



# External audit progress update and significant controls deficiencies identified

## Report to General Purposes Committee, 15 October 2020

### Purpose of this report

The purpose of this report is twofold:

- To provide the Committee with a progress report on the audits of the main Council's Statement of Accounts and of the Pension Fund
- To report on significant control deficiencies identified during the audit to date in accordance with ISA265: *Communicating Deficiencies in Internal Control to Those Charged With Governance and Management*

We are reporting the control deficiencies in advance of our Audit Completion Report because we are required to report significant control deficiencies at the earliest opportunity and because they are relevant to the progress of the audit.

### Context

For 2019/20, the Council has taken decisive action to address shortcomings in the accounts audit trail and robustness of HRA assets valuations data identified in previous years' audits. This has included replacing the previous asset register, including a thorough data cleansing exercise, and commissioning a much earlier and more detailed beacons valuation exercise.

We have previously reported that interim work on a number of key areas, including particularly on valuations of property, plant and equipment (PPE) which is a Significant Audit Risk area and one that has caused delays in prior period audit completion, was unable to be completed due to the necessary information not being available. This information included the valuers' reports and also a completed and reconciled transfer of information into the Council's new asset register.

We reported to the Audit and Risk Management Committee on 5 March 2020 that, because we had not been able to undertake the interim work as planned, it was already impossible to meet the then end of July accounts publication deadline with the Council. This position of not being able to complete planned interim work was carried forward into the final audit workload and scheduling.

Since that point, as a consequence of the Covid-19 pandemic, the Ministry of Housing, Communities and Local Government (MHCLG) has deferred the accounts publication from 31 July - initially to 30 September and finally to 30 November, with accounts preparation deadline move back from 31 May to 31 August.

We reported to the General Purposes Committee on 23 July 2020 on audit progress and revised timelines. At that point we had received valuations reports, the PPE note and supporting workings that feed into the PPE note, and an Excel version of the new asset register. The draft Statement of Accounts was circulated with the Committee papers.

The Pension Fund audit had already commenced and was making good progress. The only noted issue was that we would not be able to access journals information until the main Council SAP ledger was accessible, because the Council's accounts were being prepared to a later timetable and the Pension Fund information is not separable.

We also reported that the Council was suffering from resourcing deficits in the finance function due to short notice departures and inability to recruit appropriately skilled and experienced staff, and also some initial experiences of delays and other issues with use of the Council's SharePoint facility.



## **Current position of Audit as at 1 October 2020**

The audit has not progressed as well as expected as planned due to a number of reasons. These include:

- The Enfield finance team being under resourced due to a number of contract employees leaving and inability to recruit suitable replacements
- LBE SharePoint not working as planned for either side and needing to be supplemented by BDO's Inflo system, but with LBE continuing to run Sharepoint too
- Errors identified in the valuations information provided have led for a need for a thorough review and corrections to be made
- Omission of a key asset classification assessment paper
- Asset register trail
- Delays in obtaining an acceptable audit trail and accounts analysis to enable audit sampling to be undertaken, so in some cases staff bookings had completed before samples or, indeed, primary analyses had been received
- Incomplete audit trail including of prior period adjustments made in preparing the Statement of Accounts
- Delays and incorrect responses in sample evidence provided
- The move to remote working because of the Covid-19 pandemic and wider public sector timetable changes.

We are also, as noted above, catching up for planned interim audit work not being able to be completed as planned.

### ***Finance team resourcing***

The Enfield Finance team continues to be under-resourced compared to their ideal, with the roles of Chief Accountant and Capital Accountant remaining unfilled from March 2020 - these roles were filled on a temporary basis at the start of the year but they both left the Council. This has meant that the work that would normally be carried out by them has needed to be taken on top of existing roles by other team members, with the Head of Service - Corporate Finance taking on a significant proportion of this work. These vacancies have had an inevitable impact on the timeliness and quality of the audit trail supporting the preparation of the accounts process and the preparation and delivery of working papers to the audit team.

