

Taunton Deane Borough Council

Corporate Governance Committee – 25 June 2012

Audit Commission Report – Audit of Financial Controls

Report of the Strategic Director (Shirlene Adam)

(This matter is the responsibility of the Leader of the Council, Councillor John Williams)

Executive Summary

This report introduces the report by the Audit Commission on the Financial Controls of the authority.

1. Background

- 1.1 The Audit Commission will shortly be starting their formal audit of the Financial Statements for 2011/12.
- 1.2 In preparation for this, they carry out some early work on the Councils financial systems. This helps identify any risks in our control regime, and this then is built into the auditors work plans.
- 1.3 The conclusion of this early review is set out in the attached report.

2. Key Messages

- 2.1 It is pleasing to see further improvements in the financial control environment from previous years reviews. Progress against the action plan in the report will be monitored by the Strategic Finance Officer.

3. Finance Comments

- 3.1 There are no financial implications from this report.

4. Legal Comments

- 4.1 There are no legal implications from this report.

5. Links to Corporate Aims

- 5.1 No direct implications.

6. Environmental Implications

- 6.1 No direct implications.

7.0 Community Safety Implications

- 7.1 No direct implications.

8. Equalities Impact

8.1 No direct implications.

9. Risk Management

9.1 Any risks identified will feed in to the corporate risk management process.

10. Partnership Implications

10.1 The Finance Service is delivered via the Southwest One Partnership.

9. Recommendation

9.1 Members of the Corporate Governance Committee are requested to note the Audit Commission's report on the audit of financial controls.

Contact Officers:

Shirlene Adam Strategic Director 01823 356310 s.adam@tauntondeane.gov.uk	Maggie Hammond Strategic Finance Officer 01823 358698 m.hammond@tauntondeane.gov.uk
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Audit of Financial Controls

Taunton Deane Borough Council

Audit 2011/12

The Audit Commission is a public corporation set up in 1983 to protect the public purse.

The Commission appoints auditors to councils, NHS bodies (excluding NHS foundation trusts), local police bodies and other local public services in England, and oversees their work. The auditors we currently appoint are either Audit Commission employees (our in-house Audit Practice) or one of the private audit firms. Our Audit Practice also audits NHS foundation trusts under separate arrangements.

We also help public bodies manage the financial challenges they face by providing authoritative, unbiased, evidence-based analysis and advice.

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Summary report

Introduction

- 1** My audit plan for 2011/12, which I presented to the Corporate Governance Committee on 12 March 2012 explained the work I would be carrying out to meet my Code of Audit Practice (the Code) responsibilities.
- 2** My responsibility as auditor of Taunton Deane Borough Council under the Audit Commission Act 1998 and the Code is to give an independent assessment of whether the financial statements give a true and fair view of the financial position of Taunton Deane Borough Council (the Council) and the income and expenditure of the year then ended.
- 3** It is the Council's responsibility to put in place arrangements to ensure proper conduct of its financial affairs, and to check their adequacy and effectiveness.
- 4** Under the International Standards on Auditing (UK and Ireland) (ISAs) I am required to gain an understanding of the Council's arrangements to identify and assess risks of material misstatement to its financial statements. This will include an assessment of audit risks for the organisation and the systems it uses to produce the financial statements.
- 5** My assessment of these arrangements will decide the approach required for the audit of the Council's financial statements in later in the year.
- 6** In addition, ISA 265 specifically requires me to communicate deficiencies in internal control to those charged with governance; the Corporate Governance Committee.
- 7** I have also reviewed the Council's progress in carrying out the recommendations that I made to the Corporate Governance Committee in September 2011. The following table summarises the findings.

