



GOVERNMENT

**Interim Audit
Report 2008/09**

**Northampton
Borough Council**

June 2009

AUDIT

The contacts at KPMG in connection with this report are:

Mike McDonagh

Partner
KPMG LLP (UK)
Tel: 0121 335 2440
Fax: 0121 232 3578
michael.a.mcdonagh@kpmg.co.uk

Ian Skipp

Senior Manager
KPMG LLP (UK)
Tel: 0121 232 3694
Fax: 0121 232 3578
ian.skipp@kpmg.co.uk

Peter Evans

Assistant Manager
KPMG LLP (UK)
Tel: 0121 232 3320
Fax: 0121 232 3578
peter.evans@kpmg.co.uk

Page

Executive summary 1

Interim findings 2

Appendices 7

- A. Recommendations
- B. Prior year recommendations
- C. Accounts risks

This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Mike McDonagh, who is the engagement partner to the Authority, telephone 0121 335 2440, email michael.a.mcdonagh@kpmg.co.uk who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 236 4000, email trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Investigation Officer, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by e mail to: complaints@audit-commission.gov.uk. Their telephone number is 0844 798 3131, textphone (minicom) 020 7630 0421

Executive summary

Scope of this report

This report summarises our planning and interim audit work at Northampton Borough Council ('the Authority') in relation to the 2008/09 financial statements. A significant proportion of our accounts audit is completed before we receive your financial statements. In particular, our work to date covers the following areas:

- Audit planning and risk analysis: We have identified the key issues for the 2008/09 financial statements and discussed your progress in addressing these.
- Control evaluation: We have reviewed your progress with the closedown and accounts production process. We have also tested controls over the key financial systems. We rely on the work of internal audit wherever possible, and complete an assessment of the internal audit function as part of this work.

Section 2 provides further details of the work completed and sets out our findings.

Our recommendations are included in Appendix A. We have also reviewed your progress in implementing prior recommendations and this is detailed in Appendix B.

Summary of findings

Audit planning – risks in the accounts production process

We discussed with officers changes in accounting requirements for 2008/09 and other factors which will affect the accounts production process such as the economic downturn and the impact this has for accounting estimates. We are satisfied that officers are taking adequate consideration of these factors but will conclude on the accounting treatment during our final accounts visit in August. We note that the Authority has not yet implemented Single Status and the financial implications of implementation are still uncertain. We have made a recommendation that the Authority should monitor progress in section two.

Control environment

We have reviewed the Authority's control environment. We have noted weaknesses in some key controls, for example no bank reconciliations have been performed throughout the year and a lack of detailed reporting on the financial results of rent collection and arrears to members. We seek to rely on such controls as part of our financial statement audit work. Where these have previously been reported by Internal Audit we have not repeated their recommendations. We make one recommendation on the control environment regarding recording transactions from the housing management system on the general ledger and one on reconciling the benefits system to the ledger. We have also made a recommendation on performing bank reconciliations which we note have not been performed during the year.

As part of our assessment of the control environment we seek to rely on the work of Internal Audit. As part of this we review Internal Audit's work to satisfy ourselves that work has been performed to standard. We were able to rely on Internal Audit's work over key financial systems.

We have also reviewed the Authority's controls over key IT systems. We have noted weaknesses in controls over access to systems and that the Authority does not have a formal IT security policy. We have made three recommendations in section two.

Single Status

The Authority is currently in the process of implementing Single Status but has not yet finalised the pay modelling and negotiation process. An implementation date of 1 April 2010 has been set and officers anticipate that the process will be complete by then. Officers are currently working on the job evaluation stage and pay modelling will start once this is scheduled to complete in September 2009. Until pay modelling is complete there remains considerable uncertainty of the financial costs of implementation, therefore the Authority will need to monitor progress in the process to limit the effect on financial planning.

Acknowledgements

We would like to take this opportunity to thank officers and members for their continuing help and co-operation throughout our audit work.

Financial statements

Introduction

Our work in respect of the audit of financial statements is split into four stages as shown below:

Stage	Tasks	Timing	Completed
Planning	<ul style="list-style-type: none"> Updating our business understanding and risk assessment Assessing the organisational control environment Issuing our accounts audit protocol 	January to February 2009	✓
Control Evaluation	<ul style="list-style-type: none"> Reviewing the accounts production process Evaluating and testing controls over key financial systems Review of internal audit 	March to April 2009	✓
Substantive Testing	<ul style="list-style-type: none"> Planning and performing substantive work Concluding on critical accounting matters 	July to August 2009	-
Completion	<ul style="list-style-type: none"> Completion procedures Forming our audit opinion 	September 2009	-

Key issues in respect of each of these tasks is summarised below.

