

AUDIT COMMITTEE

24 SEPTEMBER 2015

INTERNAL AUDIT UPDATE

Report from: Internal Audit

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Summary

To inform Members of the internal audit work completed since the meeting of the Audit Committee on 14 July 2015.

1. Budget and Policy Framework

- 1.1. Council delegates responsibility for the oversight and monitoring of internal audit to the Audit Committee.

2. Background

- 2.1. The Accounts and Audit Regulations 2015 require the council to “undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance”. The Public Sector Internal Audit Standards (PSIAS) require Internal Audit to report periodically to senior management and the board on the internal audit activity’s purpose, authority, responsibility and performance relative to its plan. The Internal Audit Plan for 2015-16 was approved by the Audit Committee on 19 March 2015.

3. Update on planned audit work

- 3.1. Appendix A of this report shows the current status of all audit work from the 2014-15 Annual Audit Plan completed since the last meeting of the Audit Committee. Appendix A also shows the current status of all audit reviews on the 2015-16 Annual Audit Plan. An overall audit opinion is provided for each assurance review and management action plans are agreed with client management prior to a final report being issued. Opinions are not provided in the outputs of individual probity and site reviews; instead these form the basis of summary reports providing an overall opinion on each category of site reviewed.
- 3.2. Appendix B of this report provides a summary of the results of each audit review where a final report has been agreed with the client since the last update provided to the Audit Committee in July 2015. This appendix also details the grant and payment by results claims certified by Internal Audit since July.

3.3. Appendix C of this report provides the definitions of the assurance opinions and recommendation priorities in use, as agreed by the Audit Committee in July 2013.

4. Internal Audit Resources

4.1. As Members will be aware Medway Council has entered into a shared management arrangement for Internal Audit & Counter Fraud Services. The two councils have agreed to establish a partnership to fully share internal audit & fraud services and a report outlining progress is provided elsewhere on this agenda.

4.2. In May 2015 one of the Auditors left the council's employment. Approval was given by Cabinet to recruit to the vacant post in June. Due to the development of the Partnership, this post will be recruited to on a fixed term basis to the end of March 2016.

5. Risk management

5.1. This report, summarising the work of the internal audit function, provides a key source of assurance for the council on the adequacy and effectiveness of its internal control arrangements.

6. Financial implications

6.1. There are no direct financial implications to this report; however an adequate and effective internal audit function provides the council with assurance on the proper, economic, efficient and effective use of council resources in delivery of services, as well as helping to identify fraud and error that could have an adverse effect on the financial statements of the council.

7. Legal implications

7.1. Section 151 of the Local Government Act 1972 requires that "A relevant authority must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance." Proper practice has been defined as that contained within the Public Sector Internal Audit Standards and the CIPFA Local Government Application Note to the Public Sector Internal Audit Standards.

8. Recommendations

8.1. Members are asked to note progress on the 2015-16 Internal Audit Plan and the outcomes of the work of Internal Audit.

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Background Papers

None

Appendices

Appendix A - Annual Internal Audit Plan 2014-15 – items completed

Appendix B - Summary of Results of Finalised Audit Assurance Reviews

Appendix C - Definitions of Audit Opinions and Recommendation Levels

Appendix D – Exempt Document (see agenda item 11)

Annual Internal Audit Plan 2014-15 – items completed

Audit review	Current status	Opinion
Children's Centres probity reviews:		
Riverside Primary	Final report issued	---
Burnt Oak Primary School	Final report issued	---
Deanwood Primary School	Final report issued	---
Delce Infant and Nursery School	Final report issued	---
Miers Court Primary	Final report issued	---
Oaklands Federation	Final report issued	---
St Margarets Troy Town CEVC	Final report issued	---
Schools probity reviews:		
Fairview Community Primary School	Final report issued	---
St William of Perth RCP	Final report issued	---
The Pilgrim's School	Final report issued	---
Greenvale Infant and Nursery School	Fieldwork underway	---
Halling Primary School	Fieldwork underway	---
St Mary's Catholic Primary School	Fieldwork underway	---

