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Interim Audit Report 2010/11

**Rotherham Metropolitan Borough
Council**

July 2011



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This document summarises the key findings arising from our work to date in relation to both the audit of the Authority's 2010/11 financial statements and the 2010/11 VFM conclusion.

Scope of this report

This report summarises the key findings arising from:

- our interim audit work at Rotherham Metropolitan Borough Council (the Authority) in relation to the 2010/11 financial statements; and
- our work to support our 2010/11 value for money (VFM) conclusion up to April 2011.

Financial statements

Our *Financial Statements Audit Plan 2010/11*, presented to you in January 2011, set out the four stages of our financial statements audit process.



During January to April 2011 we completed our planning and control evaluation work. This covered our:

- review of the Authority's general control environment, including the Authority's IT systems;
- testing of certain controls over the Authority's key financial systems with the help of internal audit;
- assessment of the internal audit function;
- review of the Authority's accounts production process, including work to address prior year audit recommendations and the specific risk areas we have identified for this year; and
- review of the Authority's work to restate the 2009/10 financial statements under International Financial Reporting Standards (IFRS).

VFM conclusion

Our *VFM Audit Plan 2010/11* issued in March 2011 described the new VFM audit approach introduced this year by the Audit Commission and highlighted the key changes compared to the previous Use of Resources auditor's scored judgements regime.

We have completed some early work to support our 2010/11 VFM conclusion. This included:

- undertaking a preliminary VFM audit risk assessment; and
- initial work to assess the Authority's financial resilience following the funding settlement for 2011-13.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our interim audit work in relation to the 2010/11 financial statements.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix A. We have also reviewed your progress in implementing prior recommendations and this is detailed in Appendix B.

Acknowledgements

We would like to take this opportunity to thank Officers and Members for their continuing help and co-operation throughout our audit work.

This table summarises the headline messages. The remainder of this report provides further details on each area.

<p>Organisational and IT control environment</p>	<p>We have reviewed the operation of your organisational control environment and have concluded that these are effective overall, with one area which we have identified as a performance improvement opportunity. We have also found your IT control environment to be effective overall and here have raised two recommendations which are detailed in Appendix A.</p> <p>Organisational Control Environment</p> <p>With specific regard to your organisational controls we have deemed these to be effective overall, with one area which we have identified as a performance improvement opportunity. This relates to the risk appetite of the Authority.</p> <p>Risk appetite is a concept widely considered within the private sector however it is not widely recognised or used within the Public Sector. To be in line with best practice the Authority should document and formally consider risk appetite as part of their risk management process.</p> <p>Recently the Authority have presented a paper on this to the Senior Leadership Team and so if formally accepted this process would be improved if appetite to risk exposure was considered and monitored. With reduced resource to monitor controlled risk the benefits of documenting and considering risk appetite would be that the Authority was more focused in its approach to risk management. Detailed assessment of the Authority's risk appetite would mean that historic areas of focus may now fall within an acceptable risk tolerance and would require little or limited review.</p> <p>IT Control Environment</p> <p>We found your IT control environment to be effective overall. There are however a number of observations which we have made which we have summarised into two recommendations, these are detailed in Appendix A and relate to IT access controls and IT password security.</p> <ul style="list-style-type: none"> ■ IT Access Controls – We have identified a number of instances where user access controls are not operating effectively. There is no periodic review of user access rights across the Northgate, CedAr and PSe systems. This presents a risk that users may continue to have higher levels of access than necessary for their job role which was observed on CedAr. Within the CedAr and Radius systems we found active accounts which belonged to staff no longer employed by the Authority and in a small number of cases verbal authority was sufficient to gain access to the Pse system. ■ IT password security - Strong IT passwords are deemed to be those that include a mixture of alpha numeric and character based symbols. Radius and Northgate systems did not meet the definition of a 'strong' password creating a risk of unauthorised access to data.
<p>Controls over key financial systems</p>	<p>We have completed our controls testing through placing substantial reliance upon the work of Internal Audit therefore have not duplicated recommendations in this section that have previously reported upon by Internal Audit.</p> <p>We would also like to highlight that the scope of our controls work was limited in relation to capital due to timing issues of when these controls occur. These areas will therefore be completed during our final audit visit.</p>
<p>Review of internal audit</p>	<p>We were able to place reliance on Internal Audit's work on the key financial systems and are satisfied that they are compliant with the <i>Code of Practice for Internal Audit in Local Government</i>.</p>

This table summarises the headline messages. The remainder of this report provides further details on each area.

IFRS restatement

We will issue our audit opinion on the 2010/11 accounts at the September Audit Committee after our final audit work has been completed on both the 2009/10 restatement and the 2010/11 accounts. As at the date of our interim visit, the Authority had completed its restatement of the 2009/10 financial statements under IFRS with the exception of two areas as shown below. However, whilst we have not reviewed these areas during our interim visit these areas will be addressed by the Authority in time for the July Audit Committee and we will review this work before issuing our audit opinion at the September Audit Committee.

- The restated balances for 2009/10 for property, plant and equipment, impairment of assets, and investment property are still outstanding due to delays by CIPFA in releasing the updates for the IPF assets software.
- The disclosure notes for related parties, segmental reporting, and leases are in the process of being produced as part of the close down procedure, so will be reviewed by during our year end testing.

