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# Interim Audit Report 2011/12

Gloucester City Council

June 2012

# Contents

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**This document summarises the key findings arising from our work to date in relation to both the audit of the Council's 2011/12 financial statements and the 2011/12 VFM conclusion.**

### Scope of this report

This report summarises the key findings arising from:

■ our interim audit work at Gloucester City Council (the Council) in relation to the 2011/12 financial statements; and

■ our work to support our 2011/12 value for money (VFM) conclusion up to March 2012.

### Financial statements

Our External Audit Plan 2011/12, presented to you in February 2012, set out the four stages of our financial statements audit process.

| Planning | Control Evaluation | Substantive Procedures | Completion |

During March 2012 we completed our planning and control evaluation work. This covered our:

■ review of the Authority's general control environment, including the Authority's IT systems;

■ testing of certain controls over the Council's key financial systems with the help of internal audit;

■ assessment of the internal audit function; and

■ review of the Council'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 2011/12 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 2011/12 VFM conclusion. This included:

■ assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion;

■ considering the results of any relevant work by the Council, the Audit Commission, other inspectorates and review agencies in relation to these risk areas; and

■ identifying what additional risk-based work we will need to complete.

### 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 2011/12 financial statements. It also provides a brief update on 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 and IT control environment** | Your organisational control environment and IT control environment is effective overall.<br><br>There are some areas for further improvement within the IT control environment. |
| **Controls over key financial systems** | The controls over the key financial systems are generally sound. We will need to carry out further work at the start of our final audit visit in July before we can fully conclude. The additional control areas will be reported in the ISA 260 report to be issued in September 2012. |
| **Review of internal audit** | Internal audit fully complies with the Code of Practice for Internal Audit in Local Government. We were able to rely on their work as planned. |
| **Accounts production and specific risk areas** | The Council's overall plan for the preparation of the financial statements is adequate. However, a number of key finance staff left the finance team during the year. This has resulted in the finance team relying on external consultants to produce the financial statements.<br><br>It is important that the Council retains the improvements these external contractors have made to support future arrangements. |
| **Financial resilience** | Our VFM audit risk assessment and work to date has provided good assurance on the Council's arrangements to secure value for money on its use of resources. We have completed this initial risk assessment and consider that the challenges around your 'Three Year Money Plan' / Savings plan are the key VFM audit risks that we need to explore further in our final audit. |
| **Other VFM risks** | We still have to complete our programme of audit work to inform our value for money conclusion, to be issued in September alongside our opinion on the Council's accounts. |

# Organisational control environment

**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.

In previous years we used our work on the Use of Resources assessment to inform our findings in these areas. Due to the reduced scope of the VFM assessment we have to complete more specific work to support our financial statements opinion.

We obtain an understanding of the Council'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.

Our assessment for 'information systems relevant to financial reporting' reflects the issues identified from our review of your IT control environment. The next page sets out our summarised findings in relation to this.

| Aspect | Assessment |
|---|---|
| **Organisational structure** | ❸ |
| **Integrity and ethical values** | ❸ |
| **Philosophy and operating style** | ❸ |
| **Participation of those charged with governance** | ❸ |
| **Human resource policies and practices** | ❸ |
| **Risk assessment process** | ❸ |
| **Information systems relevant to financial reporting** | ❷ |
| **Communication** | ❸ |
| **Monitoring** | ❸ |

Key:  ❶  Significant gaps in the control environment.

❷  Deficiencies in respect of individual controls.

❸  Generally sound control environment.

# IT control environment

**Your IT control environment is effective overall.**

**We noted a number of areas for further improvement across all areas of the IT control environment.**

## Work completed

The Council relies on information technology (IT) to support both financial reporting and internal control processes. In order to satisfy ourselves that we can rely on the use of IT, we test controls over access to systems and data, system changes, system development and computer operations.

In completing this work, we can partially rely on Internal Audit's review on IT controls.  This has been complemented by our own testing of the IT control environment.

## Key findings

We found your IT control environment is effective overall. We note one high priority finding and a number of medium/low findings for further improvement. The high priority finding is set out below:

■ **Generic User Accounts:** Generic user accounts are in use on a number of the Council's systems.  Generic accounts mean that some people (usually in the IT team) can access the relevant systems without showing which individual carried out the access. No monitoring procedures are in place to validate the actions undertaken within the above generic accounts.

