

Final Accounts

Memorandum

Cheshire East Borough Council

Audit 2009/10

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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Introduction

1 The Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies (the Statement) sets out the respective responsibilities of the auditor and the Council. The Audit Commission has issued a copy of the Statement to every audited body. The Statement summarises where the different responsibilities of auditors and of the audited body begin and end, and our work is undertaken in the context of these responsibilities.

2 We comply with the statutory requirements governing our audit work and, in particular, with the Audit Commission Act 1998 and the Code of Audit Practice (the Code). The Code defines our work in two main areas, the opinion on the financial statements and our value for money conclusion.

Financial statements

3 I completed my audit of the 2009/10 financial statements of Cheshire East Borough Council (The Council) including work on the systems and controls that support the recording and reporting of financial information in September. I presented the findings from the audit to the Audit and Governance Committee and issued an unqualified opinion on 30 September.

4 This report brings together action points that officers and Members will need to consider for the preparation of the 2010/11 financial statements. These include:

- the qualitative issues reported in the Annual Governance Report;
- other identified opportunities for strengthening controls and procedures; and
- action in respect of known risk areas for the 2010/11 accounts.

5 I would like to take this opportunity to thank the Borough Treasurer and her staff for all their help and support during the audit.

Main conclusions

6 This has been a challenging year for officers as they prepared the Council's first set of accounts. In addition to a major exercise to agree opening balances, there were a number of technical issues to deal with such as the implementation of new accounting rules around the recognition of private finance initiatives and service concessions and changes to collection fund accounting. These issues were generally dealt with successfully. However, the accounts did contain a significant number of errors particularly in relation to less technical areas. The working papers and audit trail to support the accounts were adequate, with some exceptions, and officers responded positively to requests for additional information.

7 Overall there is scope to improve the accuracy of the accounts presented for Members to approve. There is also scope to improve the quality and timeliness of supporting working papers presented for audit. In particular, introducing a robust quality assurance process which includes a review of the accounts by a senior officer should ensure that the disclosures in the accounts comply with the Statement of Recommended Practice and that errors are identified and corrected before the accounts are presented to Members for approval.

8 We had set a fee of £402,925 for the audit in April 2009, based on a number of assumptions. During the audit, I had to carry out additional work on opening balances, agreeing amendments to the accounts, and detailed testing of transactions due to control failures in order to gain sufficient audit assurance to issue an unqualified audit opinion. This work was over and above the assumed level of work included within the initial fee.

9 I therefore plan to raise an additional fee of £13,650. The reasons for the increase and level of fee have been discussed and agreed with the Borough Treasurer.

Detailed findings

Qualitative issues identified in the Annual Governance Report

10 The financial statements were approved by Members before the deadline of 30 June 2010. However, the officers briefing note to the Audit and Governance Committee explained additional work was required on the Statement of Recognised Gains and Losses (STRGL), the Statement of cash flows and earmarked reserves because of balancing figures in the accounts.

11 The STRGL and Cash flow are two of the four primary financial statements in the accounts. The STRGL reports the total movement in the Council's net worth for the year by bringing the gains and losses recognised in the Council's balance sheet together with the outturn for the year reported on the Income and Expenditure Statement. The cash flow summarises the cash flows in and out of the Council during the year and is useful in assessing whether there is sufficient cash available to pay the Council's bills.

12 Officers carried out further work during the next three months and as my audit was in progress, to identify and correct the discrepancies. As a result the level of the discrepancies was reduced significantly to £91k and £196k in the STRGL and cash flow respectively.

13 The financial statements approved in June were amended for five material errors and 22 non-material errors. The adjusted errors increased the deficit reported in the draft accounts from £64,317k to £66,639k. In addition my audit identified five unadjusted misstatements which management declined to adjust.

