

**Approval of the 2014/15 Financial Statements
and to receive the External Auditor's Report
(ISA260) for 2014/15**

Portfolio	Finance
Ward(s) Affected:	All

Purpose

To approve the audited Financial Statements for 2014/15 and to receive the External Auditors Report (ISO260) for 2014/15.

Background

1. Statutory regulations require that unaudited financial statements are published by the 30th June and the audited financial statements by the 30th September each year. Only the audited financial statements need to be formally approved by members.
2. The unaudited financial statements were published on the Council's website on the 8th July 2015 and it is the audited financial statements that are now being presented to this committee for approval.

Financial Statements

3. The Financial Statements set out the Council's financial performance for the year ended 31st March 2015 and are attached to this agenda as a separate document.

ISA260 Audit Report

4. The Audit Commissions Code of Audit Practice requires the auditor to summarise the work they have carried out to discharge their statutory audit responsibilities together with any Governance issues identified. They are charged with reporting these to those charged with governance (The Audit and Standards Committee) at the time the final financial statements are considered. This report must also comply with the requirements of the International Auditing Standard 260 with regard to 'Communication of audit matters to those charged with governance'.
 5. The auditors will be presenting their report at the meeting and it can be expected to cover the following areas:
 - Proposed opinion on the financial statements, annual governance statement and audit differences
 - Critical accounting matters
 - Value for Money approach
 - Key issues and recommendations arising from the audit
 6. Members will have an opportunity to question the auditors about their report at the meeting.
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Key Issues

