

# **Report on the 2004/05 Financial Statements to the Accounts Committee**

**Carlisle City Council**

**Audit 2004-2005**

External audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services.

Audit in the public sector is underpinned by three fundamental principles:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements but also value for money and the conduct of public business; and
- auditors may report aspects of their work widely to the public and other key stakeholders.

The duties and powers of auditors appointed by the Audit Commission are set out in the Audit Commission Act 1998 and the Local Government Act 1999 and the Commission's statutory Code of Audit Practice. Under the Code of Audit Practice, appointed auditors are also required to comply with the current professional standards issued by the independent Auditing Practices Board.

Appointed auditors act quite separately from the Commission and in meeting their statutory responsibilities are required to exercise their professional judgement independently of both the Commission and the audited body.

### **Status of our reports to the Council**

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## 4 Report on the 2004/05 Financial Statements to the Accounts Committee

### Introduction

- 1 Professional auditing standards require auditors to report certain matters arising from the audit of the financial statements to 'those charged with governance':
  - expected modifications to the audit report;
  - unadjusted non-trifling misstatements;
  - material weaknesses in accounting and internal control systems;
  - qualitative aspects of accounting practice and financial reporting;
  - matters required by other auditing standards to be reported to those charged with governance; and
  - other matters that we wish to draw to your attention.
- 2 We have agreed with the Council that the communications required under these auditing standards would be with the Accounts Committee. This report sets out for the Committee's consideration the matters arising from the audit of the financial statements for 2004/05.

### Status of the audit

- 3 Our work on the financial statements is now substantially complete, although there are still some outstanding matters to be resolved.
  - The Council is carrying out further work on the bank reconciliation and cash flow statement and this has yet to be concluded.
  - We are awaiting the receipt of an amended set of financial statements which includes adjustments made by the Council in response to the errors identified during the audit.
- 4 We will provide a further update on progress at the Accounts Committee meeting. Subsequent to the meeting should any further matters arise in concluding the audit and which require reporting, we will raise these initially with the Chair of this committee.
- 5 Subject to the satisfactory conclusion of the work outstanding, we anticipate being able to issue an opinion by the end of February 2006. A draft standard audit opinion is attached at Appendix 1. However, at the time of writing this report, a number of material errors and uncertainties remain in the financial statements. Officers are carrying out further work to address these matters. Failure to address these issues in a way which removes any material uncertainty will have an adverse effect upon my ability to provide an unqualified audit opinion. If a qualified audit opinion proves necessary I will provide the wording of this in advance of giving the opinion.

## **Matters to be reported to those charged with governance**

- 6 Our audit of the Council's Financial Statements for 2004/05 has identified matters to be considered by members of the Council's Audit Committee. They are categorised under four broad headings.
- Draft unadjusted misstatements - these are items which fall below the materiality level and would not prevent a clean opinion being given. However, Members should consider what action is to be taken on these issues especially as many of the issues relate to the 2003/04 accounts. It was agreed that officers would make these corrections, where appropriate, in the 2004/05 Accounts. Cumulatively these issues if not amended may become material.
  - Draft adjusted material misstatements - these are items that must be corrected before a clean opinion can be given because they are material to the understanding of the Accounts. Work is ongoing to quantify the final adjustments required. Members need to consider whether they want to amend the accounts in these respects.
  - Material weaknesses in the accounting and systems of internal control - the Authority has failed to provide evidence of a robust bank reconciliation at 31 March 2005, and has failed to maintain regular bank reconciliations throughout 2004/05. A balanced reconciliation was not in place until December 2005. The bank reconciliation is regarded as an essential element of internal control and without it there is a fundamental uncertainty regarding the accuracy of the financial statements.
  - Qualitative aspects of accounting practice and financial reporting - we are required to bring to your attention our concerns about the Council's inability to prepare Accounts which are materially correct and which comply with proper accounting practice.