Annual Internal Audit Plan 2015-16 – progress update

Audit review	Current status	Opinion
Assurance – opinion reviews		
Housing Maintenance	Fieldwork completed, draft report with client for consideration	
South Thames Gateway Building Control Partnership	Fieldwork completed, draft report with client for consideration	
Health and Safety	Fieldwork underway	
Corn Exchange	Fieldwork underway	
Planning	Fieldwork underway	
Council Tax	Not yet started	
Local Business Rates	Not yet started	
Housing Benefit	Not yet started	
Housing Rents	Not yet started	
Risk Management	Not yet started	
Annual Governance Statement	Not yet started	
Data Quality – Transparency Reporting	Not yet started	
General Ledger	Not yet started	
Bank Account Management	Not yet started	
Debtors	Not yet started	

Appendix A

Audit review	Current status	Opinion
Business Continuity – Energy Resilience	Not yet started	
Adoption Services	Not yet started	
Care Act	Not yet started	
Medway Norse	Not yet started	
Assurance – Probity reviews		
Leisure Memberships	Fieldwork underway	
Featherby Infant and Nursery School	At planning stage	
Featherby Junior School	At planning stage	
St Augustine's	At planning stage	
St Mary's Island	At planning stage	
Local Financial Management Arrangements	Not yet started	
Central Theatre and Theatre Staffing	Not yet started	
Innovation Centre Medway	Not yet started	
Splashes	Not yet started	
Wigmore Library	Not yet started	
Libraries Expenditure	Not yet started	
Twydall Primary School	School converting to Academy; as such review not planned	
Assurance – Follow up reviews		
Staff Allowances and Loans	Fieldwork completed, draft report with client for consideration	
Disclosure and Barring Service	Fieldwork underway	
Grant Management	At planning stage	
Change Management	Not yet started	
Assurance – Grant Certification		
Medway Action for Families - Payment by Results May 2015	Review completed, claim signed off	---
Local Transport Capital Block Funding 2014-15	At planning stage	
Consultancy work		
Medway Norse	Fieldwork underway	
E-ordering	Not yet started	
Payroll Electronic Notification Forms	Not yet started	
Procurement Governance	Not yet started	
Troubled Families	Not yet started	

Summary of results of finalised audit assurance reviews

School Probity Reviews

The Guide to the Law, provided by the Department for Education, defines the required school governance structure for ensuring financial probity. The governing body hold the headteacher to account for ensuring there are appropriate and effective financial management and governance arrangements in place. The school business manager (SBM) or equivalent is responsible for the delivery of sound financial administration. Medway Council's Chief Finance Officer, under Section 151 of the Local Government Act 1972, has a legal responsibility for ensuring the proper administration of the Council's financial affairs, including schools in Medway under Local Authority control.

Internal Audit is conducting a programme of financial probity audits in all the schools Medway Council has oversight responsibility for. Each probity audit seeks to identify any weaknesses in the financial management arrangements, provide guidance and advice to the school on how to strengthen current arrangements, and provide reasonable assurance that there are no financial irregularities.

Each audit provides assurance on the overall financial management of the school by:

- Analysis of financial (transactional) data to determine a risk profile for income and expenditure;
- Determination of control arrangements, as set out in the school's finance policy and confirmed through interviews with the headteacher and the finance officer;
- Targeted testing in the areas of greatest potential risk and / or potential anomalies identified during the risk assessment.

An overarching report is provided at year end to provide assurance and an overall audit opinion on the financial management arrangements in Medway Schools.

Fairview Community Primary School

(final report issued 13 August 2015)

Fairview Community Primary is for children aged three to 11, with a pupil roll of 627. The school is much larger than an average-sized primary school; the proportion of pupils from minority ethnic groups is much lower than the national average, as is the proportion for which English is an additional language. The proportion of disabled pupils and those who have special educational needs supported through school action is lower than average however the proportion supported at school action plus or who have a statement of special educational need is above average.

The School Business Manager (SBM) supports the Headteacher with the management and operation of financial processes. The school's finance policy provides a sound framework for financial management and establishes appropriate roles and responsibilities for the governing body, resources committee, headteacher and the business manager. The school has appropriate structures in place for making procurement decisions. There are limits set for authorisation from the headteacher through to the resources committee and then the full governing body. Care should be taken however around job specification in order to obtain comparative quotes. Purchase orders were raised for approximately 75% of all transactions throughout the school and we did identify that the number of purchase orders raised by staff teaching years 3, 4, and 6 was significantly higher than the other year groups.

