CORPORATE GOVERNANCE PANEL 12TH DECEMBER 2012

FINAL AUDITORS REPORT – FINAL ACCOUNTS 2011/12
(Report by the Head of Financial Services)

1. PURPOSE

1.1 At the conclusion of each audit the external auditor issues an ISA 260 report for the panel to consider. It ensures that the Panel are made aware of any concerns the auditors have, provides their view on "economy, efficiency and effectiveness" and explains any "uncorrected misstatements".

2. BACKGROUND

2.1 The Panel is designated as "those charged with governance". Members will recall that at the meeting of the 25th September they received a draft ISA 260 that informed them of issues pertaining to the audit of 2011/12 statement of accounts. However, at that time the audit was not complete and once the audit was complete, "those charged with governance" are required to approve the final ISA 260 auditors report.

3. RECEIVING THE AUDITORS REPORT (ISA 260 REPORT)

3.1 On the 26th October 2012 the auditors signed the 2011/12 Statement of Accounts and have now issued their final ISA 260 report. This will be presented to the meeting by the Council's external auditors, PricewaterhouseCoopers LLP and is attached as Annex A.

3.2 There have been a number of amendments between the draft ISA 260 that was reported to members in September and the final ISA 260; the two amendments of significance are:

- **Other accounting issues: Valuation of inventories (Page 14).** Notification that inventories are valued using an approach that is not compliant with the Code of Accounting Practice. However, as the valuation is not material, there is no material misstatement; although it is recommended that management review this policy.

- **Judgements and accounting estimates: Provision for bad debts (page 16)**
  Notification that there is “potentially” £0.827m in debt that is irrecoverable because it is more than 5 years old but it is correctly provided for by a bad debt provision. However, the majority of this debt relates to housing benefit and is being recovered by instalments, although over a very long time scale. Recommended that management regularly review “older debts” for that which is recoverable and that which should be written off.

3.3 Following the audit of the 2011/12 Statement of Accounts, the auditors have made 21 separate recommendations and in all respects these have been accepted by management. A detailed action plan is shown at Annex B. With regard to the “journal review”, the first recommendation in Annex B, a review has been undertaken and the conclusions are noted in Annex C.

4. RECOMMENDATIONS

4.1 It is recommended that the Panel:

- approves the final Auditor’s ISA 260 report (Annex A), and

- notes the action plan for dealing with the recommendations made by the external auditor.

BACKGROUND INFORMATION
Final Accounts and Working Papers held in the Accountancy Section

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ANNEX B

Action Plan for Recommendations within the Final ISA 260 Audit Report					
Rec Number	**Page Number**	**Section**	**Recommendation**	**Proposed Action**	**Deadline for Completion**
		Audit approach			
1	6/7	Management override of controls	Review the process for journal authorisation and consider whether adequate procedures are in place to provide assurances that journals made to the ledger are correct and appropriate.	Review the journals undertaken throughout the year and analyse their "aggregate value" to determine if there is an appropriate threshold whereby management consider that segregation of duties should be introduced. The conclusions of this review are shown at **Annex C**	Completed Re-review November 2013
2	9/10	Property, Plant and Equipment	Review the instructions to the external valuer.	When procuring valuer services for 2012/13 closure, ensure that the instructions given comply with the Code of Practice for Local Government.	February 2013
3	9/10		Maintain a rolling programme of revaluation to ensure all assets are covered over an appropriate period.	The Code of Practice for Local Government permits a rolling programme that can cover up to a 5-year period. A rolling programme will be developed that ensures that all	February 2013

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Rec Number	Page Number	Section	Recommendation	Proposed Action	Deadline for Completion
				assets are revalued at least once within this period.	
4	9/10		Ensure all assets of a category of asset are revalued in the same year.	Ensure that the asset register is accurately maintained for asset categorisation. When valuer services are procured, that they value all assets within an asset category.	February 2013
5	9/10		Periodic review for physical verification of assets.	Introduce a 6-monthly verification of a sample of property, plant and equipment.	March 2013
6	9/10		Annual impairment review for all categories of asset.	When valuer services are procured, ensure that an impairment review of all categories of assets is undertaken.	February 2013
7	9/10		Annual review of useful economic lives.	When valuer services are procured, ensure that the economic lives of all categories of assets are reviewed.	February 2013

Action Plan for Recommendations within the Final ISA 260 Audit Report					
Rec Number	**Page Number**	**Section**	**Recommendation**	**Proposed Action**	**Deadline for Completion**
8	10	Code Changes and IFRS	Develop procedures and working papers to assist in the preparation and audit of the financial statement.	To meet this audit recommendation, the following are to be undertaken: • Training on the Statement of Accounts for all Finance Staff. • Training on what constitutes "good working papers". • Provide budget holder training to ensure that year-end closure processes within departments are efficient and effective. • Conduct a process of "lessons learnt" with finance staff. • Ensure accounts closure working practices reflect materiality. • Review general ledger and financial reporting processes to ensure that information is effectively held within the financial management system (general ledger) and is effectively reported.	Completed December 2012 February 2013 November 2012 November 2012 January 2013

