

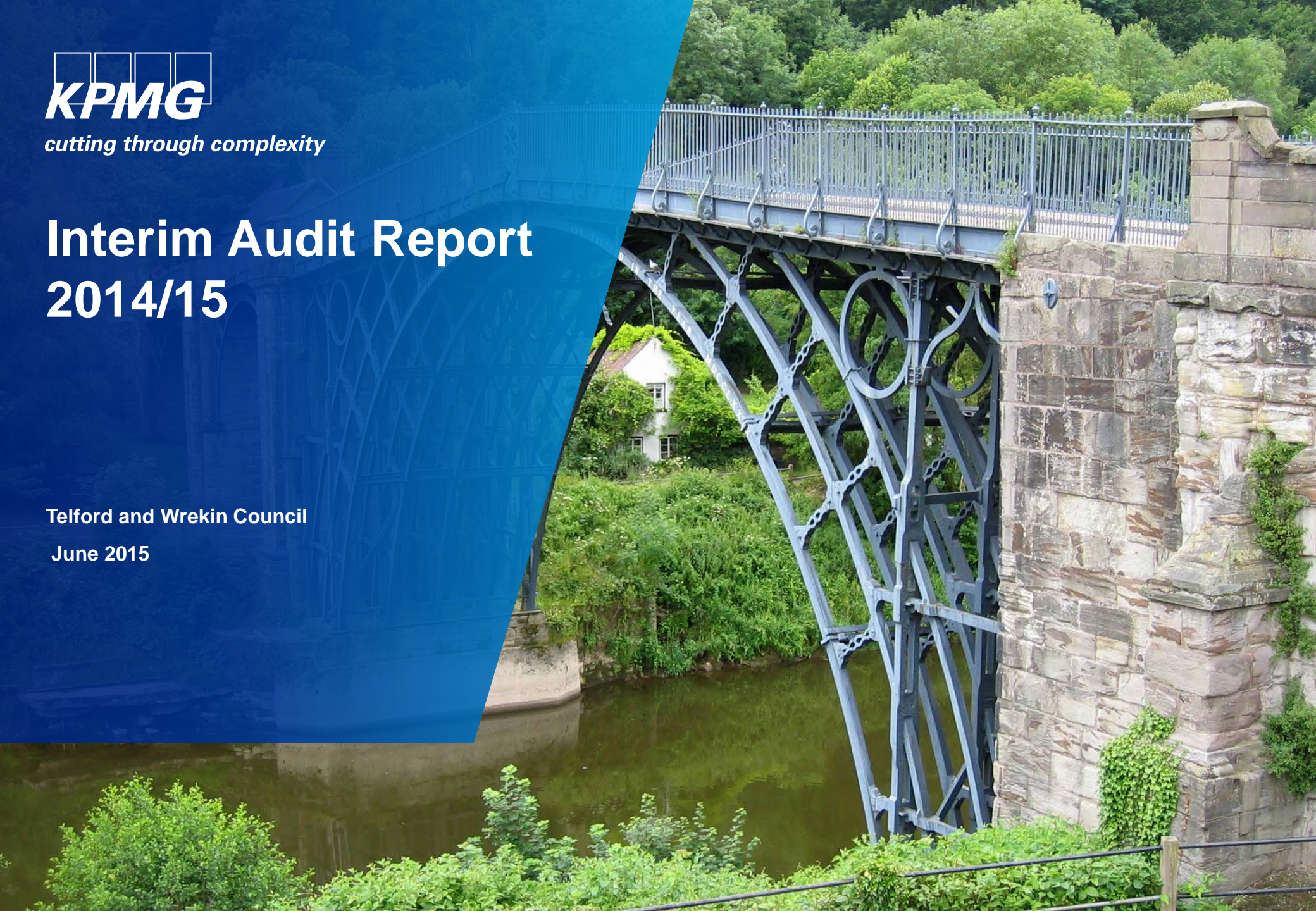


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Interim Audit Report 2014/15

Telford and Wrekin Council

June 2015



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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document which is available on Public Sector Audit Appointment's website (www.psa.co.uk).

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.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Ian Pennington, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Trevor Rees (on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3H.

This document summarises the key findings arising from our work to date in relation to both the audit of the Authority's 2014/15 financial statements and the 2014/15 VFM conclusion.

