

Report on the 2004/05 Financial Statements to the Audit Committee - June 2006 Update

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.
- 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, 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

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors/members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

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For further information on the work of the Commission please contact:

Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ

Tel: 020 7828 1212 Fax: 020 7976 6187 Textphone (minicom): 020 7630 0421

www.audit-commission.gov.uk

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Introduction

- 1 Professional auditing standards require auditors to report certain matters arising from the audit of the financial statements to 'those charged with governance': We have agreed with the Council that the communications required under these auditing standards would be with the Accounts Committee and the newly formed Audit Committee. This report sets out for the Committee's consideration the matters arising from the audit of the financial statements for 2004/05 following the amendment of issues identified in our first SAS610 report presented to the Accounts Committee on 15 February 2006.

Status of the audit

- 2 Following consideration of our first SAS610 report, an amended set of financial statements and associated information was received from the authority on 13 April 2006. Our work on these financial statements is now complete.
- 3 At its meeting on 15 February 2006 the Accounts Committee resolved to correct all of the specific non-trifling errors identified by us at the audit regardless of their materiality. This has now been done.
- 4 However, in our first SAS610 report we pointed out that there were a number of issues where further information was needed to determine if an adjustment to the accounts was required. We have now received this information from officers and it has led to the identification of further non-trifling errors and uncertainties in the financial statements. None of these are material and they do not require adjustment for opinion purposes. These items have not been adjusted by management as significant additional work would be required to determine the adjustment needed.
- 5 Although I do not require the Council to address these further errors and uncertainties before giving my opinion on the 2004/05 financial statements, they should be addressed as an urgent priority to prevent them leading to cumulative errors in the 2005/06 accounts. Members should be aware that the basis for calculating materiality in 2005/6 has changed as a result of the introduction of International Standards on Auditing and as a result these adjustments may be considered as material in 2005/6. Appendix 2 to this report identifies these matters for Members' attention.
- 6 We anticipate being able to issue an unqualified opinion. A draft standard audit opinion is attached at Appendix 1.

Matters to be reported to those charged with governance

- 7 As noted in our first SAS610 report, our audit of the Council's financial statements for 2004/05 identified a number of matters requiring consideration by the Accounts Committee. An update on these matters is provided below.
- Draft unadjusted misstatements - these are items which we identified during the audit and which fell below our materiality level and therefore were not preventing us from giving an unqualified opinion. All of these specific errors identified in our previous SAS610 report have now been adjusted.
 - However, Members need to consider what action is to be taken regarding the remaining non-trifling errors and uncertainties (listed in Appendix 2) many of which have been identified since 15 February 2006 following receipt of outstanding information from officers. These errors and uncertainties would require significant additional work to arrive at substantive amendments for the financial statements and as they are not material I do not require them to be addressed before giving my opinion on the 2004/05 accounts. However, if not amended, these issues amended may become cumulatively material in subsequent years and could have a serious impact upon our opinion for 2005/06.
 - Draft adjusted material misstatements - these are items that we identified as requiring correction before an unqualified opinion can be given because they are material to the accuracy and understanding of the financial statements. Work has been completed on all of the material errors identified during the audit.
 - Material weaknesses in the accounting and systems of internal control - the Council 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. We have undertaken significant additional audit work to compensate for the assertions that should have been provided by the bank reconciliation. This has increased significantly the audit fee for the 2004/05 audit year. We understand that the bank reconciliation for 31 March 2006 has not yet been balanced. The bank reconciliation is an essential element of internal control and if the 31 March 2006 reconciliation is not balanced and formatted in an understandable manner then that may affect our ability to give an unqualified opinion the Council's 2005/06 accounts. Members may wish to consider what further information they require on the 31 March 2006 bank reconciliation to enable them to sign the Statement of Internal Control and the Accounts for 2005/06.

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- 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. Significant improvements will be required to the arrangements for preparing the 2005/06 financial statements and supporting working papers as the deadline for the 2005/06 audit opinion is 30 September 2006.

Next steps

- 8 We are drawing these further matters to the Audit Committee's attention so that you can consider them before the financial statements are approved and certified.
- 9 In particular, this provides the Committee with the opportunity to amend the financial statements in response to the remaining unadjusted misstatements and uncertainties, and to respond to the significant qualitative aspects of financial reporting issues identified above. Should you chose not to amend further 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.
- 10 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.
- 11 We have highlighted the need for Members to consider what, if any, action they wish to take to ensure that issues identified in this report which relate to 2005/06 are appropriately addressed. In summary these issues are:
 - completion and balancing of the 31 March 2006 bank reconciliation in auditable format; and
 - adjustments of outstanding non-material adjustments identified in the 2004/05 accounts

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

- 1 Our audit has identified the following misstatements in the financial statements which management have decided not to adjust.
- 2 All material items disclosed in our previous SAS610 report have been adjusted. In some cases further information and detailed work was required to determine the adjustment required. We have confirmed that these errors, both individually and in total, are not material. The total net impact of the remaining unadjusted errors on the Consolidated Revenue Account is £7,590 (credit).
- 3 However, it is essential that these matters are addressed in the ledger and financial statements for 2005/06 to avoid the danger of a qualified opinion if the cumulative balance of unadjusted errors exceeds materiality. Members should ensure that this work is undertaken as an urgent priority to avoid problems in the 2005/06 audit which is due to start in July 2006.