There were a few areas we examined in more detail due to the value or nature of the

Summary of results of finalised audit assurance reviews

expenditure:

- High value expenditure;
- Discretionary pay awards (headteacher);
- Staff paid by timesheet (e.g. overtime);
- Assets;
- Income;
- Petty cash

The school has appropriate processes for handling potential conflicts of interest. The audit found evidence that all governors and staff had completed declarations of interest within the last year. The governing body minutes show that the governor who had declared a conflict of interest left the meeting when matters affecting her business were discussed.

The finance policy provides a framework for making procurement decisions but there are opportunities for enhancing this, particularly when considering aggregate spend, specification of work and ensuring decisions are documented fully in governing body minutes. Audits at most other schools have found similar issues.

Audit testing showed that orders had been raised and delivery checked for most transactions before payment. There was evidence of separation of duties throughout the normal payment process, with the bank mandate requiring two signatures. There were appropriate processes to manage and monitor petty cash usage.

Income is logged by the office at the point of collection and held in a safe until it is banked. Each income stream is recorded separately. However, the banking records were not reconciled to local income records and the audit identified a small (£6) discrepancy between the two. In addition, there is no reconciliation of income to expenditure for each trip. As a result, the school does not know how much it is subsidising each trip or how much of this is for pupil premium funded children.

The audit identified a number of inconsistencies in the handling of Human Resources (HR) / payroll issues. We regard this to be a probity issue. In line with Section 12A of the Local Government Act, details are included in an exempt appendix and are not contained in this public report as the information relates to an individual/s and is likely to reveal the identity of that individual/s.

Conclusion

We are able to provide assurance that the school has reasonable controls in place to manage its financial processes. Apart from the issue with the HR issues we did not identify any other probity issues in our testing of payments and procurement.

The Pilgrim School
(final report issued 6 July 2015)

The Pilgrim School is an average sized voluntary controlled primary school that takes pupils from 3-11. The school has approximately 240 pupils on roll. The proportion of pupils for whom the school receives the pupil premium is broadly average whilst those classified with Special Educational Needs is above average. The Finance Officer supports the Headteacher with the management of financial processes.

The school's finance policy provides a sound framework for financial management, establishing appropriate roles and responsibilities for the governing body, finance committee

Summary of results of finalised audit assurance reviews

and Headteacher. We were able to account for all staff on the payroll and were satisfied that the school's processes would ensure only legitimate staff were paid. There were no obvious missing income streams. The school makes the majority of its creditor payments by cheque through SIMS, but also uses a business card and a small amount of petty cash.

There were a few areas we examined in more detail due to the value or nature of the expenditure:

- High value expenditure;
- Staff reimbursements
- The business card
- Petty cash
- Assets
- Income

We confirm we found no probity issues but agreed an action plan to strengthen current arrangements.

Conclusion

We are able to provide assurance that the school has reasonable controls in place to manage its financial processes and we did not identify any probity issues in our testing of payments and procurement.

St William of Perth School
(final report issued 3 August 2015)

The Guide to the Law, provided by the Department for Education, defines the required School governance structure for ensuring financial probity. The Governing Body hold the Headteacher to account for ensuring there are appropriate and effective financial management and governance arrangements in place. The School Business Manager (SBM) or equivalent is responsible for the delivery of sound financial administration. Medway Council's Chief Finance Office, under Section 151 of the Local Government Act 1972, has a legal responsibility for ensuring the proper administration of the Council's financial affairs, including Medway Schools under Local Authority control.

Internal Audit is conducting a programme of financial probity audits in all the schools Medway Council has oversight responsibility for. Each probity audit seeks to identify any weaknesses in the financial management arrangements, provide guidance and advice to the school on how to strengthen current arrangements, and provide reasonable assurance that there are no financial irregularities.

A report for each audit is provided to the individual School, Senior Management within the Council, and once finalised to the Council's Audit Committee. A report providing assurance on the overall financial management in Medway Council's schools is provided at year end, drawing on the findings of the individual probity reviews undertaken.

