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Scottish Borders Council

Interim management report and audit status summary

For the year ending 31 March 2016

21 March 2016

For audit and risk committee consideration on 29 March 2016

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Contents

About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").

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If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Hugh Harvie, who is the engagement leader for our services to the Council, telephone 0131 527 6682 email: hugh.harvie@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Alex Sanderson, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6720 or email to alex.sanderson@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN.

Purpose of document

In line with our audit strategy, we have completed an interim audit. Key activities performed were the testing of a selection of system controls and holding discussions with management to update our understanding and our assessment of the key risks and audit focus areas.

This report provides the committee with an update on:

■ significant risks and other focus areas (page three and four); and

■ the results of the control framework testing, encompassing overarching governance and systems controls (pages five to eight).

Significant risks and other focus areas in relation to the audit of the financial statements

The significant risks identified are:

■ fraud risk from management override of controls;

■ income and expenditure recognition fraud risk; and

■ financial position.

The other focus areas identified are:

■ retirement benefits;

■ provisions; and

■ accounting for transport infrastructure assets.

Wider scope responsibilities: audit dimensions

As introduced in the audit strategy document, we consider the Code of Audit Practice 2016 audit dimensions during the audit. The audit dimensions are financial sustainability, financial management, governance and transparency and value for money. From the interim audit we consider the following matters warrant consideration under the wider scope audit dimensions:

Financial sustainability and *financial management* – uncertainty over future funding and the need for robust medium to long term financial forecasting. We will extend our audit work in respect of the "financial position" risk to address this and set out our findings in the annual audit report.

Governance and transparency – following the formation of the Scottish Borders Integration Joint Board there are new governance arrangements within the Council, which we will consider and set out our findings with regards to adequacy of in the annual audit report. In addition, the Audit Scotland assessment of the Council's public performance reporting ('PPR') highlighted some areas for further improvement (staff engagement and satisfaction; property maintenance, repairs and vehicles; response to welfare reform; use of customer satisfaction information; and benchmarking with comparators). We will consider progress with PPR reporting and set out our findings in our annual audit report.

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RISK	WHY	UPDATE FROM STRATEGY
Fraud risk from management override of controls	Professional standards require us to communicate the fraud risk from management override of controls as a significant risk; as management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.	We have performed controls testing over expenditure, journal entries, bank reconciliations, budget monitoring and general IT controls. Overall, all controls tested were deemed to be designed, implemented and operating effectively. These are discussed further on pages seven and eight. Substantive procedures will be performed during the yearend audit, including over journal entries, accounting estimates and significant transactions that are outside the organisation's normal course of business, or are otherwise unusual.
Fraud risk from income recognition	Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.	Controls testing over higher level controls is set out on page seven. In addition, substantive procedures will be performed during the year end audit. We will consider each source of income and analyse results against budgets and forecasts, performing substantive analytical procedures and tests of detail.
Financial position	Delivering services in the environment of continued financial pressures and funding uncertainty remains a challenge for the sector. Recently the Council has underspent against budget in total. In 2014-15 the Council recorded an underspend of £0.4 million against the final, revised budget. In the aftermath of Storm Desmond, Scottish Borders Council has notified the Scottish Government of their intention to make a claim for Bellwin funding to support recovery efforts. Whilst the Council undertakes robust financial planning, financial sustainability is an inherent risk in the sector.	We have performed controls testing over the budgeting process including the monitoring of budgets throughout the year. We will perform substantive analytical procedures over income and expenditure comparing the final position to budget. Additional expenditure was incurred as a result of the severe weather in late 2015. An application to the Bellwin Scheme will be made for this which will be subject to audit. We will consider management's capital monitoring reports and provide commentary on the achievement of the capital budget and impact on the capital limits and associated borrowing during our yearend audit.

