

Annual Governance Report

September 2007



# Annual Governance Report

**Cumbria County Council**

**Audit 2006/07**

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.
- 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, 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 reports**

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.

### **Copies of this report**

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## Purpose of this document

- 1 In accordance with the Audit Commission's Code of Audit Practice (the Code), this report provides a summary of the work we have carried out during our 2006/07 audit of accounts, the conclusions we have reached and the recommendations we have made to discharge our statutory audit responsibilities to those charged with governance (in this case the Audit Committee) at the time they are considering the financial statements.
- 2 In preparing our report, the Code requires us to comply with the requirements of International Standards on Auditing (United Kingdom & Ireland) – ISA (UK&I) - 260 'Communication of Audit Matters to Those Charged with Governance', by reporting to you matters relating to the audit of the financial statements. Other auditing standards require us to communicate with you in other specific circumstances including:
  - where we suspect or detect fraud;
  - where there is an inconsistency between the financial statements and other information in documents containing the financial statements; and
  - non-compliance with legislative or regulatory requirements and related authorities.
- 3 We are also required to communicate to you the Audit Commission's requirements in respect of independence and objectivity, and these are set out at Appendix 1.
- 4 This report has been prepared for presentation to the Audit Committee on 28 September 2007. Members are invited to:
  - consider the matters raised in the report before the financial statements are approved;
  - approve the representation letter on behalf of the Authority and those charged with governance before we issue our opinion; and
  - consider amending the financial statements for unadjusted misstatements, significant qualitative aspects of financial reporting and any recommendations for improvement in the action plan.
- 5 Our work during the year was performed in line with the plan that we presented to you on 1 March 2007. We have issued separate reports during the year having completed specific aspects of our programme, which are listed in Appendix 2.

## Key messages

- 6 Our work on the financial statements is substantially complete although there are still outstanding issues to be resolved. In particular, our work on the Whole of Government Accounts and also the Group Accounts has yet to be concluded. Should any further matters arise in concluding the outstanding work that need to be reported, we will raise them with the Chair of the Audit Committee. We propose issuing an unqualified audit opinion on 28 September 2007 (a draft report is attached at Appendix 3).
- 7 We have made recommendations for improvements and these are included in Appendix 9.
- 8 In our view, the financial statements of the pension fund do present fairly the financial transactions of the pension fund. We are pleased to note that the presentation of the Pension Fund accounts has improved this year, with no amendments required.
- 9 In our view, the revised Statement on Internal Control (SIC) has been prepared in accordance with proper practice specified by CIPFA and is consistent with the findings from our audit. We recommended that the SIC be amended to include reference to the waste management charges control issues and the action being taken by the Council to improve controls and that the Annex to the SIC be included.
- 10 Our work on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources is now complete. We propose issuing an unqualified value for money conclusion on the use of resources on 28 September 2007 (a draft report is attached at Appendix 3).

## Audit status

- 11 At the date of issue of this report (24 September 2007) our detailed audit is substantially complete. We have yet to complete the audit of the Whole of Government Accounts (WGA) return.
- 12 The Authority has taken a positive and constructive approach to our audit and we would like to take this opportunity to express our appreciation for the Authority's assistance and co-operation.
- 13 The financial statements were prepared by the Corporate Accounting Officer (CAO) who left the Authority before the audit commenced. He provided comprehensive and detailed working papers with links to all the statements. His replacement worked on the accounts issues on a part time basis until the end of August, when she was able to work full time as the CAO. The absence of a full time CAO at a crucial time in the audit cycle affected the speed with which management were able to respond to audit queries, which in turn has made the task of auditing the Council's accounts more difficult.
- 14 In 2007/08 there will be further changes to the Statement of Recommended Practice (SORP) which governs the way in which local authority accounts are drawn up. In 2008/09 the International Financial Reporting Standards will require yet more changes to the presentation of the accounts, including the re-statement of the 2007/08 comparative figures.

### **Recommendation**

*R1 The Council should review its resources and arrangements for preparing the accounts to ensure that the known changes to accounting requirements can be anticipated and that the next round of accounts preparation is achieved with the minimum disruption.*

## Accounts and Statement on Internal Control

- 15 Our work on the financial statements is substantially complete although there are still outstanding issues to be resolved. In particular, our work on the Whole of Government Accounts and the Group Accounts has yet to be concluded.
- 16 Auditors are required to obtain written confirmation of certain representations from management and those charged with governance before an audit report is issued, such as acknowledgement of responsibility for the fair presentation of the financial statements in accordance with the applicable financial reporting framework and responsibility for the design and implementation of internal control to prevent and detect error.
- 17 The auditor should also obtain written representations from management on matters material to the financial statements when other sufficient appropriate audit evidence cannot reasonably be expected to exist.

- 18 The final drafts of the letters of representation have been attached in Appendix 4. In them we ask that the Council explains the reasons for not adjusting the misstatements referred to in this report and refers particularly to the issue of equal pay.

