



INFRASTRUCTURE, GOVERNMENT AND
HEALTHCARE

Telford and Wrekin Council

Interim Audit Report 2007/08

June 2008

AUDIT

The contacts at KPMG in connection with this report are:

Michael McDonagh
Partner
KPMG LLP (UK)

Tel: 0121 335 2440
Fax: 0121 232 3578
michael.a.mcdonagh@kpmg.co.uk

Andrew Cardoza
Senior Manager
KPMG LLP (UK)

Tel: 0121 232 3149
Fax: 0121 232 3578
andrew.cardoza@kpmg.co.uk

Tim Pearce
Manager
KPMG LLP (UK)

Tel: 0121 232 3149
Fax: 0121 232 3578
timothy.pearce@kpmg.co.uk

Peter Evans
Assistant Manager
KPMG LLP (UK)

Tel: 0121 232 3694
Fax: 0121 232 3578
peter.evans@kpmg.co.uk

1 Executive summary 2

- 1.1 Scope of this report
- 1.2 Summary of findings
- 1.3 Acknowledgements

2 The accounts production process 3

- 2.1 Background to the changes in accounting requirements
- 2.2 Changes in accounting requirements for 2007/08
- 2.3 Single Status

3 The control environment 5

- 3.1 Financial controls
- 3.2 Assessment of the internal audit function

4 The Authority's financial position 8

A. Action plan 9

This report is addressed to all the members of Telford and Wrekin Council ("the Authority") and has been prepared for the sole use of the Authority. We take no responsibility to any officer or member acting in their individual capacities, or to third parties.

Any party other than the Authority that obtains access to this report and chooses to rely on it (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Authority.

The Audit Commission has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Mike McDonagh, who is the engagement partner to the Authority, on 0121 335 2440 or by email at michael.a.mcdonagh@kpmg.co.uk. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, email trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Team, Nicholson House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SU or by e mail to: complaints@audit-commission.gov.uk. Their telephone number is 0117 975 3131, textphone (minicom) 020 7630 0421.

Executive summary

1.1 Scope of this report

This report summarises the findings of our planning and interim audit work at Telford and Wrekin Council (“the Authority”).

A significant proportion of our accounts audit work is completed before we receive the Authority’s financial statements. In particular, our work to date covers the following three areas.

- 1. Audit planning:** We have held discussions with officers to identify the main risks over the accounts process. The main areas identified were changes to accounting standards and the implementation of Single Status. We have set out our current understanding of these risk areas in section 2 of this report.
- 2. Controls testing:** We have performed testing on controls over the core financial systems, including IT general controls. We rely on the work of Internal Audit wherever possible, and also complete an assessment of the internal audit function as part of this work. We have reported our findings in section 3 of this report.
- 3. Understanding year end balances:** We audit some areas of the accounts by gaining an understanding of the factors which influence them; this enables us to predict the year end values. We also consider the Authority’s financial position as part of this work, and have commented on this in section 4 of this report.

We have commented by exception on each of these areas where we have issues to raise.

1.2 Summary of findings

Audit planning – risks in the accounts production process

We have held initial discussions with officers on the changes in accounting requirements which are being introduced in 2007/08. These include the introduction of a Revaluation Reserve for fixed assets, new standards on accounting for financial instruments (which include cash, investments and loans) and the new requirement to prepare an Annual Governance Statement.

Officers have made good progress in considering the actions which will be needed to address these changes. However, we cannot provide feedback that all the changes have been dealt with correctly until we have reviewed the detailed workings as part of our final accounts work.

As part of our planning work, we also reviewed the Authority’s 2006/07 accounts to consider how the previous year’s accounting changes were implemented. We specifically considered the Statement of Total Recognised Gains and Losses (STRGL), which was a new requirement in 2006/07 and was problematic for a number of Authorities. We identified a reconciling difference in the STRGL which will need to be investigated and may need to be adjusted for as part of the 2007/08 accounts. The issue is explained further in section 2 of this report.

The control environment

Based on our work to date, the Authority has generally sound financial controls. We have made three recommendations which would further strengthen the control environment.

We have also assessed the internal audit function against relevant standards and confirmed overall compliance.

The Authority’s financial position

The Authority has a clear risk assessment process in place to determine the level of reserves which it needs. This is a sound process and is also beneficial to members in that it communicates clearly the reasons why a given level of reserves is felt to be needed. Where in some cases the financial impact of a risk is difficult to quantify, officers make assumptions to ensure that some provision is made where appropriate – for example, in relation to Single Status which is an area where developments are ongoing.