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FOCUS AREA	WHY	UPDATE FROM STRATEGY
Transport infrastructure assets	The 2016-17 Code will require measurement of transport infrastructure assets on a depreciated replacement cost basis. This will represent a change in accounting policy from 1 April 2016 and require full retrospective restatement.	No update from strategy, no impact on 2015-16 audit procedures.
Retirement benefits	The Council accounts for its participation in the Scottish Borders Council Pension Fund in accordance with IAS 19 *Employee benefits*, using a valuation report prepared by actuarial consultants. The calculation of the pension liability is inherently judgemental. The Council's actuaries use membership data and a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases. IAS 19 requires the discount rate to be set by reference to yields on high quality (i.e. AA rated) corporate bonds of equivalent term to the liabilities.	All audit procedures will be performed during our year end audit. Prior to the fieldwork we will request the agreed assumptions from management to facilitate consideration and benchmarking by our team of actuarial specialists.
Provisions	A provision is held to cover the future costs associated with the aftercare and decommissioning of landfill cells at its Easter Langlee landfill site. Management have received advice from internal and external specialists in this regard. No provision is currently required for contributions related to the Borders Railway, however we will continue to monitor the appropriateness of this conclusion as s75 contributions are collected and remitted to Scottish Ministers. Management is awaiting the outcome of recent legal proceedings to consider if there is a contingent liability that requires disclosure as at 31 March 2016 in relation to holiday pay.	No update from strategy, procedures to be performed during the yearend audit.

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Overarching and supporting governance arrangements remain primarily unchanged and provide a solid framework for decision-making. The work of internal audit continues to provide assurance over the key risks identified in the corporate register, while the risk information management system is used to monitor and manage risks on an ongoing basis.

Test	Description	Results
Organisational policies	Organisation-wide policies are important as they set the tone of the Council, outline expectations of employees, document key processes to be followed by all staff, and communicate the culture of honesty and ethical behaviour. These should be updated in a reasonable timeframe to reflect new requirements, and be easily accessible to all staff on the intranet. Our interim work identified some key polices that have not been updated in what we consider to be a reasonable timeframe: • The Local Corporate Code of Governance has not been updated since 2012 and is based on the CIPFA/SOLACE Delivering Good Governance in Local Government Framework published in 2007 and the supporting Guidance Note for Scottish Authorities published in May 2008. CIPFA/SOLACE have since issued an Addendum to the Delivering Good Governance in Local Government Framework in 2012 and an accompanying briefing note. It was noted through discussions that an annual statement is issued each year on updates and that the Local Corporate Code of Governance document will be updated as part of internal audit's work in 2016. Therefore, a recommendation is not required. • The Financial Regulations state that a review should take place annually, however some key policies have not been updated since 2012. Items such as payment authorisation thresholds, budgetary controls and delegated authorities should be reviewed periodically to ensure Financial Regulations are applicable and fit for purpose.	Key polices have not been updated in line with the timeframe stated within the policies. We have not identified any additional audit risks created as a result of this and consequently we have not modified our audit approach. However, management should review and update the Financial Regulations in line with the timeframe established. ***Recommendation one***
Related parties	Separate registers of interest exist for chief officers and elected members. Members are required to declare relevant interests during meetings if appropriate. Our year end audit procedures will include a review of these registers of interests to confirm that all registers are up to date and that any related party transactions have been appropriately disclosed in the financial statements.	Satisfactory – no exceptions to date. Further review will take place as part of our year end work.
National fraud initiative	We prepared a return to Audit Scotland in February 2016, assessing management's participation in the exercise. As at the end of February 2016, the Council had closed 2,827 matches out of a total of 3,990 and the overall rating of the council's participation was assessed as satisfactory ("green").	Overall engagement with NFI is satisfactory.