Scope of this report

This report summarises the key findings arising from:

- our interim audit work at Telford and Wrekin Council (the Authority) in relation to the 2014/15 financial statements; and
- our work to support our 2014/15 value for money (VFM) conclusion up to 31 May 2015.

Financial statements

Our *External Audit Plan 2014/15*, presented to you in January 2015, set out the four stages of our financial statements audit process.

During March to April 2015 we completed our planning and control evaluation work. This covered:

- review of the Authority's general control environment;
- testing of key controls over the Authority's key financial systems;
- assessment of the internal audit function; and
- review of the Authority's accounts production process, including work to address prior year audit recommendations and the specific risk areas we have identified for this year.

VFM conclusion

Our *External Audit Plan 2014/15* explained our risk-based approach to VFM work, which follows guidance provided by the Audit Commission. We have completed some early work to support our 2014/15 VFM conclusion.

Our *External Audit Plan 2014/15* set out the specific risks to our VFM conclusion identified at the planning stage. We have not identified any further risks up to the date of this report.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our interim audit work in relation to the 2014/15 financial statements.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1.

Acknowledgements

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

This table summarises the headline messages. The remainder of this report provides further details on each area.

Organisational control environment	Your organisational control environment is effective overall. Our work in relation to this area identified no issues to report.
Controls over key financial systems	<p>In relation to those controls upon which we will place reliance as part of our audit, the key financial systems are generally sound.</p> <p>Despite this, there are some weaknesses in respect of</p> <ul style="list-style-type: none"> ■ The formal monitoring and timely clearance of reconciling items identified by way of the monthly bank reconciliations. ■ Overpayments being made to staff ceasing to work for the Authority as a result of leaver forms not being completed on a timely basis. <p>Full details are set out page 6.</p>
Review of internal audit	<p>In relation to our work on the Authority's financial controls, we were able to place reliance upon the work of Internal Audit in those areas where we are intending to rely upon controls. Working papers produced by Internal Audit were of an appropriate standard, and were supported by the required evidence.</p> <p>However, we identified the following areas for improvement:</p> <ul style="list-style-type: none"> ■ Greater clarity and consistency is needed of sample sizes when the population consists of a number of sub-categories (i.e sampling across multiple payrolls). ■ Reminders are required in respect to ensuring a consistent file review process and recording of appropriate evidence. <p>Full details are set out page 5.</p>
Accounts production and specific risk areas	<p>The Authority's overall process for the preparation of the financial statements is adequate.</p> <p>The Authority appears to be on track with the implementation of the one recommendation made in our <i>ISA 260 Report 2013/14</i>. We will revisit this as part of our final audit work.</p>
VFM risks	<p>We have not identified any further risks in addition to those set out in our <i>External Audit Plan 2014/15</i>.</p> <p>We have undertaken initial work in relation to the risk areas identified with no issues being identified. Further work will be undertaken as part of our final audit visit.</p>

Your organisational control environment is effective overall.

Work completed

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit.

We obtain an understanding of the Authority’s overall control environment and determine if appropriate controls have been implemented. We do not complete detailed testing of these controls.

Key findings

We consider that your organisational controls are effective overall.

Aspect	Assessment
<i>Organisational controls:</i>	
Management’s philosophy and operating style	3
Culture of honesty and ethical behaviour	3
Oversight by those charged with governance	3
Risk assessment process	3
Communications	3
Monitoring of controls	3

- Key:
- 1 Significant gaps in the control environment.
 - 2 Deficiencies in respect of individual controls.
 - 3 Generally sound control environment.

Following our assessment of Internal Audit, we were able to place reliance on their work on the key financial systems.

However, we identified the following areas for improvement:

- **Clarity and consistency of sample sizes; and**
- **Quality and consistency of file review processes.**

Background

United Kingdom Public Sector Internal Audit Standards (PSIAS) apply across the whole of the public sector, including local government. These standards are intended to promote further improvement in the professionalism, quality, consistency and effectiveness of internal audit across the public sector. Additional guidance for local authorities is included in the *Local Government Application Note* on the PSIAS.

Work completed

The scope of the work of your internal auditors and their findings informs our audit risk assessment.

We work with your internal auditors to assess the control framework for certain key financial systems and seek to rely on any relevant work they have completed to minimise unnecessary duplication of work. Our audit fee is set on the assumption that we can place full reliance on their work.

