

Falkirk Council

Report to those charged with governance on the 2011/12 audit



Prepared for Falkirk Council
September 2012

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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Summary

Introduction

1. International Standard on Auditing (ISA) 260 requires auditors to report certain matters arising from 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:
 - relationships that may bear on our independence and the integrity and objectivity of the appointed auditor and audit staff
 - the overall scope and approach to the audit, including any expected limitations, or additional requirements
 - expected modifications to the audit report
 - management representations requested by us
 - unadjusted misstatements, other than those that are clearly trivial
 - material weaknesses in internal control identified during the audit
 - qualitative aspects of accounting practice and financial reporting, including accounting policies
 - matters specifically required by other auditing standards to be communicated to those charged with governance and any other matters that are relevant to the audit.
3. This report sets out for the council's consideration the matters arising from the audit of the financial statements for 2011/12 that require reporting under ISA 260. We are drawing to your attention those matters we think are worthy of note, so that you can consider them before the financial statements are approved and certified. An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. This report has been prepared for the use of Falkirk Council and no responsibility to any third party is accepted.

Status of the Audit

4. Our work on the financial statements is now 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 require 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

5. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in the Audit Plan presented to the Audit Committee on 12 March 2012, and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011.

Audit opinion & representations

6. Subject to the satisfactory conclusion of any outstanding matters and receipt of a revised set of accounts for final review, we anticipate being able to issue an unqualified auditor's report on 25 September 2012 (the proposed report is attached at Appendix A). There are no anticipated modifications to the audit report.
7. The accounts have been adjusted to correct a number of identified financial misstatements and other typographical or presentational changes. The significant errors which required amendment are as follows :
 - a prior year adjustment was made to correctly reflect the timing of a significant payment of £14.4 million, made on 1 April 2011 to Falkirk Schools Gateway. Corresponding corrections were also required to the Cash Flow Statement
 - In the 2011/12 Cash Flow Statement £20.611 million of debt transferred from long-term borrowing to short-term borrowing has been incorrectly treated as redeemed in year. Cash receipts of short and long-term borrowing (£20.726 million) and Repayments of short and long-term borrowing (£31.646 million) were overstated by £20.611 million. Corrections have now been made.
8. Three other errors identified have not been corrected. If adjustment were made for these items, the comprehensive income and expenditure account would disclose an increase in expenditure of £2.231 million. The net effect on the balance sheet would be a decrease in the net worth of the council of £0.549 million. These items are summarised at Appendix B and are 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 signed and returned by the Chief Finance Officer with the signed accounts prior to the independent auditor's opinion being certified.

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.

Matters arising

11. In our view, the following issues require to be brought to your attention regarding the appropriateness of accounting policies or accounting estimates and judgements, the timing of transactions, the existence of material unusual transactions or the potential effect on the financial statements of any uncertainties.
12. **Going Concern** - the Group balance sheet as at 31 March 2012 discloses an excess of liabilities over assets of £119 million (2010/11 £55 million) due to the accrual of pension liabilities in accordance with International Accounting Standard 19 (Employee 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, 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. We have asked the Chief Finance Officer for formal assurance, in the letter of representation, as to the council's ability to continue as a going concern.

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.

13. **Movement in pension liability** - the pension liability has increased by £43 million as at 31 March 2012 due to the annual review of the financial assumptions used by the actuary to value the accrual of pension liabilities in accordance with International Accounting Standard 19 (Employee Benefits).

Resolution: The actuary provides appropriate evidence in relation to amounts relating to the retirement benefits recognised in the accounts of Falkirk Council. The liability is reviewed on an annual basis.

14. **Council house valuations** - the accounting code for local authorities requires council dwellings to be measured using the existing use value-social housing (EUV-SH) method of valuation. At present the council uses a discounted cash flow approach to the valuation of its housing stock, totalling £54.381 million, which results in a lower valuation.

15. ***Resolution: The council will revise its method of housing stock valuation to align with the Code at the next valuation which is due in 2015/16.***

16. **Non-depreciation of council house dwellings** - 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 2011/12.

17. **Equal pay provision:** the Equal Pay Act 1970 makes it unlawful for employers to discriminate between men and women in terms of their pay and conditions where they are doing the same or similar work, work rated as equivalent, or work of equal value. Employees who consider that they have been discriminated against in terms of pay and are dissatisfied with the council's proposed resolution or compensation can elect to have a case heard before an employment tribunal. Falkirk Council has received a significant number of claims for compensation and the council currently has a provision of £5.216 million included in its accounts to cover these costs. The ultimate cost to the council remains uncertain and it is likely that resolution of the issue will take some time. As the tribunal process unfolds the extent of the council's eventual liability will become clearer.

Resolution: the equal pay provision will be reviewed on an annual basis.

18. **Heritage assets** - the Code of practice on local authority accounting (the Code) requires local authorities to account for tangible heritage assets under FRS 30 *Heritable assets*. Heritage assets include historical buildings, archaeological sites, scientific equipment of historical importance, civic regalia, museum and gallery collections and works of art.
19. The council has identified that it holds six different categories of heritage assets: the museums collection, the arts collection, the archives collection, the libraries local history collection, war memorials and town clocks and civic regalia. With the exception of civic regalia these are assets are not recognised in the council's Balance Sheet either because the council does not consider that reliable cost or valuation information can be obtained or because it considers that the cost of obtaining valuations for these is disproportionate in terms of the benefits to the users of the accounts. Civic regalia is carried in the balance sheet at insurance valuation based on market values.
20. **Resolution: the valuation and disclosure of heritage assets will be kept under review.** **Other unrealised gains and losses** - the council has included 'other unrealised gains' of £1.592 million (2010/11 £2.148 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 financial statements have not been amended, but this is not considered material for our audit opinion.

Outstanding Information

21. **Letter of Representation:** The formal Letter of Representation is required prior to the auditor's certification of the financial statements.

22. 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

23. We would like to express our thanks to the staff of Falkirk Council for their help and assistance during the audit of this year's financial statements which has enabled us to provide an audit report within the agreed timetable.

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 2012 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the group and the authority Comprehensive Income and Expenditure Statements, Balance Sheets, Cash-Flow Statements and Movement in Reserves Statements, the Trust and Third Party Funds, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Statement, the Council Tax Income Account, the Non-Domestic Rates Account, the Common Good Funds 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 2011/12 (the 2011/12 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 125 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 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 statement of accounts 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 2011/12 Code of the state of the affairs of the group and Falkirk Council as at 31 March 2012 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 2011/12 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 Explanatory Foreword 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.

Fiona Mitchell Knight, FCA
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25 September 2012

Appendix B

Non-Adjusted Errors within the 2011/12 Annual Accounts

Below is a summary of the non-adjusted errors which have not been processed in the accounts, with an explanation.

Narrative	DR £000	CR £000
Income & Expenditure Account		
Expenditure	1,567	
General Fund		1,567
Difference between actuarial estimate and actual pension contributions reversed out of General fund for financing purposes.		
General fund	549	
Under accrual in respect of 2011/12 payroll costs		
General Fund	115	115
Under accrual of flexi leave and time off in lieu reversed out of General fund for financing purposes.		
Totals	2,231	1,682
Net total	549	
Balance Sheet		
Defined Benefit pension Scheme Liability		1,567
Pensions reserve	1,567	
Difference between actuarial estimate and actual pension contributions reversed out of General fund for financing purposes.		
Short Term Creditors		549
Short Term Creditors		115
Accumulated Absences Account	115	
Under accrual of flexi leave and time off in lieu reversed out of General fund for financing purposes.		
Totals	1,682	2,231
Net Totals		549