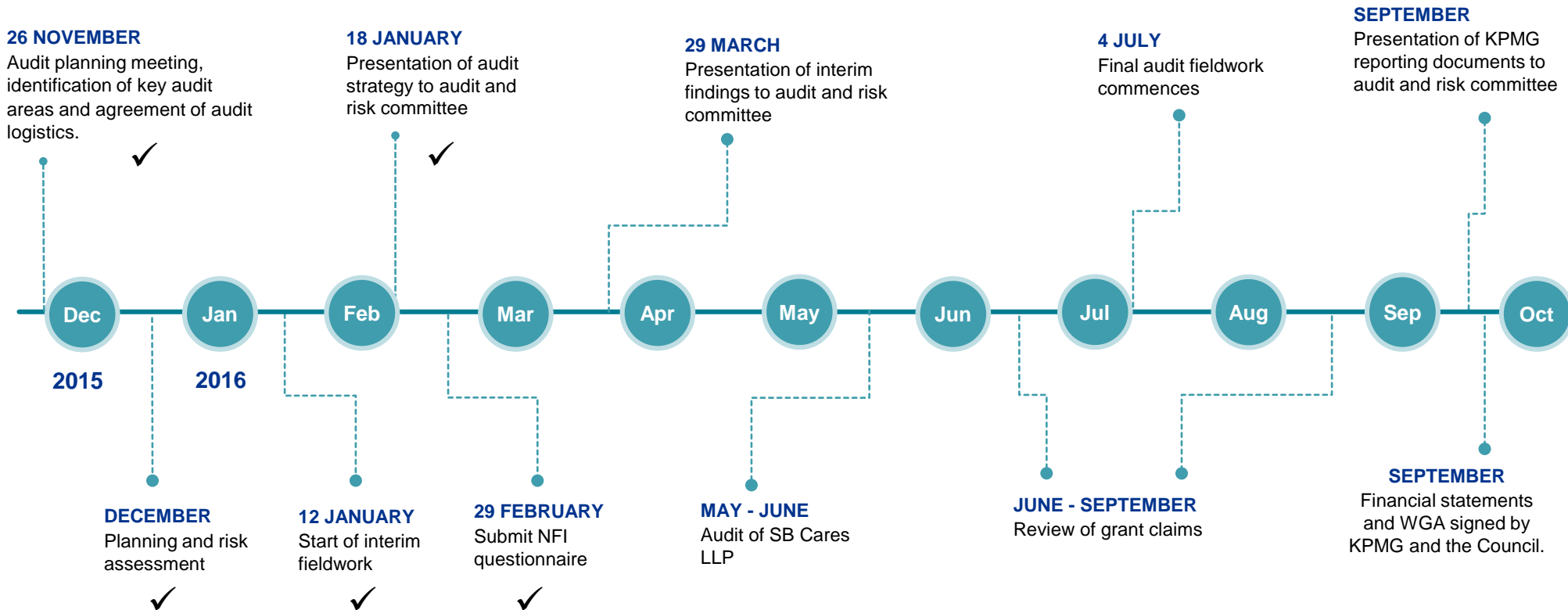| Test	Description	Results
Internal audit	The annual internal audit plan is aligned to the financial year. The chief executive, depute chief executives and service directors are consulted and the risk register considered as part of planning. The 2015-16 plan was approved in March 2015 and progress to December 2015 has been reported to the audit and risk committee. As in previous years, we intend to place reliance on internal audit's work on non domestic rates controls and statutory performance indicators. This year we will also rely on internal audit for a number of controls related to SB Cares, a wholly-Council owned LLP which has been in place as a separate legal entity from 1 April 2015. This may include, but is not limited to the following: • Balance sheet reconciliations • Budget monitoring controls • Payroll and payment authorisation We have held discussions with internal audit who are finalising the above work for 2015-16. We will review relevant internal audit files, findings and recommendations as part of our year end procedures and assess any impact on our substantive audit work. We will continue to review the findings from other internal audit reviews in order to assist in our overall risk assessment of the Council. For example, although we have not placed direct reliance on them, we have considered the reports on ICT, payroll and creditors useful for our information.	Satisfactory. No additional risk areas identified through review.
Integration of health and social care	The Integration Joint Board ("IJB") has met regularly since establishment in April 2015. An audit committee was established in February 2016 and an interim chief financial officer was appointed in March 2016. Strategic plans are required to be submitted to Scottish Ministers by 1 April 2016. Consultation on the draft strategic plan was completed in December 2015 and the health and social care strategic plan was approved by the IJB in March 2016. First year financial statements may be required to be prepared for the IJB, in compliance with the Code of Practice on Local Authority Accounting in the United Kingdom 2015-16, the Local Authority Accounts (Scotland) Regulations and any other guidance need to be met.	Satisfactory - we will confirm whether or not there is a requirement to audit the financial statements of the IJB for the year ending 31 March 2016.