Table 1: **Review of progress with the recommendations from the Annual Governance Report 2010/11**

2010/11 Recommendation	Follow-up finding	Audit conclusion
R1 Provide clear written instructions to the valuer to ensure the Council meets the requirements of the Code.	Instructions have been provided to the Valuer for 2011/12.	I will review the results during my audit of the financial statements.
R2 Provide a full segmental analysis required by the Code for the financial statements for 2011/12	The Council will include the segmental analysis in the 2011/12 financial statements.	I will review the results during my audit of the financial statements.
R3 Examine and clear the unallocated cash balances	The unallocated cash balance has been cleared in the year.	I will review the results during my audit of the financial statements.
R4 Review how the cash flow statement is prepared to remove significant balancing items	As part of the preparation of the 2011/12 accounts, a review of the cashflow statement is being undertaken to ensure there are no significant balancing items.	I will review the results during my audit of the financial statements.
R5 Review the how rental income is recognised and accounted for in advance	The Council is currently reviewing the treatment of income received in the year and intends to disclose the assumptions made regarding the recognition and accounting for rental income, and the impact on the Balance sheet in the Accounting Policies.	I will review the Accounting Policies during my audit of the financial statements.
R6 Review the accounting treatment and value for money arising from sale and leaseback proposals before they are approved.	There have been no further sale and leaseback proposals in the last year.	There are no further sale and leaseback proposals to review.
R7 Review its bad debt provision for former tenants and ensure that the aged debt analysis for all debts is reconciled to the figures in the balance sheet.	As part of the 2011/12 accounts closedown a detailed review of the Councils sundry debts is being undertaken and will inform the level of bad debt provision to be made. The aged debt analysis will be reconciled to the figures in the balance sheet.	I will review the results during my audit of the financial statements.

Source: 2010/11 Taunton Deane Borough Council Annual Governance Report

8 My assessment of these arrangements will decide the approach and testing required for the audit of the Council's financial statements from July to September.

Audit approach

9 Information is material if its omission or misstatement could influence the economic decision of users taken based on the financial statements.

10 My audit of the financial statements occurs in two phases:

- during the period of account I review the systems that produce entries in the financial statements over £1.4 million (the materiality threshold) and, in particular, test the controls in these systems that prevent material errors in the statements; and
- I test entries in the completed financial statements. This takes place after the year-end, usually from July to September.

11 ISA 315 requires the auditor to show understanding of the financial information systems that provide material balances in the accounts and to assess the risk of material misstatement arising from the processes and controls within these systems.

12 Under ISA 330 'the auditor's procedures in response to assessed risk, 'the auditor can rely on controls if they have not changed since they were last tested. The auditor should test the effectiveness of such controls at least every third year. Where there are several controls which the auditor decides that it is correct to use audit evidence gained in prior audits, the auditor should test the effectiveness of a sample of these controls each audit.

13 My 2011/12 work includes walk through testing on the material information systems to confirm my understanding of the key controls.

14 The Council has accepted there had been weaknesses in controls following the implementation of SAP. For 2011/12 I have reviewed the key controls in SAP that were not operating in 2010/11 to see if they are now working and can be relied on.

15 The material information systems for the Council are:

- General Ledger;
- Accounts Payable (creditors);
- Accounts Receivable (debtors);
- Payroll;
- Property Plant and Equipment (fixed assets);
- Council Tax;
- National non-domestic rates (NNDR);
- Housing Rents;
- Housing Benefits;
- Car Park Income;
- Cash receipting;
- Treasury Management; and
- DLO (Cosy) System.

16 The Information Technology system of the Council has also been considered through the IT Risk Assessment.

17 In 2011/12 I have undertaken a detailed review of Internal Audit's working papers and supplemented its work with my own procedures for key controls of all the material information systems.

Main conclusions

18 I assessed the controls operating for each information system that lead to material balances in the financial statements (above £1.4 million).

19 I have documented below the findings from testing the controls and recommendations for improvement in the future. I have also set out the approach I propose to follow at the post statement audit, to gain the required assurances the 2011/12 financial statements are materially correct.

20 The Council has strengthened the control environment compared with the previous year but some control weaknesses remain. The external audit team has undertaken additional work (testing transactions) to provide me with assurance for my audit opinion. My conclusions are summarised in table 2.