Table 1 Summary of unadjusted non-trifling misstatements

Uncertainties

Error (£)	Comments
Further information required to confirm	<p>Leases</p> <p>The authority has not provided sufficient information to determine the status of leases held for refuse vehicles. We have undertaken testing and confirmed that this uncertainty has not caused a material misstatement in the accounts. The authority needs to determine whether these vehicles are held under finance or operating leases and amend the ledger and 2005/06 accounts accordingly.</p>
Further information required to confirm	<p>Depreciation</p> <p>The authority has not provided sufficient information to determine that depreciation has been correctly applied to fixed assets held. We have undertaken testing and confirmed that this has not caused a material misstatement or uncertainty in the accounts. The authority needs to confirm that depreciation is correctly shown in the ledger and 2005/06 financial statements.</p>

Error (£)	Comments
Further information required to confirm	<p>Assets held by Carlisle Leisure Limited</p> <p>The authority has not provided sufficient information to determine that assets transferred to Carlisle Leisure Limited have been classified correctly in the financial statements. We have undertaken testing and confirmed that this has not caused a material misstatement in the accounts. The figure shown is not an actual error but a projection of the worst case error if all items were incorrectly shown. The authority needs to undertaken a detailed FRS 5 review to determine the correct treatment of these assets.</p>
Further information required to confirm	<p>Flood damaged equipment</p> <p>The authority has not provided sufficient information to determine that flood damaged equipment has been correctly treated in the financial statements. We have undertaken testing and confirmed that this has not caused a material misstatement in the accounts. The authority needs to determine that all flood damaged items are shown correctly in the ledger and accounts.</p>
Further information required to confirm	<p>Sheepmount assets</p> <p>The authority has not provided sufficient information to determine that Sheepmount assets are correctly classified in the fixed assets note categories. We have undertaken testing and confirmed that this has not caused a material misstatement in the accounts. The authority needs to confirm that assets are correctly shown as operational or non operational in the 2005/06 ledger and accounts.</p>
Further information required to confirm	<p>Capital/revenue expenditure</p> <p>The authority has not provided sufficient information to determine that capital and revenue expenditure has been correctly classified. We have undertaken testing and confirmed that this has not caused a material misstatement in the accounts. The authority needs to confirm that capital expenditure has not been posted to revenue in the 2005/06 ledger and accounts.</p>
Further information required to confirm	<p>Preserved right to buy debtor</p> <p>The authority has not provided sufficient information to determine that preserved right to buy debtors are correctly stated in the accounts. We have undertaken testing and confirmed that this has not caused a material misstatement in the accounts. The authority needs to confirm that assets are correctly reconciled to the figures in Carlisle Housing Association audited accounts in the 2005/06 ledger and accounts.</p>

- 4 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

- 5 Our audit has identified the following misstatements in the financial statements which management have adjusted.

Table 2

Error (£'000)	Comments
361	Intangible fixed assets/IEG costs Adjustments are required to the disclosure of intangible assets including details of hardware/software costs.
Note	Fixed asset valuations The fixed asset note needs to be updated to include revaluations of assets.
1,500	Fixed assets - duplication of land The accounts are to be amended to remove duplication of land values currently included.
944	Asset management revenue account Disclosure adjustment to show impairment costs as required by accounting practice.
Note	Expenditure and financing - note 2 Adjustment required to a note to reconcile capital expenditure and financing as required by accounting practice.
393	Work in progress/stock Adjustment required to show this balance as part of amounts due to the Authority rather than as stock.
5,300	Deferred credits/capital receipts Adjustment required to disclose this balance as a usable capital receipt in line with accounting practice.

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Appendix 3 – Material adjusted misstatements

Error (£'000)	Comments
700	Provisions/deferred charges/revenue account Adjustment required to deferred charges and revenue account disclosures to ensure compliance with accounting practice.
1,000	Contingent liability 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.
892	Consolidated revenue account 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	Cash flow statement A number of adjustments were required to the cash flow statement following our audit work.
Various	Statement of total movements in reserves A number of adjustments were required to the statement of total movements in reserves following our audit work.
N/A	Statement of Internal Control 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.
134,490	Fixed asset additions Amounts totalling £134,490 have been omitted from additions to fixed assets.
128,000	Fixed assets - overstatement of additions Expenditure incurred in 2004/05 on the installation of an interactive play water feature has been incorrectly shown in the accounts.
428,890	Fixed assets - unadjusted errors brought forward from 2003/04 No action has been taken during 2004/05 in respect of the errors identified in 2003/04.

Error (£)	Comments
168,151	Deferred charges Accounting requirements state that expenditure and grants should be accounted for on a gross rather than net basis.
696,312 126,662 63,104	Fixed asset restatement account No action has been taken during 2004/05 in respect of the errors identified in 2003/04 for these three amounts.
294,647	CFA - errors brought forward No action has been taken during 2004/05 in respect of the errors identified in 2003/04 for these three amounts.
150,252	Useable capital receipts - errors brought forward No action has been taken during 2004/05 in respect of the errors identified in 2003/04 for these three amounts.
187,859	Reserve balances - errors brought forward No action has been taken during 2004/05 in respect of the errors identified in 2003/04 for these three amounts.
306,079	AMRA - depreciation charges Depreciation charges have not been calculated correctly.
258,155	CRA appropriation to specified reserves Amounts from the revenue account transferred to specified reserves are understated by £258,155.