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Test	Description	Results
Income and expenditure	The council has a robust budget setting process, with involvement from various key members of staff. Formal revenue and capital budget monitoring is completed and reported to the corporate management team on a monthly basis and four times a year to the executive committee. Our testing confirmed that budget monitoring arrangements are designed, implemented and operating effectively. Management report progress against the achievement of efficiency saving targets as part of the suite of financial information that elected members receive in their quarterly revenue monitoring reports. The payment run control was found to be designed, implemented and operating effectively.	Satisfactory – no exceptions identified.
Treasury	Testing confirmed that there are bank reconciliations prepared for each month, with bank balances reconciled to the general ledger and reconciliations signed and dated as prepared and authorised by an appropriate member of staff. However, there is a historic issue with the system resulting in differences being reported each month between the bank statement and general ledger, which cannot be fully reconciled. The corporate finance team is aware of this issue, and has been attempting to resolve it for several months. In addition, the authorisation of bank reconciliations has not been signed and dated in a timely manner. Management explained this was due to revision of the reconciliation in an attempt to identify the recurring error, although no original reconciliation was saved in the file.	While we conclude that this control has been designed and implemented appropriately, some weaknesses have been identified. *Recommendation two*
Journals	A new authorisation control was introduced during 2013-14. This control appears to have been designed appropriately, however control failures were identified. Across the sample of 25 journal entries, there were five cases where authorisation had not been received as required by the control. In four of these cases this was due to a difference in the procedure used by two separate teams, where authorisation was either not sought, or authorisation was deemed to have been granted in the absence of a reply to a confirmation e-mail. The testing therefore revealed inconsistencies in the ways in which the control over manual journal entries is implemented by different teams. Management should ensure all employees are aware of the control and are following the process as designed in all cases, or should ensure allowed exceptions to the procedure are clearly documented.	This key control appears to have been designed appropriately, however control failures were identified. We found that five journals from our sample of 25 did not have the required authorisation. *Recommendation three*

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Test	Description	Results
General ledger access controls over FIS (financial information system)	Starters and leavers were processed correctly and in line with procedures, with users added and removed from the system appropriately and in a timely manner. We noted in one instance a new user form had been authorised by a member of staff who did not appear on the IT approved signatories list for user requests. However, after enquiry with the systems administrator team leader we determined that an original incident report was logged by an authorised signatory requesting that a new user be added. From this a new user form was then filled out and signed off by an unauthorised signatory. This does not affect our audit overall as there was an authorised signatory who placed the original request, however new user forms should follow procedure and be signed off and authorised only by an approved signatory. Super users were deemed appropriate based on individuals' job titles. There are four generic super user accounts which management consider appropriate, and we have discussed the nature of each account to verify appropriateness.	Satisfactory overall, although we have raised a recommendation in relation to the new user forms. *Recommendation four*
Program changes and IT policies	Requests for a program change are sent via an authorised change request form to the central IT team and then considered at the next weekly change meeting where the change board will decide to change the status of the request to "approved", "not approved" or "more information needed". This status is updated on the system during the meeting at the point the decision is made. If approved, the changes are made, tested and then implemented if there are no issues. Our testing found that the ten program changes in our sample were properly approved before going live, and: • full testing prior to implementation had taken place for six changes; • for two of the changes testing was not possible due to the infrastructure; and • for another two, the changes were considered minor so testing did not take place. There is an IT security policy in place which is sufficiently detailed and widely available to staff on the Council's intranet. It states that it should be reviewed at least annually. Our testing showed that it was last reviewed in April 2015 and therefore currently meets the requirement. Discussions with IT indicate this will be reviewed again in April 2016; we will review this updated policy during our final audit. The password policy states that it will be reviewed on an annual basis, with the next review date January 2016. However, this was updated in April 2015 as a result of previous recommendations, therefore the next review date is not until April 2016. We will review this updated policy during our final audit to ensure it has been subject to the annual review.	Satisfactory – no exceptions identified.

Appendices

Timeline and reporting

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26 NOVEMBER
Audit planning meeting, identification of key audit areas and agreement of audit logistics.
✓

18 JANUARY
Presentation of audit strategy to audit and risk committee
✓

29 MARCH
Presentation of interim findings to audit and risk committee

4 JULY
Final audit fieldwork commences

SEPTEMBER
Presentation of KPMG reporting documents to audit and risk committee

Dec — Jan — Feb — Mar — Apr — May — Jun — Jul — Aug — Sep — Oct

2015 **2016**

DECEMBER
Planning and risk assessment
✓

12 JANUARY
Start of interim fieldwork
✓

29 FEBRUARY
Submit NFI questionnaire
✓

MAY - JUNE
Audit of SB Cares LLP

JUNE - SEPTEMBER
Review of grant claims

SEPTEMBER
Financial statements and WGA signed by KPMG and the Council.