Where we intend to rely on internal audit's work in respect of the Authority's key financial systems, auditing standards require us to complete an overall assessment of the internal audit function and to evaluate and test aspects of their work.

The Public Sector Internal Audit Standards define the way in which the internal audit service should undertake its functions. Internal audit last completed a self-assessment against the PSIAS for 2013-14. Since then they have been monitoring progress with the agreed action and provided us with an updated status of this plan as at March 2015.

We reviewed internal audit's work on the key financial systems and re-performed a sample of tests completed by them. We only review internal audit work that has relevance to our audit responsibilities, to effectively scope out other internal audit work from our findings. Our review of internal audit work does not represent an external review against PSIAS, as required at least every five years.

Key findings

Based on the self-assessment performed by internal audit, our assessment of their files, attendance at Audit Committee and regular meetings during the course of the year, we have not identified any significant issues which would prevent us from relying on internal audit work for 2014-15.

Based on the reports we reviewed, Internal Audit appear to be progressing well with the implementation of the agreed PSIAS Action Plan.

We did not identify any significant issues with internal audit's work and are pleased to report that we are again able to place full reliance on internal audit's work on the key financial systems.

We particularly noted improvements in terms of the rotation within the internal audit team of assignments for ongoing assurance engagements and other internal audit responsibilities.

There are, however, some improvements that could be made to further enhance the quality of internal audit's work and reduce the level of top up testing we are required to complete to satisfy our audit requirements:

- **Sampling:** Improvements in respect of sampling accuracy are required. Specifically, we found for some tests the complete population had not been used as the basis for sample selection (i.e. sampling across multiple payrolls).
- **File Review:** Our review of the bank reconciliation testing we found that supporting evidence had not been adequately obtained for reconciling items and that this had not been identified during the file review. Whilst this would appear to be an isolated issue however, enhancements to the quality and consistency of file review are required to ensure all the requisite supporting evidence for controls testing is obtained and referenced accurately on file

These areas have been discussed with Audit & Information Governance SDM and we have included a recommendation in **Appendix 1**.

The controls over the key financial systems are sound.

However, there are some specific weaknesses in respect of

- Timely clearance of reconciling items on bank reconciliation;
- Formal documentation of General Ledger reconciliations; and
- Adequacy of leaver controls and establishment checks.

We will need to complete additional substantive work in these areas at year-end.

Work completed

We review the outcome of internal audit's work on the financial systems to influence our assessment of the overall control environment, which is a key factor when determining the external audit strategy.

Where we have determined that this is the most efficient audit approach to take, we evaluate the design and implementation of the control and then test selected controls that address key risks within these systems. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Our assessment of a system will not always be in line with your internal auditors' opinion on that system. This is because we are solely interested in whether our audit risks are mitigated through effective controls, i.e. whether the system is likely to produce materially reliable figures for inclusion in the financial statements.

Key findings

Based on the work of your internal auditors, most of the controls over the key financial systems are sound.

We noted some weaknesses in respect of individual financial systems that will impact on our audit:

- **Bank Reconciliation:** The Bank reconciliation we reviewed had unreconciled balances with a value of over £30k for which there was no supporting evidence. Other months had figures in excess of this and it is not clear whether these are just monthly timing differences or persistent ongoing differences in cash balances. Reconciling items should be promptly identified cleared on a timely basis.
- **Leaver Controls:** In a number of instances leaver forms had not been completed on a timely basis. As a result of this over £38k of overpayments have been made due to late notification of leavers.

Recommendations are included in [Appendix 1](#).

We have not yet assessed all the controls over Property, Plant & Equipment and Pensions. Many of the key controls in these areas are operated during the accounts closedown process and our testing will be supplemented by further work during our final accounts visit.

The weaknesses identified mean that we will need to complete additional substantive work at year-end.

Financial system	Controls Assessment
Property, Plant and Equipment	③ - provisional
Cash and Cash Equivalents	②
Pension Liabilities/Pension Costs	③ - provisional
Non pay expenditure	③
Payroll	②

- Key:
- ① Significant gaps in the control environment.
 - ② Deficiencies in respect of individual controls.
 - ③ Generally sound control environment

The Authority's overall process for the preparation of the financial statements is adequate.

