

BACKGROUND PAPER (iv)

ACCOUNTS COMMITTEE

TUESDAY 7 MARCH 2006 AT 2.00 PM

PRESENT: Councillor Stevenson (Chairman), Councillors Aldersey (as substitute for Councillor P Farmer), Mrs Bradley, Glover, Joscelyne, Mrs Prest, Ms Quilter and Mrs Styth

ALSO

PRESENT: Councillor Mitchelson (Leader of the Council)
Councillor Firth (Finance and Resources Portfolio Holder)
Councillor Jefferson (Policy and Performance Management Portfolio Holder)
Councillor Bloxham (Environment, Housing, Infrastructure and Transport Portfolio Holder)

Mr Mark Heap and Ms Fiona Daley, Audit Commission

AC.7/06 ADDITIONAL INFORMATION

Copies of the Auditor's Commentary Report on the 2004/05 accounts to the Accounts Committee (dated March 2006) and a draft Bank Reconciliation Template were tabled.

A Member requested that the Committee be given time to read the documentation. In response, the Chairman indicated that he would allow Members time to do so.

AC.8/06 APOLOGY FOR ABSENCE

An apology for absence was submitted on behalf on Councillor P Farmer.

AC.9/06 DECLARATIONS OF INTEREST

There were no declarations of interest affecting the business to be transacted.

AC.10/06 MINUTES OF PREVIOUS MEETING

The Minutes of the meeting of the Accounts Committee held on 15 February 2006 were noted.

The Chairman extended his thanks to the members of staff involved, and to the Auditors, for the considerable amount of work undertaken over the past three weeks. He also thanked the Auditors for their commentary report referred to at Minute AC.7/06 above.

Referring to Minute AC.6/06 resolution (4), the Chairman wished it to be placed on record that he had had no communication from the Auditors since the meeting of the Committee held on 15 February 2006.

He further drew Members' attention of resolution (6) thereof which would be considered by the City Council at its meeting later that day.

AC.11/06 STATEMENT OF ACCOUNTS 2004/05 – PROGRESS AND ACTION PLAN

The Town Clerk and Chief Executive began by reporting that she wished to make the following statement, which covered both reports being presented to Members, before the Director of Corporate Services went into the detail thereof -

"The first meeting of the Accounts Committee on the 15th February was a very difficult one for Officers and Members. The concerns raised by the Audit Commission would have been hard enough to hear had they just been for one year, but they were not, they were concerns which were cumulative.

What we need to provide now are reassurances to Members and the Audit Commission, because what is at stake here is confidence – you have to have confidence in the financial management work of the Council and to do that we, as Officers, have to provide demonstrable evidence that we have taken this matter very seriously and not just to get us through the short term, but an overarching strategy – including a formal action and improvement plan for the medium and long term.

You will see in the report on the Statement of Accounts that we have drawn together an Action Plan and that was requested by the Accounts Committee. This Action Plan, which I had lead responsibility, draws together all the issues identified by the Audit Commission in three key reports. However we know from our discussion with Fiona Daley and Tina Meyer on 27th February, that there are other matters which need to be part of our Plan and Fiona's letter to me of 6th March, goes through these. We will make sure that wherever appropriate we will get them in the Action Plan, but there are some – and particularly financial management which need to be part of an overarching strategy and medium/long term Improvement Plan. Can I also say at this point that I felt that the meeting with Fiona and Tina was very constructive.

I would like to go through the formal arrangements we are putting into place to ensure we give the Audit Commission and Members the confidence and reassurance you will need –

- Our Senior Management Team will monitor the Action Plan on a weekly basis and it will also drive forward financial management issues;
- Subject to approval by Council tonight we will start to progress work on establishment of an Audit Committee which will take on the Members' scrutiny role and our reports will also change to make sure that Members

are able to understand and scrutinise and that will require us to make those reports and supporting papers clear and transparent;

- The Executive will also play a key role and in its leadership of the Council, it will not only receive the recommendations of the Audit Committee, but will ensure that the financial management of the Council is central to our Agenda, not taken in isolation, but linked to value for money and performance management of our services. The Leader and Portfolio Holder may wish to say more about this as the meeting progresses.