Planning - Risk assessment

Our 2008/09 *Audit and Inspection Plan*, presented to you in July 2008, included our initial assessment of the risks impacting on the 2008/09 financial statements. We have updated this and consider the following areas to be the key accounting issues for 2008/09.

- Compliance with the 2008 Statement of Recommended Practice on Local Authority Accounting the UK (SORP):** The 2008 SORP includes a number of changes, including a change in the valuation basis for pension assets and prohibiting the revaluation of fixed assets on disposal. Officers have considered the main changes to the 2008 SORP and we have discussed these with finance officers. We will conclude on the accounting treatment of these changes as part of our final accounts audit.
- Accounting estimates and valuations:** The current economic environment introduces a number of risks for the financial statements, in particular for estimates and valuations. This includes the valuation of fixed assets which are carried at market value (such as investment properties) and the assessment of recoverability of debts to determine appropriate provisions. We have discussed suggested methodologies for valuing the Authority's housing stock in light of current market conditions and have agreed that the sector standard methodology is used. This methodology values a property type and extrapolates this valuation over the same type/s of property. We will conclude on the results as part of our final accounts visit.
- Single Status:** The Authority is currently in the process of implementing Single Status but has not yet finalised the pay modelling and negotiation process. An implementation date of 1 April 2010 has been set and officers anticipate that the process will be complete by then. Officers are currently working on the job evaluation stage and pay modelling will start once this is scheduled to complete in September 2009. Until pay modelling is complete there remains considerable uncertainty of the financial costs of implementation, therefore the Authority will need to monitor progress in the process to limit the effect on financial planning.

Recommendation 1: Implementation of Single Status

The Authority should ensure that progress on the Single Status project plan is monitored to minimise the uncertainties within financial and organisational planning that are associated with late or non-implementation.

- Trade Waste Service:** The Authority sold its Trade Waste service in 2008/09. We have asked officers for information on the sale but have not yet received sufficient information to form a view on how the Authority proposes to account for it. We will review this as part of our final accounts work.

Further details are included in Appendix C, which also provides a summary of work you have completed to date to address these risks.

Financial statements (continued)

Control Evaluation - Accounts production process

The audit of the 2007/08 financial statements proved challenging and took longer than planned. A major contributing factor to this was that the Authority had purchased an upgrade to its fixed asset register to facilitate changes to the 2008 SORP relating to capital accounting, however officers established towards the end of the accounts production process that the information produced by the fixed asset register was inaccurate. As a consequence, Officers' took several weeks to rectify the errors and we did not receive a full set of working papers in support of the accounts and were unable to audit several significant balances until officers had corrected errors caused by the fixed asset register.

Officers this year are proposing to use a spreadsheet instead of the fixed asset register to prepare accounting entries relating to fixed assets.

Control Evaluation - Controls over key financial systems

We work with Internal Audit to:

- update our understanding of key financial systems;
- confirm our understanding of these systems by completing walkthrough testing; and
- document, evaluate and test the control framework for these systems.

We have relied on the work performed by Internal Audit when it had a bearing on our external audit. For each of the key financial systems, they agreed to test the high level controls that we would expect to be in place. High level controls are strong controls that should address the key risks. Examples are reconciliations or exception reports.

Our review of your high level control environment identified some weaknesses, highlighted below. Where Internal Audit have not previously identified these we have made recommendations; otherwise we have not sought to repeat their recommendations.

- A monthly reconciliation of Council Tax benefits per the Council Tax system (Northgate) and the general ledger is performed. However we noted that the monthly reconciliation performed only checks that the monthly journal to the ledger to record the month's transactions agrees to the total of transactions per Northgate and that a full reconciliation of Northgate to the ledger is not performed. We reviewed balances for February and found that Northgate did not agree to the ledger.
- We reviewed the reconciliation of the housing management system (IBS) to the general ledger, which is performed weekly. We noted errors in the reconciliation and could not agree the reconciliation to the systems being reconciled. Insufficient codes have been created on the general ledger to record all transactions processed by IBS and consequently a large number of transactions are not recorded on the ledger until the year end.