The audit provides assurance on the overall financial management of the school by:

- Analysis of financial (transactional) data to determine a risk profile for income and expenditure;
- Determination of control arrangements, as set out in the school's finance policy and confirmed through interviews with the Headteacher and the Finance Officer;
- Targeted testing in the areas of greatest potential risk and / or potential anomalies identified during the risk assessment.

Summary of results of finalised audit assurance reviews

St William of Perth Catholic Primary School is an average sized primary school for children aged three to eleven years with a pupil roll of approximately 210 places. The Finance Clerk supports the Headteacher with the management of financial processes. The school has an average number of pupils with special educational needs.

The school's finance policy provides a sound framework for financial management, establishing appropriate roles and responsibilities for the governing body, finance committee and headteacher. We were able to account for all staff on the payroll and were satisfied that the school's processes would continue to ensure only legitimate staff were paid. The school made creditor payments through SIMS. The school does not have a credit card and does not use petty cash. The school receives very little income.

There were a few areas we examined in more detail due to the value or nature of the expenditure:

- Agency supply teacher payments
- Staff paid by timesheets (e.g. overtime)
- Payments to staff
- Procurement
- Leases

We confirm we found no probity issues but agreed an action plan to strengthen current arrangements.

Conclusion

We are able to provide assurance that the school has reasonable controls in place to manage its financial processes and we did not identify any probity issues in our testing of payments, procurement and income.

<p style="text-align: center;">Children's Centres <i>(final report issued 4 August 2015)</i></p>

Management Summary

Local authorities have a statutory duty to ensure there is sufficient children's centre provision but have the freedom to determine how to best meet local needs and priorities under section 5A of the Childcare Act 2006, as amended by section 198.

There are 19 children's centres in Medway, all funded primarily from the general fund of the Council's budget. 18 of these are co-located with primary or infant schools, with whom they share some management and facilities costs. 10 of these schools remain under local authority control. All the children's centres are subject to the same monitoring regime in order to ensure that each centre had the right level of funding and that the expenditure was for its intended purpose.

This audit reviewed the compilation of quarterly monitoring returns for seven local authority schools in order to provide assurance on the accuracy and reliability of the financial data, that each children's centre was in a sound financial position and the returns contained no major probity issues. The schools visited were:

- Riverside Primary School
- Deanwood Primary School and Children's Centre
- Oaklands Federation School
- Miers Court Primary School

Summary of results of finalised audit assurance reviews

- St. Margaret's of Troy Town CEVC Primary
- Burnt Oak Primary School and Children's Centre
- Delce Infant School and Nursery School and Children's Centre

Each school received a short report on the issues relating to their site (see Appendices A-G).

Framework

Medway Sure Start Children's Centre Finance Coding Guidance has been issued to all the schools. It outlines eligible expenditure and explains where this expenditure should be coded on the schools' financial management system (SIMS). This guidance is based on the government's "Consistent Financial Reporting" standards (CFR). Schools complete monitoring returns from SIMS reports. The spreadsheet template has direct links to the SIMS coding structure. The Principal Officer (Children's Centres) provided support where necessary and reviewed the apportionment of shared costs between the school and children's centre. All schools commented on how helpful they found this advice.

All the schools visited had been given the tools necessary for completing timely and accurate returns. However, the audit identified a number of opportunities to enhance the framework by improving consistency and efficiency of the reporting process and these are outlined below.

Coding issues

Children's Centre expenditure is broken down between two costs centres. This separates staffing costs and all other children's centre costs. Each of these cost centres is broken down into ledger codes. There are a further two cost centres for income. The guidance outlines the income and expenditure that should be coded against each cost centre and ledger code in a manner that is consistent with the CFR. There was one error in guidance, with telephone costs included in utilities instead of administration supplies. Four of the schools visited followed the guidance and the other three followed CFR.

All the schools visited were using the staff costs ledger codes appropriately. There were, however, noticeable inconsistencies in the coding of non-staff costs. There appeared to be confusion between:

- Occupation costs and buildings / grounds maintenance
- Session delivery costs and equipment / resources
- Professional services delivery and professional services other
- Miscellaneous and other ledger codes. All items coded to miscellaneous had been coded elsewhere by other schools.

Clearer guidance with more examples for the different ledger codes would have resulted in greater consistency in coding across the schools.

