

Audit Summary Report

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# Post statements report

**Stevenage Borough Council**

**Audit 2005/06**

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For further information on the work of the Commission please contact:

Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ

Tel: 020 7828 1212 Fax: 020 7976 6187 Textphone (minicom): 020 7630 0421

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## Introduction

- 1 Our audit plan for 2005/06 set out the work we would carry out to meet our Code of Audit Practice (the Code) responsibilities and also to comply with the International Standards on Auditing (UK and Ireland) (ISA+).
- 2 The Code requires us to form an opinion on whether the annual financial statements present fairly the financial position of the Council. To support this ISA+ 315 requires us to document our understanding of the information systems and the control activities relevant to the material balances in the financial statements.
- 3 Our audit of the financial statements was carried out in two stages:
  - pre-statements testing of the systems which have a material impact on the statements and the controls in these systems that prevent material errors in the statements; and
  - post-statements testing of the entries in the financial statements.
- 4 We have already reported on the majority of findings of our pre-statements work. The issues we have identified in our post statements audit, and some further issues from the pre-statements testing, are set out in the attached action plan.

## Audit approach

- 5 The most significant changes from our previous audit approach have resulted from the introduction of ISA+ 315, 'Understanding the entity and its environment' and ISA+ 330 'the auditor's procedures in response to assessed risks'.
- 6 These ISA+s place a greater emphasis on identifying information systems that lead to material balances in the financial statements, and evaluating and testing relevant key controls at the assertion level.

## Pre Statements Testing

- 7 The work carried out prior to receipt of the financial statements was as follows.
  - Stage 1: carry out a risk assessment of the general environment within which the Council's information systems operate.
  - Stage 2: map the systems that provide material figures in the financial statements.
  - Stage 3: document the processes and controls in place within each system and undertake a walkthrough to ensure the system is operating as stated.
  - Stage 4: assess which are the key controls to ensure the integrity of the accounting entries and obtain evidence that they are operating as intended.

- 8 As in previous years, we sought at all stages to place reliance on the work of Internal Audit.
- 9 Our work identified the extent to which we could gain assurance from the controls the Council has put in place and informed the testing strategy once the financial statements were presented for audit.
- 10 We identified the Council's main information systems as:
  - general ledger;
  - fixed assets;
  - purchase ledger;
  - sales ledger;
  - payroll;
  - council tax system;
  - NNDR system;
  - treasury management;
  - cash receipting;
  - housing rents; and
  - housing and council tax benefits.
- 11 Where Internal Audit had reviewed some of the systems, we reviewed their work and placed reliance where possible. For the other systems, we undertook detailed testing to determine whether internal controls were operating effectively.
- 12 Generally, we found most of the Council's control environment to be robust and controls to be operating effectively, with the exception of the Fixed Asset Register (FAR) – 'IPF CAPS' system. We raised significant concerns on the robustness, completeness and accuracy of the FAR, and the overall processes for complying with FRS15 and FRS11 for capital accounting. Our testing identified discrepancies between the inventories held by individual service delivery units, and the information held as per the FAR. As a result, we were unable to obtain assurance on the accuracy of the fixed asset register from our pre statement testing, which meant substantive post statement testing was carried out during our final accounts audit.

## Post statements testing

- 13 The draft financial statements were approved by the Council on 29 June 2006 in advance of the statutory deadline of 30 June 2006. We issued an unqualified opinion on 20 December 2006.
- 14 Prior to the start of the final accounts audit, we provided a working paper requirement checklist to officers to assist with the closedown preparation of the audit.