Recommendation 2: Reconciliation of the Benefits system to the ledger

The Authority should ensure that Council Tax benefits per the Council Tax system is reconciled to the general ledger on a monthly basis. The reconciliation should reconcile the two systems rather than checking that the journal to the ledger is correct.

Recommendation 3: Recording transactions processed by the housing management system on the ledger

The Authority should review the coding of the general ledger to facilitate easier reconciliation with IBS.

Financial statements (continued)

In addition, reconciliations of the ledger to the Authorities' bank accounts have not been performed during the year. Officers have found the bank reconciliation process challenging historically and in recent reconciliations have been performed at the year end only. In 2007/08 approximately £100,000 was written off as an expense as part of the reconciliation to adjust for historical differences between the ledger and the bank account which could not be reconciled. This write off was intended to make reconciliations easier going forward.

Officers plan to perform the bank reconciliation on a monthly basis throughout 2009/2010.

Recommendation 4: Performing bank reconciliations regularly

The current plan to reconcile the general ledger to bank accounts on a monthly basis should be given a priority. The reconciliation should be reviewed and signed off by a more senior officer.

Control Evaluation - Review of internal audit

The *Accounts and Audit Regulations 2003* require public bodies to maintain an adequate and effective system of internal audit of their accounting records and of their system of internal control. For principal local authorities, guidance is contained in the *Code of Practice for Internal Audit in Local Government* ('the Code'). The Code defines the way in which internal audit should be established and operated and applies equally to in-house audit teams and those provided by external contractors.

We assessed internal audit against the requirements of the Code. Based on our assessment, internal audit complies with the Code. In determining whether we will rely on the work of Internal Audit, auditing standards require us to re-perform some of their work. We were able to place reliance on work performed by Internal Audit on high level controls as where we re-performed work we agreed with their findings. However there were some recommendations in Internal Audit's reports relating to the production of the financial statements. These related to the Authority's policy on depreciation and its methodology for providing for doubtful debts. Our review established that the new policies are still in accordance with the Statement of Recommended Accounting Practice.

Recommendation 5: Internal audit recommendations

The Authority should discuss with External Audit when it is proposing to make changes to accounting policies.

Control Evaluation – IT controls

We also consider controls over the use of information technology (IT). We review access to systems, IT policies and procedures and security of data. Our work identified the following weaknesses:

- There is no Information Security Policy in place. Consequently there is a risk that users are not aware of their responsibilities in relation to information security;
- We identified a number of weaknesses relating to access to the Revenues and Benefits Oracle database. We were able to access the Revenues and Benefits Oracle database using supplier default passwords. We identified that 12 users have high level access to the database and are able to make any changes to the database, that there are six generic accounts which have this access. We identified a user account still active for an employee that had left the Authority two years ago and there are no formal procedures for reviewing user access levels; and
- Administrative tasks in the Revenues and Benefits Northgate system are performed using generic user accounts. Similarly generic user accounts are in use for administrative tasks performed on the IRAS cash receipting system.

Recommendation 6: IT security policy

The Authority should produce a formal IT security policy. This should be made available to all staff who use IT systems and should form part of standard training.

Financial statements (continued)

Recommendation 7: Access to the Revenues & Benefits database




The Authority should restrict the number of users with high level access to the Revenues & Benefits database. It should also review quarterly access to the database so that leavers' access is removed.

Recommendation 8: Generic access accounts

Generic access accounts should be closed and individual accounts be assigned to users for Northgate and IRAS.

Appendix A: Recommendations

We have given each recommendation a risk rating (as explained below) and agreed what action management will need to take. We will follow up these recommendations next year.

Priority rating for recommendation		
<p>Priority one: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.</p> 	<p>Priority two: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.</p> 	<p>Priority three: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.</p> 

No.	Risk	Issue and recommendation	Management response	Officer and due date
Implementation of Single Status				
1	● (one)	The Authority should ensure that progress on the Single Status project plan is monitored to minimise the uncertainties within financial and organisational planning that are associated with late or non-implementation.		
Reconciliation of the Benefits system to the ledger				
2	● (two)	The Authority should ensure that Council Tax benefits per the Council Tax system is reconciled to the general ledger on a monthly basis. The reconciliation should reconcile the two systems rather than checking that the journal to the ledger is correct.		
Recording transactions processed by the housing management system on the ledger				
3	● (two)	The Authority should review the coding of the general ledger to facilitate easier reconciliation with IBS.		
Performing bank reconciliations regularly				
4	● (one)	The current plan to reconcile the general ledger to bank accounts on a monthly basis should be given a priority. The reconciliation should be reviewed and signed off by a more senior officer.		
Internal audit recommendations				
5	● (two)	The Authority should discuss with External Audit when it is proposing to make changes to accounting policies.		

