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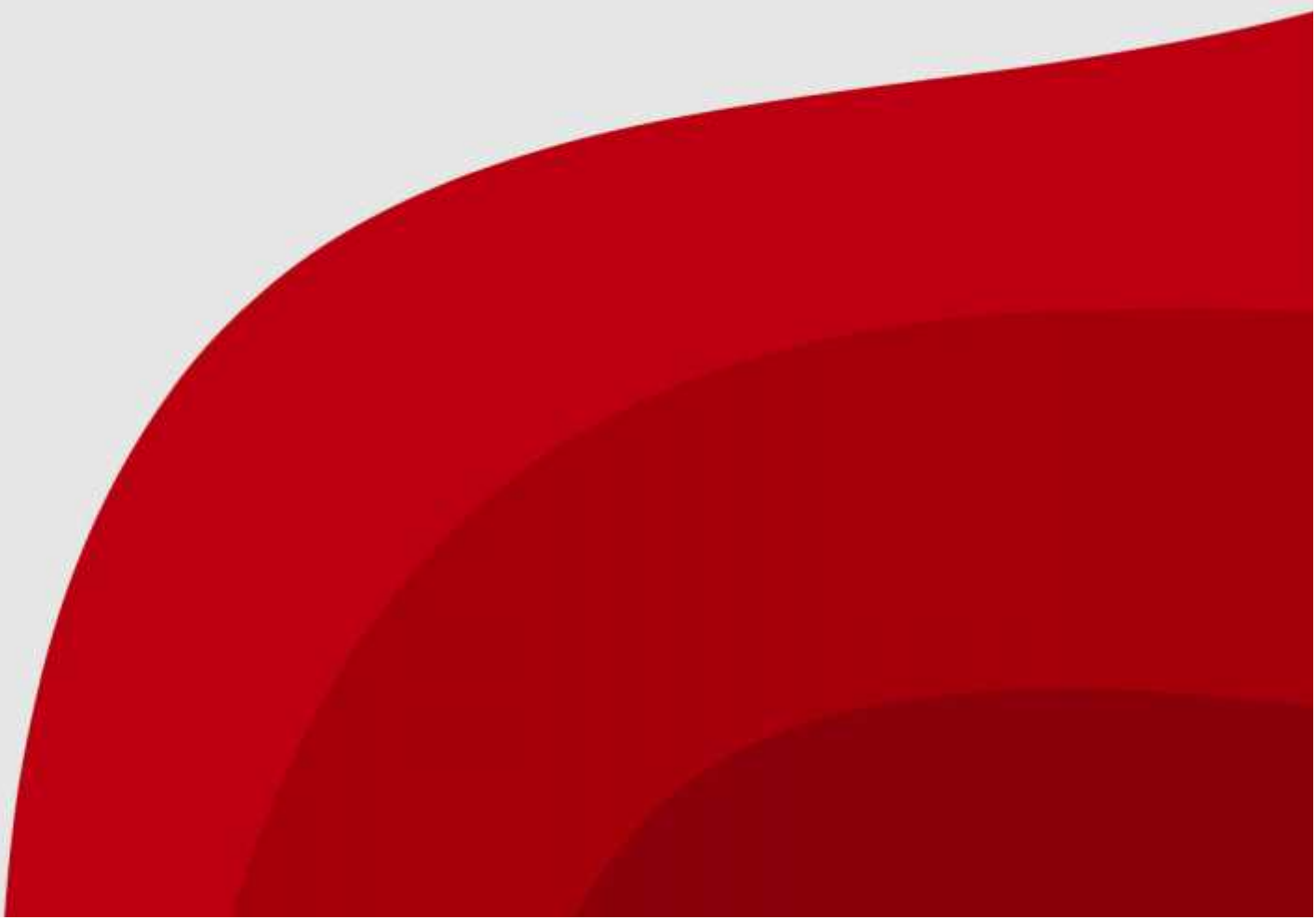
Financial Statements Memorandum

