

Plymouth City Council

Interim Report and Update to Financial Audit Plan 2010-11

June 2011



Contents

| | |
|--|--------|
| 1 Introduction | p2 |
| 2 Executive summary | p3 |
| 3 Audit approach | p4-6 |
| 4 Update on accounts audit risk assessment | p7-8 |
| 5 Results of interim audit work | p9-11 |
| 6 IFRS arrangements review | p12-15 |
| Appendices | p16-18 |

1. Introduction

Introduction

This report provides additional information on our audit approach, as previously set out in our Audit Plan 2010-11 issued in December 2010, as well as an update on our response to key risks from the results of interim audit work.

Use of this report

This report advises you of the matters arising from our interim work and should not be used for any other purpose or be given to third parties without our prior written consent. Our report is part of a continuing dialogue between the Council and ourselves and should not be relied upon to detect all errors, system or control weaknesses or opportunities for improvements in management arrangements that might exist.

The Council should assess the wider implications of our conclusions and recommendations before deciding whether to accept or implement them, seeking your own specialist advice, as appropriate.

We accept no responsibility in the event that any third party incurs claims, or liabilities, or sustains loss, or damage, as a result of their having relied on anything contained within this report.

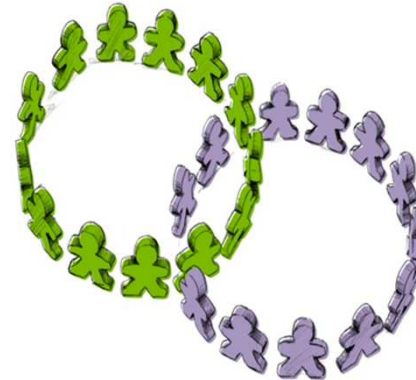
The way forward

We have set out our findings and the associated recommendations are in an appendix to this report. We have agreed actions to implement the recommendations made with appropriate Council staff.

Acknowledgements

We would like to record our appreciation for the assistance and co-operation provided to us during our interim audit by the Council's staff.

Grant Thornton UK LLP
June 2011



2. Executive summary

The table below provides a summary for the Audit Committee of the work performed to date and our key findings. For further detail refer to the relevant section within this report. How this work has been performed is outlined in the Audit Approach section, on pages 4 to 6.

| | |
|------------------------------------|--|
| Audit approach | <ul style="list-style-type: none">• There have been no changes to our audit approach as set out in our Audit Plan 2010-11. |
| Risk assessment | <ul style="list-style-type: none">• The audit risks were outlined in our Audit Plan 2010-11. To date, we have not identified any new risks facing the Council. |
| Review of internal controls | <ul style="list-style-type: none">• We have evaluated the design effectiveness of internal controls over the financial reporting process through a combination of inquiry and observation procedures and, where appropriate, systems walkthroughs.• We have raised five recommendations from our review of controls, which are set out in Appendix B. |
| Review of internal audit | <ul style="list-style-type: none">• We have concluded that the Internal Audit service continues to provide an independent and satisfactory service to the Council and that we can take assurance from their work in contributing to an effective internal control environment at the Council.• We have raised two recommendations for further improvement, which are set out in Appendix B. |
| IFRS arrangements review | <ul style="list-style-type: none">• Our review identified that the Council is making adequate progress in its transition to IFRS. We acknowledge that there is still some work being undertaken by the Council to collate and review all relevant information. We will review this work and the related accounting entries during the final accounts audit. |

3. Our accounts audit approach

Audit approach reminder

We will:

- work closely with the finance team to ensure that we meet audit deadlines and conduct the audit efficiently;
- plan our audit on an individual task basis at the start of the audit, and agree timetables with all staff involved;
- consider the materiality of transactions when planning our audit and when reporting our findings; and
- continue to review and provide feedback on the work the Council has performed through its transition to International Financial Reporting Standards (IFRS).

The logistic details of our annual accounts audit, as agreed with the Director for Corporate Support, are detailed in Appendix A.