Table 2: **Summary of results of controls testing**

This table summarises the conclusions of external audit on the reliance that can be placed on key financial controls

System	Findings	Conclusions
General Ledger	The Council needs to strengthen the controls over the authorising of journals. The Council has delayed posting the audited closing balances at 31 March 2011 into the ledger as opening balances for 2011/12.	I will undertake further testing during the audit of the financial statements.
Accounts payable (creditors)	The Council should strengthen controls around direct input payments (where no matching of invoices is required).	I tested a sample of these payments and found them to be correctly processed. I have assurance for my opinion.
Accounts receivable (debtors)	The Council still needs to strengthen evidence of authorisation of the credit notes.	I tested a sample of credit notes and I found that they were valid and appropriately processed.
Payroll	A leaver was processed through the payroll system without a signed authorised form	I plan to seek to place reliance on other controls including manager confirmations of staff details charged to their budgets.
Property Plant and Equipment	The Council's controls for this system operate after the end of the financial year.	I will undertake my review of controls from July to September.

System	Findings	Conclusions
Council Tax	My review did not identify any failures in controls.	Subject to year-end testing I plan to rely on the Council's controls for my opinion.
Non-domestic rates	My review did not identify any failures in controls.	Subject to year-end testing I plan to rely on the Council's controls for my opinion.
Housing Rents	My review did not identify any failures in key controls. There is one key control which is undertaken after the year-end, reconciling properties between finance and housing.	Subject to year-end controls testing, I plan to rely on the Council's controls for my opinion.
Housing Benefits	The Council undertakes full reconciliations between material financial systems at the end of the year.	Subject to year-end controls testing, I plan to rely on the Council's controls for my opinion.
Car Park Income	The Council introduced checks in May 2011 that information recorded on the cash sheets (collected and banked from the car park machines), agrees to the amounts recorded on the car park receipt tickets produced by the machines when they are emptied.	Subject to year-end controls testing, I plan to rely on the Council's controls for my opinion.
Cash receipting	The Council has provided evidence that it reconciles the ledger with feeder systems for cash receipting such as planning fees and land charges.	Subject to year-end controls testing, I plan to rely on the Council's controls for my opinion.
Treasury management	Interest (receivable and payable) is not material for 2011/12 and I will test the year-end balances.	I will seek direct confirmation from counter parties for entries in the balance sheet.
DLO (Cosy) system	The same person can order, receipt goods and allow payment. The segregation of duties is insufficient.	I have undertaken additional audit procedures and I have sufficient assurance for my opinion, subject to year-end review
Information Technology system	I found that there was no formal Data Recovery Plan or Restoration testing. A formal plan should be developed and formal restoration testing should occur regularly.	No significant issues were identified, and therefore I am able to rely on the IT controls.

Source: Internal Audit and External Audit

Independence and objectivity

21 One of my team has a relationship with an IT contractor who is working on a project refresh for South West One. The IT contractor is not involved in any finance activity. This member of my audit team will not be involved in any review of the contract with South West One or the IT replacement project.

22 I am satisfied that this provides a satisfactory safeguard for me to comply with the ethical standards issued by the Auditing Practices Board (APB) and with the Commission's requirements for independence and objectivity as summarised in appendix 2.

Detailed report

General Ledger

23 The main controls within SAP are electronic controls based on specific roles and access rights.

24 System access management is a key control. It ensures that transactions are independently checked, to confirm they are accurate and relate to the Council's operations.

25 A member of staff emails a request for system access to the controls team on a standard form, which includes the name of the person sanctioning the request. I have reviewed these controls and I am able to place reliance on them for my opinion.

26 I also reviewed the process for approving journal adjustments and found that access controls restricted the input of journals. An officer can complete a journal on a standard form and email to a central mailbox for input. Staff who prepare journals check to confirm that journals balance and the account codes have been set up on the system.

27 In 2010/11 the Council agreed the recommendation that there would be an independent check of journal adjustments over £50,000. The Council has performed this within the Finance Advisory team from August, but journals are still being input without checks by the Master Data/Shared Finance and Cashiers teams.

28 However, the Council has agreed to carry out a retrospective review of journals processed during the financial year to provide assurance the journals were correctly approved. I will use this review to inform my testing strategy on the financial statements in the summer.