Powys County Council

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Status of report

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Summary report

Summary

1. Powys County Council (the Council) was responsible for preparing financial statements that give a true and fair view of the state of affairs of the Council at 31 March 2013. This included its Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, the Movement on the Housing Revenue Account Statement and the Housing Revenue Account Income and Expenditure Statement for the year then ended. It should also ensure that they are properly prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2012-13 based on International Financial Reporting Standards (IFRS).
2. It was also responsible for preparing an Annual Governance Statement (AGS) in accordance with guidance issued by HM Treasury and the Welsh Government.
3. As auditors, we are required to audit the financial statements and to issue an auditor's report which includes an opinion on whether the financial statements give a true and fair view of the state of affairs of the Council as at 31 March 2013.
4. In giving this opinion, we comply with International Standards on Auditing (ISAs). In particular: ISA 315 requires us to obtain a comprehensive understanding of the activities of the Board's operations and its internal controls; to identify and assess the level of material risks to the financial statements; and for each risk of material misstatement identified, ISA 330 requires us to undertake audit procedures to address the identified risks.
5. In undertaking this work we assessed: if there is an effective internal control environment; whether the significant financial systems have appropriate internal controls; and if the Board has appropriate arrangements for producing financial statements that are free from material misstatements.
6. Based on our risk assessment we identified, documented and evaluated the significant financial systems that support the Council's financial statements. We tested the high-level financial controls for the main accounting system, budgetary control and accounts preparation and closedown procedures. These systems and processes contribute to the Council's preparation of the financial statements and we assessed the extent to which we could place reliance upon them. We also undertook detailed audit work on the accounts and relevant account areas which was tailored to reflect both national and local issues.
7. The key matters arising from our audit in terms of the qualitative aspects of the Council's accounting and reporting practices were reported to the Audit Committee (those charged with governance) on 26 September 2013 (ISA260 report). This memorandum summarises the more detailed matters arising from the audit and identifies any scope for improvement.
8. The Appointed Auditor was able to issue an unqualified opinion on 30 September 2013. However, the audit has not been formally concluded and an audit certificate issued as enquiries arising from matters raised by a number of whistleblowers have yet to be completed.

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9. The Council had adequate internal control procedures and arrangements to reduce the risk of material misstatement to the financial statements, and an unqualified audit opinion was given. However, we have identified the need for significant improvements in a number of areas including working papers supporting the financial statements, quality control arrangements, financial reporting and internal audit (IA) documentation.

Recommendations

10. The recommendations for improvement are shown in the Action Plan in [Appendix 1](#). The recommendations highlight that there is scope for the Council to significantly strengthen its policies and procedures in relation to the production of its financial statements, and internal control environment generally.

Detailed report

The Council had adequate internal control procedures to reduce the risk of material misstatement to the financial statements. However, there were areas where improvements could be made

We did not identify any material weaknesses in the internal control environment

11. We reviewed the Council's internal control framework to help us understand the Council's activities and assess the risk of material misstatements to the financial statements. ISA 315 identifies the following components of internal control:
 - Control environment
 - Risk assessment process
 - Information system
 - Control activities
 - Monitoring of controls
12. We did not identify any material weaknesses in the Council's internal control environment.

Controls within the budgetary control system were effective in identifying material variances. However, financial reporting could be strengthened by improving the quality and detail of the information provided to officers and members

13. Budgetary control is an important part of the control system, acting as a backstop against material errors remaining undetected. As a result, it forms part of the Council's internal control environment and is a high-level control in terms of our audit risk assessment.
14. We reviewed the key controls in the system which we consider are necessary to provide assurance that the system is operating effectively and as intended. We also assessed whether the Council has put in place adequate arrangements to monitor its own financial standing.
15. Our assessment of the Council's system overall gave us assurance that the budgetary control system was effective in identifying a potential material error or omission.
16. However, our work has identified a number of issues which should be addressed to improve the effectiveness of the budgetary control process, and financial reporting to members.
17. We found that there are currently no up-to-date detailed budgetary control procedures in place and as a result roles and responsibilities are not clearly defined.

