

Exeter City Council

Interim Report and update to Financial Audit Strategy

23 May 2011



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Introduction

Introduction

This memorandum is intended to provide additional details regarding our audit approach, as set out in our Financial Audit Strategy 2010-11 issued in February 2011, as well as an update on our response to key risks from the results of interim audit work carried out to date.

Use of this report

This report has been prepared to advise you of the matters arising from our interim work and should not be used for any other purpose or be given to third parties without our prior written consent. Our report is part of a continuing dialogue between the Council and ourselves and should not be relied upon to detect all errors, systems or control weaknesses or opportunities for improvements in management arrangements that might exist.

The Council should assess the wider implications of our conclusions and recommendations before deciding whether to accept or implement them, seeking your own specialist advice as appropriate.

We accept no responsibility in the event that any third party incurs claims, or liabilities, or sustains loss, or damage, as a result of their having relied on anything contained within this report.

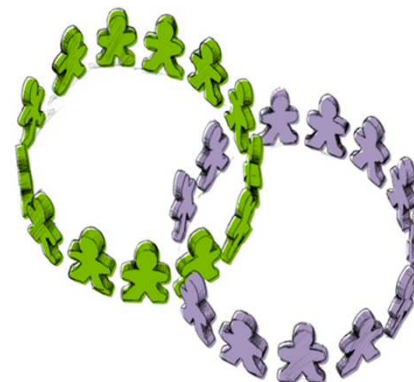
The way forward

We have set out our findings and recommendations in the appendices to this report. We have agreed action to implement the recommendations made with the Director of Finance.

Acknowledgements

We would like to record our appreciation for the assistance and co-operation provided to us during our interim audit by the Councils staff.

Grant Thornton UK LLP
23 May 2011



Executive Summary

The table below provides a summary of the work performed and our key findings to date. For further detail refer to the relevant section within this report.

Audit Approach	There have been no changes to our overall audit approach as set out in the Financial Audit Strategy 2010-11.
Risk assessment	<ul style="list-style-type: none">• Our audit risks were outlined in our Financial Audit Strategy 2010-11. We have not identified any new risks facing the Council.
Review of internal controls	<ul style="list-style-type: none">• We have evaluated the design effectiveness of internal controls over the financial reporting process through a combination of inquiry and observation procedures, and, where appropriate, systems walkthroughs.
Review of internal audit	<ul style="list-style-type: none">• We have concluded that the Internal Audit service continues to provide an independent and satisfactory service to the Council and that we can take assurance from their work in contributing to an effective internal control environment at the Council.
IFRS arrangements review	<ul style="list-style-type: none">• Our review identified that the Council is making progress in its transition to IFRS. Work is being undertaken by the Council to collate and review all relevant information but there is a need to complete the restatement of the 2009-10 accounts and supporting notes. We will review this remaining work during the final accounts audit.

Our accounts audit approach

Audit approach

We:

- work closely with the finance team to ensure that we meet audit deadlines and conduct the audit efficiently;
- plan our audit on an individual task basis at the start of the audit, and agree timetables with all staff involved;
- consider the materiality of transactions when planning our audit and when reporting our findings; and
- review the processes and position of the Council for its transition to International Financial Reporting Standards (IFRS).

The logistic details of our annual accounts audit, as agreed with the Finance team, are detailed at Appendix A to this memorandum.

In summary our audit strategy comprises:

Planning	<ul style="list-style-type: none">• Updating our understanding of the Council through discussions with management and a review of the management accounts
Control evaluation	<ul style="list-style-type: none">• Review of management accounts• Review IFRS transition arrangements• Review the design effectiveness and implementation of key controls
Substantive procedures	<ul style="list-style-type: none">• Review material disclosure issues in the financial statements• Perform analytical review• Verify all material income and expenditure and balance sheet accounts, taking into consideration whether audit evidence is sufficient and appropriate
Completion	<ul style="list-style-type: none">• Perform overall evaluation of the financial statements• Determine an audit opinion• Report to the Scrutiny Resources Committee

Our accounts audit approach (continued)

Materiality

An item would be considered material to the financial statements if, through its omission or non-disclosure, the financial statements would no longer show a true or fair view.

Materiality is set at the outset of planning to ensure that an appropriate level of audit work is planned. It is then used throughout the audit process in order to assess the impact of any item on the financial statements. Any identified errors or differences below £21,000 which we deem to be clearly inconsequential under the auditing standards will be recorded on a schedule of potential misstatements.