14 The adjusted errors included numeric errors, changes to classification of items of account and amendments to disclosures. For example:

- Overstatement of long-term debtors and long-term creditors (£18 million)
- Misclassification of short term investments and debtors as cash ~ (£10 million and £22.7 million respectively)
- Amendment to disclosures in accounting policies to fully comply with SORP guidance.

15 In addition we identified a number of errors due to netting off balances instead of reporting items at their gross value. For example:

- PFI impairment shown at net value in the income and expenditure account resulting in an understatement of expenditure of £2.1 million.
- Fixed asset additions and impairments netted off against each other resulting in understatement of both items of £10.6 million.

16 The working papers and audit trail to support the accounts were adequate but there were some exceptions. Officers responded very positively to requests for additional information.

17 However, there is still scope to significantly improve the quality and accuracy of the accounts presented for audit and the quality and timeliness of supporting working papers. In particular, the accounts should be reviewed by a senior officer to ensure that the disclosures in the accounts comply with the Statement of Recommended Practice (SORP) and that compilation errors are identified and corrected before the accounts are presented to Members.

Recommendation

R1 Implement a quality assurance process to improve the standard of the accounts presented for audit, ensure compliance with the SORP and reduce the number of accounts compilation errors.

R2 Ensure that a full set of working papers to support the accounts is available when the accounts are submitted for audit

Other improvement areas

18 During the audit, we identified other areas where controls and procedures can be strengthened.

Issues arising from our review of the control environment

19 As part of our planning work we reviewed the Council's IT control environment to assess potential risks. This work was carried out during January / February 2010.

20 Overall we assessed the risk that weaknesses in the IT general control environment could reduce the effectiveness of system level automated controls as low. The key findings from this assessment were as follows.

- A number of interim IT security policies were still in use nine months after the Council came into being and some of the information they contained was out of date. A new suite of Cheshire East ICT security policies was in development but had not yet been approved or made available for use by March 2010.
- The Disaster Recovery Plan was out of date and did not reflect the current arrangements with the disaster recovery supplier. The plan did not link with the individual services business continuity plans and there was no prioritised system recovery timetable based on business needs. Very little testing had been carried out on systems disaster recovery during the year.
- The new data centre has been built on a flood plain - and this will need to be considered as part of the review of the Disaster Recovery Plan.

Issues arising from our review of financial controls

21 Our testing of key controls in the financial systems at both the Council and the shared service found that controls were generally operating as intended with the following exceptions.

22 We reviewed the year end bank reconciliations and found reconciling items totalling £1.1 million, relating to income received in the bank but not posted onto the general ledger before the year end. This resulted in an understatement of income and bank balances recorded in the accounts.

Recommendation

R3 As part of the reconciliation process, reconciling items should be cleared on a timely basis to ensure that income, expenditure and cash balances are accurately reflected in the ledger.

23 Our review of payroll controls operating at the shared service found insufficient evidence had been kept throughout the year to demonstrate payroll payment runs had been authorised by the supervisor prior to payment. As a result, we undertook additional checks to obtain assurance payments made were valid Council expenditure.

Recommendation

R4 Remind staff that they should evidence the operation of controls that they are responsible for operating.

24 The control over the authorisation of income invoice requisitions was turned off by management early in the year. This control provides assurance that all expected income is invoiced at the correct amount and coded correctly. We undertook additional testing to gain assurance over the accuracy and classification of income reported in the accounts.

Recommendation

R5 Council to consider re-instating the control over the authorisation of income invoice requests.

25 We found the controls over journal authorisation, coding and supporting documentation were operating as expected. Despite this, detailed testing of journals as part of the accounts audit, found that a significant number of the journals posted were corrections of or to journals previously posted.

26 An example of this was the overstatement of year end debtors and creditors by £1.9 million due to the posting of a journal intended to adjust for items in the accounts that had previously been adjusted.

Recommendation

R6 Strengthen managerial oversight of journals to ensure that the initial journals posted are accurate and that the need for correcting journals is kept to a minimum.

