

East Lothian Council

Report to those charged with governance on the audit of the
2009/10 Financial Statements **(DRAFT)**

September 2010



 AUDIT SCOTLAND

Contents

Key Issues	1	Proposed Independent Auditor's Report	7
Introduction	1	Appendix B	9
Status of the audit	2	Non-Adjusted Errors within the 2009/10 Annual Accounts	9
Matters to be reported to those charged with governance	2		
Appendix A	7		



Key Issues

Introduction

1. International Standard on Auditing 260 (ISA 260) requires auditors to communicate matters relating to the audit of the financial statements to those charged with governance of a body in time to enable appropriate action.
2. ISA 260 requires us to highlight:
 - relationships that may bear on our independence and the integrity and objectivity of the audit engagement lead and audit staff
 - the overall scope and approach to the audit, including any expected limitations, and the form of reports expected to be made
 - expected modifications to the audit report
 - management representations requested by us
 - unadjusted misstatements
 - material weaknesses in internal control identified during the audit
 - views about the qualitative aspects of accounting practices and financial reporting, including accounting policies
 - matters specifically required by other auditing standards to be communicated and any other matters that are relevant to the audit.
3. This report sets out for the Council's consideration the relevant matters arising from the audit of East Lothian Council's financial statements for 2009/10 that require reporting under ISA 260. The contents should be brought to the attention of the Head of Finance, Chief Executive and Convenor so that they can consider them before the financial statements are signed. An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. The report has been prepared for the use of East Lothian Council and no responsibility to any third party is accepted. This report is also considered by the Audit and Governance Committee on 28th September 2010, before the audit is concluded.



Status of the audit

4. Our work on the financial statements is now nearing completion. Should any further matters arise in concluding our work that require to be reported under ISA 260, we will raise them with the Head of Finance.

Matters to be reported to those charged with governance

Conduct and scope of the audit

5. Information on the integrity and objectivity of the audit engagement lead and audit staff, and the nature and scope of the audit, were outlined in the Annual Audit Plan submitted to management in February 2010 and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in March 2007.
6. The audit process this year, as in previous years, was greatly assisted through open dialogue between council officers and Audit Scotland staff and the degree of preparation the council had undertaken to ensure that they properly addressed the new requirements of the 2009 SORP.

Audit opinion & representations

7. My anticipated auditor's report (appendix A) is unqualified.
8. The accounts have not been adjusted to correct xx **(O/S)** financial misstatements. The effects of these unadjusted errors are detailed in appendix B and are not material.
9. Management letters highlighting opportunities to improve internal control were submitted to and accepted by management in June 2010. The more significant issues will be highlighted in the Report to Members on the 2009/10 audit.
10. As part of the completion of our audit, we seek written assurances from the Head of Finance on aspects of the accounts and judgements and estimates made. A draft letter of representation under ISA 580 has been provided to the Head of Finance. This should be returned and signed by the Head of Finance as soon as practicable and prior to the independent auditor's opinion being certified.

Accounting and internal control systems

11. 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.



12. All amendments have not been finalised as yet **(O/S)**.
13. Significant changes were made to the unaudited Financial Statements in respect of new IFRS fixed asset accounting disclosures for Private Finance Initiative assets and liabilities, as well as revalued assets.
14. All other changes were either merely typographical in nature or were presentational changes to comply more fully with SORP requirements

Matters arising

15. In our view, XX **(O/S)** issues require to be brought to your attention regarding the appropriateness of the council's accounting policies or accounting estimates and judgements, the timing of transactions, the existence of any material unusual transactions or the potential effect on the financial statements of any uncertainties:
16. **Movement in the pension liability:** The pension liability has increased by £83.5 million to £142.8 million at 31 March 2010 following the latest actuarial review for the purposes of FRS17 – *Retirement Benefits*. This considers the long term view for the council in meeting its future commitments having taken employer's contribution rates and revenues generated from investments into account. The increased liability is mainly due to growth in the value of liabilities, which reflects the present low interest rate environment currently evident in the UK economy.
17. Having considered the work of the actuary in relation to the FRS17 valuation in accordance with ISA 260 *Using the Work of an Expert*, I am satisfied that:
 - the expert was suitably competent and objective
 - there was sufficient appropriate evidence that the scope of the expert's work at East Lothian Council was adequate for the purposes of the Audit Scotland audit
 - the expert's work provided appropriate evidence in relation to amounts relating to the retirement benefits recognised in the accounts of East Lothian Council.

