



Manchester City Council

**Annual report to those charged with
governance 2007/08**

18 September 2008

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1 Introduction

Background and purpose of the report

- 1.1 Manchester City Council ('the Council') is responsible for the preparation of accounts which record its financial position as at 31 March 2008 and its income and expenditure for the year then ended. We are responsible for undertaking an audit and reporting whether, in our opinion, the Council's accounts 'present fairly' the financial position of the Council.
- 1.2 Under the Audit Commission's Code of Audit Practice we are also required to reach a conclusion on whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').
- 1.3 The Audit Commission's Statement of Responsibilities, which sets out the respective responsibilities of the Council and the auditor in relation to the accounts and arrangements for securing economy, efficiency and effectiveness in the use of resources, have been re-produced in full in Appendices A and B and reflect the scope of our audit.
- 1.4 This report summarises the principal matters arising from our audit. The issues raised have been discussed with the City Treasurer and his team and other officers as appropriate. Auditing standards require us, as the Council's external auditors, to report to those charged with governance certain matters before giving an opinion on the accounts and the Code of Audit Practice requires us to report key matters relating to our VFM conclusion. For the Council, this function will be carried out by the Audit Committee at its meeting on 25 September 2008.

The accounts opinion

- 1.5 We have performed our audit of the 2007/08 accounts in accordance with the Audit Commission's Code of Audit Practice and applicable auditing standards. Our approach has varied from that set out in the Audit and Inspection Plan 2007/08, due to previously reported issues with Internal Audit coverage. Consequently, we needed to perform additional work to complete the audit and will be raising a small additional bill to cover the cost of this.
- 1.6 At the time of reporting to the Audit Committee, the audit is substantially complete and, subject to the resolution of a small number of outstanding matters including a final post balance sheet events review, we expect to issue **an unqualified opinion on the Council's accounts** by the 30 September deadline.

- 1.7 The Council has demonstrated commitment to improving the accuracy of its accounts, through:
- active participation in our December 2007 accounts workshop
 - good progress in implementing most of the recommended improvements from the prior year audit
 - early engagement and discussion of key issues
 - good performance in responding to audit queries
 - processing all recommended audit adjustments.
- 1.8 We reported in our Interim accounts report to those charged with governance (June 2008) that, following difficulties with the 2006/07 closedown process, the Council was better prepared for the production of the 2007/08 accounts. By implementing a comprehensive closedown plan and introducing electronically filed audit working papers, the Council produced the 2007/08 accounts and working papers in good time.
- 1.9 We are pleased to note that the level of proposed adjustments reduced from last year. We recommended a small number of significant adjustments to the Council's 2007/08 and prior year figures, which had the overall effect in 2007/08 of:
- reducing the deficit on the income and expenditure account by £8.6m
 - reducing the general fund by £1.4m
 - reducing other reserves by £20.9m.
- 1.10 We also identified:
- a number of accounting and presentational adjustments to improve disclosures
 - some control improvements for the Council to address in future years.
- 1.11 Management agreed to process all of the recommended adjustments and agreed to implement actions to address the identified control issues.
- 1.12 The Council's ambition is to become a top rated authority under the Comprehensive Area Assessment (CAA) framework in the next two years. During this time, the Council will have to prepare for and implement accounting under International Financial Reporting Standards (IFRS). The Council will need to plan carefully and commit sufficient resource to further improve the quality of its financial reporting to meet these significant challenges. We will continue to help support the Council in addressing these changes through our annual accounts workshops and early discussion of key issues.
- 1.13 Further details of our accounts audit are given in section two.

The VFM conclusion

- 1.14 We have substantially completed our work on the Council's arrangements for achieving economy, efficiency and effectiveness in its use of resources and we expect to issue an **unqualified VFM conclusion** by the 30 September deadline. This is based on our assessment that the Council has at least adequate arrangements, during 2007/08, in respect of all of the areas covered by the conclusion.
- 1.15 Audit work that has contributed to the VFM conclusion has been reported to the Council in the Audit Commission's January 2008 use of resources and data quality reports, our Interim accounts report to those charged with governance (June 2008) and other local use of resources reports issued during the year.
- 1.16 In giving our VFM conclusion, we have also considered emerging findings from our 2008 use of resources key lines of enquiry (KLoE) assessment. Following national submission of our KLoE scores and Audit Commission quality assurance, we will write to the Council confirming 2008 KLoE scores, in December 2008.
- 1.17 With the exception of reported difficulties with Internal Audit arrangements, the Council has undertaken a significant amount of organisational development work during the year, including improvement of the governance framework, partnership governance and risk management.
- 1.18 Through our reports and presentations to management and members, we have emphasised the importance of co-ordinating the various strands of development activity to ensure that they complement each other and make the most effective use of the Council's management resource.
- 1.19 In summer 2009, we will carry out our first use of resources audit under the new CAA framework, which will be more challenging in requiring demonstration of the outcomes resulting from organisational arrangements. To achieve its CAA ambitions, the Council will need to invest heavily in further improving its management arrangements. After the Audit Commission has issued its use of resources 2009 guidance, we will meet with management in late October to facilitate preparation for next year's assessment.
- 1.20 Further details of work to support our VFM conclusion are given in section three.

Use of this report

- 1.21 This report has been prepared solely for use by the Council to discharge our responsibilities under the Audit Commission Code of Audit Practice and relevant auditing standards and should not be used for any other purpose. No responsibility is assumed by us to any other person. This report should be read in conjunction with the Council's draft letter of representation.
- 1.22 This report includes only those matters that have come to our attention as a result of performance of the audit. An audit of the accounts and use of resources is not designed to identify all matters that may be relevant to those charged with governance. Accordingly the audit does not ordinarily identify all such matters.