In October 2014, Early Years contributed £7,850 to room hire costs for an independent nursery that works in partnership with Burnt Oak Children's Centre. This payment was routed through the school's accounts. We were satisfied that this was a legitimate grant payment but the route used for the transaction had the net effect of inflating the school's income and expenditure. Early Years have agreed to make future payments direct to the independent provider.

Shared costs

Children's centres all have dedicated staff, whose costs are all charged to the children's centre. There are also staff such as the headteacher, office and premises staff whose work covers both the children's centre and the school. Similarly, there are invoices for goods and

Summary of results of finalised audit assurance reviews

service contracts cover both the school and centre. Early Years expect each school to have methodology for apportioning shared costs, but accepts not all will be scientific and there will be some differences between the schools. We confirmed that each of the schools visited had a reasonable methodology for splitting its shared costs, but this had only been documented by one of the schools (Riverside).

Our comparison of the apportionments for a range of shared costs is shown in table 1 below. There are broad similarities in the way the majority of costs are shared between the school and the children's centres. However, at least one school has taken a different approach for most of the types of expenditure. Some schools are charging the children's centre for a service and others are not.

The advice that the Early Years team has been giving schools is that the children's centre should only be charged if the cost has increased as a result of the children's centre being on site. However, this approach has not been agreed with Finance and there is an argument that the children's centre should be contributing in proportion to their use of a service.

There are additional complications with Local Business Rates (LBR). Schools are fully funded for their business rate costs from the Dedicated Schools Grant (DSG). If the children's centre contributes to the LBR, the school is making a profit on the business rates but if the school does not charge, the children's centre is effectively subsidised from the DSG.

Table 1: Shared cost analysis

Apportioned Cost	Riverside	Deanwood	Oaklands	Miers Court	St Margarets of Troy Town	Burnt Oak	Delce Infants
Staffing							
Headteacher	5%	5%	5%	5%	5%	8%	8%
Finance Staff	20%	15%	3%	3%	10%	6%	2%
Premises Staff	10%	10%	13%	0%	10%	2%	4%
Other Costs							
Utilities	10%	10%	10%*	20%	15%	5%	15%
Business Rates	0%	0%	0%	0%	15%	5%	0%
Refuse collection	10%	10%	10%	0%	15%	5%	12.5%
Cleaning contract	10%	Separate contract	0%	0%	15%	0%	Separate contract
Clinical waste	10%	10%	10%	Separate contract	15%	15%	20%
IT support	10%	10%	0%	0%	15%	0%	0%
PAT / Fire extinguisher testing	10%	10%	0%	0%	15%	10%	20%
SLAs with Medway Council	0%	10%	0%	0%	Varies according to SLA	Varies according to SLA	0%

* Oaklands School has a swimming pool which increases the utility costs for the school, but not the Children's Centre.

Reporting to Early Years

Summary of results of finalised audit assurance reviews

The audit confirmed that all seven schools were using the spreadsheet template for their monitoring returns to Early Years and using data from SIMS reports. All schools included actual expenditure and year-end forecasts for its income and expenditure. Variances from budgets were explained for most of the returns but two of the schools had not allocated their budget to individual codes, which made realistic forecasting more difficult. One school had indicated a budget deficit and corrective action was taken following a visit by the Principal Officer (Children's Centres).

The guidance from Early Years provided a framework for coding transactions on SIMS but did not give instructions on how to complete the template. Each of the schools uses different processes to extract SIMS data for inclusion in the quarterly return and we found there were five different SIMS reports in use. All of these datasets present the SIMS data in slightly different formats i.e. some reports allow the user to set the period whilst others are instant snapshots; some are summary reports and others give transactional details. As a consequence, there is variation in the range of data included (see Table 2).

Table 2: Extraction of Children's Centre Data from SIMS

School	SIMS report	Timing difference (days)	Comments
Riverside	Chart of Accounts	+15	
Deanwood	Cumulative Expense Analysis	N/K	Report not retained, so not possible to confirm.
Oaklands	Cumulative Expense Analysis / General Ledger cost centre transactions.	0	The school correctly adjusted for late input of the payroll data.
Miers Court	Detailed Transaction Listing by Ledger Code	-7	Report run early
St Margarets of Troy Town	Detailed Transaction Listing by Ledger Code	+42	
Burnt Oak	Cumulative Expense Analysis	0	
Delce Infants	Detailed Transaction Listing by Ledger Code / Trial Balance	0	

Schools would benefit from definitive guidance on how to use SIMS to produce the quarterly monitoring report.