In summary, our audit strategy comprises:

| | |
|-------------------------------|---|
| Planning | <ul style="list-style-type: none">• Updating our understanding of the Council through discussions with management and a review of the management accounts• Reviewing IFRS transition arrangements |
| Control evaluation | <ul style="list-style-type: none">• Reviewing the design and implementation of internal financial controls including IT, where they impact on the financial statements• Assessing audit risk and developing and implementing as appropriate audit strategy• Assessing internal audit against the CIPFA Code of Practice |
| Substantive procedures | <ul style="list-style-type: none">• Performing analytical review• Verifying all material income and expenditure and balance sheet accounts, taking into consideration whether audit evidence is sufficient and appropriate• Reviewing material disclosure issues in the financial statements |
| Completion | <ul style="list-style-type: none">• Performing an overall evaluation of the accounts and control environment• Determining an audit opinion• Reporting to the Audit Committee |

3. Our accounts audit approach (continued)

Materiality

An item would be considered material to the financial statements if, through its omission or non-disclosure, the financial statements would no longer show a true or fair view.

Materiality is set at the outset of planning to ensure that an appropriate level of audit work is planned. It is then used throughout the audit process in order to assess the impact of any item on the financial statements. Any identified errors or differences greater than **£135,000** (below this level we consider errors to be trivial) will be recorded on a schedule of potential misstatements.

These are assessed individually and in aggregate, discussed with you and, if you do not adjust, signed off by you in your letter of representation to us, confirming your view that they are immaterial to the financial statements. We will then consider what impact, if any, not adjusting has on our audit opinion.

An item of low value may be judged material by its nature, for example any item that affects the disclosure of directors' emoluments. An item of higher value may be judged not material if it does not distort the truth and fairness of the financial statements.

Internal audit

We will work with the Devon Audit Partnership to ensure our audit approach takes account of the risks identified by it and the work it has conducted; subject to our review of the effectiveness of the internal audit function.

Review of IT and outsourced systems

The Council make extensive use of Information Technology (IT) to process financial transactions and produce its financial statements. Accordingly, our approach requires a review of the Council's internal controls in the IT environment.

We have involved IT specialist team members during the audit. This approach is based on the complexity of IT used in the Council's significant transaction cycles and a control risk assessment.

Internal controls

Auditing standards require that we evaluate the design effectiveness of internal controls over the financial reporting process to identify areas of weakness that could lead to material misstatement. As a result, we focus our control review on the high risk areas of the financial statements.

3. Our accounts audit approach (continued)

We are also required to assess whether controls have been implemented as intended. We have done this through a combination of inquiry and observation procedures and, where appropriate, systems walkthrough tests. However, our work cannot be relied upon to identify all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive controls review exercise might identify.

Transition to International Financial Reporting Standards (IFRS)

The IFRS based Code of Practice on Local Authority Accounting in the United Kingdom (the Code) has effect from 1 April 2010. The 'transition date' to IFRS is therefore 1 April 2009.

The Council is responsible for the preparation of a restated opening balance sheet as at 1 April 2009 following the introduction of International Financial Reporting Standards (IFRS) and in accordance with the Code.

Auditors do not have any direct reporting responsibilities in respect of transition balances although they will form the opening balances for the comparative period.

Our work to date has taken the form of an arrangements review intended to provide feedback on the Council's approach to restatement and is not an audit of

the restated balance sheet figures. Detailed work on the restated figures will take place during the 2010-11 final accounts audit. This assessment has focussed upon material balances either in regard to their value or nature.

We have met regularly with the Council's finance team to discuss issues arising and to review progress in making the transition to IFRS. We consider that the Council has made adequate progress in preparing for the production of the 2010-11 accounts and restated comparatives in accordance with the 2010-11 Code of Practice. Although the Council intended to provide restated 2009-10 accounts for audit in January 2011, their work fell behind schedule. Consequently the adjustments to prior year comparatives will be reviewed as part of our final accounts audit in July 2011.

Our work to date has not identified areas of non-compliance with the Code nor any issues which had not already been considered by the Council.

4. Update on accounts audit risk assessment

As part of our planning and control evaluation work we have reviewed the audit issues identified in our Audit Plan for 2010-11 and have set out below the outcome of work completed to date and further work planned.

We will report our full findings and conclusions in respect of each risk identified in our Annual Report to Those Charged with Governance (ISA 260) on completion of our final accounts audit.