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18. We also noted that monitoring reports do not contain action plans setting out how significant variances will be addressed in order to achieve the year-end forecast position, nor have the Council set 'trigger levels' for variances that require explanations from budget holders. Furthermore, there is no formal mechanism recording that budget holders have reviewed monitoring information for accuracy prior to inclusion in the Head of Service report; or that Heads of Services have reviewed information prior to inclusion in the Cabinet Report.
 19. Additionally, there is scope to improve the process for identifying and authorising virements. We had difficulty in identifying virements on the ledger as they were classified in the same way as an initial budget upload or a budget re-profile. Furthermore, virement procedures should be updated to clarify the process for the authorisation and posting of inter-directorate virements.
 20. Our work also identified potential improvements that could be made to the information contained in the Cabinet Reports. In our view these reports should inform Members of the original approved budget as well as revised budget figures. It should show the actual income and expenditure position for the reporting month as well as forecast outturn position. This would give members increased scope to provide appropriate scrutiny and challenge, and should help improve decision making. The reports should also clearly set out how transfers to and from reserves have impacted on the financial position in-year.
 21. Since our review back in the summer of 2013, the Accountancy Manager has already begun the process of improving the financial reporting to members. The latest reports now include the original budget and have information on how reserves are used.

Controls within the main accounting system were operating as intended, however, there are some actions that can be taken to help minimise future potential risks to the IT environment

22. The main accounting system formed the basis for preparing the 2012-13 financial statements. We therefore assessed the effectiveness of the controls within the main accounting system and considered whether it accurately reflected the transactions recorded by the respective feeder systems during the year.
23. Our work also included a review of key feeder systems: Payroll; Creditors; Debtors; Revenues; Cash Receipting; ROCC and the Fixed Asset Register. We identified no material weaknesses in these systems. However, we have identified some areas where improvements could be made:
 - The Windows 2003 operating system is approaching the end of its life cycle, some servers are still running this software, which is currently within the extended support stage (which is expensive) and will not be supported after July 2015.
 - Microsoft Windows XP is approaching the end of its lifecycle. Desktops are currently being refreshed with Windows 7, as the current operating system will not be supported from 8 April 2014.

- Generally, physical and environmental controls are robust, but the server room fire suppression facilities are inadequate. There is a hole in the server room wall which would allow the fire suppression gas to leak in the event of a fire. If not resolved, this would affect the functioning of the fire-suppression system, increases the risk that it may not be effective in the event of a fire. Methods of access for suppliers are secure, however, access is not limited to a specific time period. This means that access could be left open for a period after the work has been completed, and increases the risk of unauthorised changes to its systems and software.
- The location of offsite backup media storage is inadequate as it is still stored too close to the main building. This situation provides an increased risk that backup data may not be available in the event of a major disaster and the Council may not be able to restore the ICT systems.
- The Council's scheme of delegation states that journals greater than £100,000 must have additional authorisation, but our sample testing found one of three journals did not have the additional authorisation required..

Recommendations

R1 The Council should ensure that there are up-to-date detailed budgetary control procedures in place to act as a reference point for staff involved in the process.

R2 The quality and quantity of budget monitoring information should be improved to enhance decision making. The Council should consider:

- setting 'trigger' points to ensure that all significant variances are adequately explained;
- including action plans in the reports detailing how the variances will be addressed in order to the achieve the year-end forecast position; and
- clarifying the process for monitoring and reporting reserves and ensure it is consistently applied.

R3 The Council should ensure that there is a clear process for the identification, recording, authorisation and reporting of virements.

R4 The Council should review the budget reports produced for the Cabinet to ensure there is adequate information to enable informed decisions. Consideration should be given to producing original budget figures as well as revised budget figures, and also producing the actual income/expenditure position for any given reporting month as well as forecast position. The Council should also consider the way in which it reports transfers to and from reserves to ensure the position is transparent.

R5 Ensure that Windows 2003 operating systems are replaced before the end of the extended support lifecycle.

Recommendations

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|-----|---|
| R6 | Ensure that the desktop refresh project is completed before the end of Microsoft support for Windows XP. |
| R7 | Expedite the repair of the hole in the server room wall which would allow the fire-suppression gas to leak in the event of a fire. |
| R8 | Consider implementing time limited access for supplier/third parties. |
| R9 | Identify a new location for storage of offsite backup media at a suitable distance away from the main building, based on risk assessment of the surrounding area. |
| R10 | All journals should be appropriately authorised in line with the scheme of delegation prior to being posted to the ledger. |

Powys County Council produced the draft financial statements within the agreed timetable. However, there were significant issues with closedown procedures, quality control procedures and supporting working papers

