DERBY CITY COUNCIL

AUDIT AND ACCOUNTS COMMITTEE
24 SEPTEMBER 2009

ITEM 7

Report of the Corporate Director of Resources

REPORT TO THOSE CHARGED WITH GOVERNANCE 2008/09

RECOMMENDATION

1.1 To receive the external auditor's memorandum for the financial year 2008/09 including the report to those charged with governance.

1.2 To request updates at future meetings on the progress made on the implementation of the recommendations made by external audit.

SUPPORTING INFORMATION

2.1 The memorandum from our external auditors Grant Thornton is attached at Appendix 2. The purpose of the memorandum is to highlight the key issues affecting the results of the Council and the preparation of the Council's financial statements for the year ended 31 March 2009.

2.2 The memorandum includes the report to those charged with governance to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260 – known as the ISA260 report. This report summarises for the Audit and Accounts Committee, in its capacity as the body charged with governance, the conclusions of the audit work. It sets out the auditor's views and opinions on two main issues:

- the Authority's financial statements; and
- the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources.

2.3 The principal purposes of the report are:

- to reach a mutual understanding of he scope of the audit and the respective responsibilities of the auditor and the Council
- to share information to assist both the auditor and those charged with governance to fulfill their respective responsibilities; and
- to provide the Council with recommendations for improvement arising from the audit process.

2.4 The Council's action plan to address the recommendations is also included in Appendix 2. A progress report will be brought back to this Committee at a future date.

For more information contact:	Carolyn Wright, Head of Accountancy, 01332 255360 e-mail Carolyn.wright@derby.gov.uk
Background papers:	None
List of appendices:	Appendix 1 – Implications Appendix 2 – Report to those charged with governance 2008/09

IMPLICATIONS

Financial

1.1 An appendix to the ISA260 report contains details of the audit fees, which for 2008/09 are consistent with the planned fees.

Legal

2.1 The auditors are required to comply with the International Standards on Auditing – ISA – which means that they must provide their opinion of the Council's statement of accounts.

Personnel

3.1 None directly arising

Equalities Impact

4.1 None directly arising

Corporate objectives and priorities for change

5.1 The areas that are to be subject to external audit or inspection are generally relevant to delivery of corporate objectives and priorities.

Appendix 2

Grant Thornton

Key Issues Memorandum

Derby City Council

For the year ended 31 March 2009

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The purpose of this memorandum is to highlight the key issues affecting the results of the Council and the preparation of the Council's financial statements for the year ended 31 March 2009. It is also used to report to those charged with governance to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

In addition, we have a number of statutory responsibilities under the Code of Audit Practice, which we report in this document. Most significantly, our responsibility to provide an opinion on the Council's arrangements for securing economy, efficiency and effectiveness in its Use of Resources.

We take responsibility for this memorandum, which has been prepared on the basis of the limitations set out at Appendix D.

We would like to take this opportunity to record our appreciation for the kind assistance provided by the finance team and other staff during our audit.

Grant Thornton UK LLP
Birmingham

www.grantthornton.co.uk

Contents

1 Executive summary

1.1 Status of audit

Our audit is substantially complete subject to continuing consideration of post balance sheet events.

1.2 Financial statement conclusion

We anticipate providing an unqualified opinion on the Council's financial statements, following the acceptance of this report by the Audit and Accounts Committee on the 24 September 2009 and the subsequent re-adoption of the Council's accounts.

A number of fundamental misstatements were identified during the course of our audit testing resulting in a £117m (9.7%) reduction the carrying value of tangible fixed assets at 31 March 2009. The Audit Committee will need to formally consider these and other issues set out in Section 2 and determine whether they agree with officer's treatment in the accounts.

It is, however, pleasing to report that the overall quality of the Council's working papers presented for audit was considerably improved from 2007/08 and the Council presented its accounts by the 30 June 2009 deadline.

1.3 Use of Resources conclusion

In providing our opinion on the financial statements we are required to provide a conclusion on the Council's Use of Resources. We anticipate providing an unqualified Use of Resources conclusion with regard to the Council's arrangements for ensuring economy, efficiency and effectiveness in its Use of Resources. This conclusion is drawn from our work through the organisational assessment of Comprehensive Area Assessment which will be reported separately to the Council.

1.4 Way forward

The Audit and Accounts Committee is required to approve the annual accounts of the Council for re-adoption for the year ended 2008/09. In forming its conclusions the Committee is required to assess unadjusted items detailed at Appendix A and form a conclusion on the appropriateness of their exclusion from the accounts.

This report, along with our forthcoming Use of Resources report, will form the basis of our Annual Audit Letter, which well be issued to Members by 31 December 2009.

We also provide an Action Plan at Appendix B that summarises the key recommendations arising from our audit of the Council's accounts.

2 Detailed audit findings

2.1 Audit opinion

Our audit is substantially complete and we expect to issue an unqualified audit opinion on the Council's Financial Statements. This is subject to the re-approval of the financial statements by the Council.

2.2 Matters identified at the planning stage

In the conduct of our audit, we have had to alter our audit plan, which we communicated to you in our Audit Strategy Document (ASD) dated 18th June 2009. The principal areas and reasons for change are as follows:

- Tangible Fixed Assets - fundamental errors were identified from our initial testing which resulted in a complete restatement of the note to the accounts and re-performance of our procedures in this area.
- Creditors - additional procedures undertaken to assess the extent of cut off errors identified from our testing.

These matters, detailed at Section 2.3 below, resulted in large number of amendments being made to the Statements of Account, which required additional audit procedures to confirm the accuracy of the changes.

Our response to the matters identified at the planning stage are detailed below.

