

AUDIT COMMITTEE – 24TH JUNE 2004

EXECUTIVE SUMMARY AND RECOMMENDATIONS

INTRODUCTION

At the last committee meeting a verbal presentation of the matters discussed at the meeting was made. The formal minutes are now attached for consideration. Attention is drawn in particular to various points in the audit management letter from BDO Stoy Hayward, which will be addressed by Finance and others.

DECISION

The Committee is requested to note the document. No decision is required.

BACKGROUND INFORMATION

Both BDO Stoy Hayward and the National Audit Office produce management letters following their annual audit visit. Although a draft has been seen, the formal receipt of the letter from the National Audit Office has yet to arrive. It will be discussed by the Audit Committee in due course.

Both sets of auditors are encouraging us to broaden the scope of the Audit Committee to cover non-financial risks. The National Audit Office will be making a one-day presentation to the Audit Committee, the Chairman of the Finance & Resources Committee and the Chief Executive before the next Audit Committee meeting in November. Other members of the committee who wish to attend should give their names to the Secretary.

RESOURCE IMPLICATIONS

None

FINANCIAL IMPLICATIONS

None

BACKGROUND PAPERS

See attached minutes

APPENDICES

None

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AUDIT COMMITTEE

MINUTES of the 6th Meeting of the Audit Committee held at 9 a.m. on **Thursday 24th June 2004** at Park House, 164 Kennington Park Road, London, SE11 4BU.

PRESENT

Mrs Jackie Stark, Vice-Chairman, acting as Chairman
Mr Michael Barham
Mr Daniel Ross (co-opted)

Mr David Robinson (BDO Stoy Hayward) (BDO)
Mr Jonathan Chantler (BDO)
Mr David Waddell (National Audit Office) (NAO)

Mr Paul Baker (Secretary)

The Chairman welcomed Mr David Robinson and Mr Jonathan Chantler of BDO Stoy Hayward and Mr David Waddell of the National Audit Office.

AUD11/04 APOLOGIES FOR ABSENCE

11.1 Apologies had been received from Dr Sandy Yule (Chairman) and Mr Steven Corbishley of the NAO.

AUD12/04 APPROVAL OF AGENDA

12.1 The Draft Agenda was adopted as the Agenda for the Meeting.

AUD13/04 APPROVAL OF MINUTES OF THE MEETING OF COMMITTEE HELD ON 17TH MARCH 2004.

13.1 It was agreed that the minutes were a true record and were signed by the Chairman.

AUD14/04 MATTERS ARISING

- 14.1 Following the comments made at the last meeting by David Waddell (NAO), which were endorsed by David Robinson (BDO), that the Audit Committee should cover all risks, not just financial ones, in its remit, Sandy Yule at the last meeting agreed that he would have the matter revisited at a subsequent meeting of the Finance and Resources Committee. It was reported that as yet no further work has been undertaken on this.
- 14.2 David Waddell (NAO) had produced a checklist by which the Audit Committee could measure its activities against best practice and also indicated that they might host a discussion day on the subject, should members find this valuable.
- 14.3 The Committee agreed that it should spend a day, prior to the next scheduled meeting of the Committee, considering the remit of the Audit Committee and associated corporate governance issues, the day to be led by the NAO and supported by BDO. Other relevant parties such as the Chairman of the Finance and Resources Committee and the Chief Executive should be invited to attend.
- 14.4 It was agreed that the Secretary should convene a date and venue suitable to all.

ACTION: PAUL BAKER

AUD15/04 AUDIT MANAGEMENT LETTER – BDO STOY HAYWARD

- 15.1 David Robinson (BDO) presented his Report to the Audit Committee for the year ended 31st March 2004. He indicated that the report was designed to provide the committee with feedback from the audit and highlight key audit and accounting issues. The report thanked the staff of HPC for their time and assistance during the course of the audit.
- 15.2 He indicated that, based on the work completed to date, they expected to issue an unqualified audit opinion in respect of the HPC financial statements included within the annual report.
- 15.3 The report disclosed a brief financial analysis for the year and also commented on Income, Expenditure and Gains and Losses. He also discussed the financial position of the organisation at 31st March 2004.
- 15.4 The Key audit issues are listed below, being an extract from the report:

Issues identified at the planning stage

- 1) The collection systems following the trail from registered registrants to invoicing, cash collection and banking.

It was anticipated that our Information Systems Assurance (ISA) staff would be able to extract data from the LISA membership database system to enable them to follow the trail from data inputted on this to the income account codes within SAGE. This was not possible and manual walkthroughs were undertaken to check the trail.

- 2) Revenue recognition ensuring it is recognised in the correct accounting period.