The main reassurance and confidence building, I believe, will be helped by this framework, but we still need an overarching strategy that moves us positively forward.

- We are commissioning the Institute of Public Finance to undertake an Independent Review of the Council's management arrangements. This will involve:
 - (i) A comprehensive review to focus on the processes and management underpinning our current arrangements. And this is not a narrow focus on our Finance team, and its function, it has to go wider and there are many staff who have a role in financial management.
 - (ii) The Review will make comparisons between our own financial management arrangements with best practice. We have to know where we sit and that has to go beyond Cumbria. We have to know where our 'performance gap' is and how we resolve it.
 - (iii) The outcome of this Review, which will be intensive and over a 25 day period, will involve discussions with Members, the Audit Commission and result in a detailed Improvement Plan. And it is that Plan that will drive our overarching strategy and take us beyond our current Action Plan.
 - (iv) I believe we will get there. We have a real will and commitment and though it has been a painful lesson for us to learn, we are learning and gaining back that confidence that you and we need."

A Member welcomed the Town Clerk and Chief Executive's comments. However, she believed that they amounted to a report with assurances and requested that Members be provided with a copy thereof. The Town Clerk and Chief Executive undertook to action that request.

Pursuant to Minute AC.6/06 the Director of Corporate Services presented Report FS.48/05 providing an update on progress with the 2004/05 Statement of Accounts.

Copies of the following documentation (which formed the background to the content of Report FS.48/05) had been circulated by way of background information -

- (i) Statement of Accounts 2003/04 – Audit Issues (Report FS.39/04) together with an Excerpt from the Minutes of the Corporate Resources Overview and Scrutiny Committee held on 22 November 2004 (Minute CROS.157/04);
- (ii) Review of Financial Statements 2003/04 – 19 November 2004;
- (iii) Annual Audit and Inspection Letter – 29 December 2004 together with an Excerpt from the Minutes of the Joint Management Team on 23 December 2004 (Minute JMT.203/04);
- (iv) Interim Report – Core Process Review – July 2005;
- (v) Working Paper Requirements – April 2005; and
- (vi) Statement of Accounts 2002/03 – SAS 610 Statement (Report FS.02/04).

Details of progress achieved to date on the specific issues identified by the Audit Commission under the following areas were provided –

- Draft Unadjusted Misstatements;
- Draft Adjusted Material Misstatements (including further information on the material issues specifically mentioned in the Audit Commission report of flooding costs, cashflow statement and fixed asset valuations);
- Material Weaknesses; and
- Qualitative Aspects.

In particular, the Director wished to make it clear that the delay detailed in paragraph (iv) on page 3 of the report concerning the Interim Report – Core Process Review - had not been the primary cause of the late closure of the accounts. She further pointed out that the late closure of accounts for 2003/04 was due to the fact that the adjustments required were more fundamental than had first been thought.

The Director stated that the finance staff had been under significant pressure over the past year due to the impact of losing their offices and working papers in the January 2005 floods. Additional temporary resources were to be secured to assist staff. Officers were also grateful to the Audit Commission for the assistance provided.

Attention was then drawn to the Action Plan attached at Appendix 1 to Report FS.48/05 which covered the following main areas –

- (i) Issues arising from the Audit Commission Report on Financial Statements considered by the Accounts Committee on 15 February 2006 and as detailed in paragraph 2 of Report FS.48/05.
- (ii) Any outstanding issues from the Audit Commission Interim Report – Core Process Review received in July 2005.

- (iii) Any outstanding actions from 2003/04 included in the Audit Commission report, Review of Financial Statements issued November 2004.

The Director further reported that any additional issues raised by the Audit Commission arising from past or future audit reports and, in particular, the Interim Audit Commission Core Process Review now due in late May 2006 would be added to the Plan as appropriate.

At the invitation of the Chairman, Ms Daley then read out to the Committee the following statement (copies of which were circulated) –

"Thank you to Officers and Members for providing the completed Action Plan within the timescale agreed.

I am satisfied with the proposed response to the recommendations made for improving the final accounts reporting procedures and with the proposals that it is monitored by the Management Team.

