# Argyll and Bute Council

## Report on the 2006-07 Accounts Audit

**18 September 2007**

# Contents

# Executive Summary

## Introduction

We have audited the financial statements of Argyll and Bute Council (the Council) for the year ending 31 March 2007. This report sets out our key findings and discharges our responsibilities under ISA260 - reporting matters arising from our audit to those charged with governance.

## Key findings

We expect to give an unqualified opinion on the financial statements of the Council for 2006-07. We will, however, draw attention to a failure to comply with the statutory requirement that all significant trading organisations break even on a rolling three year basis.

Our audit identified a number of adjustments to the Council's draft accounts. The combined impact of these adjustments is to amend the reported deficit in the Council's draft accounts from £0.686 million to show a surplus of £0.385 million in the revised accounts.

The key recommendations arising from our financial statements audit are that the Council should:

- ensure it has clear plans in place to use all reserves earmarked within its general fund, and does not build up reserves unnecessarily;
- review its debt collection procedures and establish a formal debt recovery scheme for outstanding debtor balances;
- ensure all banks accounts are recorded in the financial ledger and reconciled at least monthly;
- ensure all Trusts and Common Good Fund charities are registered with the Office of the Scottish Charity Regulator as required by the Charities and Trustee Investment (Scotland) Act 2005.

## Status of our Report

This report is part of a continuing dialogue between the Council and Grant Thornton UK LLP and is not, therefore, intended to cover every matter which came to our attention. Our procedures are designed to support our audit opinion and they cannot be expected to identify all weaknesses or inefficiencies in the Council's systems and work practices.

The report is not intended for use by third parties and we do not accept responsibility for any reliance that third parties may place upon it.

## Acknowledgements

We would like to take this opportunity to thank the Head of Strategic Finance, the Corporate Accounting Manager and other staff who have been involved in this audit for their assistance and co-operation.

# Detailed Findings

## Introduction

In accordance with the Code of Audit Practice (the Code) we are required to audit the financial statements of the Council for the year ended 31 March 2007. In auditing the financial statements, we give an opinion on whether:

- they present fairly the Council's financial position as at 31 March 2007 in accordance with Part VII of the Local Government (Scotland) Act 1973 (the Act) and the CIPFA 2006 Statement of Recommended Practice (2006 SORP);
- the Statement on the System of Internal Financial Control is consistent with the information we obtain through our audit.

We expect to give an unqualified opinion on the Council's 2006-07 financial statements and conclude that the financial statements are prepared in accordance with the Act and the 2006 SORP.

The Local Government in Scotland Act 2003 requires significant trading operations to break even over a three year rolling period. The accounts record that, for the three year period to 2006-07, two trading operations failed to achieve the statutory break even financial requirement:

- Leisure Trading Account records a deficit of £0.422 million; and
- Catering and Cleaning Trading Account records a deficit of £2.416 million.

This does not impact on the fair presentation of the financial statements and, therefore, does not affect the opinion on the accounts. This matter will be referred to in an explanatory paragraph in the draft audit report.

## The 2006 SORP

The 2006 Statement of Recommended Practice (SORP) introduced wide ranging changes to the presentation of local government accounts. These changes are intended to improve the presentation and understanding of the accounts. Key changes include:

- the replacement of the Consolidated Revenue Account with an Income and Expenditure account that reports actual financial performance for the year;
- appropriations to and from reserves are omitted from the I&E account and are shown separately in the Statement of Movement on the General Fund Balance; and
- the order of the financial statements has been amended, primarily to group together the primary statements, including the I&E account, balance sheet and cash flow statement.

In preparing the 2006-07 accounts in accordance with the new SORP, the Council has restated its 2005-06 accounts resulting in the Council's reported deficit for that year increasing from £0.367 million to £5.050 million. The increase in the deficit been caused by implementation of the 2006 SORP, but statutory adjustments ensure there is no overall impact on the Council's general fund position.

