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# Interim Audit Report 2013/14

**Gloucester City Council**

June 2014



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This document summarises the key findings arising from our work to date in relation to both the audit of the Authority's 2013/14 financial statements and the 2013/14 VFM conclusion.

### Scope of this report

This report summarises the key findings arising from:

- our interim audit work at Gloucester City Council (the Authority) in relation to the 2013/14 financial statements; and
- our work to support our 2013/14 value for money (VFM) conclusion up to May 2014.

### Financial statements

Our *External Audit Plan 2013/14*, presented to you in March 2014, set out the four stages of our financial statements audit process.



During March to May 2014 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 Authority's key financial systems with the help of internal audit;
- assessment of the internal audit function; and
- review of the closedown process and progress in implementing prior year recommendations.

### VFM conclusion

Our *External Audit Plan 2013/14* 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 2013/14 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 Authority, 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 2013/14 financial statements.
- Section 4 provides an overview of our VFM approach and sets out our findings from our interim audit work in relation to key VFM conclusion risks.

### 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.

<b>Organisational control environment</b>	<p>We have carried out an assessment of the Council's overall control environment, which is a key factor in determining the external audit strategy.</p> <p>We consider that the Authority's organisational controls are effective overall.</p>
<b>Controls over key financial systems</b>	<p>The controls over the financial systems upon which we rely are generally sound, but Internal Audit have identified some issues through their work which will impact on our audit approach.</p> <p>We have not repeated any recommendations raised by Internal Audit in this report.</p>
<b>Review of internal audit</b>	<p>We are pleased to report that we are again able to place full reliance on Internal Audit's work on the key financial systems.</p>
<b>Accounts production and specific risk areas</b>	<p>In previous audits we have reported the need for significant improvements to the Authority's financial reporting and closedown procedures. The Authority has an understanding of the specific risk areas 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.</p> <p>We have not identified any further risks in addition to those communicated to you through our <i>External Audit Plan 2013/14</i>.</p>
<b>Group Audit plan</b>	<p>During our interim visit, we have revisited our approach to auditing the group based on an assessment of the impact each significant component has on the group accounts. From a materiality and efficiency perspective, we consider it more appropriate to perform specific audit procedures ourselves for significant account balances for both Gloucester City Homes Ltd and Gloucestershire Airport Ltd.</p> <p>We do not therefore plan to place reliance upon the work of Baker Tilly and Hazlewoods as the external auditors of Gloucester City Homes Ltd and Gloucestershire Airport Ltd respectively.</p>
<b>VFM risks</b>	<p>We have identified a number of specific VFM risks. In most 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.</p> <p>We will carry out additional risk-based work on a small number of residual risks.</p>
<b>Other matters</b>	<p>Following the recent departure of the Chief Executive and the announcement that the Corporate Director of Resources will also be leaving the Authority, the Council will need to consider and manage the impact on senior management capacity. The Council has already appointed officers to the posts of Electoral Registration Officer, Returning Officer and Section 151 Officer to ensure all statutory responsibilities are discharged.</p>

Your organisational control environment is effective overall.

Following the departures of the Chief Executive and Corporate Director of resources, the Council will need to consider and manage the impact on senior management capacity.

**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.

In completing this work, we can partially rely on internal audit’s reviews. This has been complemented by our own re-performance of a sample of internal audit’s testing.

**Key findings**

Overall, we consider that your organisational controls are effective.

**Other matters**

We are aware that the Corporate Director of Resources will shortly be leaving the Council to take up a post elsewhere. This will leave the Council with only one Corporate Director, following the recent departure of the Chief Executive. The Council will need to consider and manage the impact on senior management capacity, both in the short and long term. Appointments have already been made to the posts of Electoral Registration Officer, Returning Officer and Section 151 Officer to ensure all statutory responsibilities are discharged.

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

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

**We were able to place reliance on internal audit's work on the key financial systems.**

**Review of internal audit**

The scope of the work of your internal auditors and their findings inform 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.

We reviewed internal audit's work on the key financial systems and re-performed a sample of tests completed by them.

**Key findings**

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 their work on the key financial systems.

In our opinion Internal Audit's files contained appropriate evidence to support the conclusions reached; reports are clear and easy to follow; and there is clear evidence of management review of work completed.