## Unadjusted misstatements

- 19 We are required to report to you all unadjusted misstatements that we have identified during the course of our audit, other than those that are clearly trivial. These are recorded in full at Appendix 5 but we provide an analysis of the most significant items below for your attention.
- 20 We invite you to consider whether the financial statements should be amended for the unadjusted misstatements identified at Appendix 5. Should you choose not to amend the financial statements, in accordance with ISA (UK&I) 260 we request that you extend the representation letter to explain why. We ask that the letter specifically details the misstatements and/or qualitative aspects of reporting to which it relates.
- 21 The Statement of Recognised Gains and Losses (STRGL) is reported for the first time this year. It provides an explanation of the movement on the Council's net worth between years. It includes several entries for both the 2005/06 comparators and the 2006/07 movements which should not be included, eg:
- the sums set aside to supplement the Revenue Support Grant amendments (-£924,000 in 2005/06 and -£320,000 in 2006/07);
  - Capital receipts (£753,000 in 2005/06 and £1.46m in 2006/07); and
  - Usage of the Capital Fund (£1.4m in 2005/06).
- 22 The profit and loss on the sale of fixed assets shown in the I&E account (£6,000) has been incorrectly calculated. Failure to reconcile capital receipts to disposals within the asset register means that the correct figure has yet to be calculated. This error links to figures incorrectly included in the STRGL mentioned in the above paragraph.
- 23 Kendal Library has been removed from the balance sheet within the net revaluations figure. We understand this was because the building is leased. However the latest revaluation schedule shows that only the recent extension is leased and therefore it is not correct to remove the £2m of the main library building. The error is not material to the overall financial statements.

## Adjustments to the financial statements

- 24** We are also required to bring to your attention misstatements that have already been corrected by management where we consider them relevant to your wider governance responsibilities. Paragraphs 27 to 32 provide an analysis of the most significant items below for your attention. They are recorded in full at Appendix 6.
- 25** Towards the end of our audit, we were informed that a mistake had been made in the preparation of the accounts and that it had been the intention of the Council to only increase the Equal Pay Reserve by £6m rather than £6.5m, which would leave a further £500,000 for the General Fund balance. We read the papers and Minutes of the Council and the stated intention throughout 2006/07 had been to increase the Equal Pay Reserve by £6.5m from £15.3m to £21.8m. However the accounts have been amended to record a closing General Fund Balance of £7m and the Equal Pay Reserve closing balance is £21.3m.
- 26** The narrative within the Deputy Leader's Preface, the Explanatory Foreword and the narrative within the accounts have also been amended to reflect the adjustment to the Equal Pay Reserve and the General Fund Balance. This and the other amendments referred to below and in Appendix 6 should be reported to the Council so that they can ratify the decision to change the earmarked reserves and be made aware of the other required amendments to the accounts which were adopted by the Council on 28 June 2007.
- 27** The Council spent £4.0m capital monies on assets it does not own - mostly foundation schools. In accordance with its own accounting policies, such sums should be accounted for as a deferred charge and charged to revenue. By not doing so, the Council has failed to comply with its own accounting policy. The effect of adjusting for this error is to increase the deficit on the Income and Expenditure account from £7.5m to £11.5m. However, there is no effect on the General Fund balance because expenditure on deferred charges is adjusted within the Statement of Movement on the General Fund Balance (SMGFB).
- 28** The Cash Flow Statement and accompanying notes did not comply with the Statement of Recommended Practice (SORP). In addition most of the entries within the statement were presented on an income and expenditure basis rather than on a cash basis. This means that the entries are not disclosed accurately and also the line 'Other operating costs' is effectively a balancing figure rather than being supported by evidence. The cash flow statement is one of the Primary Statements and is important because, together with the supporting notes, it provides a link between the other Primary Statements - the income and expenditure account and the balance sheet.
- 29** The balance sheet showed a single figure for the Council's closing cash balance (£975,000 cash in hand). However this figure is a net figure and disguises the fact that there are imprest balances of some £286,000 in hand, the County's schools are some £16.2m in hand, but the Council's County Fund balance is overdrawn by some £15.5m. Cash and bank balances should not be netted off unless there is a right of set off. The balance sheet was amended.

- 30 Amendments were made to the Explanatory Foreword and the note on Contingent Liabilities regarding the cost of paying out equal pay claims to explain that additional borrowing to finance any payouts would only be allowed if the Council was able to charge the expenditure to capital as a result of a direction from the DCLG.
- 31 Additional notes were made within the Accounting Policies and with the Income and Expenditure Account to explain the significant changes to the Statements required by the SORP, primarily the introduction of the Income and Expenditure account and the Statement of Recognised Gains and Losses.
- 32 Our initial overview of the accounts identified that net expenditure on Highways, Roads and Transport Services had dropped by one third (some £10m). Part of the reason for the difference is because an error has been made on the 2005/06 adjusted comparative figure and £6.2m of capital charges which should have been included in the Highways, Roads and Transport has mistakenly been charged to Social Services. In addition £720,000 of PFI set up costs (for the CNDR scheme) have been omitted from the reported expenditure in 2006/07.

## Accounting practices

- 33 We are also required to report to you our view on the qualitative aspects of the Authority's accounting practices and financial reporting and have set out below our observations on the key issues affecting the Authority.
- 34 The accounting treatment of capital expenditure and the way in which assets are recognised and managed should be reviewed. We plan to undertake detailed audit work on the Council's system for accounting for capital expenditure as part of our audit of the Council's 2007/08 accounts. We were concerned about the treatment of capital and fixed assets in a number of areas which are summarised below and noted in more detail in Appendix 7.
  - The Council has not set a de minimis level for capital expenditure.
  - There is a risk that items which should be charged to revenue have been charged to capital.
- 35 Over half the £25.3m capital expenditure on land and buildings has been written off on the basis that it did not add value to the assets.
  - The presentation of the movement on fixed assets in the year within note 3.20 needs to be improved to ensure the transactions on land and buildings are clearly reported.
  - There is a lack of clarity over the Council's policy regarding which property assets are recorded in the balance sheet, foundation and aided schools are excluded from the balance sheet but controlled schools are included even when it clear that the Council does not own the property.