7. The Council introduced a new financial system on the 1st April 2014. Although the system was introduced successfully in terms of transactions there were a number of issues on the accountancy side. These were:
 - a. The bank reconciliation did not work for most of the year because of issues around the interfacing of other systems with the finance system. Despite many conversations with Civica this was not resolved until late February 2015. Consequently a significant amount of finance staff time was used trying to resolve the bank reconciliation when staff should have been working on the final accounts. The bank reconciliation is now works properly and all the bank reconciliations are up to date.
 - b. The budget monitoring reports did not reflect accurate profiling of budgets and there were issues around the way that support costs were calculated. This meant that services were asked to look at their actuals to date and estimate their variance to final outturn – this was the process followed for several years before. Some services were more successful at this than others and the auditor has highlighted this in their report. Clearly any form of estimation looking forward is going to be difficult hence for the 2015/16 budget we have accurately profiled the budget and services are required to compare actuals with budget to date rather than making a yearend predication.
 - c. Resources for the implementation of the new finance system with hindsight were insufficient thus putting strain on the finance team.
 8. In addition as a result of the transition to the new financial system it came to light that the way the Collection Fund (the fund which includes Council Tax and Business Rates collected and then passed on to preceptors) had not been accounted for correctly for a number of years nor picked up through the audit process. In particular there were issues around the ways that “payments in advance” were treated over many years which had not come to light before. This meant that the council had to engage outside expertise, which added to the delay, to correct this and this has resulted in a prior year adjustment to the 2013/14 accounts. Full details are included within the financial statements.
 9. All of the problems above led to extra pressure on staff and thus increased sickness within the team thereby increasing the pressure on the remaining staff and adding to the problems encountered.
 10. Due to the delays caused by the items above in order to try and meet the 30th June deadline (or at least close to it) the financial statements were compiled without the checks and review that has been carried out in previous years. As a result not only did they contain a large number of presentational errors but also a number of technical errors such as the correct accounting of asset valuations. There was also confusion around the way some items, such as investments, were described. This resulted in a large number of adjustments and several versions of the accounts prior to the one you see here. This level of adjustments is unprecedented for Surrey Heath when compared to previous years where there were virtually no changes at all arising out of the audit. These changes are all symptomatic of issues with capacity within the finance team and of the very thorough audit that we were subjected to. The adjustments are all detailed in the ISA260 report
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11. All of the problems above led to extra pressure on staff and thus increased sickness within the team thereby increasing the pressure on the remaining staff and adding to the problems encountered.
 12. As a result the publication of the draft accounts did not meet the statutory deadline of 30th June and instead were published on the 8th July and were not able to be presented to you before the 30th September but are being presented now.
 13. As the audit could not be completed within the allotted time there have been many changes in audit staff and this has resulted in a lot of work being repeated and poor communication as to what was required. In addition due to the errors described the auditors decided to conduct a very thorough audit, checking each section several times, which has also led to delays and duplication of work with the auditors going through numbers several times with different staff. This has meant that the process has been extended far longer than was actually necessary.
 14. The auditor has decided to give an "Except for" Qualification on the "value for money" judgement in the accounts. The "value for money" judgement is required by statute. The qualification has been made as in the judgement of the External auditor there are issues around the capacity and capability of the finance team leading to problems with the accounts. This will be addressed in the coming months and in the mean time we have taken on additional staff to assist with the 2015/16 year end process. In all other respects the Council did make proper arrangements to secure the economy, efficiency and effectiveness in its use of resources. Members should however take in to account that the Council did satisfy the other 60 parts that make up the criteria for judging "value for money". In addition they auditors are not saying that Surrey Heath provides bad value for money but rather there were issues with the accounts production process.
 15. In order to ascertain whether there should be any changes made the Executive Head of Finance commissioned an independent consultant to prepare a report on potential improvements to the accounts process and this has been attached to this report as Annex A together with actions taken.
 16. In addition a number of other changes have been made this year which should prevent a recurrence of the events of this year. These are:
 - a. The bank reconciliation now functions correctly and should present no problems at the year end
 - b. Last year the processing of the asset valuations was delayed due to staff working on the bank reconciliation. This year the work should be completed before the year end
 - c. The calculation of management costs and recharges was delayed last year due to issues with the new financial system. These problems have been addressed and these will be completed before the year end
 - d. Last year there was a lack of expertise within the finance team in respect of the collection fund. This has been addressed through training and the use of external advisors
 - e. There was a great deal of confusion as to what the auditor's requirements were and this lead to a lot of wasted and duplicated work. This is being addressed by us seeking to have a planning meeting prior to the commencement of the audit.
 - f. The financial statements are prepared on a word document interlinked with Excel tables. This became increasing unstable during the accounts process and was prone to crash. This has been addressed by having the entire document re written
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- g. There were issues with staffing capacity during the year. To provide support during the accounts process additional staff with the relevant expertise have been taken on and the department will be restructured once the accounts for 2015/16 have been completed.
 - h. Our 2014/15 audit has been so detailed and thorough that it is highly unlikely that there is anything else that is going to “jump out of the woodwork” and cause concerns
17. Members should note that the delays in agreeing the 2014/15 accounts may have an impact on the production of the 2015/16 accounts. Whilst everything is being done to avoid late submission of the 2015/16 accounts members should note that they will not be submitted until complete checks and reviews have been carried out.
18. The new financial system has brought great challenges during the year but it is anticipated that with the knowledge gained through the year things should go much more smoothly next year.

Other Matters

19. The Committee is asked to consider the Draft Letter of Representation required by the auditors which is included in the ISA260 and comment as appropriate. Members will be advised at the meeting if the auditors wish to make any changes
20. Final copies of the Financial Statements are on the council’s website and will be available at the meeting.

Options

21. The committee can accept or reject the auditor’s report and the comments contained within it, the accounts and/or the Letter of Representation as it sees fit. However these actions may have implications in respect of the auditor signing off the Council’s financial statements

Resources Implications

22. The only resource implication arises due to audit fees. The successor to the audit commission (PSAA) set the audit fees for 2014/15 at £55,000 for the year. There has been a lot of downward pressure on fees as a result of the audit commission tender process. For example in 2010 the fees were £98,000. There is no doubt that the issues arising from the new system and staffing has meant that the auditors have had to spend more time on the Surrey Heath audit than was originally budgeted for however they too have not mitigated costs by auditing sections of the accounts several times. This has certainly been the most thorough audit KPMG has ever done at Surrey Heath. As a consequence of this KPMG will request an additional fee. This will be submitted to the regulator (Public Sector Audit Authority) who will make a judgement as to the merits of the claim and we are then required to comply with that. For information the scale fee for 2015/16 has been set at £41,900 and Council’s in 2017 will be given the opportunity to tender for audit services themselves from an approved list of firms.