These potential misstatements are assessed individually and in aggregate, discussed with you and, if you do not adjust, signed off by you in your letter of representation to us, confirming your view that they are immaterial to the financial statements. We will consider whether any unadjusted items impact on our audit opinion.

An item of low value may be judged material by its nature, for example any item that affects the disclosure of directors' emoluments. An item of higher value may be judged not material if it does not distort the truth and fairness of the financial statements.

Reliance on internal audit

We will work with the internal audit function to ensure our audit approach takes account of the risks identified and the work they have conducted, subject to our review of the effectiveness of the internal audit function.

Review of IT and outsourced systems

Our audit approach assumes that our clients use a computer system for accounting applications that process a large number of transactions. Accordingly, our approach requires a review of the Council's internal controls in the information technology (IT) environment.

We have involved IT specialist team members during the audit. This approach is based on the complexity of IT used in the Council's significant transaction cycles and a control risk assessment.

Internal controls

Auditing standards require that we evaluate the design effectiveness of internal controls over the financial reporting process to identify areas of weakness that could lead to material misstatement. Therefore, we will focus our control review on the high risk areas of the financial statements.

Our accounts audit approach (continued)

We are also required to assess whether controls have been implemented as intended. We have done this through a combination of inquiry and observation procedures, and, where appropriate, systems walkthrough tests. However, our work cannot be relied upon necessarily to identify defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive controls review exercise might identify.

Transition to International Financial Reporting Standards (IFRS)

The IFRS based Code of Practice on Local Authority Accounting in the United Kingdom (the Code) has effect from 1 April 2010. The 'transition date' to IFRS was therefore 1 April 2009.

The Council is responsible for the preparation of a restated opening balance sheet as at 1 April 2009 following the introduction of International Financial Reporting Standards (IFRS) and in accordance with the Code.

Auditors do not have any direct reporting responsibilities in respect of transition balances although they form the opening balances for the comparative period.

Our work has taken the form of an arrangements review intended to provide feedback on the Council's approach to restatement and is not an audit of the

restated balance sheet figures. Detailed work on the restated figures will take place during the 2010-11 final accounts audit. This assessment has focussed upon material balances either in regard to their value or nature.

Our review identified that the Council is making fair progress in its transition to IFRS. The transition balance sheet was supported by working papers which clearly set out the approach adopted by the Council and justified the conclusions reached. The approach was confirmed as in accordance with the requirements of the Code and we did not identify any issues which had not already been considered by the Council.

The Council is currently in the process of drafting the IFRS Comprehensive Income and Expenditure statement and notes. We will review these as part of our final accounts audit visit.

Update on accounts audit risk assessment

As part of our planning and control evaluation work we have reviewed the audit risks identified in our Financial Audit Strategy 2010-11 and have set out below the outcome of work completed to date and further work planned.

Our update of the audit risks facing the Council has not identified any new risk areas.

We will report our full findings and conclusions in respect of each risk identified in our Annual Report to Those Charged with Governance (ISA 260) on completion of our final accounts audit.

Issue	Audit areas affected	Work completed	Further work planned
<p>2010-11 financial statements do not comply with the requirements under International Financial Reporting Standards (IFRS)</p>	<p>All areas of the financial statements</p>	<ul style="list-style-type: none"> We have reviewed the process put in place by the Council for completing the transition to IFRS and have reviewed the restated balance sheets and the accounting policies. No significant issues were identified. 	<ul style="list-style-type: none"> Material balances which are impacted by the transition to IFRS and the related accounting policies will be reviewed in detail at the time of the final accounts audit.
<p>Insufficient finance team resources available to deliver statutory requirements by 30 June 2011</p>	<p>All areas of the financial statements</p>	<ul style="list-style-type: none"> We have reviewed the closedown timetable and project plan and are satisfied with the timetable in place. 	<ul style="list-style-type: none"> We will continue to work with the Council to ensure that all deadlines are met.

