

Peterborough City Council

2007/08 Report to those charged with governance



September 2008

The Audit Committee
Peterborough City Council
Town Hall
Bridge Street
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September 2008

Ladies and Gentlemen

2007/08 ISA 260 report to those charged with governance

We are pleased to present our report on the results of our audit work for 2007/08. We hope that the information contained in this report provides a useful source of reference for members.

Yours faithfully

PricewaterhouseCoopers LLP

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Executive Summary

The purpose of this report

This report summarises the results of our 2007/08 audit of Peterborough City Council.

It covers the issues arising from our audit of the financial statements and those issues which we are formally required to report to you under the Audit Commission's Code of Audit Practice and International Standard of Auditing (UK & Ireland) (ISA(UK&I)) 260 - "Communication of audit matters with those charged with governance".

It also includes the results of the work we have undertaken under the Code of Audit Practice in forming our opinion on the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources.

Our work during the year was performed in line with the plan that we presented to you in June 2007. We have issued a number of reports during the audit year detailing the findings from our work and making recommendations for improvement where appropriate. A list of these reports, and others yet to be issued, is included at Appendix A to this letter. Each report we issue is discussed with senior officers and the Audit Committee.

We have set out below the most important issues that have arisen during the course of our work.

Financial Statements

We have now completed our audit of the Council's 2007/08 Financial Statements. Arising from this work there are a number of matters that we wish to bring to your attention as you consider adopting the final accounts. These matters are set out in more detail in the section of this report titled "Financial Statements". At the time of preparing this report there are a

small number of areas of audit work to be completed, but subject to those and your adoption of the accounts in due course, our intention would be to issue an unqualified opinion on the 2007/08 accounts.

The more significant matters to bring to your attention concern:

- A prior period adjustment in relation to investment properties of £13.1m, due to an error with information provided by the asset valuer;
- The inclusion of transactions relating to Private Finance Initiative ("PFI") schemes in the accounts; and
- Amendments required for the implementation of the Revaluation Reserve and accounting for financial instruments.

These matters have been set out in more detail within the Financial Statements section of this report.

We would like to take this opportunity to thank all officers who have assisted us during the audit process. In particular, we were impressed by the quality of working papers provided by the Strategic Finance Department and the prompt responses from officers to queries raised.

Use of Resources

Under the new Audit Commission Code of Practice, we are also required to form a conclusion on the Council's Use of Resources. This is arrived at following an assessment of the Council against a set of criteria issued by the Audit Commission.

We have completed our assessment against these criteria and anticipate signing an unqualified conclusion.

Financial Statements

Formal communication of relevant audit matters to those charged with governance (ISA 260 Report)

ISA 260 - "Communication of audit matters to those charged with governance" requires us to communicate relevant matters relating to the audit of the financial statements to those charged with governance of the entity, sufficiently promptly to enable them to take appropriate action. We have agreed with you that these matters should be communicated to the members of the Audit and Accounts Committee through this letter. ISA 260 specifically requires us to communicate the following matters to those charged with governance:

- Expected modifications to the auditors' report;
- Changes in significant accounting policies and practices;
- Unadjusted misstatements;
- Material weaknesses in the accounting and internal control systems identified during the audit;
- Views about the qualitative aspects of the entity's accounting practices and financial reporting;
- Matters specifically required by other auditing standards to be communicated to those charged with governance; and
- Any other relevant matters relating to the audit.

The table below details how each of these requirements have been met and where they are reported in this letter:

ISA 260 requirement	Where reported
Expected modifications to the auditors' report	<i>None</i>
Changes in significant accounting policies and practices that have had a material effect on the authority's financial statements	<i>Financial statements section</i>
Unadjusted misstatements	<i>Financial statements section</i>
Material weaknesses in the accounting and internal control systems identified during the audit	<i>None</i>
Views about the qualitative aspects of the entity's accounting practices and financial reporting	<i>Financial statements section</i>
Matters specifically required by other ISAs (UK and Ireland) to be communicated to those charged with governance	<i>None</i>
Any other relevant matters relating to the audit.	<i>Other matters section</i>

ISA 260 also requires us to communicate with those charged with governance regarding:

- The concept of materiality and its connection to our audit approach;
- Our approach in addressing the risk of material misstatement;
- Our approach to the assessment of, and reliance on, internal controls;

- Intended reliance on the work of internal audit;
- The work to be undertaken by any other firms of auditors, and how we will obtain assurance over the procedures of other auditors; and
- The independence and objectivity of the audit team.