**Public Sector Internal Audit Standards**

From April 2013, the 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. The PSIAS replace the *Code of Practice for Internal Audit in Local Government*. Additional guidance for local authorities is included in the *Local Government Application Note* on the PSIAS.

Internal Audit are planning to complete a self-assessment against the standards and are required to get an independent review of the service once in every five year period.

Our review of Internal Audit has not included an assessment of the Internal Audit function against the PSIAS.

The controls over the financial systems upon which we rely are generally sound, but Internal Audit have identified some issues through their work which will impact on our audit approach.

**Controls over key financial systems**

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.

We also work with your internal auditors to update our understanding of some of the Authority’s key financial processes where these are relevant to our final accounts audit.

Where we have determined that this is the most efficient audit approach to take, we 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 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.

The table below sets out the key financial systems and Internal Audit reports on which we seek to place reliance. The issues arising are the specific findings and control weaknesses that Internal Audit have identified which have a direct impact on our audit and the work we intend to carry out.

Financial systems	Issues arising	Impact on the audit
<b>General ledger</b>	Weaknesses identified around segregation between posting and authorising journals.	More substantive approach to journal testing to be undertaken, focusing on those journals that have been posted and authorised by the same person.
<b>Budget monitoring</b>	Progress has been made to improve the budget monitoring process, but this has not operated for the full year. There was a difference of £117k between the budget loaded onto the general ledger in March 2013 and the net budget requirement agreed by the Full Council. Management investigated and resolved this difference during the year.	We will review the year end outturn report to identify the reported position against budget.
<b>Cash</b>	No significant control deficiencies identified.	No impact on audit approach.
<b>Treasury management</b>	No significant control deficiencies identified.	No impact on audit approach.
<b>Capital accounting</b>	The completion and independent review of the monthly asset register/general ledger reconciliation should be evidenced.	We will reconcile the figures reported as at 31 March in the asset register and the general ledger as part of our audit.
<b>Payroll</b>	No significant control deficiencies identified.	No impact on audit approach.

**The controls over the financial systems upon which we rely are generally sound, but Internal Audit have identified some issues through their work which will impact on our audit approach.**

This year our audit approach has been amended so that we have not defined payroll, non payroll expenditure and benefits expenditure as systems requiring detailed controls testing, as a result of the low risk of material misstatement occurring. This assessment is on the basis that there is a high volume of low value transactions, with a low level of complexity and with a low level of judgement involved in the transactions, as well as good coverage by internal audit. In addition, we complete detailed testing on the benefits expenditure during the Housing Benefit grant claim audit later in the year, so we will utilise these findings and not duplicate audit effort during the interim audit visit.

Detailed audit work will be completed during the final audit visit which will focus on substantive analytical procedures. If issues are identified with these tests then further work will be completed.

#### **Key findings**

Based on the work of your internal auditors, the controls over the financial systems upon which we rely are sound.

Internal audit included recommendations in their reports as appropriate and we have not duplicated their recommendations in this report.

#### **Controls over other financial systems**

We have also reviewed internal audit reports where, although we do not place reliance upon the work, we inspect the findings as part of our wider consideration of the control environment in operation. These reports include Council tax, National Non-Domestic Rates and Sundry Debtors.

No issues or additional risks relating to the overall control environment were identified from our review of these files.



The Authority has taken steps to improve its process for the preparation of its financial statements, but this remains an area requiring close monitoring to ensure the anticipated improvements are delivered.

The Authority has implemented the majority of the recommendations in our *ISA 260 Report 2012/13*.

**Work completed**

We issued our Accounts Audit Protocol to the Head of Financial Services on 10 March 2014. 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 the same date.

As part of our interim work we specifically reviewed Internal Audit’s review on the Authority’s progress in addressing the recommendations in our *ISA 260 Report 2012/13*.

**Key findings**

The Authority has incorporated a number of measures into its closedown plan to further improve the project management of this complex process.

We consider that the overall process for the preparation of your financial statements is adequate. The areas which you need to pay particular attention to are:

- capital accounting. This is a critical area to get right and where material adjustments have previously been identified.
- year end reconciliations, e.g. between the general ledger and the Benefits system. This has historically been a complex area and resulted in significant audit adjustments.

The Authority has implemented the majority of the recommendations in our *ISA 260 Report 2012/13* relating to the financial statements in line with the timescales of the action plan. The table below sets out the Authority’s progress against high priority recommendations that have not been fully implemented.