- 1.23 We would like to take this opportunity to remind the Audit Committee of the need to monitor implementation of the recommendations arising out of this report (see Appendix C) and other reports issued during the year (see Appendix E).

Independence

- 1.24 We are able to confirm our independence and objectivity as auditors and note the following:
- we are independently appointed by the Audit Commission
 - the firm has been assessed by the Audit Commission as complying with its required quality standards
 - the appointed auditor and client service manager are subject to rotation periodically
 - we comply with the Auditing Practices Board's Ethical Standards. We have not undertaken any non-audit work for the Council (Appendix F).

Acknowledgements

- 1.25 We would like to record our appreciation for the co-operation and assistance provided to us by the Council's management, officers and members during the course of our audit.

Grant Thornton UK LLP
18 September 2008

2 The accounts opinion

Introduction

- 2.1 We summarise in this section matters arising from our audit of the Council's 2007/08 accounts which we are required, under auditing standards, to report to those charged with governance.

Approach to the audit

- 2.2 We carry out work to enable us to report to the Council our opinion as to whether the financial statements 'present fairly' the financial position of the Council in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2007 ('the SoRP').
- 2.3 Our approach to the audit was set out in our 2007/08 audit plan. We have planned our audit in accordance with international auditing standards and the Audit Commission's Code of Audit Practice.
- 2.4 Our normal audit approach is to determine whether key controls are operating effectively within core financial systems, which allows us to place reliance on the key accounting systems operating at the Council. We reported in our Interim accounts report to those charged with governance (June 2008), that we were unable to place reliance on Internal Audit's work on core financial systems for our final accounts audit due to insufficient coverage.
- 2.5 This means that we have had to alter our planned approach to the audit, which has involved a greater level of detailed substantive testing. We have previously indicated to management and the Audit Committee that this additional work would result in additional audit fee and we can now confirm this as £15,000.
- 2.6 In order to be able to place reliance on key accounting systems for our 2008/09 audit, we are liaising with Internal Audit to ensure it delivers a programme of work to provide assurance on the effective operation of key controls. Internal Audit will update the Audit Committee during 2008/09 with progress against this plan.
- 2.7 We have also tested a number of IT controls for the purposes of our accounts opinion and will report our findings and recommendations separately to the Council in October 2008.

Key audit findings

2.8 We summarise our key audit findings below:

Area	Key messages
Accounting policies and practices	<p>The Council has adopted appropriate accounting policies, in accordance with the 2007 SoRP.</p> <p>There were a number of areas in which the draft accounts did not, in our view, comply with the 2007 SoRP, relating to:</p> <ul style="list-style-type: none"> • allocation of premia arising from debt restructuring, where the treatment previously agreed with the Audit Commission is no longer allowable under the 2007 SoRP • Local Public Service Agreement (LPSA) grant income which, following confirmation that the Council has achieved performance reward targets, should be recognised in the 2007/08 accounts • ensuring that there is sufficient evidence to support the calculation of general bad debt provisions based upon current debt collection rate data. <p>We have discussed these matters with management, who have agreed to process adjustments to the accounts and improve procedures for next year. Further details are provided in Appendix C.</p> <p>We have discussed a number of areas where the clarity of disclosure of accounting policies and prior year adjustments can be improved and we will continue to work with management to support the implementation of these improvements.</p> <p>Following agreement of a number of amendments we are satisfied that the relevant financial information disclosed in the Explanatory Foreword is consistent with the accounts.</p>
Material risks and exposures	<p>The Council has confirmed in its draft letter of representation that it has no material risks and exposures, to date, which should be reflected in the accounts.</p> <p>Our audit procedures have not identified any significant risks and exposures to the Council, to date, which should be reflected in the accounts.</p> <p>This review will be updated on the date the Council signs the final letter of representation and we sign our audit opinion.</p>

Area	Key messages
Audit adjustments	<p>We recommended a small number of significant adjustments to the 2007/08 accounts and the prior year figures. The adjustments to the 2007/08 accounts have resulted in a decrease in the reported deficit of £8.6m, largely due to the earlier recognition of £4.3m LPSA income, and a decrease in general fund reserves of £1.4m.</p> <p>An explanation of the most significant adjustments is set out overleaf. We also recommended a number of presentational adjustments to improve clarity of disclosure in the accounts.</p> <p>Management agreed to process all proposed adjustments which are set out in Appendix D. There are currently no unadjusted errors to report to the Audit Committee.</p>
Other matters	<p>The overall quality of the Council's working papers to support the 2007/08 accounts was good, and improved from last year. The Council has been innovative in providing all working papers in an electronic filing system and has performed well in responding to audit queries and agreeing required amendments.</p> <p>We received, and the Audit Committee approved, the draft accounts on 27 June 2008.</p> <p>The appointed day for electors to ask the auditor questions on the accounts was 6 August 2008. We received no questions or objections from the public in relation to the accounts.</p> <p>Having considered the Council's medium term financial strategy and 2008/09 budgets we agree that it is appropriate for the Council to account on a going concern basis.</p> <p>We have made recommendations in respect of a number of control issues identified from the accounts audit. The most significant of these relate to:</p> <ul style="list-style-type: none"> • ensuring that sufficient management review of HRA accounting takes place prior to submission for audit, to prevent avoidable errors • improving procedures for calculating and evidencing general bad debt provisions <p>We have also recommended that the Council prepares for future changes to local government accounting that will require different accounting for areas such as PFI, treatment of assets and financial instruments.</p> <p>We reported previously that the Annual Governance Statement was consistent with our knowledge of the Council.</p> <p>We have not identified any matters, that we have not already reported, that require the attention of the Audit Committee.</p> <p>We have discussed these and other matters arising with the City Treasurer and his team and have reflected their responses to the matters raised in the Action Plan attached at Appendix C.</p>

