

Audit Summary Report

November 2006



Final Accounts Memorandum

Salford City Council

Audit 2005/2006

External audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services.

Audit in the public sector is underpinned by three fundamental principles:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements but also value for money and the conduct of public business; and
- auditors may report aspects of their work widely to the public and other key stakeholders.

The duties and powers of auditors appointed by the Audit Commission are set out in the Audit Commission Act 1998 and the Local Government Act 1999 and the Commission's statutory Code of Audit Practice. Under the Code of Audit Practice, appointed auditors are also required to comply with the current professional standards issued by the independent Auditing Practices Board.

Appointed auditors act quite separately from the Commission and in meeting their statutory responsibilities are required to exercise their professional judgement independently of both the Commission and the audited body.

Status of our report

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

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

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Introduction

- 1 The Audit Commission Act 1998 and the Code of Audit Practice require the external auditors to give an opinion as to whether the statement of accounts presents fairly the financial position of the Council and its income and expenditure for the year in question. In accordance with this requirement we gave an unqualified opinion on the 2005/06 accounts on 27 September 2006.
- 2 This report summarises the issues which arose from our audit of the financial statements.

Background

- 3 The 2005/06 audit of the financial statements was the first year that our work has been carried out having regard to the newly introduced International Standards on Auditing (ISAs). This has resulted in significant changes to our audit approach. Our previous audits have concentrated heavily on documenting and testing the core processes in the main accounting system and placing reliance where possible on budgetary control arrangements. The new standards, particularly ISA 315 and ISA 330, require auditors to demonstrate an understanding of the information systems which have a material impact on the accounts. In essence the new approach requires that we:
 - identify the material systems which are the subsidiary information systems to the main accounting system and document the key controls for each system;
 - evaluate the controls, individually or in combination with other controls, as to their impact on potential material misstatements in the accounts; and
 - design and carry out appropriate tests on the operational controls for each of the systems on which we are seeking to place reliance for the purposes of giving our opinion on the financial statements.
- 4 In view of the significant change in our approach we have had regular discussions with key staff in the accountancy and audit sections and we would like to record our gratitude for the assistance which they have provided. Apart from helping us to meet the new standards there have been benefits to the Council, which include the following.
 - Documentation of the main accounting system (SAP) has been improved with regard to identifying key controls and will be used to help train and develop accounting staff in their understanding of the system.
 - The process of identifying material systems has been used to help inform Internal Audit's risk based planning.
 - The Audit Commission's approach to the IT risk assessment is being used by Internal Audit's IT auditors to help strengthen their approach to assessing the Council's IT risks.

- 5 No major issues arose from our review and testing of the material systems which impact on our opinion on the final accounts. There were a few relatively minor matters arising relating to possible strengthening of systems controls which we will follow up with Internal Audit.
- 6 As this was the first year of the new approach we recognise that further learning and good practice is likely to emerge. We will therefore keep this matter under review at our regular liaison meetings with accountancy and audit staff.

Main issues arising

Approval of the accounts

- 7 Members approved the Council's annual accounts on 26 June 2006 which was within the deadline of the end of June 2006 required by the whole of government accounts initiative. The Council is commended for its early closure which was about three weeks earlier than the previous year.
- 8 Our review again confirmed that the financial statements generally comply with good practice and that there is a good understanding of current technical accounting issues. Responses to queries and matters arising were dealt with expeditiously and steps are being taken to continually improve working papers.

Amendments to the accounts

- 9 We are required by professional standards to report to 'those charged with governance' certain matters before we give an opinion on the accounts. In accordance with this requirement we reported the matters arising from our audit to the Accounts Committee on 26 September 2006. The main issues arising related to:
 - reconciliations between the new benefits system and the SAP main accounting system were incomplete when the financial statements were approved in June 2006. An increased provision for repayment of grant was therefore included in the accounts to cover the uncertainties which remained at that time. Subsequent work on the reconciliations identified that the Department for Works and Pensions debtor was overstated by £769k. This was amended in the accounts and was offset by a similar reduction in the provision for repayment of grant;
 - short term investments included £10m which the Council has invested for five years and was reclassified as long term;
 - several amendments which were made relating to the qualitative aspects of accounting practices and financial reporting, for example;
 - improving disclosure notes relating to pension funds liabilities, the housing stock option review and pooled budget surpluses;
 - correcting the classification of creditors/debtors between the different categories (e.g. Government departments, other local authorities, sundry creditors, etc); and

- various relatively minor amendments to the accounts relating to inconsistencies between statements and accuracy of reporting.

