

Angela Cassels BA CPFA
Assistant Director of Audit (Local Government)
7th Floor
Plaza Tower
East Kilbride
G74 1LW

Telephone:
01355 619200

Fax:
01355 619201

Website:
www.audit-scotland.gov.uk

23 September 2005

Members of the Audit Committee
Argyll and Bute Council
Council Offices
Kilmory
Lochgilphead
PA31 8RT

Dear Members

Audit of Argyll and Bute Council 2004/05

Statement of Auditing Standard 610

Statement of Auditing Standard 610 (SAS 610) *Communication of audit matters to those charged with governance* 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.

SAS 610 requires me to highlight:

- the nature and scope of the audit, including any limitations, and the form of reports expected to be made. This information was outlined in an audit planning memorandum for 2004/05 which was submitted to members of the Audit Committee in March 2005;
- expected modifications to the audit report;
- 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.

./..

I wish to highlight, therefore, that:

- my expected auditor's report (copy attached) on the Council's financial statements concludes that the financial statements present fairly the council's financial position at 31 March 2005 and have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and directions made thereunder;
- the accounts have not been adjusted to correct three financial misstatements detailed in the appendix to this letter. Individually, and cumulatively, these misstatements are not material to the financial statements; and
- 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. A number of opportunities to improve internal control, however, have been reported to the Council during the year in reports to management. The more significant issues will be highlighted in my annual report to members on the 2004/05 audit.

In my view, six issues require to be brought to your attention:

- We identified that a significant number of control accounts are being maintained and operated for the purpose of recording income and expenditure in relation to various grant claims and initiatives. Although these amounts have been accounted for in the financial ledger, they have not been included within the suite of ledger codes which facilitate their inclusion within the consolidated revenue account (CRA). As a result both gross income and gross expenditure are currently understated by some £3.881 million (although they aggregate to a nil effect on the surplus shown in the CRA). The Council have agreed that in future, all such amounts will be correctly recorded in the CRA;
- The final report on the previous year's audit commented on the lack of procedures to review non-operational assets, and to document and review assets for impairment. These are two important processes which contribute to a proper system of asset management and valuation. No review of non-operational assets took place in 2004/05, and we are informed that the Council has been awaiting finalisation of the asset reconciliation, prior to services confirming which assets actively contribute to service objectives. In respect of the review of impairment of assets, we noted that a year-end exercise did take place, and no impairment was identified. However, officers have confirmed that during 2005/06, they intend to develop a set of documented procedures for routinely identifying significant asset impairment during the year;
- It is essential, where capital expenditure has been incurred during the year, that the relevant asset is formally revalued to ensure any non-enhancing expenditure is identified and excluded from the fixed assets balance. Whilst we are aware that the Council conduct a five yearly cyclical revaluation process, there is no method of ensuring that assets, which have been subject to capital works, are revalued in the same year. It may therefore be up to 5 years before non-enhancing expenditure is identified and removed from the accounts. (This issue was identified during the previous year's audit and our enquiries have established that procedures have yet to be devised.) Officers have confirmed that, during 2005/06, they intend to set a level of expenditure or percentage of expenditure to current asset value, beyond which, a revaluation will be triggered in respect of the relevant asset;

- 2004/05 is the second year of reporting the results of trading accounts. All trading accounts are reporting a cumulative surplus, although our enquiries have established that the Leisure Trading Account income was increased by £27k for 2004/05 in respect of FRS 17 costs, contrary to proper accounting practice. Although there is no impact on the overall financial position of the Council, the Leisure Trading Account should report a trading deficit of £27k for 2004/05. This adjustment will be recognised for 2005/06 in identifying any trading operation failing to meet the statutory requirement to break even over a rolling 3 year period.
- One of the tests of whether trading accounts are required is whether the service is charged on a basis other than a straightforward recharge of cost. Our enquiries have established that a number of significant year-end income adjustments were made to the Waste Management Trading Account and the Catering and Cleaning Trading Account which represent recharges based on actual cost of service provision. Specifically:
 - Former client costs of some £1.08 million in relation to waste management, street sweeping and the skip service which are now charged to the trading account, were recharged at the year end based on actual expenditure.
 - Former non-statutory catering, cleaning and janitorial services costs of some £2.1 million were recharged during 2004/05 on the basis of actual costs plus 10%, based on a long standing arrangement with the client.
 - Actual support service costs of £675k were recharged at the year-end from the Catering and Cleaning trading account to the client department based on historic percentage allocations.

Officers have confirmed that these issues will be addressed during 2005/06; and

- Our enquiries have established that there is a process in place whereby former tenants rent arrears are billed via the corporate debtors system, whilst also remaining in the housing rents system. As a result, former tenants arrears have been double counted in the debtors figure shown in the balance sheet, resulting in a gross overstatement of £148,848. Our enquiries also established, however, that two provisions had been made in respect of the debt, each being approximately 95% (£145,405) of the value of the gross debt. This effectively cancels the original error, leaving only a net debtors overstatement of some £3,000. Officers have agreed that this debtor balance and corresponding provision will be included only once in next year's accounts.

I would like to express my thanks to members of the Council and Council staff for your help and assistance during the audit of this year's accounts which has enabled me to certify the accounts by the Controller of Audit's target date.

Yours sincerely

Angela Cassels
Assistant Director of Audit (Local Government)

Enc

**ARGYLL AND BUTE COUNCIL
SCHEDULE OF UNADJUSTED ERRORS- 2004/2005**

MATTERS ARISING	POTENTIAL EFFECT ON THE ACCOUNTS		
	CRA	DEBTORS	CREDITORS
Net effect of former tenants rent arrears debtor (£148k) and corresponding bad debt provision (£145) being double counted. These result in a net overstatement of £3k.	-	3,000	-
£53k of payments made to rent accounts after the 2004/05 year end were incorrectly posted against rent accounts in the 2004/05 financial year. Consequently, the net rent arrears figure is understated.	-	(53,000)	-
£33k of direct debit payments were received on 31 march 2005. However, these were not posted to rent accounts until the 2005/06 financial year. Consequently the net rent arrears figure is overstated by this amount.	-	33,000	-
TOTAL	nil	(17,000)	nil
OVERALL EFFECT	nil	Debtors are understated by £17,000	nil