The Authority has is on track with the implementation of the one recommendation made in our *ISA 260 Report 2013/14*.

Accounts production process

We issued our Accounts Audit Protocol to Pauline Harris and Bernie Morris on 28 January 2015. This important document sets out our audit approach and timetable. It also summarises the working papers and other evidence we require the Authority to provide to support our audit work. We discussed our requirements in detail in a meeting on 28 January 2015.

We continued to meet with the Finance Manager and Finance Team Leader on a regular basis to support them during the financial year end closedown and accounts preparation.

Key findings

In our *ISA 260 Report 2013/14* we raised one recommendation in relation to the adequacy of debtors and creditors reports provided for audit purposes. As part of our interim work we specifically reviewed the Authority's progress in relation to this matter and met with key officers in order to determine a practical solution and that we are happy with the approach to be adopted. We will assess the outcome as part of our final audit work.

We consider that the overall process for the preparation of your financial statements is adequate.

Specific audit risk areas

The Authority has a good understanding of the key audit risk areas we identified and is making progress in addressing them.

However, these still present significant challenges that require careful management and focus. We will revisit these areas during our final accounts audit.

Work completed

In our *External Audit Plan 2014/15*, presented to you in January 2015, we identified the key audit risks affecting the Authority's 2014/15 financial statements.

Our audit strategy and plan remain flexible as risks and issues change throughout the year. We have now confirmed that the Group Accounting no longer applies to this year's financial statements as the subsidiary company will not be in place for 2014/15.


We have been discussing the remaining risk with the Finance Manager and Finance Team Leader as part of our regular meetings. In addition, we sought to review relevant workings and evidence and agree the accounting treatment as part of our interim work.

Key findings


Group Accounting - is no longer a key audit risk as the subsidiary company in question had not yet been set up as at 31 March 2015.

Accounting for LA Maintained Schools - we have a jointly agreed approach with the Authority to addressing the associated audit issues. This issue still presents significant challenges that require careful management and focus. We will revisit this area during our final accounts audit.

The table below provides a summary of the work the Authority has completed to date to address these risks.

Key audit risk	Issue	Progress
	<p>During 2014/15, the Authority has approved investment in a commercial project to develop housing for the private rental market. In order to facilitate this, the Authority will establish a wholly owned subsidiary which will procure the development of the housing units and be responsible for the subsequent maintenance and management.</p> <p>In the event that the subsidiary company has undertaken accounting transactions in advance of 31 March 2015, the Authority will be required to consider whether they are required to produce group accounts for the period.</p>	<p>The proposed subsidiary company was not in existence as at 31 March 2015. This is therefore no longer an audit risk for financial year 2014/15.</p> <p>No further work is required for this year's audit.</p> <p>We will revisit this matter in relation to the planning for the 2015/16 audit.</p>

Specific audit risk areas

Key audit risk	Issue	Progress
	<p>LAAP Bulletin 101 Accounting for School Assets used by Local Authority Maintained Schools issued in December 2014 has been published to assist practitioners with the application of the Code in this respect. The challenges relate to school assets owned by third parties such as church bodies and made available to school governing bodies under a variety of arrangements. This includes assets used by Voluntary-Aided (VA) and Voluntary-Controlled (VC) Schools as well as Foundation Schools.</p> <p>Authorities will need to review the agreements under which assets are used by VA/VC and Foundation schools and apply the relevant tests of control in the case of assets made available free of charge, or risks and rewards of ownership in the case of assets made available under leases. This is a key area of judgement and there is a risk that Authorities could incorrectly omit school assets from, or include school assets in, their balance sheet.</p> <p>Particular risks surround the recognition of Foundation School assets which may or may not be held in Trust. Authorities should pay particular attention to the nature of the relationship between the Trustees and the school governing body to determine whether the school controls the Trust and the assets should therefore be consolidated into their balance sheet.</p>	<p>We have jointly agreed a satisfactory approach to the accounting issues with the Authority. On this basis staff have established the position with respect to different schools and have provided working papers accordingly.</p> <p>We will review these working papers in advance of the final audit visit and provide feedback to officers accordingly.</p>

Our VFM conclusion considers how the Authority secures financial resilience and challenges how it secures economy, efficiency and effectiveness.

We follow a risk based approach to target audit effort on the areas of greatest audit risk.

Our *External Audit Plan 2014/15* describes in more detail how the VFM audit approach operates.