10 The Strategic Director of Customer and Support Services issued a report in response to these issues and the Accounts Committee agreed with his recommendation to make the appropriate amendments to the accounts. These amendments did not impact on the reported balances in the Council's general fund reserve or the housing revenue account.

Treasury management issues

11 For the past two years we have drawn attention to an issue which is of national relevance and applies to other authorities as well as Salford concerning the accounting treatment of LOBO interest and amortisation of premiums on debt rescheduling. In October 2005 the Strategic Director of Customer and Support Services presented a report to the Accounts Committee which explained the background to these issues and quantified the financial effects and risks relating to the alternative accounting treatments that are currently being recommended.

12 A further year has now elapsed without a satisfactory solution to this matter and uncertainties remain on how these issues will finally be resolved. If the Audit Commission's favoured method of accounting treatment was used this would have resulted in an additional charge to the General Fund over the past two years totalling about £2.9m. This is made up of the following:

- £1m additional interest on LOBO loans, and
- approximately £1.9m additional amortisation of premium.

13 In determining our opinion on the accounts we adopt a concept of materiality and an unqualified opinion may not be given if there are material misstatements in the accounts. Our materiality level for the General Fund is currently set at £6.8m (based on updated guidance from the Audit Commission in line with the new ISA requirements). We are therefore satisfied that although there are differences of opinion in the favoured accounting treatment for LOBO interest and amortisation of premiums on debt rescheduling the Council's preferred method is within our materiality guidelines.

14 Looking ahead, we understand that the DCLG plan to issue regulations (following consultation with relevant bodies) which will come into force on 1 April 2007 on the future accounting treatment for premiums and discounts. We will consider any further advice which becomes available on this and keep this matter under review at our regular liaison meetings with the Strategic Director of Customer and Support Services.

Pooled budgets

- 15 The Council operates three pooled budgets (agreements made under section 31 of the Health Act 1999) in partnership with Salford PCT. The auditor of the host body (the Council) is responsible for providing letters of assurance on the information included in the NHS accounts and agreeing protocols for this work with the auditors of those accounts.
- 16 We concluded from our review that the Partnership Boards responsible for managing the pooled budgets should determine how they plan to utilise the accumulated pool surpluses (£1.25m as at 31/3/06) and how they will take these into account in their future financial planning and monitoring.

Whole of government accounts

- 17 This is the first year that the auditor is responsible for issuing a report on the consistency of the Authority's consolidation pack with the statutory financial statements in accordance with the whole of government accounts initiative. We are pleased to confirm that we issued our report to the DCLG by the deadline of 6 October 2006. Looking ahead, for next year, we suggest that the completion of the consolidation pack is included earlier in the accounts closure programme.

Mitigating accounting risks

- 18 Over recent years the Council has become involved with a number of partnership initiatives, for example, schools' PFI schemes, LIFT, SHIFT, Higher Broughton regeneration, Urban Vision, SCL, Homes to Trust, NPHL, Housing Market Renewal, etc. All of these partnership arrangements have accounting implications and some involve agreements which are planned to last for many years. We feel that there would be benefits in setting up a log for such schemes which summarises the accounting issues and any trigger points which might impact on the Council's budget and / or financial reporting. Taking such action should ensure that the risk of errors of omission in the financial statements are minimised and that any budget implications are addressed at the relevant time.

Other issues

- 19 Two other issues have arisen during our audit, which although they are not material for the purposes of giving our opinion on the final accounts, are significant and are reported here for completeness.
- We raised concerns with the Assistant Director, Accountancy and Exchequer about the number of creditor cheques, (around 6,000 in a 12 month period), which were going through the abeyance process. This process relates to cheques that are collected by officers rather than being paid through the normal channels and are therefore a higher 'fraud' risk because the standard controls in the system can be circumvented. We have been assured that action is being taken to reduce the number of cheques which are processed in this way and that a reduction of about 50% has been achieved to date.

- Testing of the Council's NNDR3 Return identified one organisation that had received mandatory relief for the past five years, (about £70k in total) although there was no supporting evidence that it had charitable status. It was agreed with the Business Rates Section Leader that he would arrange for further checks to be completed on mandatory charity cases and take appropriate steps to strengthen the relevant procedures.