Other Issues arising from our review of financial statements

Fixed assets

27 Our audit of fixed assets found a number of errors mainly due to classification errors and the inclusion of net amounts in respect of additions and impairments. A number of amendments were agreed as follows.

- Increase in valuation of assets under construction by £1.045 million being expenditure previously classified as 2010/11 expenditure and by £1.195 million expenditure previously written off as capital expenditure not adding value.
- Decrease in land and building valuation of £4.023 million relating to an asset demolished in year but not excluded from the asset register.
- Increase in value of additions and impairments of £10.6 million to show these items gross in line with recognised accounting practice.

28 The following errors were not adjusted in the accounts.

- Depreciation of £0.11 million charged in error on surplus assets and investment properties.
- Community assets revalued in error giving rise to an overstatement of £0.172 million.

29 From our review of the form and content of the asset register for compliance with guidance, we identified scope to improve the information recorded in the register by recording the cost centres to which assets are allocated, the basis of valuation of assets, reasons for impairments (to aid subsequent reversal) and the value and reasons for impairments charged to I&E.

Recommendation

R7 Review the level of information recorded in the fixed asset register to ensure compliance with guidance.

R8 Strengthen the procedures in place to ensure that asset disposals or demolitions and the reclassification of assets between, for example, operational and non-operational are actioned promptly in the asset register.

30 During the year, a revaluation exercise was undertaken covering all ex-district land and buildings. This work was undertaken by the District Valuer (for ex Crewe and Congleton assets) and a private valuer with previous knowledge and experience of ex-Macclesfield assets. The overall results of the valuations were:

- 1.2 per cent decrease in operational asset valuation for Congleton;
- 9 per cent increase in operational asset valuation for Crewe; and
- 25 per cent increase in operational asset valuation for Macclesfield.

31 Enquiries of officers did not identify any significant local circumstances which would account for this wide variation. This may have been because officers did not scrutinise and challenge the information received back from the valuers before using it as the basis of valuation.

32 We carried out additional testing to gain assurances as to the professional credentials of valuers, scope and nature of work carried out, basis of valuations and corroborative procedures on the results of revaluations.

Recommendation

R9 Officers should formally record the steps taken to gain assurances around the qualifications and expertise of the experts on whose work they plan to place reliance to derive figures used in the accounts.

R10 Officers should undertake corroborative procedures on the results of experts' work to assure themselves that the results fully address the work specified; that the results are in line with expectations, and if not reasons for variations are understood.

Opening balances

33 As a result of local government reorganisation, the Council was required to prepare an opening balance sheet to reflect the three ex-district assets and liabilities and the share of the County Council's balance sheet, using merger accounting principles. The balances were subsequently adjusted to reflect cash postings on legacy systems.

34 Our work concluded that while the inherited assets and liabilities were accurately reflected in the Council's ledger and accounts, opening intra authority debtors and creditors of £1.2 million net had not been removed from the opening balance sheet in line with merger accounting principles. These amounts were written out during the year through a mixture of cash transactions and journal postings.

35 In addition we identified adjustments to opening balances on debtors and creditors of £0.69 million and £0.87 million for which there was no supporting audit trail. These items were reported as unadjusted items in my Annual governance report to the Committee on 30 June 2010.

Recommendation

R11 Carry out a post implementation review to identify lessons learned from the restatement exercise, particularly around timing of work, adequacy of audit trail and control and accuracy of journal postings, to inform planning of the International Financial Reporting Standards restatement exercise in 2010/11.

Doubtful debt provision

36 Our review of the doubtful debt provision which comprises a number of elements, found that there was an over provision for housing benefits debts. This was offset by an under provision for sundry debts so the overall provision was not materially understated. This arose because the method used to calculate the provision did not comply with the Council's stated accounting policy where provision should be made for all debts over six months old.

Recommendation

R12 Ensure that the methodology used to calculate the doubtful debt provision complies with the Council's accounting policy.