As with point 1) it was expected that the ISA staff would be able to undertake this work and provide audit assurance. Failure of the ISA staff to obtain the necessary information resulted in manual checking of the deferred income cut-off of which a sample of 130 were checked which was time consuming for both our staff and HPC's finance staff.

- 3) Ensuring that the tendering processes are adhered to.

Tendering procedures are in place for major expenditure; however it was not possible for us to test the system as no tendering has yet been done due to all major expenditure being with established suppliers.

- 4) Ensuring all expenditure is correctly authorised in line with HPC's guidelines.

All expenditure tested including major expenditure, general expenditure, council members' expenses and payroll had been properly authorised. In particular the Finance Director authorising the Autopay has now been implemented following the BDO internal audit report on the payroll system. One occurrence of authorisation procedures not being adhered to was identified.

- 5) Ensuring cheque signatory procedures are adhered to.

Tested as part of the expenditure work above; cheque signatory procedures have been adhered to.

- 6) Review of the IT system to ensure adequate controls are in place.

Passwords are used to access all systems. There is restricted access to some information such as payroll. A disaster action plan has been developed during the year which has ensured that in the event of restrictions over access to the building or corruption to the system, information lost would be kept to a minimum and the costs to HPC would be minimal.

- 7) Review of risk areas in the profit and loss account in particular ensuring that legal costs and unbilled fees are accrued.

All areas of the profit and loss account have been examined with no problems highlighted. Confirmation from the solicitors suggests that there are no unbilled fees and post year-end invoice review suggests that no costs have been missed.

- 8) Ensuring HPC does not face litigation with regards to any 'incompetence'.

Per discussion with Paul Baker and review of solicitors responses to audit requests no instances of litigation with regards to incompetence were identified.

- 9) Review of the investment portfolio to ensure that the value included in the accounts is market value and that income from the investments has been properly accounted for.

Investments were confirmed by the Investment Advisors, Carr Sheppards Crosthwaite Limited.

- 10) Reviewing the accounting policies to ensure that they are appropriate to HPC.

There have been no changes in accounting policies from the prior year accounts. All policies were reviewed and appear to be appropriate, prudent and fit within the regulations of both Financial Reporting Standards and the Treasury guidelines.

11) Considering the value of the freehold property contained in the accounts is reasonable.

The Drivers Jonas valuation of 184 Kennington Park Road and 20 Stannary Street in December 2003 was reviewed. This suggests that the value of the land and buildings at this time was £1,700,000. The increase in cost of £400,000 was correctly made in the accounts at the time giving a surplus on revaluation of £452,000.

12) Reviewing the financial statements and supporting notes to ensure they comply with required reporting requirements and in particular, Section 46(1)(b) of the Health Professions Order 2001 and the directions made by Privy Council and the Treasury.

The financial statements were reviewed using the National Audit Offices disclosure checklist as guidance and all matters were discussed with both HPC and the NAO before any corrections made.

13) Reviewing HPC's forecasts for the next year to ensure that after taking account of any borrowing facilities, the company has adequate funds in order to meet its liabilities as and when they fall due, i.e. to ensure that HPC is a going concern.

A review has been made of the forecasts for the coming financial year including any borrowing facilities. The version 3 budget forecasts a surplus of income over expenditure of £1m. This predicts an increase in income of approximately £2.7m combined with an increase in expenses of only £457,000. This seems reasonable on the basis that the fee increase implemented from July 2003 will be active for the whole of the 2003/04 year. Additionally more professions are expected to join HPC. Some costs would be expected to increase e.g. payroll, legal, office and partners' costs whilst many of the large one-off costs associated with the start-up of HPC will be reduced or eliminated.

The use of the £1m overdraft facility secured on the building has been extended until June 2004 when NatWest and HPC will review the position. At the time of the audit the overdraft was not being utilised and it is unlikely that it will be required this year.

Overall the review of the current and predicted future position of HPC indicates that it is a going concern.

15.5 Various errors had been found during the audit which would have resulted in an increase in the deficit of £30,100 which is below the threshold of materiality and therefore have not been adjusted through the accounts.

15.6 His report also covered a Key Accounting Issue which is shown below:

Revaluation reserve

A revaluation reserve has been created following the revaluation of the freehold land and buildings held by HPC at the end of the year. Previously, there had been no requirement within the previous year's accounts as only investment losses had been made and both categories of assets were valued at less than actual cost. It was however noted that the categorisation of the investment losses within the statement of recognised gains and losses was incorrect.