Significant changes to the accounts

Prior year adjustments made by the Council in the draft accounts

- 2.9 Following our early accounts meetings, the Council included a number of prior year adjustments in the draft 2007/08 accounts to correct entries in the 2006/07 accounts to reflect changed accounting, in order to ensure that the accounts are comparable year on year. The impact of these adjustments on the income and expenditure account was to turn the 2006/07 surplus of £134.8m into a deficit of £461.4m, and the value of the balance sheet reduced by £166.4m. These adjustments had no impact on the Council's reserves.
- 2.10 The reasons for the most significant of the prior year adjustments made to the draft accounts were explained to Audit Committee in May 2008, including:
- Large Scale Voluntary Transfer (LSVT) - the Council corrected a prior year error, based on external audit advice at the time, in accounting for the disposal of Council houses, leading to an increase in the recorded loss of £586.7m.
 - Downward valuation of schools and playing fields of £146.6m - this adjustment was made to facilitate comparison between years, following correction of an error made when schools and playing fields were last valued.
 - Improving presentation of the Statement of Total Recognised Gains and Losses by eliminating non-SoRP compliant entries, through processing a number of other corrections to the prior year accounts.

Prior year adjustments made as a result of the final accounts audit

- 2.11 The Council has processed additional adjustments to 2006/07 figures following our audit. The most significant of these relate to accounting for premia and discounts arising from debt rescheduling. We have discussed with the Council over recent months the most appropriate accounting treatment to fully comply with the 2007 SoRP and statutory requirements. The Council has made two prior year adjustments:
- The Council agreed to write off £26.3m premia to the income and expenditure account, funded from reserves. This fully resolves the historical undercharge to revenue reserves that the Council had been correcting over 10 years, in agreement with the Audit Commission.
 - The Council reclassified premia and discounts that were accounted for as part of replacement loans as overhanging premia and discounts not attributable to replacement loans. This resulted in an increase of £21.3m to loan liabilities on the balance sheet, with a corresponding increase in the financial instruments adjustment account.

2007/08 adjustments

- 2.12 We recommended a number of adjustments to the 2007/08 accounts, which have been accepted and processed by management. These have resulted in a decrease in the reported deficit of £8.6m and a decrease in general fund reserves of £1.4m.
- 2.13 The most significant adjustment that impacts on the deficit is the recognition of an additional £4.3m of LPSA performance reward grant income. The Council's LPSA2 scheme was completed on 31 March 2008. At this date the Council had earned entitlement to £4.3m grant income, but had not verified its performance against the targets when the draft accounts were produced. This income should be recognised in the 2007/08 accounts, although payment will not be received until 2008/09 and 2009/10.
- 2.14 The Council has amended the 2007/08 accounts to include this income. This adjustment decreases the 2007/08 deficit by £4.3m, however, there is no effect on general fund reserves as the income has been transferred to earmarked reserves.
- 2.15 It was identified that the Council had incorrectly charged £3.5m to the income and expenditure account in relation to premia and discounts. The Council agreed to correct the income and expenditure account. There is no overall impact on the general fund balance as there is a corresponding adjustment to the Statement of Movement on General Fund Balance.
- 2.16 The other significant adjustment to the 2007/08 accounts is in relation to the LSVT that occurred during the year. Whilst the Council correctly accounted for the loss on disposal, resulting from the transfer of properties at nil consideration, the income and expenditure account showed the gross loss on disposal and disclosed the associated repayment of related debt separately.
- 2.17 In order to demonstrate the actual loss on disposal of assets, the Council should have included the repayment of debt in the calculation of the loss on disposal. Management clarified the proper treatment during the audit and processed a presentational adjustment. This has resulted in a movement of £142.8m between headings in the income and expenditure account, with no impact on either the reported deficit or reserves.
- 2.18 The impact on the reported deficit and the general fund, of these and other audit adjustments, is set out in the tables overleaf. Further details for the other adjustments shown can be found at Appendix D.

Reconciliation of movement of surplus / (deficit) on the I&E	£m
Draft surplus / (deficit) for the year	(184.5)
Reduced schools expenditure	0.4
Reduced rent income and expenditure	(1.7)
Increased HRA subsidy	1.3
Increased gain on disposal of fixed assets	0.8
Additional performance reward grant	4.3
Reduction in premia and discounts charged	3.5
Amended surplus / (deficit) for the year	(175.9)

Reconciliation of movement on general fund reserves	£m
Draft general fund reserves	29.0
Additional interest allocation from general fund to HRA	0.3
Reduced rent income and expenditure	(1.7)
Amended general fund reserves	27.6

Next steps

- 2.19 We will continue to work with the Council to ensure that outstanding finalisation issues are completed in time for the accounts opinion to be formally signed in accordance with the statutory deadline of 30 September 2008.
- 2.20 Subject to satisfactory resolution of a small number of outstanding issues, we expect to issue an **unqualified opinion on the Council's accounts**.
- 2.21 We are required to provide an audit opinion on the consolidation pack that is to be completed as part of Whole of Government Accounts. This work is not covered by our opinion on the Council's accounts. We will complete this work once the accounts audit has been finalised and in time for the 3 October deadline.
- 2.22 The Audit Committee should monitor implementation of the recommendations arising from this report.

