



*cutting through complexity*

# Scottish Borders Council

Interim management report and audit status summary

Audit: Year ending 31 March 2015

11 March 2015

For audit and risk committee consideration on 23 March 2015

**The contacts at KPMG in connection with this report are:**

**Hugh Harvie**

*Partner, KPMG LLP*

Tel: 0131 527 6682

Fax: 0131 527 6666

[hugh.harvie@kpmg.co.uk](mailto:hugh.harvie@kpmg.co.uk)

**Matthew Swann**

*Senior Manager, KPMG LLP*

Tel: 0131 527 6662

Fax: 0131 527 6666

[matthew.swann@kpmg.co.uk](mailto:matthew.swann@kpmg.co.uk)

**Rhona Mitchell**

*Assistant Manager, KPMG LLP*

Tel: 0141 228 4295

Fax: 0141 204 1584

[rhona.mitchell@kpmg.co.uk](mailto:rhona.mitchell@kpmg.co.uk)

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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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The purpose of this document is to update the audit and risk committee on our progress on the audit of Scottish Borders Council (“the Council”) for the year ended 31 March 2015.

## Introduction

We have completed our interim audit visit, where we tested a selection of higher level, process level and general IT controls and held discussions with management to update our understanding of the key business and audit issues for the Council.

This report provides the committee with an update on:

- the key business issues identified in our audit strategy document;
- additional audit matters identified during our interim visit; and
- the results of our higher level and entity wide controls testing.

## Significant risks

As identified in our audit strategy document, we do not consider there to be a significant fraud risk in relation to income recognition and our audit procedures are inherently designed to consider the risk of management override of controls.

The interim testing did not identify instances where management override of controls had occurred and controls tested were found to be operating effectively.

Our risk assessment procedures identified one additional significant risk for consideration in the 2014-15 audit in relation to the Council’s financial position, including revenue and capital. As outlined in our audit strategy, the Council is operating in a challenging economic environment, with funding reductions and increasing expenditure pressure and therefore requiring specific audit consideration. We have reviewed the Council’s performance in these areas at the time of our interim audit work on the following pages.

We will provide an updated list of significant risks and other matters in our annual audit report, which will be reported to the audit and risk committee in September 2015.

## Other focus areas

Other matters noted in the audit strategy document were in respect of the accounting for:

- reserves;
- property, plant and equipment;
- landfill sites; and
- participation in the Scottish Borders Council Pension Fund.

These are set out further on page five.

As part of our interim audit procedures we have reviewed the current financial position and anticipated outturn to the year end.

Consideration of management information and the Council's arrangements for its compilation and monitoring has not identified any additional audit risks, and the Council's financial performance appears to be broadly in line with expectations.

### Financial position - revenue

Budget monitoring is carried out on a monthly basis, with quarterly reports being submitted to the Executive Committee. The Council acknowledges the need to maintain efficient departments and respond to the challenge of funding restrictions. At 30 September 2014 it was reported that all pressures identified across departments had been addressed in order to project a break even position for 2014-15 against the revised budget.

The September 2014 revenue outturn monitoring report is shown in the table on the right and this forecasts a projected outturn of £0.7 million underspend against the revised budget accompanied by appropriate adjustments to how this has been financed. This includes earmarking of additional reserves of £1.5 million for use in future years as a result of the establishment of a Treasury Reserve in September 2014.

Loan charges are forecast to be less than budget due the Council entering into less capital borrowing than anticipated when the budget was set. Management has endeavoured to finance expenditure through robust cash management and to minimise borrowing where possible.

The base budget has been updated to include increased revenue support grant funding of £10.6 million which was confirmed by government outwith the settlement letter and not included in the original revenue budget. This has allowed for a breakeven position to be forecast despite an additional £11.5 million of expenditure across various departments, largely attributable to out of area placements and the council tax reduction scheme.