### **Draft unadjusted misstatements**

- 7 Our audit identified a significant number of non-trifling misstatements in the financial statements which management has decided not to adjust. Appendix 2 of this report provides a list of all non-trifling unadjusted misstatements. These relate to less significant errors and presentational issues which officers have agreed will be corrected where appropriate in the 2005/06 financial statements. The cumulative total of the final non-trifling misstatements is not expected to be material (although as yet the amendments to the accounts have not been made by officers). As some final audit adjustments are yet to be quantified these amounts may change. We will provide an updated schedule of the final non-trifling misstatements prior to giving the audit opinion.

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### **Draft adjusted material misstatements**

- 8 We are also required to consider reporting adjusted misstatements to you where these are material and are relevant to your governance responsibilities. We draw your attention to the following material misstatements that management has agreed to adjust:
- flooding costs are being amended to reflect the actual income due to the Authority in 2004/05 and to ensure that the accounts are prepared on an accruals basis as required by accounting standards. The amendment required is in the region of £1 million;
  - cashflow statement - officers are continuing to work on revisions to this statement and the final adjustments are in the process of being confirmed. Adjustments are in excess of £4 million;
  - a number of adjustments are to be made to the fixed assets balance to reflect errors and uncertainties regarding revaluations, additions and disposals. Some final adjustments are yet to be determined however the approximate value of these amendments is in excess of £2 million; and
  - other material misstatements as detailed in our final accounts memorandum.
- 9 Appendix 3 of this report provides a list of all non-trifling misstatements which management have agreed to adjust.

### **Material weaknesses in accounting and internal control systems**

- 10 Our audit identified the following material weaknesses in systems of accounting and financial control.
- The existence of robust and timely bank reconciliations represents a fundamental internal financial control aimed at ensuring the accuracy and integrity of the accounting records and financial statements. Following problems with the implementation of the new ledger system no bank reconciliations were completed during the whole of 2004/05 and the bank was not reconciled at 31 March 2005.
  - Although a number of problems within the system have now been addressed, bank reconciliations have continued to show unreconciled balances during 2005/06. We recognise the difficulties encountered following the floods in January 2005. Nevertheless, the lack of balanced reconciliations throughout the year represents a serious control and governance weakness. We are unable to give an unqualified opinion on the financial statements until sufficient assurance is provided to demonstrate that there is not a material misstatement in the accounts owing to the lack of complete and balanced bank reconciliations. Work is ongoing with the Authority to determine whether sufficient assurance can be gained from other compensating controls to demonstrate that there are no material errors in the financial statements.



- The absence of a robust bank reconciliation represents a serious financial control weakness. We understand that at 31 December 2005 the first balanced reconciliation has been produced following the implementation of the new system. The Council should ensure that arrangements for the production of an accurate and balanced bank reconciliation are in place on an ongoing basis.

### **Qualitative aspects of accounting practices and financial reporting**

- 11 This section of our report includes consideration of the qualitative aspects of the financial reporting process, including items that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the financial statements.

### **Quality of supporting working papers/audit information**

- 12 Our SAS 610 report for the 2003/04 accounts referred to the need to improve the quality of working papers and audit information provided by officers. To promote improvement in the audit process and associated liaison arrangements, we agreed a formal audit protocol with the Authority. This document noted that our proposed audit timetable for 2004/05 was based on the key assumptions that officers would provide appropriate evidence to support the figures in the Accounts in the form of good quality working papers and accounting records. It was agreed by officers that requested information would be provided within agreed timescales and with clear supporting documentation. We also provided full details of the information that we would require to enable us to complete our audit in an economic and efficient manner. We are of the opinion that officers have made little progress in addressing shortcomings in the accounts preparation process and in providing evidence to support the entries in the financial statements.
- 13 We raised concerns regarding the standard of working papers in our SAS 610 report for 2003/04. We recognise that the flooding had an adverse effect on the task of preparing the 2004/05 financial statements. However, notwithstanding this, we wish to bring to your attention that we have encountered further significant problems this year with regard to incomplete audit evidence. In addition, responses to some audit queries have been subject to extensive delay. Prompt and accurate presentation of the Council's annual accounts is a key way in which local authorities demonstrate proper stewardship of public funds. We have concerns that the task of preparing the financial statements and assisting our audit is not given sufficient priority by senior management and this has led to the fourth year in succession in which we have been unable to give our opinion by the due date.
- 14 The accounts as presented for audit contained a significant number of material errors and misstatements. Finance staff were unable to provide suitably amended accounts without significant additional and extensive consultation from ourselves.