3 The VFM conclusion

Introduction

- 3.1 Under the Audit Commission's Code of Audit Practice we are required to reach a conclusion on whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion'). In meeting this responsibility we review evidence that is relevant to the Council's corporate performance management and financial management arrangements, which are assessed against twelve criteria specified in the Code of Audit Practice.

Approach to the audit

- 3.2 The following pieces of work have informed our assessment against the Code criteria:
- review of relevant findings from the Council's Comprehensive Performance Assessment (CPA) Direction of Travel statement
 - assessment of the Council's data quality management arrangements, using criteria prescribed by the Audit Commission
 - assessment of the Council's arrangements for financial reporting, financial management, financial standing, internal control and value for money, using the Commission's key lines of enquiry (KLoE)
 - other local risk based use of resources work set out in our 2007/08 plan.
- 3.3 The key findings from each of these pieces of work are summarised in this section of the report.

VFM conclusion

- 3.4 We have substantially completed our work on the Council's arrangements for achieving economy, efficiency and effectiveness in its use of resources and we expect to issue an **unqualified VFM conclusion** by the 30 September deadline.

3.5 Our conclusions for each of the 12 Code criteria are set out in the table below:

Code area	Source of evidence	Arrangements adequate?
Setting, reviewing and implementing strategic and operational objectives	Direction of travel statement	Yes
Communication with service users and other stakeholders and partners	Direction of travel statement	Yes
Management of performance against strategic objectives	Direction of travel statement	Yes
Monitoring the quality of published performance information	Data quality audit 2007	Yes
Maintaining a sound system of internal control	KLoE 2007	Yes
Managing significant business risks objectives	KLoE 2007	Yes
Managing and improving value for money	KLoE 2007	Yes
Maintaining a medium-term financial strategy	KLoE 2007	Yes
Ensuring that spending matches available resources	KLoE 2007	Yes
Managing performance against budgets	KLoE 2007	Yes
Managing the asset base	KLoE 2007	Yes
Promoting and ensuring probity and propriety in the conduct of business	KLoE 2007	Yes

Direction of Travel statement

- 3.6 We are required to review the Council's latest corporate assessment or Direction of Travel statement in order to satisfactorily conclude on three of the Code criteria (see table above). In completing this work we are not required to re-perform the work of the corporate assessment team and the comprehensive area assessment lead, rather we are looking to place reliance on this work.
- 3.7 Our assessment is based on the latest Direction of Travel statement, dated March 2008. Based on this work, we assess the Council as having adequate arrangements for objective setting, consultation and performance management.

Data quality audit 2007

- 3.8 The audit work that we have used to reach our conclusion in respect of Code criterion on published performance information is the Audit Commission's 2007 audit of the Council's corporate management arrangements for data quality (January 2008).
- 3.9 The audit concluded that the Council's management arrangements for data quality are adequate. However, a number of recommendations were identified for the Council to address and these were agreed in the report.
- 3.10 Our 2008 review of data quality management arrangements, which is nearing completion, supports our conclusion that the Council's arrangements are adequate for monitoring the quality of published performance information.

Use of resources KLoE 2007 and local risk based work

- 3.11 We draw upon and update the findings from the Audit Commission's 2007 key lines of enquiry (KLoE) audit work in order to satisfactorily conclude on a number of the VFM Code criteria. The results of this work, and associated recommendations, were included in the CPA Use of Resources report of January 2008. The Council's arrangements were assessed as at least adequate in all areas relevant to the VFM conclusion.
- 3.12 We included in our 2007/08 audit plan, a number of pieces of local risk based use of resources work, which have been used to update and supplement the results of the 2007 KLoE assessment in key areas. We have reported the results of this work to the Council during the year. The key messages from our local risk based work are set out in the table overleaf.

Local risk based work	Key messages
<p>Interim accounts report to those charged with governance</p> <p>Relevant to internal control area of VFM conclusion</p> <p>(Reported to Audit Committee June 2008)</p>	<p>We concluded that the Council had adequate arrangements in place for producing the AGS, based on a new, structured system of assurance gathering.</p> <p>The Council has developed a plan to further develop its governance and assurance gathering processes. These planned developments, when implemented, will further strengthen the Council's governance arrangements.</p>
<p>Review of Internal Audit arrangements</p> <p>Relevant to internal control area of VFM conclusion</p> <p>(Reported to Audit Committee June 2008)</p>	<p>We concluded that that Internal Audit does not fully comply with the CIPFA Code of Practice for Internal Audit.</p> <p>We identified a number of improvement opportunities and agreed an action plan with management. The highest priority actions are for the Council to formally clarify the role and function of Internal Audit, within an integrated framework of governance, and finalise and resource an agreed structure.</p>
<p>Review of risk management arrangements</p> <p>Relevant to internal control area of VFM conclusion</p> <p>(Reported to Audit Committee June 2008)</p>	<p>We concluded that the Council has made reasonable progress in implementing a system of risk management, coming from inadequate arrangements three years ago. There is evidence of improved awareness of risk, and risk registers have now been developed for all areas of the Council's activities.</p> <p>We identified a number of areas where the Council needs to further develop its arrangements including:</p> <ul style="list-style-type: none"> • ensuring that risks are being managed and controlled by departments throughout the year, through regular maintenance of risk registers • demonstrating consideration of risk when making key decisions and initiating major projects • developing procedures, registers, training, corporate support and partnership risk management. <p>Following completion of the risk management SIP, the Council has begun to implement the agreed action plan.</p>