Looking forward

Shared services

37 Cheshire East uses a shared service, hosted by Cheshire West and Chester Council, to manage its major financial ledgers including payroll. All the Council's financial transactions are processed by the shared service and the Council is reliant on shared service staff to operate various financial controls including managerial checks.

38 Effective auditing of the shared services operation is fundamental to establishing a sound control environment. It provides assurances to Council managers and those charged with governance on the accuracy and completeness of the underlying of the financial records used in day-to-day management and decision making and for statutory financial reporting.

39 Cheshire East and Cheshire West and Chester Councils are currently developing an internal audit protocol around the audit of shared services. The protocol covers audit planning, delivery and reporting. Agreement of this protocol, and of a tailored internal audit plan for the audit of shared services in 2010/11, should significantly strengthen the assurance gained over the effective working of your financial systems.

International Financial Reporting Standards

40 The Council's financial statements will be prepared using International Financial Reporting Standards for 2010/11. This will require restating the closing balances from the 2009/10 financial year. This is a major exercise requiring input and expertise from across the organisation, from both service areas and back office teams such as HR, Finance and Estates.

41 Council officers are in the process of pulling together detailed plans and timetables for the restatement exercise. The 2009/10 experiences around the opening balances exercise should provide useful lessons to assist officers in preparing and implementing their detailed plans. We will work closely with the Borough Treasurer and her team over the coming months to monitor progress in delivering the implementation plans.

Appendix 1 Action plan

Recommendations	
Recommendation 1	
Implement a quality assurance process to improve the standard of the accounts presented for audit, ensure compliance with the SORP and reduce the number of accounts compilation errors.	
Responsibility	
Priority	
Date	
Comments	
Recommendation 2	
Ensure that a full set of working papers to support the accounts is available when the accounts are submitted for audit.	
Responsibility	
Priority	
Date	
Comments	
Recommendation 3	
As part of the reconciliation process, reconciling items should be cleared on a timely basis to ensure that income, expenditure and cash balances are accurately reflected in the ledger.	
Responsibility	
Priority	
Date	
Comments	
Recommendation 4	
Remind staff that they should evidence the operation of controls that they are responsible for operating.	
Responsibility	
Priority	
Date	
Comments	
Recommendation 5	
Council to consider re-instating the control over the authorisation of income invoice requests.	

Responsibility	
Priority	
Date	
Comments	
Recommendation 6	
Strengthen managerial oversight of journals to ensure that the initial journals posted are accurate and that the need for correcting journals is kept to a minimum.	
Responsibility	
Priority	
Date	
Comments	
Recommendation 7	
Review the level of information recorded in the fixed asset register to ensure compliance with guidance	
Responsibility	
Priority	
Date	
Comments	
Recommendation 8	
Strengthen the procedures in place to ensure that asset disposals or demolitions and the reclassification of assets between, for example, operational and non operational are actioned promptly in the asset register.	
Responsibility	
Priority	
Date	
Comments	
Recommendation 9	
Officers should formally record the steps taken to gain assurances around the qualifications and expertise of the experts on whose work they plan to place reliance to derive figures used in the accounts	
Responsibility	
Priority	
Date	
Comments	
Recommendation 10	
Officers should undertake corroborative procedures on the results of experts' work to assure	

themselves that the results fully address the work specified expectations; that the results are in line with expectations, and if not reasons for variations are understood.

Responsibility

Priority

Date

Comments

Recommendation 11

Carry out a post implementation review to identify lessons learned from the restatement exercise, particularly around timing of work, adequacy of audit trail and control and accuracy of journal postings, to inform planning of the International Reporting Standards restatement exercise in 2010/11.

Responsibility

Priority

Date

Comments

Recommendation 12

Ensure that the methodology used to calculate the doubtful debt provision complies with the Council's accounting policy.

Responsibility

Priority

Date

Comments

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