Throughout the conversion to IFRS the Authority have taken a proactive approach and involved us in early discussions which has led to a smooth transition. During the course of our IFRS conversion testing we identified two minor adjustments that were required:

- Provisions - A balance of £500k had been missed off the 2009/10 adjustment in error.
- Cash & Cash Equivalents - An adjustment was made to the classification of cash and cash equivalents, with all fixed term deposits being classified as investments rather than a mixture of cash equivalents and investments.

VFM - Financial resilience

We have reviewed the Authority's response to the emergency budget and its budget strategy for 2011/12, as well as the process followed to arrive at these.

Emergency Budget 2010/11

The Authority positively responded to the Government's emergency budget (May 2010) which reduced its in year revenue and capital funding by £5m each. Through early planning, taking a calm and measured approach and having an inclusive approach the Authority identified saving proposals to mostly mitigate the in year resources gap supplemented by a £0.6m planned use of generally available reserves. The revised budget was approved by Cabinet in November 2010.

The Authority's year end financial performance achieved a £1.9m underspend with revised budget which is testament to the recognition by the Authority that not only did it need to face up to the short term financial challenge but also the unprecedented, difficult medium term financial climate facing local government as confirmed in the Comprehensive Spending Review (October 2010).

Financial Settlement 2011/12

The Authority's final settlement for 2011/12 resulted in a reduction in formula grant by £16.2m or 11.6 percent to £123.2m. The withdrawal of central government funding and grant allocations to local government resulted in the Authority facing a £30.3m resources gap in 2011/12.

The Authority, in setting about bridging the resources gap, identified a clear set of principles for considering budget saving proposals. By adopting a measured approach the Authority was able to protect services for those most in need while delivering a balanced budget without a planned use of available reserves.

Throughout the budget setting process Cabinet Members' involvement was integral and opportunities for scrutiny were provided

Your organisational control environment is effective overall.

Work completed

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit.

In previous years we used our work on the Use of Resources assessment to inform our findings in these areas. Due to the reduced scope of the VFM assessment we have to complete more specific work to support our financial statements opinion.

We obtain an understanding of the Authority's overall control environment and determine if appropriate controls have been implemented. We do not complete detailed testing of these controls.

Key findings

We consider that your organisational controls are effective overall, with one area which we deem to have performance improvement opportunity.

Risk Management

Risk appetite is a concept widely considered within the private sector however it is not widely recognised or used within the Public Sector. To be in line with best practice the Authority should document and formally consider risk appetite as part of their risk management process.

Recently the Authority have presented a paper on this to the Senior Leadership Team and so if formally accepted this process would be improved if appetite to risk exposure was considered and monitored. With reduced resource to monitor controlled risk the benefits of documenting and considering risk appetite would be that the Authority was more focused in its approach to risk management. Detailed assessment of the Authority's risk appetite would mean that historic areas of focus may now fall within an acceptable risk tolerance and would require little or limited review. This would require framing risk appetite and documenting as part of the risk registers.

Aspect	Assessment
Organisational structure	● [G]
Integrity and ethical values	● [G]
Philosophy and operating style	● [G]
Participation of those charged with governance	● [G]
Human resource policies and practices	● [G]
Risk assessment process	● [G]
Information systems relevant to financial reporting	● [G]
Communication	● [G]
Monitoring	● [G]

Key: ● (red)
● (amber)
● (green)

Significant gaps in the control environment.
Minor deficiencies in respect of individual controls.
Generally sound control environment.

Your IT control environment is effective overall however we noted a number of areas for further improvement.

Work completed

The Authority relies on information technology (IT) to support both financial reporting and internal control processes. In order to satisfy ourselves that we can rely on the use of IT, we test controls over access to systems and data, system changes, system development and computer operations.

Testing of these areas has been completed by our IT specialists, who looked at the IT controls for the core financial systems. The table below highlights our assessment of the key IT controls across all core systems:

	CedAr	Northgate	Radius	PSe
Access configuration – Access levels have been defined based upon established business rules and job roles for assigning user rights within each of the in-scope applications.	● [G]	● [G]	● [G]	● [G]
Access administration – Appropriate administration processes are in place for allowing and revoking access.	● {A}	● [G]	● [A]	● [A]
Identification and authorisation – Unique, password controlled accounts exist for all users.	● [A]	● [A]	● [A]	● [G]
Access monitoring – Review of user access rights is carried out on a regular basis to identify dormant accounts and inappropriate levels of access.	● [A]	● [A]	● [A]	● [A]
Super user access - System administrator level privileges within the in-scope applications are restricted to only the system owners or IT staff responsible for management of the systems. Such highly privileged access is adequately controlled.	● [G]	● [A]	● [G]	● [G]
Program change - Changes to the in-scope applications require business and technical approval prior to implementation. Changes to the in-scope applications are tested in the test environment by the technical teams and business users and signed off.	● [G]	● [G]	● [G]	● [G]
Computer operations - Interfaces and batch jobs are monitored by the system administrators through regular manual checks and automated system alerts of job failures. Any errors noted are investigated and resolved.	● [G]	● [G]	● [G]	● [G]

Key:

- Significant gaps in the control environment.
- Minor deficiencies in respect of individual controls.
- Generally sound control environment.

