Money is could be significantly improved.
Uncontrolled	Controls are considered to be insufficient to effectively control at least one of the risks reviewed as part of the audit. Remedial mitigating action is required. There is also a need to improve compliance with existing controls and errors and omissions have been detected. Failure to improve controls could have a significant impact on service delivery, or lead to material financial loss or embarrassment to the Authority.	Failure to comply with large numbers of key controls across a high proportion of the risks reviewed.	Objectives are not being achieved economically, effectively and efficiently.

DEFINITIONS OF RECOMMENDATION PRIORITIES

High

The finding highlights a fundamental weakness in the system that puts the Council at risk. Management should prioritise action to address this issue.

Medium

The finding identified a weakness that leaves the system open to risk. Management should ensure action is taken to address this issue within a reasonable timeframe.

Low

The finding highlights an opportunity to enhance the system in order to increase the efficiency or effectiveness of the control environment. Management should address the issue as resources allow.

Completed Audit Activity

Activity ↓	Directorate →	Opinion	Authority Wide	Children and Adults	Regeneration Community and Culture	Business Support Department
Credit card refunds		I				I
Department of Health Stroke Care Grant Claim		●				●
EU Grant Claim <ul style="list-style-type: none"> Interreg IV A 2 claim to end June 2010 		●				●
Grounds Maintenance Contract Monitoring follow-up		S			S	
Highways Maintenance Contract Follow-up		S			S	
Mobile Phones – value for money		S				S
Compliance with Financial Procedures <ul style="list-style-type: none"> Silverbank Pupil Referral Unit 		I		I		

Key:

G = Good, S = Satisfactory, I = Insufficient, U = Uncontrolled

- Work carried out but no opinion provided in that area

Completed Audit Activity

Audit: Department of Health Stroke Care grant claim**Opinion:** n/a

Internal Audit were asked to audit the grant claim and certify that the claim was correct before submission.

Main Findings	Main Risk	Main Recommendations	Management Response
<p>Detailed testing was conducted (but no guidance was provided by DoH on the level and extent of testing).</p> <p>No significant issues arose and the audited claim has been submitted for payment.</p>	None	None	N/a.

Audit: EU grant claim – Interreg IVA 2**Opinion:** n/a

Interreg IVA 2 project is funded by the European Regional Development Fund (ERDF) and Medway Council. The aim of the project is to improve the delivery of public sector services through improved customer profiling techniques.

Internal Audit were asked to audit the grant claim submission to the European Regional Development Fund to:-

- validate the expenditure declared and,
- ensure that it is in line with the original application, programme requirements and EU and national regulations.

Main Findings	Main Risk	Main Recommendations	Management Response
<p>Detailed testing was conducted in line with guidance provided by ERDF. The testing was conducted within the narrow timetable required by ERDF.</p> <p>No significant issues arose and the claim has been submitted to ERDF.</p>	None	None	N/a.

Completed Audit Activity

Audit: Highways Maintenance Contract Follow-up

Opinion: Satisfactory

The Council is the highways authority for the Medway area and is statutorily responsible for repairing and maintaining all carriageways (except the M2), including footways, bridges, tunnels and other structures, verges, signs etc, within the Medway area at the public expense. The Highways section is responsible for ensuring that the maintenance function is carried out and in August 2007, the Council entered into a 5-year contract with Fitzpatrick Contractors Ltd (subsequently taken over by Volker Highways – the current contractor). The contract provided for annual extensions up to 5 years, subject to the contractor's performance.

In 2009-10, the Council spent approximately £5m on responsive repairs and planned maintenance works placed with the contractor - Volker Highways.

The audit report was issued on 17 August.

Main Findings	Main Risk	Main Recommendations	Management Response
<p>Recommendations from the last audit have been implemented to ensure schedule of rates (SORs) are now negotiated for jobs where none existed previously; and the contractor is requested to raise variation orders (VOs) for variances in value with the task order, prior to submitting requests for payment. Results of data analysed and tests undertaken, however, showed that there is scope for improvement in monitoring the contractor's compliance with data input to ensure job completion timescales are met.</p> <p>Recommendations from the previous audit have been implemented to improve controls.</p>	<p>The contractor may not be completing tasks on time.</p>	<p>5 medium priority recommendations were raised relating to:</p> <ul style="list-style-type: none"> ▪ Better recording and monitoring of task completion dates; ▪ Fixing a software bug that prevents variation order authorization being captured by the Confirm system; ▪ Ensuring contractors provide photographic evidence that work has been completed; ▪ Improved recording of poor performance by the contractor. 	<p>Management accepted all five recommendations and have already implemented four of them.</p> <p>The software bug has been reported to the software supplier and will be fixed on a future upgrade (October / November 2010). In the meantime, management have identified a method of working around the problem.</p>