Our update of the audit and assurance risks facing the Council has not identified any new risk areas.

| Issue | Audit areas affected | Work completed | Further work planned |
|---|--|---|---|
| <p>The 2010-11 financial statements may not be prepared in accordance with IFRS</p> | <p>All areas of the financial statements</p> | <ul style="list-style-type: none"> We have reviewed the Council's arrangements for completing the transition to IFRS. We have reviewed the draft accounting policies against the requirements of the IFRS Code. We have continued to meet regularly with the Council's finance staff to provide timely review of proposed accounting treatment under IFRS. | <ul style="list-style-type: none"> We continue to discuss the implication for any developing issues with the finance team. Material areas that are impacted by the transition to IFRS will be reviewed in detail at the time of the final accounts audit. We will review the final accounting policies on receipt of the final accounts. |
| <p>There may be insufficient finance resource to deliver statutory requirements by 30 June 2011</p> | <p>All areas of the financial statements</p> | <ul style="list-style-type: none"> We have monitored the Council's progress against its IFRS project plan and are satisfied that the Council is on track to deliver its first set of IFRS accounts by 30 June 2011. | <ul style="list-style-type: none"> We continue to liaise with the Council's finance team on an on-going basis to discuss emerging issues and respond to technical queries. |

4. Update on accounts audit risk assessment (continued)

| Issue | Audit areas affected | Work completed | Further work planned |
|--|---|---|--|
| <p>Pressures over financial performance may affect the Council's ability to deliver its budget and provide services to the public</p> | <p>All areas of the financial statements</p> | <ul style="list-style-type: none"> • We have reviewed the Council's financial performance for the year against its agreed budget, noting a forecast overspend of £105,000. • We have reviewed the Council's arrangements to achieve planned savings through the 'Procure to Pay' project. | <ul style="list-style-type: none"> • We will review the Council's financial performance outturn and its achievement of savings against plan. • Our audit work will address audit risks in relation to understatement of expenditure and the use of reserves. |
| <p>Revaluation of fixed assets are not correctly accounted for</p> | <p>Property, plant and equipment</p> | <ul style="list-style-type: none"> • We have discussed proposals to reclassify assets to ensure the categorisation and valuations are appropriate. | <ul style="list-style-type: none"> • We will review any valuations undertaken to ensure that these comply with the requirements of IFRS, particularly in relation to the valuation of schools being performed in 2010-11. |

5. Results of interim audit work

Scope

As part of the interim audit, and in advance of our final accounts audit visit, we considered:

- the effectiveness of the Internal Audit function;
- Internal Audit's work on the Council's key financial systems;
- the controls over key systems relevant to our accounts risks; and
- the Council's information technology controls.

The findings from our work are set out in this section of our report on an exception basis. We have included recommendations identified by our work in the appendix B to this report. We have agreed actions to implement the recommendations with the finance team.

The internal audit function

We review Internal Audit's overall arrangements against the 2006 CIPFA Internal Audit Standards. Where the arrangements are deemed to be adequate, we can gain assurance from the overall work undertaken by Internal Audit and can conclude that the service itself is contributing positively to the internal control environment and overall governance arrangements within the Council.

Overall, we have concluded that the Internal Audit service continues to provide an independent and satisfactory service to the Council and that we can take assurance from their work in contributing to an effective internal control environment at the Council.

However, we have identified a small number of areas where the current arrangements could be strengthened further. Our review has highlighted that although each audit file is subject to robust review by an audit manager, there is no overall quality assurance process in place to ensure that audit staff are complying with the Devon Audit Partnership's audit manual. A quality review by other partnership staff would provide the Council with further assurance that the work of the Internal Audit function is being delivered effectively.

Recommendation 1

Internal audit should implement a quality assurance process to demonstrate compliance with the audit manual.

In assessing the effectiveness of Internal Audit work, we reviewed two Internal Audit files to ensure that:

- systems were adequately documented;
- key controls have been identified and evaluated;
- key controls have been tested; and
- weaknesses have been reported to management.