Ensuring compliance with FRS 3 - Reporting financial performance, it was decided to restate the 2003 comparatives so that the unrealised losses on investments were

correctly taken through the income and expenditure account. The 2004 gains could be taken through the income and expenditure account to the extent that historical losses had been written off to the income and expenditure account. The balance of £32,746, being the excess of this amount, was taken to a revaluation reserve through the statement of recognised gains and losses.

Due to the restatement of the 2003 comparatives on the income and expenditure account and statement of recognised gains and losses, a note to explain this restatement is required and has been added to the financial statements.

15.7

There were a number of significant internal control weaknesses, largely derived from the implementation of the LISA system and these are listed below, together with HPC's comments and/or proposed actions. These are followed by a number of more minor issues.

Significant internal control weaknesses

Weakness	Effect	Recommendation	Client Comment
<p>Membership statistics HPC do not produce monthly reports which detail current registrant numbers or other statistics such as new registrations, lapsed registrants, restored registrants, international & grandparenting applications.</p>	<p>This demonstrates a lack of control over key statistics.</p>	<p>A monthly pack containing statistics on the registrant & application numbers by profession should be produced for review at the Finance and General Purposes Committee.</p>	<p>Monthly reports will be extracted and kept in future.</p>
<p>HPC do not undertake monthly reconciliations between the LISA membership database and balances shown within the monthly management accounts</p>	<p>HPC's monthly management accounts may not be accurate as membership numbers multiplied by fee income and the deferred income calculation are not checked.</p>	<p>Undertake a monthly test in total of income compared to membership numbers by profession and investigate variances. Also, test the deferred income calculation.</p>	<p>This will be attempted. Such a reconciliation may be extremely complicated and time-consuming.</p>
<p>LISA membership database No historical reports are currently available</p>	<p>HPC is unable to reproduce information as at a specific date in the past which may be necessary to make an informed decision. The result is that incorrect decisions may be made due to insufficient information.</p>	<p>Review the current reporting capabilities of the LISA database system and if found to be insufficient liaise with the developer, Digital Steps to enable additional reporting capabilities.</p>	<p>A planning meeting to assess this as a project will be held shortly.</p>
<p>LISA membership database Data from the database could not be extracted in a format compatible with BDO's Information Systems Assurance auditing package which uses standard Microsoft Excel and Access formats.</p>	<p>Manual auditing of deferred income was required which required significant additional time to complete.</p>	<p>Establish the reason why this information was not able to be produced and liaise with BDO's audit team to ensure that processes are in place that will allow the data to be extracted into the required format.</p>	<p>The LISA system is not based on Access. A meeting will be set up to discuss the way forward. The use of Crystal Reports by the auditors may well be a suggestion.</p>

Weakness	Effect	Recommendation	Client Comment
<p><u>Communication between departments with HPC</u> There appears to be insufficient communication between the Finance, Information Technology and Registrations departments. This was highlighted during the audit by the difficulties in:</p> <ul style="list-style-type: none"> - Obtaining information for our ISA audit work; and - Obtaining information for our manual analytical review work on fee income. 	<p>Information exchange does not always occur and this may cause individual departments to make incorrect decisions.</p>	<p>Establish a communication policy such that information can be freely shared between departments.</p>	<p><i>A regular month-end meeting will be convened.</i></p>
<p><u>IT in general</u> There is an active user account with full administrator privileges which has the username "administrator".</p>	<p>This is an obvious account to be targeted should a security breach occur, since it has clear administrator privileges.</p>	<p>This account should be disabled.</p>	<p><i>Security will be tightened in this area.</i></p>
<p><u>Reserves policy</u> HPC currently does not have a reserves policy.</p>	<p>The Council has no benchmark level of general funds to integrate into its future strategy. The lack of a 'buffer' level of reserves may cause cash flow problems in the future.</p>	<p>The Council should set a minimum reserve level for its general funds; an example which might be six months operational expenditure.</p>	<p><i>To be raised at a future meeting of the Finance & Resources Committee.</i></p>