Executive summary

1.3 Acknowledgements

We would like to take this opportunity to thank officers and members for their help and co-operation throughout our work.

Report timetable:

Stage	Date
Formal draft issued	23 May 2008
Authority comments received	13 June 2008
Revised draft issued	20 June 2008
Authority comments received	26 June 2008
Final report issued	30 June 2008

The accounts production process

2.1 Background to the changes in accounting requirements

In our 2007/08 Annual Audit and Inspection Plan, we noted that the key issue for the 2007/08 accounts is the need to comply with changes to the SORP which take effect this year, since these will have a significant effect on the accounts. This follows on from 2006/07, when there were also substantial changes in accounting requirements.

As part of our planning work, we have carried out a desk-top review of the Authority's 2006/07 accounts, with a particular focus on how the 2006/07 SORP changes were implemented.

One of the changes to requirements in 2007 was the requirement to compile a Statement of Total Recognised Gains and Losses (STRGL). The purpose of this statement is to summarise all changes to the Authority's net worth, bringing together transactions in the Income and Expenditure Account (I&E) with other gains and losses, such as revaluation gains, which do not appear in the I&E. Many authorities found the process of compiling the STRGL was very challenging.

The table below summarises the position shown by the STRGL and the actual movement recorded on the balance sheet. This shows that the STRGL records total gains of £29.5m, whereas the Balance Sheet only shows total gains of £0.265m. We would expect these figures to agree, so a difference of £29.235m needs to be explained.

	£000	£000
<i>Balance sheet position</i>		
Balance sheet total as at 31 March 2007:	78,666	
Balance sheet total as at 31 March 2006:	78,401	
Movement on balance sheet (increase):		265
<i>STRGL position</i>		
Total gains reconciled during 2006/07		29,500
Unreconciled difference		29,235

Whilst this is a significant adjustment to the presentation of the accounts, the correction of the difference is unlikely to affect the Authority's financial position.

Officers believe that they have identified the items which make up this difference. We are currently discussing this in order to agree the adjustments which will be required as part of the 2007/08 accounts.

2.2 Changes in accounting requirements for 2007/08

Our work on the current year's SORP changes remains in progress. We have reviewed the preparations which the Authority has made during 2007/08, but have not reviewed year end accounting entries, since the closedown process remained ongoing at the time of our work.

We intend to continue working with officers to address any queries on these accounting changes as they arise.

Introduction of the Revaluation Reserve

This change requires authorities to account for revaluations and impairments on an asset-by-asset basis. This entails additional record-keeping, since the amount by which each asset has historically been revalued needs to be recorded, and also changes year end accounting entries.

The accounts production process

We have confirmed that the asset register has been updated to accommodate the new information requirements and discussed some of the accounting implications with officers. However, because most of the accounting entries are not made until after year end, we have not been able to confirm how these changes have been implemented.

Accounting for financial instruments

This SORP change significantly alters how the Authority accounts for investments, borrowings and other financial assets and liabilities, and affects both the Balance Sheet (the classification and valuation of the items) and the Income and Expenditure Account (for example, the amount of interest payable or receivable to show in the accounts during the year). Whilst these changes are unlikely to have a substantial effect on the Authority's financial position, they will increase the amount of work needed in the accounts closedown process, particularly in this first year of implementation.

Officers are currently considering their response to each aspect of the new requirements and we have held some preliminary discussions with officers on the areas which they feel will have the greatest impact.

However, at the time of our on-site work, officers were still working through the implications of the changes in consultation with the Authority's treasury management advisors. We will follow the issue up in subsequent meetings with officers and during our final audit visit.

Introduction of the Annual Governance Statement

Since 2003, local authorities have been required to produce an assurance statement as part of their accounts. Initially, this covered only financial controls, but was subsequently expanded to cover all aspects of how the Authority achieves its objectives.

For 2007/08, the remit of the assurance statement has been expanded further to include an assessment of the effectiveness of members' roles in the Authority's governance. This therefore requires the Authority to have suitable mechanisms in place to provide assurance over these areas.

Some progress has been made to develop this. Current structures provide for informal engagement of members in the assurance framework, through the involvement of the Cabinet Member for Resources who is responsible for governance, discussions at Portfolio level (for example, where risks are discussed between the Cabinet Member and Corporate Director) and, at the end of the year, the formal sign-off of the Governance Statement at year end.