Key findings

We found your IT control environment to be effective overall, however there are two recommendations. Recommendations can be found in Appendix A however we have highlighted the key detailed issues into four areas.

The control weakness that we observed related to:

(I) Radius / CedAr Access Controls

- We observed eight Radius and three CedAr user accounts that were still active despite the employees having left the Authority. For the three CedAr accounts these had all been accessed after the actual employee had left the Authority;
- Whilst there was no indication that Radius accounts had been accessed or that the CedAr accounts had been inappropriately used it does expose the Authority to the risk of unauthorised access;
- This issue would be rectified through integrating the HR and IT leaver controls and ensuring accounts are closed immediately upon a staff member leaving the Authority.

(II) PSe Access Administration

- Users are given access to the PSe system on the verbal authorisation of a team leader. The Authority procedure is for all system authorisation to be documented;
- There is a risk that access rights are given to staff without need or training which could lead to error in postings made to the system however we observed no evidence that this had happened;
- The authorisation process should be reinforced for all IT systems.

(III) Access Monitoring

- There is no periodic review of user access rights across the Northgate and CedAr systems;
- This presents a risk that users may continue to have higher levels of access than necessary for their job role which was observed for the CedAr system;
- The Authority would benefit from monitoring access rights to ensure that staff have appropriate need and training for the systems they use.

(IV) Radius / Northgate Password Strength

- The password parameters for both Radius and Northgate were not in line with best practise as 'strong', presenting a risk of unauthorised access to data.
- A 'strong' password would include a mixture of alpha numeric and character based symbols, for example capital / lower case mix, etc.

The majority of these observations are linked to system access which becomes more pertinent in the context of the substantial restructuring activity throughout the Authority. There would be benefit from the Authority reviewing its system of internal control around the IT systems to ensure that they are still relevant to a streamlined organisation.

The controls over the majority of the key financial system are generally sound.

However, there are some minor weaknesses in respect of NNDR, non-pay expenditure and benefits expenditure.

Work completed

We work with your internal auditors to update our understanding of the Authority's key financial processes where these are relevant to our final accounts audit. We confirm our understanding by completing walkthroughs for these systems.

We then test selected controls that address key risks within these systems. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Key findings

The controls over the majority of the they key financial system are generally sound but we noted some weaknesses in respect of individual financial systems.

- NNDR: The quarter one Rateable Values Changes exception report did not show sufficient evidence that the exceptions had been addressed in a timely manner however this had been addressed in future periods.
- Benefits Expenditure: There is no evidence of timely preparation and review on the reconciliations between Cedar (General Ledger) and Northgate (Benefits System). Whilst we were able to re-perform the tests and confirm that the control is operating effectively, the Authority would gain additional assurance if there was evidence of management review.
- Non-Pay Expenditure: There are 4,200 open orders on the creditors system. This is a reduction from 32,000 noted during the 2009/10 audit. We have been informed that these will all be closed by our final audit visit, so we will carry out additional work then to confirm that these orders have now been closed.

Internal audit gave a rating of 'moderate assurance' for these systems and included recommendations in their reports as appropriate. For this reason we have not included these issues in our recommendations in Appendix A.

We have not yet assessed the controls over capital expenditure, asset disposal, and asset valuation. Many of the key controls in respect of these areas are operated during the closedown process and our testing will be supplemented by further work during our final accounts visit.

System	Assessment
Financial reporting	● [G]
Grant income	● [G]
Housing rents income	● [G]
Council tax income	● [G]
Business rates income	● [A]
Sundry income	● [G]
Payroll expenditure	● [G]
Non-pay expenditure	● [A]
Benefits expenditure	● [A]
Cash	● [G]
Treasury management	● [G]

- Key:
- Significant gaps in the control environment.
 - Minor deficiencies in respect of individual controls.
 - Generally sound control environment.

Internal audit fully complies with the *Code of Practice for Internal Audit in Local Government*.

Work completed

In order to maximise the efficiency of the audit function across the Authority, we work closely with Internal Audit to avoid duplication. As part of this process we evaluate the effectiveness of Internal Audit in line with *The Code of Practice for Internal Audit in Local Government* (the Code).

The table left highlights the key criteria that is covered when evaluating the effectiveness of Internal Audit against the Code.

Key findings

We have reviewed Internal Audit's work and are satisfied that they are compliant with the *Code of Practice for Internal Audit in Local Government*.

This is based on our reported assessment of Internal Audit in 2009/10, our assessment of their files and our knowledge from continual liaison with key personnel, review of documents and attendance at Audit Committee.

There has been a loss of two FTEs within the function as a result of cost savings that needed to be made. This included the retirement of the Head of Internal Audit who will not be replaced in the new structure. Roles and responsibilities are expected to change as a consequence which should be reflected through updating the self assessment held against the standard.

During our interim audit some additional top-up work was required. This is because at present where a control is daily, internal audit tend to test consecutive days. This does not give assurance that the control has worked effectively over the year.

Internal Audit have covered all areas included in our joint working protocol to a good standard, and we are again able to place reliance on that work.

Aspect	Assessment
Scope of internal audit	● [G]
Independence	● [G]
Ethics for internal auditors	● [G]
Audit Committee	● [G]
Relationships with management, other auditors and other review bodies	● [G]
Staffing, training and development	● [G]
Audit strategy and planning	● [G]
Undertaking audit work	● [G]
Audit strategy and planning	● [G]
Due professional care	● [G]
Reporting	● [G]

Key:

- Non-compliance with the standard.
- Minor deficiencies.
- Full compliance with the standard.