We have identified that although the samples selected by internal audit provide adequate coverage of the period being tested, there is no justification recorded on file to support the number of items selected. This may result in the samples selected being either too large or too small.

5. Results of interim audit work (continued)

Recommendation 2

Internal audit should ensure that the justification for the sample sizes used is documented on the audit file.

Journal entry controls

We have identified from our review of journal controls that the Council continues to rely on the integrity of user access controls rather than requiring journals to be authorised. This introduces the risk that incorrect or fraudulent journals posted into the ledger may not be detected

Recommendation 3

The Council should ensure that high risk journals are appropriately authorised prior to being posted.

We have reviewed the staff members with access to post journals and note that over 70 users with this access have not posted journals in the first ten months of the financial year. We have also identified that the Council's IFRS consultant has been given this level of access although this had not been used in the period we reviewed.

Recommendation 4

Users with journal access should be periodically reviewed to remove those whose duties do not include posting journals.

Our review has identified a small number of journals where there was no description of the nature and reason for the journal, which is required by the Council's journal entry procedures.

Recommendation 5

Staff members should be reminded of the need to enter a relevant description when posting a journal. Compliance with the Council's journal procedures should be monitored.

Maintenance of supplier masterfile

Access to amend supplier details on the Council's system, including bank details, is restricted to the creditors team and any changes made are electronically logged.

Changes do not require authorisation and there is no subsequent review of the amendments that have been made. This creates the risk that unauthorised changes to supplier details, particularly bank details, may not be detected.

Recommendation 6

Changes to supplier details should be authorised, or a periodic review of changes made should be performed.

5. Results of interim audit work (continued)

Review of information technology controls

Our information systems specialist performed a high level review of the general IT control environment, as part of the overall review of the internal controls system, and concluded that, from the work undertaken to date, there are no material weaknesses which are likely to adversely impact on the Council's financial statements.

We have, however, identified a number of areas where improvements could be made. We do not consider these to pose a significant risk to the accounts and have reported them to management through our interim audit feedback meeting. The most significant of these is detailed below.

At the time of our review we examined the administration accounts set up within the 'Active Directory' to ascertain whether they were necessary and appropriate and whether such accounts were subjected to periodic review. We have noted that accounts with this level of access are not subject to periodic review and the number of accounts set up with admin access was excessive. This may lead to unauthorised access to the Council's systems.

Prior year recommendations

As part of our planned programme of work, we followed up the recommendations made in our 2009-10 interim report.

We made two low priority recommendations relating to the Council's IT systems, specifically reducing the account lock-out threshold and the implementation of an intrusion detection and prevention system. There has not been any progress on addressing these issues and we have reported this to management.

Recommendation 7

Management should review access levels, including staff with administration access on a periodic basis to ensure that these remain appropriate.

6. Review of arrangements for implementation of International Financial Reporting Standards (IFRS)

Introduction and Background

Local authorities are required to comply with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). From 2010-11 this Code will be based in International Financial Reporting Standards (IFRS) rather than a UK GAAP based Statement of Recommended Practice (SORP). The Code requires a restated balance sheet at 1 April 2009, restated 2009-10 accounts and full published IFRS accounts for 2010-11.

Basis of assessment

This report details the findings of our initial review. For each significant balance sheet item, we have considered the Council's arrangements against each of the following questions:

- Are the Council's arrangements for identifying and reporting their accounting policy adequate?
- Are the Council's arrangements for identifying and reporting their adjusted UK GAAP values at 1 April 2009 and 1 April 2010 adequate?
- Are the Council's arrangements for reporting IFRS values adequate?
- Are the Council's arrangements for restating their notes to the balance sheet adequate?
- Are the Council's arrangements for preparing quality supporting working papers adequate?

The Council's arrangements for each line in the balance sheet have been assessed using a red/amber/green rating using the following definitions:

**Green
(G)**

Adequate arrangements appear to be in place for the balance sheet area to provide not materially misstated amounts for the restatement.

**Amber
(A)**

Adequate arrangements are in place in some respects for the balance sheet area to provide not materially misstated amounts for the restatement. There is evidence that the Council is taking forward areas where arrangements need to be strengthened.

**Red
(R)**

The Council's arrangements are generally inadequate to provide not materially misstated amounts for the restatement.

