
PKF REPORT ON ISA 265 – INTERNAL CONTROL

1 SUMMARY

- 1.1 The external auditors are required to report on any deficiencies in internal control to those charged with governance and management in accordance with the International Standard on Auditing 265 (ISA 265).

2 INTRODUCTION

- 2.1 A letter has been sent to the Chairman of the Audit Committee reporting internal control weaknesses identified during the audit of the financial statements. It is attached for Members' consideration.

3 FINDINGS

- 3.1 Part of the external auditors' work on determining any weaknesses of internal control, which from their professional judgment could lead to a material misstatement within the final accounts, must be reported to the Chairman of the Audit Committee. A full report on the audit of the financial statements is also included elsewhere on the Agenda for this Committee.
- 3.2 All the issues listed in the appendix to the external auditors' letter have already been discussed with managers and those considered important have been reported to Members, as Internal Audit was aware of them from its own testing of these systems.
- 3.3 All recommendations received from External Audit will be implemented and monitored through this Committee.

4 RISK

- 4.1 The failure of key controls is a significant weakness in the Council procedures and has the potential to lead to material misstatements of the financial statements. This risk is mitigated by the correction of any weaknesses and the inclusion of other controls that form part of the holistic process.
- 4.2 With the implementation of the PKF recommendations, the continued auditing undertaken by Internal Audit and the control procedures already in place it is the view of the Audit & Performance Manager that these significant weaknesses have been mitigated.

5 RECOMMENDATION

- 5.1 It is proposed that the Committee **RESOLVES**

- (1) That the deficiencies in internal control, as defined in the attached report, be agreed.

- (2) That the implementation of the recommendations identified within the attached report be monitored.

Yvonne Woodward

Head of Finance

Background Papers:-

None.

For further information please contact Tracey Metcalf (Audit and Performance Manager) on:-

Phone: 01702 318031

Email: tracey.metcalf@rochford.gov.uk

If you would like this report in large print, Braille or another language please contact 01702 318111.



Accountants &
business advisers

Councillor Mrs Mockford
Audit Committee Chairman
Rochford District Council
Council Offices
South Street
Rochford
Essex
SS4 1BW

Our ref: 1012597/2010-11/RSB/LJC

5 September 2011

Dear Cllr Mrs Mockford,

Audit of financial statements for the period ended 31 March 2011

In accordance with International Standard on Auditing 265 - Communicating deficiencies in internal control to those charged with governance and management (ISA 265), we are required to report to you significant deficiencies in internal control identified during the course of our audit.

The purpose of our audit is for us to express an opinion on the financial statements. Our audit includes consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purposes of expressing an opinion on the effectiveness of internal control. The matters that we have reported to you are limited to those matters that we have identified during the audit and our work is not designed to provide a comprehensive statement of all deficiencies which may exist in internal control or of all improvements which may be made.

We have now completed our audit of the Council's key financial systems and controls and details of the significant matters identified that we would like to bring to your attention can be found in the appendix to this letter.

All of the deficiencies identified have been discussed and reported to Management by

Tel 020 7065 0000 | Fax 020 7065 0650

Email richard.bint@uk.pkf.com | www.pkf.co.uk

PKF (UK) LLP | Farringdon Place | 20 Farringdon Road | London | EC1M 3AP | DX 479 London/Chancery Lane

PKF (UK) LLP is a limited liability partnership registered in England and Wales with registered number OC310487.

A list of members' names is open to inspection at Farringdon Place, 20 Farringdon Road, London EC1M 3AP, the principal place of business and registered office. PKF (UK) LLP is authorised and regulated by the Financial Services Authority for investment business activities. PKF (UK) LLP is a member firm of the PKF International Limited network of legally independent firms and does not accept any responsibility or liability for the actions or inactions on the part of any other individual member firm or firms.

Internal Audit, although not all deficiencies have been reported to Those Charged with Governance.

The deficiencies and related action plan will be included in our Annual Governance Report which will be presented to the Audit Committee on 29 September 2011.

We would also like to take this opportunity to report to you, under ISA260 - Communicating with Those Charged with Governance, the results of our updated risk assessment, performed on receipt of the Council's draft accounts for audit and with the benefit of our knowledge of developments since we presented our original audit plan to you. We identified the following additional significant risk:

Audit risk identified	Audit response
There is a risk that the Council's accounts do not appropriately reflect any disclosure that might be required in respect of contingent liabilities relating to a litigation issue arising from the tendering of the Materials Recycling Facility contract because of the difficulties inherent in the Council determining the potential outcomes of this.	We will review the latest legal opinion and other documentation to determine the potential liability of the Council at the balance sheet date and whether appropriate disclosures have been made.

Yours faithfully,



Richard Bint
Senior Partner
PKF (UK) LLP

cc Yvonne Woodward, Head of Finance
Tracey Metcalf, Audit & Performance Manager

Appendix

Significant deficiencies in internal control have been identified in the system areas set out below:

Control weakness	Potential impact	Audit response	RDC Comment
Payroll			
1.1 Confirmation of the establishment: Annual circulation of Establishment Lists to all Departments was introduced during the year, which required each department to confirm the accuracy of the list and thus the accuracy of the information held on the Payroll System. One of the 7 Departments did not respond to confirm the accuracy of their Establishment List. The control failure breaches our tolerable level set for the effective operation of a control.	There is an increased risk that the payroll information is inaccurate leading to erroneous payments which could result in material misstatement of payroll expenditure. The primary impact on our audit approach, however, is that we are unable to satisfy ourselves of the accuracy of the payroll staff numbers information that would support a proof in total approach to the audit of gross pay costs.	The combination of control failures at 1.1 and 1.2 reduces the level of assurance we can gain over the completeness and accuracy of the information recorded on the payroll system and thus generating the correct payroll charges. Our revised approach will be to complete substantive testing on a sample of employees to ensure that they are valid employees and that they have been paid in accordance with their contractual terms.	Fully agree with this, as it has been a longstanding issue. However, this particular case was explained in the Working Paper. The Head of Environmental Services was working on various changes within the department with HR.