	Issue note in ASD	Auditor response [and conclusion]
1	**Asset Valuations** The current economic climate is having a potentially material impact on asset values. We will review the Council's processes to ensure the valuer has correctly considered impairment and that asset values are appropriately recorded in the Statement of Accounts.	Our audit procedures identified a number of fundamental issues in relation to asset valuations and impairment. These are discussed in more detail at Section 2.3.

	Issue note in ASD	Auditor response [and conclusion]
2	**Single Status Agreement** Many authorities are experiencing large numbers of claims for back pay from appeals about unequal pay arising from the implementation of the single status agreement. In some cases these claims can take several years to settle. We will review the Council's assessment of the likelihood of any such claims resulting in financial settlement and its associated treatment in the Statement of Accounts.	The Council has included a provision in the accounts to cover the expected liability arising from a settlement offer made to a number of claimants who lodged Equal Pay claims at a tribunal. In addition, a contingent liability as been disclosed to reflect the Council's potential exposure to future claims. Testing of the provision against legal correspondence identified an overstatement of £173,000, which is included at Appendix A as an adjustment to the accounts, reducing the provision to £364,000. As the likely success of any future claims brought against the Council cannot be assessed at this time we consider the inclusion of a contingent liability note appropriate.
3	**Capital Cut Off** A number of errors in capital cut off were identified during our 2007/08 audit. Testing will be undertaken to ensure that a similar misstatement has not occurred in 2008/09.	Sample testing of capital transactions identified a land disposal, accounted for in 2008/09, that had not legally completed at 31 March 2009. An adjustment has been made, as detailed at Appendix A, to correctly disclose the transaction as a receipt in advance of £2.4m at 31 March 2009. We have included a recommendation at Appendix B that the treatment of capital receipts in advance is specifically considered in future years

	Issue note in ASD	Auditor response [and conclusion]
4	**Housing and Council Tax Benefit Scheme - 2007/08 Qualification** Our certification of the Council's Housing and Council Tax Benefit Scheme claim for 2007/08 was qualified in a number of areas. Given the nature of the matters raised, the Council confirmed to us that additional work would be undertaken to quantify the extent of the errors noted and provide assurance over their claim. Given the qualification, the DWP will usually instruct the Council to obtain additional audit work to quantify the extent of errors. Whilst such a request has yet to be made, in any event, we will need to satisfy ourselves that the subsidy claimed in 2007/08 was not materially misstated. We will therefore review the work undertaken by the Council, in response to our findings, to assess the potential errors.	The Council has received formal communication from DWP on 15 September 2009 as to the impact of the qualification issued on the 2007/08 Housing and Council Tax Benefit Scheme claim. We have discussed the qualification issues with officers and gained an understanding of the work undertaken by the Council in response to this. We have also discussed with officers the potential liability arising from the claim and the implication of this for the 2008/09 accounts. The Council has estimated the potential repayment resulting from the 2007/08 subsidy claim at £200,000 and has included a reserve for this amount in the 2008/09 accounts. As the likelihood of a repayment is considered possible, rather than probable, a formal provision has not been made in the accounts but the amount has been disclosed as a contingent liability in the accounts. This treatment appears appropriate. We are meeting with Council officers to go through the DWP letter on 18 September 2009.
5	**Disclosure** A number of additional disclosures and amendments to existing disclosures were required to the Statement of Accounts presented for audit in 2007/08 before we could conclude that they were materially compliant with the local government Statement of Recommend Practice (SORP) 2007. As part of our audit for 2008/09 we will undertake a review against the SORP 2008 and also consider the process the Council has in place to ensure compliance.	We are pleased to report that our review of the 2008/09 accounts against the SORP 2008 identified considerably fewer disclosure omissions and misstatements compared to our review in 2007/08. This is a direct result of the Council's Resources Department undertaking a detailed review of the 2007/08 Statement of Accounts against the SORP 2008 prior to presenting them for audit. However, a number of amendments to existing disclosures were required to the Statement of Accounts before we could conclude that they were materially compliant with SORP 2008. A summary of the disclosure amendments made is included at Appendix A.

	Issue note in ASD	Auditor response [and conclusion]
6	**Classification** Our 2007/08 audit identified a number of instances where transactions had been inappropriately classified in the Statement of Accounts, such as: • the bad debt provision treated as a creditor rather than a reduction in debtors; • a cancelled invoice being adjusted against creditors rather than debtors; • notified interest balances being included in debtors rather than added to the investment value; and • an element of depreciation on HRA assets being taken to the Income and Expenditure account, rather than the HRA Income and Expenditure account. We will review the classification of material amounts as part of our procedures.	Our 2008/09 audit procedures did not identify a reoccurrence of the classification issues noted in our 2007/08 report.
7	**Changes in Central Finance Team** A number of changes have occurred in the core Resources Department team responsible for compiling the Statement of Accounts since last year's audit. As this is a relatively small team, the loss of key individuals is likely to have caused a cumulative loss of knowledge, while new members settle into post. This increases the risk of misstatements not being identified within the information provided by other teams. It is also likely to result in additional time being required for financial close and the preparation of the Statement of Accounts, as new team members are unfamiliar with systems or methods of operation during their first accounts close cycle.	We have observed no detrimental impact from the changes in the core Resource Department team during the delivery of our audit work and are pleased to report a considerable improvement in the timeliness and quality of responses to audit queries and general co-ordination of the audit process from the Council.