There are a few issues which have not been picked up in the Action Plan:

These are recommendations 1 and 2 of the interim audit memo which are around Internal Audit's work programme and the requirement on the Authority to document financial systems.

Recommendation 10 of the same report refers to issues around the monitoring of variances against budget and the action taken in response to correct the position and review or amend underlying budget assumptions for future years.

Both these issues are included in our Use of Resources report and I am content for them to be picked up as part of the Action Plan arising from Members and Officers consideration of that report. However, I would advise you that as the UOR scores feed in to next years proposed CPA scoring framework, early action on these recommendations is desirable if the authority want to improve its current scores.

I am also concerned about the format of the bank reconciliation going forward. A readily understandable format which conforms to a traditional structure, is not ledger system driven and is readily substantiated by reference to bank statements, un-presented cheques etc is in my view essential if we are to avoid a repetition of the significant amount of work required this year and the additional audit fee arising from this work. This revised approach is advisable at least until the full computerised reconciliation methodology can be proven.

Mark will talk about the 2004/5 reconciliation. My concern is about the improvements required for 31 March 2006 based on my understanding of the reconciliation at Appendix C to report A.2 for the period to January 2006.

I have written to the Chief Executive about this yesterday and hope that we will be able to meet to agree a more detailed proposal for improvement in format, review and certification of the monthly bank reconciliation.

Looking to the future:

It is appropriate that the Audit and Accounts Committee is in receipt of Internal and External Audit reports. The normal process is that draft reports are discussed with Officers and Action Plans with agreed dates for implementation are then presented to the Audit Committee.

In completing the review of the AAIL and the interim and Governance report for 2004/05 the authority has covered a large proportion of the 2004/5 external audit work programme. At some stage Members will need to consider the final accounts memo.

I hope that the work to date by the Accounts Committee is a strong foundation on which we can build.

Going forward I would suggest that it would be desirable if a timetable of meetings could be agreed with the Accounts Committee. The type of reports which need to be considered in 2006 are:

- Internal and External audit plans for 2006/7
- Use of Resources Report and proposed authority Action Plan
- Interim Audit memo 2006
- Statement of Internal Control (SIC)
- Approval of the Accounts (as a separate exercise from the SIC)
- Reports to those charged with Governance
- Final Accounts memo
- Internal Audit reports in accordance with internal timetable."

Ms Daley added that the Auditors were grateful for the work done. Referring to the timing of reports she said that an indicative timetable was produced but that was always open to negotiation and could be adjusted to fit the Council's internal workload.

The Chairman asked whether the accounts which had now been prepared, and which incorporated the amendments requested, were satisfactory.

Mr Heap responded that work was ongoing and good progress being made, but he was not in a position to say that they were complete. He also thanked the Accountancy Services Manager for work undertaken.

In scrutinising the Report and Action Plan Members raised the following main questions and issues -

1. A Member expressed concern that attempts to get additional temporary resources to manage the position had been largely unsuccessful due to the specific technical expertise required and very steep learning curve and yet the Director had referred to additional temporary resources being made available which did not seem to tie up.

In response the Director of Corporate Services advised that previously posts had been advertised externally and had been unsuccessful. This time internal resources would be reorganised so that resources could be diverted to address high priority work which may have an effect on other units. An approach would be made to an Agency with a view to securing an additional member of staff, but it may be difficult to get someone who was suitably qualified and conversant with the Council's systems. CIVICA had offered additional resources but that had been delayed because their consultant was on sick leave.

2. A Member made reference to background information report (i) (FS.39/04), commenting that the SAS 610 Statement attached thereto was not the amended version which had been circulated and considered at Corporate Resources Overview and Scrutiny Committee on 22 November 2004 and at the City Council on 23 November 2004. The main difference related to the section concerning quality of supporting working papers/audit information.

That point was pertinent since Members had varying degrees of knowledge, were not professionals, and had to rely upon senior Officers' advice. The Member quoted from the Minutes of the meeting of Corporate Resources Overview and Scrutiny Committee held on 22 November 2004 and said that Members had been given the impression from the Audit Commission Report that the unadjusted misstatements identified by the Audit Commission were not of great import and would be corrected where appropriate in the 2004/05 financial statements.