These matters have already been communicated to you in the 2007/08 audit service plan and we have no changes to report to you. In particular, we confirm that we consider that we remain independent within the requirements of ethical and auditing standards.

Accounts

We have completed the audit of the Council's accounts in line with the Code of Audit Practice and Auditing Standards, subject to the outstanding matters identified below. We will provide an update on completion of these matters to the meeting on 23 September. We anticipate issuing an unqualified audit opinion on the financial statements.

At the date of writing this letter, some work remains outstanding to complete the audit. This is as follows:

General

- Final completion and quality control procedures in respect of Financial Instruments;
- Final checking and proof reading of the final version of the accounts;
- Receipt of lawyer's letter from the Monitoring Officer; and
- Receipt of letter of representation from management.

Changes in significant accounting policies and practices that have had a material effect on the authority's financial statements

The 2007 CIPFA Statement of Recommended Practice (the "SORP") introduced a number of changes to the format of the accounts and policies adopted by the Council. These changes include:

- The adoption of Financial Report Standard ("FRS") 25, 26 and 27 in relation to financial instruments. The SORP requires that the Council now analyses financial instruments so that the carrying value includes any outstanding interest. In addition, fair value of financial instruments needs to be disclosed. To compensate for adjustments relating to this requirement, statute allowed the creation of a Financial Instruments Adjustment Account so that there is no impact on the Council's General Fund balance.
- Balance Sheet figures for 31 March 2007 have been adjusted from those included in the Statement of Accounts for 2006-07 to accommodate the implementation of the Revaluation Reserve. The Revaluation Reserve replaces the Fixed Asset Restatement Account ("FARA"). The FARA and the Capital Financing Account ("CFA") have been combined as at 1 April 2007. The Revaluation Reserve is also included in the Balance Sheet at that date with a £nil opening balance. The closing position on the Reserve at 31 March 2008 therefore only shows revaluation gains accumulated by virtue of upward revaluations of fixed assets since 1 April 2007.
- In line with guidance provided in Local Authority Accounting Panel ("LAAP") bulletin 73 issued in April 2008 the Council has also revised the accounting treatment of grants and contributions applied to finance assets in the course of construction. Previously these amounts were transferred to the capital contributions deferred account in advance of the asset becoming operational. Contributions in respect of assets in the course of construction are now retained within the capital contributions unapplied account until construction of the asset is complete.

- The SORP has placed two new requirements on local authorities with regards to financial instruments:
 - The need to consider the activities of the Council and identify which financial instrument assets and liabilities exist; and
 - The need to provide new and extensive disclosures on financial instruments and the exposure to financial risk in the accounts.

We are satisfied that the Council has properly implemented and disclosed the new requirements in the Statement of Accounts.

Unadjusted differences

We are required to report to you all unadjusted misstatements which we have identified during the course of our audit, other than those of a trivial nature. These misstatements are described in Appendix B to this report.

We will seek your view on whether the final list of unadjusted items identified from the audit needs to be adjusted in the accounts before the accounts are approved.

Significant adjusted differences

No material adjustments have been made to the draft accounts.

Systems of internal control

We are required to report to you any material weaknesses in the accounting and internal control systems identified during the audit.

We identified from our interim audit work performed in March 2008 a number of matters that management should be aware of when producing the 2008/09 financial statements and where procedural improvements can be made. Recommendations from our interim work were reported in the following reports:

- *Peterborough City Council: Business Process Mapping*; and
- *Debt Management Review: Follow Up*

We are pleased to note that the Council has made significant improvements in the systems of internal control in operation when compared to previous years. Whilst we have reported two frauds on Page 9 of this report, both frauds occurred prior to the full implementation of the upgraded Oracle Purchase-to-Pay system in July 2007.

