

Audit Detailed Report

05/07/2005

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Interim Report - Core Process Review

Carlisle City Council

2004-2005

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For further information on the work of the Commission please contact:

Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ

Tel: 020 7828 1212 Fax: 020 7976 6187 Textphone (minicom): 020 7630 0421

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Summary Report

Introduction

- 1 This report summarises our work on your core financial systems. We have also included issues arising from our early final accounts work.
- 2 Our Audit Plan for the year 2004/05 explained the work we would be carrying out to meet our Code of Audit Practice responsibilities. This report gives the results of our work.

Background

- 3 Our interim visit was carried out during April and May 2005. Early final accounts work was carried out in June 2005, and findings have been presented together to highlight common themes. Due to the flooding, internal audit's timetable was necessarily delayed and officers concentrated on operational issues as required. Our report has therefore been finalised after the original intended date noted in the audit plan.

Audit approach

- 4 Wherever possible we have placed reliance on the work of internal audit to ensure no duplication takes place.

Main conclusions

Internal audit

- 5 We have not carried out a full review of internal audit but have looked at internal audit work on documentation of the new systems. We have discussed with the authority the need to complete full systems documentation of the new system, which will be particularly important in 2005/06 when international standards of auditing require that all material systems are adequately documented. Our audit fee, as noted in the audit plan, is based on the assumption that this work will be carried out by internal audit. An internal audit workshop was held to discuss this with internal audit and finance staff across Cumbria and we have issued an internal audit protocol summarising the results of this workshop. We understand that arrangements are still being considered but would stress this is an area that needs to be resolved in good time before the 2005/06 audit in order for us to resource any work not intended to be performed by internal audit and to assess the subsequent impact on our audit fee.
- 6 Internal audit working papers reviewed as part of our work were of good quality. The file included an internal audit working paper detailing the core process testing

undertaken, however further improvements could be made by clearly referencing work performed to the list of relevant tests to be carried out. Not all tests on this list had been addressed, for example, opening balances had not been tested (our testing subsequently noted that there was an error in opening balances as described below).

Recommendation

<p><i>R1 Arrangements to be finalised regarding compliance with the new international standards of auditing requiring full documentation of all material systems.</i></p>

<p><i>R2 The authority should formally agree the internal audit protocol and evidence this by signature of the Head of Finance</i></p>
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meets
15/7

Core process review

Main accounting system

- 7 We note that a number of recommendations have been raised by internal audit following their work on the new system, relating to a universal/central procedure manual being established to fully document key accounting functions and responsibilities. Management and update of the Financial Guide needs to be reviewed to ensure that it reflects current financial and accounting and budgetary arrangements, and the Financial Services duties and responsibilities list should be brought up to date to reflect revised/new changes brought about by the new ledger system, staff changes and team structures. These issues should be followed up as soon as possible. As noted above, full systems documentation will be required to ensure compliance with International Standards of Auditing.

Recommendations

<p><i>R3 Full systems documentation and procedure manuals for the new financial management system to be prepared.</i></p>

- 8 Testing of opening balances revealed that the audit adjustments identified in our 2003/04 final accounts memo as requiring adjustment have been included in the ledger. Our final accounts memo also noted further matters to be adjusted in the 2004/05 ledger. It is important that these adjustments are made before our 2004/05 final accounts audit begins to ensure that there are no errors or areas of confusion when testing 2004/05 balances.
- 9 Review of opening balances also identified that the pensions liability and reserve had both been understated as £7,567 instead of £7,567,459. As both sides of the entry had been misstated this error was not picked up. There was a similar error in last year's final accounts which also was not identified before being presented for audit. It is important that an effective internal quality review is implemented and evidenced, particularly before working papers are presented for the final accounts audit, to eliminate these errors, and also to ensure that senior finance

staff are assured that the evidence presented for audit fully substantiates all material figures without the need for further enquiry.

