

Audit Detailed Report

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Interim Audit Memorandum

Surrey County Council

Audit 2007/08

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Summary Report

Introduction

- 1 The purpose of this report is to summarise our work to date on Surrey County Council's (the Council's) 2007/08 accounts.
- 2 Our interim work was carried out as required by the International Standards of Auditing (ISAs) and can be summarised as:
 - Review of material financial systems;
 - Information Technology risk assessment (ITRA); and
 - Review of Internal Audit.
- 3 We use the findings of this stage of our audit to inform the focus and amount of work that we will carry out on the financial statements. At appendix 2 we attach the Opinion audit plan, which we are required to produce under ISA 300 and consider the impact of this plan on our 2007/08 audit fee.

Main conclusions

- 4 We have reviewed the council's internal audit function against the requirements of the CIPFA code and the CIPFA internal Audit Manual. We have been able to place reliance on Internal Audit's work this year in all areas where reliance was planned.
- 5 In 2005/06 and 2006/07 we raised concerns over the adequacy of the control environment in Benefits and Charging. This continues to be an issue in 2007/08. We had hoped to rely on controls operating in this area to obtain assurance over the income and debt shown in the Council's financial statements. Unfortunately the weaknesses that we have identified mean that a substantive testing approach will need to be adopted.
- 6 Work carried out by Audit and Risk Assurance, as part of the managed audit, has identified a number of instances where the Council's procedures for processing journals do not appear to have been followed. These matters are currently being followed up with officers but it likely that we will have to carry out some substantive testing of journals during our post statements audit due to these procedural weaknesses.
- 7 Our documentation and walkthrough testing of Schools Payroll has identified some areas where the Council could improve segregation of duties and the controls in place over service returns made by Schools. We have made some recommendations in this respect.

The way forward

- 8 Our action plan at appendix 1 sets out the recommendations arising from this report. We will discuss these with Council officers. We will also use the findings from this report to inform the scope of our work in our post statements audit, which will take place from July to September 2008.
- 9 We would like to thank the Shared Service Centre and Audit and Risk Assurance for their support and co-operation during this audit.

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Detailed Report

Financial systems

- 10 We confirmed our understanding of the Council's key financial systems by documenting the processes and controls in place for each key system and carrying out walkthroughs of each system to verify this documentation. We identified the key financial controls in each system, and we tested controls for those systems that were due for testing in 2007/08 as part of our cyclical testing strategy, which were:
- general ledger (including cash and bank); and
 - benefits and charging.
- 11 In carrying out the testing of controls we placed reliance on the work carried out by the Council's Audit and Risk Assurance team.

General Ledger and Cash and Bank

- 12 The Annual Governance Reports in 2005/06 and 2006/07 both included recommendations regarding residual balances on the control and suspense accounts that underpin the Council's general ledger. Work carried out this year identified that the processes in this area had been enhanced and, although outstanding balances remain on several of these accounts, the risk of material mis-statement in the Council's accounts as a result of this issue has been reduced.
- 13 As part of our post-statements testing we will review the key control and suspense accounts to evaluate whether balances have been cleared. We will also carry out detailed testing on any accounts which had significant balances outstanding at the end of the year which were cleared during the accounts closedown process.
- 14 The Council's procedures for processing journals require journal requests to be sent to the FMR team for processing. The FMR team should only process requests received from a list of authorised personnel. Testing carried out by Audit and Risk Assurance has identified a number of instances where journals have been processed by people outside the FMR team, or where the person requesting the journal was not on the authorised list of signatories. Management responses to this finding are currently being finalised, so we will assess its impact as part of our post-statements planning. At present it is probable that we will have to undertake additional and unplanned testing on in year journals to gain sufficient assurance on the validity of journal transactions.

Recommendation

R1 Processing of journals should be carried out by the FMR team as set out in the Council's procedures. Any valid exceptions to this general rule should be identified and appropriate monitoring controls put in place.