Local risk based work	Key messages
<p>Review of partnership management arrangements</p> <p>Relevant to performance management, financial management, internal control and value for money themes of VFM conclusion</p> <p>(Reported to Audit Committee March 2008)</p>	<p>During the year, the Council implemented a new Partnership Governance Framework (PGF), designed to identify all significant partnerships, create and maintain a central record of governance, financial, risk and performance management arrangements and assess how partnerships provide VFM.</p> <p>We recommended that the Council ensures that PGF processes going forward are clarified, including arrangements for periodic review of the significant partnerships list, monitoring and review of actions to address identified assurance gaps, and officer resource required to maintain framework arrangements.</p> <p>We also recommended that the Council strengthens arrangements in a number of areas, including demonstrating the value for money of partnership working and introducing robust risk, financial and performance management arrangements for significant partnerships.</p>
<p>Review of management of external funding</p> <p>Relevant to performance management, financial management and value for money themes of VFM conclusion</p> <p>(Reported to Audit Committee June 2008)</p>	<p>We concluded that the Council has well developed arrangements in place to manage externally funded capital projects throughout the project life cycle of project appraisal, delivery, completion and evaluation. These arrangements have enabled the Council to be proactive in seeking external funding and achieve success in regenerating Manchester through securing significant external funding.</p> <p>Our work identified areas where the Council could extend the capital project management arrangements for externally funded projects to revenue funding streams. We also recommended that the Council should develop an overall external funding strategy to ensure that key elements of external funding management are consistently applied across the Council.</p> <p>Management has agreed an action plan to implement our recommendations and have already taken steps to strengthen arrangements, particularly through the proposed development of a revenue 'Gateway' process to improve arrangements for the assessment of externally funded revenue projects.</p>

- 3.13 The results of this work confirm that, for 2007/08, the Council had at least adequate arrangements in place in the areas covered by the KLoE 2007 assessment.

KLoE 2008

- 3.14 Our 2008 KLoE assessment is underway. We are not able to formally report scores to the Council until after the Audit Commission's national quality assurance processes are complete. We can, however, confirm that no issues have arisen to date that impact on the VFM conclusion. We will report the results of our work and confirm scores with the Council in December 2008.

KLoE 2009

- 3.15 There have been significant changes to the use of resources assessment criteria for 2009, as part of the new Comprehensive Area Assessment. The Council's management arrangements for the 2008/09 financial year will be assessed against the new criteria that represent a 'harder test,' with a greater focus on outcomes resulting from organisational arrangements.
- 3.16 Whilst we will not formally assess the Council against the new criteria until Summer 2009, as part of next year's plan, we will continue to carry out our use of resources work with reference to revised requirements to help the Council prepare for future assessments.

Next steps

- 3.17 We will carry out our final review against any emerging findings and will then issue our VFM conclusion by the 30 September deadline.
- 3.18 The Audit Committee should monitor implementation of the recommendations referred to in this report.

Appendix A Statement of responsibilities - accounts

The accounts, which comprise the published accounts of the audited body, are an essential means by which it accounts for its stewardship of the resources at its disposal and its financial performance in the use of those resources.

It is the responsibility of the audited body to:

- put in place systems of internal control to ensure the regularity and lawfulness of transactions
- maintain proper accounting records
- prepare accounts that present fairly the financial position of the body and its expenditure and income.

The audited body is also responsible for preparing and publishing with its accounts a statement on internal control.

Auditors audit the accounts and give their opinion, including:

- whether they present fairly the financial position of the audited body and its expenditure and income for the year in question
- whether they have been prepared properly in accordance with relevant legislation and applicable accounting standards.

Subject to the concept of materiality, auditors provide reasonable assurance that the accounts:

- are free from material misstatement, whether caused by fraud or other irregularity or error
- comply with statutory and other applicable requirements
- comply with all relevant requirements for accounting presentation and disclosure.

Auditors examine selected transactions and balances on a test basis and assess the significant estimates and judgements made by the audited body in preparing the statements.

Auditors evaluate significant financial systems, and the associated internal controls, for the purpose of giving their opinion on the accounts. Where auditors identify any weaknesses in such systems and controls, they will draw them to the attention of the audited body, but they cannot be expected to identify all weaknesses that may exist.

Auditors review whether the Annual Governance Statement has been presented in accordance with relevant requirements and report if it does not meet these requirements or if it is misleading or inconsistent with other information of which the auditor is aware. In doing so auditors take into account the knowledge of the audited body gained through their work in relation to the audit of the accounts and through their work in relation to the body's arrangements for securing economy, efficiency and effectiveness in the use of its resources. Auditors are not required to consider whether the statement on internal control covers all risks and controls, nor are auditors required to form an opinion on the effectiveness of the audited body's corporate governance procedures or risk and control procedures.

Appendix B Statement of responsibilities - VFM

It is the responsibility of the audited body to put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, and to ensure proper stewardship and governance, and regularly to review the adequacy and effectiveness of them. Such corporate performance management and financial management arrangements form a key part of the system of internal control and comprise the arrangements for:

- establishing strategic and operational objectives
- determining policy and making decisions
- ensuring that services meet the needs of users and taxpayers and for engaging with the wider community
- ensuring compliance with established policies, procedures, laws and regulations
- identifying, evaluating and managing operational and financial risks and opportunities, including those arising from involvement in partnerships and joint working
- ensuring compliance with the general duty of best value, where applicable
- managing its financial and other resources, including arrangements to safeguard the financial standing of the audited body
- monitoring and reviewing performance, including arrangements to ensure data quality
- ensuring that the audited body's affairs are managed in accordance with proper standards of financial conduct, and to prevent and detect fraud and corruption.

