



Grant Thornton

Watford Borough Council

Audit of Accounts 2009-10

Annual Report to those Charged with Governance

15 September 2010

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1 Executive Summary

Purpose of the report

- 1.1 This report has been prepared for the benefit of discussion between Grant Thornton UK LLP and the Audit Committee of Watford Borough Council (the Council). The purpose of this report is to highlight the key issues arising from the audit of the Council's financial statements for the year ending 31 March 2010.
- 1.2 This report meets the mandatory requirements of International Standard on Auditing 260 (ISA 260) to report the outcome of the audit to 'those charged with governance', designated as the Audit Committee. The requirements of ISA260, and how we have discharged them, are set out in more detail at Appendix A.
- 1.3 The Council is responsible for the preparation of financial statements which record its financial position as at 31 March 2010, and its income and expenditure for the year then ended. We are responsible for undertaking an audit and reporting whether, in our opinion, the Council's financial statements present a true and fair view of the financial position.
- 1.4 Under the Audit Commission's Code of Audit Practice we are also required to reach a formal conclusion on whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

SAUK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the objectivity of the engagement team
- nature and scope of the audit work
- the form of reports expected.

Audit conclusions

Financial Statements Opinion

- 1.5 The Council produced its draft 2009/10 accounts in advance of the 30 June 2010 deadline and presented them to the Audit Committee on 25th June 2010. The working papers were of a satisfactory standard this year and we will be looking for improvement in the following year, especially within regard to the production of year end account listings to support the year end debtor balances of Council tax and NNDR.
- 1.6 The key highlights from the audit are set out in the paragraphs below.
- 1.7 Our review of the new accounting requirements for the Collection Fund demonstrates that the Council has correctly applied the new SORP regulation effective from 1 April 2009, in relation to accounting for Council Tax and National Non-Domestic Rates for billing authorities.
- 1.8 The impact of the global economic downturn continues to impact on the Council. Its share of the assets and liabilities of the Hertfordshire Pension Fund show an estimated £78.694m shortfall as at 31 March 2010. We appreciate that this is not an immediate deficit to be met now and that the problem is a national problem for pension funds in both private and public sectors.
- 1.9 The Shared Service arrangement between Watford Borough Council and Three Rivers District Council appear to be embedding with its objectives gradually falling into place. However, it is essential that Council staff continue to be provided with adequate training on all new software systems to enable them to continue to effectively carry out their duties and responsibilities.

- 1.10 We anticipate providing an unqualified opinion on the Council's financial statements, following approval of the accounts by the Audit Committee on 30 September 2010.
- 1.11 Further details of the outcome of our financial statements audit are given in Section Two and Appendix B (adjustments to the financial statements).

Value for Money Conclusion

- 1.12 In providing our opinion on the financial statements, we are required to reach a conclusion on the adequacy of the Council's arrangements for ensuring economy, efficiency and effectiveness in its use of resources (the Value for Money conclusion).

Our Value for Money conclusion is informed by our work on Use of Resources. In order for us to provide an unqualified conclusion, the Council needs to have adequate arrangements in place for each of the Code of Practice criteria. We are pleased to report that the Council has met the requirements for the Code criteria and we therefore propose to give an unqualified conclusion.

- 1.13 Based on our assessment, the Council has strengthened its arrangements for the management of finances with clear plans for the challenges of the medium term. The Council has a structured medium term approach to financial planning that engages the local community and a track record of achieving budget surpluses with a sustained focus on achieving priorities as demonstrated in the Shared Service arrangement with Three Rivers District Council. In addition, there was an improvement in the quality of working papers submitted for the audit of the Use of Resources assessment. The financial performance reporting function appears robust.
- 1.14 Further information on the outcome of our Value for Money audit is contained in Section Two.

The way forward

- 1.15 Matters arising from the financial statements and Value for Money audit have been discussed with the Head of Strategic Finance. We have made a number of recommendations, which are set out in the action plan at Appendix C. This has been discussed and agreed with the Head of Strategic Finance and his senior finance team.

Use of this report

- 1.16 This report has been prepared solely for use by the Council to discharge our responsibilities under ISA260, and should not be used for any other purpose. We assume no responsibility to any other person. This report should be read in conjunction with the Statement of Responsibilities and the Council's Letter of Representation.

Acknowledgements

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

Grant Thornton UK LLP

15 September 2010

2 Detailed Findings

Introduction

- 2.1 This section provides a summary of findings arising from our audit of the financial statements and Value for Money (VFM) audit.