Projected outturn against revised budget			
	Revised budget	Projected Outturn	Variance to revised budget
	£'000	£'000	£'000
Chief executive	30,493	30,633	(140)
People	164,678	165,356	(678)
Place	36,603	36,819	(216)
Loan charges	21,443	19,875	1,568
Other	10,536	10,403	133
<b>TOTAL</b>	<b>263,753</b>	<b>263,086</b>	<b>667</b>
<b>Financed by:</b>			
Revenue Support Grant	(174,410)	(175,199)	789
Non-domestic rates	(31,183)	(31,183)	0
Council tax income	(51,126)	(51,126)	0
Earmarked balances from 2013-14	(5,337)	(5,337)	0
Earmarked balances for future years	420	1,920	(1,500)
Transfer to/(from) reserves	(2,117)	(2,161)	44
<b>TOTAL</b>	<b>(263,753)</b>	<b>(263,086)</b>	<b>(667)</b>

Source: September 2014 revenue monitoring report

**We have reviewed capital expenditure forecasts for the year against budget.**

## Capital programme

The Council developed a five year corporate property asset strategy and management plan ("CPASMP") in 2010 which set the overall strategy for the management of the Council's property assets in order to maximise the contribution to the Council's corporate and service goals and objectives as economically, efficiently and effectively as possible – "the right space, at the right time, in the right place at the right cost".

The five year capital budget approved in February 2013 included £42.3 million of capital expenditure in 2014-15.

The spending in the capital plan 2014-15 has been re-profiled throughout the year to allow for various slippages, accelerations and additional allocation of resources. These changes have been reported to the Council's Executive Committee in quarterly update reports. The revised budget for capital expenditure in the year was £48.3 million at 30 September 2014.

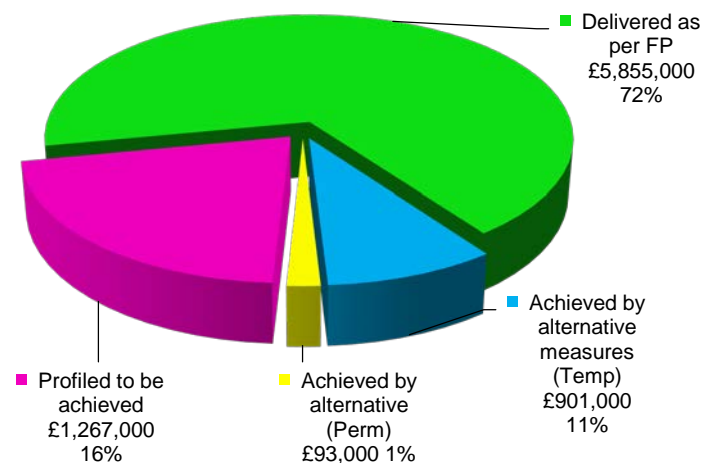
At 30 September 2014, capital expenditure of £9.2 million had been incurred. This represented 19% of the latest approved annual budget. Projected outturn is now £45.8 million representing a £2.5 million underspend against revised budget, mainly due to the re-profiling of the Selkirk Flood Protection project.

## Efficiency savings

The Council's financial strategy was produced recognising the continuing difficult economic outlook and the need for tight fiscal constraint for the foreseeable future. The high level financial strategy for the next five financial years includes continued investment in business transformation and efficiency projects to deliver long term financial savings and service benefits.

The 2014-15 financial plan forecast a breakeven outturn but required savings totalling £8.1 million to be met across all Council departments for this to be achieved. Management continue to develop the reporting of the financial position, including detailed monitoring of the achievement of efficiency savings. At 30 September 2014, only 16% of planned efficiency savings were still to be achieved in the remainder of 2014-15.

### 2014-15 efficiency savings progress



Source: September 2014 revenue monthly monitoring report

### Reserve levels

On 9 February 2012 the council adapted its basis of setting appropriate reserve levels to one which used the corporate risk register as a starting point. The process used applies a financial amount to each risk, adjusted for the perceived probability of the risk crystallising. While this is a judgemental process it is clear and offers the opportunity to make assessments of the required level of reserves on a disaggregated basis.

The corporate risk register was last considered at the executive committee in August 2014. The total financial risk in the register is assessed to be £10.1 million and the projected useable general fund balance at 31 March 2015, at £6.8 million, is sufficient to cover 67% of risks identified at that time. The recommended balance to be maintained on the general fund reserve will continue to be monitored by the Council on a regular basis and we will comment on this in our annual audit report.