We recognise that this is a significant issue and is not what was originally planned by the Council. Whilst some of the issues described below would, we expect, have been mitigated by the original planned resourcing level, these issues nevertheless did arise and we are required to report what has actually happened to the Council.

### ***Valuations information and asset register***

We identified a number of issues with the Council's audit trail and valuers' reports and supporting information. These are set out in more detail in the section dealing with progress against significant audit risks below (non current asset valuations and migration to new asset register).

### ***Audit trail***

Access to working papers proved challenging at the start of the final audit. This was due to issues with the length of time it took Enfield Finance team staff to upload working papers on to the SharePoint site as a result of limits to system bandwidth capacity, and then for the audit team to be able to download working papers. This has now largely been resolved with the introduction of the Inflo software hosted by BDO, although there remain issues for some Enfield users and the Council is continuing to duplicate filing through SharePoint.

We have noted a number of omissions relating to key elements of audit trail. These have included, critically:

- Lack of documented trail for prior period adjustments (PPAs). There has been a considerable amount of movement and also amendments in balances from changes to code mappings in the financial statements and also changes in prior period values. However, only material corrections of errors (i.e. those at or in excess of approximately £20m) qualify as valid PPAs - anything else, including revisions of estimates, should be actioned through an in-period movement. The changes have not been tracked and differentiated so this trail is being created so that we can then audit this. This trail should have been prepared during the course of preparing the draft financial statements and been subject to review, but it was not;
- No accounting asset classifications paper was prepared as part of the valuations process, as had been explicitly agreed as part of the 2018/19 completion and then debrief process, for the Meridian Water assets. This paper was necessary as a first step in obtaining appropriate valuations because the classification and accounting treatment drives the valuation method that needs to be applied. This paper was repeatedly requested but not forthcoming. Intervention by senior finance officers has seen this paper commissioned from a recognised external accounting expert, and this has now been received and is subject to audit;
- Issues in obtaining breakdowns to the level of end of year balance components (i.e. a list of outstanding creditor and debtor balances as at 31 March 2020 making up the various categories of creditors and debtors disclosed in the notes to the financial statements). This issue has undergone several iterations, including providing us with transaction listings (so not just the actual items outstanding, meaning we could not be sure to select appropriate items), but the majority of areas have been resolved by our sampling certain areas and supporting analyses then being obtained. However, there remains an issue relating to lease holder debtors where the breakdown is only available on a real time basis and not easily exported from the system. This is a relatively small balance but has been identified as a balance for sample testing this year.

### ***Evidence provided in support of audit queries and sampling***

We have encountered repeated issues with existence, completeness and accuracy of information requested, in some cases complicated by duplicated filing arrangements. Issues have included:

- Response provided for preliminary analytical review analysis not being of sufficient quality/detail to explain identified variances outside of expected ranges;
- Information stated as being delivered but was not available on either Inflo or Sharepoint;
- Information stated as provided but subsequently agreed as not being available (e.g. PPA working papers trail);
- Information stated as provided but actually totally different information (e.g. provision of title deeds when rental invoices requested);
- Information stated as provided but not the specific items requested (e.g. rental invoices re 2020/21 provided when March 2020 requested).



A considerable amount of time has been spent in repeatedly working through issues and sampling trackers lists to address the issues of sampled items. We have also offered to provide some “space” for the resource-stretched Council team to work through samples by offering to withdraw booked audit team resource for a week, and this has enabled some catch up, but of course at the expense of the audit input being reduced. Unless improvements are achieved in “right first time” responses to audit queries and samples requests, potentially through improved quality review and control, there is a threat to our achieving deadlines.

### ***Remote working and wider public sector timetable changes***

The move to remote working has meant that the audit is less efficient as the audit team are not all in the same room having informal conversations and overhearing other discussions both internally and with Enfield staff. For example, an impact of this has been a number of duplicated requests where one member of the audit team has not realised that another member has already requested a report/ explanation. This could have been mitigated had the summary of information provided/outstanding items that we requested been provided.

The position also restricts the ability of senior audit staff to supervise on a “live basis” and junior staff to freely seek guidance or clarification as issues arise. There is, unfortunately, no virtual equivalent of being able to sit down with relevant contacts and simply work through issues and working papers by discussion.