Recommendation

23. The Committee is advised to RESOLVE that the Executive Head of Finance be authorised to sign the Letter of Representation on behalf of the Council;
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24. The Committee is advised to RECEIVE the audited financial statements for 2014/15 and RESOLVE that the Chairman of the Committee APPROVES the financial statements on behalf of the Council

Background Papers: None

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1. Increasing in-year assurance

Area of work	Weakness in 2014-5 closedown process	Recommendation	Implementation Date	Comments from Exec head of Finance
Collection Fund	<p>The Collection Fund was not completed accurately as part of the 2014-5 accounts submission.</p> <p>Problems with the Collection Fund were not identified until very late in the accounts compilation process and were so fundamental that the audit opinion on the Council's Accounts was put at risk.</p> <p>The Council has incurred significant cost in additional audit fees and external consultancy time in order to rectify these issues.</p>	<p>The Collection Fund must be produced in full, including any supporting notes, twice a year going forward.</p> <ul style="list-style-type: none"> - Month 9, to be completed for review by Executive Head of Finance by 31 January each year - Year-end to be completed for review by Executive Head of Finance by 30 April each year <p>External Audit should be invited to carry out an audit of the month 9 Collection Fund as part of interim audit checks, and this assurance banked for the final accounts audit.</p>	Essential for 2015/6 Accounts	The Collection Fund will be completed by 30 th April and will be balanced on a more regular basis in future years
Collection Fund	<p>There are a number of general ledger codes relating to the Collection Fund that are not reconciled to records from the revenues system on a regular basis.</p> <p>It is important that all general ledger codes relating to the Collection Fund are reconciled to the revenues system on a regular basis.</p>	<p>A full review of reconciliation processes for Collection Fund cost centres on the general ledger should be carried out by the Finance Department.</p> <p>This review must ensure all cost centres on Civica Financials required for the production of the Collection Fund are fully reconciled back to the Revenues system on at least a quarterly basis.</p>	To be implemented from 1.4.2016 in year.	This will be implemented in 2016/17
Bank Reconciliation	The bank reconciliation process did not work effectively throughout the whole of 2014-5, due to problems in the way it had been configured by Civica. Whilst these issues were resolved in time for the compilation of the statement of accounts, this issue had serious resource implications for the Finance Team.	The bank reconciliation process is generally working well now. However, this must not be allowed to slip, and the bank reconciliation must be completed and reviewed within 15 days of each month end. Any difficulties in meeting this target must be reported to the Executive Head of Finance.	Essential for 2015/6 Accounts	The bank reconciliation is regularly reviewed and is currently working well

Opening Balances	The opening balances loaded on to Civica Financials were not subject to independent check by Internal Audit.	The check of opening balances is a check that should be done early in the financial year. Opening balances should be loaded on to the general ledger as soon as the statement of accounts for the previous year has been signed off by the auditors. Internal Audit should then carry out a fully documented check of all opening balances and make this available to external audit at their interim audit visit.	Essential for 2015/6 Accounts	Internal audit have been advised that this check is required once the 2014/15 accounts have been finalised
Trial Balance - Accounts Mapping	KPMG complained that there was no clear trail between the statement of accounts and the Council's finance system. This is a basic requirement of any external audit team. Failure to provide such a trail will result in difficulties in getting accounts cleared by audit, and will result in an increased audit fee.	<p>Trail Balance to accounts map should be maintained as a standing document by the Finance Department. Changes to GL structure should result in the mapping document being amended.</p> <p>Internal Audit should carry out a fully documented check of the trial balance to statement of accounts, once the draft accounts have been submitted. This should be made available to KPMG.</p> <p>This work can be completed before year end.</p>	Essential for 2015/6 Accounts	Civica has been structured to ensure that there is a direct correlation between the accounts and the ledger system.