This initiative has strengthened controls in accounts payable and has enabled us to place an increased amount of reliance on the controls in operation at the Council. This has reduced the amount of testing we have needed to undertake as part of the audit process.

We will be issuing a final 'Report to Management 2007/08' summarising all issues identified from our work not already included in this report and those listed above. We anticipate doing this in late 2008, following completion of all audit work in relation to 2007/08.

We encourage the Council to build upon the controls it has introduced to further enhance its system of internal control.

Accounting practices

We are also required to report to you our view on qualitative aspects of the Council's accounting practices and financial reporting and have set out below our observations.

Prior period adjustment

The 2007/08 Statement of Accounts includes a prior period adjustment in relation to the investment properties included on the Balance Sheet.

An error in information provided by the valuer resulted in the value of these properties being overstated by £13.1m in the 2006/07 accounts. The Council has adjusted for this error by restating the position at 31 March 2007. This has resulted in a decrease to fixed assets, the Capital Adjustment Account and the Statement of Total Recognised Gains and Losses.

The adjustments made by the Council in respect of this error are in accordance with the requirements of Financial Reporting Standard 3: Reporting Financial Performance.

PFI Scheme

In September 2007, the Council's schools Private Finance Initiative ("PFI") scheme commenced. The scheme encompasses refurbishments at the Jack Hunt and Ken Stimpson Schools and new buildings at the Voyager School. These schemes have resulted in an increase in the PFI Deferred Consideration Account to a balance of £28.4m at 31 March 2008.

This balance represents:

- the cost of up-front capital contributions the Council has made to the schemes (£3.9m in the prior year and £13.1m in the current

year);

- the value of existing assets that are now operated by the private sector PFI partner (£12.0m);
- "Residual Interest" (£1.4m), which represents the expected future value of the schools that will transfer back to the Council at the end of the PFI scheme. This figure will increase over the life of the scheme.

The prepayment and up front contribution elements of the Deferred Consideration balance are charged to the Income and Expenditure Account over the life of the PFI contract, whereas the residual interest element is credited to the Income and Expenditure Account.

However, any charges or credits to the Income & Expenditure account in relation to the PFI scheme are reversed out through the Statement of Movement on the General Fund Balance, so there is no effect on Council Tax payers.

We have considered the treatment of the PFI scheme in the Statement of Accounts. Other than the calculation of the Residual Interest figure, we are satisfied that the Council has accounted for the PFI scheme appropriately. The Residual Interest figure has been calculated by discounting the current value of the schools, rather than by discounting the expected future value of the school and the end of the PFI contract.

Management has calculated that the potential maximum overstatement of the Residual Interest is £374k, whilst the potential maximum understatement of Residual Interest is £713k. We have audited this assessment and are satisfied that the difference between the two methods described above does not give rise to a material error in the Council's

accounts.

Single Status

During 2007/08, the Council finalised the Single Status Job Evaluation Scheme and new pay rates were determined for many of the Council's employees. This resulted in backpay being awarded to some employees, and this backpay was included in the April payroll.

The Council correctly accrued for the backpay in the 2007/08 accounts. In addition, the Council has been granted permission by the Secretary of State for Communities and Local Government to capitalise up to £3.4m of expenditure in relation to Single Status in the 2007/08 Statement of Accounts.

This will allow the Council to charge the cost of the backpay to the Income and Expenditure Account over a number of years, rather than incurring a one-off exceptional charge in 2007/08.

Capitalised salaries

In our Report to those Charged with Governance in relation to the 2006/07 accounts, we reported that our audit noted approximately £2.9m of salary costs that had been capitalised. £106k of these could not be supported to demonstrate that they were directly linked to the construction or acquisition of a capital asset. Furthermore, £218k of salary costs had been capitalised by Strategic Property Services in relation to the costs incurred by the Council before certain fixed assets were disposed of.

FRS 15 states that salary costs can only be included to the extent to which those individuals are "directly linked to the construction or acquisition of a capital asset". Administration and other general overhead costs are revenue items that should be excluded from capital expenditure.

