

# Report of the Comptroller and Auditor General on the Home Office Resource Accounts 2004-05

## Introduction

1. The purpose of the Home Office (the Department) is to build a safe, just and tolerant society, to enhance opportunities for all, and to ensure that the protection and security of the public are maintained and enhanced. This is reflected in its objectives, set out in its Public Service Agreement agreed in the 2004 Spending Review, which are as follows:
  - People are and feel more secure in their homes and daily lives;
  - More offenders are caught, punished and stop offending and victims are better supported;
  - Fewer people's lives are ruined by drugs and alcohol;
  - Migration is managed to benefit the UK, while preventing abuse of immigration laws and the asylum system; and
  - Citizens, communities and the voluntary sector are more fully engaged in tackling social problems and there is more equality of opportunity and respect for all people of all races and religions.
2. The resource accounts of the Home Office consolidate the accounts of the core Department with those of HM Prison Service, the UK Passport Service, the Criminal Records Bureau and the National Probation Service.
3. As set out in *Government Accounting*, the Accounting Officer of the Home Office is personally responsible to Parliament for the following:
  - The propriety and regularity of the public finances for which he is answerable;
  - For the keeping of proper accounts;
  - For prudent and economical administration;
  - For the avoidance of waste and extravagance; and
  - For the efficient and effective use of all the available resources.

## My obligations as Auditor

4. I am required, under Auditing Standards issued by the Auditing Practices Board, to obtain evidence to give reasonable assurance that the Department's financial statements are free from material misstatement. In forming my opinion I examine, on a test basis, evidence supporting the disclosures in the financial statements and assess the significant estimates and judgements made in preparing them. I also consider whether the accounting policies are appropriate, consistently applied and adequately disclosed.
5. Under the Government Resources and Accounts Act 2000 (the Act), I am required to examine and certify all departmental resource accounts received under the Act. I inform Parliament if a department does not meet the statutory reporting timetable, which is outlined below.
6. Under the Act, the Accounting Officer of the Department was required to submit to me, as Comptroller and Auditor General, the signed accounts for his department for 2004-05 by 30 November 2005. I am required by the Act to certify the accounts by 15 January 2006 and to

send them to the Treasury. The Treasury is required to lay the accounts before the House of Commons by 31 January 2006.

7. As well as the statutory reporting timetable set out in the Act, every department is committed to the Treasury's 'faster closing' initiative. The goal is for departments to have their resource accounts from 2005-06 onwards signed, certified and laid before Parliament before the Summer Recess. The benefits of this are as follows:
  - Improved Parliamentary accountability as statements will be more timely and relevant;
  - Earlier information improves departmental financial planning and provides the Treasury with reliable figures for actual expenditure; and
  - A department's ability to produce timely financial statements, with clean audit opinions, is evidence of financial discipline and data integrity.

### Purpose of report

8. The purpose of this report is as follows:
  - To inform Parliament that the Home Office has not met the statutory reporting timetable in respect of its 2004-05 resource accounts;
  - To explain why I have been unable to reach an opinion as to whether the accounts show a true and fair view;
  - To explain the reasons for the Department's delay in providing me with accounts for audit; and
  - To indicate the steps the Department is taking to address the weaknesses in the system of control that led to this situation and to prevent a recurrence in the future.
9. The issues raised in my report relate to the preparation of accounts for the core Department and the consolidation of those accounts with those of the bodies referred to in paragraph 2. I have certified the individual accounts of the bodies listed in paragraph 2 without qualification.

### Failure to deliver accounts to the required timetable

10. Under the faster closing programme the Home Office undertook to accelerate the accounts production timetable in order to achieve certification of the 2004-05 accounts by 30 September 2005, and pre-recess for the 2005-06 accounts. On this basis my staff agreed an audit timetable for the 2004-05 accounts with the Home Office. This timetable committed the Department to the delivery of draft consolidated accounts to me by 30 June 2005. However the first draft accounts were not received until ten weeks later on 9 September 2005. These accounts contained numerous errors and internal inconsistencies. In particular, amounts relating to cash, Exchequer funding and non retainable income due to the Consolidated Fund were contradictory and did not reconcile between the different places in which they appeared in the accounts. There were also material omissions and misstatements, for example the value of the private prison estate was incorrectly recorded in the accounts.
11. Following discussions with senior management and the Home Office Audit Committee, it was agreed that second draft accounts would be provided by 14 December 2005. These were subsequently produced with the supporting papers being made available to us on 16 December 2005. The amounts in the revised accounts had changed significantly from the first draft. In particular nearly every major balance was markedly different. To illustrate the scale of the movements: the amount owed to the Exchequer by the Home Office of £68 million in the September draft accounts became an amount owed by the Exchequer to the Home Office of

£112 million in the December draft accounts. This swing is due to major changes elsewhere in the accounts resulting in a change to the cash required by Home Office.

### Basis of disclaimer audit opinion

12. The factors which have led me to conclude that I cannot form an opinion on the truth and fairness of the Home Office financial statements for 2004-05 are set out below.