### Valuation of property, plant and equipment

Under the Council's rolling basis of revaluations, Common Good and Charitable Trust properties will be subject to valuation as at 1 April 2014. As part of our year end procedures we will liaise with our internal valuation experts to review the methodology and assumptions used in the revaluation. We will also consider the accounting implications of the valuations to ensure that they are appropriately reflected in the financial statements.

### Accounting for landfill sites

We have updated our understanding of the issue and continue to liaise with management over accounting for the Council's landfill obligations. We will review this in detail as part of our year end procedures. Based on our previous year's audit work, we are not expecting that this area will have a material impact on the financial statements.

### Pensions

The Council accounts for its participation in the Scottish Borders Council Pension Fund in accordance with IAS 19 *Retirement benefits*, using a valuation report prepared by actuarial consultants, Barnett Waddingham. We have tested the operating effectiveness of controls designed to ensure that amendments to pensioner data are accurately updated on the pension system accessed directly by the actuary, with issues identified.

The financial and operating environment in which the Council operates continues to change, with developing priorities and emerging financial and non-financial risks. The Council's governance arrangements also continue to develop.

Our interim audit fieldwork was based on gaining an understanding of the strategic and operating culture and framework in which services are delivered. In response to some of the challenges highlighted in the Council's financial strategy and also in response to the changing public sector environment, the Council will be required to make fundamental changes to the way that it has provided services in the past. Some of these changes have already impacted the Council, whilst some are in their infancy and will not have an impact until future years. Below we have identified some of the significant changes occurring at the Council as well as our consideration of these from an audit perspective.

Test	Description	Results
Organisational restructure	<p>A new staffing structure has been in place since 1 April 2014. Under the revised structure, four director posts were replaced with two deputy chief executives. There will also be a reduction in the number of heads of service/chief officers from the current headcount of 19 to 12, together with a number of changes lower down the organisational hierarchy.</p> <p>This does not require a modification to our audit approach, but we will review any severance costs associated with the restructure as part of our audit work on the 2014-15 remuneration statement.</p>	Satisfactory.
Employee terms and conditions	<p>Revised set of employee terms and conditions in place since 1 April 2014. This will affect the 2014-15 financial statements, although this does not require modification to our audit approach.</p> <p>We will ensure we have taken these changes into account when auditing the Council's staff costs for 2014-15.</p>	Satisfactory.
Committee restructure	<p>There have been changes made to the committee structure to improve accountability and clarify roles and reporting lines. These have been in place since 1 January 2015.</p> <p>Now that the Council review of governance and accountability has been completed, we will carry out a targeted follow-up in this area as part of the final audit. This area was identified as requiring additional scrutiny by the Local Area Network (LAN).</p>	To be assessed during final audit.
Related parties	<p>Separate registers of interest exist for chief officers and elected members. Members are required to declare relevant interests during meetings if appropriate.</p> <p>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.</p>	Satisfactory.

## Control framework: governance arrangements (continued)

Test	Description	Results
Organisation-wide policies	<p>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.</p> <p>These should be updated in a reasonable timeframe to reflect new requirements, and be easily accessible to all staff on the intranet.</p> <p>There are a number of policies which have not been updated in what we consider to be a reasonable timeframe. The Housing and Council Tax Benefit Counter Fraud Policy has not been updated since 2010 and this was the subject of a recommendation in 2013-14.</p> <p>The password policy and computer security policy both state that the policies will be reviewed on an annual basis, however they were both overdue at the time of our interim audit. We note that they have been reviewed and endorsed by the council's information governance group since our interim audit but have yet to be published on the intranet.</p>	<p>There are a number of policies which were not updated in what we consider to be a reasonable timeframe.</p> <p>We have not identified any additional audit risks created as a result of this and consequently we have not modified our audit approach. However, it would be good practice for management to review and update these policies.</p> <p><b><i>Recommendation one</i></b></p>
Charitable trusts	<p>From 2013-14, all charitable trust funds registered with the Office of the Scottish Charity Regulator ("OSCR") require an audit. In the prior year, the Council has two registered charitable bodies, the Scottish Borders Council Charitable Trusts and the Common Good Funds, which were subject to audit in 2013-14.</p> <p>Reorganisation of the Council's charities was ongoing at the time of our interim audit therefore we will continue to monitor management's progress and will agree arrangements for the relevant audits in due course.</p>	Satisfactory.
National fraud initiative	<p>We prepared a return to Audit Scotland in December 2014, assessing management's participation in the exercise. The review identified that more than half of the data matches for 2013-14 had been processed and that the exercise was still ongoing. There will be further data matching exercises in February and May 2015.</p> <p>The Council's internal team will transfer to DWP from 1 March 2015 and responsibility for investigation will pass to DWP.</p> <p>We will submit another return to Audit Scotland in June 2015.</p>	Satisfactory.



