

## FOLLOW UP FROM AUDIT RESULTS REPORT

### SUMMARY AND RECOMMENDATIONS:

**SUMMARY:** This report sets out a proposed course of action in response to observations made by Ernst & Young and set out in their annual Audit Results Report, and in the Annual Audit Letter, previously reported to the Licensing & General Purposes Committee on 25<sup>th</sup> September 2017 and on 27<sup>th</sup> November 2017 respectively.

**RECOMMENDATION:** To consider the proposals and agree an action plan in response to the observations.

## 1 BACKGROUND

- 1.1 Ernst and Young LLP, the Council's appointed auditor, presented their Audit Results Report to the Licencing & General Purposes Committee on 25<sup>th</sup> September 2017. An unqualified audit opinion was subsequently issued in respect of the Council's Annual Statement of Accounts and concluded that the Council has in place proper arrangements to secure value for money in its use of resources.
- 1.2 The Audit Results Report is scrutinised by the Licensing and General Purposes Committee as part of their role as 'those charged with governance' i.e. the Committee of the Council that has responsibility for matters such as the Annual Governance Report and approval of the Council's financial statements.
- 1.3 The Executive Summary within the report contained the following paragraph in relation to the operation of internal controls.

### Control observations

We have adopted a fully substantive approach and so have not tested the operation of controls. As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in the Council's financial statements of which they are not aware. However we note some areas for improvement, covering the operation of the Councils governance, assurance and risk management processes, which are discussed in Section 7.

- 1.4 Section 7 of the report, Assessment of Control Environment, set out detailed recommendations in respect of four observations.

<b>Assessment of control environment</b>
It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as auditor is to consider whether the Council has adequate arrangements to satisfy itself that the systems of internal financial control are both adequate and effective in practice. As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. As we have adopted a fully substantive approach, we have not tested the operation of controls.
Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate significant deficiencies in internal control. We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in the Council's financial statements of which they are not aware. However we note four areas for improvement which we have identified as part of our work.
<b>Observation 1: Revised Terms of Reference and work programme for the L&amp;GP Committee</b>
Following the committees restructure the L&GP Committee is responsible for carrying out the functions of an audit committee for the Council. Our review of its current Terms of Reference and output for 2016/17 showed that the Committee could be more effective if it followed CIPFA's best practice guidance for Audit Committee which includes (1) an agreed work programme for the year, (2) regular risk management updates, (3) self-assessment of its effectiveness and (4) production of an annual report of its achievements for Cabinet.
<b>Recommendation</b>
The Licensing and General Purposes Committee Terms of Reference should reflect those requirements of an audit committee as specified in CIPFA's Position Statement and guidance on Audit Committees to ensure that its work programme for the year covers all best practice requirements.
<b>Observation 2: Mapping and reporting of the Council's Assurance Framework</b>
The Council is lacking an overarching assurance framework which is a structured means of identifying and mapping the main sources of assurance, and co-ordinating them to best effect. The Council can then use this to effectively manage performance and risk through identifying and reporting on continuous improvement and areas where management need to focus their attention. A good assurance framework, if reported to the Council's L&GP Committee will provide wider assurance than controls, integrating financial, risk and performance measurements, independent assurance with VFM outcomes. It also underpins planning, performance management and risk management leading to a good understanding of how the Council achieves its objectives and addresses areas for improvement. This will be a useful investment and may reduce the amount of scrutiny committee time needed.
<b>Recommendation</b>
The Council should consider mapping its Assurance Framework, where it obtains its assurances, where there are gaps and risks to manage and actions to take. Also then agree on the reporting of this to the Licensing and General Purposes Committee, which will give members a clear view of how the Council is achieving its objectives and addressing areas for improvement.
<b>Observation 3: Review of Risk Management Framework</b>

The Internal Auditor's Opinion on the adequacy and effectiveness of the Council's risk management, control and governance processes provides underlying assurances for the Council's Annual Governance Statement. The Head of Internal Audit's Opinion for 2016/17 was based on eight reviews, six of which were financial system reviews. Improvements have been made in terms of to the planning and scoping of internal audit work for 2017/18, however there is no planned review of the effectiveness of the Council's Risk Management Framework.

The Council's Risk management framework was identified as a significant governance issue in both the 2015/16 and the 2016/17 Annual Governance Statements as the Council recognises that risk management needs to be better embedded within the Council. The Council is currently updating the Corporate Risk Register, risk policies and practice through its re-invigoration of the Risk Management Group. However the Risk Register still needs to be based on the risks around the delivery of the Council's strategic objectives.

#### Recommendation

Internal Audit should provide assurance over the adequacy of the Council's Risk Management Framework, to underpin the 2017/18 Annual Governance Statement, if they carried out a review of the Council's improved risk management arrangements before March 2018.

#### Observation 4: Robust challenge of experts

The Council's valuers, Wilks, Head and Eve (WHE) estimated that there was a £24.192 million upward revaluation of land and buildings compared to the Council's PPE asset opening balance of £67.455 million. Given the significant increase of some £24 million, it appears that management did discuss the outcome of the valuation work with WHE, however management did not document how they were satisfied that the valuation estimates were reasonable. Also, given the differences identified in section 2 of this report, it is our view that the valuers need a more robust setting of scope and challenge process to ensure the valuation approach meets the individual circumstances of the assets being revalued.