Furthermore, FRS15 allows subsequent expenditure on fixed assets to be capitalised where it provides an enhancement of the economic benefits of the tangible fixed asset in excess of the previously assessed standard of performance of that asset. The Council could not provide sufficient

evidence that these costs provided an enhancement of the economic benefits of the assets in question.

We have reviewed the measures taken by the Council in 2007/08 to record salary costs and justify these as capital. In particular, we have assessed capitalised salaries attributed to disposals and are satisfied with the evidence that the Council has provided to us to justify these costs.

We are content with the treatment of capitalised salaries in the 2007/08 statement of accounts. We encourage the Council to continue to maintain robust working papers to support these transactions.

Unidentified assets

The Council has completed its review of fully depreciated assets or assets with non-specific asset descriptions that made identification in previous years difficult. This has resulted in assets with a net book value of £8.4m being written off.

This follows the recommendation we made in 2006/07 that the Council reviewed the fixed assets carried in its Balance Sheet, and that an exercise was undertaken to remove vague items.

The Council has written these items off through the Statement of Total Recognised Gains and Losses. This has therefore had a £nil impact on the Council's deficit for the year in the Income and Expenditure account. We are satisfied with the Council's treatment of these items.

Assets with a negative net book value

Our review of the fixed asset register identified a number of assets carried at a negative value. This was due to incorrect charges for depreciation being made against these assets. The impact of this is an understatement of the carrying value of Vehicles, Plant and Equipment in the accounts of £532k. The Council has chosen not to amend this error as it considers it immaterial.

We recommend that the Council undertakes a review of the fixed asset register once depreciation charges have been calculated to ensure that

assets with negative values are not included.

Landfill Allowance Trading Scheme

The Landfill Allowance Trading Scheme (“LATS”) is a scheme that allocates each local authority a number of ‘allowances’ for the disposal of waste. Each authority is able to trade allowances, save them for future years (bank) or use some of its future allowances in advance (borrow).

In line with many other local authorities, in 2007/08 the Council has recognised the LATS allowances at a £nil value. We are satisfied that the Council has taken appropriate steps to consider the value of the allowances and has done so on a prudent basis.

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Other matters

Internal Audit

We have maintained a good working relationship with the Council's internal audit service during 2007/08. We hold regular liaison meetings with the Head of Internal Audit, placed reliance on Internal Audit's work in the area of payroll and worked with the service in respect of our Business Process Mapping report to ensure the transfer of knowledge.

We have reviewed the 2007/08 Internal Audit plan and, where applicable to our audit approach, individual audit reports and working paper files.

Standards of Financial Conduct and the Prevention and Detection of Fraud and Corruption

In our 2006/07 Audit and Inspection Letter, we reported that fraudulent payments, with a value of £110,000 were identified, and that Internal Audit were due to produce a report on the matter. We reviewed Internal Audit's report as part of our completion of the 2006/07 Children's Fund grant claim audit and understand that the offender was convicted.

A second fraud, involving six invoices totalling approximately £58,000, occurred in April and May 2007 and was discovered during budgetary control checks at the beginning of August 2007. We understand that the offender was convicted.

Both frauds occurred prior to the full implementation of the upgraded Oracle Purchase-to-Pay system in July 2007.

No other matters have arisen from our audit in relation to the Council's Standards of Financial Conduct and arrangements for the prevention and detection of fraud and corruption to bring to your attention.

Legality of Financial Transactions

No matters have arisen from our audit in relation to the legality of financial transactions to bring to your attention.

Elector's Questions

We have not been asked any questions by electors relating to the 2007/08 accounts.

Use of Resources

Work performed

In accordance with the Code of Audit Practice, we have performed work to conclude on the Authority's arrangements for achieving economy, efficiency and effectiveness in its use of resources. Our work to support our conclusion comprised the following elements:

- Use of Resources assessment for CPA:
 - Financial Reporting
 - Financial Management
 - Financial Standing
 - Internal Control
 - Value for Money
- Data Quality review
- Review of the Statement on Internal control
- Audit of the Best Value Performance Plan

2007/08 Use of Resources Conclusion

Under the Code of Audit Practice we are required to provide a conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources. This conclusion is reached by assessing the Authority's arrangements against a set of criteria issued by the Audit Commission.