## Control framework: governance arrangements (continued)

Test	Description	Results
<p>Integration of health and social care</p>	<p>In March 2014 the Public Bodies (Joint Working) (Scotland) Act was passed by the Scottish Government. This requires all Councils and NHS Boards to formally and legally establish integration of health and social care by April 2016. The Council has agreed that in conjunction with NHS Borders, the body corporate model should be adopted and the scheme of integration should be based on this model.</p> <p>Integration schemes must be submitted to Scottish Ministers for approval by 1 April 2015. We understand from management that the Council is on track to meet this deadline.</p> <p>A wholly-Council owned limited liability partnership, SB Cares, will be put in place as a separate legal entity from 1 April 2015. It will therefore fall within the definition of a group entity and hence be required to be included in the Council's group financial statements for 2015-16.</p> <p>Auditors are required to consider the Council's progress in the integration of health and social care, and report our findings in the annual audit report.</p>	<p>Satisfactory.</p>
<p>Internal audit</p>	<p>The annual internal audit plan is aligned to the financial year. Directors are consulted and the risk register considered as part of planning. The 2014-15 plan was approved in March 2014 and progress to December 2014 has been reported.</p> <p>As in previous years, we intend to place reliance on internal audit's work on non domestic rates controls and statutory performance indicators.</p> <p>We have had discussions with internal audit and staff are finalising the above work for 2014-15. 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.</p> <p>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 health and social care, sports trusts and human resources useful for our information. Other reports that may be of interest once finalised include capital investment, financial planning, procurement and governance.</p>	<p>Satisfactory. No additional risk areas identified through review.</p>

## Control framework: systems controls

**Where an audit objective has a controls approach, we have updated our understanding of accounting and reporting activities over each significant account and identified and tested key financial controls as well as reviewing higher level organisational controls.**

**We have evaluated the design and implementation of these controls and, where appropriate, tested the operating effectiveness.**

Our audit does not seek to test all transactions or controls established by management. Testing of the design and operation of key financial controls for the purposes of our financial statements audit, however, confirms that, with the exception of some weaknesses reported, those controls are designed appropriately and operating effectively.

Test	Description	Results
Income and expenditure	<p>The council has a robust budget setting process, with involvement from various key members of staff.</p> <p>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.</p> <p>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.</p> <p>The payment run control was found to be designed, implemented and operating effectively.</p>	Satisfactory – no exceptions identified.

## Control framework: systems controls (continued)

Weaknesses were identified in relation to bank reconciliations and journals. We have assessed the impact of control weaknesses on our audit approach and due to the minor nature of these we do not consider it necessary to increase our substantive audit testing as a result.

Test	Description	Results
Treasury	Testing confirmed that there are bank reconciliations prepared for each month, with bank balances reconciled to the general ledger and reconciliations signed as prepared and authorised by an appropriate member of staff.	While we conclude that this control has been designed and implemented appropriately and is operating effectively, we have suggested some control improvements that could be made to ensure that items are fully reconciled on a timely basis and evidenced as such.  <i>Recommendation two</i>
Journals	<p>A new authorisation control was introduced during 2013-14. This control appears to have been designed appropriately, implemented and operating effectively on the whole, although a control deficiency was identified.</p> <p>We found that 4 journals from our sample of 25 did not have documentation to support the performance of the authorisation control.</p> <p>Confirmation of authorisation of these journals had not been retained as required and therefore we could not confirm that this had been received before the journal was released. However, as a mitigating measure we were able to verbally confirm this, as well as reviewing supporting documentation to confirm that the journal was not posted in error, therefore we do not consider this a control failure.</p> <p>However, management should ensure all employees are aware of the control and are following the process as designed in all cases.</p>	<p>This key control appear to have been designed appropriately, implemented and operating effectively on the whole, although a control deficiency was identified.</p> <p>We found that 4 journals from our sample of 25 did not have supporting documentation to support the performance of the authorisation control.</p> <p><i>Recommendation three</i></p>