Completed Audit Activity

Main Findings	Main Risk	Main Recommendations	Management Response
<p>Task order reports are now being produced to identify any variances in value between the original order and payment requests – enabling investigation as to the cause(s), and ensuring only valid payments are made. A new ‘quality assurance’ spreadsheet has also been introduced to record details of the contractor’s failures. Management have also specified a minimal acceptable level of site visits to be made. Closer monitoring is, however, still required to ensure the contractor provides photographic evidence of satisfactory completion of task orders.</p> <p>Delegation of various budget headings to senior engineers/inspectors and regular monthly meetings to discuss the budgetary position, as well as the constant liaison with the directorate accountant ensures the overall budget is monitored effectively.</p>			

Completed Audit Activity

Audit: Mobile phones (value for money)

Opinion: Satisfactory

In the interests of operational efficiency and personal safety, some members of staff are provided with mobile phones. The Council's ICT section is responsible for administering a new corporate contract arranged in the autumn of 2007 for the provision of mobile phones and related services to Council staff. Records indicated that almost 1,400 mobile phones have been issued to staff and that payments made for purchases and service/call charges in the 2008/09 financial year totalled about £60,000.

The objective of this audit was to provide an opinion on the effectiveness of controls to minimise the risks that:

- Mobile phones may not be issued to officers only for improving the operational effectiveness of service provision.
- The most appropriate handsets and tariffs necessary for the needs of the service may not be available to officers.
- Usage of the mobile phones may not be for business purposes only and costs may not be kept at a minimum.

The audit report was issued on 19 August.

Main Findings	Main Risk	Main Recommendations	Management Response
<p>Comparison of ICT's record of mobile phone holders against HR records and the Outlook address book identified that approximately 50 phones are shown as issued to people who are no longer, or have never been, employees of Medway Council.</p> <p>Analysis of detailed call data identified continued instances of apparently excessive and/or non-business related use, including approximately £50 spent each month on calls/messages to international numbers, or receipt of calls/ messages whilst 'roaming' outside the UK, by around 21 individuals who appear to have no business need to</p>	<p>Call charges that do not relate to Medway Council business may be incurred.</p> <p>Not possible to apportion responsibility for any misuse of phones being used by others or allocated to teams and, therefore, take appropriate action against the individuals concerned.</p> <p>The Council is evidently incurring costs for excessive and/or non-business related calls/ messages, with a resultant impact on the funds available to deliver front-line services.</p>	<p>One high priority and one medium priority recommendations made, that the Chief Finance Officer should:</p> <ul style="list-style-type: none"> ▪ reiterate to budget managers that they should be monitoring mobile phone charges regularly to identify instances of excessive, inappropriate and/or personal use; ▪ issue an instruction to budget managers requiring them to: <ul style="list-style-type: none"> • check the accuracy of phone numbers and users being charged to their cost centre; • notify ICT of any amendments required to user details; • locate any unused phones and return them to ICT; 	<p>The recommended actions are to be addressed by issuing a briefing note to all budget managers, to be disseminated via their respective finance managers, by the end of September 2010.</p>

Completed Audit Activity

Main Findings	Main Risk	Main Recommendations	Management Response
<p>contact numbers outside the UK, or be contacted about business issues whilst abroad.</p> <p>Furthermore, there is a lack of assurance that many budget managers are monitoring the billing data available to identify any excessive or personal use.</p>	<p>Failure to identify excessive and/or non-business related use and take appropriate action to address this.</p>	<ul style="list-style-type: none"> • retrieve any phones issued to non-employees (eg consultants) and return these to ICT; • ensure that phones are recovered whenever a holder leaves the Council's employment; • ensure that ICT are notified whenever a phone is re-allocated to another user. • and remind them that all requests for new mobile phones should be routed via ICT and not to enter into any agreement to obtain phones outside of the corporate contract. 	