## Matters Arising

Under ISA260, we are required to communicate certain matters arising from the audit to those charged with governance. This function is discharged by the Council's audit committee on 20 September 2007. The areas considered are summarised in the table below:

| **Area** | **Key Messages** |
|---|---|
| Independence and objectivity of the audit team | We are able to confirm our independence and objectivity as auditors and note the following:<br>• we are independently appointed by Audit Scotland;<br>• we comply with the Auditing Practices Board's Ethical Standards; and<br>• we have not performed any non Code or advisory work during the year. |
| Quality of the Accounts | The draft financial statements were presented for audit on 18 June 2007 in line with the agreed timetable. The accounts and supporting working papers were of a good standard and, as a result, few adjustments were required to be processed following our audit.<br>The Council had good arrangements in place to deal with implementation of the significant changes introduced by the 2006 SORP. |
| Approach to the audit | Our approach to the audit was set out in our 2006-07 audit plan. We have planned our audit in accordance with International Auditing Standards and the Code.<br>We have considered the materiality of items in the financial statements both in determining the audit approach and in determining the impact of any errors.<br>During the 2006-07 audit, we reviewed the core financial systems in operation at the Council for the purpose of relying on controls for our accounts opinion. Our interim report has identified some improvement actions to strengthen internal controls but no material internal control weaknesses have been identified. |
| Accounting policies and practices | We consider that the Head of Strategic Finance has adopted appropriate accounting policies in the areas covered by our testing, in accordance with the 2006 SORP.<br>The accounts record a large pensions deficit of £236 million which will be funded from ongoing revenue expenditure. The Head of Strategic Finance has considered and confirmed that the Council remains a going concern and confirms this in the Letter of Representation. |
| Material risks and exposures | The Council has considered and confirmed that it has no material risks and exposures which should be reflected in the financial statements, and the Head of Strategic Finance will confirm this in the Letter of Representation. |

| | |
|---|---|
| Audit adjustments and unadjusted errors | We have identified several disclosure amendments and reclassifications to improve the presentation of the accounts.<br><br>The net impact of agreed audit adjustments is to increase the General Fund by £0.678 million. There is one unadjusted audit difference to report:<br><br>• a new £84,000 lease taken out in the year has been classified as an operating lease, but should be classified as a finance lease.<br><br>A full summary of adjusted and unadjusted differences is included at Appendix 2. |

The key matters arising from the audit are:

## Financial position

The Council's Income and Expenditure Account records a surplus for the financial year of £0.385 million (£5.050 million deficit in 2005-06). The significant improvement in the Council's financial position from the prior year emerged mainly from: increases in government grant funding (£7.402 million); improvement in the returns gained on pensions assets (£2.740 million); and a past service cost gain from the introduction of commutation benefits in the Local Government Pension Scheme (£3.369 million). This has been offset by the loss incurred on disposal of fixed assets of £4.998 million arising from the transfer of council dwellings to Argyll Community Housing Association (ACHA) at nil consideration as part of the housing stock transfer.

At the financial year end, the Council held usable reserves of £29.928 million (£18.157 million 2005-06) representing 20% of net operating expenditure. The increase in the Council's reserves is caused partly by a £3.173 million increase in council tax income from second homes and by a change in the way unspent government grants are accounted for, which has increased income by £2.991 million. Underspends of £1.990 million and £2.311 million against the Council's revenue and capital budgets respectively, contribute most of the remainder.

The Council's reserves policy is to retain unearmarked reserves of at least 2% of its net operating expenditure. At 31 March 2007 the Council's unearmarked reserves totalled £4.674 million representing 2.2% of net operating expenditure in line with this policy.

We acknowledge that the Council continues to face significant financial pressures and much of its reserves are earmarked to finance existing commitments. However, the Council should ensure it has clear plans in place to use all reserves earmarked within its general fund, and does not build up reserves unnecessarily.

***Refer action plan point 1***

## Housing Stock Transfer

The Council transferred its housing stock with a net book value of some £44.766 million to ACHA on 21 November 2006 under a large scale voluntary transfer arrangement. As part of this arrangement, the Scottish Executive repaid the Council's outstanding housing loan debt of £36.451 million, together with a further £1.327 million to cover early repayment costs and the existing premium incurred when the Council re-scheduled its HRA debt some years ago. The Scottish Executive also met 'breakage costs' of £9.483 million charged by the Public Works Loans Board in respect of the early repayment of debt.

The draft accounts recorded the repayment of both HRA debt and the loan premium as grant income. Following our audit, the Council agreed to amend the accounts to record the debt and premium repayment as proceeds from the transfer of assets to ACHA. This approach reduces both HRA income and the loss on the disposal of fixed assets in the income and expenditure accounts by £37.769 million.