Way forward

- 20 The Action Plan attached at Appendix 1 has been agreed with a view to tackling the issues referred to above and includes the recommendations reported to the Accounts Committee on 26 September 2006. It also includes agreed action on some of the less significant matters arising from the audit that have been discussed which relate to the following.
- Methodology for assessing the council tax bad debt provision.
 - Balances included in the provision for repayment of grant.
 - Valuation of the investments managed by Scottish Widows.
 - Disclosure requirements relating to debtors/creditors.
 - Reconciliation of housing rent arrears between Saffron and SAP.
 - Consistent improvements required to working papers.
- 21 There are also various issues which arose during the audit which we would like to consider and discuss further as part of our preparing the audit plan for 2007/08. These include the following.
- Council tax collection
 - School balances
 - Housing rent arrears.

Appendix 1 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
Benefits reconciliations						
5	R1 Ensure that reconciliations of the benefits system with the SAP main accounting system are completed on a timely basis.	3	Steve Fryer / Irene Topping	Yes	Reconciliation procedures between the benefits system and SAP have been strengthened. Customer Services officers will ensure that manual adjustments to the benefits system are identified monthly and reconciled to the subsidy claim report.	November 2006
Investments classification						
5	R2 Review investments at the year end and ensure that these are classified as short / long term as appropriate.	3	Elaine Marks-Parker	Yes	This check has now been built into our closure procedures.	April 2007

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
Qualitative review						
5	R3 Build sufficient time and resources into the accounts closure programme to carry out a qualitative review of the accuracy and completeness of the disclosure notes in the financial statements.	3	Chris Hesketh	Yes	We have recognised a need for the Corporate Accountancy Team to have more time to consider qualitative aspects of the statement towards the end of the final accounts process. The closure timetable will be considered further by the Accountancy Development Group to try to allow this.	January 2007
Treasury management						
6	R4 Take appropriate action when clarification is received on the outstanding treasury management issues. In particular the accounting treatment relating to : <ul style="list-style-type: none"> • amortisation of premium on rescheduled loans; and • annual interest charges on LOBOs. 	3	John Spink/ Chris Hesketh	Yes	Action to be taken if necessary when clear guidance is received. Currently, the Council has recognised the issue in its risk-assessed calculation of its minimum level of reserves. We are currently considering the proposals in the SORP 2007 Invitation To Comment that relate to premiums and LOBO interest. We note that the draft Capital Finance Regulations would not require existing premium balances to be charged to the revenue account.	Subject to further guidance

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
Pooled budgets						
7	R5 Partnership Boards (PB) should determine how they plan to utilise the accumulated pool budget surpluses and how they will take these into account in their future financial planning and monitoring.	3	Keith Darragh	Yes	The agreement between the PCT and the Council has previously been that the accumulated surplus will be held by the accountable body. However, the PCT has indicated that it now intends to draw its share of surplus each year. We are considering the implications of this on accounting, reporting, custody of funds and possible changes to the partnership agreements. Reports will be taken to Partnership Boards during 2006/07.	In line with PB meetings and in any event by March 2007.
Whole of government accounts (WGA)						
7	R6 Completion of the WGA consolidation pack should be built in to the accounts closure programme at an earlier stage.	3	Phil Prady	Yes	The Corporate Accountancy Team will consider how closure procedures can facilitate information gathering for the WGA process. The closure programme will be reviewed, and signed off by the Accountancy Development Group, to ensure that sufficient time is built in for completion and audit of WGA.	January 2007

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
Mitigating accounting risks						
7	R7 Accounting and budget issues arising from the Council's various partnership agreements should be logged and reviewed on an ongoing basis to ensure that the risk of errors of omission are minimised and that any budget implications are considered at the relevant time.	3	Chris Hesketh	Yes	The Corporate Accountancy Team will develop documentation to provide accounting background on each partnership, and to log the future impact of financial transactions on the Council's single entity and group accounts. We will consider access and format to ensure that the documentation is easy to reference and useful for the preparation of future years' accounts. We will liaise with you as this information source develops to help ensure that it is fit for purpose.	January 2007
Abeyance cheques						
7/8	R8 Continue to identify ways of reducing the number of cheques which are paid through the abeyance process. Monitor the number of cheques which are processed in this way and take action as appropriate.	3	Andy Pollard	Yes	We have introduced procedures to ensure that requests for payment to be made by cheque, and to be held in abeyance, are challenged and monitored. We are promoting the use of BACS and purchasing cards as alternative, more suitable, methods of payment. These steps have already significantly reduced the number of cheques that are now held in abeyance.	November 2006