- The asset register was not fully completed.
  - The £22.7m of revaluations in the year were actually net of two adjustments amounting to £10m which should more properly have been shown as reclassifications.
- 36** The SORP requirements for capital accounting will change for 2007/08 with the introduction - among other changes - of a Revaluation Reserve. This change will mean that there should be clarity over the revaluation of assets as any future impairments of fixed assets will be charged to revenue once any amount accumulated in the reserve has been used up.
- 37** The working papers to support the bank reconciliation were poorly presented and those to support capital receipts and the surplus/deficit on the sale of fixed assets were inadequate. These are two vital areas and the working papers should be improved for next year.
- 38** Most of the entries in the Cash Flow Statement were presented on an income and expenditure basis rather than on a cash basis, as referred to in paragraph 28 above.
- 39** We have yet to see the Whole of Government Accounts (WGA) pack. The guidance notes for local authorities recommend that the WGA returns are completed at the same time as the accounts are presented to the Council, ie by the end of June, and that are passed to auditors by the end of August. We are required to certify the returns by 1 October 2007. Given the late submission of this pack, we cannot guarantee achieving this date. The Council is required to inform the DCLG of late submissions.
- 40** The creditors figure includes £1.2m in respect of the County's outstanding contribution to an Intermediate Care pooled fund hosted by Cumbria PCT. Under the terms of FRS9 each partner is responsible for its own assets, liabilities and cash flows relating to the partnership and should not show any creditor liability to the pool. The Council should ensure that the partnership arrangements are improved to enable it to comply with this accounting standard.

<b>Recommendations</b>	
<i>R2</i>	<i>The accounting treatment of capital expenditure and the way in which assets are recognised and managed should be reviewed.</i>
<i>R3</i>	<i>The working papers to support the bank reconciliation and those to support capital receipts should be improved.</i>
<i>R4</i>	<i>The practice of including items in the cash flow statement on an income and expenditure basis rather than the cash transactions should not continue.</i>
<i>R5</i>	<i>The Council should comply with the timetable for the provision of the information required by the DCLG for the preparation of the Whole of Government Accounts.</i>

### **Recommendations**

*R6 Partnership arrangements with Cumbria PCT should be improved to ensure that the Council can comply with FRS9.*

## **Systems of internal control**

- 41** As part of our audit, we consider the systems of accounting and financial control and report to you any material weaknesses identified.
- 42** We have not provided a comprehensive statement of all weaknesses which may exist in internal control or of all improvements which may be made, but have addressed only those matters which have come to our attention as a result of the audit procedures we have performed.
- 43** We reviewed whether the Statement on Internal Control (SIC) has been prepared in accordance with proper practice specified by CIPFA and is consistent with the findings from our audit. The SIC was considered by the Audit Committee on 11 June 2007. However, the SIC which was included within the Statement of Accounts adopted by the Council on 28 June 2007 did not include the Annex of control issues and therefore was incomplete.
- 44** With regard to the control issues relating to charges for waste management, we understand that the County Council cannot prejudge the outcome of current legal proceedings but we are aware that a more general review of the management of contracts has been undertaken. This is now mentioned within the SIC.

## Use of resources

### Work performed

- 45 The Code requires us to reach a conclusion as to whether we are satisfied that the Council has proper arrangements in place for securing economy, efficiency and effectiveness in its use of resources – the value for money conclusion. In meeting this responsibility, we review evidence that is relevant to the Council's corporate performance management and financial management arrangements across a range of criteria specified by the Audit Commission. Our work to support our conclusion comprised the following elements:
- use of resources assessment;
  - data quality work; and
  - the best value performance plan.
- 46 The Audit Commission has published, in accordance with the Code of Audit Practice, 12 criteria on which auditors are required to reach a conclusion on the adequacy of an audited body's arrangements for economy, efficiency and effectiveness in its use of resources. These are shown at Appendix 8, along with our initial conclusions as to the effectiveness of each of the criteria.
- 47 Our work on the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources will be completed shortly. However, subject to finalisation of outstanding issues, at this stage we are expecting to issue an unqualified value for money conclusion at the same time that we issue the opinion on the Council's financial statements (a draft report is attached at Appendix 3). If any further observations are necessary regarding our value for money conclusion these will be reported to a subsequent Audit Committee.

### Use of resources assessment

- 48 We are currently finalising our work on our use of resources assessment. When finalised, we will discuss this with the relevant officers.

### Data quality work

- 49 We are currently finalising our data quality review and will report our findings to the relevant officers.

### Best value performance plan

- 50 Our work in respect of the Authority's 2006/07 Best Value Performance Plan (BVPP) was reported in the 2006 annual audit and inspection letter. No recommendations were made to the Audit Commission or the Secretary of State.

## Audit fee update

- 51 We reported our fee proposals as part of the Audit Plan for 2006/07. The table below reports the outturn fee against that plan.

	<b>Plan 2006/07</b>	<b>Actual 2006/07</b>
Financial statements and Statement on Internal Control	£201,749	£201,749
Use of Resources	£98,181	£98,181
Total Audit Fees	£299,930	£299,930
Grants certification work	£115,000	2006/07 claims work is under way

- 52 The analysis above shows that our audit fee has been contained within the totals you have already agreed
- 53 The outturn on inspection fees will be reported in the annual audit and inspection letter.