Where items and areas have been assessed as amber, we have discussed these with officers to support the preparation of first set of IFRS accounts.

6. Adequacy of arrangements - findings

Assets

| Balance sheet item | Accounting policies | UK GAAP values | IFRS values | Supporting notes | Working papers | Overall assessment |
|-------------------------------------|---------------------|----------------|-------------|------------------|----------------|--------------------|
| Property, plant & equipment | A | A | A | A | A | A |
| Investment properties | G | A | A | A | A | A |
| Current and non-current investments | G | A | A | A | A | A |
| Trade & other receivables | G | A | A | A | A | A |

Liabilities

| Balance sheet item | Accounting policies | UK GAAP values | IFRS values | Supporting notes | Working papers | Overall assessment |
|------------------------------------|---------------------|----------------|-------------|------------------|----------------|--------------------|
| Trade & other payables | A | A | A | A | A | A |
| Current & Non-current borrowings | A | A | A | A | A | A |
| Non-current trade & other payables | G | A | A | A | A | A |
| Provisions | G | A | A | A | A | A |
| Non-current other liabilities | G | A | A | A | A | A |
| Taxpayers' equity | N/A | N/A | N/A | N/A | N/A | A |

KEY: G - Green rating A - Amber rating R - Red rating

6. Adequacy of arrangements – amber ratings

| Balance sheet item | Reason for rating | Next steps |
|--------------------|---|--|
| All areas | <p>Reporting of UK GAAP and IFRS values At the time of our review, the Council had not restated the 2009-10 accounts and therefore the reconciliation between UK GAAP and IFRS figures was not complete.</p> | Adjustments made upon transition, including adjustments identified under UK GAAP, will be reviewed as part of our final accounts audit |
| All areas | <p>Supporting notes Restated disclosure notes had not been completed at the time of our review.</p> | Supporting notes and disclosures to be drafted by the Council and agreed to supporting working papers. |
| All areas | <p>Preparation of working papers The Council has made adequate progress in preparing working papers to support the adjustments made upon transition and will complete these as part of the preparation of restated accounts.</p> | Working papers to be finalised and presented for audit along with the 2010-11 and restated 2009-10 accounts. |
| Minority of areas | <p>Accounting policies Draft accounting policies were presented for review in January 2011, with a minority of areas still requiring finalisation.</p> | Final accounting policies to be reviewed through out final accounts audit. |

5. Overall conclusion and recommendations

Overall project planning arrangements for IFRS transition

Overall, we are satisfied that the Council's approach to project planning was appropriate, with detailed impact assessments carried out to identify areas of risk.

We note that the restatement process has fallen behind schedule as a result of work required to prepare the 2011-12 budget following the funding settlement and unexpected staff absence. As a result, we will audit both the 2010-11 accounts and the transition adjustments made to the 2009-10 comparatives as part of our final accounts audit in July 2011.

Conclusion

Overall at this stage we are satisfied that the processes undertaken by the Council have enabled management to highlight the accounting, explanatory, and presentational adjustments required for restatement to IFRS. Significant work has been required alongside the closedown process in order to complete the restated comparatives and we will continue to raise any issues identified during our audit with the Council's finance team.

Acknowledgements

We would like to record our appreciation for the assistance and co-operation provided to us during our review by the Council's finance team.

Appendix A - Logistics

Timetables and milestones

The following proposed timetable and deadlines have been set:

| Event | Date |
|--|-----------------------|
| Interim audit including internal controls review | February & March 2011 |
| Interim audit report | June 2011 |
| Commence accounts audit fieldwork | 4 July 2011 |
| Annual report to those charged with governance (ISA 260) | September 2011 |
| Annual Audit Letter | November 2011 |

The audit process is underpinned by effective project management to ensure that we co-ordinate and apply our resources efficiently to meet your deadlines. It is therefore essential that we work closely with your team to achieve this timetable.

Information requirements

The information and working paper requirements that would assist us in an efficient and timely audit of the year-end financial statements have been communicated to the finance team within our Arrangements Letter, which was issued in February 2011.

