

Exeter City Council  
Interim Audit Report

---

May 2012

## Contents

1. Our accounts audit approach	2
2. Update on accounts audit risk assessment	4
3. Results of interim audit work	7

## Appendices

A. Logistics	11
B. Action plan	12
C. Follow up of prior year recommendation	14

# Our accounts audit approach

This memorandum is intended to provide additional detail regarding our audit approach, as set out in our Audit Plan 2011-12 issued in January 2012 as well as an update on our response to key risks from the results of interim audit work carried out to date.

## Audit approach reminder

We will:

- 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; and
- consider the materiality of transactions when planning our audit and when reporting our findings.

**The logistical details of our annual accounts audit, as agreed with the Assistant Director of Finance are detailed in Appendix A to this memorandum.**

## Planning

- Updating our understanding of the Council through discussions with management and a review of in year internal financial reporting
- Identifying and resolving specific accounting treatment issues

## Controls evaluation

- Reviewing the design effectiveness and implementation of internal financial controls including IT, where they impact the financial statements
- Assessing audit risk and developing and implementing an appropriate audit strategy
- Testing the operating effectiveness of selected controls
- Assessing the Council's arrangements for complying with tax legislation and Bribery Act requirements
- Assessing the effectiveness of Internal Audit

## Substantive procedures

- Reviewing material disclosure issues in the financial statements
- Performing analytical review
- Verifying all material income and expenditure and balance sheet accounts, taking into consideration whether audit evidence is sufficient and appropriate

## Completion

- Performing overall evaluation of our work on the financial statements to determine whether they give a true and fair view
- Determining an audit opinion
- Reporting to the Scrutiny Committee Resources through our ISA 260 report and Annual Audit Letter

### 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 greater than 2% of materiality will be recorded on a schedule of potential misstatements.

These are assessed individually and in aggregate, communicated to you and, if you agree with any management decisions to not adjust for such items, signed off by you in your letter of representation to us, confirming your view that they are immaterial to the financial statements.

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

### Reliance on internal audit

We work with the internal audit function to ensure our audit approach takes account of the risks identified from reviews they have conducted relevant to the financial statements, subject to our review of the effectiveness of the internal audit function.

Where significant risks to the financial statements are identified from our own work, it may be possible to coordinate with the work of internal audit to avoid unnecessary duplication of effort. Where such reliance takes place this will be specifically detailed in the reporting of our results.

### Review of IT

Our audit approach assumes that our clients utilise complex computer systems and accounting applications to routinely process large numbers of transactions. These may be used either directly or indirectly in preparing financial reporting information, including the annual accounts. Accordingly, our approach requires a review of the internal controls in the Council's information technology (IT) environment.

Based on our assessment of the complexity of the overall IT environment, we have involved specialist Technology Risk Services (TRS) team members in our audit work in order to undertake a review of the overall IT control environment. Where significant systems are outsourced, or new systems or applications introduced in year, additional review work may be undertaken on this risk assessed basis.

### 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.

In order to assess whether controls have been implemented as intended, we will conduct a combination of inquiry and observation procedures, and, where appropriate, transaction walkthroughs. Where further assurance or audit efficiency may be gained, we will consider directly testing any controls that we may consider to be key in relation to the identified risk.

However, our controls work cannot be relied upon to identify all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive controls review exercise might identify.

# Update on accounts audit risk assessment

As part of our planning and control evaluation work we have reviewed the key audit risks identified in our Audit Plan 2011-12 and have set out in Table 1 below the outcome of work completed to date and further work planned.

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.

Our updated review of the key risks facing the Council has not identified any new risk areas to those reported in our audit plan.