### New accounting system

13. Adelphi is the Home Office's new, Oracle based, integrated finance, human resource and procurement system. In May 2004, the Home Office implemented the accounting module which was designed to automate manual processes, bring greater efficiency and control and improve the timeliness and quality of information.

14. In my report on the 2002-03 Home Office Resource Accounts I highlighted some of the key risks to the Department which could damage successful implementation of the new accounting system. Not all of these risks were adequately addressed and various problems arose during implementation. Difficulties were encountered in the transfer and cleansing of data, and staff were not trained to use the new system on a timely basis. These problems and delays, together with a lack of understanding of the new accounting system, meant that the Home Office could not use data from its new accounting system effectively to produce a cogent set of accounts to the required faster closing and statutory timetables.

15. Additionally, reviews carried out by the Home Office's Audit and Assurance Unit (the internal audit function) and by my staff revealed significant control weaknesses within the main accounting systems. The reviews found control weaknesses within key Information Technology applications including access to the system, inadequate segregation of duties, the creation of standing data and the ability to interrogate and monitor changes made. These weaknesses made access to the database by unauthorised staff possible, representing a risk to the integrity of Adelphi data and exposing the Home Office to a greater risk of fraud and error. The Home Office has now taken significant steps to address these weaknesses.

### Cash management

16. Due to difficulties in implementing the new accounting system, the Home Office has been unable to reconcile its cash at bank position, i.e. match its own records of cash payments and receipts with those shown on its bank statements. Bank reconciliations are one of the most fundamental of all accounting controls as they enable payments, receipts and cash balances to be validated to an external source and provide assurance about debtor and creditor balances. They are also a key control for the prevention and detection of fraud. Regular reconciliations would enable the Home Office to identify and action omissions and processing errors and would provide a check on whether fraudulent transactions have occurred. It is therefore important that they are carried out monthly, reviewed at a senior level and action taken promptly to follow up any issues arising. Table 1 sets out the chronology of actions in relation to the Home Office's bank reconciliation difficulties. Home Office has found no evidence of fraud following the actions taken as set out in this table.

Table 1: Cash timeline	
Date	Event
May 2004	New accounting system implemented.
May 2004 – November 2004	Cash – general ledger technical processing errors identified and corrected by Oracle consultants.
May 2004 – March 2005	Ongoing investigation of reconciling differences means that the cash position is not fully reconciled.
February 2005	Consultant employed to reconcile main cash account.
June / July 2005	Reconciliation attempted for 31 March 2005. £67 million of adjustments identified by consultant to correct interfaces with debtors/creditors leaving a £3 million unreconciled balance which was written off to the Operating Cost Statement.
September 2005	Unreconciled cash balances came to NAO attention during audit work. Issue raised with the Home Office by the NAO.
October 2005	Escalated to senior management by NAO. Chair of Audit Committee informed.
November 2005	Second consultant employed to assist on cash reconciliation. Difficulties reported to Audit Committee.
January 2006	Entries to reverse the unreconciled £3 million difference will be processed. An adjustment affecting creditors (net increase of £67 million) and cash reconciles the cash position. Gross adjustments totalled £946 million.
31 January 2006	Some commercial accounts remain unreconciled.

17. In February 2005 the Home Office employed an Oracle experienced consultant to rectify matters. The consultant identified £67 million of reconciling transactions but this work left a difference of £3.035 million unresolved which the Home Office, after considering the potential causes and risks, judged should be written off to administration costs without further investigation. My staff were concerned that the £3.035 million difference still represented a significant financial risk which could mask substantial errors, and potential losses. Following discussions between my staff and the Home Office a second consultant was employed in November 2005 to undertake further work on the difference. This further work revealed a range of errors which are set out in Table 2 with gross adjustments totalling £946 million necessary to correct the £3.035 million difference. As noted previously, the Home Office has found no evidence of fraud following the work.

**Table 2: Errors contained within unreconciled cash**

1.	Opening balances transferred to new accounting system contained unreconciled transactions
2.	The Adelphi accounting system could not deal with failed payments processed through the Bank Automated Clearing System and Oracle consultants were employed to fix the glitch between May and November 2004
3.	Inaccurate bank statement information loaded into Adelphi system
4.	The processes put in place for the reconciliation of cash were not robust enough to identify differences for investigation and to provide an audit trail
5.	User error occurred to correct perceived reconciliation differences which were generated elsewhere and this compounded the level of error in the cash reconciliation process.

18. Unreconciled items of £3,500 remain on the main bank account in respect of the position at 31 March 2005. The bank account has also yet to be reconciled successfully on a monthly basis in 2005-06.

19. There is a further bank account on the ledger holding £1 million which is the umbrella account for a large number of small commercial accounts. This ledger balance has not been reconciled to the bank statement.

### Weaknesses in financial management

20. The Home Office has put in place a clear budgetary control framework and detailed budgeting delegations. The effectiveness of the framework is, however, undermined by weaknesses in the overall financial control framework.

21. As noted earlier, controls over the accounting system during 2004-05 were weak and the Home Office is taking action to address the:

- Poor controls and weaknesses in the audit trails maintained over the assignment of access rights;
- Absence of checks made against Human Resources records to ensure that new users are authorised, and leavers are removed promptly; and
- Absence of controls to detect unauthorised access to the database.