Trial balance – reconciliation procedures	<p>Regular reconciliation of all control accounts is essential to ensure any posting or processing errors are identified promptly, and rectified before year end.</p> <p>Whilst key control accounts such as debtors / cash / creditors are reconciled regularly, other control accounts on the trial balance are not reviewed until year end.</p> <p>Examples include</p> <ul style="list-style-type: none"> - reserve accounts - collection fund accounts - fixed asset accounts 	<p>A review of all ledger codes on the Council's trial balance should be carried out, and decisions made as to the nature of each ledger code</p> <ul style="list-style-type: none"> - Income and expenditure - no reconciliation needed, but ensure reviewed via budget monitoring procedures - Balance sheet – regular transactions – balance must be reconciled to supporting documents monthly - Balance sheet irregular transactions - balance sheet – regular transactions – balance must be reconciled to supporting documents quarterly <p>The complete trial balance must be covered by one of the above processes.</p>	<p>Essential for 2015/6 Accounts</p>	<p>Control accounts are reconciled on a monthly basis.</p>
In year balance sheet and financial accounts	<p>The Council should look to improve financial reporting going forward by producing a draft income and expenditure account and draft balance sheet on a half yearly basis.</p> <p>The Council now has a fully operational purchasing system, and is planning to implement the fixed assets module of Civica financials.</p>	<p>Production of a half yearly balance sheet and income and expenditure account direct from the general ledger would significantly reduce the risk of error in the year end statement of accounts:</p> <ul style="list-style-type: none"> - It would be possible to identify significant accounting issues in year, rather than waiting until year-end - External audit would be able to enhance the interim audit, enabling year end testing to be reduced. 	<p>To be implemented from 1.4.2017</p>	<p>This will be built in to the program for 2016/17</p>
Corporate Budget Monitoring	<p>The 2014-5 audit process identified a number of material classification errors on the Council's Consolidated Income and Expenditure Account.</p> <p>In addition, the Finance Team had difficulty in</p>	<p>Corporate Budget Monitoring Processes should be reviewed to ensure that reconciliation to financial accounting records is included as part of the process.</p>	<p>To be implemented from for 2015/6</p>	<p>This will be done as part of the 2015/16 accounts closure process</p>

	explaining a number of variances identified by the external auditor's analytical review.	It is essential that as part of the year end process for 2015-6, reconciliation is carried out to explain any differences between the Consolidated Income and Expenditure statement and variances identified as part of Corporate Budget Monitoring.		
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2. Reduce Year-end Journals and associated workload

Area of work	Weakness in 2014-5 closedown process	Recommendation	Implementation Date	Executive Head of Finance comments
Fixed Assets	The Council has not yet implemented the fixed assets module in Civica Financials. This accounting module would significantly reduce the workload at year end, as a large number of processes currently carried out manually would be automated.	Implement the assets module before year end 2015/6 and use this to prepare fixed asset balances in the statement of accounts. This is however a complicated exercise that will need to be thoroughly tested.	Essential for 2015/6 Accounts	The asset module will be implemented in July as a result of a software upgrade. Manual calculation of assets will be completed mid april for 2015/16 accounts
Fixed Assets	Fixed asset accounting is dependent on work carried out by external valuers, who are relied on to revaluation and impairment figures that need to be entered on to the asset register.	It is recommended that external valuers compete valuations and impairment reviews and deliver reports to SHBC by the end of November each financial year This should be input to the finance system by the end of December each year. The Finance Team will only need to update the system with details of additions and disposals of assets in the last three months of the year at year end.	To be implemented from 1.4.2016 in year.	Valuations received and being processed before the 31 st March 2016. For 2016/17 valuations will be done earlier in the year
Fixed Assets	Internal Audit no longer checks fixed asset accounts as part of the Council's financial year end process. It is better that any errors and adjustments needed are identified by the Internal Audit Team. This helps keep the external audit fee under control.	Internal Audit should carry out substantive testing of fixed asset balances as reported in the accounts as soon as practicable after year end.	Essential for 2015/6 Accounts	Internal audit advised that checks will be required
Accruals and Cut – off	The Final Accounts project plan set out clear deadlines for receipt of accrued income and	It is essential that deadlines are adhered to. Requests from Service Departments to make	Essential for 2015/6 Accounts	Services advised of deadlines and