Background

Auditors are required to give their statutory VFM conclusion based on two criteria specified by the Audit Commission. These consider whether the Authority has proper arrangements in place for:

- securing financial resilience: looking at the Authority's financial governance, financial planning and financial control processes; and
- challenging how it secures economy, efficiency and effectiveness: looking at how the Authority is prioritising resources and improving efficiency and productivity.

We follow a risk based approach to target audit effort on the areas of greatest audit risk. We consider the arrangements put in place by the Authority to mitigate these risks and plan our work accordingly.

Our VFM audit draws heavily on other audit work which is relevant to our VFM responsibilities and the results of last year's VFM audit. We then assess if more detailed audit work is required in specific areas.

Overview of the VFM audit approach

The key elements of the VFM audit approach are summarised below.



Specific VFM risks

We identified a number of specific VFM risks at planning.

In all cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

We have undertaken some initial work to date in response these risks


Work completed


We identified a number of risks to our VFM conclusion at the planning stage and have undertaken some work to date to assess the Authority's approach to managing these risks.

Key findings

Below we set out our interim assessment of the response to these risks.

We will report our final conclusions in our *ISA 260 Report 2014/15*.

Key VFM risk	Risk description and link to VFM conclusion	Work undertaken to date and interim assessment
	<p>At the time of our audit planning the Authority was required to make savings of £17.2m in 2014/15 (including additional in year savings), and forecast showed that the Authority would have delivered these savings and achieve an underspend of £4.8m.</p> <p>The Authority estimated that £5.5m in additional savings would need to be achieved during 2015/16. We were aware the Authority was in the process of developing and agreeing proposals with Members for these savings. Further significant savings will be required in 2016/17 and 2017/18 to principally address future reductions to local authority funding alongside service cost and demand pressures. The need for savings will continue to have a significant impact on the Authority's financial resilience.</p> <p>This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion.</p>	<p>We have reviewed the Authority's Medium Term Financial Plan and Budget Monitoring processes and are now benchmarking these against peer organisations.</p> <p>As part of our final audit visit we will assess the way in which savings plans have been developed, the extent to which they are spread throughout the organisation, and the outturn delivered.</p>

Key VFM risk	Risk description and link to VFM conclusion	Work undertaken to date and interim assessment
	<p>Whilst the Authority has identified, and delivered, savings of £70.1m in response to the central government funding reductions, it has also sought to find additional sources of income. As a result of this, the Authority is pursuing the following commercial projects:</p> <p>The development of housing units for the private rental market;</p> <p>The construction of a solar farm with the resulting excess energy being sold to the National Grid; and</p> <p>Investment in a new Ministry of Defence storage and distribution depot.</p> <p>These projects are expected to generate additional income through additional council tax and non-domestic rates income, new homes bonus receipts, energy tariff proceeds, and profits from a wholly owned subsidiary established to manage the private housing scheme. In order to generate these incomes, the Authority will be required to make significant investments which will need to be recovered over a prolonged period.</p> <p>This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion.</p>	<p>Throughout the year to date we have met with key officers and management in order to monitor the progress of the commercial projects.</p> <p>As part of our final audit work we will review the way in which such projects have been approved, the returns that are expected to be generated, and the way in which such returns are monitored.</p>

Key issues and recommendations

We have given each recommendation a risk rating and agreed what action management will need to take.

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations at the end of the final audit.

Priority rating for recommendations		
<p>1 Priority one: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.</p>	<p>2 Priority two: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.</p>	<p>3 Priority three: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.</p>