22. In addition, in my opinion, there are weaknesses in the contractual arrangements over the new accounting system in respect of:

- Over reliance on the Home Office contractor to undertake security checks, and a lack of effective processes to address the risks this exposes the Department to; and
- Unmonitored access to the database by the Home Office's contractor, and over reliance on the contractor's expertise, for example in report production.

23. Weaknesses also exist over business and monitoring controls which the full implementation of the human resource and procurement modules of Adelphi will help address. However for 2004-05 we noted that:

- The absence of contract registers recording all contracts entered into by the Home Office makes it difficult for the Department to be satisfied all liabilities are included in the financial statements and all commitments disclosed where appropriate. The central procurement function

would be more effective with this information and it would assist the Home Office in its drive for efficiency savings;

- Purchase order levels and overall contract amounts can be exceeded without being challenged;
  - Contract letting and extension procedures were not always followed properly. On one significant contract a contract extension was granted at short notice, which was not allowed in the original contract, and serious deficiencies in this contract were not addressed;
  - Key reconciliations such as those between the register of fixed assets and the general ledger, between the payroll system and the general ledger, and headcount had not been performed routinely; and
  - Management did not routinely review key reconciliations and take action where appropriate.
24. The poor quality and delay to the production of the financial statements reflected a lack of skills within the accounts branch compounded by late recognition by management of the serious problems being encountered. The effort required to fully investigate and reconcile cash and inadequate in-year procedures for ensuring the quality of the financial information also impacted on the accounts timetable. Management procedures to ensure the quality of the financial information produced were also inadequate. With the exception of the Immigration and Nationality Directorate, the financial statements preparation process was not subject to project management disciplines resulting in consistent slippage against planned timetabling.

### Implications for my audit of the Home Office's financial statements

25. The Home Office's preparation of accounts for 2004-05 for Parliament has been significantly delayed for the reasons noted above. A constructive discussion about the difficulties was held at the Home Office Audit Committee on 29 November 2005 and it was agreed that my staff would work to audit the accounts provided they were available by 14 December 2005. This would have left only one month for the audit to be completed for me to provide an opinion within the timeframe required by statute. The Home Office worked hard to try and resolve the underlying difficulties and presented my staff with a revised set of draft accounts by the agreed date. However, these accounts were materially different from the September draft and were themselves subject to further material adjustment to reflect amendments needed following the Home Office's and my staff's ongoing work in December 2005 and January 2006, including adjustments arising from the work to reconcile the Home Office's bank account. The scale of audit work required therefore meant that it has not proved possible for my staff to obtain all the evidence and explanations necessary to verify the amounts and disclosures in the accounts prior to the statutory deadline.
26. As a result of the weaknesses in the financial control framework, on which I have commented above, I cannot obtain sufficient confidence in the financial systems operated by the Home Office without significant additional audit work, which is not practical given the statutory requirement for the financial statements to be laid by 31 January 2006. My staff will, however, continue to work with the Home Office to resolve outstanding matters as far as possible.
27. As a result of the difficulties experienced by the Home Office in preparing accounts for 2004-05, the scale of adjustments required to resolve key balances, and other errors and omissions, in my opinion the Home Office has failed to maintain proper books and records in 2004-05. The pervasive and fundamental nature of the problems encountered in my audit of the Home Office's accounts for 2004-05 mean that I am unable to reach an opinion as to whether they show a true and fair view.

## The way forward

28. Home Office has appointed a new professionally qualified Director General Finance and Commercial who took up post in April 2005 and a new Head of Performance and Finance in January 2006. They and the Home Office have recognised the need to strengthen its financial control framework, and to improve its financial statements preparation processes to enable it to meet its accountability obligations to Parliament. Actions taken to address the problems include:
- The Home Office has redesigned and restructured its financial accounting function which will result in an increase in the number of qualified and experienced accountants in the team from three to eight. The function will also be moved from Liverpool to be co-located with the management accounting function located in London. This will integrate the activities more closely, improve the financial control environment and increase interaction with other Home Office financial activities located in the London area.
  - The Home Office will continue work on the all aspects of the 2004-05 account in order to provide a more robust basis for preparing a timely account for 2005-06, and to minimise the impact on the audit opinion.
  - The Home Office has commissioned a review of the factors that prevented the timely preparation of the 2004-05 accounts and the further action that is required. Oversight of this review and the subsequent implementation of its recommendations will be an area of particular focus for the Home Office Audit Committee.
  - The Home Office and its Audit Committee will ensure that focus is maintained on financial control environment by closely monitoring the implementation of those recommendations arising from this audit and those of its internal audit function.
29. The Home Office will need to work rapidly to resolve its financial accounting difficulties, to produce accounts for 2005-06 in accordance with the faster closing and statutory requirements. Senior management leadership and commitment will be vital to the Department's success.

**John Bourn**  
**Comptroller and Auditor General**  
**26 January 2006**

**National Audit Office**  
**157-197 Buckingham Palace Road**  
**London SW1W 9SP**