2.3 Matters identified during the course of the audit

	Issue	Auditor response [and conclusion]
1	**Impairment of Council Dwellings** It was noted from our testing that an impairment review of Council Dwellings had not been undertaken to assess any material change in assets values from 1 April 2008, the date of the latest valuation, to 31 March 2009 - a period during which asset values have been widely reported to have fallen as a result of the economic climate.	Following discussions with Officers, the Council engaged its in-house valuer to assess whether the value of Council Dwellings was impaired at 31 March 2009. The valuer concluded that values had fallen by 16% at 31 March 2009. This has resulted in an adjustment to the 2008/09 Statement of Accounts of £108m, as detailed at Appendix A. As part of our testing, we have confirmed that the approach taken by the Council and the experience of the valuer is compliant with the SORP. We have also assessed the general movement in asset values against expectations formed from our experience at other councils and national valuation information, provided by the Audit Commission, and concluded that the movement, for the adjusted accounts, is within reasonable expectations.
2	**Impairment of tangible fixed assets** In preparing the draft Statement of Accounts for 2008/09 the Council undertook an impairment review of each category of tangible fixed assets, other than Council Dwellings as noted above, the results of which indicated that assets revalued on or after 1 April 2007 required an impairment write down at 31 March 2009. Sample testing of the application of the percentage impairments provided by the Council's valuer, identified that assets last revalued at : • 1 April 2008 had not been impaired, despite an impairment percentage having been determined; and • 1 April 2007 had not been appropriately impaired, as percentages had been incorrectly applied or omitted for a proportion of the population.	Following discussions with Officers, the Council undertook a complete review of the impairment calculations processed though the Fixed Asset Register (FAR), the related depreciation calculation and the impact on Government grant deferred. Subsequent re-performance of our audit procedures on the revised FAR identified no further issues. As part of our testing, we also considered the valuer's approach to determining the various impairment percentages applied, particularly the assertion that valuation before 1 April 2007 would not be impaired, and are satisfied with the approach adopted. The amendments made to the Statement of Accounts, as a result of this issue, are detailed at Appendix A.

	Issue	Auditor response [and conclusion]
3	**Fixed Asset Register** Procedures to confirm the FAR had been accurately updated for assets valued during 2008/09 identified the following matters: • a number of valuation reports selected for testing could not been traced to the FAR, initially suggesting that the FAR may be incomplete; and • input errors had occurred when the FAR was updated for the 2008/09 valuations.	Initial investigation of these matters by officers determined that inconsistencies existed between the FAR and the asset register maintained by the Estates Department and that the FAR did not accurately reflect in-year valuations. As a result, the Council undertook an exercise to match the FAR to the Estates Department register and to check all in year valuations to valuers' certificates. Matching of the FAR to Estates Department records identified that they were broadly consistent but in some cases had used differing levels of aggregation, descriptors and were allocated to different asset categories. The exercise did however identify a number of assets that required adding to or removing from the FAR, amounting to £0.8m and £2.7m respectively. The impact of these adjustments on Government grant deferred was also assessed. Subsequent re-performance of our audit procedures on the revised FAR identified no further issues. The amendments made to the Statement of Accounts, as a result of this, are detailed at Appendix A and a number of recommendations have been included at Appendix B.
4	**Non Enhancing Capital Expenditure** Non-enhancing capital expenditure incorrectly included the following: • any capital additions to assets that had been revalued during 2008/09, whether enhancing or otherwise; and • impairment and revaluation of in-year new build assets.	As detailed at Appendix A, an amendment has been made to the accounts to reduce non-enhancing expenditure by £23.7m, with a corresponding adjustment to asset additions and impairments. We have also raised with officers the need to introduce a formal policy for capitalising non enhancing capital expenditure, as detailed at Appendix B.

	Issue	Auditor response [and conclusion]
5	**Creditor cut off** Testing of transactions around the year-end date, to confirm the correct allocation of liabilities between accounts year, identified a number of cut off errors.	Investigation by officers established that these errors were incorrect adjustments intended to correct cut off errors identified by the Council's year-end procedures. Additional sample testing was completed by officers to determine the extent of the errors and, on the basis that only a small number of similar errors were identified, we concurred with the Council's view that the errors were not systematic. As detailed at Appendix A, a net adjustment of £1.3m has been made to correct creditor cut-off errors. We have included a recommendation at Appendix B that further training be provided to departments with respect of year-end cut off, particularly within Corporate and Adult Services.
6	**Correction of Prior Year Comparatives** The 2008/09 draft Statement of Accounts included disclosure of a misstatement in the comparative figures for 2007/08 of £5.1m. This was identified as the accounts were being finalised and officers subsequently determined that housing depreciation (£5.1m) and housing impairments (6.4m) had been misclassified, leading to the understatement of expenditure by £11.5m within the Income and Expenditure Account and a corresponding misstatement of depreciation and impairment within the Statement of Movement on the General Fund Balance. It was also noted that a similar misstatements had occurred for a number of years.	The Council has considered the bearing this misstatement would have on the 2007/08 Statement of Accounts and has concluded that as the error does not have an impact on General Fund balances in 2007/08 and does not alter 2008/09 figures, the error is not considered to be fundamental, or to have a detrimental impact on the validity of the financial statements. Therefore, the Council has amended the 2007/08 comparatives included in the 2008/09 accounts under FRS28 'Corresponding Amounts'. This does not represent a prior year adjustment. We have considered the impact of this misstatement on the accounts and concur with the amended treatment adopted by the Council. Details of the amendments made are included at Appendix A.

2.4 Misstatements

Fundamental errors were identified during the course of our work and, while it is pleasing to note the prompt action taken by officers to address these matters, we consider that further attention should be given to the robustness of the Council's procedures for reviewing the accounts prior to issue, in future years. A recommendation is included at Appendix B that the Council strengthens the internal review process to increase the likelihood of such errors being identified in future.

The majority of identified misstatements have been adjusted. These adjustments resulted in the reported Income & Expenditure Account deficit increasing by £95.5m to £109m but had no overall impact on the General Fund deficit which remained unaltered at £12.1m after audit adjustments. The most significant adjustment was the overall reduction in Tangible Fixed Assets by £117m to £1,127m.