Recommendation

R1 The Council should set up a control which provides assurance that all journal adjustments accurately reflect Council transactions and are correctly classified in the ledger.

29 Bank reconciliations are a key control within the general ledger. They provide the Council with assurance that all income received into the bank accounts and all payments made have been correctly accounted for in the ledger.

30 Bank reconciliations are carried out monthly, and I can place reliance on this control for my audit opinion for 2011/12.

31 Although the Council reconciles cash receipts and payments daily, many of the Council's feeder systems are not fully reconciled into the General ledger until the year-end. These include the Housing Benefits, Council Tax, and NNDR systems.

32 As part of the year-end processes the Council should ensure that these systems are fully reconciled and any differences examined and corrected.

33 During my review (March 2012), the opening balances for 2011/12 were being loaded into the general ledger, almost 12 months after the start of the year. The Council experienced some problems that it was working to resolve for the accounts closedown.

34 These balances will be checked as part of the final accounts audit later in the year.

Recommendation

R2 The Council should ensure that opening balances are input into the ledger and checked within a reasonable time from the beginning of the new financial year.

Accounts Payable (Purchase Ledger)

35 My review and testing of this system confirms the controls, including 3-way matching, have been fully operational and reliance is being placed on them.

36 However, I identified that similar to last year there are still issues with direct input payments.

37 While these payments are input by an approved processor, there is no check to confirm the authorisation of these payments is correct. Direct payment forms require three signatures, but they are not checked against an authorised signatory list.

38 A new system involving Electronic Payments Request forms that are approved through the delegation tables has been introduced. However, this was only introduced in July and manual direct input payments are still being widely used. The Council cannot provide a separate analysis of electronic and manual authorisations. Therefore, it has not been possible to test or rely on this control for the whole year.

39 I tested a sample of direct payments and found them to be correctly processed.

Recommendation

R3 The Council should set up procedures, to confirm that all direct input payments are correctly approved. The Council should review the number of direct payments, by providing clear guidance detailing when it is suitable to use this type of payment.

Accounts receivable (debtors)

40 I have reviewed accounts receivable and concluded that there have been improvements within the system.

41 However, similar to 2009/10 and 2010/11, I have identified that there is insufficient evidence that the credit notes have been properly authorised within the system.

Recommendation

R4 The Council should ensure that procedures are put in place to approve credit notes within the system.

42 I could not rely on the control. Therefore, I tested a sample of credit notes and I concluded that this sample of was valid and accurate.

43 I have also found that there is a risk remaining around the monitoring of aged debt. Internal Audit tested this and found that only some service managers were running aged-debt reports. I have not been able to rely on this control, and Internal Audit has already reported it to the Council.

Payroll

44 Internal Audit found that not all leavers' forms were authorised, but I plan to rely on other controls to provide the assurance on the figures from payroll. Internal Audit has already raised this issue with the client.

45 The establishment lists are signed as agreed by managers at the end of year, and therefore I will review the operation of this control.

Recommendation

R5 The Council should ensure that all leaver forms are properly authorised before being processed through the payroll system.

Property, plant and equipment

46 Capital invoices are processed in the same way as revenue invoices, through the accounts payable system but flagged as capital when they are input. I will include a sample of capital invoices in my testing of transactions in the accounts payable system.

47 The financial transactions associated with property, plant and equipment such as the depreciation calculation, updating the fixed asset register for additions, disposals and revaluations, will only be processed at the end of the financial year.

48 I will undertake audit procedures on a sample of transactions at the post statement audit to confirm accuracy in the accounts.

Council Tax

49 In 2010/11, there had been a lack of evidence to verify that the precept information had been checked before its input. However, for the 2011/12 parameters, there was evidence that a check had taken place. Consequently, I was able to place reliance on this check.

50 My review also included the Council's arrangements for reviewing discounts and exemptions. The Council has introduced and recorded a regular programme of checking of discounts. As part of my systems work, I have reviewed this control and am able to rely on it for my opinion.

National Non-Domestic Rates (NNDR)

51 In response to my recommendations from 2010/11, the Council has introduced:

- a regular programme of checking of business rate accounts to ensure that reliefs are correct; and
- the requirement that evidence is retained to show that refunds above £10,000 have been checked and approved before payment is made.