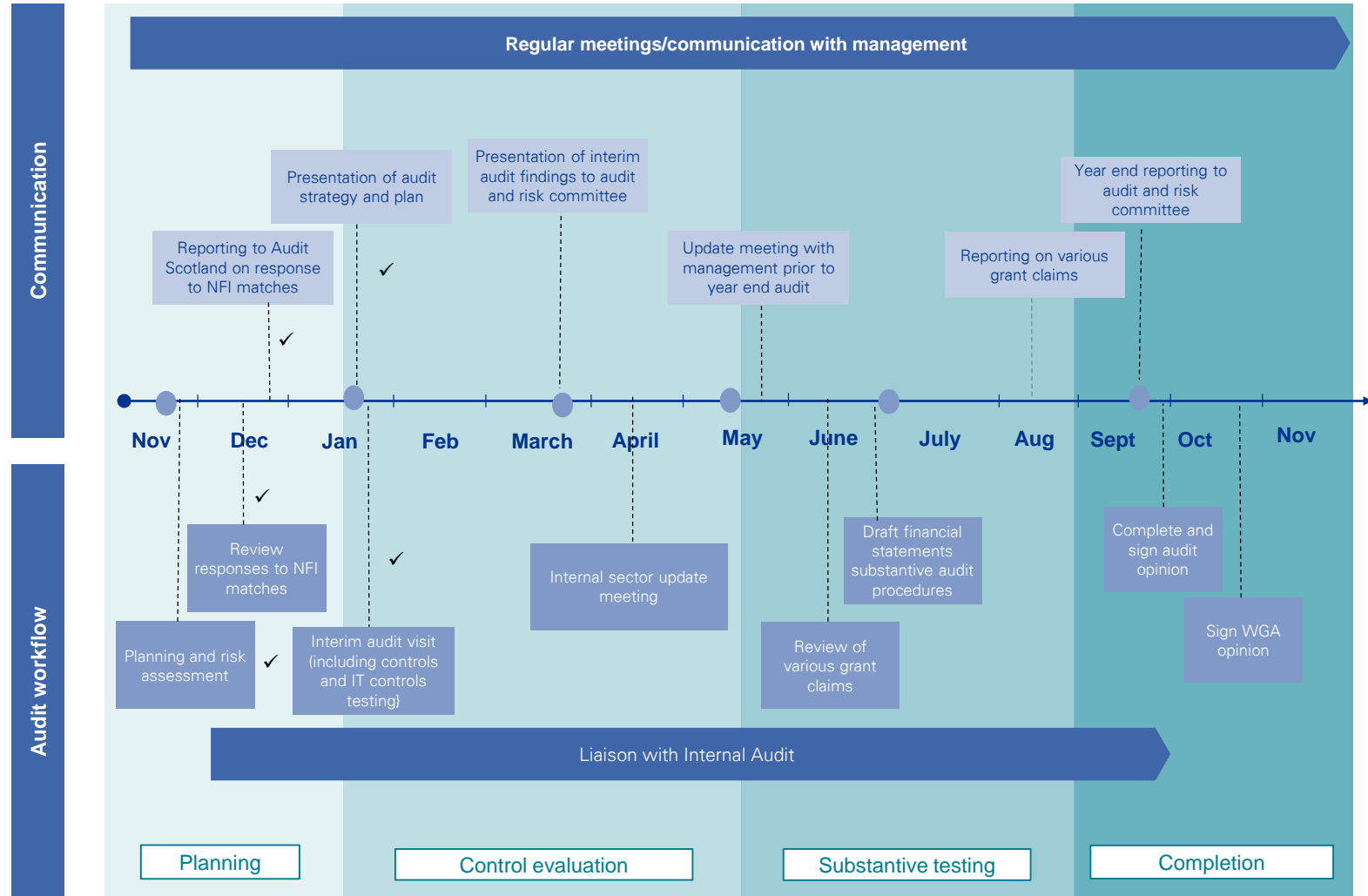
Our audit approach for 2014-15 involves testing the design, implementation and operating effectiveness of the Council's general IT controls for its ledger system, FIS (financial information system).