<p>Resolution: The statutory arrangements for funding the deficit mean that the financial position of the council remains robust as the deficit will be made good by increased contributions over the remaining working life of employees as assessed by the scheme actuary.</p>

18. **General Fund Reserves:** The Council has reported a deficit on the Income and Expenditure account of £8.1 million (£4.2 million 2008/09). After taking account of statutory adjustments of £9.45 million,



an additional £1.3 million statutory surplus was added to reserves. This surplus was attributable to unanticipated receipts such as the recovery of VAT and utilities charges, better than anticipated council tax receipts and savings on treasury management costs, as well as savings across service budgets, particularly Adult Social Care.

19. The general fund balance of £10.9 million has £3.1 million earmarked for specific purposes. This leaves an unallocated balance of £7.8 million at 31 March 2010 and compares favourably to the council's reserve policy. This policy sets a minimum unallocated reserve level of £2 million (£2 million 2008/09) to guard against financial risk. This minimum unallocated reserve level is just under 1% of current net expenditure and will increase the risk of not having enough cash reserves available to meet any unforeseen events.

Resolution: We are seeking representations from the Head of Finance as to the sustainability of the minimum unallocated reserve level.

20. **Musselburgh Joint Racing Committee:** The council has reviewed the status of the joint venture/partnership and its fixed assets have been transferred to the council. An updated 'Minute of Agreement' is to be issued clarifying future operational arrangements.
21. Currently, Musselburgh Joint Racing Committee accounts are in draft and we require a specific representation from the Head of Finance that the draft figures included in the Group Financial Statements will not be subject to material change.

Resolution: The draft account figures will not be subject to material change.

22. **Annual Governance Statement:** The Annual Governance Statement highlights a number of areas of improvement in relation to ELC's code of corporate governance. However, the draft does not include a review of the effectiveness of Internal Audit or any financial matters. It also does not mention the receipt of control statements. The current statement could be made more transparent and effective by a restatement of the areas where progress is still being made e.g. Corporate Asset Management Plan etc. We are seeking assurances that all weaknesses identified in the Audit Governance Statement will be addressed in the current year.

Resolution: The council acknowledges the need for continuous improvement and is dealing with these improvements, the majority of which will be completed in the current year but some will, by their nature, take longer to complete.

23. **Land and building valuations:** The council's Balance Sheet at 31 March 2010 contains Investment Properties' Assets with a net book value of £17 million. In line with established accounting policies of



the council these assets are subject to revaluation at least every 5 years. These valuations are carried out by the council's estates staff. It is a FRICS, and by implication SORP, requirement that such internal valuations are subject to independent review. Such an independent review does not appear to have been carried out.

Resolution: We have asked the Head of Finance for formal assurance, in the letter of representation, as to the reasonableness of the Investment Properties' Asset valuations accounted for in the Financial Statements.