Completed Audit Activity

Audit: Silverbank– Financial procedures

Opinion: Insufficient

Medway Council's gross revenue spending for 2010/11 is £614m, with a net budget of £380m. In order to facilitate the delivery of its services financial control for over 10% of expenditure has been delegated to managers at satellite sites throughout the Authority. Silverbank Park has two Pupil referral units on one site that cater for Key Stage 3 and Key Stage 4 pupils that may experience behavioural, emotional and social difficulties. Some pupils have significant learning difficulties while others have been identified by their mainstream school as being at risk of permanent exclusion.

The 2010/11 gross expenditure for the site is approximately £2.5 million and income approximately £ 3600.

The audit report was issued on 22 July.

Main Findings	Main Risk	Main Recommendations	Management Response
<p>Appropriate staff have delegated responsibility for Silverbank's budget.</p> <p>Although budget monitoring spreadsheets are completed and returned to finance on a monthly basis and are compared to local records, there is a risk they may be inaccurate as variable costs for e.g. supply teaching are not estimated and local income record reflects only payments received rather than expected/invoiced income.</p> <p>Duties between raising orders, receiving goods and authorising payments are separated.</p> <p>Although officers stated that delivered goods are received and charged prices are correct by signing the '3-in-1 box' on non-</p>	<p>Forecast expenditure and income may be inaccurate.</p> <p>Budgets may be exceeded.</p> <p>Ordered goods and services may not be for business use.</p> <p>Delivered goods may not agree with delivery notes or orders and prices are not verifiable.</p> <p>Budgets may be exceeded.</p>	<p>2 high priority recommendations were raised to:</p> <ul style="list-style-type: none"> Ensuring manual invoices meet required standards and the income is controlled properly; Write-off and disposal of asset. <p>9 Medium priority recommendations were also raised relating to:</p> <ul style="list-style-type: none"> Improving local records to support budget monitoring; Improving records of orders placed Obtaining/retaining 3 quotes for orders in excess of £10,000 Retaining evidence of checks of checks to ensure invoices are accurate and due; Recording and reconciling Imprest use; 	<p>Management advised that the majority of actions recommended, had been implemented by the time the final report was issued and 1 outstanding action will be implemented by the end of September 2010 at the latest.</p>

Completed Audit Activity

Main Findings	Main Risk	Main Recommendations	Management Response
<p>purchase order slips, evidence supporting checks to e.g. orders, delivery notes and invoices is not consistent and utility meter readings are not recorded and compared with billed units. Evidence to support checks of delivered goods and delivery notes to orders and invoices is not consistent.</p> <p>Several weaknesses were identified in the use of imprest funds. Supporting documents are not authorised formally, consistently produced and/or retained. Furthermore there was no evidence that expenditure has not been subject to management review. Testing was conducted on a period prior to the Office Manager attending imprest training.</p> <p>Silverbank has not had a material income stream in the past. The new Headteacher negotiated with schools and agreed the transfer of funds for some pupils that 'moved' to Silverbank in the 2009/10 academic year.</p> <p>Invoices were raised in January 2010 with an appropriate</p>	<p>Purchases may not be for business use.</p> <p>All claimed expenditure may not be appropriate.</p> <p>All charged may not be raised and/or raised for the correct period/amount.</p>	<ul style="list-style-type: none"> • Receipting income received; • Prompt banking of income; • Reconciling received payments to invoices and banking records. 	

Completed Audit Activity

Main Findings	Main Risk	Main Recommendations	Management Response
<p>separation of duties between billing and debt chasing. Silverbank should be commended on the work done to identify this income stream. However, the development of the control processes for the new income stream left significant gaps that may reduce the income collected:</p> <ul style="list-style-type: none"> • There is no independent review process to ensure all charges have been raised or are for correct amounts. • Payments are not receipted or reconciled to invoices or banking records. • Invoices do not comply with VAT regulations. <p>An electronic asset register is in use, however improvements are needed in the consistency of recording information on assets and in the approval process for write-offs.</p>	<p>Due debt may not be identifiable</p> <p>The council's records are not promptly updated. All income may not be accounted for. Fraudulent invoices may be raised, payment redirected and gaps in numbers will not be identified. The Authority's VAT exemption may be adversely affected.</p> <p>Write offs may be inappropriate and losses may occur.</p>		