

Falkirk Council

Report to those charged with governance on the 2010/11 audit



Prepared for Falkirk Council
September 2011

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds

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Key Issues

Introduction

1. International Standard on Auditing 260 (ISA 260) requires auditors to communicate matters relating to the audit of the financial statements to those charged with governance of a body in sufficient time to enable appropriate action.
2. ISA 260 requires us to highlight:
 - the integrity and objectivity of the audit engagement lead and audit staff;
 - the nature and scope of the audit, including any limitations, and the form of reports expected to be made;
 - expected modifications to the audit report;
 - management representations requested by us;
 - unadjusted misstatements (other than those which are clearly trifling);
 - material weaknesses in the accounting and internal control systems identified during the audit;
 - views about the qualitative aspects of accounting practices and financial reporting; and
 - matters specifically required by other auditing standards to be communicated and any other matter relevant to the audit.
3. This report sets out for the Council's consideration the relevant matters arising from the audit of the Falkirk Council's financial statements for 2010/11 that require reporting under ISA 260. The contents should be brought to the attention of the Chief Finance Officer, Chief Executive and Leader so that they can consider them before the Financial Statements are signed. An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. The report has been prepared for the use of Falkirk Council and no responsibility to any third party is accepted.
4. This financial year (2010/11) is the first year of adoption of International Financial Reporting Standards (IFRS) by the council and we commend the Chief Finance Officer and finance staff for the extra effort that was required to lay the foundations for the production of draft financial statements on time.

Status of the audit

5. Our work on the financial statements is substantially complete and all matters arising during the audit have been discussed with the Chief Finance Officer's staff with responsibility for the preparation of the financial statements. Should any further matters arise in concluding our work that requires to be reported under ISA 260, we will raise them with the Chief Finance Officer.

Matters to be reported to those charged with governance

Conduct and scope of the audit

6. Information on the integrity and objectivity of the audit engagement lead and audit staff and the nature and scope of the audit, is outlined in the Code of Audit Practice approved by the Accounts Commission for Scotland in March 2007 and in the Annual Audit Plan submitted to management in April 2011 and presented to the Audit Committee on 16 May 2011.

Audit opinion & representations

7. My anticipated auditor's report (appendix A) is unqualified.
8. The accounts have been adjusted to correct a number of identified financial misstatements and other typographical or presentational changes. However, eight items have not been amended in the financial statements where, if adjustment were made for these items, the comprehensive income and expenditure account would disclose an increase in expenditure of £1.834 million. The net effect on the balance sheet would be a decrease in the net worth of the Council of £1.834 million. These items are summarised at Appendix B and not material to the accounts as a whole. The Chief Finance Officer proposes not to adjust the accounts for these items and we concur on this.
9. As part of the completion of our audit, we seek written assurances from the Chief Finance Officer on aspects of the accounts and judgements and estimates made. A draft letter of representation under ISA 580 has been provided to the Chief Finance Officer. This should be returned and signed by the Chief Finance Officer as soon as practicable and prior to the independent auditor's opinion being certified. We expect to receive all the representations requested.

Accounting and internal control systems

10. No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the accounts.
11. We reviewed the governance statement included within the financial statements and obtained evidence as to its completeness and accuracy. The Statement is consistent with our understanding of the governance arrangements in the Council.

Matters arising

Provisions

12. We have requested and received a specific representation from the Chief Finance Officer that actual and potential claims in relation to equal pay legislation have been reviewed and the amount recognised as a provision (£5.0 million) is the best estimate of the expenditure likely to be required to settle the present obligation at the balance sheet date. A contingent liability is also disclosed in the accounts, highlighting that recent legal judgements may mean that the

council is at risk in respect of further potential equal pay obligations. The Council has further disclosed that it has received permission to carry forward borrowing consent of £1million in relation to equal pay costs under the terms of Finance Circular No. 11/2009.