Status of the audit

- 2.2 We carried out our audit in accordance with the final Accounts Audit Plan presented to the Audit Committee in March 2010. Our audit is substantially complete, subject to the following finalisation procedures:
- obtaining and reviewing the Council's Letter of Representation
 - updating our post balance sheet events review, to the date of signing the accounts.

Key risks

- 2.3 Our 2009/10 Accounts Audit Plan set out the key risks relating to the audit of the financial statements. As part of our final accounts audit, we reviewed the key risk areas and have set out in Exhibit One, the outcome of work completed.

Exhibit One: 2009/10 Key audit risks

Key audit risk	Conclusion
Risk 1 - Shared Service	
2009/10 was the first year that the Shared Service arrangement with Three Rivers District Council came into effect.	Notwithstanding some teething problems, information requests were provided in a timely manner and the change appears to be embedding well.
Risk 2 - Collection Fund	
2009/10 was the first year that the Council was required to account for Council Tax and National Non-Domestic Rate under the new regulations required by SORP 2009.	Our review of the Collection Fund demonstrates that the new accounting requirements have been successfully processed including the restatement of the prior year in accordance with the requirements of the SORP.
Risk 3 - Officers Remuneration	
LAAP 85 requires additional disclosures for Senior Officers remuneration. Particularly important as an additional 6 officers were included due to payment of compensation for loss of office under the Council's restructuring exercise.	Our review of the disclosures in the accounts against the relevant standard supports our assurance that the disclosures are accurate and complete
Risk 4 - Property, Plant and Equipment	

The impact of the economic downturn should be reflected in the valuation of Property, Plant and Equipment.	The economy did not weaken significantly since the start of the financial year and hence there was no significant reduction in property values. We have reviewed the revaluation and impairment of property, plant and equipment and are assured that they are not materially misstated in the financial statements.
Risk 5 - Payroll	
The Council outsourced its payroll function to an external provider (NORTHGATEARINSO) during 2009/10.	Our audit procedures showed that the controls around this arrangement could be more robust. We recommend that additional controls are implemented and regularly monitored.
Risk 6 - New Revenues & Benefits System	
The Council went live on a new revenues and benefits system (ACADEMY) in February 2010.	The changeover appears to have been transitioned satisfactorily and we are satisfied that the Collection Fund is not materially misstated. However, the Council needs to continue with a comprehensive training programme for revenues and benefits staff.

Matters arising from the financial statements audit

- 2.4 We were presented with the draft financial statements on 25th June 2010, in advance of the statutory deadline of 30 June 2010. The supporting working papers were also provided in accordance with the agreed timetable for audit.
- 2.5 Regular liaison meetings were held between the audit team and key finance officers prior to the preparation of the draft accounts, and throughout the audit fieldwork. This enabled early resolution of emerging issues. We would like to place on record our appreciation to those officers involved in this process.
- 2.6 Matters arising from the financial statements audit are set out below. None of these matters have been significant enough to impact on our opinion or our value for money conclusion. Where appropriate, we have made recommendations for improvement, as set out in the agreed action plan at Appendix C.

Council Tax and National Non-Domestic Rate Debtors

- 2.7 The Council has recently changed over to a new Revenues and Benefits software system. Although substantial assurance was gained on the balances, there were no detailed account listings to support the Council Tax and Non-Domestic Rate debtors of £3.359m and £3.778m respectively. This meant more detailed procedures had to be performed to gain that assurance over the balances.

Payroll

- 2.8 The Council's payroll is outsourced to an outside Provider (NorthgateArinso). Some of the detailed controls around this arrangement do not appear to be sufficiently robust. Starters and leavers are not promptly identified and processed. This has not impacted on our opinion but represents a control issue which should be addressed going forward.

Journal Processing

- 2.9 The process for the raising and posting of journal entries in the accounts is not sufficiently robust as there is no segregation of duties between the originating and posting of journals. In practice the Head of Finance will review most journals over £50,000. There is the risk of intentional or unintentional errors in financial data going unnoticed if due care is not exercised when posting journals.

Accruals

- 2.10 There is currently no separate code for accruals. Accruals are analysed under Other Creditors. A separate analysis would facilitate control and review of information to support regular and non standard accruals. .

Adjusted misstatements

- 2.11 Our audit identified the following non-material adjustments which Finance Managers have agreed to amend.

Related Parties

- 2.12 There is reference to an £85,000 share in the net assets of West Hertfordshire Crematorium. However, the recalculation of this shows that it is actually (£85,000) therefore a share in the net liability.

Miscellaneous Disclosures

- 2.13 There are a number of disclosures in the Financial Statements including the Building Control and Publicity Expenditure that are no longer required by the SORP.
- 2.14 All adjusted misstatements are included at Appendix B. These adjustments have no impact on the Council's general fund reserve.