The Authority has made significant progress in completing its restatement of 2009/10 financial statements under IFRS.

Work is still outstanding on areas of fixed assets and some disclosure requirements which we will cover as part of our final audit visit.

We have reviewed the restatement work and are content that the key changes have been appropriately identified and addressed.

Work completed

From 2010/11 local authorities are required to prepare their financial statements under the IFRS based *Code of Practice for Local Authority Accounting in the United Kingdom*. This contains a number of significant differences compared to the previous financial reporting regime.

We will issue our audit opinion on the restatement to IFRS at the September Audit Committee, after our final audit work has been completed. We have reviewed the work the Authority has undertaken to restate its 2009/10 financial statements under IFRS and its preparations for producing 2010/11 balances in its accounts under IFRS during our interim audit.

Key findings

At interim, the Authority had made significant progress in restating their 2009/10 financial statements under IFRS having taken a proactive approach. There are a number of areas as highlighted below where we will complete our work during the year end audit.

During our interim visit we received initial working papers which were of a good quality and were easy to follow regarding material areas identified in our initial IFRS impact assessment. We have focused our work on high risk areas as noted in our audit plan and specifically reviewed the processes and controls in place to ensure completeness and accuracy of the restatement work.

Based on our initial review, the Authority's accounting policies are in line with the Code and we identified only two minor adjustments that were required:

- Provisions - A balance of £500k had been missed off the 2009/10 adjustment spreadsheet. This was due to human error and was amended when we identified.
- Cash & Cash Equivalents - An adjustment was made to the classification of cash and cash equivalents, with all fixed term deposits being classified as investments rather than a mixture of cash equivalents and investments.

Outstanding Work

After our interim visit we still had the following work still outstanding and will complete this during our year end audit visit:

- Related Parties and Leases – The disclosure note is still to be produced. It is more efficient for this to be produced during close down, along with the disclosure for 2010/11, therefore testing will be carried out at year end.
- Segmental Reporting – A review of the segments and their reconciliation to BVACOP analysis is still to be tested. Due to the nature of this disclosure, testing is more appropriate at year end.
- Decommissioning Liabilities – The method statement on the review of potential decommissioning liabilities is outstanding. The total balance of the potential liability is unlikely to be material.
- Property, Plant and Equipment; Investment Property; and Impairment of Assets – Work is still required on the 2009/10 balances in these areas. There was a delay in CIPFA releasing the update to the IPF asset register software, which has had a knock-on effect on the production of the restated balances. Work around componentisation is also outstanding, again due to issues with IPF.

Specific risk areas

The Authority has taken the key risk areas we identified seriously and made good progress in addressing them.

However, these still present significant challenges that require careful management and focus. We will revisit these areas during our final accounts audit.

Work completed

In our *Financial Statements Audit Plan 2010/11*, presented to you in January we identified the key risks affecting the Authority's 2010/11 financial statements.

Our audit strategy and plan remain flexible as risks and issues change throughout the year. To date there have been no changes to the risks previously communicated to you.

We have been discussing these risks with central finance as part of our regular meetings. In addition, we sought to review relevant workings and evidence and agree the accounting treatment as part of our interim work.



Key findings

You have taken these issues seriously and made good progress in addressing them. However, these still present significant challenges that require careful management and focus. We will revisit these areas during our final accounts audit.

The table below provides a summary of the work the Authority has completed to date to address these risks.

Key audit risk	Issue	Progress
	<p>The Authority have made a number of material impairments over the past two accounting periods as a result of economic conditions. In 2009/10, we also reported the need to undertake a detailed impairment review of the leisure PFI. As a result, we will focus additional effort upon this area of the financial statements.</p>	<p>Our review of the Authority's asset valuation will be undertaken during the course of our final audit visit.</p> <p>At interim, the Authority had not finalised processing the valuations through their fixed asset systems.</p>
	<p>There will be significant pressures on all Local Authorities due to funding cuts from Central Government and other sources such as Regional Development Agencies as a result of the Comprehensive Spending Review. Implementation of cost saving initiatives will be required to ensure that the Authority's financial position remains stable.</p>	<p>As at April 2011 we have undertaken a review of the Emergency Budget set by the Authority in November 2010 and the 2011/12 revenue budget. Our findings are documented in Section four on page 15.</p>

Specific risk areas (cont.)