Members had relied upon the information provided to them and what was minuted at meetings as regards the unadjusted misstatements and bank reconciliation and Members had been concerned to learn of the current position.

In conclusion the Member sought assurances because her confidence had been shaken.

In response the Director of Corporate Services apologised that the amended version of the SAS 610 report had not been circulated.

It was fair to say that the Audit Report treated the unadjusted misstatements as non-material. The non-material misstatements had now been adjusted and would have no ongoing effect. She hoped that the Action Plan before Members would go some way to restoring their confidence.

3. A Member questioned the authority's governance arrangements. Joint Management Team had on 23 December 2004 considered the Annual Audit and Inspection Letter for 2003/04 and the issues identified should have been picked up but were not. The Executive was in charge and it was entirely unsatisfactory that the Accounts Committee was now in the position of having to sort out errors spanning four years. Parts of the reports were patronising and it was not Members' job to keep the accounts and ensure that they were properly prepared. The Member stressed that she would not be a party to that.

Another Member indicated that he could not agree with the statements made by the Member and did not consider apportioning blame to the Executive to be helpful. The seriousness with which the Audit Commission viewed the misstatements had been underestimated, but Members should not over react either way.

The Portfolio Holder for Finance and Resources indicated that he had some responsibility for finance and wished to respond to the criticisms made by the Member at 3. above.

The Portfolio Holder quoted from the 2003/04 Annual Audit and Inspection Letter dated December 2004 which stated –

- The Council's financial standing is currently soundly based.
- Improvements had been secured in a number of areas during that year.
- The Council had made progress in clarifying the roles and operating arrangements for Executive and Scrutiny functions.
- Progress had been made in the performance management of large scale projects.
- The Council's overall financial standing is currently healthy.
- We have not identified any significant weaknesses in the overall control framework other than the failure to complete the bank reconciliation.
- Our review found Internal Audit arrangements to be substantially compliant with standards set out in CIPFA's Code of Practice for Internal Audit and other good practice measures.
- We have not identified any significant weaknesses in the standards of financial conduct and your arrangements to prevent and detect fraud and corruption.

The Portfolio Holder added that an unqualified opinion had been received in December 2004 and he would have read that as acceptable.

Ms Daley responded by referring to page 7 of that Letter "For a second year we have experienced delays in receiving proper explanations for entries in the accounts and there were a significant number of adjustments necessary to the accounts to enable us to give our opinion." She had reflected that the financial standing of the Council was sound but, in terms of financial governance in December 2004, she was raising problems.

4. A Member referred to points 8 and 9 of the Action Plan which stated that Senior Management Team (SMT) and the Strategic Financial Planning Group (SFPG) would regularly monitor the audit process. He had understood that the Accounts Committee had been established to undertake a monitoring role.

He further questioned the role of the Executive since there appeared to be no mention of that. Also Joint Management Team was a closed meeting which other Members could not attend.

The Director of Corporate Services replied that the SFPG was an advisory body, the terms of reference for which was as detailed in the Medium Term Financial Plan approved by Council.

The Leader added that briefings on financial matters were provided through the SFPG to the Portfolio Holder and other Executive Members, together with Senior Management Team, throughout the year.

Joint Management Team was a briefing for Executive Members. Tina Meyer and Keith Power from the Audit Commission had attended on 23 December 2004 and proceedings were as detailed in Minute JMT.203/04, a copy of which had been circulated.

The Leader considered that the political oversight on the Council's accounts for 2004/05 was the responsibility of the Corporate Resources Overview and Scrutiny Committee, rather than the Executive. The Executive and Portfolio Holder would, however, monitor the Action Plan to ensure that it was implemented.

Another Member questioned whether that amounted to a duplication of effort. The Chairman suggested that Officers come back with clarification on that point.

The Director of Corporate Services added that SFPG had no decision making powers and therefore could not monitor the Action Plan from a corporate governance point of view.

A Member queried the point that the Leader appeared to be stating that the Corporate Resources Overview and Scrutiny Committee was responsible for the problems when the former Chairman of that Committee could not defend himself. Joint Management Team on 27 October 2005 had received an update on the final accounts and yet six months elapsed before the first meeting of the Accounts Committee was called. Another Member expressed his disagreement with those sentiments.