52 I have been able to rely on these controls for my audit opinion.

53 Some controls operate at the year-end only, ie the reconciliation of the business rates system to the general ledger. I will review these year-end controls in the summer of 2012.

Housing Rents

54 There is one key control that does not operate until the year-end. The Council has agreed to ensure there is reconciliation between the number of properties recorded within the rent system, the records held by Finance and the records preserved by the Housing Information Assistant is retained. This will need to be confirmed at the year-end.

55 Subject to this year-end testing, I can place reliance on the key controls for my opinion.

Housing Benefit

56 The reconciliation of the Housing Benefit system to the subsidy claim is undertaken at the year-end and I will review this reconciliation in the summer of 2012.

57 In 2011/12 the Council has retained the evidence that it had checked changes to systems parameters. Consequently, I was able to place reliance on this control.

Car Park Income

58 The Council checks the information recorded on the cash sheets (collected and banked from the car park machines), agrees to that recorded on the car park vault tickets produced by the machines when they were emptied. This check was reintroduced in early May 2011 after not operating in 2010/11.

59 Subject to testing controls at the year-end I can place reliance on this control for my opinion.

Cash receipting

60 The Council has provided evidence that it reconciles the ledger with feeder systems for cash receipting such as planning fees and land charges. Subject to year-end controls testing, I plan to rely on the Council's controls for my opinion.

Treasury management

61 Investments and loans are material balances within the financial statements. I will obtain direct confirmation from counterparties to support the amounts disclosed in the financial statements.

DLO (COSY) System

62 The same person can order, receipt goods and approve payment. There is inadequate segregation of duties, unlike the other goods that are ordered through SAP Accounts Payable.

63 The risk is that unauthorised goods are ordered and inaccurate payments are made for items the Council has not ordered.

Recommendation

R6 The Council should strengthen segregation of duties so that the same individual cannot complete all stages of a transaction (order, receipt goods, and approve payment).

64 I selected a sample of purchase orders and confirmed that the goods were correctly ordered and could be linked back to specific jobs.

Information Technology System

65 There is no formal Data Recovery Plan and there was no testing to restore data. A formal plan should be developed and restoration testing should occur regularly.

Recommendation

R7 The Council should ensure that a formal Data Recovery Plan is introduced, and that regular Restoration testing is carried out.

Way forward

66 The Council should consider the recommendations in the action plan in Appendix 1 so that controls can be further improved. I would like to thank the Strategic Director and her team for the support provided during the audit.

Stephen Malyn

May 2012

Appendix 1 Action Plan

Recommendations

Recommendation 1

The Council should set up a control which provides assurance that all journal adjustments accurately reflect Council transactions and are correctly classified in the ledger.

Responsibility	Financial Services Manager
Priority	High
Date	The Council believes that the controls already in place provide sufficient assurance.
Comments	Within Shared Services, all journals are covered by a reconciliation statement that is done at least monthly. These reconciliation statements are reviewed and signed off.

Recommendation 2

The Council should ensure that opening balances are input into the ledger and checked within a reasonable time from the beginning of the new financial year.

Responsibility	Financial Services Manager
Priority	Medium
Date	Completed
Comments	Exceptional circumstances have delayed posting of opening balances in 2011/12. These have now been posted, and will be confirmed in October post-audit in future years

Recommendation 3

The Council should set up procedures, to confirm that all direct input payments are correctly approved. The Council should review the number of direct payments, by providing clear guidance detailing when it is suitable to use this type of payment.

Responsibility	Strategic Finance Officer, Maggie Hammond
Priority	High
Date	September 2012
Comments	It is acknowledged that there is significant direct input other than the E-PRF (electronic payment request form). The Strategic Finance Officer will meet with SWOne to set up procedures to confirm that these transactions are correctly approved. The first meeting has been booked for mid July 2012.

Recommendations

Recommendation 4

The Council should ensure that procedures are put in place to approve credit notes within the system.