Key audit risk	Issue	Progress
	<p>The repairs and maintenance contracts have been tendered to external providers during 2010/11. In addition, the authority are considering bringing the ALMO fully back in-house which raises a number of accounting queries under IFRS.</p>	<p>On the 23rd February, Cabinet approved bringing the housing management function back in house which made 2010 Rotherham Ltd dormant. The transfer will commence when the current management agreement ceases in May 2011.</p> <p>We have held discussions with the senior leadership team around the tax and pensions implications of bringing the ALMO in house whilst there are also a number of employment related issues that also need to be considered.</p> <p>As at 31st March 2011, we anticipate that there will be provisions / liabilities arising within the single entity accounts. The Authority have an obligation to take responsibility for the pensions deficit and cumulative trading losses that currently sit in 2010 Rotherham Ltd.</p>
	<p>The local government pension schemes have under gone a triennial valuation which impacts the Council through an increased pension liability. In its June 2010 budget, the government announced that it intended for future increases in public sector pension schemes to be linked to changes in the Consumer Price Index (CPI) rather than, as previously, the Retail Price Index (RPI). These changes will have a substantial impact upon the authority's financial statements.</p>	<p>We have discussed the impact of triennial valuation with the Authority and as a result there is an increased contribution rate of 17.8% from 17.1%.</p> <p>During our visit we followed up on the Audit Commission report SYPA Data Flows issued in 2010. It has been noted that there are a number of items still outstanding from this report which are:</p> <ul style="list-style-type: none"> ■ Backlog of un-notified leavers due to the early leavers initiative; and ■ Confirmation of contributions paid by schools with external providers. <p>At year end, we will review the scheme valuation and ensure that the accounting recognition is accurate. We would expect the overall Authority liability to increase in line with the contribution rates however this will not be known until the Actuary valuation is received.</p>

Key audit risk	Issue	Progress
<p>Pension Liability (Continued)</p>		<p>The Authority propose to treat the change from RPI to CPI based assumption as an Income Statement item which is consistent with CIPFA technical accounting guidance.</p> <p>This will generate a one off credit through the Income and Expenditure account.</p>
<p>IFRS Conversion Process</p>	<p>The Council will require a lot of planning and resources to ensure a smooth and successful transition to IFRS</p>	<p>We have maintained regular dialogue with the Authority over progress with its IFRS restatement work.</p> <p>As at interim the majority of work has been completed however there are a number of discrete areas which are still outstanding and will be completed at our final account visit.</p> <p>A breakdown of outstanding areas and significant adjustments resulting from IFRS are discussed at pages 9 and 10 respectively.</p>
<p>Leases</p>	<p>The conversion process to IFRS requires that the Authority identify and review all significant contracts to identify potential aspects that may require specific accounting treatments under the new IFRS based Code, such as embedded leases.</p> <p>Due to amendment of the definitions of finance and operating leases under IFRS, the Authority needs to consider the substance of all leases identified and consider whether the criteria for finance leases are met.</p>	<p>Work within the financial statements on leases has now been completed with limited impact upon the re-stated financial statements.</p> <p>We have tested a number of lease classifications made by the Authority in line with the requirements of IFRS. This ensures that the correct categorisation between on and off balance sheet disclosure has been employed.</p> <p>This testing has covered both the Authority lease arrangements as lessee and lessor.</p>

Specific risk areas (cont.)

Key audit risk	Issue	Progress
	<p>Under IAS 19, there is now a requirement to disclose a liability on the balance sheet where the Authority is required to pay wages and salaries, bonuses and holiday pay.</p>	<p>The Authority do not have an automated system in place that would allow them to collect this data and therefore they have created a manual system based upon sample data. We have verified the approach and ensured that the sample is representative of the Authority's workforce.</p> <p>Our review of the employee data found small isolated errors however these did not have a significant impact upon the restated financial statements.</p> <p>Work in this area is now complete.</p>
	<p>Local authorities are to component account for any additions or valuations on or after 1 April 2010. This means when an item of property, plant and equipment comprises individual components for which different depreciation methods or rates are appropriate, each component is accounted for separately.</p>	<p>The Authority were still in the process of restating balances that related to this category of asset.</p> <p>The Authority's software provider has failed to release the update that allows them to complete adjustments relating to the componentising of assets. We are currently in discussions to identify a resolution to this issue to ensure that the year end position is fairly stated.</p>
	<p>UK GAAP emphasises the substance of control, whereas IFRS considers the power to control. As a result there may be a different interpretation of those entities consolidated into group.</p>	<p>We have assessed the group reporting boundary which has been proposed by the Authority. This has been reset under IFRS to omit Digital Region and RBT as these entities are not material.</p> <p>The boundary still includes 2010 Rotherham and the Authority will continue to prepare group accounts until the entity is formally brought back into the Authority during 2011/12.</p> <p>This area will be finalised at our final audit visit.</p>

We follow a new VFM audit approach this year.

Our VFM conclusion will consider how the Authority secures financial resilience and challenges how it secures economy, efficiency and effectiveness.

Our VFM Audit Plan 2010/11 describes in more detail how the new VFM audit approach operates and includes our assessment of the risks impacting on our VFM conclusion.

We will report on the result of our work in our ISA 260 Report 2010/11.

Background

For 2010/11, auditors are required to give their statutory VFM conclusion based on two criteria specified by the Audit Commission. These consider whether the Authority has proper arrangements in place for:

- securing financial resilience: looking at the Authority's financial governance, financial planning and financial control processes; and
- challenging how it secures economy, efficiency and effectiveness: looking at how the Authority is prioritising resources and improving efficiency and productivity.

There are no scored judgements under the new approach and the VFM conclusion is the only output. This remains a 'pass / fail' style assessment.

We follow a risk based approach to target audit effort on the areas of greatest audit risk. We consider the arrangements put in place by the Authority to mitigate these risks and plan our work accordingly.

Our VFM audit draws heavily on other audit work which is relevant to our VFM responsibilities and the results of last year's VFM audit. We then assess if more detailed audit work is required in specific areas. The Audit Commission has developed a range of audit tools and review guides which we can draw upon where relevant.