The only unadjusted misstatement, the non-consolidation of the Council's 50% shareholding in Connexions Derbyshire Ltd, was discussed with us prior to audit and agreed as being immaterial to the accounts for our opinion purposes, it is however reported for completeness.

Full details of adjusted and unadjusted misstatements are set out at Appendix A.

Members are required to formally consider officers' treatment of the accounting adjustments referred to in this report and minute their decision accordingly.

2.5 Disclosure omissions

There were a number of areas in which disclosures in the notes to the accounts did not fully comply with the 2008 SORP. Minor errors relating to classification and narrative included in the accounts were also identified. We are pleased to report that the Council has addressed the majority of the disclosure issues/omissions identified.

Full details are set out at Appendix A.

2.6 Annual Governance Statement (AGS)

We have examined the Council's arrangements and process for compiling the AGS. In addition, we have read the AGS and we consider the statement to be in accordance with our knowledge of the Council.

No issues were identified from the review performed and therefore we can conclude the statement is in line with the requirements of the SORP checklist.

2.7 Accounting Policies

We have considered the appropriateness of the accounting policies adopted by the Council against the requirements of the 2008 SORP and have suggested a number of narrative amendments to improve the clarity of disclosed policies which the Council has reflected in the revised accounts.

2.8 Use of Resources

Our Use of Resources conclusion is drawn from our work through the organisational assessment under the new Comprehensive Areas Assessment regime. We will provide the Council will a full and comprehensive report in due course.

Our assessment for the Council is summarised below.

Themes and Key Lines of Enquiry (KLOEs)	Score
Managing finances	**2**
1.1 Planning for financial health	3
1.2 Understanding costs and achieving efficiencies	2
1.3 Financial reporting	2
Governing the business	**3**
2.1 Commissioning and procurement	2
2.2 Use of information	3
2.3 Good governance	3
2.4 Risk management and internal control	3

Underlying principles of performance:
Level 2 - performs adequately
Level 3 - performs well
Level 4 - performs excellently

Themes and Key Lines of Enquiry (KLOEs)	Score
Managing resources	**2**
3.1 Natural resources	2
3.2 Strategic asset management	2
3.3 Workforce	N/a

Our assessment of KLOE 1.3, Financial Reporting, draws on the findings of our 2008/09 accounts audit which, as detailed in this report, identified fundamental misstatements to Tangible Fixed Assets Whilst the Council has failed to meet the minimum requirements for this aspect of the assessment, we are satisfied that arrangements in other areas 'perform well', and have concluded that, on balance, the Council 'performs adequately' against the headline KLOE requirements.

In addition, we have considered the impact of the issues identified from our accounts audit relating to the Council's Fixed Asset Register, in arriving at our assessment of Strategic Asset Management (KLOE 3.2). We do not consider that these matters have impacted on KLOE 3.2, but note that this will remain an area for the Council to develop in the future.

Based on the work carried out to date, supported by local Use of Resources work, we propose to issue an unqualified Use of Resources conclusion.

2.9 Treasury Management

Treasury management arrangements were identified nationally as a key risk for auditors to consider when revising their plans for 2008/09 in light of the Icelandic bank failures.

In response, the Audit Commission has mandated a work programme on treasury management which we have completed as part of our audit procedures. This has identified a number of improvement opportunities, as detailed at Appendix B.

2.10 Allowances and expenses

In response to the recent increased scrutiny of allowance and expense claims, we have included specific procedures in our audit approach to consider the Council's expenses and allowances policies for members and senior offices, including reviewing the work undertaken by Internal Audit in this area and limited testing of member and officer claims against Council policies.

The Council's policy for members allowances provides for a basic allowance with additional allowances granted for specific responsibilities. The basic allowance does not cover travel and subsistence cost, which increases the number of claims and the risk of irregularities compared to councils operating inclusive allowances policies.

A high level review of allowance/expense claims for ten members and ten officers identified no unusual transactions. Testing of disclosures in the Statement of Accounts identified that members' allowances and expenses had been misstated as the amounts paid for members' travel & subsistence and co-optee allowance has not been included. This is reported, as a disclosure adjustment at Appendix A and has been corrected.

We also noted that the Internal Audit plan for 2009/10 includes a review of members allowances, the last review having been undertaken in 2007/08. Given the continuing public focus on this area, we consider this an important review and will consider the findings from this as part of our detailed audit planning for 2009/10.

2.11 Improving audit efficiency

Considerable improvements have been noted during the course of our 2008/09 audit in the quality of working papers presented for audit, the timing and quality of responses to audit requests/queries and the general co-ordination of the process, as a whole, by the Council. This has been the direct result of a series of improvements to the accounts preparation process, wider involvement and training with Departments, strong recruitment to key posts in the Resources Department and the return to post of the Head of Accountancy, whose input and leadership in the process is considerable.

Whilst fundamental issues have been identified during our 2008/09 audit, we welcome the improvements made and intend to continue to work with the Council to further improve the process in 2009/10. We propose to do this by undertaking similar sessions to those held in 2008/09, namely:

- a post audit debrief meeting with the Assistant Director Corporate Finance and the Head of Accountancy to discuss opportunities to further improve the efficiency of the audit process for 2009/10;
- wider debrief/feedback sessions with Heads of Finance in departments, to help identify opportunities to improve the process for compiling the accounts and also meet audit requirements; and
- encouraging the Council to hold another Accounts Launch Event for the 2009/10 Statement of Accounts, which we will be pleased to attend and present at.