Update on accounts audit risk assessment (continued)

Issue	Audit areas affected	Work completed	Further work planned
<p>Incorrect accounting for Icelandic Bank investments</p>	<p>Investments & Financial Instruments</p>	<ul style="list-style-type: none"> We have reviewed guidance that has been issued and have discussed these with the client. 	<ul style="list-style-type: none"> We will continue to discuss emerging issues with the Council around Icelandic investments and ensure that these have been correctly accounted for in the accounts.
<p>Financial performance pressures affecting the Council's ability to deliver its budget and provide services to the public</p>	<p>All areas of the financial statements</p>	<ul style="list-style-type: none"> We have reviewed the Council's financial controls and its budgetary reports to complete our preliminary analytical procedures. 	<ul style="list-style-type: none"> Our final audit work has been tailored to address the risks identified. This will involve analytical reviews, where explanations and corroborating evidence will be sought for significant movements. We will consider the use of general reserves in the year.

Results of interim audit work

Scope

As part of the interim audit, and in advance of our final accounts audit visit, we considered:

- the effectiveness of the Internal Audit function;
- internal audit's work on the Council's key financial systems;
- a review of closedown procedures in preparation for the final accounts under International Financial Reporting Standards (IFRS);
- review of Financial reporting controls;
- review of Information Technology controls; and
- prior year recommendations.

The internal audit function

We review internal audit's overall arrangements against the CIPFA Internal Audit Standards. Where the arrangements are deemed to be adequate, we can gain assurance from the overall work undertaken by internal audit and can conclude that the service is contributing to the internal control environment and overall governance arrangements within the Council. We also review work performed in areas we assess as representing an accounts risk to establish the issues and whether we can place reliance on that work.

Overall, we have concluded that the Internal Audit service continue to provide an independent and satisfactory service to the Council and that we can take assurance from their work in contributing to an effective internal control environment at the Council.

We reviewed internal audit's work on the key financial systems to determine whether issues identified impact on our audit of the financial statements. Where work has been completed, all reports were provided. No significant issues have been identified through review of these reports.

In assessing the effectiveness of internal audit work, we reviewed two internal audit files to ensure that:

- systems were adequately documented;
- key controls have been identified and evaluated
- key controls have been tested; and
- weaknesses have been reported to management

We are pleased to note that we did not identify concerns over internal audit's work and their work was performed to a high standard.

Results of interim audit work (continued)

Close Down Procedures

We have reviewed the annual accounts closedown schedule and guidance issued to the finance team. The closedown schedule is comprehensive and outlines the necessary information required and the timescale for the preparation of the financial statements.

We have provided the Council with an arrangements letter which sets out our working paper requirements for the final accounts audit that support the individual areas reported in the accounts.

Financial Reporting Controls

As part of the audit, we reviewed the monitoring controls to ensure information generated and communicated from various sources comes together to achieve reliable financial reporting. We found that the Council's process and controls are generally sound. Previous recommendations have been implemented where agreed.

Key Financial Systems

As part of our audit, we document the processes and activities for all the key significant financial systems. We review the controls over the key financial systems where we consider that it is reasonably possible that a risk of misstatement in the financial statements could occur.

We do this to assess whether there are any major controls weaknesses that could affect the level of testing required at our final accounts audit.

We review and rely on the work undertaken by Internal Audit, where appropriate to do so.

We have documented the following key financial systems including, grants revenue and accounts receivable, expenditure and accounts payable, property plant and equipment (PPE) and payroll.

We assessed where we consider that there is a higher risk of material misstatement and we have reviewed the controls over these financial systems in the areas of expenditure and PPE. We have also evaluated the performance of these internal controls through a combination of review of individual systems and walkthrough tests. No material control deficiencies were found from our work.

Review of information technology controls

The Council makes use of Cedar Open Accounts (COA) eFinancials, a finance package purchased from a third party, to administer its accounts. COA eFinancials is administered within the Finance department and sits within the Council's main IT network, which is managed by the ICT department.

Results of interim audit work (continued)

Our information systems specialist performed a high level review of the general IT control environment, as part of the overall review of the internal controls system, and concluded that from the work undertaken to date, there are no material weaknesses which are likely to adversely impact on the Council's financial statements.

We have, however, identified a small number of areas where arrangements could be improved. We do not consider these to pose a significant risk to the accounts, and have reported them to management through our interim audit feedback meeting. These include:

- User access reviews; and
- Network intrusion detection and prevention.

User access reviews

There is no formal process in place to ensure user access is reviewed on a regular basis. Although the ICT team and system administrators are automatically notified of leavers from the HR system this does not cover users who change departments or whose access requirements change.

If user access is not reviewed by management on a regular basis, there is a risk that access will become disproportionate over time the users job responsibilities. There is also a higher risk of segregation of duties weaknesses as individuals transfer or move on to different positions within the Council.