## **Appendix 1 – The Audit Commission’s requirements in respect of independence and objectivity**

- 1 We are required to communicate the following matters to those charged with governance.
  - The principal threats, if any, to objectivity and independence identified by the auditor, including consideration of all relationships between the Authority, directors and the auditor.
  - Any safeguards adopted and the reasons why they are considered to be effective.
  - Any independent partner review.
  - The overall assessment of threats and safeguards.
  - information about the general policies and processes for maintaining objectivity and independence.

We are not aware of any relationships that may affect the independence and objectivity of the audit team and which are required to be disclosed under auditing and ethical standards.

## Appendix 2 – Audit reports issued

<b>Planned output</b>	<b>Due date</b>	<b>Actual date</b>	<b>Key contact</b>
Report on Data Quality	November 2006	November 2006	Audit Manager
Use of resources report	December 2006	December 2006	Audit Manager
CPA report	December 2006	December 2006	CPA Lead
Supporting People inspection report	December 2006	December 2006	Lead Housing Inspector
BVPP report	December 2006	December 2006	Area Performance Lead
Fire Use of resources report	March 2007	March 2007	Audit Manager
Fire Direction of travel assessment	March 2007	March 2007	Area Performance Lead
VFM conclusion	September 2007	September 2007	District Auditor
Annual Governance Report	September 2007	September 2007	Audit Manager
Opinion on financial statements	September 2007	September 2007	District Auditor
Final accounts memorandum	October 2007		Audit Manager
Annual audit and inspection letter (including direction of travel assessment)	February 2008		Relationship Manager

## **Appendix 3 – Proposed auditor’s report**

### **Independent auditor’s report to the Members of Cumbria County Council**

#### **Opinion on the financial statements**

I have audited the financial statements and pension fund accounts of Cumbria County Council and its group for the year ended 31 March 2007 under the Audit Commission Act 1998. The financial statements comprise the Income and Expenditure Account, the Statement of the Movement on the General Fund Balance, the Balance Sheet, the Statement of Total Recognised Gains and Losses, the Cash Flow Statement, the Group Accounts and the related notes. The pension fund accounts comprise the Fund Account, the Net Assets Statement, and the related notes. The financial statements and pension fund accounts have been prepared under the accounting policies set out within them.

This report is made solely to Cumbria County Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 36 of the Statement of Responsibilities of Auditors and of Audited Bodies prepared by the Audit Commission.

#### **Respective responsibilities of the Chief Finance Officer and auditors**

The Chief Finance Officer’s responsibilities for preparing the financial statements, including the pension fund accounts, in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2007 are set out in the Statement of Responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements and the pension fund accounts present fairly, in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2007:

- the financial position of the Authority and its income and expenditure for the year; and
- the financial transactions of its pension fund during the year and the amount and disposition of the fund’s assets and liabilities, other than liabilities to pay pensions and other benefits after the end of the scheme year.

I review whether the statement on internal control reflects compliance with CIPFA’s guidance: ‘The statement on internal control in local government: meeting the requirements of the Accounts and Audit Regulations 2003’ issued in April 2004. I report if it does not comply with proper practices specified by CIPFA or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered, whether the statement on internal control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the Authority’s corporate governance procedures or its risk and control procedures.

I read other information published with the financial statements, and consider whether it is consistent with the audited financial statements. This other information comprises only the Preface and the Explanatory Foreword. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

## **Basis of audit opinion**

I conducted my audit in accordance with the Audit Commission Act 1998, the Code of Audit Practice issued by the Audit Commission and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Authority in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Authority’s circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

## Opinion

In my opinion:

- the financial statements present fairly, in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2007, the financial position of the Authority and its group as at 31 March 2007 and its income and expenditure for the year then ended; and
- the pension fund accounts present fairly, in accordance with the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2007, the financial transactions of the Pension Fund during the year ended 31 March 2007, and the amount and disposition of the fund's assets and liabilities as at 31 March 2007, other than liabilities to pay pensions and other benefits after the end of the scheme year.

**Mark Heap, District Auditor**

**Date**

## **Conclusion on arrangements for securing economy, efficiency and effectiveness in the use of resources**

### **Authority’s responsibilities**

The authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to regularly review the adequacy and effectiveness of these arrangements.

Under the Local Government Act 1999, the authority is required to prepare and publish a best value performance plan summarising the authority’s assessment of its performance and position in relation to its statutory duty to make arrangements to ensure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.

### **Auditor’s responsibilities**

I am required by the Audit Commission Act 1998 to be satisfied that proper arrangements have been made by the authority for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires me to report to you my conclusion in relation to proper arrangements, having regard to relevant criteria specified by the Audit Commission for principal local authorities. I report if significant matters have come to my attention which prevent me from concluding that the authority has made such proper arrangements. I am not required to consider, nor have I considered, whether all aspects of the authority’s arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

I am required by section 7 of the Local Government Act 1999 to carry out an audit of the authority’s best value performance plan and issue a report:

- certifying that I have done so;
- stating whether I believe that the plan has been prepared and published in accordance with statutory requirements set out in section 6 of the Local Government Act 1999 and statutory guidance; and
- where relevant, making any recommendations under section 7 of the Local Government Act 1999.