Some council houses involved in the transfer had been built on land not owned by the Council. The transfer agreement requires the Council to purchase this land and transfer it to ACHA at nil cost. The District Valuer has valued the land at approximately £1.040 million, however, a price has yet to be formally agreed with the land owners. The accounts have been adjusted to remove this land from the Council's fixed assets and to record a contingent liability to better reflect the substance of the transaction.

## Accounts Presentation

The 2006 SORP requires the Council's accounts to be presented in compliance with the requirements of the Best Value Accounting Code of Practice (BVACOP). Our audit identified some presentation differences between the Council's draft accounts and the required BVACOP presentation as outlined below:

- the accounts were adjusted to remove the 'Other Operating Income and Expenditure' line from the Income and Expenditure Account and to remove £1.221 million of net expenditure relating to the Dunbartonshire and Argyll and Bute Valuation Joint Board (DABVJB) which is now recorded on a separate line. The remaining £0.785 million of expenditure has been reallocated to other Council services;
- £1.346 million of unfunded benefits within Non-distributed costs have been reclassified from gross expenditure to gross income;
- an explanatory note has been prepared to explain the departure from BVACOP resulting from the inclusion of DABVJB expenditure within the Income and Expenditure account; and
- a number of other minor presentation amendments were made to improve the overall presentation of the financial statements, including the addition of a note to provide more detail on creditor balances at the financial year end.

***Refer action plan point 2***

## Bank Accounts

Our audit found 12 bank accounts held in the Council's name that were not included on the ledger. Two accounts are in regular use by the legal department, and the remainder are considered dormant. The Council should review these accounts to determine whether they should be closed or included within its ledger.

We found that the Income Bank Account had not been reconciled since August 2006. As a result, the reconciliation for this bank account at the 31 March 2007 took a significant amount of time to complete.

***Refer action plan points 3 & 4***

## Debt Management

The Council records significant amounts of aged debt in its balance sheet. The total value of trade debtors over 9 months old at 31 March 2007 was £0.914 million. The Council has also retained former tenant rent arrears with a value of £0.248 million following the housing stock transfer.

We found that there is no formal debt recovery scheme in place for outstanding debtor balances and, whilst the Council has adequately provided for these debts, it has not reviewed them for some time to consider recoverability.

***Refer action plan point 5***

## Trust Funds and Common Good

Our review found that some Trust Funds and Common Good Funds managed by the Council are not registered with the Office of the Scottish Charity Regulator under the provisions Charities and Trustee Investment (Scotland) Act 2005 (the Act). The Council should review the Trust Funds and Common Good accounts not registered to confirm they remain outwith the scope of the Act.

***Refer action plan point 6***

**Grant Thornton UK LLP**
**18 September 2007**

# Appendix A – Action Plan

| No | Finding | Priority | Recommendation | Management Response | Implementation date |
|---|---|---|---|---|---|
| **Financial Position** | | | | | |
| **1** | The total value of the Council's reserves is high, representing 20% of its annual net cost of services. | Medium | The Council should ensure it has clear plans in place to use all reserves earmarked within its general fund, and does not build up reserves unnecessarily. | Whilst a timescale for expenditure is in place for earmarked funds more detailed plans will be completed. | 30 November 2007 |
| **Accounts Presentation** | | | | | |
| **2** | The Council's accounts required a number of presentational amendments to ensure full compliance with BVACOP. | Medium | The Council should undertake a supervisory review of its accounts prior to submission to audit to ensure they are presented in full compliance with the BVACOP. | Agreed. Will put this review in place for 2007/08 accounts. | 30 June 2008 |
| **Bank Accounts** | | | | | |
| **3** | We identified a number of bank accounts held by the Council which do not appear on the ledger. The total cash balance held in these accounts was not material to the financial statements. | Medium | The Council should review its banking arrangements to ensure that all bank accounts held are recorded on the ledger. Any surplus or dormant bank accounts should be closed. | Agreed. Will close dormant accounts and bring non imprest accounts on to ledger. | 31 October 2007 |