24. We received the draft financial statements for audit in line with the agreed deadline of 28 June 2013.
25. The draft accounts included a number of errors, and adjustments were identified and corrected through the course of our audit. The amendments made to the draft financial statements were summarised in our *Audit of the Financial Statements Report* presented to the Audit Committee (those Charged with Governance) on 26 September 2013. Also included in this report were other significant issues arising from the audit this year. We reported concerns about the qualitative aspects of the accounting practices and financial reporting as well as difficulties during the audit obtaining accurate and timely information to support the figures in the financial statements. These issues related to:
 - a lack of supporting documentation for the valuation of assets;
 - some out-of-date and inaccurate information recorded on the asset register;
 - some valuations not being in compliance with the CIPFA Code;
 - inaccurate and incomplete systems reports produced and provided as audit evidence;
 - material internal recharges included within the draft financial statements;
 - an initially unsupported job evaluation provision of £3.5 million;

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- Note 27 – segmental reporting not reconciling to the main financial statements and notes; and
 - the late submission for audit of the Whole of Government Accounts.
- 26.** In addition to those issues reported to you in September, we had difficulties in other areas, which whilst less significant still require improvement or clarification for 2103-14. These areas are summarised below:
- Prints were not being produced to support the financial position at the year-end for the insurance system. As the system is a 'live system' it was not possible to run a report for the year-end at the time of the audit and fully support the figures included in the accounts.
 - Purchase card reconciliations – reports and reconciliations were requested for audit testing at the end of July but the information was not provided until September.
 - Disclosure requirements not always adhered to – only the income and expenditure details were disclosed for information in relation to Rhayader Leisure Centre, the balance sheet should also have been disclosed.
 - The working papers reconciling the Housing Revenue Account statements to the ledger were not complete.
 - Working papers provided in some cases were not the final documents, a quality review of the files and working papers as part of the Council's closedown process would have identified these errors.
 - A number of omissions and errors were identified in the Whole of Government Accounts return.
 - There were a number of errors identified in the calculations and classification of figures feeding into the Cash Flow Statement. The figures for interest paid and received were incorrectly recorded, and it was problematic to tie back the cashflow figures to the figures in other statements within the accounts and supporting documents.
 - There still remain some school bank balances that have not been reconciled to the ledger.

Procedures for the recording of the capital grants do not always ensure capital grants are classified and accounted for correctly

- 27.** Inconsistencies were found in the accounting for capital grants. Care needs to be taken to ensure that all capital grants are correctly classified as either:
- grants received in advance but full conditions of the grant not fully met;
 - grants received and conditions met – but not used (capital grants unapplied); and
 - capital grants applied in the year to fund capital expenditure.
- 28.** It is essential that the accounting treatments of the grants reflect the position correctly and that changes are clearly documented, particularly where a grant moves from one category to another.

Recommendations

- R11 The significant issues raised in the *Audit of Financial Statements Report* presented to the Audit Committee in September must be addressed.
- R12 A review should be carried out of the production of the final accounts working papers and supporting documents. All working papers and system prints supporting the statement of accounts should be retained and be complete.
- R13 The procedures for producing the cashflow need to be reviewed and changed to ensure that errors in classification and calculation of cashflow figures are minimised. The figures included must be fully supported.
- R14 Reconciliations of the schools bank balances to the financial ledger should be carried out to ensure that SIMS balances have been transferred accurately.
- R15 The process for accounting for capital grants should be reviewed and the balances checked for correct classification and accounting treatment.
- R16 When completing the Whole of Government Accounts care needs to be taken to ensure that all significant balances and transactions with other public bodies are clearly identified and recorded.
- R17 All balances over the £5 million threshold set by the Welsh Government should be confirmed and agreed with the body in question.

Powys County Council has appropriate arrangements in place for Internal Audit, however, improvements are needed to ensure that there is a clear audit trail from the identified audit risks to the work carried out

29. Internal Audit (IA) is a key part of an audited body's internal control arrangements. ISA 610 requires us to assess IA each year where it is relevant to our risk assessment. We review IA to assess whether it complies with the CIPFA professional standards. The requirements of the standards form the basis of our assessment and the conclusions we draw. We can conclude that IA generally met the standards, but have made recommendations for improvement.
30. Our approach involved meetings and discussions with the Head of IA, a review of key documentation including audit files, and a detailed review of a sample of their work.

