

Auditor's report on 2004/05 accounts to the Accounts Committee Commentary Report

Carlisle City Council

Audit 2004/2005

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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.

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Introduction

- 1 This document represents a commentary to accompany the above report (referred to as 'the SAS610 report') which was presented to the Accounts Committee on 15 February 2006.
- 2 The District Auditor is required by professional auditing standards to report to the Council (in this case via the Accounts Committee) the matters arising from the audit of the financial statements prior to giving an opinion on the Council's accounts for the financial year.
- 3 The report contains matters specific to the Council's 2004/05 accounts, but I have also raised some concerns about the Council's wider financial management arrangements and our views as to how arrangements may be improved and taken forward.
- 4 With regard to the 2004/05 accounts, the matters on which the District Auditor is required to report are shown in the six bullets within **Paragraph 1**.
- 5 Our report which members had in front of them at the 15 February meeting represented the situation which was prevailing at 10 February 2006. To update members as to the very latest status of the audit as at 15 February:
 - we have continued to accept submissions from the Council regarding its bank reconciliation. As a result, we are continuing to consider what assurance we have as to the material accuracy of the accounts in this respect. Failure to obtain the necessary assurance may result in a qualification of my opinion on the Council's accounts; and
 - we have yet to receive a full amended set of financial statements which includes the adjustments made in response to the errors identified during the audit.
- 6 As a result of these two outstanding issues, I am unable at this point to confirm that my opinion on the accounts will be unqualified. Appendix 1 of the SAS610 report sets out a draft standard (ie unqualified) audit opinion. I must emphasise again that members should not take this to mean that I am currently in a position to issue such an opinion. Indeed, there is currently a danger that a qualified opinion may prove necessary due to the uncertainty surrounding the Council's bank reconciliation arrangements.

Detailed comments

- 7 **Paragraph 6** outlines the four categories of matters which I am reporting to the Accounts Committee

- 8 **Paragraph 7** deals with the **draft unadjusted misstatements**. These are non-trifling misstatements in the accounts which management has decided not to adjust. These are listed in Appendix 2. The cumulative total of these non-trifling misstatements is not expected to be material. However, I regard the number of misstatements identified to be significant.
- 9 The report by the Director of Corporate Services which accompanies this report asserts that corrections will be made to reflect these non-trifling errors in the 2005/06 accounts. However, it is my belief that the problems encountered with regard to the closure and audit of the 2004/05 accounts have arisen at least in part because of failures by management to correct errors which arose in the 2003/04 accounts (despite it being agreed that the non-trifling 2003/04 errors would be put through in 2004/05 a number of these adjustments were not made and this led to some confusion during the closedown process and at the audit). If management decides not to adjust the errors at the time of the audit then it is imperative that this is done properly before the following year's closedown.
- 10 **Paragraph 8** deals with the **adjusted material misstatements**. These adjustments have been required to ensure that the accounts comply with the relevant professional standards:
- Income due to the Council to offset the costs of the floods had been included in the accounts on an incorrect basis (ie the whole cash amount had been included rather than that amount of income which was properly associated with 2004/05 financial year). The error may be as much as £1 million.
 - The total value of required adjustments to the cash flow statement (which is one of the principal accounting statements) was in excess of £4 million.
 - A number of adjustments (in excess of £2 million) were needed to ensure that the Council's fixed assets are correctly stated.
- 11 Appendix 3 shows all of the material errors which management has agreed to adjust.
- 12 The Director of Corporate Services' report suggests that the levels of significant error are much reduced from 2003/04. I regard the number of material errors in the 2004/05 accounts as significant.
- 13 **Paragraph 10** sets out what I believe to be **material weaknesses in systems of accounting and internal control** within the Council.
- I have already referred to the problems encountered with regard to the Council's bank reconciliation. No bank reconciliations were completed during the whole of 2004/05 and the bank was not reconciled at 31 March 2005. The existence of robust and timely bank reconciliations represents possibly the most fundamental internal financial control aimed at ensuring the accuracy, completeness and integrity of the Council's accounts.
 - The Director of Corporate Services' covering report says that the manual version of the bank reconciliation which was provided did not balance by a few pence. I would like to emphasise that the issue of accuracy of the bank reconciliation is not about a few pence.