24. **Enjoy East Lothian Ltd:** The council have excluded Enjoy East Lothian Ltd from the Group Financial Statements on a narrow interpretation of the council's 'interest' in the company. The council have entered into an agreement with Enjoy to provide an agreed level of service for a 'Funding Commitment' to finance the body's deficit expenditure. Both funding and service level provision can only be varied with the council's agreement. The council is also a guarantor to the Lothian Pension Fund for Enjoy Ltd to obtain admitted body status to the pension fund. As such, the council in terms of 'substance over form' have an interest in the body.
25. Enjoy is a corporate body in its own right, which provides a service to the council. As well as the council having access to the benefits of the service they also have exposure to the risk of losses by variation to the 'Funding Commitment' and/or alteration of the level of service as describe above. The council does not control the majority of voting rights in the body, but has a significant influence by controlling 33% of the voting rights. In addition, the significant influence is supported by the council's control of the body's 'Business Plan' and 'Funding Commitment' where the body has to adopt council policies and enhance the image and reputation of the council etc.
26. Thus, the council satisfies all the major requirements for treating Enjoy East Lothian Ltd as an associate in their Group Accounts. The six month account figures omitted from the Group Accounts are significant, but do not result in a material error. A full year's figure may breach the accounts materiality level in 2010/11.

Resolution: We have asked the Head of Finance to reconsider the inclusion of Enjoy East Lothian Ltd in the Group Financial statements for 2010/11.

Outstanding Information

27. **Local government financial information return:** The information provided in this return will be used for the 2010 Local Government Overview Report. Under Freedom of Information it is possible



that any national figure reported could be requested on a council by council basis. It is very important therefore that the information provided is accurate. The figures in this return, prepared by your auditor, are in accordance with your council's 2009/10 accounts. Information in the format issued by Audit Scotland should be completed and signed by the Head of Finance for inclusion in a national overview analysis.

Acknowledgements

28. We would like to express our thanks to the staff of East Lothian Council for their help and assistance during the audit of this year's financial statements which has enabled the appointed auditor to certify the statements by the Controller of Audit's target date.



September 2010



Appendix A

Proposed Independent Auditor's Report

Independent auditor's report to the members of East Lothian Council and the Accounts Commission for Scotland

I certify that I have audited the financial statements of East Lothian Council for the year ended 31 March 2010 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Income and Expenditure Account, Statement of Movement on the General Fund Balance, Statement of Total Recognised Gains and Losses, Balance Sheet and Cash-Flow Statement, the Housing Revenue Account Income and Expenditure Account, Statement of Movement on the HRA Balance, the Council Tax Income Account, the Non-Domestic Rate Income Account, the Common Good Account, the Trust Funds Account and the related notes and the Statement of Accounting Policies together with the Group Accounts. These financial statements have been prepared under the accounting policies set out within them.

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 123 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Head of Finance and auditor

The Head of Finance's responsibilities for preparing the financial statements in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009 - A Statement of Recommended Practice (the 2009 SORP) are set out in the Statement of Responsibilities for the financial statements.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission.

I report my opinion as to whether the financial statements give a true and fair view, in accordance with relevant legal and regulatory requirements and the 2009 SORP, and have been properly prepared in accordance with the Local Government (Scotland) Act 1973.

I also report to you if, in my opinion, the council has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I review whether the Annual Governance Statement reflects compliance with the SORP, and I report if, in my opinion, it does not. I am not required to consider whether this statement covers all risk and controls, or form an opinion on the effectiveness of the council's corporate governance procedures or its risk and control procedures.

I read the other information published with the financial statements, and consider whether it is consistent with the audited financial statements. This other information comprises the Foreword by the Head of Finance. 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 Part VII of the Local Government (Scotland) Act 1973 and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board as required by the Code of Audit Practice approved by the Accounts Commission. 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 judgements made by the Head of Finance in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Council'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

- give a true and fair view, in accordance with relevant legal and regulatory requirements and the 2009 SORP, of the financial position of East Lothian Council as at 31 March 2010 and its income and expenditure for the year then ended; and
- have been properly prepared in accordance with the Local Government (Scotland) Act 1973.

Gillian Woolman ACA, Assistant Director
Audit Scotland – Audit Services
Osborne House, 1/5 Osborne Terrace
Edinburgh, EH12 5HG

XX September 2010



It can be seen from the above figures that the net effect of the above transactions would be to:

- Increase the General Fund balance and total net worth by £615,000
- Increase the total assets less liabilities in the balance sheet and Financed by £615,000