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- 15 It is essential that the preparation of the Council's annual financial statements - and support of the audit process - is given a high priority. We do not consider this to be the case at present. There is a need for greater cooperation on the part of council staff to engage with the audit process and to take a joint and proactive approach to problem solving.
- 16 There is a clear need for the Council to demonstrate proper stewardship of public funds by ensuring proper compliance with accounting regulations and providing promptly full supporting evidence in support of material balances in the financial statements in order to avoid any future delays in the certification of the accounts or potential qualification. Members should be aware that the deadlines for adopting the 2005/06 accounts (30 June 2006) and providing the audit opinion (30 September 2006) are a month earlier than those in place for the 2004/05 accounts. We will continue to work with officers to achieve the improvements required, but the Authority needs to ensure that a clear, robust project plan and management arrangements have been established in support of the closedown and audit process.
- 17 A number of non-trifling errors were identified during the 2003/04 audit. It was agreed with officers that these would be corrected during the preparation of the 2004/05 accounts. However, a number of these adjustments were not made. Failure to carry out agreed audit adjustments has added significantly to the problems in preparing and reconciling the financial statements, as well as our audit of them. All agreed action arising from the audit and all agreed amendments to the accounts should be carried out in future.

### Next steps

- 18 We are drawing these matters to the Accounts Committee's attention so that you can consider them before the financial statements are approved and certified.
- 19 In particular, this provides the Committee with the opportunity to amend the financial statements for the unadjusted misstatements/significant qualitative aspects of financial reporting issues identified above. Should you chose not to amend the financial statements, we are required by SAS 610 to request from you a letter of representation explaining why you are not adjusting the financial statements. We ask that the letter specifically details the misstatements and/or qualitative aspects of reporting to which it relates, either in the body of the letter or in a document appended to it.
- 20 As a result of the additional work required to complete this audit - and the additional input required from us to ensure that the adjustments have been put through the accounts correctly - an additional fee will be charged. This will be quantified fully following the completion of the audit.



## Appendix 1 – Draft audit opinion

### Basis of audit opinion

I conducted my audit in accordance with the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission, which requires compliance with relevant auditing standards issued by the Auditing Practices Board.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Council in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Council's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the statement of accounts is free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion, I evaluated the overall adequacy of the presentation of the information in the financial statements.

### Opinion

In my opinion the statement of accounts presents fairly the financial position of Carlisle City Council at 31 March 2005 and its income and expenditure for the year then ended.

### Certificate

I certify that I have completed the audit of the accounts in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.

Signature:.....

Date:.....

Name:.....

Address:.....

## Appendix 2 – Unadjusted non-trifling misstatements

- 21 Our audit has identified the following misstatements in the financial statements which management have decided not to adjust.
- 22 We have asked the Authority to undertake further work necessary to determine the total adjustments required. This may lead to changes in the non-trifling errors shown below and we will update you with final figures once these are known.