A Adjustments to the financial statements

Adjusted misstatements

As detailed at Sections 2.2 and 2.3 a significant number of amendments have been made to the Statement of Accounts as result of our audit findings. A summary of the balance sheet impact of the adjustments made is set out in the table below. These adjustments resulted in the reported Income & Expenditure Account deficit increasing by £95.5m to £109m but had no overall impact on the General Fund deficit which remained unaltered at £12.1m, after audit adjustments.

Adjustment in £'000s	Report reference	Fixed Assets	Current Assets	Current Liabilities	Long Term Liabilities	Net Worth
Draft Statement of Accounts		**1,243,830**	**152,683**	**(64,146)**	**(687,659)**	**644,708**
Impairment of council dwellings	2.3 - 1	(108,111)				(108,111)
Impairment of tangible fixed assets	2.3 - 2	(12,635)				(12,635)
Fixed Asset Register - net amendments	2.3 - 3	(20,301)				(20,301)
Non-enhancing expenditure	2.3 - 4	23,831				23,831
Government grants deferred	2.3 - 2 & 3				(19,556)	(19,556)
Debtors - Raynesway land receipt in advance	2.2 - 3		(2,402)			(2,402)
Creditors cut off	2.2 - 5	80	(1,423)	1,342		0
Provisions	2.2 - 2				173	173
Final Statement of Accounts		1,126,694	148,858	(62,804)	(707,042)	505,706

The following adjustments have also been made which are not evident from the table above:

- Housing Revenue Account Balance has increased by £500,000 to £17,068,000 - the reserve included £500,000 earmarked for equal pay claims. As the probability of the liability occurring has been assessed as low, the reserve has now been released.
- Revenue Earmarked Reserves have decreased by £327,000 to £48,770,000 - this is a net adjustment to reflect the £500,000 HRA adjustment noted above and the reduction in the single status provision noted at 2.2-2.
- Government Grant Deferred/Unapplied - an adjustment of £343,000 has been between to transfer Government grant from 'deferred' to 'applied' within long term liabilities on the balance sheet. This amendment is the result of capital errors identified as part of the creditor cut off adjustments, noted in the table above.
- Group accounts were amended by £153,000 to reflect a late adjustment made to the Council's accounts for Area Based Grant that had not been updated in the consolidation.

Unadjusted misstatements

The Council's 50% shareholding in Connexions Derbyshire Ltd, a company jointly owned with Derbyshire County Council, has not been consolidated in to the group accounts. This treatment was discussed with us prior to audit when we confirmed that this would not be considered material to our audit opinion. As the company has assets of £1.2m and reserves of £0.2m it is above our reporting threshold to Audit and Accounts Committee.

No other unadjusted misstatements were identified during the course of our work.

Disclosure omissions

Our review identified a number of additional disclosures and amendments to existing disclosures before we could conclude that the Statement of Accounts were materially compliant with CIPFA's Statement of Recommended Practice. The following table sets out the key disclosure amendments identified through our audit.

	Issue	Commentary
1	**Connexions Derbyshire Ltd** No disclosure had been made of the Council's holding, or the reason for not consolidating the subsidiary company in the Statement of Accounts.	The accounts have been amended to disclose the Council's holding in the Company and the total assets (£1.2m), total liabilities (£1m) and net assets (£0.2m) at 31 March 2009.
2	**Provisions** The disclosure requirements of Financial Reporting Standard 12 relating to provisions had not been fully complied with.	The following additional disclosures have been added to the notes accounts for each class of provision: • separate disclosure of the amounts used (i.e. incurred and charged against the provision) during the period, and, the unused amounts reversed during the period; and • the expected timing of any resulting transfers of economic benefits and an indication of the uncertainties about the amount or timing of the transfers of economic benefits.
3	**Members' Allowances and Expenses** Note 11, Members' allowances and expenses did not include amounts paid for members' travel & subsistence and co-optee allowance payments.	The Members' Allowances disclosure has been amended from £781,537 to £796,065. The comparative figure has been amended from £772,134 to £806,835.
4	**Commitments under Operating Leases** A duplicate entry was identified within the operating lease disclosure relating to the property at Cardinal Square which should have been disclosed as a HRA operating lease commitment.	Disclosures have been amended to reduce Land and Buildings operating leases due to expire over 5 years by £193,000 to £311,000 and to include the appropriate disclosure to the HRA.
5	**Commitments under Capital Contracts** The 'Housing - Private Sector' commitment was overstated.	Note 18b has been amended to decrease the commitment relating to 'Housing - Private Sector' by £2,417,000, from £2,619,000 to £202,000.

	Issue	Commentary
6	**Auditor fees** Audit fees were not accurately presented in note 7.	The Audit Fees note has been revised as follows: • Code of Audit Practice fees in the financial year 2008/09 have been revised from £315,000 to £366,000; • Audit Commission statutory inspections fees in the financial year 2008/09 have been revised from £22,392 to £26,081; and • The fees payable for certification of claims returns have been revised from £114,343 to £224,909. It should be noted that the Council has historically accounted for Auditors' fees on a payments rather than accruals basis. Full disclosure of our audit fees for the year is set out at Appendix D.
7	**Collection Fund** The Council failed to comply with the SORP by not disclosing the total non-domestic rateable value at the year-end and the national non-domestic rate multiplier for the year in the notes to the Collection Fund.	Disclosures have been amended to state that the non-domestic rateable value at 31 March 2009 was £198,942m (£197,513m in 2007/08) and the national non-domestic multiplier for 2008/09 was 46.2p (44.4p in 2007/08).
8	**FRS 17 Retirement Benefits** Our review identified a number of disclosures required by the SORP guidance that had not been included in the accounts.	Officers have indicated that these disclosures had been considered but omitted, as the required information could be extracted from the FRS17 disclosures that had been made. Additional disclosures have, however, been made so that these reporting requirements are now explicitly met.