Recommendations are included in Appendix 1.

| Aspect | Assessment |
|---|---|
| **Access to systems and data** | ❷ |
| **System changes and maintenance** | ❷ |
| **Development of new systems and applications** | ❷ |
| **Computer operations, incl. processing and backup** | ❷ |

Key:   ❶   Significant gaps in the control environment.

      ❷   Deficiencies in respect of individual controls.

      ❸   Generally sound control environment.

**The controls over the key financial systems that were selected for testing were found to be generally sound.**

**However, there are some weaknesses in respect of cash, payroll, budgetary control and debtors.**

**We will need to complete a further review of internal audit working papers and control testing at the start of the final audit visit before assessing the level of substantive work required at year-end.**

### Work completed

We work with your internal auditors to update our understanding of the Council's key financial processes where these are relevant to our final accounts audit. We confirm our understanding by completing walkthroughs for these systems.

We 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 key system will not always be in line with the 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

The controls over the key financial system are generally sound but we noted some weaknesses in respect of individual financial systems.

- **Cash:** Bank reconciliations are being carried out monthly. However, reconciling items are remaining on the reconciliations instead of being cleared on a timely basis.

- **Payroll:** We agree with the weakness identified by Internal Audit, that there is still no distribution of establishment lists to chief officers.

- **Budgetary control:** At the time of our interim audit (March 2012) the detailed reports for budgetary monitoring had not been produced since September 2011. Also, it was not possible to reconcile the September budget monitoring report to the approved budget which had been presented to Cabinet in February 2011.

- **Debtors:** During the interim audit there were unreconciled items on the debtors reconciliation between the general ledger (Cedar) and the debtors system (Ash). Work was being undertaken to rectify these differences and we will review the situation during our final accounts audit.

We have not yet assessed the controls over housing rents income, collection fund or creditors, where we are waiting for the internal audit reports. We have also not yet assessed the controls over capital expenditure and financial reporting as many of the key controls in these areas are operated during the closedown process and our testing will be supplemented by further work during our final accounts visit.

| System | Assessment |
|---|---|
| **Financial reporting** | TBC |
| **Housing rents income** | TBC |
| **Collection Fund** | TBC |
| **Payroll expenditure** | ❷ |
| **Benefits expenditure** | ❸ |
| **Cash** | ❷ |
| **Accounting for the Local Government Pension Scheme** | ❸ |
| **Capital expenditure** | TBC |
| **Significant contracts** | TBC |
| **Debtors** | ❷ |
| **Creditors** | TBC |
| **Reserves** | ❸ |
| **Senior management restructuring** | ❸ |

Key:  ❶  Significant gaps in the control environment.

❷  Deficiencies in respect of individual controls.

❸  Generally sound control environment.

# Review of internal audit

**Internal audit fully complies with the *Code of Practice for Internal Audit in Local Government.***

## Work completed

We work with your internal auditors to assess the control framework for 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 Council'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 Code of Practice for Internal Audit in Local Government* (the Code) defines the way in which the internal audit service should undertake its functions. We assessed internal audit against the eleven standards set out in the Code.

Internal Audit have completed the work agreed through our External & Internal Audit Joint Working Protocol, but we have delayed the completion of some audit tests to enable internal audit to finalise their reports. We reviewed internal audit's work on the other key financial systems and re-performed a sample of tests completed by them.

## Key findings

We completed a full assessment this year. Based on our assessment, internal audit fully complies with the Code.

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.

| Aspect | Assessment |
|---|---|
| **Scope of internal audit** | ❸ |
| **Independence** | ❸ |
| **Ethics for internal auditors** | ❸ |
| **Audit Committee** | ❸ |
| **Relationships with management, other auditors and other review bodies** | ❸ |
| **Staffing, training and development** | ❸ |
| **Audit strategy and planning** | ❸ |
| **Undertaking audit work** | ❸ |
| **Audit strategy and planning** | ❸ |
| **Due professional care** | ❸ |
| **Reporting** | ❸ |

Key: ❶ Non-compliance with the standard.

❷ Areas for improvement.

❸ Full compliance with the standard.

**The Council's overall plans for the preparation of the financial statements is adequate.**

**We will follow up the progress against our 2010/11 recommendations during our final audit visit in July 2012.**

### Work completed

We continued to meet with Finance staff on a regular basis to support them during the financial year.