Appendix A: Recommendations

No.	Risk	Issue and recommendation	Management response	Officer and due date
		IT security policy		
6	● (two)	The Authority should produce a formal IT security policy. This should be made available to all staff who use IT systems and should form part of standard training.		
		Access to the Revenues & Benefits database		
7	● (two)	The Authority should restrict the number of users with high level access to the Revenues & Benefits database. It should also review quarterly access to the database so that leavers' access is removed.		
		Generic access accounts		
8	● (two)	Generic access accounts should be closed and individual accounts be assigned to users for Northgate and IRAS.		
		HRA rent collection reporting		
9	● (one)	The Authority's HRA financial monitoring should systematically include details on rent collection and arrears. The reports should include details of arrears for both current and former tenants.		

Appendix B: Prior year recommendations

This appendix summarises the progress made to implement the recommendations identified in our ISA 260 2007/08 report

No.	Risk	Issue and recommendation	Management response	Officer and due date	Status at May 2009
1	● (two)	<p>Working papers and the accounts closedown process</p> <p>The Authority should review its accounts closedown timetable and consider whether sufficient time is built into the timetable to produce working papers.</p>	<p>The accounts closedown timetable is reviewed every year to adjust for known issues. The closedown timetable for 2007/08 was affected by the changes to fixed asset accounting which had a knock-on effect on the revenue account because of capital charges. This resulted from errors in the software employed by the Council and the resultant delays affected most areas of the timetable. This issue could not have been foreseen when the timetable was produced. A review will be undertaken as normal.</p>	<p>Bill Lewis February 2009</p>	<p>The Authority has reviewed its closedown timetable and has chosen not to use the fixed asset register to compile the accounts this year. We will review this at our final visit in August.</p>
2	● (two)	<p>Provision for doubtful debts</p> <p>The Authority should assess the recoverability of its debtor balance and should use this information to determine its provision for doubtful debts.</p>	<p>Where possible, the Authority will perform an assessment of the debtor balance and this will inform the provision for doubtful debts.</p>	<p>Phil Morrison March 2009</p>	<p>We have discussed the provision for doubtful debts with the authority and will review at our final visit in August.</p>
3	● (one)	<p>HRA rent collection reporting</p> <p>The Authority's HRA financial monitoring should systematically include details on rent collection and arrears. The reports should include details of arrears for both current and former tenants.</p>	<p>Reporting to members on the collection of rent is already being developed and will be incorporated into regular budget monitoring reports alongside the reporting on garage rents which has already been introduced as a pilot.</p>	<p>Phil Morrison March 2009</p>	<p>This recommendation has not been implemented. We therefore re-iterate.</p>
4	● (two)	<p>Records of debtor and creditor balances</p> <p>The Authority should review its year-end accounting processes for debtor and creditor balances to ensure that there is a clear trail to supporting evidence.</p>	<p>The Authority recognises that more improvements are necessary in this area. These improvements are to be built in during the review of the financial system and the in-year reconciliations of balance sheet accounts which are being introduced.</p>	<p>Bill Lewis February 2009</p>	<p>We have discussed this with officers and agreed the need for clearly presented balances for our final visit.</p>
5	● (two)	<p>Building control account charges</p> <p>The Authority should undertake a review of charges for work operated through its building control account so that regulations are complied with and the account breaks even over a three year period.</p>	<p>The charges will be reviewed during the 2009/10 budget setting process. Charges will be revised if the Authority is able commercially to do so.</p>	<p>Ann Davies February 2009</p>	<p>We have requested information on this but have not been provided with any. We will therefore review at our final visit.</p>