	Issue	Commentary
9	**Private Finance Initiative (PFI)** The Council's accounting policy for PFI did not set out the treatment of reversionary interests, residuals interests and dowry payments. Furthermore, as required by the SORP, an explanation that deferred consideration amortisation charges are notional and are reversed out in the Statement of Movement on the General Fund Balance, to remove any impact on council tax or rents, had been omitted. We also identified that the note to the accounts (Note 9) made no reference to PFI schemes that are currently being developed, namely Building Schools for the Future and Waste Disposal contracts.	Additional disclosures have been added to the Statement of Accounts for these matters.
10	**Explanatory Foreword** The Explanatory Foreword did not include commentary on interest payable, other operating costs or income from grants and taxpayers, as required by the SORP. We also made a recommendation that it would be useful to include some narrative in the Explanatory Foreword about the planned introduction of IFRS in 2010/11, and, in particular, the changes relating to PFI for 2009/10, which are expected to significantly increase assets and borrowings.	A table has been added to the Explanatory Foreword comparing operating costs to budget. The Explanatory Foreword has also been amended to include reference to the impact of conversion to International Financial Reporting Standards.

	Issue	Commentary
11	**Narrative disclosures** Other disclosure issues were identified in the financial statements. The more significant matters are set out in the commentary adjacent.	Narrative descriptions were revised/added in a number of areas including: • Fixed Assets been separately identified as operational and non-operational, as required by the SORP; • the geographic reach covered by the pooled budget arrangement with Derby City Primary Care Trust being explicitly stated; • a misclassification of £423k within Note 5, trading services, between income and expenditure; • reclassification of the voluntary revenue provision for capital finance of £1.7m in the SMGFB to include this as part of the statutory provision inline with current MRP requirements; • separate disclosure in the notes to the HRA of £855k of Other Contributions and Grants; • a minor presentational issues and typographical errors; and • a small number of casting errors.

B Action plan - Audit Issues

<table>
<tr><th></th><th>Priority</th><th>Issue and risk</th><th>Recommendation</th><th>Management response</th></tr>
<tr><td>1</td><td>High</td><td>Fixed Asset Register
As detailed at Section 2, a number of inconsistencies were noted between the Fixed Asset Register, maintained for financial reporting purposes by the Resources Department and the asset register used by the Estates Department, namely:
- the assets listed;
- the valuation amounts and dates recorded;
- the descriptors used to identify assets; and
- the level of aggregation of assets in the registers.</td><td>The current practice of maintaining separate registers will continue to increase the risk of material misstatement and ultimately the Council should strongly consider the introduction of an integrated asset management system.

In the meantime, closer working practices should be introduced between the Resources and Estates Departments to ensure that the registers are consistent, in terms of monetary amounts and descriptors. We recommend that formal reconciliations are introduced between the two registers and that a standard asset referencing system is used.</td><td>Agreed

Fixed Asset Register(FAR) action already taken
• Introduction of a unique reference number on the FAR
• One common file on a shared drive with restricted access
• Monthly reconciliation to financial and Estates data and sign-off by the Group Accountant(capital)

Action in progress
• Documented procedure on the maintenance of the FAR including responsibilities. Deadline: 30 October 2009. Group Accountant (Capital) in conjunction with Estates
• Business Case and project plan to be developed for the introduction of an integrated Asset Management system to include FAR. This will be progressed through the Transformation programme</td></tr>
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	Priority	Issue and risk	Recommendation	Management response
2	Medium	**Group Accounting Policies** FRS 2 and FRS 9 require that the accounting policies of Derby Homes Ltd are aligned with the policies of the Council, as adjusted to comply with UK GAAP, for the purposes of Group Accounts. From review of Derby Homes Ltd's accounting policies, inconsistencies in policy exist with those of the Council. No consolidation adjustments are deemed necessary in 2008/09, on the basis that any adjustment would not be material.	It is recommended that Derby Homes Ltd's accounting policies are fully aligned with those of the Council, or that resulting consolidation adjustments are quantified.	Agreed The Group Accountant(Corporate) will liaise with the Group Accountant at Derby Homes and agree an action plan to be delivered as part of the preparation for the 2009/10 Annual Accounts. Deadline 31 December 2009
3	Medium	**Bad Debt Provision** The Council has not undertaken a formal review of current debt collection rates against the percentages used to calculated bad debt provisions, to ensure that they still reflect a best estimate of recoverability. This results in a risk of overstatement of debtors.	The Council should review the percentage rates applied each year to calculate bad debt provisions, against current collection patterns, to ensure the percentages remain appropriate. The results of this review will then form a working paper that will support the Council's approach for audit purposes.	The principle of determining a BDP based upon more accurate information of our Sundry Debt arrears is agreed. However, currently the Oracle system which houses Sundry Debts does not provide this information. The External Payments Manager will work closely with colleagues from the Business Systems team and will liaise with other sites using Oracle to determine how this information can be extracted. If better Management Information can be extracted then this will form the basis for future BDP calculations. Deadline 31 December 2009