In addition, we believe that the Enfield Finance team are also having similar issues with remote working resulting in answers to queries taking longer.

Audit resource has been challenging to manage across the firm this year as a result of delays to the NHS Audits and Local Government clients also delaying audits due to Covid-19. NHS deadlines were pushed back to the end of June (from end of May) and both provider and commissioner audits suffered from very late key third party information, so all audits were right up against the deadline. This meant that early phase local government audits were delayed/deprived of resource, and the position continued during the summer. Despite considerable overtime hours worked, this position has not fully recovered, and we have also needed to reallocate staff to try and compensate.

Further, pushing the work back beyond the original deadlines leads to clashes with existing holiday bookings. BDO, as other employers, have required staff to take a summer break during lockdown in support of staff wellbeing, particularly given the intense early NHS and also central government audits phase.

This has all meant that we have not been able to have the continuity of staff from prior years that we would have had in a normal year. This has occurred as a result of needing to reorganise resource across our portfolio in response to timetable deferrals and that Local Government audit scheduling was in the same period as pre-booked annual leave and college time, resulting in breaks in staff bookings to Enfield.

### ***Conclusion***

We continue to work with the Council towards the goal of enabling the Council to publish an audited Statement of Accounts by the 30 November 2020 deadline.

This goal is achievable if there are no further delays or significant issues identified, and we receive “right first time” audit responses and evidence.

Neither we nor the Council has any further resource that we can draw on to address any further significant issues arising.



## Progress against significant risks

In our Audit Planning Report we identified 6 significant audit risk areas. We have set out in the Appendix to this report full details of the planned work and progress to date for all of these risk areas. The key issues arising were:

- ***Management override of controls:***
  - No work concluded yet
  - Our review of the accounts noted that a number of changes had been made to the prior period balance sheet lines. This is because of LBE not knowing how the mapping was done in the prior year and therefore amending the prior year audited figures to reflect the current year. At the time of writing we have not been provided with a working paper explaining the changes.
- ***Expenditure cut-off:***
  - No work concluded yet.
  - Awaiting evidence for cut-off testing and manual accruals
- ***Valuation of non-current assets:***
  - Work deferred from interim because valuations reports and asset register not available at that time
  - Errors with HRA beacons sheets and supporting valuations trail, in part linked to the valuer providing the wrong information to the Council to test check pre audit. Our initial sampling showed an error rate of 1 in 6 across the 30 sampled.
  - No Meridian Water asset classification paper which determines the basis of valuation that needs to be used
  - Issues with investment properties valuations reports and supporting sample evidence
  - Infrastructure useful economic lives have been reset, but we are reviewing the treatment applied because revised estimates usually put through in year not PPA
- ***Valuation of pension liability***
  - Actuarial assumptions incorrect/out of range so we have requested a new valuation be undertaken
  - Almost completed our work on membership data checks of information sent to the actuary
- ***Preparation of the financial statements***
  - Lack of clear audit trail for PPAs and non-adjusting errors and lack of detailed quality review prior to authorisation for issue
  - Issues in responding to our audit queries relating to preliminary analytical review variances outside of tolerable range (this being the audit equivalent of a numerical quality control exercise - we use this for audit risk assessment purposes)
- ***Migration of fixed asset register***
  - Work is ongoing, linked to valuations.
  - We have noted instances where potentially the opening balance per the new FAR for assets not revalued this year do not agree to balance per the last year valuation report. The work is ongoing



## Significant control deficiencies identified

The following deficiencies linked to significant audit risks (and therefore representing significant control deficiencies) have been identified by audit work undertaken to date:

### 1. *Financial statements preparation quality control*

Resource shortages and pressures within the finance department have contributed to reduced levels of quality control reviews of the financial statements and of the supporting working papers. Whilst the draft financial statements were submitted to the scheduled General Purposes Committee on 23 July 2020, the accounts were presented later for audit than had originally been agreed (end June). The compressed timetable prevented the Council undertaking of the originally planned quality review and control processes.