Unadjusted misstatements

- 2.15 There were no unadjusted misstatements to report to the Audit Committee, all adjustments identified were processed by management.

Financial Statements Opinion

- 2.16 We anticipate providing an unqualified opinion on the Council's financial statements, following approval of the accounts by the Audit Committee on 30 September 2010.

Financial performance

- 2.17 The Council has reported an Income and Expenditure account deficit of £6.716m which is in line with the revised medium term financial plan. In 2008/09 the Council reported a deficit of £7.028m. The Statement of Movement on the General Fund Balance adjusts the Income and Expenditure deficit to exclude specific costs, which are determined by statute, in order to calculate the impact on the Council's General Fund. The Council's General Fund Working Balance was left unchanged at £1.696m and additionally there is a HRA Working Balance of £1.251 million which will be transferred to the General Fund at the end of next financial year after obtaining approval from the Secretary of State

The Council managed revenue expenditure within the budget for the year. The capital budget recorded a £3.488m under-spend against the original budget of £12.152m. The main reason for the under-spend are slippages on Cardiff Road Health Campus of £0.983m, refurbishment works on Town Hall and Colosseum of £0.768m and section 106 funded schemes of 0.620m.

Evaluation of key controls

- 2.18 We have undertaken sufficient work on key financial controls for the purpose of designing our programme of work for the financial statements audit.
- 2.19 We performed a high level review of the general IT control environment as part of the overall review of the internal control system and concluded that the Council should take immediate actions to address some of the issues identified. An interim report on our review of IT controls in place at the Council has been issued. Where appropriate we have made recommendations for improvement as set out in the agreed action plan at appendix C. The key issues arising from our review resulting in high priority recommendations being made are:

Change of Management Policy

- 2.20 No defined Change Management Policy and Procedures are in place to provide for consistent and effective change control (including patch management) to the Council's financial management system, Aptos. Changes are usually required to keep a system current or to add additional required functionality. As such, changes should be subjected to stringent change control procedures whereby all changes, including routine patches, are appropriately requested, logged, assessed, tested and transported to the production environment. Without an appropriate change management methodology (with defined policies and procedures) the live environment and data contained within may be at risk.

Employee Change of Circumstance

- 2.21 Historically, monthly emails were sent by Payroll to the Aptos System Administrator and ICT informing them of the recent leavers within the Council. Since the payroll function was outsourced to Northgate in September 2009 this ceased to happen. Therefore, there is no formal/consistent process in place to inform System Administrators of leavers, so that their IT access can be disabled on a timely basis. Without proper documentation on granting, changing and revoking user access, management cannot be assured that the desired policies, responsibilities (from HR, IT or System Administrator/s) and other related controls are implemented effectively.

Housing Benefit

- 2.22 The recent review of the qualification letter that accompanied the 2008/09 certified claim, at the request of the DWP, resulted in a potential liability of the clawback of benefit. The initial liability was reduced from £3.5million to £189,000, after further evidence was provided in a transitional period of the Benefits service. However, the liability remains at £189,000. With the forthcoming audit of the 2009/10 claim we recommend an advance cleansing of the data, which would subsequent resolve any issues in advance of the audit.

A full internal review of the supervisory and quality assurance controls in place is recommended in order to address any service framework issues dealing with the increased volume and complexity of caseload. The point is particularly pertinent with regard to the Council using external short term agency staff in order to address the capacity issues of clearing the existing caseload backlog, resulting from a merger of the service.

Housing Revenue Account

- 2.23 Our audit procedures found that at the time of audit the Housing Revenue Account ('HRA') remained open, even though the stock had been transferred to Watford Community Housing Trust on the 12 September 2007. The result of this is that the Council has to maintain the Housing Revenue Account and are required to file the 2007/08 claim. Correspondence with the Audit Commission has revealed that the 2006/07 claim has been signed and the 2007/08 claim is eligible for sign off. We recommend the provision of working papers to support the claim are provided on a timely basis. Once the claim has been successfully audited the Council may apply for the closure of the HRA to the Secretary of State. Successful application will result in the transfer of balance of approximately £1million from the HRA to the General Fund.

Internal Audit

- 2.24 We have reviewed the work of internal audit and concluded that the scope and conduct of internal audit work was appropriate to provide adequate assurance on the effective operation of controls. We have therefore taken broad assurance from the work of internal audit in our evaluation of controls as it impact on our overall use of resources conclusion.