## **Conclusion**

I have undertaken my audit in accordance with the Code of Audit Practice and having regard to the criteria for principal local authorities specified by the Audit Commission and published in December 2006, I am satisfied that, in all significant respects, Cumbria County Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2007.

## **Best Value Performance Plan**

I issued my statutory report on the audit of the authority's best value performance plan for the financial year 2006/07 on 12 December 2006. I did not identify any matters to be reported to the authority and did not make any recommendations on procedures in relation to the plan.

## **Certificate**

I certify that I have completed the audit of the accounts in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.

**Mark Heap, District Auditor**

**Date**

## **Independent auditor’s report to Cumbria County Council on the whole of government accounts (WGA) consolidation pack**

I have examined pages [X to Y] of the consolidation pack of Cumbria County Council for the year ended 31 March 2007, which has been prepared and certified by the Consolidation Officer in accordance with instructions from HM Treasury.

I confirm that we have performed the procedures for Band 2 bodies as set out in the Audit Commission’s Auditor Briefing 1/2006.

This report is made solely to Cumbria County Council in accordance with section 10 (2) of the Government Resources and Accounts Act 2000 and for no other purpose, as set out in paragraph 36 of the Statement of Responsibilities of Auditors and Audited Bodies prepared by the Audit Commission.

In my opinion, pages [X to Y] of the consolidation pack are consistent with the statement of accounts for the year ended 31 March 2007 on which I have entered my opinion in accordance with section 9 of the Audit Commission Act 1998.

[If the consolidation pack is not consistent, this sentence should be amended to set out the inconsistencies identified ‘In my opinion, pages [X to Y] of the consolidation pack are consistent with the statutory financial statements except for...’].

[If the opinion on the statutory financial statements is qualified, a further sentence/sentences should be added ‘My opinion on the full financial statements was qualified because.....’].

[If the opinion on the statutory financial statements includes an emphasis of matter paragraph dealing with a significant uncertainty, a further sentence/sentences should be added ‘My opinion on the statutory financial statements included an emphasis of matter paragraph because of the significant uncertainty relating to .....’].

**Mark Heap, District Auditor**

**Date**

## Appendix 4 – Management Representation letter

Draft management representation letter (ISA+580)

To:

The Audit Commission

[address]

### **Cumbria County Council - Audit for the year ended 31 March 2007**

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other officers of Cumbria County Council, the following representations given to you in connection with your audit of the council's financial statements for the year ended 31 March 2007.

I acknowledge my responsibility under the relevant statutory authorities for preparing the financial statements which present fairly and for making accurate representations to you.

I acknowledge my responsibilities under the relevant statutory authorities to prepare the County's accounts in accordance with proper practices as defined in relevant legislation or guidance.

I confirm that I believe that the effects of the uncorrected financial statements misstatements listed in the attached schedule are not material to the financial statements, either individually or in aggregate. These misstatements have been discussed with those charged with governance within the council and the reasons for not correcting these items are as follows;

reason 1 etc;

reason 2

The council has no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

### **Specific representations:**

Equal pay claims

## **Supporting records**

All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the council have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of all members meetings, have been made available to you.

## **Group entities**

[specific representation if needed]

## **Related party transactions**

I confirm the completeness of the information provided regarding the identification of related parties.

The identity of, and balances and transactions with, related parties have been properly recorded and where appropriate, adequately disclosed in the financial statements

## **Contingent liabilities**

There are no other contingent liabilities, other than those that have been properly recorded and disclosed in the financial statements. In particular:

- there is no significant pending or threatened litigation, other than those already disclosed in the financial statements;
- there are no material commitments or contractual issues, other than those already disclosed in the financial statements; and
- no financial guarantees have been given to third parties.

## **Law, regulations and codes of practice**

There are no instances of non-compliance with laws, regulations and codes of practice, likely to have a significant effect on the finances or operations of the council.

## **Irregularities**

I acknowledge my responsibility for the design and implementation of internal control systems to prevent and detect error.

There have been no:

- irregularities involving management or employees who have significant roles in the system of internal accounting control;
- irregularities involving other employees that could have a material effect on the financial statements; and

- communications from regulatory agencies concerning non-compliance with, or deficiencies on, financial reporting practices which could have a material effect on the financial statements.

### **Post balance sheet events**

Since the date of approval of the financial statements by Members of the council, no additional significant post balance sheet events that have occurred which would require additional adjustment or disclosure in the financial statements.

Signed on behalf of Cumbria County Council

Signed

Name

Position

Date

# Management Representation letter

## Local Government Pension Scheme

To: Mr. Mark Heap

District Auditor

The Audit Commission

Aspinall Close Middlebrook

Horwich

BOLTON BL6 6QQ

## Cumbria Local Government Pension Scheme – Audit for the year ended 31 March 2007

I confirm to the best of my knowledge and belief, and having made appropriate enquiries of other officers of the Authority, the following representations given to you in connection with your audit for the year ended 31 March 2007.

### Specific representations

There are no specific representations.

### Related party transactions

There are no other material transactions with related parties, other than those which have been properly recorded and disclosed in the financial statements.

### Contingent liabilities

There are no other contingent liabilities, other than those that have been properly recorded and disclosed in the financial statements. In particular:

There are no significant pending or threatened litigation, other than those already disclosed in the financial statements.

There are no material commitments or contractual issues, other than those already disclosed in the financial statements.