Weakness	Effect	Recommendation	Client Comment
<p>Post opening procedures Only one staff member normally opens the post except during periods of where anticipated activity is significantly increased.</p>	<p>As an estimated 20% of fees are paid by cheque or cash this area is predisposed to the risk of theft.</p>	<p>Despite the modest size of the organisation and its staff numbers capacity should allow a second individual to oversee the opening of the post and allow for the recording of what is received.</p>	<p><i>The Chief Executive is against the recruitment of an additional staff member in this area. However steps will be taken to mitigate this risk wherever possible.</i></p>
<p>OTHER MATTERS</p>			
<p>A bank account was identified on the bank audit confirmation that did not appear within the accounts.</p>	<p>The amount held within this account was only £207 which is immaterial to adjust; however this highlights the need to ensure HPC's authorised staff has full control of its bank accounts.</p>	<p>Investigate why this account still exists and ensure only current bank mandates are active.</p>	<p><i>This appears to be an old Capital Reserve account held by CPSM but not in that organisation's trial balance. The account will be closed and credit taken.</i></p>
<p>Several old cheques that were over 6 months old remain on the bank reconciliation.</p>	<p>Creditors are currently understated by £7,301 which is immaterial to adjust.</p>	<p>Ensure these cheques are written back in the current year and re-issue new cheques to satisfy these liabilities. Investigate if necessary why cheques issued are not being cashed by the recipients.</p>	<p><i>Many of these cheques are for small amounts to Registrants who do not bother to bank them. They will be written back to creditors and credit taken if not cleared by 31 March 2005.</i></p>
<p>A difference of £10.95 exists on the main current account bank reconciliation which has been carried forward for several months.</p>	<p>An underlying problem may exist within the bank reconciliation process which may result in an incorrect cash book position being reported.</p>	<p>Investigate why the difference occurred and ensure procedures to investigate differences are established.</p>	<p><i>Will be investigated and written off as appropriate.</i></p>

Weakness	Effect	Recommendation	Client Comment
<p>A purchase invoice sampled during our controls testing was not countersigned by the Purchase Ledger Officer.</p>	<p>An invoice may be processed without the correct procedures as per the Financial Procedure Manual section 4.1.2 being undertaken. This may result in an invoice being processed that has not been authorised</p>	<p>Ensure staff are aware of the financial procedures in place and undertake random audits of the purchase ledger function.</p>	<p><i>This area will be covered by Internal Audit work this year.</i></p>

- 15.8 The meeting ACCEPTED the report and requested the Secretary to ensure that the executive followed through on the points concerning LISA and reported back.

ACTION – PAUL BAKER

AUD16/04 AUDIT MANAGEMENT LETTER – NATIONAL AUDIT OFFICE

- 16.1 David Waddell apologised that there was no written report, indicating that the NAO's letter was still in the course of production and review. This was due to the delays in the audit caused by the difficulties experienced by BDO in auditing income and deferred income, which had a knock-on effect on the NAO's timescales. However, he enumerated a number of points verbally as follows.

16.2 Progress:

- a) The financial statements presented for audit were significantly better than last year;
- b) DAO letters, NAO checklist and NDPB guidance had been provided to HPC, who have been very receptive to comments and advice on public sector issues;
- c) A number of adjustments have been made in the financial statements, but these have mainly been of a technical nature;
- d) BDO Stoy Hayward have had problems in auditing income and deferred income. This has led to delays in them completing their audit with knock-on effect on NAO audit. BDO papers were still being received at the date of the meeting;
- e) David Waddell will finish reviewing BDO work, write up notes and submit to Steven Corbishley for review by early in the week commencing 28th June.
- f) The likely impact (subject to review comments) is further enhancement of disclosures in the financial statements but there was unlikely to be an impact on the main account figures.

16.3 Issues arising:

- a) The HPC can develop corporate governance arrangements further, e.g. the role of Audit Committee and Internal Audit, as requirements have changed significantly over the last two years. The NAO is happy to facilitate a learning session, at no charge, for members of the Audit Committee and perhaps the Chairman of the Finance and Resources Committee and Chief Executive to help achieve improvements.
- b) Modified Historic Cost Accounting is still not being applied as there were no material adjustments (particularly as land and buildings were revalued in December 2003) but this will need to be looked at each year. The wrong period had been used in the calculation but there was no significant error.
- c) Better Payment Practice Code Performance not being disclosed but will be from 2004/5 onwards.
- d) A Reserves Policy is required. HPC will determine appropriate levels but reserves cannot be too high or too low.
- e) The NAO reiterate support for BDO's recommendation on post opening.

16.4 It was hoped that the accounts could be signed during week commencing 5th July 2005.

16.5 The meeting ACCEPTED the report.

AUD17/4 ANY OTHER BUSINESS

17.1 At this point the Secretary was asked to leave the room so that the committee could discuss his and his department's performance. Both auditors were very happy with the performance of the Finance Department this year but were inevitably disappointed that there had been audit problems with the LISA system.

17.2 There was no further Any Other Business.

AUD18/04 DATE AND TIME OF NEXT MEETING

18.1 The next formal meeting was confirmed as Tuesday 23rd November 2004 at 9.30 a.m. at Park House. The principle purpose of the meeting would be to review the internal audit carried out during the summer and also to review the way forward following the review day discussed above.

Signed  (Chairman)

Date 23rd November 2004