13. Having considered the requirements of the Code and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, reviewed evidence of the estimated value of potential liabilities and considered the terms of related borrowing consent, our view is that the council should provide for an additional £1.2 million of expenditure in 2010/11 in relation to equal pay costs.
14. The Chief Finance Officer has disagreed with this, taking the view that recognising the expenditure without matching it to the corresponding funding through application of borrowing under consent would understate the general fund. While we understand the argument presented, we do not agree with this view given the accounting rules that apply.
15. While there remain uncertainties over the actual costs that will be incurred, we are satisfied that in all other respects the council's approach is reasonable. We have also agreed with the Chief Finance Officer that it is not appropriate to recognise funding until the point that the borrowing under the consent is made.
16. The disputed amount is not considered material to our opinion on the audit, but we consider that the disagreement on accounting approach is significant enough to be highlighted in this report. The amount involved is included in the overall unadjusted financial misstatements summarised in appendix B.

Resolution: The accounts have not been amended, but this is not considered material for our audit opinion.

Movement in the pension liability

17. The pension liability has decreased by £117.4 million at 31 March 2011 largely as a result of a change in government policy which is accounted for as a change in benefits. The liability is now being linked to the consumer price index rather than the retail price index as in prior years. This results in a cost reduction, the effect of which is recognised as income in the Comprehensive Income and Expenditure Statement, although the impact on the general fund will only be realised on future reviews of the pension contribution rate.
18. Having considered the work of the actuary in relation to the IAS 19 valuation in accordance with ISA 620 - Using the Work of an Expert, I am satisfied that
 - the expert was suitably competent and objective
 - there was sufficient appropriate evidence that the scope of the expert's work at Falkirk Council was adequate for our purposes.

Resolution: The expert's work provided appropriate evidence in relation to amounts relating to the retirement benefits recognised in the accounts of Falkirk Council.

Non-depreciation of council house dwellings

19. The Council has not charged depreciation on its council housing stock on the grounds that the amount involved would not be material. We have requested a specific representation from the Chief Finance Officer that in his view this treatment is appropriate on the grounds that the impact of depreciation would not be material. Subject to receipt of this representation, we are satisfied that the approach adopted does not have a material impact on the accounts.

Resolution: *No depreciation has been charged on council dwellings and we have accepted the Chief Finance Officer's representation that depreciation of these assets is not material in 2010/11.*

Going concern (Group Accounts)

20. The Group Balance Sheet at 31 March 2011 has an excess of liabilities over assets of £54.9 million due to the accrual of pension liabilities in accordance with IAS 19 (retirement benefits). The Group net worth reflects both the IAS 19 liability for the council and for the unfunded pension schemes in its associate bodies, Central Scotland Joint Police Board and Central Scotland Fire & Rescue Joint Board. The Council and its group have adopted a 'going concern' basis for the preparation of the financial statements as future actuarial valuations of the pension fund will consider the appropriate employer's rate to meet the funds' commitments.

Resolution: *We are satisfied that the process which the Council and its group has undertaken to consider the group's ability to continue as a going concern is reasonable.*

Assets not previously recognised

21. The council has brought non-current assets into its accounts in 2010/11 which had been held by the council since 2003 but had not been recorded in its asset register system. The assets were provided to the council by a developer in return for existing land and buildings. A sum of £2.715 million has been added to the non-current assets within the accounts for these assets, being the valuation determined for these assets at that time. In my view, the building assets should have been depreciated since their construction. The absence of depreciation has resulted in the balance on the Comprehensive Income and Expenditure Statement and the value of the non-current assets being overstated by £0.149 million. There is no impact on the General Fund Balance however, as the overstatement in the Comprehensive Income and Expenditure Statement is reversed out through the Capital Adjustment Account for funding purposes.

Resolution: *There is no impact on the general fund arising from the understatement in depreciation. Non-current assets are overstated however, and this is reflected in appendix B Non-adjusted Items.*

Other unrealised gains and losses

22. The council has included 'other unrealised gains' of £2.148 million (2009/10 £2.907 million) in its Comprehensive Income and Expenditure Statement. These mainly relate to transactions on sales of assets which are not 'other unrealised gains', These transactions have also been incorrectly presented in the Movement in Reserves Statement, therefore there is no impact on the General Fund balance.