The audited body is responsible for reporting on these arrangements as part of its annual statement on internal control.

Auditors have a responsibility to satisfy themselves that the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

In meeting this responsibility auditors should review and, where appropriate, examine evidence that is relevant to the audited body's corporate performance management and financial management arrangements, as summarised above, and report on these arrangements.

Auditors are responsible for reporting annually their conclusion, having regard to relevant criteria specified by the Audit Commission, as to whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. Auditors report if significant matters have come to their attention that prevent them from concluding that the audited body has put in place proper arrangements. However, auditors are not required to consider whether aspects of the audited body's arrangements for securing economy, efficiency and effectiveness in its use of resources are effective.

In planning their audit work in relation to the arrangements for securing economy, efficiency and effectiveness in the use of resources, auditors consider and assess the relevant significant business risks. These are the significant operational and financial risks to the achievement of the audited body's statutory functions and objectives, which apply to the audited body and are relevant to auditors' responsibilities under the Code, and the arrangements it has put in place to manage these risks. The auditor's assessment of what is significant is a matter of professional judgement and includes consideration of both the quantitative and qualitative aspects of the item or subject matter in question. Auditors discuss their assessment of risk with the audited body.

When assessing risk auditors consider:

- the relevance and significance of the potential business risks faced by all bodies of a particular type
- other risks that apply specifically to individual audited bodies
- the audited body's own assessment of the risks it faces
- the arrangements put in place by the body to manage and address its risks.

In assessing risks auditors have regard to:

- evidence gained from previous audit work, including the response of the audited body to previous audit work
- the results of assessments of performance carried out by the Commission
- the work of other statutory inspectorates
- relevant improvement needs, identified in discussion with the Commission or other statutory inspectorates.

Where auditors rely on the reports of statutory inspectorates as evidence relevant to the audited body's corporate performance management and financial management arrangements, the conclusions and judgements in such reports remain the responsibility of the relevant inspectorate or review agency.

In reviewing the audited body's arrangements for its use of resources, it is not part of auditors' functions to question the merits of the policies of the audited body, but auditors may examine the arrangements by which policy decisions are reached and consider the effects of the implementation of policy. It is the responsibility of the audited body to decide whether and how to implement any recommendations made by auditors and, in making any recommendations, auditors should avoid any perception that they have any role in the decision making arrangements of the audited body.

While auditors may review audited bodies' arrangements for securing economy, efficiency and effectiveness in the use of resources, they cannot be relied on to have identified every weakness or every opportunity for improvement. Audited bodies should consider auditors' conclusions and recommendations in their broader operational or other relevant context.

Auditors are not required to report to audited bodies on the accuracy of performance information that the audited bodies publish. Auditors' work is limited to a review of the systems put in place by the audited body to collect, record and publish the information, in accordance with guidance issued by the Commission.

Audit work in relation to the audited body's arrangements to ensure that its affairs are managed in accordance with proper standards of financial conduct, and to prevent and detect fraud and corruption, does not remove the possibility that breaches of proper standards of financial conduct, or fraud and corruption, have occurred and remained undetected. Nor is it auditors' responsibility to prevent or detect breaches of proper standards of financial conduct, or fraud and corruption, although they will be alert to the possibility and will act promptly if grounds for suspicion come to their notice.

Appendix C Action plan

Finding	Actions required	Management response	Implementation details
<p>HRA accounting</p> <p>Last year, as a result of a number of required audit amendments, the Audit Commission recommended that the Council perform better checking of HRA accounting prior to audit.</p> <p>In 2007/08, although the number of required audit amendments has reduced, there remained a number of adjustments in relation to HRA accounting (Appendix D).</p>	<p>The Council should improve its validation checking on HRA accounting prior to submission of accounts for audit.</p>	<p>Improved validation in relation to the HRA will be undertaken.</p>	<p>A senior officer will undertake a validation check of the HRA prior to finalisation of the 2008/09 accounts.</p>

Finding	Actions required	Management response	Implementation details
<p>Income recognition for LPSA2 grant</p> <p>FRS5 Application Note G provides guidance on how to account for grant income. The Council should recognise income at the point it has earned entitlement to it, not when the income is actually received.</p> <p>The Council's LPSA2 scheme was completed on 31 March 2008. At this date the Council had earned entitlement to £4.3m grant income, although this grant will not be received until 2008/09 and 2009/10. When producing the draft accounts the Council had not verified its performance against the targets.</p> <p>The Council has amended the 2007/08 accounts to include this income (Appendix D). This adjustment decreases the 2007/08 deficit by £4.3m, however, there is no effect on general fund reserves as the income has been transferred to earmarked reserves.</p> <p>The Council does not have income recognition guidance in place.</p>	<p>The Council should issue guidance to financial managers on recognising and accounting for grant income.</p>	<p>Guidance will be issued on recognising and accounting for grant income. In such cases as this where the entitlement to the grant has not been validated a prudent view will be taken.</p>	<p>Guidance will be issued as part of the guidance issued before the start of the 2008/09 year end accounts process. This will be reinforced at briefing sessions to be held with finance officers and also at 2007/08 accounts review meetings.</p>