Our conclusion is based on the use of resources assessment undertaken in December 2006 as part of the CPA process and updated as necessary,

our data quality work, and other information that came to our attention during the course of our audit work.

Details of our conclusion for each of the criteria specified by the Code of Practice are set out in Appendix C.

We intend to issue an unqualified use of resources conclusion.

Use of Resources Conclusion 2008/09

We have already received the Council's self assessments for 2008 and have undertaken some of the interviews with Officers. We are still in the course of gathering our evidence and at this stage, are not in a position to provide members with an interim judgment.

We remind members that our conclusion on the Financial Reporting element of the 2008/09 Use of Resources assessment will relate to the audit work we are currently undertaking on the 2007/08 accounts.

We will report our opinions and any significant matters arising to the Director of Strategic Resources, as well summarising them in the Audit Letter produced by the Audit Commission – both of which will be presented to the Audit Committee later in the year.

Data Quality work

Our data quality work is in progress and the results will be reported to you when our work is completed. However, based on work to date we are satisfied that the Council has adequate arrangements for the purposes of forming our conclusion on Use of Resources.

Statement on Internal Control

Local Authorities are required to produce a Statement on Internal Control (SIC) which is consistent with guidance issued by CIPFA / SOLACE. The

SIC was included in the financial statements.

We reviewed the SIC to consider whether it complied with the CIPFA / SOLACE guidance and whether it is misleading or inconsistent with other information known to us from our audit work.

We found no areas of concern to report in this context

Best Value Performance Plan

Our report on the Council's 2007/08 Best Value Performance Plan (BVPP) was issued on 18 October 2007, and there were no matters arising from our review which we wish to bring to your attention.

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Appendix A: Reports issued and to be issued for 2007/08

Report title	Date issued/ to be issued
Audit Plan	June 2007
Review of Project and Performance Management	July 2007
Review of Benefits Realisation	July 2007
Review of Internal Audit Effectiveness	August 2007
Auditors' Report on Best Value Performance Plan for the year ending 31 March 2008	October 2007
Report on Data Quality arrangements 2007/08	November 2007
CPA Use of Resources assessment	January 2008
Business Process Mapping	June 2008
Debt Management Review: Follow-up Report [Currently issued in draft]	August 2008
Report on the 2007/08 financial statements to those charged with governance (ISA 260)	September 2008
Statement of Accounts 2007/08: Report to Management	October 2008
Annual Audit Letter	January 2009
Grants Report to Management	January 2009

Appendix B: Unadjusted differences

We have identified the following errors during our audit of the financial statements that have not been adjusted by management. The Audit Committee is requested formally to consider the unadjusted errors listed and determine whether it would wish the accounts to be amended. If the errors are not adjusted we will require a written representation from you explaining your reasons for not making the adjustments.

Unadjusted Misstatement	Income & Expenditure Account		Balance Sheet	
	Dr	Cr	Dr	Cr
During the review of the Fixed Asset Register negative assets values have been detected.	SMGFB* £532k	Various expenditure lines £532k	Accumulated depreciation £532k	Capital Adjustment Account £532k

* SMGFB = *Statement of Movement on the General Fund Balance*

Appendix C: Use of Resources Conclusion

The Audit Commission has published 12 Code of Practice 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 code criteria are linked to the CPA and Data Quality Review Key Lines of Enquiry (KLoEs). A score of Level 2 or higher under the KLoEs will result in an assessment of adequate for the purposes of the Code criteria. The Code criteria and the linked KLoEs are shown in the table below.

Code Criteria	Description	Associated KLoE	Use of Resources 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.	N/A	Adequate
5	The body has put in place arrangements to maintain a sound system of internal control	4.2	Adequate

Code Criteria	Description	Associated KLoE	Use of Resources Conclusion
6	The body has put in place arrangements to manage its significant business risks.	4.1	Adequate
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

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