However, the Authority is already making progress to deepen members' involvement. For example, we recommended in our *Use of Resources and Data Quality Report* that the Standards and Audit Committee review its effectiveness. This review has been initiated and, additionally, a decision has been taken to amend the structures to separate the standards and audit roles into separate committees. This is, in part, triggered by the changing role of local authority standards committees, but will also strengthen the audit remit. We understand that the Authority is considering giving the new Audit Committee an enhanced role in relation to the assurance framework, which should further strengthen the review of governance underlying the annual statement.

Recommendation 1: Managing changes to the SORP

Whilst we recognise that the Authority is making progress in addressing this year's SORP changes, we would reiterate the importance of focusing on technical accounting changes in order that they are implemented correctly.

2.3 Single Status

The Authority has branded its Single Status implementation programme "Beyond Excellence Through People" (BETP). Its project plan aims to implement revised pay structures before the end of the 2008/09 financial year.

Job evaluation is now largely complete with some minor issues remaining to be resolved before detailed pay modelling commences. However, it will only be at this stage that the financial implications of the BETP programme will become known with greater certainty.

We will need to follow up progress with officers regularly through the year to determine whether the project plan is being achieved and, in particular, to discuss and agree any implications of Single Status for the 2007/08 accounts.

The control environment

3.1 Financial controls

We have reviewed the controls over the Authority's financial systems, covering both IT general controls (such as controls over access to systems and to maintain data integrity) and other aspects of the Authority's material financial processes. In the course of our work, we have identified three areas where financial controls should be further enhanced.

Reconciliation between the debtors system and cash receipting system

Internal Audit reviewed this control and identified a reconciling difference of approximately £100,000 between the two systems. Finance staff have now completed further work and reduced the reconciling difference to £7,933. Nonetheless, we would reiterate the importance of Internal Audit's recommendation that the remaining imbalance be resolved and that the reconciliation should be kept promptly reconciled in the future.

Access to the HR/payroll system

We reviewed arrangements for security to IT systems. We found that payroll users can access both payroll and HR data. This presents the risk that there may not be segregation of duties between the HR and payroll functions, and could allow "ghost" employees to be set up on the HR system and added to the payroll.

To mitigate this risk, officers produce a daily report of all changes made on the system. These are independently reviewed, and so should detect entries which are unauthorised or made in error. We tested this control and concluded that it operates effectively.

Whilst this control mitigates the risk, it would nonetheless be beneficial to address the configuration of access rights on the system; this could bring efficiencies through reducing the need for the manual control. We understand that the Authority has previously approached the system supplier, but they were not able to make this change. However, we recommend that officers again investigate whether it would be possible for the supplier to make this configuration change. Where the change could be implemented but would attract a cost, this should be compared with the benefits and savings which would arise in reaching a decision.

Recommendation 2: IT security

The Authority should discuss with its HR/payroll software supplier whether access rights to the system can be amended so that payroll staff are prevented from amending HR data. Where the change could be implemented but would attract a cost, this should be compared with the benefits and savings which would arise in reaching a decision.

Reviewing establishment lists

One of the key controls we expect to see in place over the payroll system is regular review of establishment lists. This involves managers in each area of service reviewing a list of employees provided by HR to verify that they are genuine and details are correct, and confirming this to HR staff as evidence of their review. This helps detect invalid "ghost" employees on the payroll.

In our discussions, we identified that HR staff only produce regular establishment lists for schools, and only issue them to managers in other service areas when requested. Moreover, staff reviewing the lists normally only confirm the results of their review to HR when an issue has been identified. This means that HR staff do not have assurance that the establishment has been confirmed across the Authority.

Other controls, such as budgetary control, help to mitigate this risk. However, as a good practice point, we recommend that establishment lists be issued regularly to officers covering all of the Authority's functions and that all officers confirm the findings of the review to HR staff.

The control environment

Recommendation 3: Payroll controls

Establishment lists should be issued regularly to officers across the Authority, who should formally confirm the results of their review to HR staff.

3.2 Assessment of the internal audit function

Compliance with the Code of Practice for Internal Audit

We have prepared a Joint Working Protocol in conjunction with Internal Audit which aims to facilitate our reliance on their work to avoid duplication of effort and reduce audit costs to the Authority. The Protocol has assisted us in relying on relevant Internal Audit work.