Finding	Actions required	Management response	Implementation details
<p>Accounting for commercial property rents</p> <p>The council maintains a separate system to administer commercial property rents. The system issues invoices on a monthly basis but the terms vary in length and may be in advance or in arrears. It was identified that income and expenditure had been included for a 12 month period that did not match the 2007/08 financial year. An adjustment was proposed and accepted by management (Appendix D).</p> <p>The net effect of the adjustment is to increase the 2007/08 deficit and reduce the general fund reserves by £1.7m</p>	<p>The Council should undertake year end reconciliations of the commercial property rents system to ensure that income and expenditure is recognised in the correct accounting period.</p>	<p>Year end reconciliations will be undertaken to ensure that income and expenditure is recognised in the current accounting period.</p>	<p>Discussions have already started with the Finance staff involved to ensure that the correcting accounting adjustments are input at each period end and at year end. This will be reinforced during briefing sessions with finance officers and as part of the year end guidance issued.</p>
<p>Housing rents debtors</p> <p>The housing rents system includes debts relating to repairs and maintenance charges that have been raised in error due to a system issue. Whilst these debts have a provision against them, and are not material in total (£260k), rent debtor accounts should be reviewed to remove these erroneous repairs and maintenance charges.</p>	<p>The Council should review the repairs and maintenance debtors on the housing rents system and remove erroneous debtors and associated bad debt provisions.</p>	<p>Agreed. This happened following the introduction of the new rents system.</p>	<p>Now corrected so that a sundry debtor is raised rather than adding the debt to the rent account</p>

Finding	Actions required	Management response	Implementation details
<p>NNDR reconciliation records</p> <p>National non-domestic rate debtor balances should agree to underlying system reconciliations, including arrears and overpayments reports.</p> <p>The NNDR system contains live data that is updated daily and it is therefore important that the Council retains reconciliations performed at year end.</p> <p>The required supporting evidence, as at 31 March was not made available by the Council, which meant that we had to perform additional audit work to support the NNDR debtor balances shown in the accounts.</p>	<p>The Council should ensure that the required year end supporting national non-domestic rate evidence is made available to audit.</p>	<p>Copies of the supporting evidence for the NNDR reconciliations will be made available to External Audit.</p>	<p>Copy of system balances and debtor lists will be made available in the final accounts document library for future years.</p>

Finding	Actions required	Management response	Implementation details
<p>General bad debt provisions</p> <p>The 2007 SoRP requires the Council to review categories of debtors and use past experience to judge the percentage of each type of debt that will not be recovered. The council should prepare working papers setting out the basis of the percentages used.</p> <p>In 2006/07 the Council introduced a general bad debt provision calculation based upon the experience of officers, supported by financial ledger analysis. These percentages have been used again in 2007/08. However, the Council was initially unable to provide supporting working papers to confirm that these percentages remain an accurate basis for the provision. The Council ultimately provided current year debt collection data which supports the percentages used in 2007/08.</p>	<p>The Council should better evidence the appropriateness of the bad debt provision based on up to date collection data.</p>	<p>The Council will review the method of calculations of the 2008/09 bad debt provisions to ensure that it remains appropriate. An audit trail will be maintained to support the assessment.</p>	<p>Discussions will be held with finance staff to ensure the calculation of bad debt provisions is appropriate and adequately evidenced. Assistance will be provided on this and the calculations will be reviewed centrally.</p>

Finding	Actions required	Management response	Implementation details
<p>Capitalisation policy</p> <p>The Council has put in place a capitalisation policy to ensure that expenditure on fixed assets is capitalised in accordance with relevant accounting guidance.</p> <p>Whilst our audit work has not shown any accounting errors in this area, inclusion in the policy of relevant guidance for capitalisation of expenditure on intangible assets or expenditure that does not enhance the value of an asset will help ensure consistency of accounting treatment in the future.</p>	<p>The Council should extend the current capitalisation policy to include guidance on the treatment of intangible assets and non-enhancing capital expenditure.</p>	<p>The capitalisation policy will be extended to guidance on the treatment of intangible assets and non-enhancing capital expenditure.</p>	<p>The guidance will be extended and issued to finance staff who will be briefed on this. Detailed guidance on non-enhancing capital expenditure will be provided.</p>

Finding	Actions required	Management response	Implementation details
<p>PFI</p> <p>In our Interim accounts report we recommended that the Council ensures that it retains a clear audit trail of accounting and audit opinions in relation to significant and complex transactions, such as PFI.</p> <p>During the final audit, we have discussed the issue of Council house de-recognition with management and were provided with a justification for the assets being held off the Council's balance sheet, which we have accepted.</p> <p>Accounting for PFI will change significantly with the requirement to account under IFRS from 2010/11. Early indications from the NHS are that this will involve a significant degree of analysis to identify appropriate accounting entries under IFRS, as well as the reversal of existing accounting. The Council will need to ensure that it retains sufficient records, and commits sufficient resource to support this exercise, which may take place in 2009-10.</p>	<p>The Council should ensure that it retains sufficient records, and commits sufficient resource to support the forthcoming significant challenge of accounting for PFI under IFRS.</p>	<p>The Council will ensure it retains sufficient records and commits sufficient resources to deal with this issue.</p>	<p>A document library will be set up to retain all accounting and audit opinions relating to transactions such as PFIs.</p> <p>Resources are to be reviewed to ensure that they are sufficient to meet the challenge of accounting under IFRS.</p>