| No | Finding | Priority | Recommendation | Management Response | Implementation date |
|---|---|---|---|---|---|
| **4** | The Income Bank Account had not been reconciled on a monthly basis during the year. The reconciliation for this bank account at the 31 March 2007 covered 8 months of the financial year and took a significant amount of time to complete. | High | The Council should ensure that all bank accounts are reconciled at least monthly. This will reduce the risk of undetected errors and discrepancies in the bank account.<br><br>A senior officer should review the reconciliation to ensure it has been completed in a timely manner and all reconciling items are cleared. | Monthly reconciliations fell behind due to long term illness of a staff member. They were carried out to end of November 2006, but due to the delay, the later months were rolled up together. Reconciliation since the year end has been done for each month and end of July has recently been completed. More staff members have been trained to reduce the reliance on one key person. | In place since June 2007 |
| **Debt Management** | | | | | |
| **5** | We found that there is no formal debt recovery scheme in place for outstanding debtor balances and, whilst the Council has adequately provided for these debts, it has not reviewed them for some time to consider recoverability. | Medium | The Council should develop a formal debt recovery scheme to formalise its procedures for following up, reviewing and writing off aged debtors. | A formal policy has always been in place in relation to sundry debts but due to transfer of staff under TUPE in connection with Housing Staff Transfer, the internal resources for this largely disappeared. Outsourcing arrangements are now being considered. | Tender by December 2007 with contract in place by April 2008 |
| **Trust Funds and Common Good** | | | | | |
| **6** | Our review found that some Trust Funds and Common Good Funds managed by the Council are not registered with the Office of the Scottish Charity Regulator (OSCR) under the Charities and Trustee Investment (Scotland) Act 2005. | High | The Council should review all Trust Funds and Common Good Funds and consider the need for these to be registered as charities with OSCR.<br><br>We understand that OSCR will require financial statements for local authority charities to be submitted for the 2007-08 financial year onwards. | Agreed. Will review Trust Funds and Common Good to establish if it is necessary to register with OSCR. | 31 March 2008. |

# Appendix B - Summary of Accounting Adjustments

## Adjusted differences

This is a summary of accounting adjustments processed by the Council following our audit.

| | Income & Expenditure account | | Balance Sheet | |
|---|---|---|---|---|
| | Dr £000s | Cr £000s | Dr £000s | Cr £000s |
| ***Housing Stock Transfer*** To remove amounts paid by the Scottish Executive in respect the housing stock transfer from income to capital contributions. | 37,769 HRA Income | 37,769 Loss on disposal of fixed assets | | |
| ***Housing Stock Transfer*** The accounts have been adjusted to remove land valued at £1.040 million, that the Council has committed to purchase and transfer at nil cost to ACHA, from the Council's fixed assets. This commitment is recorded as a contingent liability within the accounts. | | 1,040 Loss on disposal of fixed assets | 1,040 Creditors 1,040 FARA | 1,040 Fixed assets |
| ***Other income and expenditure*** Reallocation of 'Other income and expenditure' to services as required by BVACOP. | 785 Service Expenditure 16,347 Other income and expenditure | 17,132 Other income and expenditure | | |
| ***Non Distributed Costs (NDCs)*** Contribution gains in respect of unfunded benefits moved from gross expenditure to gross income | 1,346 NDCs | 1,346 NDCs | | |

| | Income & Expenditure account | | Balance Sheet | |
|---|---|---|---|---|
| | Dr £000s | Cr £000s | Dr £000s | Cr £000s |
| ***Repairs and Renewals Fund*** Contributions to the repairs and renewals fund incorrectly shown as a debit in the Statement on Movement of the General Fund. | 230 Environment services | | | 230 General Fund |
| ***Single Status Provision*** The provision for the costs of implementing single status for 2006-07 was updated to take account of the Council's revised offer to employees. | 468 Service Expenditure | | | 468 Provisions |
| ***Creditors*** Reversal of an accrual for private sector housing renewal expenditure. | | 200 Service Expenditure | 200 Creditors | |
| **Disclosure Adjustments** | A number of disclosure adjustments have been agreed to improve the clarity and presentation of the accounts that do not affect the reported financial position. | | | |
| **TOTAL Adjustments** | **56,945** | **57,487** | **2280** | **1,738** |

The net effect of these adjustments is to increase the general fund for the financial year by £0.678 million. During the audit, the Council notified us of additional adjustments of £0.393 million, which we agreed. The combined impact of these adjustments is to amend the reported deficit in the Council's draft accounts from £0.686 million to show a surplus of £0.385 million in the revised accounts.

## Unadjusted differences

There is one unadjusted difference in the finalised accounts.

| | Income & Expenditure account | | Balance Sheet | |
|---|---|---|---|---|
| | Dr £000s | Cr £000s | Dr £000s | Cr £000s |
| ***Operating and finance leases*** A lease taken out in the year has been classified as an operating lease, but should be classified as a finance lease. | | | 84 Fixed assets | 84 Creditors |