	expenditure transactions. All accruals were to be sent to Finance by 10 April. However, accruals were still being processed by the Finance Department in late May.	accruals after the agreed deadline must be rejected unless material to the accounts. This will reduce the number of year-end journals.		finance staff going round departments to ensure adhered to
Accounting for year-end journals	Month 12 was not closed promptly in 2014-5. As a consequence a significant number of year-end manual journals were posted to period 12 on the general ledger. This made period 12 reconciliations on the main control accounts for transactions systems very difficult.	It is important that period 12 is closed promptly after 31 March in line with pre-agreed timetables. All year end journals should then be posted to period 13. If this is not done, reconciliation of year-end figures on the main transactions control accounts becomes difficult, and increased numbers of journals are required to correct period posting errors.	Essential for 2015/6 Accounts	Month 12 will be closed on the 31 st March and all post year end journals put in to period 13

3. Management of the Final Accounts Project Plan

Area of work	Weakness in 2014-5 closedown process	Recommendation	Implementation Date	Executive head of Finance comments
Final Accounts Project Plan	The Finance Department has a final accounts project plan in place. However, this failed to produce a sound set of accounts by the statutory deadline of 30 June 2015. Consequently, the project plan must be replaced as existing arrangements have failed.	<p>A full review of the final accounts project plan should be carried out light of the failure to meet statutory deadlines in for the 2014/5 statement of accounts. This must be a result of an honest assessment of current arrangements by the Finance Team. A new project plan must aim</p> <ul style="list-style-type: none"> - to identify bottlenecks in the 2014/5 final accounts process and plans to deal with them - to fully implement recommendations made by KPMG - to ensure adequate resources are in place to deliver the accounts and that these resources are properly allocated to tasks to be delivered. - to incorporate recommendations in this report 	March 2016	A simplified plan has been put in place to ensure deadlines are met
Monitoring of Progress	<p>Regular meetings were held by officers in the Finance Team to monitor progress against the project plan. However:</p> <ul style="list-style-type: none"> - certain officers, notably the Head of Finance, key to the accounts process were not involved in these meetings: - Progress meetings failed to identify that there were problems with aspects of the accounts and ensure these issues were appropriately escalated. 	<p>The process for monitoring progress against the final accounts project plan must be changed.</p> <p>Above all, an honest appraisal of progress against the plan must be carried out on a weekly basis. This must involve the Head of Finance, all senior accountants and all financial accounts staff.</p>		Monitoring meetings will focus on issues and problems so that these can be addressed quickly
Annual Leave	Annual leave arrangements did not work satisfactorily. Key members of staff were on leave during the final accounts process.	Annual leave arrangements should be reviewed, this should ensure that annual leave in the finance department is minimised from 1 April to 30 June.		Leave has been restricted in the period to 30 th

				june 2016
Structure of Final Accounts Team	KPMG have raised justifiable concerns about the structure of the Finance Team in production of the annual accounts. KPMG note that it was rare for a single officer to have full responsibility for any specific accounts area, meaning that there were delays due to input being required from multiple members of the finance team	It is recommended that individual members of the Finance team have clear personal responsibility for control over specific sections of the statement of accounts. This provides a clear point of contact for KPMG.	Essential for 2015/6 Accounts	Tasks have been delegated to staff. Additional resource has been brought in to assist with the final accounts process. A restructure after the final accounts will deal with any remaining structural issues in the tea,
Use of Internal Audit	SHBC Internal Audit had very little input into the final accounts process in 2014/5. There is considerable scope to utilise Internal Audit to check the accuracy of financial statements before submission of the Accounts to the external auditors. Much of this work can be done independently of the Finance team. Suggested areas for Internal Audit support include: <ul style="list-style-type: none"> • Opening balances • Accruals raised through purchasing system • Fixed Assets • Investments • Review of chart of accounts to trial balance mapping 	More use should be made of internal audit in the final accounts process. Areas where internal audit can provide assurance should be identified as part of the final accounts planning process, and this work added to the internal audit annual plan. It is better for SHBC if errors or omissions are identified by Internal Audit rather than KPMG – this potentially saves external audit fees.	Essential for 2015/6 Accounts	Internal audit have been asked to provide assurance work in connection with the 2015/16 accounts