Engagement team

In accordance with our Audit Plan 2010-11 issued January 2011, the main engagement team for the accounts audit will include:

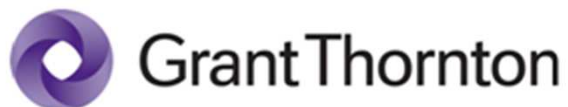
| Name | Role | Contact details |
|----------------|-------------------|---|
| Barrie Morris | Engagement Lead | T: 0117 305 7708 E: barrie.morris@uk.gt.com |
| Kate Jefferies | Audit Manager | T: 0117 305 7678 E: kate.jefferies@uk.gt.com |
| Chris Roach | In-charge Auditor | T: 0117 305 7720 E: chris.roach@uk.gt.com |

Appendix B - Action plan

| Rec No. | Recommendation | Priority | Management Comments | Responsibility & implementation date |
|---------|---|----------|---|--|
| 1 | Internal audit should implement a quality assurance process to demonstrate compliance with the audit manual. | Medium | <p>Already in place</p> <p>The new staff structure in DAP means that each Auditor has their work reviewed by different managers across the partnership. This means our quality assurance process, and compliance with the audit manual, is more robust as it results in greater consistency and sharing of best practice between teams.</p> | <p>Partnership Management Team</p> <p>In place</p> |
| 2 | Internal audit should ensure that the justification for the sample sizes used is documented on the audit file. | Medium | <p>Agreed</p> <p>Sample sizes need to be risk-based & appropriate for each review, which means some auditor judgement is necessary. Further consideration will be given as to how best to accomplish both adequacy of testing and cost effectiveness.</p> | <p>DAP Managers</p> <p>30 Sept 11</p> |
| 3 | The Council should ensure that high risk journals are appropriately authorised prior to being posted. | High | <p>Agreed</p> <p>Officers continue to encourage staff to append supporting documentation to journals wherever possible and consider this to be a more manageable and cost effective control. However, officers will look to review the potential to add journal authorisation to some journals based on high value/high risk.</p> | <p>Corporate Accountancy and Finance Manager</p> <p>March 2012</p> |
| 4 | Users with journal access should be periodically reviewed to remove those whose duties do not include posting journals. | Medium | <p>Agreed</p> <p>A review will be undertaken and journal access removed for staff who do not use this facility. A particular focus will be undertaken on the access of senior staff who may be required to review and authorise transactions, to ensure there is adequate separation of duties.</p> | <p>Corporate Accountancy and Finance Manager</p> <p>September 2011</p> |

Appendix B - Action plan (continued)

| Rec No. | Recommendation | Priority | Management Comments | Responsibility & implementation date |
|---------|--|----------|---|---|
| 5 | Staff members should be reminded of the need to enter a relevant description when posting a journal. Compliance with the Council's journal procedures should be monitored. | Low | Agreed Officers regularly remind staff of the need to enter adequate descriptions and attach supporting documents to journals. The corporate accountancy team monitor via monthly reports; in future will consider access removal for persistent misuse. | Corporate and Accountancy Finance Manager On-going |
| 6 | Changes to supplier details should be authorised, or a periodic review of changes made should be performed. | High | Agreed Reviewed as part of P2P Project and currently being reviewed as part of category management project and the updated Procurement Standing Orders within the Constitution (Financial Regs) | Strategic Procurement Manager 30 September 2011 |
| 7 | Management should review access levels, including staff with administration access on a periodic basis to ensure that these remain appropriate. | Medium | Agreed The systems administration has been handed to ICT in the last few months. It is a standard process to review and limit all administration accesses on a continuing basis, with a formal review at the end of each financial year. | ICT Strategy & Programme Manager On-going |



www.grant-thornton.co.uk

© 2011 Grant Thornton UK LLP. All rights reserved.

"Grant Thornton" means Grant Thornton UK LLP, a limited liability partnership.

Grant Thornton UK LLP is a member firm within Grant Thornton International Ltd ("Grant Thornton International"). Grant Thornton International and the member firms are not a worldwide partnership. Services are delivered by the member firms independently.

This publication has been prepared only as a guide. No responsibility can be accepted by us for loss occasioned to any person acting or refraining from acting as a result of any material in this publication.