- 15 We assessed the completeness of the working papers before we started our audit work. Although we acknowledge that more working papers were provided in 2005/06 than in the previous year, we noted some omissions and errors in the working papers provided.
- 16 We highlighted in our progress report dated 21 July 2006, where there were gaps in the working papers, in particularly a lack of supporting evidence with the fixed assets. We were provided with further working papers prior to our on site visit, although there were still some working papers outstanding.
- 17 We also noted that although a percentage year on year analytical review had been undertaken, no explanations were provided and we had to seek explanations from various officers. In addition, no audit trail with control totals was provided to reconcile the figures per the general ledger to the statement of accounts, in particularly the Consolidated Revenue Account (CRA), and as a result, extensive time was taken to resolve this. We also encountered delays in receiving responses to queries raised during the audit.
- 18 Our initial review of the financial statements found section two of the statement of accounts regarding the general fund budget did not cast correctly. For example, brackets were not inserted around 'Income' as a deduction from gross expenditure.
- 19 We raised a number of issues regarding the accuracy of the fixed asset register, as our audit identified:
  - incomplete records of assets on the FAR;
  - incorrect classification of assets;
  - incorrect capitalisations of assets; and
  - incorrect valuation of assets.
- 20 Two material amendments were made to the accounts and reported to those charged with governance:
  - a £4 million capital receipt was to be received subject to a vacant possession clause in 2006/07 and was therefore agreed to be disclosed as a contingent asset in accordance with FRS 12, instead of as a debtor in the accounts; and
  - incorrect accounting treatment of £2.8 million impairment which had been charged through the revenue account and was subsequently charged to the Fixed Asset Restatement Account.
- 21 These issues have impacted on the Council's use of resources score for financial reporting. For the Council to show improvement for 2006/07, it needs to review its arrangements for producing complete and accurate financial statements and comprehensive supporting working papers, as part of the year end closedown preparation.

- 22 We are aware that the Council set up a new Arms Length Management Organisation (ALMO) in October 2006 and a number of key personnel staff transferred across to the ALMO. We noted that the Council managed this process well, with minimum disruption to the audit as key staff that had transferred were still available to address any audit queries we had.
- 23 The Council has already started to prepare for the challenges it faces in preparing its 2006/07 accounts. A new Accountancy Services Manager has been appointed early in preparation for the closedown arrangements, to work alongside the current Accountancy Services Manager before he leaves the Council. The Council will need to develop a plan to address the changes anticipated for 2006/07 including the preparation of group accounts, the full implementation of the Whole of Government Accounts (WGA) and the new SORP capital accounting requirements (further details of which are in appendix 2).
- 24 Details of the issues raised during our final accounts audit are highlighted in the action plan attached at Appendix 1.

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## Appendix 1 – Action Plan

Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<b>Pre-statements testing</b>					
<p><b>Authorising virements</b></p> <p>Our testing on the authorisation process for virements found that:</p> <ul style="list-style-type: none"> <li>• 2 forms had not been fully completed; and</li> <li>• a virement of £80k had not been signed as reviewed by the Executive.</li> </ul>	<p>R1: Document the virements authorisation process by fully completing the authorisation form and having it authorised by an appropriate officer.</p>	3	Accountancy Services Manager	Will ensure that virements are correctly processed & authorised. Will review 2006/07 as part of 2006/07 closure process.	April 2007



Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<p><b>Variance analysis</b></p> <p>As noted in previous year, there is no set trigger level at which variances between expenditure and budget are investigated.</p> <p>We noted that where significant variances are identified, the officer contacts the budget holder and requests explanation. However, there is no formal evidence of the response or that follow up has taken place.</p>	<p>R2: Retain documentary evidence to show explanation for variances +/- 10% from budget as recommended by CIPFA.</p>	<p>2</p>	<p>Accountancy Services Manager</p>	<p>Significant variations are investigated as part of the monthly key budgetary reports. Where e-mailed, responses are stored on the Authority's computer system. Otherwise findings are documented and filed.</p> <p>A set trigger percentage for all budgets is not thought to be appropriate. Variances of less than 10% are investigated on significant / high risk areas. Triggers are determined as appropriate based on professional judgement &amp; experience.</p>	<p>Being actioned as appropriate</p>

Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<p><b>Bank reconciliations</b></p> <p>Our testing highlighted that monthly cash and bank reconciliations were not being produced. We understand that bank reconciliations have been brought up to date in 2006/07.</p> <p>We also noted that the year end bank reconciliation for Alliance &amp; Leicester used the opening balance as at 1st April 2006 rather than the closing balance as at 31st March 2006. As a result, an additional amount of £72k was included in the accounts, although this related to 2006/07 expenditure.</p>	<p>R3: Continue to perform monthly cash and bank reconciliations promptly, after the end of the month to which they relate, and use the closing monthly balances.</p>	<p>3</p>	<p>Senior Group Accountant</p>	<p>The extent of the problems that the Council had had with bank reconciliation following the introduction of our new financial system was pointed out at the commencement of the audit before testing was undertaken. These problems have now been resolved and the bank reconciliations are now done monthly within a few days of month end.</p> <p>We are still in discussion with the Audit Commission regarding the finding related to the Alliance &amp; Leicester Account where we believe our accounting treatment to correct.</p>	<p>Now resolved &amp; ongoing.</p> <p>TBD</p>

Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<p><b>Up to date inventories</b></p> <p>We found that service delivery units did not compile inventories of fixtures and fittings and other equipment. As a result, this information is not recorded on the fixed asset register correctly.</p>	<p>R4: Comply with the financial regulations and ensure all inventories held by service delivery units are correctly recorded on the fixed asset register.</p>	<p>3</p>	<p>Senior Group Accountant</p>	<p>Plans have been made ahead of 2006-07 closure to ensure correct accounting for fixed assets in producing the accounts.</p> <p>Financial Regulations to be amended to reflect current responsibilities for maintenance of Inventories.</p>	<p>2006/07 Closure</p>

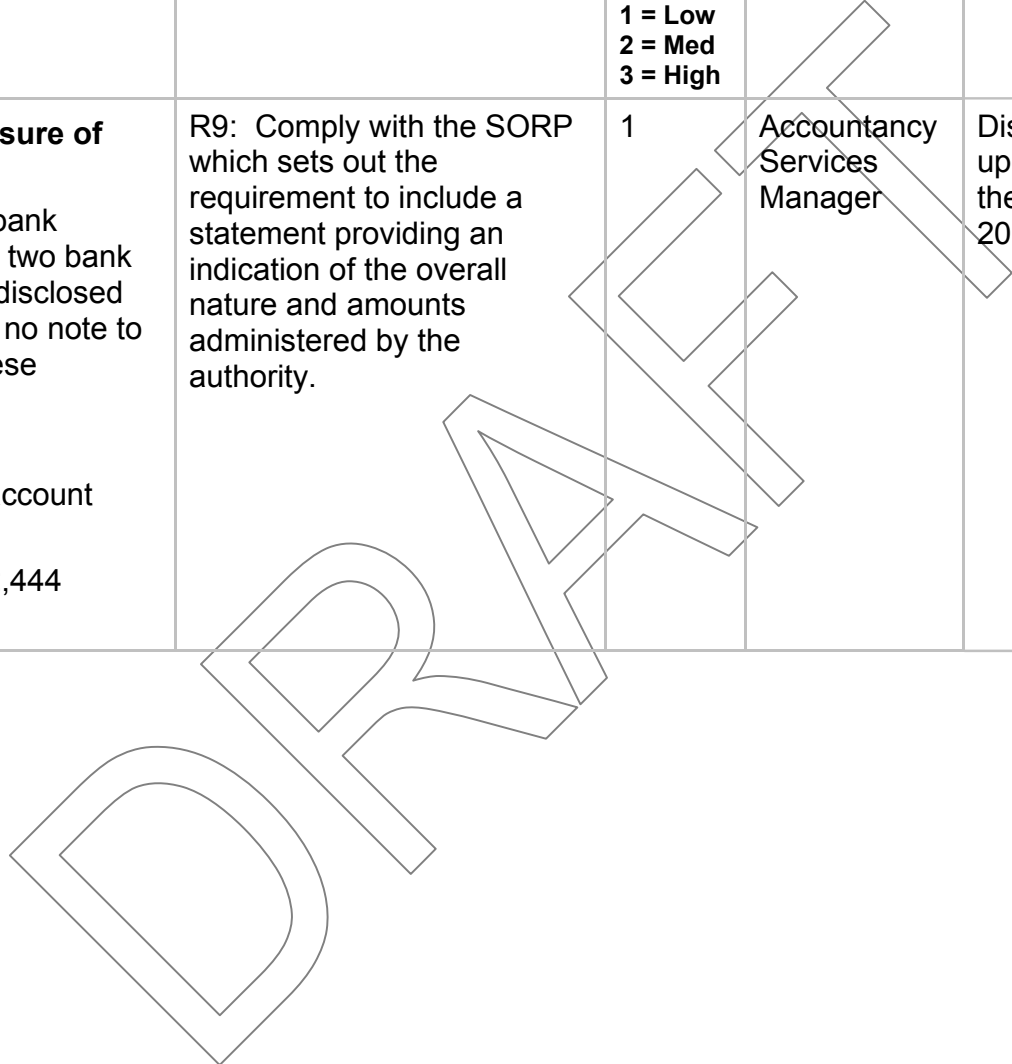
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Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<b>Post- statements testing</b>					
<b>General</b>					
<p><b>Financial statements</b></p> <p>From our initial review of the financial statements, we noted section 2 of the statement of accounts regarding the General Fund budget did not cast correctly as the brackets were not inserted around 'Income' as a deduction of gross expenditure.</p>	<p>R5: Before the financial statements are presented for member approval and for audit, they should be checked for casting and cross referencing.</p>	<p>3</p>	<p>Accountancy Services Manager</p>	<p>We are still in discussion with the Audit Commission regarding this finding.</p> <p>The financial statements were presented to the Statement of Accounts Committee on 29 June 2006. These included the Consolidated Revenue account and balance sheet, which contained bracketed figures which cast correctly.</p> <p>We clearly fully accept that Recommendation 5 should always be complied with.</p>	<p>TBD</p> <p>2006/07 Closure</p>

Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<p><b>Non Compliance to SORP</b></p> <p>We identified a number of areas of non-compliance with the SORP. For example, full disclosure was not made for:</p> <ul style="list-style-type: none"> <li>• operating leases;</li> <li>• finance leases;</li> <li>• government grants;</li> <li>• CRA Lease note;</li> <li>• purchase of investments;</li> <li>• movement in net debt; and</li> <li>• infrastructure assets not included at historical cost.</li> </ul>	<p>R6: Review the 2006/07 financial statements against the SORP disclosure compliance checklist to ensure all disclosures have been made in line with the SORP guidance.</p>	<p>2</p>	<p>Accountancy Services Manager</p>	<p>Review of the 2006/07 financial statements against the SORP disclosure compliance checklist will be undertaken to ensure all disclosures have been made in line with the SORP guidance. Specific details of the non-compliance in 2005/06 would be helpful and appreciated.</p>	<p>2006/07 Closure</p>

Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<p><b>Working papers</b></p> <p>Following our report on the assessment of working papers dated 21/7/06, we noted a number of items on the working paper requirements checklist, including fixed asset working papers that were still outstanding at the start of our audit.</p> <p>In addition, there was no audit trail with controls totals to reconcile the balances per the general ledger to the financial statements.</p>	<p>R7: Provide comprehensive supporting working papers as per the audit requirement checklist, along with a full audit trail which reconciles the balances per the general ledger to the financial statements.</p>	<p>3</p>	<p>Accountancy Services Manager</p>	<p>We are still in discussion with the Audit Commission regarding this finding.</p> <p>We clearly fully accept that Recommendation 7 should be complied with.</p>	<p>TBD</p> <p>2006/07 Closure</p>
<p><b>Bank balances</b></p> <p>A total of £330k unidentified items from the year end bank reconciliation was written off as these could not be reconciled.</p>	<p>R8: Carry out and review bank reconciliations monthly, to include the identification and correction of any unreconciled items.</p>	<p>3</p>	<p>Senior Group Accountant</p>	<p>As detailed above, the bank reconciliation problems have now been resolved and the bank reconciliations are now done monthly within a few days of month end.</p>	<p>Now resolved &amp; ongoing.</p>

Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<p><b>Inaccurate note disclosure of bank accounts</b></p> <p>From our review of the bank balances, we noted that two bank accounts had not been disclosed within the accounts and no note to explain the nature of these accounts were given:</p> <ul style="list-style-type: none"> <li>• Mayors charity account £5,972;</li> <li>• SBC Appeals £2,444</li> </ul>	<p>R9: Comply with the SORP which sets out the requirement to include a statement providing an indication of the overall nature and amounts administered by the authority.</p>	<p>1</p>	<p>Accountancy Services Manager</p>	<p>Disclosures have been updated and compliance with the SORP will be assured for 2006/07.</p>	<p>Closure 2006/07</p>



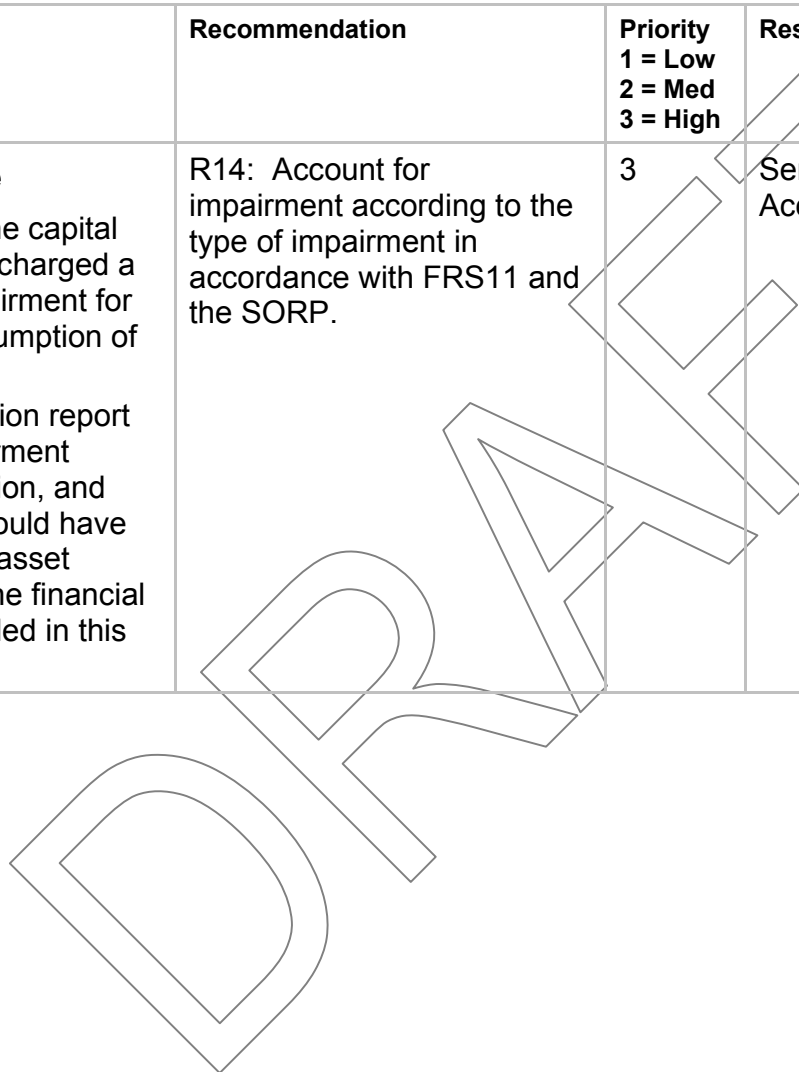
Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<b>Fixed Assets</b>					
<p><b>Omission of assets</b></p> <p>From our testing of asset disposals, we found the Canon Play Centre had actually been disposed of several years ago, but accountancy were only informed during 2005/06.</p> <p>We also found that accountancy was not informed of the disposal of Austin Paths and as a result, this was not written out of the fixed asset register or the financial statements.</p> <p>From our review of the useable capital receipts, we noted the following assets had been disposed of but had not been included on the fixed asset register:</p> <ul style="list-style-type: none"> <li>• Britain Way £1.479M</li> <li>• Stevenage North East £2.501M</li> </ul>	<p>R10: Undertake an exercise to ensure all assets have been correctly accounted for in the fixed asset register, through for example physical verification or confirmation with departments to confirm that assets are still held.</p>	3	Senior Group Accountant	<p>Work has been undertaken in advance of 2006-07 closure to ensure correct accounting for fixed assets in producing the accounts.</p> <p>Processes and liaison between responsible areas within the Council have been improved.</p>	2006/07 Closure



Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<p><b>Accounting treatment of the London Road disposal</b></p> <p>The unaudited financial statements included £4 million in debtors and the usable capital receipts reserve relating to proceeds from the disposal of the London Road depot.</p> <p>Our audit enquiries identified that the £4 million proceeds were to be received subject to a vacant possession clause in the contracts to be settled during 2006/07 financial year.</p> <p>As a result, the accounts were amended and this was disclosed as a contingent asset, in accordance with FRS 12.</p>	<p>R11: Recognise capital receipts only when they have been received by the Council.</p>	<p>3</p>	<p>Accountancy Services Manager</p>	<p>This finding was accepted as part of the 2005/06 audit and the accounts amended accordingly. At the time of accruing this receipt Accountancy were not aware of the vacant possession condition attached to it. We will seek to review exceptional capital receipts in future to avoid such a mistake.</p> <p>We are in discussions with the Audit Commission regarding Recommendation 11, because in the absence of conditions applying to a capital receipt the Council would continue to accrue in accordance with recommended accounting practice.</p>	<p>Resolved &amp; ongoing.</p> <p>TBD</p>

Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<p><b>Incorrect classification of assets</b></p> <p>We found software licenses totalling £146k were incorrectly classified as tangible assets instead of intangible assets. This was amended for in the revised version of the accounts.</p>	<p>R12: Review the classification of assets to ensure correctly classified between tangible and intangible assets.</p>	<p>2</p>		<p>We are in discussions with the Audit Commission regarding this finding.</p>	<p>TBD</p>
<p><b>Commercial garages valuation</b></p> <p>We found from our review that the valuation for commercial garages was incorrect. We noted that the valuer had amended its original valuation from £264k to £250k.</p> <p>However, this change was not filtered through to the fixed asset register which showed £264k.</p>	<p>R13: Ensure that revaluations are correctly reflected on the fixed asset register.</p>	<p>3</p>	<p>Senior Group Accountant</p>	<p>Work has been undertaken in advance of 2006-07 closure to ensure correct accounting for fixed assets in producing the accounts.</p> <p>Processes and liaison between responsible areas within the Council have been improved. Accountancy will only receive the finalised valuation report.</p>	<p>2006/07 Closure</p>

Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<p><b>Impairment disclosure</b></p> <p>Service accounts and the capital financing account were charged a £2.8 million for the impairment for Caxton Way (as a consumption of economic benefits).</p> <p>Our review of the valuation report identified that the impairment related to market valuation, and therefore the charge should have been made to the fixed asset restatement account. The financial statements were amended in this respect.</p>	<p>R14: Account for impairment according to the type of impairment in accordance with FRS11 and the SORP.</p>	<p>3</p>	<p>Senior Group Accountant</p>	<p>This finding was accepted as part of the 2005/06 audit and the accounts amended accordingly.</p> <p>We will review our Accounting treatment for impairment according to the type of impairment in the 2006/07 accounts closure to ensure compliance with FRS11 and the SORP.</p>	<p>2006/07 closure</p>



Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<p><b>Incorrect capitalisation of assets</b></p> <p>Our testing of assets purchased in the year found the first year of support and maintenance costs of £10k had been capitalised in error. As capital projects are approved by the Board in total, it is possible that other expenditure which is non-capital in nature may be capitalised incorrectly.</p> <p>Our testing of enhancement costs found that demolition costs of £54k had been incorrectly capitalised, when some garages were demolished. Demolition costs cannot be capitalised.</p>	<p>R15: Capitalise expenditure only where it meets the requirements of FRS15 and the SORP and is in line with the Council’s capitalisation policy.</p>	<p>3</p>	<p>Accountancy Services Manager</p>	<p>We accept recommendation 15 and have circulated detailed guidance to all Capital Budget Mangers to ensure that expenditure in 2006/07 is only charged to capital in line with FRS 15 and the SORP requirements.</p>	<p>January 2007</p>

Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<b>Provisions</b>					
<p><b>Bad debt provisions</b></p> <p>As part of the bad debt provision, we noted a provision of £120k had been made relating to the decline in profits from the Westgate shopping centre.</p> <p>We do not agree that this is a valid basis for a bad debt provision.</p>	<p>R16: Ensure bad debt provisions (netted off against debtors) are only made for potential bad debts.</p> <p>Review the need for any other provisions for 2006/07 to ensure they are in compliance with FRS 12.</p>	2	Accountancy Services Manager	<p>We are in discussions with the Audit Commission regarding this finding.</p> <p>We accept the requirement to review provisions annually &amp; will continue to do so in 2006/07.</p>	<p>TBD</p> <p>2006/07 Closure</p>
<p><b>Provisions</b></p> <p>The Council has not made any provisions under FRS12. For example there is no provision for insurance claims.</p> <p>It also has a relatively low level of earmarked reserves.</p>	<p>R17: Consider the need for an insurance provision and review the need for earmarked reserves.</p>	2	Accountancy Services Manager	<p>We are in discussions with the Audit Commission regarding this finding.</p>	TBD

Findings	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Comments	Date
<b>Grants</b>					
<p><b>Government grants deferred</b></p> <p>Our review of the supporting evidence provided found that grants are being written off over 5 years.</p> <p>However, our testing found the whole amount of grant of £139k for DEFRA recycling containers had been written off in 2005/06 instead of over 5 years.</p>	<p>R18: Account for government grants deferred correctly.</p>	<p>2</p>	<p>Accountancy Services Manager</p>	<p>Although not raised at the time of the audit we accept that one off the twenty-five Government Grants Deferred was inadvertently written off in one year. We will review our accounting for deferred grants to seek to ensure correct treatment in 2006/07.</p>	<p>2006/07 Closure</p>

## Appendix 2 – Changes in the 2006 SORP

The most significant changes to the SORP and other policy changes, many of which are intended to promote further convergence with UK GAAP, include:

- The abolition of capital financing charges and removal of the asset management revenue account;
- The replacement of the Consolidated Revenue Account with an Income and Expenditure Account;
- The need to account for surpluses and deficits on disposal of fixed assets;
- Ongoing refinements to FRS17; and
- Changes to the DCLG's Capitalisation Policy.

The Council will need to be preparing for these changes now to be assured of successful implementation, especially as prior year comparators will need to be restated. Looking forward even further thought will need to be given now as to whether existing asset registers are robust enough to facilitate the maintenance of a revaluation reserve as required from April 2007. The full introduction of FRS 25, 26 and 29 will also need to be considered.

It may also be helpful if the 2005/06 prior year comparatives could be amended as soon as possible after the detailed guidance for practitioners becomes available in February 2007. This would enable us to audit these as part of our interim work and hence reduce the likelihood of error when the 2006/07 accounts are drawn up.