Recommendations

<i>R4 All audit adjustments identified in the 2003/04 final accounts memo to be corrected in the ledger before the start of the 2004/05 final accounts audit.</i>

<i>R5 A senior member of the finance team, unconnected with the preparation of final accounts working papers should undertake and evidence a quality review before the information is presented for audit. This review should also be undertaken for other financial information to ensure errors such as that found in opening balances are identified and corrected.</i>
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Bank reconciliation

- 10 Following the implementation of the new ledger system, the bank reconciliation module has not been operational and no bank reconciliations have been prepared throughout the year. The year end bank reconciliation is currently being prepared manually. Internal audit have been unable to perform any work in this area as at present no reliance can be placed upon ICON system bank reconciliation reports. It is a matter of concern that the bank reconciliation system is not operational. This is a key control for the authority and its absence is a serious matter. We accept that the authority is doing its best to work on this problem however this must be addressed as a matter of urgency.
- 11 Other reconciliations and controls including the debtors' feeder and council tax income have also been subject to problems throughout the year and reconciliation of other feeder outputs to the general ledger, such as cancelled/returned cheques per Academy, have not yet been implemented. IMAN/Academy reconciliations could also be undertaken on a quarterly basis.

Recommendations

<i>R6 All reconciliations and control accounts need to be fully implemented and reconciled as a matter of urgency.</i>
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<i>R7 The manual bank reconciliation should be finalised and reviewed to enable early final accounts audit work to commence in this area.</i>

Journal procedures

- 12 We have raised concerns over the quality of supporting documentation and review for journal entries in past reports. Our interim testing work has identified that these matters have not been resolved. Internal audit testing found that, whilst the new system had improved journal controls, there were several areas in which improvements were required. These included ensuring adequate authorisation was in place and improving the quality of supporting documentation. As noted by internal audit, authorisation procedures should also be strengthened.

Recommendation

R8 Journal authorisation, documentation and evidence of review needs to be improved.

Amendment controls

- 13 There is no formalised process for the running of exception reports detailing unusual access such as out of hours or multiple password attempts. We understand that it is intended, when resources allow, that the weekly spot check from the cheque listing will recommence, and that a number of mitigating controls are in place and should identify unusual or large transactions, however exception reports would serve to formalise procedures in this area.
- 14 We note that the Authority are in the process of working on their IT strategy and have requested Section 35 work on Ethical Hacking which is currently being prepared.

Recommendation

R9 Exception reports should be run detailing all unusual attempts to access IT systems.

Suspense accounts

- 15 Our work on suspense codes indicated that all accounts were being reviewed and cleared regularly.

Budgetary control

- 16 As noted in previous reports, the authority has a history of underspending against budgets.

There are also improvements that could be made to budgetary control procedures as detailed in our last interim report. As noted in our 2003/04 report there is scope to further develop monitoring procedures. Explanations are often superficial and evidence of follow up and action (including arrangements to monitor outcomes from corrective actions) is limited. Evidence of attention given to identifying deviations from the underlying budget assumptions and the operational factors behind those departures is limited.

Recommendation

R10 Budget monitoring reports could be improved by including greater detail of the reasons behind variances, such as deviations from the underlying budget assumptions, as well as evidence of follow up and action taken in response to variances.

- 17 We note that internal audit have made a number of recommendations regarding virements and recommend that these are implemented as soon as possible.

Recommendation

R11 Internal audit recommendations on virements to be implemented as soon as possible.

- 18 Budget monitoring reports to the Board do not always show gross income and expenditure (for example, Business Unit reports show the net position only).

Recommendation

R12 Budget monitoring reports to the Board should show gross income and expenditure, as showing only the net position can mask variances.

- 19 The 2003/04 interim report included recommendations relating to budgetary control which have not yet been fully implemented, including the extension of budget monitoring reports to cover all revenue and balance sheet accounts as well as forecast outturn data.

Recommendation

R13 Audit recommendations should be regularly reviewed to ensure that all areas are addressed.

Closedown arrangements

- 20 With further reduction to the closedown timetable in 2005/06 the Authority should consider reviewing its existing arrangements for approving the annual statement of accounts to avoid logistical problems for convening SAS 610 meetings and re-approving the accounts. With a further reduction to the closedown timetable in 2005/06 the Authority may wish to review its existing arrangements for approving the annual statement of accounts.
- 21 The authority should ensure that all staff engaged in the closedown process are briefed on the standard of working papers expected. A meeting was held with finance staff earlier in the year to discuss improvements required for this year's audit. We recommend that all working papers submitted for audit should be reviewed by a senior member of staff not responsible for their preparation to identify omissions or errors before the working papers are submitted for audit.