**Table 1. Key accounting risks**

Issue	Audit areas affected	Work completed to date	Further work planned
<p><b>Incorrect accounting for Property, Plant and Equipment (PPE)</b></p>	<p><b>PPE - valuation, completeness and disclosure</b></p>	<p>We have held discussions with the Council around the introduction of heritage assets and the proposed accounting treatment. We understand that an exercise has been undertaken to identify the heritage assets owned by the Council.</p>	<ul style="list-style-type: none"> <li>• We will review the accounting treatment for heritage asset in accordance with the Code 2011-12.</li> </ul>

Table 1. Key accounting risks (continued)

Issue	Audit areas affected	Work completed to date	Further work planned
<p><b>Control weaknesses in the Council's IT systems are not addressed</b></p>	<p><b>All areas of the financial statements</b></p>	<p>Our IT auditors have undertaken a review of the Council's IT systems. Their findings are detailed later in this report on page 9</p>	<ul style="list-style-type: none"> <li>• We will follow up recommendations raised in this report during the 2012-13 interim audit.</li> </ul>
<p><b>Financial performance pressures affecting the Council's ability to deliver its budget</b></p>	<p><b>All areas of the financial statements</b></p>	<p>We have reviewed the Council's performance against its agreed budget, a small overspend of £22,000 has been reported in March 2012 against the general fund revised budget of £14.173m.</p>	<ul style="list-style-type: none"> <li>• We will continue review the Council's financial performance outturn and its achievement of savings against plan.</li> <li>• We will have due regard to the risks of incorrectly reporting the financial position and will set our audit strategy to address the risks of understatement of expenditure and overstatement of revenue.</li> </ul>
<p><b>Incorrect accounting for Icelandic Bank investments</b></p>	<p><b>Investments and Financial Instruments</b></p>	<p>We have held discussions with the Council around the treatment of Icelandic bank investments. We understand that the Council has now received £2.08 million back from Glitnir bank and just under £1 million from Landesbanki Bank. A proportion of this repayment as been received in Icelandic Krona.</p>	<ul style="list-style-type: none"> <li>• As a part of the final accounts audit, we will review any updated guidance issued by CIPFA and ensure that the Council accounted for Icelandic Investments correctly.</li> <li>• We have also sought technical advice on the required accounting treatment of amounts held by the Council in foreign currency at the Balance Sheet date</li> </ul>

Table 1. Key account risks (continued)

Issue	Audit areas affected	Work completed to date	Further work planned
<p>Insufficient finance team resources to deliver the financial statements</p>	<p>All areas of the financial statements</p>	<p>We have received and reviewed the Council's closedown timetable and we are satisfied with the details included within the timetable.</p>	<ul style="list-style-type: none"> <li>We will continue to monitor the Council's progress against the closedown timetable to ensure that the financial statements are delivered in time.</li> </ul>
<p>Compliance with key controls within the creditors system</p>	<p>Expenditure and creditor liabilities</p>	<p>We have undertaken a walkthrough of the creditors system. We followed two invoices thorough the creditor system to identify the processes and controls in place. One of the invoices followed included a purchase order while the other did not. Our findings are outlined below on page 8.</p>	<ul style="list-style-type: none"> <li>As a part of the final accounts audit, we will test a sample of year end creditors balance to ensure that the correct procedures have been followed.</li> </ul>

# Results of interim audit work

## Scope

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

- the effectiveness of the internal audit function;
- a review of closedown procedures in preparation for the final accounts;
- walkthrough testing and tests of controls to confirm whether controls are implemented as per our understanding in areas where we have identified significant accounting assertion risk; and
- a review of Information Technology controls

## The internal audit function

We have reviewed 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 itself is contributing positively to the internal control environment and overall governance arrangements within the Council.

During the past year there have been changes to the internal audit service at the Council. The Head of Internal Audit retired at the end of February 2012 and the internal audit department now directly reports to the Assistant Director of Finance. Our view is that this increases the risk that

internal audit is not seen to be independent of the Council's operating management, as required by the CIPFA Internal Audit Standards, as a significant proportion of the reviews undertaken are related to systems and controls operating within the Assistant Director of Finance's department. However, we recognise that this risk is mitigated to an extent through internal audit having access to the Chief Executive if any sensitive issues are identified.

As a result of these changes, there is currently no formal Head of Internal Audit in place, as is required by the CIPFA Internal Audit Standards. The team is led by the two internal audit managers who have significant internal audit experience and have been employed by the Council for a number of years. The Council need to satisfy themselves that the status of the audit managers are sufficient to perform the role of the Head of Internal Audit effectively.