### Law, regulations and codes of practice

There are no instances of non-compliance with laws, regulations and codes of practice, likely to have a significant effect on the finance or operation of the Authority.

### **Post balance sheet events**

Since the date of approval of the financial statements by Members of the Council, the Government has begun consultation on the removal of tapering protection in respect of the Rule of 85, as part of the transition to a new Local Government Pension Scheme from April 2008. The impact of this, and other changes, will be incorporated in the actuarial valuation at 31 March 2007.

Signed on behalf of Cumbria County Council, Administering Authority for the Cumbria Local Government Pension Fund

Signed:

Name

Position:

Date:

## Appendix 5 – Summary of unadjusted misstatements

We are required to report to you all unadjusted misstatements that we have identified during the course of our audit, other than those that are clearly trivial. The items below are brought to your attention to enable you to consider whether the financial statements should be amended for them. If you choose not to amend the financial statements in respect of these items, you should extend the representation letter to explain why.

	Description of misstatement	Nature of adjustment
1	Statement of Recognised Gains and Losses (STRGL)	The STRGL included entries for sums set aside to supplement the Revenue Support Grant amendments (-£924,000 in 2005/06 and -£320,000 in 2006/07). These were adjustments to Government grant funding which were effected by reducing allocations in subsequent years. The Council had set aside sums to meet this shortfall but had accounted for these transactions incorrectly, and therefore had to make postings to the STRGL to balance the statements.
2	Statement of Recognised Gains and Losses (STRGL)	The STRGL included entries for capital receipts (£753,000 in 2005/06 and £1.46m in 2006/07). These entries should not have been required to the STRGL and reflect the fact that the Council had accounted incorrectly for losses and gains on the disposal of fixed assets.

	<b>Description of misstatement</b>	<b>Nature of adjustment</b>
3	Statement of Recognised Gains and Losses (STRGL)	The STRGL included entries for Usage of the Capital Fund (£1.4m in 2005/06). No entries should be made to the STRGL for usage of the capital fund and this indicates that incorrect accounting entries were made for the usage of the capital fund in 2005/06.
4	Profit and loss on sale of fixed assets	As stated at 2 above, the gains and losses on sale of fixed assets have been incorrectly calculated and a £6,000 gain is shown in the I&E statement. This does not take account of all disposals in the year.
5	Kendal Library	Kendal Library has been removed from the balance sheet within the net revaluations figure. We understand this was because the building is leased. However the latest revaluation schedule shows that only the recent extension is leased and therefore it is not correct to remove the £2m of the main library building.
6	Pooled Fund Contribution due to Cumbria PCT	A creditor balance of £1,228k is included in the Council's balance sheet in respect of an outstanding contribution to a pooled fund operated by Cumbria PCT. This is incorrect accounting treatment: the pooled fund is not an entity and therefore the Council cannot have any outstanding liability at the year end. However, Cumbria PCT failed to supply the required accounting information to enable the Council to make the necessary adjustments in its accounts.

## Appendix 6 – Summary of adjusted misstatements

The following misstatements were identified during the course of our audit and the financial statements have been adjusted by management. We bring them to your attention to assist you in fulfilling your governance responsibilities.

	Description of misstatement	Nature of adjustment
1	£4m of land and buildings capital expenditure on non-owned assets charged to capital additions instead of to deferred charges.	In order to comply with the Council's own accounting policies the accounts were amended to charge the spend on non-owned assets as a deferred charge. As deferred charges are written off to revenue in the year, the deficit on the I&E account increased from £7.5m to £11.5m but there was no ultimate effect on the general fund.
2	Cash flow statement - format and notes do not conform to the SORP.	The entries reported as income and expenditure rather than on a cash basis were amended The Notes to the cash flow were amended.
3	The £975,000 cash in hand figure on the balance sheet was a net figure.	The balance sheet was amended to report the cash in hand figures (£286,000 imprests and £16.2m county schools) separately from the County Fund cash overdrawn figure of £15.5m.
4	Narrative explanations on equal pay.	We asked that the explanatory foreword and notes to the accounts include an explanation that if the Council's current reserves are insufficient to meet the final expenditure on equal pay claims then any borrowing to fund the payments will be dependent on obtaining approval to capitalise the expenditure.
5	Narrative explanations regarding the changes to the SORP.	We asked that the introductory note to the I&E and the accounting policies reflect the significant changes in the SORP which required the introduction of an I&E account and a Statement of Recognised Gains and Losses for the first time this year.

	<b>Description of misstatement</b>	<b>Nature of adjustment</b>
6	£6.2m of capital charges in 2005/06 comparators shown within social services but should have been in highways.	The accounts were amended and therefore the movement between years on the two services could be explained.
7	FRS 17 note 3.17 omitted £2m firefighters' pensions.	The accounts were amended, the liabilities on the balance sheet were increased by £2m. This impacted on the I&E account but was reversed out in the SMGFB with no overall effect on the General Fund.
8	The Statement of Movement on the General Fund Balance (SMGFB) was not as per the SORP The SORP requires a simple statement on the movement on the general fund balance with a more detailed note to support it.	The required note was added to the Statement of Accounts
9	The SMGFB note which was included did not report the gross transactions in respect of FRS 17 costs and actual costs incurred under scheme regulations.	The SMGFB note was amended to show the gross transactions, there was no effect on the I&E account nor on the County Fund balance.
10	Fixed assets statement Note 3.20 did not report any expenditure on land and buildings as enhancements, the whole £25m was shown as acquisitions in the year.	Note 3.20 was amended.
11	Note 3.20 showed £22.8m increased revaluation figure net of two items removed from the Council's assets, £8m on Morton School and £2m on Kendal Library.	Items such as these should not be netted off as it distorts the actual movements in the year. The assets which were revalued in the year increased by some £34m. Note 3.20 was amended.
12	Earmarked reserves utilisation.	Note 3.35 was amended to report the appropriations to and from the earmarked reserves. There was no effect on the I&E or the balance sheet.