Recommendation

R14 The statements and working papers should be formally reviewed by senior staff not involved in their preparation and a formal record of this process filed on the closedown files before their submission for audit.

- 22 Brought forward deadlines and the impact of the flooding and loss of documents will make this a challenging year for the authority.
- 23 The closedown plan is essentially a list of tasks, target dates and allocation of tasks to members of the central finance team. Description of the precise requirements of individual tasks is limited increasing the risk that output from tasks will not be completed in line with expectations or to the required standard.

It is however acknowledged that efforts have been made to cross reference tasks to audit working paper requirements and to insert file reference in an effort to provide some structure and enable tasks to be sorted in a more structured manner.

- 24 There was an absence of evidence to suggest application of a risk assessment to identify high risk tasks (those tasks likely to have a significant impact on the Authority's ability to complete the statements in compliance with statutory requirements and proper practices by the due date). The plan makes no reference made to start date for individual tasks, associated lead times or expected time required to complete the task (in the form of an indicative time budget). The plan also does not include provision for a review by the Head of Finance.
- 25 Planned closedown progress meetings had not taken place at the time of our interim visit. This is partially mitigated by the size and experience of the team involved in the closedown process. However, given the tightened reporting deadlines for 2004/05 accounts it is essential that the closedown timetable is adhered to as closely as possible. Progress meetings are a useful tool for ensuring that potential issues are identified and discussed before they become a problem.
- 26 The detailed closedown plan shows several tasks as allocated to 'all'. These tasks include technical areas such as the review of post balance sheet events. Such tasks require a level of technical knowledge and should be allocated to an experienced individual. Restrict allocation of responsibility for completion of tasks to one individual.

Recommendations

<i>R15 Improvements should be made to the closedown process to include a risk assessment, time allocations for tasks, and a review of working papers by the Head of Finance. Overall responsibility for each task should be clearly allocated to one member of staff.</i>

- 27 There were some delays in receiving information during our interim visit. In future the process could be improved if a basic package of electronic working papers was provided for us at the start of our interim visit, including, for example:
- copies of the most recent budget monitoring reports & control account reconciliations
 - notes detailing any changes to key personnel, controls and systems
 - closedown documentation.

Recommendations

<i>R16 Future interim visits should begin with the receipt of the working papers detailed above.</i>
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We have not currently been allocated permanent audit accommodation in the Civic Centre. We recognise the difficulties arising from movement of offices following the flooding. As the date of the final accounts audit is approaching and the timetable is demanding it is important that delays to the audit are not caused by either lack of suitable accommodation or the need to supervise accommodation moves during this time.

Recommendations

<i>R17 Audit accommodation for the duration of our final accounts audit needs to be confirmed to avoid delays and subsequent impact on deadlines.</i>

- 28 In order to achieve an efficient audit we have undertaken some early final accounts work. The results of this work are summarised in Appendix 2 of this report. These matters were emailed to the authority on 6 July 2005. We suggest that the matters arising are corrected by the start of our final accounts visit to enable these matters to be completed in early course.

Recommendations

<i>R18 Matters arising from our early accounts audit, as summarised in Appendix 2, should be addressed for the start of the final accounts audit</i>
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- 29 We have also discussed with officers starting the audit earlier than planned in our audit protocol. Staff are available at the end of July to commence the audit. However in order for this to be achieved it is necessary that we have full supporting working papers for all material items in the accounts.
- 30 A letter was sent to the authority dated 30 June 2005 noting the link of our final accounts work with the Use of Resources work to be undertaken later in the year. The links between the quality of the final accounts and working papers and the judgements necessary for our Use of Resources work should be considered by the authority.