In preparation for our final accounts audit, we sought to review internal audit's work on the financial systems. 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 selected the Payroll and Main Accounting System Part 1 files for review. Our review concluded that:

- There was limited evidence on the file to support the sampling undertaken and the sample sizes chosen did not provide adequate coverage of the population. For example a total of 10 journals were selected out of a population of 2,276 and there was no justification on the file to support the sample size. We recommend that justifications for sample sizes are included on the audit file and that the sample size is sufficient to provide appropriate assurance; and
- From the two files reviewed no walkthroughs of the systems have been documented. We recommend that annual walkthroughs of the system are undertaken and documented to ensure that the process that have been rolled over from prior periods are still in place and that there have been no significant changes to the systems during the period.

### Closedown procedures

Our review considered the Council's timetable for closedown and the arrangements for preparing the draft accounts, including guidance provided on working papers required to be made available as part of the closedown process.

The Council has established a suitable timetable and expects to meet the deadline for submission of the accounts. The Council also expects to be able to provide detailed working papers to support the accounts at the start of our final accounts audit fieldwork, which is scheduled to commence on 30 July 2012, as well as providing the draft Annual Governance Statement and explanatory foreword in advance of this date.

### Walkthrough testing

We have undertaken specific walkthrough tests for those accounts assertion risks which we consider to present a significant risk of material misstatement to the financial statements, in accordance with ISA315.

No significant issues were noted within the PPE, payroll, Housing Benefit and Council Tax systems and in-year internal controls were observed to have been implemented and operating satisfactorily, in accordance with our documented understanding.

A number of issues were however identified with the operating expenses walkthrough (creditors). We identified that whilst there is a policy in place that requires commitments to have a purchase order prior to an order being placed, this is often not the case. This has led to inconsistencies in approach and some invoices having purchase orders whilst a number of others do not. This increases the risk that orders are being raised whilst by-passing the requirements to have a purchase order.

It is possible for the staff who initiate the purchase order to also authorise the order. When the invoice is received and the purchase order is in place this is automatically matched and no further authorisation is required prior to a payment being made. We would recommend that all purchase orders should be subject to review prior to the order being placed.

When no purchase orders are in place, the invoice is sent to be authorised by the person who initially placed the order. This clearly compromises the requirement to have an appropriate segregation of duties between ordering goods and services and authorising the subsequent invoice.

Without a purchase order being raised supplemented by a secondary authorisation prior to the payment being made could result in a risk that an officer is purchasing items fraudulently. There is also a risk that expenditure is incurred which may not offer the best value for money in line with departmental priorities.

### **Review of information technology controls**

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

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 number of areas for improvement during the course of our work in this area. 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 account management**

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 levels change. This finding has been brought forward from our 2010-11 report.

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

### **Prior year recommendations**

As part of our planned programme of work, we followed up the recommendations made during the 2010-11 audit cycle. Appendix D summarises our findings.

# Appendices

## A. Logistics

### Timetables and milestones

The following proposed timetable and deadlines have been set and agreed with management:

Event	Date
Pre year end fieldwork including internal controls review	March 2012
Statutory accounts emailed to auditor	30 June 2012
Commence accounts audit fieldwork	30 July 2012
Clearance meeting to discuss our findings	24 August 2012
Draft ISA 260 report to be issued by	7 Sept 2012
Final Accounts Committee (ISA 260)	20 Sept 2012

The audit process is underpinned by effective project to meet your deadlines. It is therefore essential that we work closely with your team to achieve this timetable. An agreed format and schedule of informal update arrangements will be maintained throughout the course of our audit fieldwork in support of this aim.

### Engagement team

In accordance with our Audit Plan 2011-12 issued in January 2012, the main engagement team for the accounts audit will include:

Name	Role	Contact details
Barrie Morris	Engagement lead	T: 0117 305 7708 E: <a href="mailto:barrie.morris@uk.gt.com">barrie.morris@uk.gt.com</a>
Julie Masci	Audit manager	T: 029 20 347506 E: <a href="mailto:julie.masci@uk.gt.com">julie.masci@uk.gt.com</a>
Llinos Brown	Audit senior	T: 0117 305 7754 E: <a href="mailto:llinos.brown@uk.gt.com">llinos.brown@uk.gt.com</a>
Adam Coupland	Audit senior	T: 0117 305 7754 E: <a href="mailto:adam.coupland@uk.gt.com">adam.coupland@uk.gt.com</a>

### Information requirements

The information and working paper requirements that will 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, issued in March 2012.