As part of our interim work we considered the Council's planned approach for its year end financial closedown and the preparation of the 2011/12 financial statements. As reported in previous audits and in this year's External Audit Plan, this has been an area of weakness for the Council historically, and one where it has been focused in making improvements.

### Key findings

We consider that the overall plan for the preparation of your financial statements is adequate. However, there are some weaknesses identified in previous audits which have not yet been addressed.

As many of the recommendations made in last year's ISA 260 report relate to year end financial process it was not possible at the time of the interim audit to ascertain if they had been implemented. We will follow the recommendations up during our final audit visit in July. The table below sets out the Authority's progress against high priority recommendations.

| Issue from prior year audit | Progress |
|---|---|
| **Accounting records**<br><br>During the course of the 2011 audit it became evident that certain reporting and record keeping areas of the financial systems were cumbersome and not working efficiently. For example:<br><br>■ the fixed asset recording system includes multiple line entries even for simple assets; and<br><br>■ capital grants monitoring sheets do not easily permit monitoring of movement on individual grants and of the complex entries on receipt of taxation income.<br><br>The information is available but it is difficult to access and use. This makes the audit process slow but must also cause issues for officers using the data on a day to day basis. There is some evidence that the convoluted nature of some of the records, especially over fixed assets, resulted in a number of the capital accounting errors that arose last year and contributed towards the number of correcting journals that had to be posted during the year by finance staff.<br><br>**Prior year recommendation**<br><br>Review of the process of maintaining accounting records to consider how this can be streamlined and improved. | The Council has undertaken review of the whole year end process. However a number of key finance staff left the finance team during the year. This has resulted in the finance team relying on external consultants to produce the financial statements.<br><br>It is important that the Council retains the improvements these external contractors have made to support future arrangements.<br><br>We will review the year end process and the working papers to support the financial statements during our final audit visit in July. |

| Issue from prior year audit | Progress |
|---|---|
| **Timing of and response to Internal Audit work**<br><br>As a significant part of our audit work, we place reliance on work undertaken by internal audit.<br><br>During our 2010/11 audit we had to postpone some of this work until later in the year and, as a result, had to perform some level of additional work ourselves as internal audit work was not done by the required time. This did not appear to us to be the fault of internal audit, rather that internal audit staff were not able to complete reviews in some areas owing to work not having been completed in time by the service.<br><br>**Prior year recommendation**<br><br>The access for internal audit to service areas to allow them to complete their programme of work on time and in full will strengthen the control environment of the Council. | Similar issues were encountered during the 2011/12 interim audit. The staffing shortages within the finance team, which have been outlined above, contributed to certain internal audit reviews being delayed until later in the year. |

**The Council has taken the key risk areas we identified seriously and made good 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 2011/12, presented to you in February, we identified the key risks affecting the Council's 2011/12 financial statements.

Our audit strategy and plan remain flexible as risks and issues change throughout the year. To date there have been no changes to the risks previously communicated to you.

We have been discussing these risks with the Finance team as part of our meetings. In addition, we sought to review relevant workings and evidence and agree the accounting treatment as part of our interim work.

### Key findings

The key risks identified in the plan included:

- the Council's Saving Plans;
- Code change which includes the requirement to account for Heritage Assets;
- preparation of the financial statements;
- outsourcing of the revenues and benefits services;
- significant contracts;
- redundancy costs;
- accounting records for fixed assets;
- group accounts; and
- HRA self financing.

These risks were considered during the interim audit visit and will be the focus of work during the year end audit visit in July to ensure that the risks are monitored and addressed throughout the audit process and our findings will be reported to you in September.

One area we have discussed with the Council over the last year is the outsourcing of the revenues and benefits service to Civica. The Council undertook soft market testing that identified Civica as its preferred outsourced supplier and then followed an open and transparent decision-making process leading to the award of a contract and the TUPE transfer of staff. A comprehensive report was presented to full Council to inform the ultimate decision to outsource to Civica.

The Council sensibly obtained external legal advice on its decision not to follow a full OJEU tender process, and instead to contract with Civica following the soft market testing. However, we noted that this advice considered only the possible risks of this course of action, for example the potential for legal challenge from not following the OJEU process, and how to mitigate these risks. It did not address explicitly the primary issue of whether it was in fact lawful not to apply OJEU rules. In effect, the Council obtained advice on *how* it might proceed rather than *whether* it was able to do so.