Our planning for the 2014-15 audit determined that we would test the design, implementation and operating effectiveness of a number of general IT controls to give us comfort over the information produced by the ledger and used as the basis of our audit work. Our testing gave us comfort over the controls in place for system access and program changes.

Test	Description	Results
FIS access controls	<p>Starters, leavers and amendments were processed correctly and in line with procedures, with users added and removed from the system appropriately and in a timely manner.</p> <p>We noted that new start forms had a requirement for "requester" and "authoriser", but in many cases this was the same person. However after enquiry with management, IT and the system administrators we determined that this is accepted practice. As all new users were authorised by an existing user with authority to do this, showing segregation of duties, we have concluded that this is not an issue and that the control is operating effectively.</p> <p>Super users were deemed appropriate based on the individual's job titles. There are four generic super user accounts which management consider appropriate.</p> <p>The FIS system password parameters are not in compliance with the organisation's password policy which states that all organisational passwords should be a minimum of 9 characters. The FIS system can only support a maximum of 8 characters.</p>	<p>Satisfactory overall, although we have raised a recommendation in relation to the FIS system password parameters.</p> <p><b>Recommendation four</b></p>
Program changes and IT policies	<p>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. If approved, the changes are made, tested and then implemented if there are no issues. Our testing found that the five program changes in our sample were properly authorised and implemented in a test environment before going live.</p> <p>There is an IT security policy in place which is sufficiently detailed and widely available to staff on the Council's intranet. However, it was last reviewed in April 2013. This is less than two years ago, however section 8 of the policy itself states that it will be reviewed at least annually. We note that since our interim audit, this been reviewed and endorsed by the council's information governance group but has yet to be published on the intranet. We will review this again at our final audit and recommend that in future review is carried out as necessary on the frequency stated in the policy.</p>	<p>It was found that at the time of our interim audit the IT security policy was last reviewed in April 2013. We have raised a recommendation in relation to this, but overall and as a result of subsequent review, still consider this control to be designed, implemented and operating effectively.</p> <p><b>Recommendation one</b></p>

# Appendix

Progress against the 2014-15 audit timeline communicated in our audit strategy document is shown opposite.



● Audit and risk committee meetings

**Our audit approach for 2014-15 involves increased use of data analytics to supplement existing control and substantive testing.**

**Data analytics takes mass data sets and analyses them to draw out potential control weaknesses or value for money concerns.**

Our planning for the 2014-15 audit determined that we would utilise data analytics to enhance the delivery of the audit. During our planning and risk assessment work, we identified a number of techniques we could use throughout our final audit work. These are set out below. This is not necessarily an exhaustive list, as other opportunities could potentially be identified, nor is this set in stone as this work depends on obtaining the relevant data from the Council and agreement that this work will be value adding.

Audit area	Proposed analysis
Income and debtors	<ul style="list-style-type: none"> <li>Perform analysis of the debtors ledger and compare data between councils. This would allow us to provide benchmarking information to management regarding their collection of debts.</li> </ul>
Expenditure and creditors	<ul style="list-style-type: none"> <li>Re-age the creditors listing at year end and provide benchmarking information on Scottish Borders Council's payment of creditors in comparison to other local authorities.</li> <li>Comment on whether or not the Council is in line with the government's prompt payment guidelines.</li> </ul>
Procurement	<ul style="list-style-type: none"> <li>Perform data matching to identify any duplicate bank account details in supplier data and the payroll system.</li> </ul>
Payroll – overtime and annual leave	<ul style="list-style-type: none"> <li>Utilise data analytics in these topical areas to provide value adding information to management.</li> </ul>
Payroll and pensions	<ul style="list-style-type: none"> <li>Perform analysis of payroll and contribution rates data to verify contribution payments as part of our audit testing over pensions (using average salaries and average contribution rates to calculate expected contribution payments).</li> </ul>
NFI	<ul style="list-style-type: none"> <li>Make use of data analytics to summarise performance and make NFI benchmarking comparisons over and above what is already reported.</li> </ul>
Journals	<ul style="list-style-type: none"> <li>Use data analytics to select higher value and other higher risk journals over which we will focus our testing.</li> <li>We can also perform analysis on the volume of journals posted and other similar tests to provide value adding feedback to management.</li> </ul>