Action Plan for Recommendations within the Final ISA 260 Audit Report					
Rec Number	**Page Number**	**Section**	**Recommendation**	**Proposed Action**	**Deadline for Completion**
		Significant audit and accounting matters			
9	11	Related Party Transactions	Review processes and procedures for the identification of related party transactions.	There have been some recent "statutory" changes to the Register of Interests. It is proposed that a process is put in place that more heavily relies on what members and officers record through this registration.	March 2013
10	12	Segmental Reporting	That one common report is used in the production of financial information for the financial statements.	Reporting arrangements for financial information to support the production of information for the statement of accounts will be reviewed.	March 2013
11	13	Capital Accounting: Valuation of land and buildings	The Authority: • reviews: their policy for the revaluation of property, plant and equipment and confirms that it is fit for purpose.	The policy will be reviewed as part of the annual process of reviewing all accounting policies prior to the financial year end. There will be a report to the March Panel on Policies	March 2013

Action Plan for Recommendations within the Final ISA 260 Audit Report					
Rec Number	**Page Number**	**Section**	**Recommendation**	**Proposed Action**	**Deadline for Completion**
				for the 2012/13 closure.	
---	13		• maintains a rolling programme for the revaluation of assets that ensures that the financial statements are free from material misstatement.	A rolling programme of revaluation will be introduced (see Rec 3 above).	February 2013
---	13		• Provides adequate instructions to the external valuer about the properties it requires revaluations for.	The instructions to valuers will be reviewed and enhanced where necessary (see Rec 2 above).	February 2013
12	13		• Ensures that all assets within a category are revalued.	The assets categorisation will be agreed with the external auditors and when instructions are given to the valuer, all similarly categorised assets will be reviewed.	February 2013
13	13		• Requests that the valuer performs work to ensure that the rest of the portfolio is not materially misstated.	This will be incorporated into the valuer's instructions (including an impairment review).	February 2013
14	13		• Requests that the valuer is explicit of the need to set out their methodology, key	This will be incorporated into the valuers instructions	February 2013

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			assumptions, independence and professional requirements.		
15	13		• Reviews the information received from the external valuer in detail and confirms that it complies with the instructions and is complete before processing within the financial statements.	A working paper will be developed that ensures that information received complies with the valuer's instructions.	April 2013
16	13	Capital Accounting: Valuation of vehicles, plant and equipment	An annual impairment review be undertaken to establish if these assets remain operational or reflective of their historic cost valuation.	All such assets will be reviewed to ensure they remain operational and that their valuation is still valid.	April 2013
---	13/14		Undertake a physical verification of these assets to ensure their existence.	See Rec 5.	March 2013
---	14	Capital Accounting: Depreciation and amortisation	Undertake an annual review of useful economic lives to ensure that they remain appropriate for the asset concerned.	See Rec 7.	February 2013

Action Plan for Recommendations within the Final ISA 260 Audit Report					
Rec Number	**Page Number**	**Section**	**Recommendation**	**Proposed Action**	**Deadline for Completion**
17	14	Valuation of Inventories	The Authority is using a non-compliant approach to valuing inventories, this policy should be reviewed.	Review the instructions to the Council's stock assessor to ensure that the valuation undertaken is compliant with the Code of Practice. It should be noted that as the 2011/12 valuation is not material, it will not be necessary to "restate".	February 2013
18	14	Estimated economic useful lives of property, plant and equipment and intangibles.	The Authority should continually reviews its policy of not depreciating additions and enhancements in the year of acquisition.	This will be reviewed as part of the annual review of policies, with the development of an accounts closure working paper that will demonstrate the current policy does not materially misstate the statement of accounts.	March 2013
19	16	Provision for bad debts.	The Authority should: • Introduce a policy for the impairment of accounts receivable (bad debt provision).	A policy of impairment will be developed and implemented.	December 2012
20	16		• Review and update as necessary the basis for providing for bad debts.	The basis of calculating bad debts will be reviewed to ensure that it is reflective of both the debt type and age profile.	December 2012

Action Plan for Recommendations within the Final ISA 260 Audit Report					
Rec Number	**Page Number**	**Section**	**Recommendation**	**Proposed Action**	**Deadline for Completion**
21	16		• Undertake a regular review of “older debts” to ensure that they remain recoverable.	A 6-monthly review of “old debts” will be undertaken to ensure that they remain recoverable.	December 2012

ANNEX C

REVIEW OF JOURNAL AUTHORISATION

1.0 PURPOSE

1.1 To undertake a management review of the use of accounting journals and to determine if the current authorisation framework is adequate.

2.0 CURRENT JOURNAL AUTHORISATION FRAMEWORK

2.1 The current journal authorisation process is that journals, irrespective of value, can be produced and posted to the general ledger by all officers within Accountancy Services, regardless of their seniority, qualifications or experience. This approach has evolved because management consider there is a “low risk” of the journals materially affecting the accounts or providing an opportunity for covering up a fraud:

- All staff are suitably qualified and experienced and therefore understand the purpose of accounting journals and the need for accuracy.
- The accountancy team provides a comprehensive budget monitoring process that regularly consults with member and budget managers/holders; therefore the risk of an erroneous journal not being identified is considered minimal.
- The finance system, of which journal processing is a constituent part, is subject to regular audit review; either by external audit as part of their programme of systems review or by internal audit as part of their continuous auditing programme.
- Whilst an incorrect journal could be used to cover up a fraud on a temporary basis this would require collusion between the accountant and another employee with access to relevant systems. Any particularly vulnerable areas will have additional controls.