Future Opportunities

School finance staff are currently required to manually transfer data from SIMS reports into the monitoring spreadsheet. This increases the time it takes and introduces the risk of error. Redesign of the monitoring return would allow the SIMS report to be copied into the excel spreadsheet. The key fields in the monitoring return would then be populated with the actual income and expenditure.

In addition to completing quarterly returns for the children's centre, schools are required to

Summary of results of finalised audit assurance reviews

complete two monitoring returns per year for Education Finance. Further efficiencies could be gained if the two returns were integrated.

Before the children's centres opened, there was significant capital investment. It is likely that, over time, there will be a need to renew some of that infrastructure. Some of this (such as replacement of play equipment or redecoration) can be funded in-year from revenue income. However, it is unlikely that larger items could be funded in this way. Schools have the facility to transfer revenue funds to increase capital balances in their main fund. This allows them to plan in the longer term for improvements to the buildings or the purchase of capital equipment, such as ICT. Children's centres do not have the same provision under the CFR framework for transferring revenue to capital funding. Early Years will need to consider how best to fund infrastructure renewal in the future.

Conclusion

The Authority has reasonable processes in place to ensure the children's centre monitoring returns are accurate but the quality could be enhanced through the provision of improved guidance. There are opportunities to make the monitoring process more efficient by automation and integration with the overall school monitoring return. Management have agreed actions to address the issues raised in this report.

We can also confirm that no probity issues were identified and, where enhancements to local control arrangements have been identified, these have been raised the relevant each school.

Five material priority recommendations have been agreed with management to address the issues raised in the report. All are scheduled for implementation by April 2016:

- Three recommendations are to improve consistency in financial reporting;
- One recommendation is to ensure funds are available for infrastructure renewals (e.g. PCs);
- One recommendation was to investigate opportunities for streamlining reporting processes.

Grant Certification

Certain grants require certification by internal audit, and also some programmes of work include an element of payment by results (PBR) which need to be certified prior to claim. Below is a list of grant and PBR certificates, those in bold having been completed since the last Audit Committee meeting.

Grant	Date Signed off	Value
Medway Action for Families Payment by Results May 2015	6.05.15	n/a

Definitions of Audit Opinions and Recommendation Levels

Definitions of audit opinions	
Strong (1)	<p><u>Risk Based:</u> Appropriate controls are in place and working effectively, maximising the likelihood of achieving service objectives and minimising the Council's risk exposure.</p> <p><u>Compliance:</u> Fully compliant, with an appropriate system in place for ensuring ongoing compliance with all requirements.</p>
Sufficient (2)	<p><u>Risk Based:</u> Control arrangements ensure that all critical risks are appropriately mitigated, but further action is required to minimise the Council's risk exposure.</p> <p><u>Compliance:</u> Compliant with all significant requirements, with an appropriate system in place for monitoring compliance. Very minor areas of non-compliance.</p>
Needs Strengthening (3)	<p><u>Risk Based:</u> There are one or more failings in the control process that leave the Council exposed to an unacceptable level of risk.</p> <p><u>Compliance:</u> Individual cases of non-compliance with significant requirements and/or systematic failure to ensure compliance with all requirements.</p>
Weak (4)	<p><u>Risk Based:</u> There are widespread or major failings in the control environment that leave the Council exposed to significant likelihood of critical risk. Urgent remedial action is required.</p> <p><u>Compliance:</u> Non-compliant, poor arrangements in place to ensure compliance. Urgent remedial action is required.</p>

Definitions of audit recommendation levels	
Significant (High)	The finding highlights a weakness in the control arrangements that expose the Council to significant risk (determined taking into account both the likelihood and the impact of the risk).
Material (Medium)	The finding identifies a weakness in the control arrangements that expose the Council to a material, but not significant, risk (determined taking into account both the likelihood and the impact of the risk).
Point of Practice	Where the finding highlights an opportunity to enhance the control arrangements but the level of risk in not doing so is minimal, the matter will be shared with management, but the detail will not be reflected in the audit report.