The action plan summarises specific recommendations, together with related risks and management’s responses.

We have identified no grade one (‘significant’) or grade two (‘material’) observations and four other recommendations.

### 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
<b>1 Organisational policies</b>		<b>Grade three</b>
<p>Council policies state that they will receive an annual review, however these have not been evidenced as carried out on some of the policies we have reviewed as part of our interim audit.</p> <p>For example, the last review of the IT password policy is dated 11/11/2011 and the last review of the IT security policy was carried out April 2013.</p> <p>In addition, we made a similar recommendation in the prior year that policies should be updated, specifically the Housing and Council Tax Benefit Counter Fraud Policy (2010). It was confirmed by review of the policy on the intranet that it has not been updated.</p>	<p>The relevant policies should be reviewed and updated as necessary on the frequency stated in the policy.</p> <p>We note that since our interim audit the password policy and the security incident reporting and management procedure (associated with the computer security policy) have been reviewed and endorsed by the council's information governance group but have yet to be published on the intranet. We will review this again at our final audit and recommend that in future review is carried out as necessary on the frequency stated in the policy.</p>	<p>Agreed</p> <p><b>Responsible officer(s):</b> Chief Officer IT</p> <p><b>Implementation date:</b> 31 May 2015</p>



Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
<b>2 Bank reconciliations</b>		<b>Grade three</b>
<p>Bank reconciliations have been prepared for each month, they have been signed as reviewed and prepared but they are not dated to indicate when the preparation and review took place. Therefore we cannot ensure that these are being prepared on a timely basis.</p> <p>In addition, bank balances are not fully reconciled to the ledger each month and there are balancing figures which cannot be explained at the time of our interim audit. The largest in the two months that we sampled was £48,500 in June 2014. Staff are looking into this and these balances will be reconciled or written off at year end (31 March 2015).</p>	<p>Differences become harder to reconcile as more time passes, therefore the risk is that there will be differences which cannot be reconciled.</p> <p>The differences identified are not material at present, therefore there are no concerns that this could potentially lead to a material misstatement. However, bank balances should be fully reconciled on a regular basis.</p>	<p>Agreed</p> <p><b>Responsible officer(s):</b> Chief Financial Officer</p> <p><b>Implementation date:</b> 31 May 2015</p>
<b>3 Journal authorisation</b>		<b>Grade three</b>
<p>We found that 4 journals from our sample of 25 did not have documentation to support the performance of the authorisation control.</p> <p>Confirmation of authorisation of these journals had not been retained as required and therefore we could not confirm that this had been received before the journal was released. However, as a mitigating measure we were able to verbally confirm this, as well as reviewing supporting documentation to confirm that the journal was not posted in error.</p>	<p>All staff should follow the authorisation control as designed.</p> <p>Management could consider communicating with staff and circulating a reminder of the process.</p>	<p>Agreed</p> <p><b>Responsible officer(s):</b> Chief Financial Officer</p> <p><b>Implementation date:</b> 31 March 2015</p>

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
<b>4 Password policy</b>		<b>Grade three</b>
<p>The password policy states that all organisational passwords should be a minimum of 9 characters, however this is not followed by the FIS system.</p> <p>In addition, we made a similar recommendation in the prior year that the policy should be updated to state the systems that this does not apply to. It was confirmed by review of the intranet that this policy has not been updated.</p>	<p>The password policy should be updated to explicitly state that these minimum password requirements do not apply to the systems that cannot support the required level of complexity.</p>	<p><b>Responsible officer(s):</b>            Chief Officer IT</p> <p><b>Implementation date:</b></p>



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