Appendix B: Prior year recommendations

No.	Risk	Issue and recommendation	Management response	Officer and due date	Status at May 2009
6	● (two)	<p>Capitalisation of voids expenditure</p> <p>The Authority should consistently apply its accounting policy for capitalisation of expenditure on void property, ensuring that expenditure which only maintains, and does not enhance, properties is excluded.</p>	<p>Guidelines have been drafted for Housing Capital expenditure which are subject to consultation. The council already consistently applies this policy by ensuring that only expenditure of a capital nature are capitalised. This expenditure will include ancillary works such as redecoration which are necessary as part of the project; where the work cannot be demonstrated to be part of a capital project it will remain in revenue.</p>	N/A	We will review the application of policy on capitalisation as part of our final accounts visit.
7	● (two)	<p>Accounts disclosure</p> <p>The Authority should review disclosures in accounts and determine whether any information included is not needed or could be presented in a more user-friendly way.</p>	<p>The Authority believes that the disclosures it makes are in compliance with SORP and any additional information includes aids the reader of the accounts. Any suggestions for removing disclosure will be considered.</p>	Bill Lewis	We have discussed this with officers and made suggestions for improving the presentation of information. We will review this when the accounts are produced in June.

Appendix C: Accounts risks

This appendix summarises the key accounting issues for the 2008/09 financial statements and the progress you have made to date to address these.

Issue	Risk and implications	Progress
<p>Compliance with the 2008 SORP</p> <p>The 2008 SORP will bring in changes to accounting requirements for the 2008/09 financial year. Whilst it has not yet been finalised, it is expected to introduce changes including:</p> <ul style="list-style-type: none"> • new requirements on accounting for back pay arising from equal pay claims; • changes which reflect the replacement of Local Area Agreement grant with Area Based Grant; and • amended disclosure requirements for retirement benefits following the amendment of FRS17. <p>The Authority will need to review the changes once the SORP is finalised and determine what additional work will be needed to ensure that its accounts comply with the totality of SORP requirements, with a particular focus on the recent changes outlined above.</p>	<p>There is a risk that changes to the 2008 SORP will not be implemented correctly, which may result in increased audit resource and cost for the financial statement audit.</p>	<p>We have met with officers to discuss proposed treatment for new and contentious items. The SORP requires a change in valuation basis for pension assets. The Authority has requested information from its actuaries to determine whether the difference between the valuation of assets on the previous valuation basis as per the 2007/08 is materially different from valuation on the new basis. Once we have received this information we will conclude whether a prior period adjustment is required for the 2007/08 comparative balances. We have discussed other changes to the SORP and are satisfied that officers are taking necessary consideration.</p>
<p>Accounts production process</p> <p>The Authority has historically found the accounts production and audit process challenging. The process in 2007/08 was a significant improvement on previous years; however there remains scope to improve the quality and timeliness of working papers.</p>	<p>An inefficient accounts audit process can cause disruption and increase audit costs. Officers therefore need to ensure that working papers are produced on time and of sufficient quality.</p>	<p>The Authority has reviewed its accounts closedown process and we have discussed this with officers. Officers are producing the accounts without the fixed asset register, instead recording capital transactions on a spreadsheet. This will need to be carefully prepared and reviewed so that all transactions are recorded and presented correctly.</p>
<p>Single Status</p> <p>The process of implementing Single Status has significant potential financial implications. These include the one-off costs of settling back pay claims, and also the ongoing increased payroll costs which typically arise from the revised pay structures.</p> <p>The Authority has faced significant challenges in its work to implement the changes, and this has caused the implementation timetable to be delayed. This increases the financial risk to the Council.</p>	<p>Failure to implement the Single Status agreement would expose the Council to the risk of equal pay claims, which would in themselves have a significant effect on its financial standing.</p> <p>The delay in implementation also creates uncertainty in financial and workforce planning.</p>	<p>Officers are currently undertaking job evaluations. Once this is complete pay and grade modelling can be undertaken. Job evaluations are expected to be complete by September 2009 and full implementation by 1 April 2010.</p> <p>The Authority will need to closely monitor progress to minimise the uncertainty in planning.</p>
<p>Disposal of Trade Waste Service</p> <p>The Authority sold its trade waste service during 2008/09. This will need to be accounted for correctly in the 2008/09 accounts.</p>	<p>There is a risk that the disposal is not accounted for correctly.</p>	<p>Officers are proposing to account for the sale as a capital receipt. We have requested further information but have not as yet been provided with any. Therefore we will conclude on this at our final accounts visit.</p>