Benefits and Charging

- 15 Our testing strategy aimed to rely on the operation of two key controls within Benefits and Charging. However, in our opinion, the control environment in Benefits and Charging is poor and we have been unable to obtain the anticipated level of assurance from controls testing in this area.
- 16 The first key control on which we sought to place reliance was the professional and financial authorisation of SS358 forms. These forms set out the financial details provided by the customer and the costs of the care plan. They also provide the mechanism for professional and financial approval prior to entry of these details in to Abacus, the information system used to determine the level of benefit or charges a customer is entitled to.
- 17 Work carried out by Audit and Risk Assurance found that the application of procedures and controls over the use of the SS358 form have been inconsistently applied by the different benefit and charging area teams. In some instances the form was not being used at all, for example for referrals made by the hospital team.
- 18 We also have concerns regarding the adequacy of the control as it is currently designed. The SS358 form is an excel spreadsheet and the authorisation process is evidenced by typing the authoriser's name into the appropriate box on the form. In our opinion the IT control environment provided by spreadsheets is poor and that the completing of a box on a spreadsheet does not provide sufficient assurance that it was actually the authoriser who has completed the action. Better assurance would be provided either by some form of authorisation process built into the information system or even by a signed hardcopy of the form which could be agreed to a list of authorised signatories.
- 19 Given our reservations about the design of the control and the inconsistent application of the control in practice we feel that it would be inappropriate to seek to place reliance on it for the purposes of our opinion.
- 20 The second key control on which we planned to place reliance was the accuracy check, carried out by Area Team Managers, of five percent of the assessments made by their teams. This control, if operating effectively, would give assurance over the accuracy of data on the benefits and charging system and subsequently the charges raised through accounts receivable.

- 21 Following audit work carried out last year a process was agreed for recording these accuracy checks. However, Audit and Risk Assurance have found that compliance with this process has been inconsistent across area teams during 2007/08. The North West team have complied fully with the agreed process, North East and South West areas are carrying out some checks (but are not entirely following the agreed process) and the South East team have not completed checks and are not complying with the agreed procedures.
- 22 This inconsistent application means that we are unable to obtain assurance over the accuracy of transactions initiated through Abacus by all teams except for the North West area. This weakness will need to be addressed through further testing during our post statements audit.

Recommendation

R2 The processes and controls in Benefits and Charging should be reviewed and clarified. Procedures should be consistently applied by all teams and compliance monitored. In particular the Council should consider:

- improvements to the processes and controls for completion of SS358 forms; and
- the application of the five percent accuracy checks carried out by area team managers.

Schools' Payroll

- 23 Our walkthrough testing of schools' payroll identified weaknesses in the segregation of duties between the creating of an employee on SAP and the entering of their pay details. There is a risk that without this segregation of duties "ghost" employees may be set up on the payroll system.
- 24 This weakness is mitigated to an extent by the service returns submitted by schools, which confirm that employees and pay details are correct for a given period. However, this detection control would only identify errors after the event and is less robust than the preventative control which effective segregation of duties would provide. In addition, the robustness of the service return process is further weakened by the absence of an authorised signatories list which could provide some assurance that the authorisation of the returns is made at an appropriate level.
- 25 At this stage we are currently assessing the impact of this weakness on our testing strategy. We may need to carry out further testing in this area to obtain the level of assurance we require to give our opinion.

Recommendations
<i>R3 Segregation of duties between the creation of an employee and entering of pay details on SAP should be introduced for schools' payroll.</i>
<i>R4 An authorised signatory list should be created for service returns so that staff in Employee Services can confirm that returns are approved by staff at an appropriate level within each school</i>

Internal Audit

- 26 Wherever possible we sought to rely on the work of Internal Audit to inform our judgements during our interim audit. The purpose of this was to minimise duplication and to carry out the audit in an efficient way. We also review Internal Audit as part of the Council's system of internal control and comment on the adequacy of the audit function.
- 27 As part of our pre-statements work this year we carried out a triennial review of the Council's internal audit arrangements against the requirements of the CIPFA Code and the CIPFA Internal Audit Manual. Following our recent completion of this review, a draft report is currently being finalised which will be presented to the Audit and Governance Committee in due course.
- 28 We reviewed a sample of Audit and Risk Assurance's files in 2007/08 with a view to relying on the work that had been carried out. We have been able to rely on the work provided by Audit and Risk Assurance in all planned areas this year.
- 29 We are continuing to liaise closely with Audit and Risk Assurance and are developing a written protocol which will formalise current arrangements and set out our respective responsibilities and expectations. We continue to build on our managed audit approach to deliver our audit plans in a co-ordinated and efficient way.

Technical Accounting Issues

- 30 We have discussed accounting issues with the Council on an ongoing basis. The Audit Commission also hosted a final accounts seminar, which was attended by officers from Financial Accounting and Analysis. We are not aware at this stage of any significant accounting issues which are likely to impact upon our audit approach for the final accounts audit visit in July 2008.