**Table 1 Summary of unadjusted non-trifling misstatements**

Error (£)	Comments
134,490	<b>Fixed asset additions</b> Amounts totalling £134,490 have been omitted from additions to fixed assets.
128,000	<b>Fixed assets - overstatement of additions</b> Expenditure incurred in 2004/05 on the installation of an interactive play water feature has been incorrectly shown in the accounts.
428,890	<b>Fixed assets - unadjusted errors brought forward from 2003/04</b> No action has been taken during 2004/05 in respect of the errors identified in 2003/04.
168,151	<b>Deferred charges</b> Accounting requirements state that expenditure and grants should be accounted for on a gross rather than net basis.
696,312 126,662 63,104	<b>Fixed asset restatement account</b> No action has been taken during 2004/05 in respect of the errors identified in 2003/04 for these three amounts.
294,647	<b>CFA - errors brought forward</b> No action has been taken during 2004/05 in respect of the errors identified in 2003/04 for these three amounts.
150,252	<b>Useable capital receipts - errors brought forward</b> No action has been taken during 2004/05 in respect of the errors identified in 2003/04 for these three amounts.

Error (£)	Comments
187,859	<b>Reserve balances - errors brought forward</b> No action has been taken during 2004/05 in respect of the errors identified in 2003/04 for these three amounts.
306,079	<b>AMRA - depreciation charges</b> Depreciation charges have not been calculated correctly.
258,155	<b>CRA appropriation to specified reserves</b> Amounts from the revenue account transferred to specified reserves are understated by £258,155.

- 23 For clarity, each unadjusted non-trifling error has been described above in isolation. Each item has one or more contra entries in the accounts (for example, the purchase of an asset would affect both the cash balance and the fixed assets balance) but the error has been described once to avoid duplication or confusion.

## Appendix 3 – Material adjusted misstatements

- 24 Our audit has identified the following misstatements in the financial statements which management have agreed to adjust. This work is currently ongoing.
- 25 We have asked the Authority to undertake further work necessary to determine the total adjustments required. This may lead to changes in the material adjusted errors shown below and we will update you with final figures once these are known.

**Table 2**

Error (£'000)	Comments
To be confirmed by Authority	<b>Intangible fixed assets/IEG costs</b> Adjustments are required to the disclosure of intangible assets including details of hardware/software costs.
To be confirmed by Authority	<b>Fixed asset valuations</b> The fixed asset note needs to be updated to include revaluations of assets.
To be confirmed by Authority	<b>Fixed assets - duplication of land</b> The accounts are to be amended to remove duplication of land values currently included.
944	<b>Asset management revenue account</b> Disclosure adjustment to show impairment costs as required by accounting practice.
To be confirmed by Authority	<b>Expenditure and financing - note 2</b> Adjustment required to a note to reconcile capital expenditure and financing as required by accounting practice.
393	<b>Work in progress/stock</b> Adjustment required to show this balance as part of amounts due to the Authority rather than as stock.
5,300	<b>Deferred credits/capital receipts</b> Adjustment required to disclose this balance as a usable capital receipt in line with accounting practice.

Error (£'000)	Comments
700	<b>Provisions/deferred charges/revenue account</b> Adjustment required to deferred charges and revenue account disclosures to ensure compliance with accounting practice.
To be confirmed by Authority	<b>Leased vehicles</b> Further work is being taken by the Authority to determine how refuse vehicles should be disclosed as required by accounting standards.
1,000	<b>Contingent liability</b> The financial statements currently show a contingent liability for flooding expenditure in the sum of £1 million. The Authority is to review and adjust the statements if appropriate to ensure this amount is treated in accordance with accounting standards.
To be confirmed by Authority	<b>Consolidated revenue account</b> The Authority are to amend the flooding costs shown in the revenue account to ensure they include all income due and to use the accruals concept as required by accounting standards.
Various	<b>Cash flow statement</b> A number of adjustments were required to the cash flow statement following our audit work.
Various	<b>Statement of total movements in reserves</b> A number of adjustments were required to the statement of total movements in reserves following our audit work.
N/A	<b>Statement of Internal Control</b> The Statement of Internal Control needs to be amended to disclose problems with the bank reconciliation and action being taken by the council to ensure that similar problems do not recur.