These quality control issues are evident, for example, in:

- Prior Period Adjustments (PPAs). This is a critical and sensitive area, even in “normal” years, but particularly given the high profile reworking of the closedown process in 2019/20:
  - The note was not clear or complete. A number of matters within the main body of the accounts referred to the note but were not included within the explanations. These included the impact on the CIES, cash and debtors of changes made to the prior period.
  - There was no documented trail for or working paper to support the PPAs
  - Non-material items had not been acknowledged or identified by quality review. Non-material “PPAs” do not qualify to be PPAs and so either need to be reversed or concluded to be errors. There is no quantification of these to date.
- Meridian Water assets classification paper. As noted above, this key element of the Council’s audit accounting and valuations trail was agreed as being necessary at a very early stage. The absence of the paper was not identified in quality review.
- Issues identified in the accuracy of the valuations reports and supporting information that were used to draft the financial statements and which were then provided for audit.

### ***Recommendation***

The Council should, as part of a wider root cause analysis process:

- Reflect on the experiences of the 2019/20 closedown experience
- Revisit finance department structures, and skill set and experience needs, updating as necessary
- Secure necessary additional resources
- Ensure the closedown plan for 2020/21 enables the support for “hard close” (both for trial run but also as a key interim audit step)
- Ensure the closedown and preparation of draft Statement of Accounts allows for a thorough and robust quality control and review process
- Ensure that there is a clear plan for what will be undertaken during the quality control and review and who will undertake the various steps, with clear guidance on documentation and evidence of these processes
- The General Purposes Committee should receive and review these plans

## **2. Quality review and challenge of valuers' reports and supporting working papers**

The Council had intended to subject the valuations information provided to a thorough review and challenge as part of the closedown process. However, due to compressed timescales and significant finance team resource shortages, this was reduced.

We have identified a number of issues that should have been identified by management's own quality checking, including:

- Errors with beacon sheet entries and supporting valuations trail
- Errors in certain investment property valuations (wrong values reported) and these needing to be reissued
- Supporting information not provided as part of the initial working paper
- A draft unsigned report being provided to the audit team as a final version and the finance team taking some time to accept that it was not a final version.

### ***Recommendation***

Linked to the preceding accounts review quality control point and recommendations above, the Council should, as part of a wider root cause analysis process:

- Ensure the closedown step relating to valuations of no current assets allows for a thorough and robust quality control and review process
- Ensure that there is a clear plan for what will be undertaken during the quality control and review and who will undertake the various steps, with clear guidance on documentation and evidence of these processes
- The General Purposes Committee should receive and review these plans

## **Overall conclusion**

The delivery of the Audit by 30 November deadline remains potentially achievable but will be challenging.

The Council needs to ensure that sufficient resource of the right level is made available to support the audit team and that audit evidence provided is complete, accurate and "right first time".



## Appendix

### ***Management override of controls***

#### *Planned work:*

- Review and verification of journal entries made in the year, agreeing the journals to supporting documentation. We will determine key risk characteristics to filter the population of journals. We will use our IT team to assist with the journal
- Extraction and test a sample of these journals;
- Review of estimates and judgements applied by management in the financial statements to assess their appropriateness and the existence of any systematic bias;
- Review of unadjusted audit differences for indications of bias or deliberate misstatement; and
- Follow up on our significant control deficiency in the prior year to confirm that the Council are deactivating leavers from the system and that they are monitoring dates of journals including those which have been processed but not posted to the system.

#### *Progress to date:*

Our work on this area is ongoing and we have not concluded on any of the testing to date.

### ***Expenditure cut off***

#### *Planned work:*

- Check that expenditure is recognised in the correct accounting period by substantively testing a sample of expenditure around year-end.
- Test an increased sample of manual accruals to supporting documentation.

#### *Progress to date:*

Still waiting for evidence from the Council to support our cut-off and manual accruals sample testing. Our work in this area is therefore ongoing.