In response the Leader said that he was not apportioning blame, but merely pointing out that Corporate Resources Overview and Scrutiny Committee had had the opportunity to raise issues and questions. The position was serious and all Members had a responsibility to take the issues on board.

The Member reiterated her previous grave concerns which she considered was also a matter for the Executive.

5. A Member referred to the Action Plan, item 12 concerning weaknesses found with the quality of supporting documentation and review for journal entries. That was deemed to be of 'low' risk yet the inference in the Audit report was that they were significant issues.

In addition, the Member had real concern that the Auditors considered little progress had been made in addressing the shortcomings in accounts preparation, there would be an additional charge imposed, the Council required to demonstrate proper stewardship and the CPA scoring for next year could be affected.

Mr Heap clarified that his report, copies of which had been tabled, was no more or less than a commentary report detailing his feelings as at 15 February 2006. Part of the Action Plan was to address issues raised. He would not be in a position to quantify the additional fee until the audit was substantially complete and he had given an Audit Opinion.

The Director of Corporate Services stated that item 12 related to journal entries which was an accounting term. That had been reviewed and the level of risk was deemed to be 'low' because no specific issues had been raised in respect thereof.

6. A Member sought and received an assurance that a quality check of the working papers would be undertaken independently by a senior member of the finance team.
7. A Member expressed concern that the 2003/04 Annual Audit and Inspection Letter (dated December 2004) had not been reported to Corporate Resources Overview and Scrutiny Committee until 23 February 2006.
8. A Member referred to item 19 of the Action Plan which stated that the Use of Resources Action Plan would be finalised and monitored/implemented following receipt of the Audit Commission's judgement on the Use of Resources due in March 2006. She was concerned to ensure that was done.

Ms Daley advised that the item 19 and the issues which she had identified should be incorporated within the Action Plan.

9. Referring to item 20 of the Action Plan concerning the customer advice centre, a Member sought and received an assurance that information had been passed to the Audit Commission in February 2006.

The Chairman sought clarification from the Auditors of the process now to be followed with regard to the Accounts and whether they would submit a report to a future meeting of the Committee; and also whether they were happy for

the Action Plan to be approved, subject to amendments identified by Ms Daley in her statement to the Committee.

Mr Heap replied that it was up to the Committee, but he would at least like to correspond with the Chairman. Ms Daley confirmed her agreement with the latter question.

The Director of Legal and Democratic Services stated that it was his understanding that a further meeting of the Committee would be required to 'sign off' the accounts.

RESOLVED – (1) That the further details provided and the progress made on the issues raised by the Audit Commission be noted.

(2) That the Statement of Accounts Action Plan be approved, subject to the amendments identified above.

AC.12/06 BANK RECONCILIATION – PROGRESS REPORT

Pursuant to Minute AC.6/06 the Director of Corporate Services presented Report FS.49/05 updating Members on progress with the bank reconciliation system.

The Director reported on the background to the matter and audit progress to date, commenting that the 2004/05 reconciliation had been presented to the external auditors in July 2005 and audit work commenced on that version. Following discussions on format, the format was revised in August and resubmitted to the Audit Commission (Appendix A).

In October the auditors concluded, after acknowledging the considerable effort on both sides, that the reconciliation produced was unauditable. Agreement was reached that a manual version would be produced and that was done in October (Appendix B) but unfortunately did not fully balance and remained unreconciled by a few pence.

In January 2006, a fully balanced reconciliation was produced for the 21 month period 1 April 2004 to 31 December 2005 i.e. including the whole of the 2004/05 period (Appendix C). That was presented to the auditors but as yet no feedback had been received as to whether it provided them with the assurance sought.

The January 2006 reconciliation was underway but had not yet been fully balanced as the priority for the available resources was being devoted to providing further assurance to the Audit Commission. In addition to checking on the bank reconciliation the Audit Commission was reviewing the work carried out by Internal Audit during 2004/05 on the core financial systems. Those reports had been submitted to the Audit Commission in May 2005, and it was hoped that their review thereof would provide additional assurance that there were no material weaknesses elsewhere in the Council's internal control systems.

