

AUDIT COMMITTEE

27 SEPTEMBER 2007

2006/2007 EXTERNAL AUDIT REPORT

Report From: Financial Management

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1. Summary & Reason for Urgency

- 1.1 This report considers the issues raised by the Council's external auditors following the 2006/2007 audit
- 1.2 The Accounts and Audit Regulations 2003 require that Committee consider these issues prior to 30 September.

2. Decision issues

- 2.1 The Audit Commission's Code of Audit Practice and International Standard of Auditing (ISA 260) requires the results of the audit to be reported to those charged with governance. This Committee has been delegated with the responsibility for considering these reports and agreeing the Council's response. In addition, the Committee, on behalf of the Council, must explain reasons for not adjusting the Statement of Accounts for the issues raised within the auditor's report.

3. Background

- 3.1 The draft Statement of Accounts for 2006/2007, along with the Statement on Internal Control, was considered and approved by this Committee on 26 June. At that stage the accounts were subject to final verification and Members were advised that any proposed changes as a result of the audit would be reported at a later stage.

4. Auditors Report 2006/2007

- 4.1 For completeness, Pwc's report is attached at Appendix 1 and contains: --
 - its report on the Financial Statements
 - its report on the Use of Resources
 - associated appendices.
- 4.2 The Council's response to the issues identified, as proposed by officers, is included in the appropriate areas of the document.

5. Financial Statements

- 5.1 Attached at Appendix 2 are the main financial statements, as adjusted to reflect issues arising during the audit. Understandably, with the introduction of a new SORP and a radically new format for the accounts, there are a number of changes to the accounts previously submitted. In the main, these are presentational but the ones affecting the Core Financial Statements are attached as Appendix 2 and summarised below :-
- **Income and Expenditure Account** The deficit for the year has increased by some £3.051m, due principally to the revised treatment of KCC debt payments of £3.2m now included in Interest Payable. These entries are reversed out in the Statement of Movement on the General Fund Balance and therefore do not affect the General Fund balance as at 31 March 2007.
 - **Balance Sheet** The 'Net Worth' of the council has decreased by £19.071m principally due to a change in the treatment of capital contributions. These were previously included as reserves but, following discussions with the auditor, are now reported as long term liabilities until such time as they are applied to fund the capital programme.
 - **Movement on Reserves** Total reserves have been adjusted down by £19.015m to reflect the change in treatment of capital contributions, asset revaluations and disposals and changes to the pensions reserve. None of these changes affects 'useable' funds.
 - **Schools Balances/Earmarked Revenue Reserves** In the draft accounts presented for audit the issue of the 2006/2007 overspending on the central allocation of the Dedicated Schools Grant was covered by way of reducing the overall schools balances shown on the balance sheet. It has now been agreed with the auditors that a more appropriate representation is to show this against the earmarked revenue reserves balance which has been reduced accordingly.
- 5.2 The executive summary of Pwc's report states that an unqualified audit opinion will be issued in relation to the financial statements. Its detailed findings and observations are categorised into unadjusted misstatements, summary of audit and accounting issues, and an update on prior year financial and accounting controls and recommendations.
- 5.3 In respect of unadjusted misstatements having an impact on the Income and Expenditure Account, the Committee is required to submit a written representation explaining it's reasons for not making the adjustments recommended. The issues are as follows:-
- **Recognition of Cost** This issue is also recurrent from previous years and concerns three elements of expenditure that Pwc regard as chargeable to the 2006/2007 financial year, but for which the Council has a conflicting policy.

In relation to audit fees, only one quarter of the 2006/2007 charge was accrued on the basis that the work was substantially undertaken in 2007/2008

The Council does not accrue back March related payroll costs (allowances and overtime), paid in April, on the basis that it avoids delays in the final accounts process, improves the accuracy of forecasting and has no material year on year effect.

The authority has never had a policy of splitting utility bills between years. It is the view of officers that the resources required to undertake a detailed analysis of those accounts that 'straddle' 31 March, cannot be justified in terms of efficiency or the likely materiality of any subsequent adjustment.