Overall, we are satisfied that the Council followed a reasonable process, but this is a learning point that we have discussed with senior management.

### VFM audit approach

During the interim audit visit we completed the audit risk assessment for the VFM audit approach.

We have completed this initial risk assessment and consider that the challenges around your 'Three Year Money Plan' / Savings plan are the key VFM audit risks that we need to explore further in our final audit.

We have commenced gaining audit evidence but will complete the VFM audit work during the final audit visit and report to you in September.

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 next year.

| Priority rating for recommendations | | |
|---|---|---|
| ❶ **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. | ❷ **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. | ❸ **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. |

| No. | Risk | Issue and recommendation | Management response / responsible officer / due date |
|---|---|---|---|
| 1 | ❶ | **Generic User Accounts**<br><br>Computer systems can sometimes be set up with "generic user accounts". Generic accounts do not link to specific individuals within an organisation, but are used by groups or departments.  It is not normally possible to trace which individual has used the generic account, so it is difficult to find out who has taken those actions.  The impact is that people cannot be held accountable for their actions, so opening up the risk of fraud or error.<br><br>Generic user accounts are in use on the following systems within the Council:<br><br>■ Revenue & Benefits system;<br>■ General Ledger;<br>■ Payroll system;<br>■ Corporate Network.<br><br>The Council has no monitoring procedures in place to validate the actions undertaken within the above generic accounts.<br><br>**Recommendation**<br><br>Remove and replace generic user accounts with individually named user accounts.<br><br>Disable the third party domain administrator accounts to prevent inappropriate access, re-enabling the accounts as required to provide support.  Monitoring should be undertaken of all access made through these accounts. | |

# Key issues and recommendations (continued)

| No. | Risk | Issue and recommendation | Management response / responsible officer / due date |
|---|---|---|---|
| 2 | ❶ | **Budgetary control**<br><br>At the time of the interim audit (March 2012) the detailed reports for budgetary monitoring had not been produced since September 2011. These detailed reports are produced quarterly and are used to support the summary reports which are presented to Cabinet. Therefore at the time of the audit the December detailed report should have been available for review. Also it was not possible to reconcile the September budget monitoring report to the approved budget which was presented to Cabinet in February 2011.<br><br>The detailed reports are intended to allow officers to review and understand the financial performance of individual departments, and to identify errors, issues and anomalies that do not appear in summary information. They give additional assurance over the reliability of the summary financial information.<br><br>**Recommendation**<br><br>Budget monitoring should be completed on a monthly basis. The summary reports presented to Cabinet should reconcile to the detailed budget monitoring reports produced by finance. | |
| 3 | ❷ | **Debtors**<br><br>During the interim audit there were unreconciled items on the debtors reconciliation between the general ledger (Cedar) and the debtors system (Ash). Work was being undertaken to rectify these differences and we will review the situation during our final accounts audit.<br><br>There were a number of 'old' debts amounting to £154,000 remaining in the system. Some of the invoices reviewed related back to 1994.<br><br>**Recommendation**<br><br>The differences identified between the general ledger and the debtors system should be reconciled.<br><br>Aged debtors should be reviewed with the intention to identify recovery action against old balances and if necessary to write off irrecoverable debts (with provisions for bad debts adjusted accordingly). | |

# Key issues and recommendations (continued)

| No. | Risk | Issue and recommendation | Management response / responsible officer / due date |
|---|---|---|---|
| 4 | ❷ | **Removing user access**<br><br>One of the important controls over the security of an organisation's systems is making sure that people who leave employment are no longer able to get access to the Council's systems and data, and to reduce the risk of data loss or fraud. The Council has a documented process in place for removing the access right of leavers from the Council's IT systems.<br><br>During our review, we have identified a number of instances where the leaver's network or access rights have not been removed:<br><br>• Corporate Network: 24 users had retained access inappropriately. In four cases, these users had logged into their account after their leaving date. In the 24 cases, the users concerned did not retain access to any council operational or financial systems.<br>• Revenues & Benefits System: two users had retained access inappropriately, however the account passwords had expired, so no further access would be possible.<br>• General Ledger: nine users had retained access inappropriately.<br><br>**Recommendation**<br><br>The HR department should notify the IT team promptly of all leavers so that user access can be removed on a timely basis. | |