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	<b>Description of misstatement</b>	<b>Nature of adjustment</b>
13	The Council is required to disclose any related party transactions.	Our review of the Council's register found two declarations by Members which should be reported in the accounts. Note 3.40 was amended to include the transactions.
14	Mental health pooled budget - discontinued operation.	Note 3.15 was amended to report the transactions and the fact that the pooled budget has been discontinued.
15	£832,000 of income from fees and charges had been incorrectly netted off expenditure on central services to the public.	The accounts were amended to show the correct gross figures, no effect on general fund balance.
16	A dividend of £500,000 was received from Cumbria Waste Management in 2006/07. This figure has been netted off the finance and central service overhead in the costs of services.	The dividend has been disclosed as part of interest and investment income below the net cost of services.
17	Accounting for Amey transaction. Part of the accounting treatment agreed last year was to treat £2.2m of future payments as deferred capital receipts. In 2006/07 £391,000 was received in respect of this deferred capital receipt. The accounting entries made by the County were incorrect and have led to capital receipts unapplied being understated by £391,000 with a corresponding overstatement of capital receipts deferred.	The accounts were amended to increase capital receipts unapplied by £391,000 and reduce capital receipts deferred by the same amount.
18	Education Service Specific Grants on the I&E account incorrectly included £2,602k of capital grant.	The accounts were amended. This was a presentational error only, with a corresponding understatement of Education fees and charges which was also amended with no net effect on the I&E statement.

	<b>Description of misstatement</b>	<b>Nature of adjustment</b>
19	Reference to the Unitary bid in the explanatory foreword.	We asked that the wording be amended to reflect that fact that the Unitary bid was unsuccessful.
20	There were several examples of where the brackets used to denote income or expenditure or surplus/deficit were applied inconsistently.	Brackets were amended to report transactions accurately.
21	The Council's accounting policies state that preparatory costs for the Carlisle Northern Development Route PFI scheme are treated as deferred charges and written off in the year. £720,000 was spent on preparatory work in 2006/07 but this was capitalised as an infrastructure asset.	The accounts were amended to include this expenditure within deferred charges and write it off in year. The fixed assets on the balance sheet were reduced by £720,000. This increased the deficit on the I&E statement but had no impact on the General Fund balance.
22	£582,000 of LPSA capital grant was incorrectly posted to Government Grant Deferred.	Capital grant is posted to Government Grant Deferred only when it has been applied. As this LPSA grant was not applied in year, the accounts were amended to show it as a receipt in advance.

## Appendix 7 – Capital accounting issues

- 1 Accounting standards, FRS15 and the Statement of Recommended Practice (SORP) require that only expenditure which enhances the value and/or the life of an asset should be accounted for as capital. In particular, general expenditure on repairs and maintenance should always be charged to revenue. The Council recognises this within its Central Maintenance Fund report to Cabinet of 2 May 2006. However, in 2006/07 capital expenditure included over 200 'projects' of less than £12,000 amounting in total to over £600,000. There must be some doubt as to whether this expenditure should be classified as capital.
- 2 The use of a de minimis level for capital expenditure is recognised as good practice by the SORP. However, the Authority has not set such a level. We found that there were many examples of low levels of expenditure being charged to capital projects, which suggests that these monies may not relate to legitimate capital items. The Council should review its approach to accounting for capital expenditure to ensure that all such expenditure can be justified for capital purposes.
- 3 Most of the Council's capital expenditure on land and buildings is 'written off' in the year. This means that it is not recognised as adding any value to the Authority's asset base and does not appear on the balance sheet. Expenditure on land and buildings (which has been incorrectly referred to as work in progress in the balance sheet note 3.20) amounted to £25.2m in 2006/07. Of this total some £12.3m was written off on the grounds that it had added no value to any asset. A further £7.3m was written off on the basis that the properties had been revalued and the increased value would therefore be recognised in the revaluation line of the note.
- 4 £4.1m was written off on the grounds that the County did not own the properties (mainly foundation schools). This was an accounting error as the expenditure should have been treated as deferred charges. Furthermore the analysis of work in progress provided by the Authority included negative items of £1.3m which indicates that the work in progress figure may be wrongly stated. Accounting practice needs to be reviewed in this area.
- 5 In addition to our concerns with the accounting treatment of capital, we also felt that Note 3.20 in the accounts which shows the movement on each category of fixed asset was confusing and potentially misleading. The note shows no acquisitions or enhancements to land and buildings in the year - all expenditure is classified as work in progress and subsequently written off. The underlying assumption is that any increase in asset values will be picked up through revaluation. Acquisitions and enhancements to land and buildings should be shown as such within Note 3.20. We also found that the revaluation figure was net of a £10.5m reduction relating to the removal of Morton School and Kendal Library from the asset base. Material items such as these which do not relate to revaluations should be separately disclosed.