Overview of the new VFM audit approach

The key elements of the VFM audit approach are summarised below.



We have completed our initial work to assess the Authority's financial resilience following the funding settlement for 2011-2013.

Whereas there has been some slippage within individual directorates, the Authority is on target to deliver its planned 2010/11 savings in overall terms, and is forecasting to underspend against budget. It should be noted that this does factor in an original budget overspend of £5.1m in CYPS.

Work completed

We have reviewed the Authority's Budget Strategy 2011/12 as well as the process followed to arrive at these.

We have specifically assessed:

- the actions used by the Authority to secure the necessary savings in its 2011/12 draft budget; and
- the capacity of the Authority's 2011/12 budget to secure financial stability.

This early work was specifically completed to support an Audit Commission study on the impact of the 2011/12 local government settlement on authorities' finances. It is also a key part of our work programme on the financial resilience criterion of the VFM conclusion.

As part of our work we have compared the Authority to its 'nearest neighbours' across a number of indicators. 'Nearest neighbours' are authorities with like demographic features. We have used the latest groups defined by CIPFA for this.

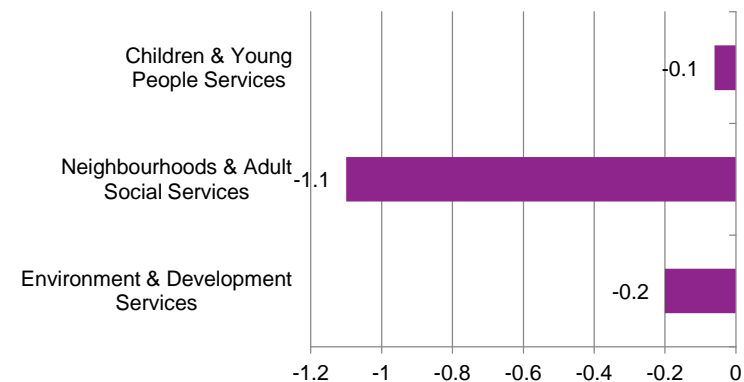
We will complete further work on the Authority's financial resilience during the coming months before we issue our VFM conclusion.

2010/11 financial performance

The Authority set its original 2010/11 revenue budget which allowed for additional investment in front line services in particular to safeguard the well being of both young and older people and continue to finance capital investment across the borough.

Since the Council revised its budget in November 2010 , regular monitoring updates to both Senior Leadership Team and Cabinet Members have been provided. In February 2011, the Council forecast outturn position showed a £1.4m underspend. The actual position by the year end was £1.9m underspend which is notable achievement.

Forecast outturn against 2010/11 budget as at February 2011 by directorate (£m)



Source: Monthly Financial Report to Cabinet, 8 March 2011

The Authority had been preparing for funding cuts for some time and fully reviewed its priorities ahead of the final settlement.

We are satisfied that the leadership team understands the financial management challenges facing the Authority and there has been effective challenge from Members.

Preparation for the Local Government Finance Settlement

The Authority has an integrated financial and service planning process which is embedded involving Members and Officers across all services. A process of Member challenge has been undertaken on the alignment of resources with priorities, as well as proposed investments and efficiencies.

The Authority reviewed its vision and core purpose during 2010/11, with anticipated pressures on public sector funding a key driver in shaping the strategy, and set a new corporate plan for the Authority.

The Medium Term Financial Plan (MTFP) 2010-14, agreed in February 2010 assumed a 8.75 percent funding reduction for 2011/12. This estimate forecast a potential funding gap of £28m which was reiterated to £30.3m on final settlement due to a change in the formula distribution methodology.

The Authority actively used scenario planning of spending and resources across the CSR period.

Revenue budget 2011/12

The Authority's final settlement for 2011/12 resulted in a reduction in formula grant by £16.2m or 11.6 percent to £123.2m. The withdrawal of central government funding and grant allocations to local government resulted in the Council facing a £30.3m resources gap in 2011/12.

The Council in setting about bridging the resources gap identified a clear set of principles for considering budget saving proposals. By adopting a measured approach the Council was able to protect services for those most in need while delivering a balanced budget without a planned use of available reserves.

Throughout the budget setting process Cabinet Members' involvement was integral and opportunities for scrutiny were provided

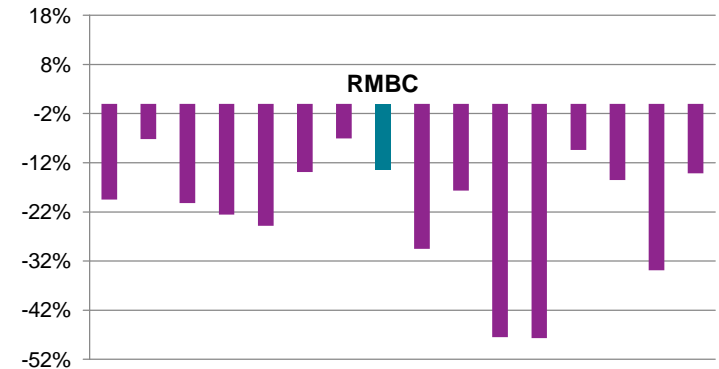
The 2011/12 budget set in February 2011 included the following cross cutting savings:

Corporate Cost Cutting Savings [-£7.3m] – removal of back office costs through review of service activities, spending and asset portfolios;

Pay Terms & Conditions [-£2m] - work with staff and trade unions to identify changes to terms and conditions that will save resource; and

NHS Social Care Funding [-£3.7m] – work jointly with Rotherham FT and NHS Rotherham to support social care at a local level enabling more vulnerable residents to remain independent.