#### Recommendation

Whilst appreciating that valuations are a matter of professional judgement, management should critically appraise the information provided to valuers to ensure it is accurate and understood, assess the methods and assumptions used against the accepted accounting practices and challenge where potential anomalies arise.

Management should then document their challenge of the significant estimates made by experts so they can satisfy themselves that the entries in the financial statements are reasonable.

- 1.5 The Annual Audit Letter (AAL) produced by Ernst & Young, and presented to Committee at its November meeting, also identified observations 1 and 2 above as matters to bring to the attention of the Committee. This is set out in the following extract from the AAL:

## Extract from Annual Audit Letter for the year ended 31 March 2017 – Ernst & Young LLP

### Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have adopted a fully substantive approach and have therefore not tested the operation of controls. However, our audit did identify the following control issues to bring to the attention of the Licensing and General Purposes Committee. **Observation**

#### **Revised Terms of Reference and work programme for the L&GP Committee**

Following the committee's restructure the L&GP Committee is responsible for carrying out the functions of an audit committee for the Council. Our review of its current Terms of Reference and output for 2016/17 showed that the Committee could be more effective if it followed CIPFA's best practice guidance for Audit Committee which includes (1) an agreed work programme for the year, (2) regular risk management updates, (3) self-assessment of its effectiveness and (4) production of an annual report of its achievements for Cabinet

#### **Mapping and reporting of the Council's Assurance Framework**

The Council is lacking an overarching assurance framework which is a structured means of identifying and mapping the main sources of assurance, and co-ordinating them to best effect. The Council can then use this to effectively manage performance and risk through identifying and reporting on continuous improvement and areas where management need to focus their attention. A good assurance framework, if reported to the Council's L&GP Committee will provide wider assurance than controls, integrating financial, risk and performance measurements, independent assurance with VFM outcomes. It also underpins planning, performance management and risk management leading to a good understanding of how the Council achieves its objectives and addresses areas for improvement. This will be a useful investment and may reduce the amount of scrutiny committee time needed.

#### **Recommendation**

The Licensing and General Purposes Committee Terms of Reference should reflect those requirements of an audit committee as specified in CIPFA's Position Statement and guidance on Audit Committees to ensure that its work programme for the year covers all best practice requirements.

The Council should consider mapping its Assurance Framework, where it obtains its assurances, where there are gaps and risks to manage and actions to take. Also then agree on the reporting of this to the Licensing and General Purposes Committee, which will give members a clear view of how the Council is achieving its objectives and addressing areas for improvement

- 1.6 These observations and the accompanying recommendations were discussed at the meetings to which they were presented. In addition, at its November meeting the Head of Financial Services agreed to bring forward a high-level action plan to the next meeting of the Committee to aid discussion on the Council's response to the recommendations.
- 1.7 The proposed plan is set out at Appendix A with indicative timescales for each action.
- 1.8 Members are invited to discuss the proposals and agree the broad themes of work to improve the effectiveness of the control environment, having consideration to the recommendations of the external auditors.

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## APPENDIX A

Observation:	Proposed action:	Comment/Date:
Revised Terms of Reference and work programme for the L&GP Committee	Review Terms of Reference against Cipfa's best practice guidance	Guide on order from Cipfa publications 15/01/18.
	Create a work programme for the year	Plan to draw up a programme based on best practice guidance to consider at first meeting of the municipal year
	Provide regular risk management updates to Committee	First report to Committee in January with planned, regular updates
	Self-assessment of effectiveness	To consider format and timing in consultation with external auditors and having due regard to best practice
	Annual Report of achievements to Cabinet	Work with Democratic Services to determine the most effective way of reporting the work of the Committee to the Cabinet
Mapping and reporting of the Council's Assurance Framework	To map the Assurance Framework, report to Committee and report on gaps/risks with an action plan	Background work has commenced led by the interim Audit Manager and informed by the external auditors. This is a longer-term piece of work that will come forward on the work plan once developed.
Review of Risk Management Framework	To ensure that the internal audit plan and the annual governance statement take due regard to a review of the Council's risk framework.	This work is underway. The internal audit plan submitted to Committee in January takes a risk-based approach with a focus on governance issues. The draft Risk Register has been improved and updated and reported to Committee in January. Risk will form part of the work of the external auditors in their review of the "Value for money" conclusion for 2017/18 financial year.
Robust challenge of experts	To improve practise around valuation requests to external experts by; providing the framework in which the Council expects the valuer to work; supplying sufficient detail to enable a robust valuation to be carried out; documenting the process and all communications; and challenging the valuations where appropriate. This will enable the Council to satisfy themselves that the entries in the financial statements are correct.	This will be an area of focus for the external auditors in the audit of the 2017/18 financial statements (as set out in the Audit Planning Report reported to Committee in January). A procurement process has been undertaken by the Council to secure expert valuers for the 2017/18 work (to be carried out between January and March). The tender set out minimum requirements both qualitative as well as quantitative, with responses setting out experience and methodology. Discussions have taken place between external audit, the Finance Manager and the Legal & Estates team to ensure the process is rigorous. Members will be updated as part of the final accounts process and through the work of the external auditor in the Audit Results Report for 2017/18.
Other actions proposed to underpin the above:	Improved communications about available training and forums	For example, list of EY Audit Committee Chair forums - next dates 25th January 2018 Reading, 5th February 2018 Southampton
	Targeted training for Members of the Committee to understand their role as "those charged with governance"	Need to develop training aligned with revised terms of reference and work plan - working with new Finance Manager on design in consultation with internal and external auditors.