	Priority	Issue and risk	Recommendation	Management response
4	Low	**Bad Debt Provision** We note that the Council's bad debt provision has increased steadily in recent years as old irrecoverable debts are not being written-off. The age of some of the debts, such as those dating back to the early 90's, makes recovery extremely unlikely.	The Council should consider undertaking a review of old debt and writing these, and the associated bad debt provision, out of the ledgers.	It is agreed that irrecoverable Sundry Debts should be written-off on a regular basis as part of a robust house-keeping regime. This will require a Debt Strategy to be written which has the approval of Corporate Director of Resources as the Council's Section 151 Officer and Elected Members. Our draft Debt Strategy will be prepared by 31st October 2009 by our External Payments Manager Once the Strategy is approved, uncollectible debts will be written –off by 31 December 2009.
5	Low	**Members Allowances** Co-optee allowance payments are not separately recorded on the Council's ledger and therefore the Council is unable to separately disclose them within the Members' Allowance note to the core financial statements.	It is recommended that the Council record all co-optee allowance payments within a separate code in the ledger.	The Group Accountant (Central Team) will investigate and action the change to financial systems to implement this, if technically feasible. Deadline 31 December 2009

	Priority	Issue and risk	Recommendation	Management response
6	Medium	**Creditors/Accruals Cut Off** As detailed at Section 2, a number of creditor cut off errors were identified from our audit testing. A number of these errors originated from the Corporate and Adult Services Department. We also noted that a capital receipt in advance had been incorrectly treated, which was a reoccurrence of an issue we reported in 2007/08.	The Council should provide further training to departments responsible for coding invoices to financial periods to ensure all relevant individuals understand the importance of accounting for these items correctly. In addition, we recommend that a specific step is introduced to the accounts preparation process to consider adjustments required as a result of capital receipts in advance.	Agreed. Group Accountant (Corporate) to action as part of preparation for the 2009/10 Annual Accounts before 31 March 2010. This was introduced as part of the 2008/9 process but due to the unusually complicated legal arrangements of the issue that arose in the 2008/9 accounts, it was treated wrongly at the year-end. The Group Accountant(Capital) in conjunction with Estates and Legal sections will re-visit and strengthen procedures for 2009/10 accounts closure before 31 March 2010.
7	High	**Technical Review of the Statement of Accounts** Our audit procedures for 2008/09 identified fundamental misstatements and numerous disclosure issues, many of which might have been identified by the Council's review of the accounts prior to issue.	The Council should review its internal review procedures and strengthen these to improve the likelihood of errors being detected prior to audit. In particular, we would suggest that the review undertaken by various officers within the Resources Department is formally documented, to increase evidence of the process.	Agreed. The review process will be considered and responsibilities assigned, and built into the 2009/10 Accounts Preparation timetable.

	Priority	Issue and risk	Recommendation	Management response
8	Medium	**Capitalisation Policy & Non-Enhancing Capital Expenditure Policy** The Capitalisation Policy has not been updated since October 2007. Furthermore the Council does not have a formal policy for capitalising non-enhancing expenditure.	We recommend that • the Council's Capitalisation Policy is reviewed and updated on an annual basis; and • a formal policy for capitalising non-enhancing capital expenditure is introduced, which we suggest is incorporated within the Capitalisation Policy.	Agreed The Group Accountant (Capital) will update the policy by 30 October 2009. It will be reviewed at least annually, or when a major change occurs.

C Action plan - Treasury Management

As described at Section 2.9, the Audit Commission mandated an audit work programme on local authority treasury management, which we undertook as part of our 2008/09 audit procedures. This review identified a range of improvement opportunities, which we recommend the Council considers, as set out below.

	Recommendation	**Management response**
1	The Council has considered a report entitled 'Risk and Return (March 2009)' published by the Audit Commission. Whilst this is very similar to the CIPFA Treasury Management Bulletin (also issued in March 2009), some differences do exist and we recommend that the Council undertakes a separate review against the CIPFA publication.	We therefore consider the Audit Commission's report to have a wider coverage of the issues relating to investment risk. compared to the CIPFA Bulletin, which is relatively brief. We believe the differences between the two documents to be minimal. We therefore consider the actions taken by the Council in light of the Audit Commission's report to be adequate, until we receive a further treasury management coded from CIPFA.
2	We note that the Council's treasury management advisors (Butlers) provide updates in respect of counterparty lists on a weekly basis but that the requirement to review ratings (and how frequently) is not included within the Treasury Management Strategy. We recommend that the Council updates its Treasury Management Strategy to include procedures in relation to how frequently ratings should be monitored.	As the minimum ratings thresholds are determined by Cabinet, officers review ratings prior to each Cabinet meeting at which treasury matters are discussed, ie. three times a year. As officers are mindful of investment risks they are also able, in agreement with the Corporate Director of Resources, to introduce further restrictions on investment limits if appropriate.

	Recommendation	Management response
3	There are no documented procedures for dealing with investments already made with institutions which have been downgraded on the counterparty list. We recommend that the Treasury Management Strategy is updated to include a section on procedures to follow to ensure the Council manages investments which no longer meet local thresholds.	Investments are made for fixed terms, and the important issue which the Council needs to consider after a downgrading is whether the risk of subsequent counterparty collapse outweighs the penalties associated with coming out of an investment early. The balancing of such costs and risks relies heavily on the judgement of the Treasury staff, and we will consider how this can be best covered in our procedures.
4	No training has been provided (to date) in relation to Treasury Management activities/plans to the nominated member. We recommend that training is arranged and continually updated to the member at sufficiently frequent periods, to ensure effective oversight of the Treasury Management function.	We are in the process of arranging training for all members of the Audit & Accounts Committee. This timing of this training will be dependent upon the availability of members.
5	It has been identified that Treasury Management specific briefings to members do not take place at regular times during the year. We recommend that regular briefings are made to members, especially in respect of serious/emergency issues which may develop (e.g. Icelandic banks), to ensure that action can be taken as soon as possible.	Regular briefings will be issued to members of the Audit & Accounts Committee after the initial training has been delivered. At the day-to-day level, the management of investment risk lies with treasury management officers in line with our Treasury Management policies, and if urgent action is to be taken by officers, this would be reported reported to members.
6	Independent compliance checks with the Treasury Management Strategy are currently only performed by Internal Audit annually. We recommend that monthly independent compliance checks with the Treasury Management Strategy/Policies should be undertaken on all investment activities.	We are satisfied that, with internal and external audits, and existing routine management controls, this provides a satisfactory level of compliance. Hence, we are not proposing monthly independent compliance checks.
7	We recommend that the Council conducts a formal review of its capacity and capability to carry out the Treasury Management function, in light of the current risks within the market.	The Council considers itself to have a high level of expertise employed within the treasury management function, and the avoidance of any losses associated with the Icelandic banks is in part due to the application of this expertise. We believe that any capacity or capability issues are can be managed by officers if they arise.