While the apparent difference may be small there remains the possibility that this could disguise a far larger error on either the income or expenditure side. The bank reconciliations which have been provided so far have provided little assurance about the accuracy of the Council's accounts. As a result, we have been working (and are continuing to work with) management to try to obtain sufficient assurance from other sources to allow me to provide an unqualified audit opinion. This work is continuing.

- The absence of bank reconciliations represents a serious financial control weakness.

- 14 **Paragraph 11** and subsequent paragraphs set out my **concerns regarding the standard of audit evidence and quality of supporting working papers** and information.
- 15 This problem has been reported in previous years' reports to this Committee and in memoranda to officers. We carried out extensive work with management - prior to the closedown of the 2004/05 accounts and prior to our audit – to try to help the Council respond more effectively to the audit process.
- 16 It is my view that little progress has been made by officers in addressing shortcomings in the accounts preparation process which have been reported in previous years. We have encountered problems with regard to incomplete and delayed provision of audit evidence. I recognise the impact which the floods have had on the Council's operations but I do not believe that the problems can be put down wholly to this issue.
- 17 I draw members' attention to my comments at the end of **Paragraph 13**. This is the fourth year in succession where we have been unable to give our opinion by the due date. Late audit opinions are the exception rather than the norm – certainly there are no other late opinions in Cumbria with respect to the 2004/05 audit year.
- 18 Prompt and accurate presentation of the Council's accounts is a key way in which local authorities demonstrate proper stewardship of public funds. I have real concerns that the Council is not giving this process adequate priority.
- 19 Not only was the Council's response to the audit inadequate, but finance staff have been unable to provide suitable amended accounts without significant and extensive help from ourselves. This (and the delays in the audit process) has necessitated further work from ourselves over and above that set out in our agreed audit plan and protocol. For this reason there will be an additional charge to the Council to reflect the work which we have performed to enable the Council's accounts to get to this stage. The extent of the additional fee will be quantified fully following the completion of the audit.
- 20 The Council needs to demonstrate its commitment to proper stewardship of public funds by ensuring that the accounts preparation and audit process is given suitable priority and by establishing and keeping to a clear, robust and detailed project plan for the closedown and audit programme.

The Council should also note that the timetable for completion of the 2005/06 accounts comes forward by another month (ie accounts approved by end June 2006 and audited by end September 2006). We remain keen to continue to work with officers to achieve the required improvements, but any significant progress will need the full engagement and commitment of officers throughout the process.

- 21** A particularly important issue is that management needs to take greater ownership of the accounts. The accounts are those of the Council – not the District Auditor. The auditor may identify errors but it is for the Council to decide how to respond to them and for the auditor to give an opinion about that response. It is not for the auditor to put entries in the Council's accounts and then audit them.

Next steps

- 22** Going back to the accounts and what happens next:
- We are completing our audit work by working with officers to follow through the errors and associated adjustments which we have identified as necessary and by reviewing the assurances which we are seeking regarding the bank reconciliation. I will update members on progress when this work is complete.
 - This report provides you with the opportunity to amend the statement for the unadjusted misstatements which I have identified in Appendix 2. Should you choose not to amend the statements in these respects I am required to request from you a letter of representation explaining why you are not adjusting the statements.
 - As I have already mentioned, I am unable to say at this stage whether my opinion is likely to be qualified or unqualified. I will advise members as to the outcome of my deliberations at a later date. However, members should be aware that whatever opinion I reach, it will be following formal consultation with Audit Commission technical support staff and it will also be subject to a further comprehensive review by an independent District Auditor.