# Key issues and recommendations (continued)

| No. | Risk | Issue and recommendation | Management response / responsible officer / due date |
|---|---|---|---|
| 5 | ❷ | **Password Configuration**<br><br>The Council has published within their 'Information Security Policy' minimum password requirements for users of the councils' systems. Eg passwords need to be "complex" , including a minimum number of characters, and a mix of alpha and numeric characters.<br><br>These minimum password requirements are not being enforced in the payroll and the cash receipt (system used to process receipts and refunds of monies for council tax ) systems. The passwords being used do not enforce any level of complexity. Weak password configurations increase the likelihood of unauthorised system access.<br><br>We have confirmed that the system has the ability to enforce password complexity.<br><br>**Recommendation**<br><br>The Council should review all systems and enforce best practice password complexity as documented within their Information Security policy.<br><br>We acknowledge that the payroll system is due for replacement in 2012 as part of the shared development with the County Council, but the recommended changes should be implemented in order to protect the integrity of the historic data which is being retained on the system. The Council should also ensure that the new payroll system has appropriate password complexity. | |

# Key issues and recommendations (continued)

| No. | Risk | Issue and recommendation | Management response/ responsible officer/ due date |
|-----|------|--------------------------|---------------------------------------------------|
| 6 | ❷ | **Super Users**<br><br>Super users are users within the Council who have the ability to add/remove and make changes to the Council's IT programs and IT systems.  The number of super users in an organisation needs to be restricted to maintain oversight on changes made to systems and avoid incorrect or unauthorised removals or changes .<br><br>We have identified an excessive number of people with powerful super user admin rights on the Revenue and Benefits system.  Thus specific user group (SYSADMIN) contained 12 users (9% of all users) at the time of the audit.<br><br>**Recommendation**<br><br>The IT Department should  perform a review of super users on the Revenue and Benefits system to ensure access is restricted to appropriate personnel. | |

# Key issues and recommendations (continued)

| No. | Risk | Issue and recommendation | Management response/ responsible officer/ due date |
|-----|------|--------------------------|---------------------------------------------------|
| 7 | ❷ | **New Starter Process**<br><br>All new users within the Council complete a "new starter form". This form is authorised by the new user's line manager. The form states the IT access requirements needed for that employee.<br><br>The IT Department is supposed to review these forms to ensure that the correct level of access is being given to employees and that fictitious employees could not be added to the system and used to carry out inappropriate transactions.<br><br>Our testing found :<br><br>• 2 instances where the IT Department could not provide copies of appropriately completed and authorised new user forms.<br><br>• 2 instances where the IT Department were unable to provide a user's signed start forms.<br><br>**Recommendation**<br><br>The Council should ensure that the existing control is properly implemented. | |
| 8 | ❷ | **Cash**<br><br>During our review of bank reconciliations we noted that there were a number of small items that remained on the reconciliations month after month without being cleared.<br><br>**Recommendation**<br><br>All unreconciled items identified during the bank reconciliation should be investigated and cleared in on a timely basis. | |

# Key issues and recommendations (continued)

| No. | Risk | Issue and recommendation | Management response/ responsible officer/ due date |
|---|---|---|---|
| 9 | ❷ | **Periodic Review of User Access**<br><br>The Council operates a number of different levels of user access to employees to make sure that only relevant people have access to particular systems.  As time passes, individuals change their job descriptions, or get promoted, and they will require different access rights to different systems.  One risk that affects all organisations is that people continue to keep access to systems that are no longer relevant, which could leave the council exposed to loss of data or fraud.  A simple control to guard against this risk is a periodic review of systems to ensure that employees have the correct level of access for their grade and department.<br><br>From review of your systems we have identified that there is currently:<br><br>• no reviews are being  performed for Revenue and Benefits and the corporate network; and<br><br>• ad-hoc reviews are performed on the payroll system and Axis,<br><br>Without a review, people may retain inappropriate or higher levels of access than is required to fulfil their job role.<br><br>**Recommendation**<br><br>The Council should periodically perform and document a review of all Council systems to verify the appropriateness of the following:<br><br>▪ all system users are current Council employees; and<br><br>▪ user access remains in line with employee job role requirements. | |

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