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- 31.** A number of fundamental financial systems reviews that were planned to have been carried out by IA have been deferred to next year. We were informed that this was largely due to staff on long-term sick leave, and unforeseen requested work (including investigations), and requests by service managers to defer reviews as they were under pressure. The long-term impact of staff absences and other demands could impact on the ability of IA to deliver a full audit plan, and an end-of-year audit opinion. This situation should be reviewed and the impact of long-term absence on the audit plan assessed.
- 32.** Our review of a sample of files has raised a number of issues this year:
- Each audit should be linked to the Corporate or individual department's Risk Register to confirm the risks associated with the system or department being audited. It ensures that audits are carried out on a 'risk priority' basis with higher risk areas given greater priority as required.
 - One of the most important tests of the effectiveness of IA files is whether there is an effective audit trail between the work recorded and carried out and the evidence to support this. A review of the working paper files found that there was a lack of this trail from the Audit Test Summary Sheets (TSS) and in some cases there was no supporting evidence behind the TSS. Where supporting working papers were present on the file these were not numbered or referenced to the TSS. This lack of an audit trail means that it would be very difficult for another auditor to re-perform the tests or to verify the work undertaken, which is a requirement of the Standard.

Recommendations

R18 The impact of staff absences and unplanned work should be continually assessed and reported to the Audit Committee.

R19 Procedures need to be put in place to ensure that all IA files record:

- a clear trail of the risk assessment through to the detailed testing carried out to support the risk identified; and
- TSS should all be supported by audit evidence allowing an independent experienced auditor to re-perform the test.

Appendix 1

Action Plan

Page	Recommendation	Agreed	Responsibility and actions	Completion date
8	R1 The Council should ensure that there are up-to-date detailed budgetary control procedures in place to act as a reference point for staff involved in the process.		Head of Professional Services	
			Development of a new Contract with services clearly defining the roles of responsibilities of both Budget Holders and Finance Staff.	May 2014
			Development of a handbook/toolkit for budget managers detailing procedures.	October 2014
			Professional Lead for Finance – Development and delivery of budget management training for budget holders.	July 2014 to March 2015

Page	Recommendation	Agreed	Responsibility and actions	Completion date
8	<p>R2 The quality and quantity of budget monitoring information should be improved to enhance decision making. The Council should consider:</p> <ul style="list-style-type: none"> • setting 'trigger' points to ensure that all significant variances are adequately explained; • including action plans in the reports detailing how the variances will be addressed in order to the achieve the year-end forecast position; and • clarifying the process for monitoring and reporting reserves and ensure it is consistently applied. 		Professional Lead Finance/Strategic Director Resource/Reporting and Data Integrity Accountant	
			Cross Council Working Group established to review and improve the provision of budget monitoring information to ensure it is effective for decision making.	April 2014 – August 2014
			Review of the roles in reporting budget monitoring information Budget Managers/HoS/Strategic Directors.	April 2014 – August 2014
			Review of Budgetary control requirements with the wholesale review of the Financial Regulations.	March 2014 – July 2014
			Centralisation of Reserves and corporate decision making in their use.	Already in place
			Reporting of reserves position included in the Financial Monitoring Reports.	Already in place
8	R3 The Council should ensure that there is a clear process for the identification, recording, authorisation and reporting of virements.		Review of Financial Regulations together with provision of clear roles and responsibilities – refer to R1 above.	June 2014

Page	Recommendation	Agreed	Responsibility and actions	Completion date
8	R4 The Council should review the budget reports produced for the Cabinet to ensure there is adequate information to enable informed decisions. Consideration should be given to producing original budget figures as well as revised budget figures, and also producing the actual income/expenditure position for any given reporting month as well as the forecast position. The Council should also consider the way in which it reports transfers to and from reserves to ensure the position is transparent.		Professional Lead for Finance – Reports being reviewed and improvements implemented for financial year 2014/15.	April 2014
			Reports have already been amended to include Original Budget, and reserve movements.	Already in place
8	R5 Ensure that Windows 2003 operating systems are replaced before the end of the extended support lifecycle.		The Windows 2003 Server refresh project is currently being commissioned to replace servers across the authority.	
9	R6 Ensure that the desktop refresh project is completed before the end of Microsoft support for Windows XP.		Windows 7 completed 31st March with the exception of a small number of library and comms centre PCs that are dependent on external software.	
9	R7 Expedite the repair of the hole in the server room wall which would allow the fire-suppression gas to leak in the event of a fire.		Quote has been received and the work has been passed to property to complete.	
9	R8 Consider implementing time limited access for supplier/third parties.		This has been reviewed inline with our security policy and will be considered when these policies are refreshed 14/15.	