Finding	Actions required	Management response	Implementation details
<p>Valuation of investments in companies</p> <p>We discussed with the Council the basis for valuing investments in companies, with reference to the 2007 SORP requirements in relation to accounting for the fair value of assets.</p> <p>Following local and national consultation, we agreed the Council's treatment of accounting for investments in companies at cost, on the basis that that a reliable fair value could not be obtained.</p> <p>Under IFRS the Council will no longer have the option of valuing its investments in this way and, therefore, will need to prepare for this by carrying out further work to establish a reliable fair value.</p>	<p>The Council should carry out further work, during 2008/09, to establish a reliable fair value for its investments in companies, in preparation for accounting under IFRS.</p>	<p>Work will be carried out to establish a fair value for investments in companies as required under IFRS.</p>	<p>Valuations of investments in companies needed under IFRS will be established.</p>

Appendix D Accounts adjustments agreed

Accounting adjustments that affect the reported deficit on the I&E account	
Finding	Impact
We identified £4.3m of LPSA2 grant income that the Council was entitled to recognise in 2007/08, in line with FRS5 Application Note G, having confirmed that performance targets were met.	Increase income £4.3m Increase debtors £4.3m
We identified three adjustments to Housing Revenue Account subsidy receivable due to: <ul style="list-style-type: none"> • an error in the consolidated rate of interest used • the inclusion of an unsupported provision for audit adjustments • the notional interest receivable reducing the subsidy claimable in error. <p>The net effect of these adjustments increases income by £1.3m.</p>	Increase income £1.3m Increase debtors £1.3m
An error was identified in calculating accrued income and expenditure from the commercial property rents system, based on the wrong 12 month period being included. The net effect of the error understates the reported deficit by £1.7m.	Reduce income £2.4m Reduce expenditure £0.7m Reduce debtors/ payments in advance £1.5m Increase creditors/ receipts in advance £0.2m
We identified an adjustment to correct a £0.4m journal for schools expenditure, which had been processed twice in error.	Reduce expenditure £0.4m Increase debtors £0.4m
We identified a £0.8m capital receipt that had been accounted for as an upwards revaluation of fixed assets instead of being attributed to gains on disposal of fixed assets.	Decrease fixed asset revaluations £0.8m Decrease loss on disposal of fixed assets £0.8m

Accounting adjustments that affect the reported deficit on the I&E account

Finding	Impact
<p>It was identified that the Council had incorrectly charged £3.5m to the I&E account in relation to premia and discounts, which were removed from the Statement of Movement on General Fund Balance. There is no overall impact on the general fund balance.</p>	<p>Decrease interest payable and similar charges £3.5m</p> <p>Decrease Statement of Movement on the General Fund Balance £3.5m</p>
<p>The net impact of the above adjustments is to decrease the deficit on the I&E account by £8.6m</p>	

Accounting adjustments that do not affect the reported deficit on the I&E account

Finding	Impact
<p>The Council has accounted for a large scale voluntary transfer of council dwellings by showing the gross loss on disposal of assets separately from the associated repayment of related debt. These entries should be shown net to reflect the overall loss on disposal of assets in the Income and Expenditure account.</p> <p>Management clarified the proper treatment during the audit and processed a presentational adjustment.</p>	<p>Reduce repayment of housing related debt £142.8m</p> <p>Reduce interest payable and similar charges £32.9m</p> <p>Reduce loss on disposal of fixed assets £109.9m</p>
<p>Revaluation figures for assets related to the Wright Robinson Sports College and Temple School PFI schemes within the accounts. As these schemes assets are accounted for off balance sheet, no related revaluations should be included within the Council's balance sheet.</p>	<p>Decrease fixed asset revaluations £0.6m</p> <p>Decrease revaluation reserve £0.6m</p>
<p>Following clarification of accounting treatment received during the audit, the Council has amended creditors, the Government Grants Deferred Account and Grants and Contributions Unapplied in the balance sheet to correctly account for capital funding for new assets.</p> <p>The amendment only affects the presentation of the balance sheet.</p>	<p>Decrease creditors £58.9m</p> <p>Increase Contributions unapplied £26.2m</p> <p>Increase Government Grants Deferred £32.7m</p>

Disclosure adjustments

We recommended a number of disclosure adjustments to improve the clarity and presentation of the accounts. The Council has responded positively in agreeing to make these adjustments.

Appendix E Reports issued

External audit reports issued during the year are listed in the table below.

Report title	Date issued
Audit and Inspection Plan 2007/08	August 2007
Data Quality 2007 (Audit Commission)	January 2008
CPA Use of Resources 2007 (Audit Commission)	January 2008
BVPP Opinion (Audit Commission)	January 2008
Partnership management arrangements report	March 2008
Interim accounts report to those charged with governance	June 2008
Review of Internal Audit arrangements	June 2008
Review of risk management arrangements	June 2008
Review of management of external funding	June 2008
Annual report to those charged with governance	September 2008

Appendix F Audit fees update

Audit area	Planned fee 2007/08	Actual fee 2007/08
Accounts (including whole of government accounts)	260,000	275,000
Use of resources	193,000	193,000
Total audit fee	453,000	468,000

Code of Practice audit

As shown in the table above, the 2007/08 actual fee is higher than than the planned fee by £15,000. The reasons for this are outlined in section 2 of the report.

Grant claims audit

Grant claim certification work will be completed between August and December 2008. The audit fee was originally estimated at £150,000.

Our work is charged to the Council based on the cost of auditing each claim and the overall fee normally varies from estimate, depending on the number and complexity of claims to be audited, as well as the quality of claim compilation and supporting documentation.

We will update the Council on the final fee charged for 2007/08, in the grant claims report that we will produce in December 2008.

Non Code work

We have not carried out audit work outside of the Code of Audit Practice audit.



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