Action plan

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Priority rating for recommendations		
Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the Council or systems under consideration. The weaknesses may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1 Organisational policies		**Grade three**
The Financial Regulations state that they should be reviewed annually, however they have not been updated since 2012. Items such as payment authorisation thresholds, budgetary controls and delegated authorities should be reviewed periodically to ensure that the Financial Regulations are applicable and fit for purpose.	Management should review and update the Financial Regulations in line with the timeframe established.	Management acknowledge the delay in bringing the review of these regulations forward for approval. The work of reviewing the Regulations has been progressed throughout 2015, however material changes to senior management structures and the creation of significant new arms-length bodies has created a continually moving governance structure to which the Regulations apply and need to reflect. In addition, the Council's decision to implement the new Business World ERP means that there will be a requirement to review and agree amended financial policies. This work will be completed by the end of May 2016. It is therefore proposed to bring the revised Financial Regulations for Council approval after that point. **Responsible officer(s):** David Robertson, Chief Financial Officer **Implementation date:** 30 June 2016

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Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 Bank reconciliations		**Grade three**
Bank reconciliations have been prepared for each month and are signed as prepared and reviewed. However, bank balances are not fully reconciled to the ledger each month and there are balancing figures which could not be explained at the time of our interim audit. The largest in the two months that we sampled was £17,202 in June 2015. Staff are aware of the problem and lengthy attempts have been made to resolve the issue, resulting in a reduction but not removal of the amount. These balances will be reconciled or written off at year end (31 March 2016). The differences identified are not material at present, however differences become harder to reconcile as more time passes, therefore the risk is that there will be differences which cannot be reconciled. In addition, the authorisation of bank reconciliations has not been signed and dated in a timely manner. Differences become harder to reconcile as more time passes, and fraud becomes harder to identify, therefore there is a risk that there will be differences which cannot be reconciled.	It is a key anti-fraud control for bank balances to be fully reconciled on a regular basis. Therefore management should ensure that all bank reconciliations are prepared and reviewed in a timely manner.	Investigation since the completion of the interim audit has identified the cause of a significant proportion of the reconciliation difference to be due to timing differences at the 2014-15 year end. Further investigation is ongoing to resolve the small (circa £1,000) remaining difference. The issue of timeliness of bank reconciliation sign off will be addressed and a sign off deadline of within 1 month of the month end for bank reconciliations will be introduced. **Responsible officer(s):** Neil Christie, Accounting Manager **Implementation date:** 30 April 2016

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Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
3 Journal authorisation		**Grade three**
The control is designed effectively, however it is being implemented inconsistently. We found that five journals from our sample of 25 did not have evidence of appropriate authorisation in line with the control, which explicitly states that all audit reports, authorisation and working papers should be saved on the shared server.	All staff should follow the authorisation control as designed. Details of the process and required steps should be re-circulated to remind staff of the protocols. Alternatively, a training session should be held for all staff that post and authorise manual journal entries as part of their role. If it is determined that exceptions to the procedure are to be allowed for particular teams this should be clearly documented within the guidance.	It is acknowledged that there is currently a difference in journal authorisation procedures across the teams and work has been identified to update the current journal authorisation procedures. With the introduction of the new Business World ERP system by April 2017 is appropriate to do this update in line with the new processes that this will bring. Clarity on this will be known by the end of May 2016. An interim communication will be made to all staff to remind them of the current procedure and ensure that there is appropriate review and sign off and where there are exceptions the reasons for this are documented and signed off by a member of the Finance Management Team. **Responsible officer - Interim communication:** Lynn Mirley, Corporate Finance Manager **Responsible officer – Update of journal process:** Neil Christie, Accounting Manager **Implementation date - Interim communication:** 30 April 2016 **Implementation date - Update of journal process:** 30 September 2016

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Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
4 FIS new user form		**Grade three**
New users that require access to FIS should have an account requested for them via a new user form, which must be signed off as authorised by a member of SBC staff who appears on the Authorised Signatory List.	Management should ensure that no user is added to the system prior to receiving an authorised signature on the new user form.	The Council will ensure that all new user forms are signed by someone on the IT authorised signatory list prior to requests being forwarded to the Financial Systems Team for execution in FIS.
In one instance of our testing, a new user form had been authorised by a member of staff who did not appear on the IT approved signatories list for user requests. After enquiry, it was determined that an original incident report was logged by an authorised signatory and from this a new user form was filled out and signed off by an unauthorised signatory.		**Responsible officer(s):** Bill Edwards, Acting Chief Officer - IT
There is a risk that members of staff are able to obtain unnecessary or inappropriate access.		**Implementation date:** 31 March 2016

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