Information Technology Risk Assessment (ITRA)

- 31 ISA+315 emphasises that the Information Technology (IT) element of internal control is an important part of the general control environment. The IT environment is also important because it underpins all of the subsidiary information systems which generate the material balances within the financial statements.
- 32 ISA+315 requires the completion of a risk assessment (the ITRA) of the general IT control environment. We are currently carrying out this assessment and will report any significant matters arising from this review to members in our Annual Governance Report in September.

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Appendix 1 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
7	R1 Processing of journals should be carried out by the FMR team as set out in the Council's procedures. Any valid exceptions to this general rule should be identified and appropriate monitoring controls put in place.					
8	R2 The processes and controls in Benefits and Charging should be reviewed and clarified. Procedures should be consistently applied by all teams and compliance monitored. In particular the Council should consider: <ul style="list-style-type: none"> • improvements to the processes and controls for completion of SS358 forms; and • the application of the five percent accuracy checks carried out by area team managers. 					
9	R3 Segregation of duties between the creation of an employee and entering of pay details on SAP should be introduced for schools' payroll.					
9	R4 An authorised signatory list should be created for service returns so that staff in Employee Services can confirm that returns are approved by staff at an appropriate level within each school.					

Appendix 2 – Opinion Audit Plan

- 33 The purpose of this appendix is to provide Surrey County Council (the Council) with an opinion audit plan for 2007/08 setting out a detailed risk assessment in relation to the planned opinion audit, and to describe our audit approach and proposed work for the 2007/08 opinion audit.
- 34 We issued the initial audit plan for 2007/08 in May 2007, which set out the work that we proposed to do in order to satisfy our responsibilities under the Audit Commission's Code of Audit Practice. We are required by professional auditing standards to specify the detailed risks that we need to consider as part of our opinion work. As the initial audit plan was produced at the start of the financial year for fee purposes, it was not possible to specify these risks at this time. We are now in a better position to do this as the opinion work is about to commence, so these detailed risks are considered in this appendix.
- 35 We are required to:
- identify the risk of material misstatements in the Council's accounts;
 - plan audit procedures to address these risks; and
 - ensure that our audit complies with all relevant auditing standards.
- 36 We have set out in this report our approach to identifying opinion audit risks and considered the additional risks that we have highlighted for the 2007/08 opinion audit.

Deadlines for engagement

- 37 The Council is required to prepare its financial statements and arrange for them to be approved by 30 June 2008. We are required to complete our audit of these financial statements and issue our opinion on them by 30 September 2008. The key stages in the process of producing and auditing the financial statements are shown in Table 1 below.

Table 1 Proposed Timetable

Task	Deadline
Approval of accounts	By 30 June 2008
Forwarding of main audit working papers to the auditor	30 June 2008
Start of detailed testing	7 July 2008
Present report to those charged with governance at the Audit and Governance Committee	22 September 2008
Issue of opinion	By 30 September 2008

- 38 We have already agreed with you a schedule of working papers required to support the entries in the financial statements.

Surrey County Council factors

Control environment issues

- 39 The detailed report accompanying this opinion audit plan raises some controls issues which we will need to consider further during our final accounts visit, including:
- control and suspense accounts;
 - journals;
 - weakness in benefits and charging controls which impact on care income and debt ; and
 - schools payroll.

Current developments in sector

- 40 Wider risks affecting the Council include new SORP changes in relation to Financial Instruments and Revaluation Reserves. The Council's compliance with these changes will be reviewed as part of our mandatory testing during the final accounts audit.

Local risks

- 41 Table 2 below sets out the key local risks that have been identified in relation to the 2007/08 accounts at this stage. These risks are based on our Annual Governance Report from 2006/07 and the issues raised in this year's interim audit memorandum.
- 42 We have yet to carry out detailed post statements planning, and further risks may well be identified through this process. Any further significant risks highlighted will be discussed with senior finance officers at the Council and if necessary the Chair of the Audit and Governance Committee.