No.	Risk	Issue and recommendation	Management response/ responsible officer/ due date
1	2	<p>Bank Reconciliations</p> <p>The Bank reconciliation we reviewed had unreconciled balances with a value of over £30k for which there was no supporting evidence. We understand that other months had figures in excess of this and are unclear whether these are just monthly timing differences or persistent ongoing differences in cash balances.</p> <p>This creates the risk that the General Ledger does not accurately reflect the cash position and also the risk that mis-posting, theft or loss of cash goes unnoticed for some period of time.</p> <p><i>We recommend that all reconciling items on the bank reconciliation should be promptly identified and then it should be confirmed they are subsequently cleared within a reasonable timeframe.</i></p> <p><i>The Authority should also set a threshold for the total value of reconciling items which, if breached, triggers further investigation. Compliance with this should be formally assessed as part of the review process.</i></p>	<p>The unreconciled items totalled £11.5k (0.0011% of total income) at the end of the year which was following extensive investigative work by officers. In total around £2.1bn was processed through the cash book in 14/15 which related to 433,000 transactions; the sheer volume of transactions makes it difficult to reconcile to the penny, particularly with cash in transit and other timing differences. We do appreciate that the ideal position is to have no unreconciled items at year end and a piece of work is currently underway to do a detailed review of April's transactions to check the bank reconciliation process and hopefully identify any items which could be causing a discrepancy.</p> <p>The aim is always to minimise the unreconciled amount each month and at year end. Going forward we will set a percentage limit for unreconciled totals each month (which we have discussed in principle with KPMG) and undertake further investigation if this limit is exceeded.</p> <p>Officer Responsible: Pauline Harris (Finance Manager) and Bernie Morris (Finance Team Leader)</p> <p>Implementation Date: 30 July 2015 for review 31 March 2016 for year end.</p>

Key issues and recommendations (cont'd)

No.	Risk	Issue and recommendation	Management response/ responsible officer/ due date
2	2	<p>Leaver Controls</p> <p>Through our review of the work of Internal Audit we identified that leavers notifications are not being completed and submitted to payroll on a timely basis.</p> <p>As a result of these deficiencies the Authority has made overpayments of £38k. This includes payment of additional amounts to continuing employees following cessation of honorariums.</p> <p>Internal Audit have raised related recommendations. Due to the risk, however, we have raised this recommendation in addition.</p> <p><i>Officers should be reminded of the importance of completing leaver notifications on a timely basis.</i></p>	<p>A report was presented to SMT on 30th March 2015 highlighting corporate recommendations from key financial audits 2014/15 and the leaver's checklist and controls were included. Following the report to SMT additional reminders were issued to Managers and staff through the managers Briefing and Staff News. Internal audit have included this area in their plan for 2015/16.</p> <p>Employment Services are implementing the recommendation from the Internal Audit report and the June overpayment report will be provided to SMT by the end of June 2015 with the subsequent report in December</p> <p>Officer Responsible:</p> <p>Julie Pugh (Employment Services Manager) and Ken Clarke (Assistant Director: Finance, Audit & Information Governance)</p> <p>Implementation Date:</p> <p>30 June 2015 31 December 2016</p>

Key issues and recommendations (cont'd)

No.	Risk	Issue and recommendation	Management response/ responsible officer/ due date
4	3	<p>Internal Audit Sampling</p> <p>Where sample testing is used to support audit findings, it is essential that there is a clear and consistent sampling methodology in place.</p> <p>As a result of our review of the work of Internal Audit we identified that in some instances the approach to sample size determination and selection was inconsistent. Specifically, in relation to payroll testing, we identified instances where the work of internal audit failed to cover each of the payrolls with no clear rationale being recorded.</p> <p><i>We recommend that Internal Audit work clarify the approach to sampling, particularly where the population to be sampled consists of a number of sub-populations.</i></p>	<p>We have updated our sampling rationales to ensure the population and associated sample size and risk are taken into account. The results will be recorded on working papers to evidence how the sample size was agreed and will be signed off by the Principal Auditor or Audit & IG SDM</p> <p>Officer Responsible: Jenny Marriot (Audit & Information Governance SDM)</p> <p>Implementation Date: Complete – in place for 2015/16 audits</p>
5	3	<p>Internal Audit File Review</p> <p>A key element of any internal audit review is the completion of an independent file review designed to confirm the adequacy of the work undertaken.</p> <p>We looked at Internal Audit’s work in relation to cash controls, and found that the internal audit file did not include supporting evidence for reconciling items on the bank reconciliation they tested. This had not been identified through Internal Audits own independent file review process.</p> <p>We would emphasise that this appears to be an isolated matter and has not been repeated in the other files we considered.</p> <p><i>We recommend that internal auditors and reviewers are reminded to include all the requisite supporting evidence for controls testing on file.</i></p>	<p>Accepted that an isolated incident occurred but reminders have been issued to reviewers and auditors.</p> <p>Officer Responsible: Jenny Marriot (Audit & Information Governance SDM)</p> <p>Implementation Date: Complete</p>



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