During our interim visit we have identified minor improvements to audit documentation which would further aid our reliance and have discussed and agreed these with the Audit and Risk Manager. The same documentation requirements should also be applied to audit work performed by contractors.

Standards for internal auditors in local government are set out in the *Code of Practice for Internal Audit in Local Government*, issued by CIPFA. We have reviewed the internal audit function's self assessment against these requirements and confirmed that it complies with the *Code* except in the minor respects set out in the service's action plan.

We have provided a summary of our assessment in the table below.

The standards	Commentary on the Authority's internal audit function
(1) Scope of internal audit	Internal Audit's annual plan was approved by the Standards and Audit Committee on 29 March 2007 and covers all the core financial systems. It also includes operational reviews, ICT and corporate governance.
(2) Independence	Whilst the Internal Audit function performs some operational work (for example performing credit checks on suppliers and employees applying for car loans), this is limited and does not compromise its independence. Auditors submit annual declarations of interests. The Audit and Risk Manager has the freedom to report on any matter and to any level of the Authority.
(3) Ethics for Internal Auditors	Staff are required to adhere to a Code of Conduct. Audit staff additionally submit a declaration of interests form annually.
(4) Audit committee (or equivalent)	Internal Audit reports quarterly as a minimum to the Standards and Audit Committee. This committee is to be split in 2008/09 with Internal Audit reporting to a separate Audit Committee; this will strengthen members' engagement with audit issues.
(5) Relationships with management, other auditors and other review bodies	The responsibilities and freedom to report of Internal Audit are set out in the Council Constitution. Internal Audit consult with management on timing and scope of reviews. KPMG have a documented, agreed Joint Working Protocol with Internal Audit to clarify mutual roles, responsibilities and expectations.
(6) Staffing, training and development	The internal audit function completes its work within its existing resource base, with contractors used where needed to meet skill or resource gaps. Training needs of auditors are identified through the annual Personal Performance Development (PPD) process.

The control environment

The standards	Commentary on the Authority's internal audit function
(7) Audit strategy and planning	Internal Audit's Business Plan covers a three year period. It is reviewed quarterly and refreshed annually. The Annual Audit Plan draws on the strategic and portfolio risk registers and is drawn up in consultation with Corporate Directors, Heads of Service and business unit managers.
(8) Undertaking audit work	<p>Internal Audit has two local PIs. These monitor the percentage of planned work completed and the percentage of work requested by the external auditor which has been completed.</p> <p>Internal Audit is piloting a new indicator which measures the percentage of draft reports issued within 15 days of completion of the fieldwork. We understand that this will formally become part of Internal Audit's PI set later in the current financial year.</p>
(9) Due professional care	All Internal Audit staff are appropriately qualified or training for relevant qualifications (eg. CIPFA, IIA) and therefore bound by the standards of their respective institutes. Procedures also require files to be reviewed by a Group Auditor or above, which also helps ensure that audit work is thorough and underpinned by sufficient evidence.
(10) Reporting	The Audit and Risk Manager reports to the Standards and Audit Committee quarterly as a minimum. Individual reports on reviews follow a set format and give an opinion on the adequacy of the controls operating in the system under review. Recommendations are followed up six months following issue of the report.
(11) Performance, Quality and Effectiveness	Internal Audit's quality assurance process includes appropriate review of audit work. An audit manual is available to audit staff.

National Fraud Initiative (NFI)

The NFI is led by the Audit Commission and seeks to identify fraud and error by comparing data sets across a large number of public bodies. Internal Audit lead on NFI investigations within the Authority.

We have reviewed the Authority's arrangements for NFI and found that sound processes are in place and good progress has been made in dealing with matches. However, at present, these arrangements are not formalised or documented in the Authority's Anti Fraud and Corruption policy, and recommend that this change be introduced to strengthen arrangements further.

Recommendation 4: National Fraud Initiative

The Authority should formalise its approach to the National Fraud initiative in a policy document – for example, as part of the Anti Fraud and Corruption Strategy.

The Authority's financial position

As part of our Use of Resources work in 2007, we reviewed the Authority's risk-based approach to managing its financial reserves. We assessed this as an effective approach. In particular, the risk analysis is beneficial for members, because it describes important factors which affect the Authority's financial position.

The risk assessment process determines a target level of reserves which should reflect the main risks which the Authority faces. The Authority is currently forecasting an underspend of £0.31m against its original budget, and so expects the target level of reserves to be achieved.