Reduction in Authority Spending Power – comparison with nearest neighbours



Source: LG Finance Settlement data

Current reserve levels are in line with other local authorities. The Authority is planning to maintain these at current levels.

In addition directorate savings of about £17m were identified through the budget saving proposals discussed and agreed with Members.

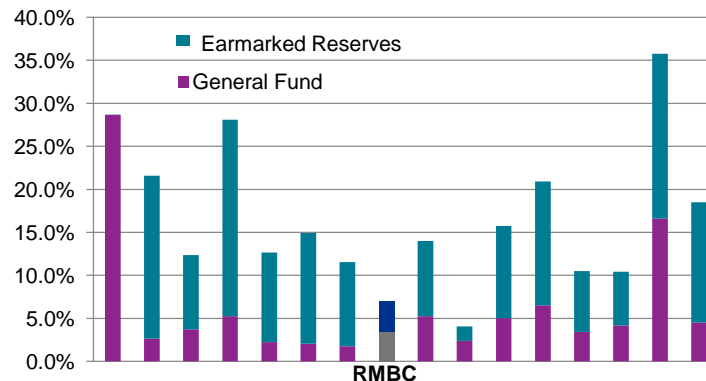
Directorates were required to provide risk assessments and mitigating actions for all proposals. The Authority acknowledges that given the unprecedented level of savings being made it will be essential that contingency proposals are developed.

Usable Reserves

In setting the budget the Council's reserves expected to be approximately £39m which is broadly in line with the Council's medium term financial strategy. The majority of the reserves (£31m) are held to meet specific needs or are ringfenced.

Approximately £8.4m (3.9% of Net revenue Budget) of reserves are generally available for use in supporting the budget which the Council considers to be prudent and reflects the risks faced.

Useable Reserves as at 31 March 2010 as a percentage of Revenue Spending Power 2011/12 – comparison with nearest neighbours



Source: Ratio tool - Audit Commission website, LG Finance Settlement data

We have given each recommendation a risk rating and agreed what action management will need to take.

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

Priority rating for recommendations

- **Priority one:** issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.
- **Priority two:** issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.
- **Priority three:** issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No	Risk	Issue and recommendation	Management response/ responsible officer/ due date
1	● (two)	<p>IT Access Controls</p> <p><i>Description</i></p> <p>We have identified a number of instances where user access controls are not operating effectively and / or there are performance improvement points that the Authority should consider:</p> <p>Our findings can be summarised as:</p> <p>A. PSe New User - Access request forms were not available for six out of thirteen new accounts created on PSe within the financial year. This was due to the HR service centre staff setting up new users at the verbal request of their team leaders without the authorisation forms being completed.</p> <p>B. CedAr 'Ghost' Users - A review of CedAr active accounts found three which belonged to staff no longer employed by the Authority. An inspection of the access log showed that the accounts had been accessed since the date the users officially left. Whilst we have no evidence that these accounts have been inappropriately used, it does create a risk that these accounts can be misused.</p>	<p>The Management for each service will review the ongoing effectiveness of the IT access controls and where appropriate (and able to) will consider the actions that need to be taken</p> <p>Due Date September 2011</p>

Key issues and recommendations (cont.)

No	Risk	Issue and recommendation	Management response/ responsible officer/ due date
	<p>● (two)</p>	<p>C. Radius 'Ghost' Users - A review of active users found eight active Radius user accounts which belonged to staff who had left the Council in the year. This observation indicates a weakness in the operation of the timely removal of leavers' accounts on the system. Whilst we identified no inappropriate activity, it is possible that individuals could gain access to the system after they have left. This creates a risk of fraud or errors relating to transaction processing and financial reporting.</p> <p>D. Cedar / Northgate / PSe Access Reviews – We identified that there is no evidence that review of user access rights have been carried out within Cedar and Northgate. Inappropriate access was identified in the Cedar system only.</p> <p>These observations present a risk over the integrity of system security which could lead to inappropriate access. The impact could be exposure to fraud or erroneous processing within the Authority's financial data. Whilst we have identified a number of instances where 'ghost' accounts have been accessed, this has been for the purpose of running tailored reporting attached to the account.</p> <p>The user access controls become even more pertinent given the current restructuring and cost saving program that the Authority is undergoing.</p> <p><i>Recommendation</i></p> <p>We recommend that the Authority review its approach to monitoring and controlling access to core financial systems. This should be prioritised through considering the controls around revoking access rights of leavers to prevent the existence of 'ghost' employees as this presents the highest risk to the Authority.</p>	

Key issues and recommendations (cont.)