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
	NNDR charitable relief					
7/8	R9 Review existing cases to ensure that relief is being granted as appropriate and evidenced by supporting records.	3	Bob Daniels	Yes	We have reviewed all existing cases in accordance with a process agreed with you. No further incorrect relief has been identified, although some further investigation is taking place into the position of Industrial & Provident Societies. We will continue to review all claims on an annual basis. Guidance notes are also being drawn up to ensure that correct checks are carried out on all new applications for relief.	December 2006
	Ensure appropriate action is taken to adjust/ recover any incorrect relief which may have been given and that this is correctly reflected in the 2006/07 NNDR3 return.	3	Bob Daniels	Yes	The account for the organisation concerned has been amended and they will be billed accordingly. The removal of relief will be accounted for in the NNDR3 return for 2006/07.	March 2007

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
Council tax - bad debt provision						
8	R10 The methodology for calculating the council tax bad debt provision needs to be demonstrated in a clear and consistent way.	2	Phil Prady	Yes	<p>Our methodology for calculating the bad debt provision relies on an assessment of our ability (or not) to achieve historical collection performance. We take into account a number of factors, such as:</p> <ul style="list-style-type: none"> • changes in the council tax debit, eg through an increase in the council tax base; • write-offs; • declaration of surplus/deficit; and • a judgement on other circumstances prevalent at that time e.g. the impacts of the introduction of SX3. <p>The methodology has been applied consistently and we believe it gives an accurate reflection of the collectibility of outstanding debt. (Continued)</p>	April 2007

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
					In order to provide further assurance that our method is accurate and consistent, we will develop a complementary calculation. This will be a simple formula multiplying arrears by standard percentages, depending on debt age. We still expect to have to apply a judgement to the resulting figure, but it will give us a useful comparator to further inform our decisions on required bad debt provision and the possible declaration of surpluses or deficits.	
Provision for repayment of grant						
8	Some of the balances held within this do not appear to be consistent with the description of the provision. The items included should be reviewed to ensure that these are being correctly presented and action taken as appropriate.	2	Chris Hesketh/ Irene Topping/ Nigel Dickens	Yes	We will review the items included in the balance to ensure they are correctly classified. The working papers will be reviewed to ensure that the method of calculating the provision is explicit, all items are properly and clearly identified, and balances are held within appropriate profit centres.	January 2007

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
Investment valuation						
8	The investments (£20m, at 31 March 2006) managed on behalf of the Council by the Scottish Widows Investment Partnership will need to be valued at 31 March 2007 and disclosed appropriately in the 2006/07 balance sheet.	2	Elaine Marks-Parker	Yes	Under the terms of the agreement with Scottish Widows Investment Partnership, we receive a report including a valuation of the investments. We will ensure that we follow SORP requirements for the Balance Sheet value of the investment and the recognition of any gains or losses in the Income and Expenditure Account.	April 2007
Debtors / creditors disclosure						
8	Accurate reporting of the different types of debtors/creditors has continued to be a problem. The level of disclosure should be reviewed, consistent with meeting the requirements of the SORP.	2	Chris Hesketh	Yes	We agree that the analysis of these items over sub-headings has been inconsistent, and a review will be undertaken by the Corporate Accountancy Team. The SORP is not prescriptive, so we will be looking to develop a form of disclosure that best suits our needs from both a single entity and a WGA perspective, and that provides the most useful information for a reader of the accounts.	January 2007

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
	Housing rents					
8	R11 There was an unexplained difference of £52k in housing rent arrears between the rent accounting system (Saffron) and SAP. Reconciliations between the systems should be undertaken on a regular and timely basis.	2	Joanne Hardman	Yes	<p>Agreed that there was a difference of £52k between Saffron and SAP. There were two main reasons for this:-</p> <ul style="list-style-type: none"> • timing differences in refunds to tenants; and • differences in the opening balance which were not completely cleared by postings relating to 2004/5. <p>A number of reconciliations are now in place to ensure that the postings on SAP agree with Saffron eg weekly monitoring of the interface to SAP across dwellings rents, garage rents and service charges and reconciliation of refunds. This will continue through the year. The discrepancy on the opening balance will be resolved as part of the 2006/07 accounts process.</p>	April 2007

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
Working papers						
8	R12 Good practice with regard to presenting final accounts working papers needs to be applied consistently across all directorates if the Council is going to achieve the 'exemplary working papers' to which it aspires.	2	Chris Hesketh / All accountants	Yes	The content and format of working papers has been considered at Accountancy Group Leaders', Accountancy Briefing and Accountancy Development Group meetings and it is believed that this has contributed to an improvement in the quality of working papers. The Corporate Accountancy Team will reconsider standard working paper templates and we will continue to seek quality improvements through the same forums.	June 2007