### ***Valuation of Non-current assets***

#### *Planned work:*

- Review the instructions provided to the valuer and the valuer's skills and expertise in order to determine if we can rely on the management expert;
- Confirm that the basis of valuation for assets valued in year is appropriate based on their usage;
- Review accuracy and completeness of information provided to the valuer, such as rental agreements and sizes;
- Review assumptions used by the valuer and movements against relevant indices for similar classes of assets;
- Follow up valuation movements that appear unusual;
- Review the classification of Meridian Water assets within the financial statements and confirm that this is consistent with the basis for valuation; and
- Confirm that assets not specifically valued in the year have been assessed to ensure their reported values remain materially correct.



*Progress to date:*

To date we have identified that

- A number of the HRA beacon revaluations used incorrect data. From an initial sample of 30 reviewed, 5 errors were identified. As a result these have all been reviewed by Enfield Staff and are pending further review by the audit team;
- We have noted instances where potentially the opening balance per the new FAR for assets not revalued this year do not agree to balance per the last year valuation report. The work is ongoing;
- The Valuation report relating to Investment properties contained errors and has been reissued;
- Where valuations were not carried out at year end, management have not adjusted the opening balances to reflect the market changes since 1 April 2019. There is an expectation that the condition of the assets will have changed since April 2019 and/or their value may have changed due to Covid-19. These should be assessed and reflected when determining the closing balance for the assets. Management have agreed to process an adjustment if the outcome is material but the work is currently ongoing.
- The Council did not prepare an asset classification assessment for the Meridian Water assets. This is key to determining the appropriate valuation basis for these assets. An assessment was commissioned from a recognised external accounting expert and is currently being reviewed by the external audit team.

***Valuation of LG pension liability***

*Planned work:*

- Agreeing the disclosures to the information provided by the pension fund actuary;
- Reviewing the competence of the management expert (actuary);
- Reviewing the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data;
- Reviewing the controls in place for providing accurate membership data to the actuary;
- Contacting the pension fund auditor and requesting confirmation of the controls in place for providing accurate membership data to the actuary and testing of that data; and
- Checking that any significant changes in membership data have been communicated to the actuary.

*Progress to date*

We reviewed the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data and identified that the assumptions used by the Actuary to calculate the liability are outside of expected ranges and have requested updated figures.

We have nearly completed work on membership data submissions to the actuary.



### ***Preparation of Financial Statements.***

We planned to carry out the following work

- Carry out an early review of the interim month 9 financial statements against the requirements of the Code of practice for Local Authority Accounting 2019/20;
- Briefing finance staff on our expectations for good quality working papers and our requirements for completing a detailed and thorough interim visit;
- Reviewing the consistency of the financial statements with underlying working papers before the start on the onsite audit visit; and
- Obtaining assurance that management has carried out a critical review of the financial statements before they are submitted for audit, including comprehensive explanations for all significant variances from the prior year.

*Progress to date:*

- We were unable to review interim financial statements as due to resource constraints the Council was unable to produce these. We reconciled the accounts to the TB and high level working papers at the start of the audit however we have had issues obtaining detailed breakdowns of some balances selected for testing.
- The accounts were reviewed before issue however our initial review identified a number on inconsistencies and that a number of balances had been amended as Prior Period Adjustments. A number of these PPAs were not referred to as such in the PPA note so it was unclear why they had been made or the movement from the prior year was immaterial and therefore is not a PPA under the Code of Accounting Practice.
- We had to request the output of management's review of the draft Statement of Accounts on a number of occasions before it was provided. The explanations initially provided were not sufficiently detailed and we required further work to be done before we had sufficient information.

### ***Migration of Fixed asset register***

*Planned work:*

- Review the work undertaken by the Council to test the migration of data from the previous fixed asset register to the new system, and the associated reconciliations.
- We will carry out further testing as necessary to obtain assurance over the completeness and accuracy of the fixed asset transfer.

*Progress to date:*

Our work in this area is ongoing and links to our work on non-current asset valuations.

We have noted that the some opening balances in the new fixed asset register for assets not revalued in the year do not agree to the prior year valuation reports. We are awaiting explanations from the Council as to the reasons for this.