- **Sundry Debtor Bad Debt Provision** Pwc maintains that the provision for irrecoverable debts is understated as no provision is made for debts less than a year old and other classes of debt such as capital are not considered. Officers will review the procedure for assessing irrecoverable debts during 2007/2008.
- **Collect Bad Debt Provision** The current policy on the Collect bad debt provision is to provide for 60% of the 'high risk' debt - Pwc recommend that this provision should be 100%. However, as the debt is not written-off until the death of the debtor, it is maintained that the current policy is robust
- **Unallocated Income** £11,000 of unidentified income has been credited to the income and expenditure account rather than to the sundry debtors bad debt provision. As this amount is unlikely to be repaid, officers consider this is an appropriate treatment.

5.4 In respect of unadjusted misstatements having an impact on disclosure classification, the Committee is required to submit a written representation explaining it's reasons for not making the adjustments recommended. The issues are as follows:-

- **Amortisation of Government Grant** This represents an estimate of the overstatement of the Government grants applied to fund work in progress. As indicated in the management response in Appendix D, this issue will be reviewed in 2007/2008.
- **Revenues & Benefits Trading Account** This issue is ongoing and has featured in previous years reports. The accumulated trading loss on this account is £345,000 as at 31 March 2007 (£531,000 as at 31 March 2006), but projections to the end of the contract anticipate that a break-even position is possible. Pwc have reviewed these projections but argue that this outcome is by no means certain and that the current losses should be written off to the cost of service, with the General Fund being reduced by this amount accordingly.
- **Unallocated Income** there will always be an element of 'netting off' between debtors and creditors and an amount of £48,000 is not considered material to disclosure within the accounts.

5.5 Pwc's summary of audit and accounting issues highlights a number of accounting and control issues. Improvements have been made during 2006/2007 with the introduction of the LOGOTECH asset management system and further control issues will be adopted now that recruitment problems have been addressed. However, the onerous requirements of the 2006 SORP have not been fully addressed as the procedures adopted in previous years do not produce the data required for full compliance with the SORP. Officers will be consulting with the incoming auditors how to address these issues.

6. Use of Resources

- 6.1 The report concludes that the Council had adequate arrangements in place during 2006/2007 to secure economy, efficiency and effectiveness in its use of resources. This conclusion covers all twelve criteria. An improvement over 2005/2006 where arrangements to manage significant business risks was rated as inadequate.

7. Update on Prior Year Financial and Accounting Controls Recommendations

- 7.1 Of the thirteen financial and accounting control recommendations made in previous years, two have now been resolved and one has made a significant advance. The remainder will be reviewed during 2007/2008. None are categorised as being high risk.

8. Management Representations Letter

- 8.1 To comply with regulations, the Chief Financial Officer of each local authority must provide the external auditors with a signed declaration which supports their work in relation to the audit of the annual accounts.
- 8.2 The draft Management Representations Letter is attached at Appendix 3 and the Committee is required to consider the content of the letter in the context of the issues raised in this report. Once agreed, the letter will be submitted to Pwc.

9. Financial and Legal Implications

- 9.1 The financial implications are contained within the body of the report.
- 9.2 Auditors are required to comply with the Statement of Auditing Standards, and thus provide an opinion on the Council's Statement of Accounts.

10. Recommendations

- 10.1 That Committee notes the issues raised by Pwc and the proposed action and response as summarised in the body of this report.
- 10.2 That Committee agree the changes to the Statement of Accounts as set in paragraph 5.1 of this report and reflected in the amended sections of the Statement of Accounts set out at Appendix 2.
- 10.3 That Committee agree to the continuance of current policies as detailed in Paragraph 5.3 and that appropriate representations are made to this effect.
- 10.4 That Committee agree the Management Representations Letter, attached at Appendix 3, for submission to Pwc.

Background papers

Medway Council's draft statement of accounts for 2006/2007
Report on Draft Statement of Accounts to this Committee 26 June 2007

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