Page	Recommendation	Agreed	Responsibility and actions	Completion date
9	R9 Identify a new location for storage of offsite backup media at a suitable distance away from the main building, based on risk assessment of the surrounding area.		PCC investigating 2nd site replication facilities to Welshpool. Tapes required near for restore requirements.	
9	R10 All journals should be appropriately authorised in line with the scheme of delegation prior to being posted to the ledger.		Professional Lead for Finance – Enforce authorisation procedures. Regular review to ensure procedures have been applied.	January 2014
11	R11 The significant issues raised in the <i>Audit of Financial Statements Report</i> presented to the Audit Committee in September must be addressed.		Strategic Director Resources	
			Review of the Closing of Accounts, work commissioned.	April 2014
			Head of Professional Services/Professional Lead for Finance – to address and rectify issues raised.	Procedures in place for Closure of Accounts for 2013/14.
11	R12 A review should be carried out of the production of the final accounts working papers and supporting documents. All working papers and system prints supporting the statement of accounts should be retained and be complete.		Head of Professional Services/Professional Lead for Finance – to address and rectify issues raised in paragraph 26.	March 2014 – Procedures in place for closure of 2013/14 Accounts.

Page	Recommendation	Agreed	Responsibility and actions	Completion date
11	R13 The procedures for producing the cashflow need to be reviewed and changed to ensure that errors in classification and calculation of cashflow figures are minimised. The figures included must be fully supported.		Professional Lead for Finance – Review of appropriate method to produce cashflow. Training and support for Financial Reporting and Policy Accountant.	Actioned for Closure of Accounts 2013/14
11	R14 Reconciliations of the schools bank balances to the financial ledger should be carried out to ensure that SIMS balances have been transferred accurately.		Professional Lead for Finance	
			Review of cash advance amounts to schools within the Scheme for the Financing Schools.	Currently underway - April 2014
			Schools requested to submit monthly Bank reconciliations to ensure that they are being completed.	Already in place
			Reconciliation of School Bank Account Balances to the Authorities Financial Ledger.	Actioned as Accounts closed with schools May 2014
11	R15 The process for accounting for capital grants should be reviewed and the balances checked for correct classification and accounting treatment.		Professional Lead for Finance – Review and ensure procedures applied for Closure of Account 2013/14.	Actioned for Closure of Accounts 2013/14

Page	Recommendation	Agreed	Responsibility and actions	Completion date
11	R16 When completing the Whole of Government Accounts care needs to be taken to ensure that all significant balances and transactions with other public bodies are clearly identified and recorded.		Professional Lead for Finance – Review processes and ensure compliance for 2013/14 submission.	Actioned for Closure of Accounts 2013/14 July 2014
11	R17 All balances over the £5 million threshold set by the Welsh Government should be confirmed and agreed with the body in question.		Professional Lead for Finance – Review processes and ensure compliance for 2013/14 submission.	Actioned for Closure of Accounts 2013/14 July 2014
12	R18 The impact of staff absences and unplanned work should be continually assessed and reported to the Audit Committee.		Internal Audit Manager – Any significant staff absences and unplanned work that impacts on Internal Audit's ability to give an opinion on control will be reported to the Audit Committee.	Ongoing

Page	Recommendation	Agreed	Responsibility and actions	Completion date
12	<p>R19 Procedures need to be put in place to ensure that all IA files record:</p> <ul style="list-style-type: none"> • a clear trail of the risk assessment through to the detailed testing carried out to support the risk identified; and • TSS should all be supported by audit evidence allowing an independent experienced auditor to re-perform the test. 		<p>Internal Audit Manager</p> <p>Internal processes will be reviewed to ensure improved transparency of risk assessment from the initial identification stage through to the audit testing/reporting.</p> <p>The processes for the collection and presentation of audit evidence will be reviewed.</p> <p>Training will be given to Team Members to support the above measures.</p> <p>A new quality control process has already been implemented to support compliance and provide constructive feedback.</p>	<p></p> <p>May 2014</p> <p>May 2014</p> <p>May 2014</p> <p>Already in place</p>

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