Recommendations

<i>R19 Officers to confirm when full working papers will be available for the start of the final accounts audit.</i>
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<i>R20 The authority should consider the links between the quality of the final accounts and working papers and our Use of Resources work later in the year.</i>
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Resources

- 31 During a number of our interim audit tests we have been told that procedures or additional controls have been delayed due to heavy officer workload. We have also noted that a number of the items requested, both for our interim work and early final accounts testing, have not been provided at the start of our visit, and on several occasions were received a significant amount of time after the original request. This is an ongoing problem which has been encountered in previous years. We are aware that both the flooding and problems with the implementation

of the new ledger system, outside of the authority's control have made this situation worse, as has lack of success in recruiting another member of staff to the finance team.

- 32 We are aware that officers are working to the best of their ability to provide information requested to us. However, the problems referred to above of flooding and operational difficulties in the new financial system will also have a significant impact on our audit, decreasing the level of reliance we are able to place on control systems and requiring us to undertake additional work to obtain the assurance we need. u
- 33 We therefore recommend that the workload of officers responsible for producing the accounts working papers and answering audit queries is reviewed to enable the audit to be treated as a high priority. Any ongoing delays in receiving information or explanations required will have a significant impact on deadlines. ✓

Recommendation
<i>R21 Officer workload to be reviewed to enable accounts working papers to be ready in full for the start of the audit and to enable officers to have time to answer and follow up audit queries in good time.</i>

Acknowledgements

- 34 I would like to take this opportunity to express my appreciation for the assistance provided during our audit visits in 2004/05.

Appendix 1 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
	R1 Arrangements to be finalised regarding compliance with the new international standards of auditing requiring full documentation of all material systems.					
	R2 The authority should formally agree the internal audit protocol and evidence this by signature of the Head of Finance					
	R3 Full systems documentation and procedure manuals for the new financial management system to be prepared.					
	R4 All audit adjustments identified in the					

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
	2003/04 final accounts memo to be corrected in the ledger before the start of the 2004/05 final accounts audit.					
	R5 A senior member of the finance team, unconnected with the preparation of final accounts working papers should undertake and evidence a quality review before the information is presented for audit. This review should also be undertaken for other financial information to ensure errors such as that found in opening balances are identified and corrected.					

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	R7 The manual bank reconciliation should be finalised and reviewed to enable early final accounts audit work to commence in this area.					
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	R9 Exception reports should be run detailing all unusual attempts to access IT systems.					

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	R12 Budget monitoring reports to the Board should show gross income and expenditure, as showing only the net position can mask					

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	variances.					
	R13 Audit recommendations should be regularly reviewed to ensure that all areas are addressed.					
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	the Head of Finance. Overall responsibility for each task should be clearly allocated to one member of staff.					
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Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
	start of the final accounts audit					
	R19 Officers to confirm when full working papers will be available for the start of the final accounts audit.					
	R20 The authority should consider the links between the quality of the final accounts and working papers and our Use of Resources work later in the year.					
	R21 Officer workload to be reviewed to enable accounts working papers to be ready in full for the start of the audit and to enable officers to have time to answer and follow up audit queries in good time.					

Appendix 2 – Early final accounts work

Feedback from Preliminary Final Accounts visit – June 2005

Interests in Companies/Group Accounts

- 35 Information relating to the Authority's classification of interests in corporate bodies and other non corporate entities (as shown in the schedule of agreed working papers set out in Appendix B of the agreed final accounts protocol – copy attached for information) was not made available to us by the date agreed. We are therefore as yet unable to provide feedback on the Authority's assessment of interests or on its requirement or otherwise to prepare group accounts.

Investments (Long Term/Short Term)

- 36 There were no significant issues noted. We are however still awaiting written confirmation of balances from the following counterparties
- Nationwide Building Society
 - National Savings (income bond) – to be reissued as at year end date
- 37 It is noted that at 31 March investments totalling £2m had a maturity date more than 1 year after the balance sheet date. The Authority will need to consider whether in light of the requirements of the SORP this balance might be more appropriately classified under long term investments.

Long Term Debtors

- 38 No matters noted requiring further consideration at this time.