## B. Action plan

### Priority

**High** - Significant effect on control system

**Medium** - Effect on control system

**Low** - Best practice

Rec No.	Recommendation	Priority	Management Comments	Implementation date and responsibility
1	Justification should be included on the file for all sample sizes chosen for each internal audit report with an explanation of how those sample sizes provide sufficient assurance.	Medium	Agreed – We will keep a documented record of our justification for the sample sizes selected. We are also developing a workable formula for calculating and setting sample sizes	Audit Manager June 2012
2	Walkthroughs should be undertaken for all significant systems prior to a review being undertaken to ensure that the processes are still in place and there have been no significant changes to the system.	Medium	Agreed – We will introduce a pre-audit checklist to assist auditors identify changes in systems	Audit Manager June 2012
3	The Council should confirm that they are satisfied that the Internal Audit department is seen to be sufficiently independent of management to perform their role effectively.	Medium	We confirm that we are satisfied that the Internal Audit department is sufficiently independent. The new management structure of the Council ensures that the Audit Manager has right of access to the Chief Executive and the Scrutiny Committee Resources which protects the independence of the Internal Audit function.	N/A

## Action plan (continued)

Rec No.	Recommendation	Priority	Management Comments	Implementation date and responsibility
4	Purchase orders should be inputted and authorised prior to any purchase being made	Medium	Agreed - however there is still some difficulty with the order matching process within the Council's finance system. This will be reviewed during the implementation of the e-Financials upgrade to version 4.1.	Service Finance Manager October 2012
5	The Council should ensure that there is adequate segregation of duties introduced into the creditors system to ensure that appropriate authorisation occurs between the ordering of goods and services and processing invoices.	Medium	Agreed – new procedures have been agreed and will be implemented shortly.	Service Finance Manager June 2012
6	Management should consider implementing a process to review user access to the COA e-financials application on a regular basis to ensure access is appropriate based on job functions. Consideration should be given to reviewing all users accounts and access levels as part of the e-Financials upgrade to version 4.1	Medium	Agreed – This will be reviewed during the implementation of the e-Financials upgrade to version 4.1.	Service Finance Manager October 2012

## C. Follow up of prior year recommendations

Rec No.	Recommendation	Management Comments
1	<p>User access reviews</p> <p>Management should consider implementing a process to review user access to the COA e-financials application on a regular basis to ensure access is appropriate based on job functions.</p>	<p>Outstanding</p> <p>No user access reviews are currently carried out for e-financials. The Council intends to carry out a user access review as part of the upgrade to version 4.1</p>
2	<p>Network intrusion detection and prevention</p> <p>The Council should consider implementing an intrusion detection or prevention system. With significant cost implications the Council could also consider a joint procurement option with another council, which could be shared through CoCo connect to share the costs.</p>	<p>Implemented</p> <p>As part of the CoCo regime there is an annual IT health check completed which produces a detailed report with risks, actions and controls. The responses to actions are monitored on a monthly basis by the IT Assurance Officer and any highlighted/common issues are reported back to CoCo for circulation. This years annual health check was in progress as at the time of this review.</p> <p>The Council has also contracted third party contractors to carry out annual penetration/vulnerability testing. Reports resulting from these tests are also reported and used to improve information security</p>



**[www.grant-thornton.co.uk](http://www.grant-thornton.co.uk)**

© 2012 Grant Thornton UK LLP. All rights reserved.

"Grant Thornton" means Grant Thornton UK LLP, a limited liability partnership.

Grant Thornton UK LLP is a member firm within Grant Thornton International Ltd ("Grant Thornton International"). Grant Thornton International and the member firms are not a worldwide partnership. Services are delivered by the member firms independently.

This proposal is made by Grant Thornton UK LLP and is in all respects subject to the negotiation, agreement and signing of a specific contract/letter of engagement.

The client names quoted within this proposal are disclosed on a confidential basis. All information in this proposal is released strictly for the purpose of this process and must not be disclosed to any other parties without express consent from Grant Thornton UK LLP