Issue	Progress
<p>Budget monitoring should be completed on a monthly basis. The summary reports presented to Cabinet should reconcile to the detailed monitoring reports produced by Finance.</p>	<p>This recommendation is in progress but Internal Audit testing indicates that further progress is required to ensure that adequate controls are applied consistently.</p> <p>The Council has been developing its approach to budget monitoring throughout the year and an improved process is in place. Management Accounts were produced from Period 2 to Period 12 in 2013/14, and were presented at Gloucester Leadership Team meetings by the Finance Change Manager and the Head Of Finance. However, Internal Audit identified that budget monitoring reporting at a service level or cost centre manager level has not been completed regularly or consistently within 2013/14. Finance are in the process of reviewing the most appropriate method to complete budget monitoring at a service level.</p> <p>Budget monitoring reporting to Members has improved and is now completed on a quarterly basis.</p> <p>Internal Audit identified that there was an unexplained difference of £117k between the budget loaded onto the general ledger in March 2013 and the net budget requirement agreed by the Full Council, which represents 0.7% of the agreed net budget requirement. Management investigated and resolved this difference during the year.</p>

## Specific risk areas

The Authority has an understanding of the key 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 2013/14*, presented to you in March, we identified the key risks affecting the Authority's 2013/14 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.

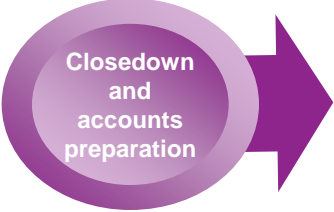

We have been discussing these risks with the Corporate Director of Resources and the Head of Financial Management as part of our regular meetings. In addition, we sought to review relevant workings and evidence and agree the accounting treatment as part of our interim work.

### Key findings

The Authority has a clear understanding of the risks and 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.

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

Key audit risk	Issue	Progress
	Recent audits have highlighted weaknesses in the accounting for fixed assets and there is therefore a risk around the completeness and accuracy of data.	<p>Internal Audit have carried out a review of Capital Accounting in 2013/14. We have reviewed the work of Internal Audit and are able to place reliance on their work in this area. No significant control weaknesses have been identified which would impact on our audit approach for 2013/14 and all prior year recommendations have been implemented.</p> <p>The Council are in the process of implementing a new fixed asset register. This will be in place for the 2014/15 financial year.</p>

Key audit risk	Issue	Progress
 <p>Closedown and accounts preparation</p>	<p>The Council has made good progress in the last two years to improve the quality of accounts presented for audit, but there has historically been a large number of adjustments made between the draft and final versions of the accounts and there remains a need to demonstrate significant improvement in these arrangements. The Council needs to continue this direction of travel and ensure it produces a good quality set of draft financial statements for audit.</p>	<p>We have reviewed the Council's arrangements closing down the ledger and preparing the financial statements and are satisfied that the planned arrangements in place are sufficient and appropriate.</p> <p>We have discussed the closedown progress to date with the Finance team and have not identified any significant risks to the preparations of the financial statements.</p>
 <p>LGPS Triennial Valuation</p>	<p>During the year, the Gloucestershire County Council Pension Fund has undergone a triennial valuation. The pension cost and net liability figures for the Authority to be included in the financial statements for 2013/14 will be based on the output of the triennial valuation rolled forward to 31 March 2014. There is a risk that the data provided to the actuary for the valuation exercise is inaccurate and that these inaccuracies affect the actuarial figures in the accounts.</p>	<p>We have reviewed the process that the Council has put in place to ensure that information provided to the actuary is complete and accurate and have not identified any issues.</p> <p>We will complete specific testing over the pension cost and net liability figures during our final accounts visit.</p>

**We will not seek to place reliance on the work of the auditors of Gloucester City Homes Ltd and Gloucestershire Airport Ltd to support our audit of the Authority's group accounts. Instead we will perform specific audit procedures ourselves.**

### **Group audit**

In our *External Audit Plan 2013/14* we communicated that, in addition to the Authority, we anticipated the following subsidiaries and joint ventures to be significant in the context of the group audit:

- Gloucester City Homes Ltd; and
- Gloucestershire Airport Ltd.

During our interim visit, we have revisited our approach to auditing the group based on an assessment of the impact each significant component has on the group accounts.