	Recommendation	Management response
8	Currently the counterparty list which is used for deciding on investments does not contain group limits. We recommend that the Council arranges with its Treasury Management advisors (Butlers) to include group data, to ensure investments in banks are still within tolerable limits set in the Treasury Management Strategy/Prudential Indicators, once group structures of the banks have been taken into account.	We have contacted our advisors with a view to implementing this recommendation.
9	We also recommend that the Council formally states its group limits within its Treasury Management Strategy.	As credit ratings can change quite quickly it would not be prudent to state investment limits to specifically named groups within our Treasury Management Strategy. Hence, we believe it would be preferable to retain the current policy of stating investment limits as applying to specified credit ratings, and allowing this to be applied to groups as well as individual counterparties.
10	The Council does not currently undertake any benchmarking exercise in respect of its investment portfolio. We recommend that the Council considers benchmarking its results and activities with other Local Authorities.	We are in regular contact with treasury staff at Derbyshire and Nottinghamshire County Councils and Nottingham and Leicester City Councils, and we exchange information with these authorities on an ad hoc basis. We are not formally involved with any treasury benchmarking club, and in light of the Icelandic banks collapse, we would resist any recommendation to benchmark rates of returns on investments, as this could encourage treasury staff to prioritise yield over security and liquidity, which is currently our priority.
11	We also recommend that the Council reviews benchmarking against its risk appetite (e.g. when it shows a higher than average yield that investments may be less secure or have lower liquidity).	We accept the need to formally compare a minimized risk approach (wherein all borrowing in excess of working capital is redeemed and re-borrowed as and when required, and all investments are placed with the Debt Management Office) with the 'acceptable' risk approach that the Council currently uses. The costs and benefits of these two approaches will be reported to Cabinet in due course.

D Reporting requirements of ISA 260

Introduction
Together with the Audit Commission's Code of Audit, this section sets out the basis on which we have undertaken your audit.

Purpose of memorandum
This report has been prepared for the benefit of discussion between Grant Thornton UK LLP (us/we) and the Audit and Accounts Committee of Derby City Council ('the Council). The purpose of this report is to highlight the key issues arising from the audit of the Council's financial statements for the year ending 31 March 2009.

The document is used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) (ISAUK) 260, and to report audit findings to "those charged with governance", designated as the Audit and Accounts Committee.

The Council is responsible for the preparation of financial statements which records its financial position as at 31 March 2009 and its income and expenditure for the year then ended. We as auditors are responsible for undertaking an audit and reporting whether, in our opinion, the Council's financial statements represent a true and fair view of the financial position.

Under the Audit Commission's Code of Audit Practice ('the Code') we are also required to reach a formal conclusion on whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. To reach this conclusion we have carried out the Use of Resources assessment using criteria prescribed by the Audit Commission. This work also informs our Use of Resources opinion.

We would point out that the matters dealt with in this report came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements of the Council.

Responsibilities of the Council and auditors
The Council is responsible for the preparation of the financial statements and for making available to us all of the information and explanations we consider necessary. Therefore, it is essential that the Council confirm that our understanding of all the matters in this memorandum is appropriate, having regard to their knowledge of the particular circumstances.

This report is made solely to the Members of the Council in accordance with Part II

ISAUK 260 requires communication of:
- relationships that have a bearing on the independence of the audit firm and the integrity and objectivity of the engagement team
- nature and scope of the audit wok
- the form of reports expected

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. To the fullest extent permitted by law, Grant Thornton UK LLP does not accept or assume responsibility to anyone other than the Council or its Members as a body, for its audit work, for this report, or for the opinions it has formed.

Clarification of roles and responsibilities with respect to internal controls

The Council's management is responsible for the identification, assessment, management and monitoring of risk, for developing, operating and monitoring the system of internal control and for providing assurance to the Audit & Accounts Committee that it has done so.

The Audit & Accounts Committee is required to review the Council's internal financial controls. In addition, the Audit & Accounts Committee is required to review all other internal controls and approve the statements included in the annual report in relation to internal control and the management of risk.

The Audit & Accounts Committee should receive reports from management as to the effectiveness of the systems they have established as well as the conclusions of any testing conducted by internal audit or ourselves.

The Audit & Accounts Committee is required to review the Council's internal financial controls. In addition, the Audit & Accounts Committee is required to review all other internal controls and approve the statements included in the annual report in relation to internal control and the management of risk.

The Audit & Accounts Committee should receive reports from management as to the effectiveness of the systems they have established as well as the conclusions of any testing conducted by internal audit or ourselves.

We have applied our audit approach to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We would be pleased to discuss any further work in this regard with the Audit & Accounts Committee.

Independence and robustness

We are independently appointed by the Audit Commission, and have been assessed as complying with its quality standards. In addition, ethical standards require us to give you full and fair disclosure of matters relating to our independence.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

We analyse our fees below:

	£
Audit of accounts*	203,500
Use of resources*	96,500
Certification of grants and claims	112,864
All other services	22,616

* Fees are unaltered from our 2008/09 audit plan.

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