Recommendation 1

Management should consider implementing a process to review user access to the COA eFinancials application on a regular basis to ensure access is appropriate and based on job functions.

Network intrusion detection and prevention

Limited intrusion prevention is performed and, there is no separate and dedicated system for intrusion detection or prevention (IDS/IPS). The Council has upgraded its firewall, which has an element of IDS available. This was inspected as part of the Code of Connection (CoCo) compliance review and the Council were rated as 'partially compliant' due to the upgraded firewall. The Council is aware of the benefits of an IDS/IPS but are mindful of the cost implications.

Weaknesses may exist in both hardware and software on a daily basis that can severely compromise the security of Council's information systems.

Recommendation 2

The Council should consider implementing an intrusion detection or prevention system. Given the significant cost implications, the Council could consider a joint procurement option with another council, which could be shared through CoCo connect to share the costs.

Results of interim audit work (continued)

We will revisit these areas in 2011-12 and follow up the actions taken by the Council.

Review of arrangements for implementation of International Financial Reporting Standards (IFRS)

Introduction and Background

Local authorities are required to comply with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). From 2010-11 this Code will be based in International Financial Reporting Standards (IFRS) rather than a UK GAAP based Statement of Recommended Practice (SORP). The Code requires a restated balance sheet at 1 April 2009, restated 2009-10 accounts and full published IFRS accounts for 2010-11.

Basis of assessment

This report details the findings of our review. For each significant balance sheet item, we have considered the Council's arrangements against each of the following questions:

- Are the Council's arrangements for identifying and reporting their accounting policy adequate?
- Are the Council's arrangements for identifying and reporting their adjusted UK GAAP values at 1 April 2009 and 1 April 2010 adequate?
- Are the Council's arrangements for reporting IFRS values adequate?
- Are the Council's arrangements for restating their notes to the balance sheet adequate?
- Are the Council's arrangements for preparing quality supporting working papers adequate?

The Council's arrangements for each line in the balance sheet have been assessed using a red/amber/green RAG rating using the following definitions:

**Green
(G)**

Adequate arrangements appear to be in place for the balance sheet area to provide not materially misstated amounts for the restatement.

**Amber
(A)**

Adequate arrangements are in place in some respects for the balance sheet area to provide not materially misstated amounts for the restatement. Evidence that the Council is taking forward areas where arrangements need to be strengthened.

**Red
(R)**

The Council's arrangements are generally inadequate to provide not materially misstated amounts for the restatement.

Where items and areas have been assessed as amber or red we have discussed these with officers and made recommendations.

Adequacy of arrangements - findings

Balance sheet item	Accounting policies	UK GAAP values	IFRS values	Supporting notes	Working papers	Overall assessment
Property, plant & equipment	G	G	A	A	G	A
Trade & other debtors	G	G	A	A	G	A
Investments	G	G	A	A	G	A
Cash and cash equivalents	G	G	A	A	G	A
Assets classified as held for sale	G	G	A	A	G	A
Trade & other creditors	G	G	A	A	G	A
Non-current borrowings	G	G	A	A	G	A
Non-current Provisions	G	G	A	A	G	A
Non-current other liabilities	G	G	A	A	G	A

Adequacy of arrangements – amber ratings

Area of Review	Reason for rating	Next steps
IFRS Values	The restated IFRS values for closing 2009-10 and the opening 2010-11 figures were not made available to us at the time of our audit review.	Officers need to restate the IFRS values, ensuring that they are compliant with the Code. We will review these values during the final accounts audit.
Supporting Notes	Final supporting notes had not been completed at the time of our review.	Final supporting notes need to be prepared to ensure that they comply with the Code.

Overall conclusion and recommendations

Conclusion

No significant issues have been identified through our interim audit work.

Whilst some progress has been made by the Council in implementing the requirements of IFRS, there is still a need to complete the 2009-10 comparative accounts and supporting notes. We will review the comparative Comprehensive Income and Expenditure Statement as a part of the final accounts audit. Understandably there is more work to do and we will be working closely with the Finance team in their preparation of full IFRS accounts for 2010-11.

Acknowledgements

We would like to record our appreciation for the assistance and co-operation provided to us during our review.