- 6 The Council should review the arrangements for accounting for the ownership of its land and buildings, particularly schools. At present all aided and foundation schools are effectively excluded from the Council's fixed assets balance in the accounts (they are recorded at a value of £1). However all controlled schools are included within the fixed assets; their net book value (NBV) at 31 March 2007 is some £60m. This accounting practice seems to reflect the way the schools are managed rather than the actual ownership. Our testing of revaluations identified that Nelson Thomlinson school is in the ownership of the Trustees, however the Council records a NBV of £15m as at 31 March 2007.
- 7 We understand that the guidance available to Councils on this area is not totally clear but it is for the Council to decide its accounting policy on recording assets on its balance sheet and accounting for depreciation on fixed assets. At present it is unclear as to what the Council's policy is in this respect and therefore it is not possible to know whether the Council is abiding by its own policy. The Council will continue to incur expenditure on the upkeep of all these categories of schools whether or not they are recorded in the balance sheet.
- 8 Kendal Library has been removed from the balance sheet within the net revaluations figure. We understand this was because the building is leased. However the latest revaluation schedule shows that only the recent extension is leased and therefore it is not correct to remove the £2m of the main library building.
- 9 We found that although the total figures on the asset register agree to the figures in Note 3.20, the Asset Register does not include the detail for the additions in 2006/07 - only an overall figure which is partly analysed in a separate sheet. The Asset Register needs to be fully completed with this detail, to show the additions as either new lines or additions to existing assets. The asset register plays an important role for management of the Council's £783m of assets and needs to be kept up to date.

## Appendix 8 – Value for money conclusion

- 1 The Audit Commission has published, in accordance with the Code of Audit Practice, 12 criteria on which auditors are required to reach a conclusion on the adequacy of an audited body's arrangements for economy, efficiency and effectiveness in its use of resources.
- 2 The Code criteria are linked to the use of resources assessment (UoR) key lines of enquiry (KLoEs). A score of Level 2 or higher under the KLoEs will result in an assessment that the Authority has adequate arrangements in place for the purposes of the Code criteria. The Code criteria and the linked KLoEs are show in the table below.

Code Criteria	Description	Associated UoR KLoE	VFM Conclusion
1	The body has put in place arrangements for setting, reviewing and implementing its strategic and operational objectives.	N/A	Adequate
2	The body has put in place channels of communication with service users and other stakeholders including partners, and there are monitoring arrangements to ensure that key messages about services are taken into account.	N/A	Adequate
3	The body has put in place arrangements for monitoring and scrutiny of performance, to identify potential variances against strategic objectives, standards and targets, for taking action where necessary, and reporting to members.	N/A	Adequate
4	The body has put in place arrangements to monitor the quality of its published performance information, and to report the results to members.	LG DQ KLoEs	Adequate
5	The body has put in place arrangements to maintain a sound system of internal control.	4.2	Adequate
6	The body has put in place arrangements to manage its significant business risks.	4.1	Adequate

<b>Code Criteria</b>	<b>Description</b>	<b>Associated UoR KLoE</b>	<b>VFM Conclusion</b>
7	The body has put in place arrangements to manage and improve value for money.	5.2	Adequate
8	The body has put in place a medium-term financial strategy, budgets and a capital programme that are soundly based and designed to deliver its strategic priorities.	2.1	Adequate
9	The body has put in place arrangements to ensure that its spending matches its available resources.	3.1	Adequate
10	The body has put in place arrangements for managing performance against budgets.	2.2	Adequate
11	The body has put in place arrangements for the management of its asset base.	2.3	Adequate
12	The body has put in place arrangements that are designed to promote and ensure probity and propriety in the conduct of its business.	4.3	Adequate

## Appendix 9 – Action plan

Page no.	Recommendation	Priority	Responsibility	Agreed	Comments	Date
7	R1 The Council should review its resources and arrangements for preparing the accounts to ensure that the known changes to accounting requirements can be anticipated and that the next round of accounts preparation is achieved with the minimum disruption.	High	Corporate Director – Finance and Central Services	Yes	The Council is strengthening its corporate accounting resources to ensure there is additional capacity to address these challenges. It is also developing further review and quality assurance arrangements.	March 2008
11	R2 The accounting treatment of capital expenditure and the way in which assets are recognised and managed should be reviewed.	High	Corporate Director – Finance and Central Services	Yes	The Council is reviewing its capital accounting arrangements as part of its preparations for E5 and will address these issues as part of that work as a matter of priority.	December 2008
11	R3 The working papers to support the bank reconciliation and those to support capital receipts should be improved.	High	Corporate Director – Finance and Central Services	Yes	The Council's improved review and quality assurance arrangements should address these concerns.	April 2008
11	R4 The practice of including items in the cash flow statement on an income and expenditure basis rather than the cash transactions should not continue.	High	Corporate Director – Finance and Central Services	Yes	The Council will prepare the 2007/8 cash flow statement in accordance with best accounting practice. Again enhanced review and quality assurance arrangements will address this point	April 2008
11	R5 The Council should comply with the timetable for the provision of the information required by the DCLG for the preparation of the Whole of Government Accounts.	High	Corporate Director – Finance and Central Services	Yes	The Council's strengthened corporate accounting resources will address the need to meet the Whole of Government Accounts timetable.	March 2008
12	R6 Partnership arrangements with Cumbria PCT should be improved to ensure that the Council can comply with FRS9.	Med	Corporate Director – Finance and Central Services	Yes	The Council will discuss these arrangements with the PCT to ensure compliance with FRS9	December 2008