4. Format of the Accounts

Area of work	Weakness in 2014-5 closedown process	Recommendation	Implementation Date	Executive head of Finance comments
Content of the Accounts	The format of the Statement of Accounts and Foreword has not been subject to a full review for a number of years. Failure to review the format of the accounts may result in disclosure that is not required and the risk of unnecessary error and audit fee.	Review of the format of the statement of accounts should be carried out with the aim of stripping out all unnecessary disclosure. Consideration should be given to commissioning peer review from another Council with strong financial reporting controls.	To be implemented from 1.4.2016 in year.	A review will be carried out for the 2015/16 accounts and the auditors consulted on what they consider to be best practice
Statement of Accounts Workbook	The Statement of Accounts is derived from a complex excel worksheet which has been used for a number of years. However, this workbook is reaching the end its useful life – there are some bugs in the document and links within the accounts do not always work.	The Statement of Accounts workbook must be rebuilt for future accounting periods. Consideration should be given to taking advice from local councils where year-end processes work well. Where possible, the new workbook must link directly to Civica Financials, be fully tested , which have properly working links between the accounts and supporting notes.	To be implemented from 1.4.2016 in year.	The statement of accounts is being retyped in to a word document which should resolve these issues. Discussions are being had with other Civica councils with a view to automation but this will not be until the 2017 year end

<p>Control over amendments to the Statement of Accounts</p>	<p>Control over amendments to the Statement of Accounts is not adequate at present. Too many officers have access to the Statement of Accounts workbook, meaning that amendments were made with no clear trail of:</p> <ul style="list-style-type: none"> - Who made amendments to the Accounts - Reason for amendments <p>This caused much frustration for the auditors and is a key reason why the audit fee had to be increased.</p>	<ul style="list-style-type: none"> - Access to the Statement of Accounts workbook must be password restricted and access only given to those officers who need access - All changes to the Statement of Accounts must result in the creation of a new version of the accounts workbook. Details of any changes made must be documented and reasons set out in a working paper, which must be included in the Statement of Accounts workbook. 	<p>Essential for 2015/6 Accounts</p>	<p>Access to the statement of accounts will be restricted to one officer who will also make all of the amendments as required</p>
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5. Managing Expectations

Area of work	Weakness in 2014-5 closedown process	Recommendation	Implementation Date	Executive head of Finance comments
Audit start date	<p>A draft statement of accounts was produced on 8 July 2015. This was 1 week after the statutory deadline of 30 June 2015. However, these accounts were not ready for audit at this point and it would have been more sensible for the accounts to be submitted for audit at a later date.</p> <p>This would have given the Finance Team a better opportunity to finalise the accounts, and make them ready for audit review. This would have enabled the KPMG audit to progress more smoothly and given the Council better control on the final accounts audit fee.</p>	<p>Whilst SHBC should improve final accounts processes with the aim of meeting audit deadlines, it is essential that audit work does not commence until the accounts are in a fit state to be audited. If this is not achieved, it is likely that the audit will not be successful and audit fees will rise.</p> <p>Timetables must allow adequate time for the accounts to be fully checked before they are submitted.</p> <p>If the accounts have not been completed by the due date agreed with KPMG, the Head of Finance should contact KPMG and delay the start of the audit until the accounts are ready.</p> <p>It is also the role of the Head of Finance to manage member expectations if such a situation arises.</p> <p>But revised final accounts processes must aim to produce auditable accounts by statutory deadlines.</p>	Essential for 2015/6 Accounts	Agreed.
KPMG - Prepared by Client (PBC) Schedule	The Council failed to supply everything required on the KPMG PBC schedule. Failure to meet PBC requirements leads to a guaranteed increase in external audit fee.	- Liaison with KPMG must improve. It is essential that a meeting is held with KPMG before the interim audit commences to ensure both sides understand what is required by the PBC issued by the auditors	Essential for 2015/6 Accounts	Agreed and meeting requested

	<p>However, the Council must improve liaison with the external audit team, to ensure that KPMG demands are not excessive and are clearly understood.</p>	<ul style="list-style-type: none">- SHBC must then ensure that the requirements of the PBC are met in full before the auditors commence work. Failure to meet this requirement is certain to result in extra audit fees and a difficult audit cycle.		
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