Control weakness	Potential impact	Audit response	RDC Comment
<p>1.2 Starters: Forms must be authorised by HR and Payroll for all new employees and all employees who leave the Council before they are input/amended on the Payroll System. Testing identified 1/8 starter forms that had not been authorised. This occurred due to staff being on annual leave and no alternate authorisation process being in place. The control failure breaches our tolerable level set for the effective operation of a control.</p> <p>Internal Audit completed a 100% testing on the remaining population of starter forms and found 1 further error.</p>	<p>Due to the deficiency in the operation of the control, there is a risk that the payroll is inaccurately paying employees, leading to payroll expenditure being inaccurate. The primary impact on our audit approach, however, is that we are unable to satisfy ourselves of the accuracy of the payroll staff numbers information that would support a proof in total approach to the audit of gross pay costs.</p>	<p>The combination of control failures at 1.1 and 1.2 reduces the level of assurance we can gain over the completeness and accuracy of the information recorded on the payroll system and thus generating the correct payroll charges. Our revised approach will be to complete substantive testing on a sample of employees to ensure that they are valid employees and that they have been paid in accordance with their contractual terms.</p>	<p>Internal Audit picked up the 1 starter case that had not been signed by HR. They extended the sample to 100% of starters and found another on the same day.</p> <p>As a business decision, payment authorisation was completed jointly by Payments and Income Manager and Payments and Income Officer to ensure that two new members of staff got paid.</p>

Control weakness	Potential impact	Audit response	RDC Comment
<p>1.3 Members' allowances: Testing completed on Members expenses found that claim forms had not been appropriately authorised for 65/70 claims. All expense claim forms should be appropriately authorised before being processed on the payroll system.</p>	<p>Although Members expenses are not material to the accounts, the significant deficiency may result in a material misstatement in future years.</p>	<p>We are unable to gain assurance over the accuracy and occurrence of members' expenses and therefore substantive testing on a sample of claims is required. Internal Audit has already completed some work in this area and we will seek to use this work for our required assurances.</p>	<p>Agreed. Identified, recommendation raised and reported to Members.</p>
<p>1.4 Payments: The Payments and Income Manager (PIM) reviews the Payroll Log Run (detailing payments above basic pay) for items over £150 and initials individual accounts as confirmation of the check. The report, along with the net pay report should be signed and dated to evidence the review. Testing found that 4/9 of the reports had not been signed as reviewed.</p>	<p>There is an increased risk that incorrect payments are made, resulting in expenditure being materially misstated in the financial statements.</p>	<p>The assurance we can gain over the accuracy and occurrence of payroll expenditure is reduced and therefore substantive testing on a sample of payroll expenditure items will be required. This will be incorporated into the testing noted at 1.1.</p>	<p>As a mitigating control the reports that are generated and processed are part of an input-to-payment process which, looked at holistically, has a multi-review feature, particularly in the Payroll Summary when all output reports are confirmed to the spreadsheet.</p> <p>Therefore although the control failure at this point in the process is acknowledged, we have assurance that the end point of the process is correct.</p>

Control weakness	Potential impact	Audit response	RDC Comment
Expenditure and creditors			
2.1 Authorisation of orders: Testing identified that there is a lack of segregation of duties between the person requesting the order and the person authorising the order within the Information & Customer Services Department.	A lack of segregation of duties between the Officer raising the order and the person authorising the order could result in inappropriate orders being made, resulting in an increased risk of undetected fraud occurring. This has the potential to be material to the accounts.	The assurance we are able to gain over the occurrence and accuracy of orders raised at the Council is reduced. As a result we will complete substantive testing on an increased sample of expenditure items, tracing the expenditure back to the original order to ensure that it is valid and an appropriate cost to the Council, that the goods were received at the Council, that the invoice raised is accurate and agrees to the original order and that the payment made for the item is correct.	Agreed – and already reported to Members.
2.2 Goods receipting & authorisation of invoices: Testing identified that 1/30 of the invoices in the sample tested were authorised for payment by an Officer outside of their delegated limit and a further 2/30 of the invoices in the sample were authorised by the	As above, Officers' authorising above their delegated limit and a lack of segregation of duties increases the risk of undetected fraud occurring. This has the potential to be material to the accounts.	As per 2.1 above, the substantive testing on expenditure will include agreeing the invoice back to the original order and ensuring that the goods were received.	Agreed and already reported to Members.

Control weakness	Potential impact	Audit response	RDC Comment
same Officer who raised the order, again showing a lack of segregation of duties.			
<p>2.3 BACS & cheque payments: 6/30 BACS payment runs and transmission reports, which were tested to ensure that they had been appropriately checked and authorised before being processed, had no evidence to confirm that they had been checked and authorised.</p> <p>1/16 cheque payment runs had not been signed as checked and authorised before being processed.</p> <p>Both of these control failures breach our tolerable level set for the effective operation of a control.</p>	There is an increased risk that inappropriate payments will be made or that payments made are inaccurate. This is a risk of fraud and error, which could lead to a material misstatement in the accounts.	As per 2.1 above, the substantive testing on expenditure will include agreeing the payment made back to the invoice and original order to ensure that it is accurate and a valid payment.	Agreed and already reported to Members.