Annual Governance Statement

- 2.25 We have examined the Council's arrangements and processes for compiling the Annual Governance Statement (AGS). In addition, we read the AGS to consider whether the statement is in accordance with our knowledge of the Council.
- 2.26 We have concluded that the Council has good arrangements in place to compile the AGS and provide a strong audit trail for the Managing Director and Mayor to sign the statement.

Value for Money

- 2.27 The Audit Commission's Code of Audit Practice requires us to assess whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. In discharging this responsibility, we are required to review and, where appropriate, examine evidence that is relevant to the Council's corporate performance management and financial management arrangements.

- 2.28 Our 2010 Value for Money conclusion has been informed by work carried out on Use of Resources up until the abolition of Comprehensive Area Assessment, and other local risk based work carried out in accordance with our 2009/10 Audit Plan.
- 2.29 The Council has met all the requirements of the Code of Practice. The Council has further improved its arrangements in the last 12 months. Key improvements identified in this area include:
- Financial planning works more closely with services and there is a responsive financial environment for service planning and delivery that involves senior management and engages local communities and other stakeholders.
 - There is a sustained focus on achieving priorities through allocation of resources to high priority areas and showing achievement of improvements. This is demonstrated in the new shared service arrangements with Three Rivers District Council that has resulted in significant annual savings.
 - The financial performance reporting function is robust. Information is provided in a timely manner that enables remedial action to be taken promptly.
 - The Council continues to demonstrate a strong corporate commitment and culture to producing good quality accounts and supporting documentation.

Next steps

- 2.30 The Audit Committee is required to approve the financial statements for the year ended 2009/10.
- 2.31 Finally, we would again like to draw to the attention of those charged with governance further significant changes to the basis on which the statement of accounts will be prepared in future years. We have noted some of the arrangements that are in place for the full implementation of International Financial Reporting Standards ("IFRS") into the 2010/11 accounts. It is important that the Council continues to develop these arrangements as there will be significant changes to the accounts under IFRS. Our experience in other sectors shows that audited bodies that are well prepared for the transition to IFRS have fewer amendments to their accounts than those who are not. We would be happy to share our experiences of working with CIPFA in this area, as well as involving our Financial Reporting Advisory Group who are specialists in planning for IFRS.
- 2.32 The most important initial task in addressing the challenges of IFRS will be in restating the 2009/10 accounts in full with notes and disclosures and obtaining appropriate assurance over those arrangements.
- 2.33 The outcome of our Use of Resources audit will be reported in full in a separate report to be presented to the Audit Committee in January 2011.

A Reporting requirements of ISA 260

The principal purpose of the ISA 260 report is:

- To reach a mutual understanding of the scope of the audit and the respective responsibilities of the auditor and those charged with governance.
- To share information to assist both the auditor and those charged with governance fulfil their respective responsibilities.
- To provide to those charged with governance constructive observations arising from the audit process.

ISA260 reporting requirement	Key messages
Independence	<p>We are able to confirm our independence and objectivity as auditors and draw attention to the following points:</p> <ul style="list-style-type: none"> • We are independently appointed by the Audit Commission. • The firm has been assessed by the Audit Commission as complying with its required quality standards. • The appointed auditor and client service manager are subject to rotation in line with the Audit Commission's requirements. • We comply with the Auditing Practices Board's Ethical Standards.
Audit Approach	<p>Our approach to the audit was set out in our 2009-10 audit plan. We have planned our audit in accordance with auditing standards and the Audit Commission's Code of Audit Practice. Other key factors to highlight include:</p> <ul style="list-style-type: none"> • We consider the materiality of items in the financial statements in determining the audit approach and in determining the impact of any errors. • We have been able to place appropriate reliance on the key accounting systems operating at the Council for financial statement audit purposes. • In 2009-10 we have been able to take assurance from the work of internal audit in respect of the key accounting systems.

ISA260 reporting requirement	Key messages
Accounting Policies	<p>The Council has adopted appropriate accounting policies in the areas covered by our testing. Accounting policies are in accordance with the SORP 2009.</p> <p>The Audit Committee should confirm that it is satisfied that the accounting policies adopted are the most appropriate, as required by IAS 8.</p> <p>We have considered the Council's financial plans and consider it appropriate for the Council to continue to account on a going concern basis.</p>
Material Risks	<p>The Audit Committee should confirm that it is not aware of any additional material risk areas facing the Council, including significant fraud risks.</p> <p>We have requested from the Council a Letter of Representation, to state that there are no additional material risks and exposures as at September 2010, which should be reflected in the financial statements.</p> <p>We will also perform our own audit procedures to ensure that all significant risks and exposures to the Council have been recognised in the accounts as at September 2010. We will focus on accounting provisions and cash flow forecasting over the next 12 months.</p>
Audit Adjustments	<p>We have discussed with management the adjustment to the accounts, primarily to improve the fair presentation of the financial statements, as well as the clarity and presentation of disclosure notes.</p> <p>This adjustment is summarised at Appendix B.</p>
Unadjusted Errors	<p>From the audit results mentioned previously we have identified no unadjusted errors.</p>
Other Matters	<p>No other matters have been noted.</p>

B Adjustments to the financial statements

The following table presents all significant adjustments made to the accounts arising from the audit process which have been processed and agreed with Officers in the Council.