Resolution: The accounts have not been amended, but this is not considered material for our audit opinion.

Outstanding Information

23. Letter of Representation: The formal Letter of Representation is required prior to the auditor's certification of the financial statements.
24. Revised draft accounts: We require revised draft accounts to ensure that all of the presentational and disclosure matters arising and communicated to the finance function have been actioned in line with our expectations.

Acknowledgements

25. I would like to express my thanks to the staff of the Falkirk Council for their help and assistance during the audit of this year's Accounts which has enabled me to certify the financial statements by the Controller of Audit's target date.
26. As this is the final year of the appointment of the current audit team, we would like to express our appreciation of the courtesy and co-operation we have received from all members, officers and directors and the internal audit team, throughout the appointment.

Mark Taylor CPFA

Assistant Director

Appendix A

Proposed Independent Auditor's Report

Independent auditor's report to the members of Falkirk Council and the Accounts Commission for Scotland

I certify that I have audited the financial statements of Falkirk Council and its group for the year ended 31 March 2011 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the group and authority-only Comprehensive Income and Expenditure Statements, Movement in Reserves Statements, Balance Sheets and Cash-Flow Statements, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 (the 2010/11 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 123 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Chief Finance Officer and auditor

As explained more fully in the Statement of Responsibilities, the Chief Finance Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and Falkirk Council's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Chief Finance Officer; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2010/11 Code of the state of the affairs of the group and Falkirk Council as at 31 March 2011 and of the income and expenditure of the group and Falkirk Council for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2010/11 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003.

Opinion on other prescribed matters

In my opinion:

- the part of the remuneration report to be audited has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 1985; and
- the information given in the Foreword by the Chief Finance Officer for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I am required to report by exception

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Annual Governance Statement does not comply with Delivering Good Governance in Local Government; or
- there has been a failure to achieve a prescribed financial objective.

I have nothing to report in respect of these matters.

Mark Taylor CPFA

Assistant Director

Audit Scotland

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Date

Appendix B

Non-adjusted Items

Narrative	General Fund		Balance Sheet	
	Dr	Cr	Dr	Cr
	£000	£000	£000	£000
General Fund Short Term Creditors <i>Under accrual in respect of 2010/11 payroll costs.</i>	634			634
General Fund Short Term Creditors General Fund Accumulated Absences Account <i>Over accrual of backdated holiday pay for teachers, reversed out of General Fund for financing purposes.</i>		44	44	
	44			44
Short Term Debtors Short Term Creditors <i>Short term creditors treated as negative debtors.</i>			86	86
Non-current Assets Revaluation Reserve <i>Undervaluation of non-current assets.</i>			179	179
Revaluation Reserve Non-current Assets <i>Building asset previously demolished but retained in the council's non-current assets balance in error.</i>			175	175

Narrative	General Fund		Balance Sheet	
	Dr	Cr	Dr	Cr
	£000	£000	£000	£000
General Fund	149			
Non-current assets				149
General Fund		149		
Capital Adjustment Account			149	
<i>Non-depreciation of previously unrecognised non-current assets, reversed out of the General Fund for financing purposes.</i>				
General Fund	1,200			
Provisions				1,200
<i>Understated provisions</i>				
Totals	2,027	193	633	2,467
Net Total	1,834		1,834	

None of the items above have been adjusted as they are individually and collectively immaterial to the financial statements as a whole.

Non-adjusted Items (Common Good)

Narrative	I &E Account		Balance Sheet	
	Dr	Cr	Dr	Cr
	£000	£000	£000	£000
Expenditure	30			
Non-current assets				30
Expenditure		30		
Capital Adjustment Account			30	
<i>Non-depreciation of Kilns House. Reversed out through the Capital Adjustment Account.</i>				
Totals	30	30	30	30
Net Total	0		0	

The item above has not been adjusted as it is immaterial to the financial statements as a whole.