Stocks and work in progress

- 39 Work in Progress balance overstated by an estimated £392,505. This relates to the carry forward of internal WIP balances connected with flood related works undertaken by Carlisle Works. However, the absence of supporting WIP costing reports or other supporting evidence meant that we were unable to undertake any further testing of the reported balances during our preliminary visit. The requirements of the SORP are such that all internal work in progress balances should be either written off to the consolidated revenue account or capitalised where the expenditure falls within the definition of capital expenditure contained in S16 of the Local Government Act 2003. (i.e. expenditure to be capitalised as a fixed asset in accordance with proper practices). Where expenditure is recoverable from the Authority's insurers or from the ODPM under the Bellwin formula an appropriate debtor account should be raised and accounted for in accordance with proper practices.
- 40 Further analysis by the Authority of the reported internal WIP balances and the collation of supporting documentation is therefore required. Supporting working papers should provide a clear link to insurance claims and Bellwin grant claim,

provide a clear explanation of the nature of the expenditure and have due regard to the terms and conditions attached to both insurance and grant claims.

- 41 All internal WIP balances should be written off to the CRA/Fixed assets and a debtor account should be raised (net of payments received on account) in respect of amounts recoverable from the Authority's insurers or ODPM (Bellwin).

External Borrowing and Capital Controls

- 42 Documentation relating to the repayment of PWLB borrowings during the year was not made available during our preliminary visit. This will be required at the start of the main scheduled final accounts visit.
- 43 Written confirmation of balances from the following counterparties is currently outstanding
- Liverpool Victoria Friendly Society
 - City of Carlisle Secured Loan Stock
- 44 Several issues were noted in respect of the MRP calculation which will require further work by the Authority prior to completing the closedown of the 2004/2005 statements.
- 45 Revised calculations are required in respect of adjustment 'A' in line with the formula set out in the Capital Finance and Accounting Regulations 2003. This includes
- correction of CFR calculation to incorporate all items of capital expenditure included on the balance sheet at 31 March 2004 not just those items included in fixed assets. This will include amounts included in long term investments and/or long term debtors and which fell within the statutory definition of capital expenditure under the part IV regime (e.g. Investment in KPP Ltd);
 - recognition of the difference between the HRA credit ceiling and the housing element of the adjusted credit ceiling. The former calculated in accordance with the 2003 capital finance regulations (Item 8 Determination) will include for example an opening balance determined by special determination as well as an adjustment for the appropriation of HRA assets to the GF. This appropriation adjustment will not however affect the housing or non housing elements of the adjusted credit ceiling (items HA and NHA in the adjustment A formula);
 - correction of credit ceiling totals in line with those included in the audited accounts 2003/2004 and HRA subsidy final claim 2003/2004.
- 46 No working papers were provided in support of the commutation adjustment. If the Authority wishes to make this discretionary adjustment calculations will need to be provided in support of this item. Although papers were lost in the flood the calculations should be re-performed.
- 47 An un-reconciled difference of £2,895,462 is noted between the CFR at March 2004 (£16,395,904) net of capital creditors carried forward un-financed at 31 March 2004 (£1,231,421) and the adjusted credit ceiling total of £14,731,863. This discrepancy implies a potentially significant cumulative overstatement of

MRP along with a corresponding error in reported balances. The size of any cumulative error will of course depend on the nature of this difference and the point in time at which this difference arose. If this is traced back to the establishment of the CC in 1990/1991 then at 4% pa would translate into a potential error of approximately £1.7m.

- 48 The need for the Authority to reconcile the CFR and CC balances as part of the 2004/2005 closedown process was highlighted during our final accounts technical update session held in March 2005. This reconciliation is a key tool for checking the accuracy of the CFR and CC calculations and for identifying those items requiring 'special' consideration under both the part IV and prudential financing arrangements. It is therefore important that the Authority takes such steps as are necessary to establish the source(s) of the reported variance and to reconcile the CFR at 31 March 2004 with the adjusted credit ceiling totals.

Partnerships and Joint Working Arrangements

- 49 Information relating to the Authorities involvement in Partnerships and Joint Working Arrangements were not made available to us. We are therefore unable to provide you with any feedback on this aspect of the 2004/2005 statements.

Consolidated Revenue Account (continued)

- 50 The requested information relating to the Authorities Finance and Operating leases commitments was not made available to us. We are therefore unable to provide you with any feedback on this aspect of the 2004/2005 statements at this time.

All the above issues should be addressed in early course, and preferably before commencement of the final accounts audit.

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