As noted above, however, there is considerable uncertainty over the financial impact of some risks, such as Single Status. The Authority is working to quantify the financial impact of Single Status more fully, building on the budget provision made in 2007/08 to ensure that the figures in the 2007/08 accounts and 2008/09 budget monitoring are as accurate as possible given the information available.

Given the April 2007 implementation date for the Single Status Agreement, the Authority will, as a minimum, need to apply any new pay structures back to this date, even if a further back pay liability does not arise. As such, the financial impact of the uncertainty increases over time: moving into the 2009/10 budget setting cycle, there is the need to consider the costs for 2007/08 and 2008/09, as well as the period 2009/10 to 2011/12 covered by the Medium Term Financial Plan itself.

Given that both the financial and operational impacts of Single Status will both be significant, it is important for ongoing work on implementation to inform organisational planning and to reduce the uncertainties which the organisation faces. For example, the pay scale modelling which officers have already started to undertake has the potential to inform planning, since it gives a view on the costs of each option which can be used to guide financial planning.

Recommendation 5: The impact of Single Status on service and financial planning

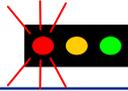
The Authority should continue to work towards implementing the Single Status Agreement. In particular, in completing this work, it should have regard to the uncertainties which Single Status creates within service and financial planning, identifying and implementing as early as possible those stages which would inform planning and help reduce these uncertainties.

We will follow up the Authority's final outturn position for 2007/08, including the impact of progress made in implementing Single Status, as part of our accounts audit later in the year.

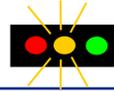
Appendix A: Action plan

Priority rating for recommendations

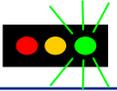
High: Issues that are fundamental and material to your system of internal control.



Medium: Issues that have an important effect on internal controls.



Low: Issues that would, if corrected, improve internal control in general but are not vital to the overall system.



Risk	Recommendation	Management response	Officer and due date
1 ● (medium)	Managing changes to the SORP Whilst we recognise that the Authority is making progress in addressing this year's SORP changes, we would reiterate the importance of focusing on technical accounting changes in order that they are implemented correctly.	To increase capacity, we are reorganising resources within Finance to bring in an additional senior accounting resource recognising the increasing requirements and workloads on the Corporate Finance team.	Head of Finance 30/09/2008
2 ● (medium)	IT security The Authority should discuss with its HR/payroll software supplier whether access rights to the system can be amended so that payroll staff are presented from amending HR data. Where the change could be implemented but would attract a cost, this should be compared with the benefits and savings which would arise in reaching a decision.	HR management agree to approach the system supplier again to discuss the issue in the context to the changes we are making to maintain the establishment control as per the response to recommendation 3 below in relation to payroll controls.	Head of HR 31/12/2008
3 ● (low)	High level controls – payroll Establishment lists should be issued regularly to officers across the Authority, who should formally confirm the results of their review to HR staff.	The Council is currently in the process of introducing a new dynamic monitoring tool to ensure that managers have access to establishment data that will be agreed and subsequently used for payroll purposes.	Head of HR 31/03/2009
4 ● (low)	National Fraud Initiative The Authority should formalise its approach to the National Fraud initiative in a policy document – for example, as part of the Anti Fraud and Corruption Strategy.	This change will be included in the update of the Anti-Fraud & Corruption Policy which is due in September 2008.	Audit and Risk Manager 30/09/2008

Appendix A: Action plan

Risk	Recommendation	Management response	Officer and due date
5 ● (medium)	<p>The impact of Single Status on service and financial planning</p> <p>The Authority should continue to work towards implementing the Single Status Agreement. In particular, in completing this work, it should have regard to the uncertainties which Single Status creates within service and financial planning, identifying and implementing as early as possible those stages which would inform planning and help reduce these uncertainties.</p>	<p>There are robust governance arrangements for the implementation of Single Status and the negotiation team includes the Heads of Audit & Democratic Services, Finance and HR amongst others. There is a Project Plan which identifies the related financial tasks and timings. These include modelling and scenarios with which the Corporate Finance team will be involved alongside union representatives and other officers. When this work commences in the next few months it will feed into the service and financial planning process as it progresses to give a firmer view of possible impacts, though the final package is unlikely to be concluded before the 2009/10 budget is set. The process over the next few months should however help to reduce these uncertainties.</p>	<p>Head of HR</p> <p>Ongoing during Single Status implementation</p>