3.0 USE OF JOURNALS

3.1 During 2011/12 there were 2,484 journal sheets processed and these were a mix of “cash” and “general ledger” journals (856 and 1,628 respectively).

3.2 Cash journals are an integral part of the Council’s bank reconciliation process. The control around their use is effectively “self-regulated” because if they were used incorrectly, the general ledger would not reconcile to the bank account (i.e. there would be an imbalance). In addition, there is also a suite of controls surrounding the authorisation of the bank reconciliation that provides management with further assurance in the processes involving cash management.

3.3 General Ledger journals are used for either in-year or year-end budgetary control/financial reporting activity; they are a business critical process that aids accurate financial management.

3.4 In any financial year, there are 13 accounting periods; Periods 1 to 12 being the main accounting period of the year and Period 13 being the period after the financial year end.

3.5 Table 1 below shows that there are, in total, a higher number of journals processed during the financial year but their average value is significantly less than those processed during accounts closure. The main reason for this is because during accounts closure the Council has to make statutory accounting adjustments and these can be of material value.

Table 1	**Number and Value of General Ledger Journal Sheets Processed in 2011/12**			
	Number of Journals	**Aggregate Value £m**	**Average Value per Journal £000**	**Net-Value Range of Journals £m**
Periods 1 to 12	1,131	495	438	0 to 57
Period 13	497	444	894	0 to 88
All Periods	**1,628**	**940**	**578**	**0 to 88**

4.0 REVIEW OF POTENTIAL JOURNAL THRESHOLDS

Cash Journals

4.1 As noted in paragraph 3.2, the cash journals are an integral part of the control framework within the bank reconciliation process. As such it is considered that there is no advantage in introducing further journal control.

General Ledger Journals

4.2 Considering the findings in Table 1, any assessment of journal thresholds should be centred on the requirements of accounts closure. One of the main thresholds used by external audit in determining whether the statements of accounts gives a “true and fair view” is whether the accounts are “materially misstated”. It is therefore suggested that this is the primary threshold to be tested, by way of example for 2011/12 this would have been in the region of £0.850m.

4.3 The number of journal sheets with a value greater than the average of £0.850m is 88; this represents only 5.4% of all general ledger journals.

4.4 If 10% sensitivity was applied to the £0.850 materiality threshold, Table 2 clearly shows that there would be little or no change in the number of journal sheets requiring authorisation. Therefore, £0.850m represents a fair threshold.

Table 2	Sensitivity Analysis of 10% Change in £0.820m Materiality "Journal" Threshold			
	Number of Journals	Decrease in Number of Journals	Increase in Number of Journals	Comments
10% increase to £0.935m	87	1	0	Marginal Change
10% decrease to £0.765m	88	0	0	No Change

4.5 Of the 88 journal sheets that exceed the £0.850m threshold, 25 (28.4%) are system generated (i.e. by feeder systems such as payroll and cash receipting) and 63 (71.6%) are generated by officers within the Accountancy Team.

4.6 Covering all of 2011/12, the range in value of journal sheets currently self-authorised by officers within the Accountancy Team is as follows:

- Principal Accountant or higher: £ 2m to £245m
- Senior Accountant: £ 50m to £177m
- Accountancy Assistant: £ 1m to £120m

4.7 Of the three levels of officer within the Accountancy Team, the Principal and Senior Accountants are expected to have considerable finance experience prior to appointment, whereas Accountancy Assistants could have limited finance experience (which might not be specifically accountancy related).

4.8 It is therefore considered that there is a potential risk in permitting Accountancy Assistants to authorise journals that exceed the materiality threshold and thus the external auditors "true and fair view" conclusion on the statement of accounts.

4.9 By introducing an authorisation threshold of £0.850m for this level of accountant would award a fair level or protection for both the officers concerned and the Council without introducing a control that would negate operational efficiency as, based on 2011/12, only 18 journal sheets would be subject to this secondary authorisation (this represents 1.1% of all general ledger journals processed in 2011/12).

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5. SUMMARY OF REVISED JOURNAL AUTHORISATION THRESHOLDS

For 2012/13 it is intended that:

1. All cash journals supporting the bank reconciliation do not require secondary authorisation.

2. All general ledger journals with a net value:

   - exceeding £0.850m that are produced by:
     - an Accountancy Assistant, are to be authorised by a Principal Accountant or more senior officer within the Accountancy Team.
     - a Senior Accountant or more senior officer are delegated to self-authorise.

   - below £0.850m, Accountancy Team officers are delegated to self-authorise.

A review will be undertaken in Autumn 2013 in the light of the audit of the accounts to ensure that this approach continues to be reasonable.