No feedback had been received to date as to whether adequate assurance had now been provided.

Throughout the period considerable effort had gone into trying to resolve the problem and the Audit Commission had recognised the considerable effort applied to the issue.

It should be noted that the Authority had never before had problems with its bank reconciliation, and the problems currently encountered related entirely to the implementation of the new Financial Information System. The supplier had recognised that fact and made available additional resources to help with the backlog and also to help develop the rest of the Financial Information System as that had been delayed pending the resolution of the bank reconciliation issue. In addition, Members had been made aware of the problems encountered.

The Director reported that as much evidence as was considered possible had now been provided to the Audit Commission in order to give them assurance that the system was robust, feedback upon which was awaited.

The supplier had recently undertaken a review of the Council's operation of the system to identify areas for future improvement and a meeting had taken place on 27 February 2006 to progress that. Other authorities were known to use the system successfully, although they had commenced such use after the system reporting problem had been fixed. The one other authority that had implemented the system to the same timescale as Carlisle did not succeed in reconciling its system fully for 2004/05 (a situation accepted by its external auditors, subject to further assurance being provided in the current year).

A further issue raised by the Audit Commission was the format of the new reconciliation. It was accepted that the format of the new system reconciliation was completely different from a traditional bank reconciliation format and ongoing discussions were taking place to agree what format would be acceptable to them.

In addition, a draft Bank Reconciliation Template had been prepared, copies of which had been circulated to Members.

Mr Heap reminded the Committee that he had, on 15 February 2006, explained that the Audit Commission had continued to accept submissions from the Council regarding its bank reconciliation and had undertaken further audit work and testing to try to gain necessary assurances.

His opinion would be given following formal consultation with Audit Commission technical support staff and review by an independent Auditor. That process was underway and he would advise on the outcome at a later date.

Mr Heap stressed that, although the position was not yet clear, there was a danger of a qualified opinion being given.

Mr Heap referred Members to paragraphs 2.7 and 3.1 of the report which implied that a balanced bank reconciliation had been produced for the whole of 2004/05. He did not consider the information provided in July 2005 to be a satisfactory bank reconciliation.

Referring to paragraph 3.3 of the report, he again stressed that the issue was not about a few pence, rather the possibility remained that it could disguise a far larger error on either the income or expenditure side. He could not allow those issues to go without challenge.

The Director of Corporate Services accepted that the Audit Commission's view differed from her own. In response to a comment made by a Member the Director said that her report was factual and there was no intention to shift blame onto others.

In response to questions, the Director advised that a fully balanced reconciliation had been produced for the 21 month period 1 April 2004 to 31 December 2005 upon which feedback from the auditors was awaited. A backlog had occurred due to system problems and that had proved difficult to address. Officers were, however, now on top of the backlog.

The supplier had accepted problems with the system and agreed to continue providing support. The results of the audit were not to hand because the person concerned was currently off sick. The consultants would come back on site and progress would be included within the Action Plan.

A Member asked whether a qualified opinion for 2004/05 would result in qualified opinions in future years.

Mr Heap said that it was difficult to say and depended upon what was going through the Council's accounts. A qualified opinion would not make matters any easier. Ms Daley added that in theory a bank reconciliation problem would carry forward until the issues were resolved. A qualified opinion could be given in 2004/05 and an unqualified opinion in 2005/06 provided the problems had been addressed.

A Member asked whether the Council had procured an unsatisfactory financial information system and whether there was any recourse open as a result thereof.

The Director advised that recourse had been considered. However the suppliers had resolved the problems in June 2005 and considered the system now to be working. They were providing assistance in clearing the backlog and she did not feel that it would be helpful to start a dispute at that stage. It would be impossible to undertake a manual reconciliation covering the past two years. Every avenue would be explored to try to resolve the matter.

The Chairman asked Mr Heap when he would anticipate that the Committee required to meet again.

Mr Heap hoped to resolve matters during March 2006, although that could not be guaranteed due to ongoing work.

RESOLVED – (1) That Report FS.49/05 be noted.

(2) That a further meeting of the Committee be convened following feedback from the Auditor.

[The meeting ended at 3.45 pm]