Table 2 Local Risks

Risk identified	Audit Response
Outstanding balances on control and suspense accounts may result in entries in the accounts being incomplete or incorrectly classified.	We will review the level of balances on key suspense and control accounts at year end. Where significant activity appears to have been undertaken to clear these balances during accounts close down we will test a sample of these transactions to determine whether the balances have been cleared correctly.
Credit balances on debtors' accounts may mean that social care income and debtors are both understated.	We will review the breakdown of the social care debtors figure in the accounts and consider the impact of any credit balances. If necessary a sample of these credit balances will be selected for further investigation.
Weaknesses in the benefits and charging control environment mean that we have been unable to obtain audit assurance from the Council's controls over social care income and debtors	We will select a sample of customer transactions raised through the benefits and charging system and carry out substantive testing to gain sufficient assurance for opinion purposes.
The Council's processes for in year journals have not been followed consistently, so there is a risk of mis-statement in the financial statements from the in year journals that were not subject to correct authorisation.	We will identify those journals that have not been processed by a member of the FMR team and assess the potential impact of errors in these journals on the financial statements. If necessary we will substantively test a sample of these journals.
The lack of segregation of duties in schools' payroll poses the risk that "ghost" employees are created and therefore that payroll expenditure is overstated.	We are currently trying to identify other controls within schools' payroll which will provide us with additional assurance over the accuracy of the payroll. If we are unable to identify such a control, or the operation of the control does not prove effective, we will need to carry out substantive testing in this area.

Detailed Plan

- 43** ISA+315 requires the documentation and understanding of how transactions flow through the information system from initiation through to appearing in the financial statements. This exercise is limited to those transactions that are material to the financial statements - these are known as material subsidiary information systems. Material subsidiary information systems have been mapped against the figures in the accounts.
- 44** The next requirement of ISA+315 is to document and then walk through the identified systems to confirm our understanding of the significant controls which operate within them to prevent material mis-statement in the financial statements. The documentation of these material subsidiary information systems and the evaluation (identification and walk-through) of the material controls therein is mandatory for all audits, and should be done irrespective of the testing strategy i.e. even if a fully substantive audit approach is to be adopted.
- 45** ISA+315 only requires us to test key controls (where these are identified) once in every three years. This year we have tested controls in the following systems:
- general ledger (including cash and bank); and
 - benefits and charging.

Mandatory tests

- 46** Mandatory tests to be completed during the final accounts audit are as follows:
- Statements: Agree to the ledger
 - Statements: Additions, consistency & cross reference
 - Statements: Opening balances
 - Statements: Completeness
 - Statements: Supplementary Information
 - Statements: Accounting policies
 - Statements: Disclosure
 - Check material year end journals
 - Cash & Bank: Direct bank confirmation
 - Cash & Bank: Year end bank reconciliation
 - Related Party Transactions
 - Events after the balance sheet date
 - Events after balance sheet date: Represent's
 - Letter of Representation
 - Statement on Internal Control

- Evidence of litigation and claims
- Long term investments
- Income and expenditure cut-off
- FRS17 testing
- Material accounting estimates
- Segmental information
- Law and regulations
- Going concern review

Documentation standards

- 47 We have provided the Council with a comprehensive list of working expectations. The standard of working papers in the past has been assessed as 'good' so we do not consider this to be an area of risk.

Resourcing

Team allocation and budgets

- 48 The final accounts audit team includes:
- Paul Grady (District Auditor)
 - Lynn Clayton (Audit Manager)
 - Iain Murray (Audit Manager)
 - Julian Gillett (Principal Auditor)
 - Andrew Ridley (Trainee Auditor)
 - Peter Milliken (Trainee Auditor)
 - Simon Keogh (Auditor)
- 49 We have agreed with the Council to carry out the bulk of our work over a four week period commencing 7 July 2008.

Fee impact

- 50 In our original audit plan, produced in March 2007, the estimated fee for the 2007/08 financial statements opinion audit was based on our best estimate at the time and agreed at £142,185. We aim to complete the audit within the fee envelope that was previously agreed, however the interim memorandum sets out a number of areas where we will need to undertake more testing than originally anticipated within this fee, because of weaknesses in the Council's control environment. This additional work may mean we need to revisit and increase the fee previously agreed. If an additional fee is required then we will discuss this with the Council as soon as potential increases are highlighted.

Reporting

- 51 On conclusion of the audit we will present our the report to those charged with governance at the Audit and Governance Committee on 22 September 2008

Key Council contacts

- Phil Walker (Head of Finance)
- Stewart Nash (Head of Audit and Risk Assurance)
- Sergio Sgambellone (Acting Head of Shared Services)
- Kevin Kilburn (Financial Accounting and Analysis Manager)
- Tracey Milner (Pension Fund and Treasury Manager)
- Nicola O'Connor (Senior Principal Accountant)
- Alison Leung (Senior Accountant (Capital))