Adjustment Type

Misstatement - A change to the value of a balance presented in the financial statements.

Classification - The movement of a balance from one location in the accounts to another.

Disclosure - A change to the way in which a balance is disclosed or presented in an explanatory note.

Adjustment type	Accounts balance	Impact on financial statements
Disclosure	Note 7 - Publicity Note 8 - Discretionary Expenditure Note 9 - Building Control Account Note 10 - Agency Income & Expenditure	These disclosures are no longer a requirement under LG SORP 2009.
Disclosure	Note 15 Related Party	There is reference to an £85,000 share in the net assets of West Hertfordshire Crematorium. However, the recalculation of this shows that it is actually (£85,000) therefore a share in the net liability.
Disclosure	All	A number of disclosure adjustments have been agreed to improve clarity and presentation of the accounts which do not affect the reported financial position.

C Action Plan

Rec. No.	Para Ref	Recommendation	Priority H/M/L	Council response	Implementation date and responsibility
1	2.8	Council Tax and National Non-Domestic Debtors Adequate software system training should be provided to staff to assist them in carrying out their duties.	M	Agreed. Training to be sourced by Revenues Manager	November 2010 Head of Revenues & Benefits (Shared Services)
2	2.10	Payroll Adequate controls should be implemented and regularly monitored to support assurance of the Payroll figures.	M	Agreed. Recommendations from recent reviews and internal audits are actively being progressed, including control procedures.	Ongoing Head of Human Resources (Shared Services)
3	2.11	Journal entries The journal entries are originated and posted by different officers.	L	Agreed. Procedures for originating and authorisation journals to ensure effective internal control were implemented with the new Financial Management System	Implemented on 1 April 2010 Head of Finance (Shared Services)
4	2.12	Accruals Separate codes should be set-up for accruals to improve clarity and presentation of the accounts.	L	This has been actioned	Head of Finance (Shared Services)

5	2.22	<p>Change Management Policy A formal change management policy and associated procedures should be developed, covering the following areas:</p> <ul style="list-style-type: none"> • Assessment of the impact of the change request on the Business; • Assessment of level of testing and supporting documentation required (test scripts, test results, issues logs, etc.); • Change authorisation and release management, including sign-off by System Owners; and • Emergency procedures. 	H	With the implementation of the new COA financial management system these procedures are in place	<p>Implemented on 1 April 2010</p> <p>Head of Finance (Shared Services)</p>
6	2.23	<p>Employee Change of Circumstances We recommend that the security administration function is automatically notified by Human Resources when there are changes to the roles of employees or when they leave the Council.</p> <p>Moreover, we recommend that a formal user access administration policy and related procedures should be defined.</p>	H	<p>A system is now in place whereby ICT are notified of all starters & leavers on a monthly basis using system generated reports</p> <p>ICT security policies are being harmonised and procedures will be addressed accordingly</p>	<p>Implemented / Ongoing</p> <p>Head of Human Resources (Shared Services)</p> <p>Head of ICT (Shared Services)</p>

7	2.23	<p>Housing Benefit</p> <p>We have noted that in the current financial year the the DWP have required the Council to potentially return £189,000 of housing benefits grant funding. In light of the current economic climate unbudgeted payments such as these are not sustainable we therefore recommend full internal review of housing benefits, supervision and quality assurance functions</p>	H	<p>Agreed. Review conducted August 2010 and recommendation that Subsidy Officer role be implemented approved by Shared Services Committee 13/09/10. Anticipated to be in post by December 2010</p>	<p>December 2010</p> <p>Head of Revenues & Benefits (Shared Services)</p>
8	2.24	<p>Housing Revenue Account</p> <p>Working papers supporting the 2007/08 Housing Revenue Account subsidy claim are provided on a timely basis in order that the claim may be subsequently certified to allow the Council to apply for closure of the account and subsequent transfer of the balance to the General fund.</p>	H	<p>The former Head of Finance at Watford has assembled the necessary data so that it is ready for external audit scrutiny</p>	<p>Head of Strategic Finance to agree a date for external audit with Grant Thornton.</p>



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