No	Risk	Issue and recommendation	Management response/ responsible officer/ due date
2	<p style="text-align: center;">● (three)</p>	<p>IT General Controls: Password Security</p> <p><i>Description</i></p> <p>The password parameters for key IT systems were inspected, and it was found that the password parameters for both Radius and Northgate were not as strong as could be, giving a risk of unauthorised access to data. A 'strong' password would include a mixture of alpha numeric and character based symbols.</p> <p><i>Recommendation</i></p> <p>We were informed that the upgrade of the Radius application planned for April 2011 would resolve the Radius password parameter issue. We recommend that the upgrade be implemented as planned and the new settings implemented to meet the Council's password standards.</p> <p>The Northgate system administrators should amend the password parameters for all Northgate user account profiles to conform with the Council's password policies.</p>	<p>The Management for each service will review the ongoing effectiveness of the IT access controls and where appropriate (and able to) will consider the actions that need to be taken</p> <p>Due Date September 2011</p>

Key issues and recommendations (cont.)

No	Risk	Issue and recommendation	Management response/ responsible officer/ due date
3	<p>● (three)</p>	<p>Risk Management: Appetite to Risk</p> <p><i>Description</i></p> <p>A review of the Authority's risk register has highlighted that there is currently no process in place to assess the Authority's appetite to risk. This would include the Authority differentiating between areas where greater responsibility should be delegated to Officers and those that need to be controlled to a low level of residual risk.</p> <p>In previous years the Authority have had resource to monitor all areas of risk however this intensive approach may not be feasible or efficient with the recent funding cuts.</p> <p>There is a greater benefit on focussing attention to unwanted area of risk, for example areas that most significantly effect the corporate plan. This would typically be areas where the controlled risk exceeds the risk that the Authority are willing to accept.</p> <p><i>Recommendations</i></p> <p>We recommend that the following are considered to focus risk management resource:</p> <ul style="list-style-type: none"> ■ The risk register is extended to provide an 'acceptable risk' level which is benchmarked against controlled risk to highlight areas that need greater attention; ■ Training is provided to Cabinet / Audit Committee to explain risk appetite and the importance in an environment of reducing resource. 	<p>The Director of IA and Governance will review the suggested recommendation to identify the appropriate action that can be taken with regard to ICT changes and will look to provide an update to the Audit Committee on risk appetite</p> <p>Due Date October 2011</p>

Follow-up of prior year recommendations

The Authority has not implemented two of the five recommendations in our Interim Audit Report 2009/10.

This is due to pending software upgrades and plans to move to a new council building.

This appendix summarises the progress made to implement the recommendations identified in our Interim Audit Report 2009/10 and reiterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	5
Implemented in year or superseded	3
Remain outstanding (re-iterated below)	2

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at April 2011
1	● (two)	<p>Password Parameters – Radius system</p> <p>We inspected the password parameters across Council systems. We noted that the password parameters for the Radius system do not comply with best practice criteria. This issue was also reported in 2008-09.</p> <p>We recommend that management increase the level of password complexity required for the Radius system to meet industry best practice guidelines.</p>	<p>Financial Systems Manager December 2010</p>	<p>This recommendation has not been implemented and has been raised again in Appendix 1.</p>
2	● (two)	<p>Data Backup and Restoration</p> <p>We enquired of management and were informed that regular test restores of key databases is not undertaken.</p> <p>We also noted that the backups are stored in the Library, which is located opposite to the building in which the data centre is housed. This issue was also reported in 2008-09.</p> <p>We recommend that management implement regular testing of backup media to ensure that the restore process operated as expected.</p> <p>We recommend that management investigate off-site storage locations that are not in the proximity of the building in which the data centre is located.</p>	<p>ICT Client December 2011</p>	<p>As part of the planned movement to a new Council building, an increased separation between the main data centre and the backup location is being considered.</p>

Follow-up of prior year recommendations (cont.)

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at April 2011
3	● (two)	<p>IS Policy Acceptance</p> <p>We inspected a sample of 15 new starters and identified that for 8 of these, they did not confirm their acceptance of the Information Security Acceptable Use Policy.</p> <p>We recommend that IT ensure that the Information Security Acceptable Use Policy is disseminated to all staff and require signed acceptance of the policy.</p>	<p>HR/Data Protection Officer/ICT Client</p> <p>September 2010</p>	<p>A list of new starters is now produced on a monthly basis and checked against the e-induction system to identify any starters which have not completed their IT induction. Their line manager is then notified to ensure this is carried out.</p>
4	● (three)	<p>Monitoring – Active Directory, Radius and PSE systems</p> <p>We inspected the processes and controls for monitoring user access rights across Council systems. No monitoring of user access rights for Active Directory (controls access to the network) and Radius is operated on a regular basis. In addition, we noted that no evidence was available to demonstrate whether regular monitoring of users on PSE is undertaken.</p> <p>We recommend that regular monitoring of user access rights across Council systems is completed and evidence of the monitoring is retained.</p>	<p>RBT ICT (for AD)</p> <p>Financial Systems Manager (for Radius)</p> <p>June 2010</p>	<p>This recommendation has not been implemented and has been raised again in Appendix 1.</p>
5	● (three)	<p>New User Access Administration – Radius system</p> <p>We inspected the process for setting up new users across systems. We noted that for Radius, line manager or business/system owner approval is not required for a new user to be created.</p> <p>We recommend that all new users on Radius are subject to authorisation from a relevant member of management prior to access being granted.</p>	<p>Financial Systems Manager</p> <p>May 2010</p>	<p>Each area now has an approved authoriser who has to approve user access to Radius before it is granted.</p>



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