Appendix A. Logistics

Timetables and milestones

The following proposed timetable and deadlines have been set:

Event	Date
Pre year end fieldwork including internal controls review	February & March 2011
Interim audit report	June 2011
Commence accounts audit fieldwork	18 July 2011
Financial statements report - to those charged (ISA 260)	September 2011
Annual Audit Letter	November 2011

The audit process is underpinned by effective project management to ensure that we co-ordinate and apply our resources efficiently to meet your deadlines. It is therefore essential that we work closely with your team to achieve this timetable.

Information requirements

The information and working paper requirements that would assist us in an efficient and timely audit of the year-end financial statements have been communicated to the finance team within our Arrangements Letter, which was issued in March 2011.

Engagement team

In accordance with our Financial Audit Plan 2010-11 issued December 2010, the main engagement team for the accounts audit will include:

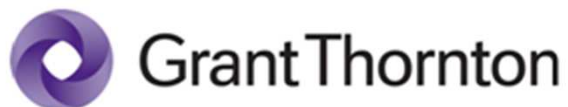
Name	Role	Contact details
Barrie Morris	Engagement Lead	T: 0117 305 7708 E: Barrie.Morris@uk.gt.com
Perminder Sethi	Manager	T: 0113 200 2547 E: Perminder.Sethi@uk.gt.com
Llinos Williams	In-Charge Auditor	T: 0117 305 7754 E: Llinos.Williams@uk.gt.com
Rhys Jenkins	Assistant	T: 029 203 47588 E: Rhys.Jenkins@uk.gt.com

Appendix B. Action plan

Rec No.	Recommendation	Priority	Management Comments	Implementation date and responsibility
1	Management should consider implementing a process to review user access to the COA eFinancials application on a regular basis to ensure access is appropriate based on job functions.	Low	Agreed – The Assistant Accountants already action all changes, which we are informed of via the starters and leavers forms and work has been done to remove historic errors from the system. However, Our Systems Accountant has been asked to implement these reviews. Initially we will do this on a six monthly basis, checking with Heads of Service. We will also implement for Ash and PARIS.	Corporate Finance Manager September 2011
2	The Council should consider implementing an intrusion detection or prevention system. Given the cost implications, the Council could consider a joint procurement option with another council, which could be shared through CoCo connect to share the costs.	Low	This has been considered by the Council but there are currently no plans to procure an intrusion detection system (IDS) due to the significant cost implications. The Council will continue to pursue any opportunities for a joint procurement option. We are currently working on a protective monitoring solution in partnership with other authorities which may provide a part solution in the interim.	Head of IT Ongoing
3	Officers need to recalculate IFRS values for closing 2009-10 and opening 2010-11 figures as soon as possible.	High	Agreed – the final accounts process is being implemented and the work required for 2009-10 is being undertaken alongside the closure of 2010-11	Corporate Finance Manager June 2011
4	A detailed review of all of the notes to the accounts should be undertaken prior to the accounts being submitted to audit as this is the first year the accounts have been prepared under IFRS.	High	Agreed – the template for the new accounts has already been set up and amendments to the notes have been made in line with IFRS	Corporate Finance Manager June 2011

Appendix C. Prior year Recommendations and Updates

Rec No.	Recommendation in 2009/10	Update in 2011
1	Each test carried out by Internal Audit which utilises a sampling approach should include an explanation of the reason why that approach is the most appropriate and a justification for the number of items selected for further testing.	Confirmed through detailed review of Internal Audit that explanation is provided why the sampling approach was adopted, including justification for the number of items selected.
2	<p>User administrative access</p> <p>Management should consider the feasibility of removing powerful administrative access from operational users of COA eFinancials to ensure appropriate segregation of duties is maintained in the system. If this is not feasible, then management should consider monitoring the actions performed by the administrator accounts to ensure actions performed are appropriate and authorised.</p>	This recommendation has been implemented.
3	<p>User access reviews</p> <p>Management should consider implementing a process to review user access to the COA eFinancials application on a regular basis to ensure access is appropriate based on job functions.</p>	This recommendation has not been implemented and has been recommended again.
4	<p>Regular leaver listings</p> <p>Management should implement a review process to ensure that access has been appropriately removed by each system administrator in a timely manner.</p>	This recommendation has been implemented.
5	<p>Journal entry controls</p> <p>As recommended in 2008-09, the Council should introduce a requirement for independent approval of journals above pre-determined thresholds.</p>	We will undertake detailed journal work during our final accounts audit.



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