### **Gloucester City Homes**

On consolidation, the material balances consolidated are the expenditure, income, debtor and creditors. As part of the consolidation process, the majority of these balances are eliminated to reflect the inter-company trading between the Council and Gloucester City Homes. The net impact on the group accounts is therefore immaterial.

### **Gloucestershire Airport Ltd**

The impact upon the Group accounts is to recognise the investment in the joint venture rather than the cost of the shares held on the Gloucestershire Airport Ltd balance sheet.

The movement in the year on the joint venture investment recognised would be due to the profit or loss made by the Airport and any land valuation changes. Gloucestershire Airport Ltd has historically made low profits. We will therefore perform a desktop review of the financial results for 2013/14 and the land valuation as these would drive any change in the consolidated group accounts.

We therefore do not plan to place reliance upon the work of Baker Tilly and Hazlewoods as the external auditors of Gloucester City Homes Ltd and Gloucestershire Airport Ltd respectively.

Instead we will perform specific audit procedures for significant account balances for both Gloucester City Homes Ltd and Gloucestershire Airport Ltd.

**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 2013/14 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. The Audit Commission has developed a range of audit tools and review guides which we can draw upon where relevant.

#### Overview of the VFM audit approach

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



## Specific VFM risks

We have identified a number of specific VFM risks.

In most 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 will carry out additional risk-based work in the following area:

- Contract monitoring
- Savings plans
- Budgetary control

### Work completed

In line with the risk-based approach set out on the previous page, we have



- assessed the Authority's key business risks which are relevant to our VFM conclusion;
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit; and
- considered the results of relevant work by the Authority, other inspectorates and review agencies in relation to these risk areas; and
- concluded to what extent we need to carry out additional risk-based work.

### Key findings

Below we set out our preliminary findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion,

We will report our final conclusions in our *ISA 260 Report 2012/13*.

Key VFM risk	Risk description and link to VFM conclusion	Preliminary assessment
	<p>The Council has a number of contracts with third parties to provide services, such as neighbourhood services and IT.</p> <p>An Internal Audit review in 2012/13 identified that the Council had overpaid on one of its contracts.</p> <p>There is a risk that the Council is not carrying out effective contract monitoring to ensure that it pays the correct amount for services provided and that it obtains value for money from its contractors.</p> <p>This is relevant to the economy, efficiency and effectiveness criteria of the VFM conclusion.</p>	<p>The Council is undertaking a detailed review of one of its major outsourcing contracts. A formal report is due to be presented to the Corporate Director of Resources. We will review the output from this when it is available.</p>

Key VFM risk	Risk description and link to VFM conclusion	Preliminary assessment
	<p>The savings plan target for the Authority for 2013/14 is £1.9m. This was built into the budget agreed by the Council and Cabinet at the start of the year.</p> <p>There is a risk that savings plans are not being monitored and that the Authority does not make the required savings in order to meet its budget. This is relevant to the financial resilience criteria of the VFM conclusion.</p>	<p>The Council is in the process of updating the ledger to reflect the savings that have been agreed for each budget. The project plans have to be agreed by the Service Manager responsible for delivering the savings and will include a timeplan and actions taken in order for the savings to be delivered.</p> <p>However, progress has been made to improve the budget monitoring reports and overall process throughout the year and detailed monthly has been produced since month 9.</p> <p>As part of our final accounts audit visit, we will track the performance against the savings plans through to year end and review the final outturn position against the planned savings for the year.</p>
	<p>The Council took steps last year to address weaknesses relating to its budgetary control arrangements. This process has continued during the year. Robust budgetary control and monitoring is key to delivering value for money, so we will follow up the recommendations made in our 2012/13 <i>Report to Those Charged with Governance (ISA 260 Report)</i>.</p> <p>This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion.</p>	<p>Internal Audit have completed a review over the Council's arrangements relating to Budgetary Control. We have reviewed the Internal Audit files and can place reliance on their work.</p> <p>Progress has been made to improve the budget monitoring reports and overall process throughout the year.</p> <p>However, the original 2013/14 budget within the general ledger did not fully agree to the net budget requirement set by Members. There was a difference of £117k between the budget loaded onto the general ledger in March 2013 and the net budget requirement agreed by the Full Council. Management investigated and resolved this difference during the year.</p> <p>We will revisit this area during our final accounts visit to consider the Authority's response to the issues identified.</p>



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