Responsibility	Strategic Director, Shirlene Adam
Priority	High
Date	30 June 2012
Comments	The RFS (request for service) has been completed. A role mapping exercise now needs to take place. Paul Harding has a completion date of 30 June 2012 for this piece of work.

Recommendation 5

The Council should ensure that all leaver forms are properly authorised before being processed through the payroll system.

Responsibility	Retained HR Manager
Priority	Medium
Date	Completed
Comments	Operationally this is delivered by SWOne HR Admin and Payroll. A signatory list is reviewed half yearly by MH and MG. Any forms that do not have a signature or have an invalid signature are returned to MH and MG to check. This process is in place.

Recommendation 6

The Council should strengthen segregation of duties so that the same individual cannot complete all stages of a transaction (order, receipt goods, and approve payment).

Responsibility	Theme Manager (Chris Hall)
Priority	High
Date	31 March 2013
Comments	There is a project being delivered during 2012/13 to replace a range of DLO systems including COSY. Segregation of duties will be considered as part of the specification for the system replacement. If the system does not have the necessary functionality, alternative controls will be considered.

Recommendations

Recommendation 7

The Council should ensure that a formal Data Recovery Plan is introduced, and that regular restoration testing is carried out.

Responsibility	Retained IT Lead
Priority	Medium
Date	To be confirmed
Comments	The Council is negotiating with SWOne for disaster recovery of SAP that will include annual restoration testing. The date of completion will also be part of the negotiations

Appendix 2 Independence and objectivity

Auditors appointed by the Audit Commission are required to comply with the Commission's Code of Audit Practice and Standing Guidance for Auditors, which defines the terms of the appointment. When auditing the financial statements, auditors are also required to comply with auditing standards and ethical standards issued by the Auditing Practices Board (APB).

The main requirements of the Code of Audit Practice, Standing Guidance for Auditors and the standards are summarised below.

International Standard on Auditing (UK and Ireland) 260 (Communication of audit matters with those charged with governance) requires that the appointed auditor:

- discloses in writing all relationships that may bear on the auditor's objectivity and independence, the related safeguards put in place to protect against these threats and the total amount of fee the auditor has charged the client; and
- confirms in writing that the APB's ethical standards are complied with and that, in the auditor's professional judgement, they are independent and their objectivity is not compromised.

The standard defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case, the suitable addressee of communications from the auditor to those charged with governance is the Corporate Governance Committee. The auditor reserves the right, however, to communicate directly with the Council on matters which are considered to be of sufficient importance.

The Commission's Code of Audit Practice has an overriding general requirement that appointed auditors carry out their work independently and objectively, and ensure that they do not act in any way that might result in, or could reasonably be perceived to result in, a conflict of interest. In particular, appointed auditors and their staff should avoid entering into any official, professional or personal relationships which may, or could reasonably be perceived to, cause them inappropriately or unjustifiably to limit the scope, extent or rigour of their work or impair the objectivity of their judgement.

The Standing Guidance for Auditors includes a number of specific rules.

The key rules relevant to this audit appointment are as follows.

- Appointed auditors should not perform additional work for an audited body (ie work over and above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might give rise to a reasonable perception that their independence could be compromised. Where the audited body invites the auditor to carry out risk-based work in a particular area that cannot otherwise be justified as necessary to support the auditor's opinion and conclusions, it should be clearly differentiated within the Audit Plan as being 'additional work' and charged for separately from the normal audit fee.
- Auditors should not accept engagements that involve commenting on the performance of other auditors appointed by the Commission on Commission work without first consulting the Commission.
- The District Auditor responsible for the audit should, in all but the most exceptional circumstances, be changed at least once every five years.
- The District Auditor and senior members of the audit team are prevented from taking part in political activity on behalf of a political party, or special interest group, whose activities relate directly to the functions of local government or NHS bodies in general, or to a particular local government or NHS body.

The District Auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.

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- any third party.



Audit Commission

1st Floor
Millbank Tower
Millbank
London
SW1P 4HQ

Telephone: 0844 798 3131

Fax: 0844 798 2945

Textphone (minicom): 0844 798 2946