

# Knowsley Metropolitan Borough Council 2005/06 Report to those charged with governance



Governance and Audit Committee  
Knowsley Metropolitan Borough Council  
PO Box 24  
Municipal Buildings  
Archway Road  
Huyton  
Knowsley  
Merseyside  
L26 9YZ

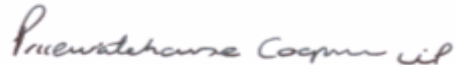
September 2006

Elected Members

**2005/06 Report to those charged with governance**

We are pleased to present our report on the results of our audit work for 2005/06. We hope that the information contained in this report provides a useful source of reference for members.

Yours faithfully



PricewaterhouseCoopers LLP

Encs

**PricewaterhouseCoopers LLP**

101 Barbirolli Square  
Lower Mosley Street  
Manchester M2 3PW  
Telephone +44 (0) 161 245 2000  
Facsimile +44 (0) 161 245 2904

# Contents

Section	Page
1. Executive summary .....	4
2. Financial statements.....	5
3. Use of Resources .....	8
4. Audit fee update.....	10
Appendix A: Audit reports issued in relation to the 2005/06 audit year .....	11
Appendix B: Summary of adjusted misstatements.....	12
Appendix C: Use of Resources conclusion .....	14
Appendix D: Summary of recommendations.....	16

**Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies**

*In March 2005 the Audit Commission issued a revised version of the ‘Statement of responsibilities of auditors and of audited bodies’. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is to be expected of the audited body in certain areas. Our reports and management letters are prepared in the context of this Statement. Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the audited body and no responsibility is taken by auditors to any Member or officer in their individual capacity or to any third party.*

# 1. Executive summary

## **The purpose of this report**

This report summarises the results of our 2005/06 audit of Knowsley Metropolitan Borough 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 2005.

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

## **Financial Statements**

2005/06 is our first year of audit and our approach is different to that of our predecessors. We would like to thank the Borough Treasurer and his staff for their assistance in completing our audit – this will help next year.

We have identified a number of errors, this is normal in a fresh audit and we would like to praise the positive way in which our recommendations have been received.

There are some significant areas in which improvements are necessary, but we are confident that working with you they can be introduced for 2006/07.

The key issues arising from the audit of the financial statements have been set out in section 2.

## **Use of Resources**

We are currently carrying out work in relation to our Use of Resources assessment, and will report this to you when completed. At the present time there is nothing which we consider will change our overall assessment that Knowsley is a well performing authority and we intend to issue an unqualified opinion on value for money following the conclusion of our Data Quality and BVPI audit.

## 2. Financial statements

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 members through this letter.

### Audit opinion

We have completed the audit of the Authority's accounts in line with the Code of Audit Practice and Auditing Standards. We anticipate issuing an unqualified audit opinion on the financial statements

### Unadjusted misstatements

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 (i.e. items less than £1,000 in value). There are no unadjusted misstatements for us to bring to the attention of members.

### Adjustments to the Financial Statements

We also bring to your attention the following misstatements which have been corrected by management but which we consider you should be aware of in fulfilling your governance responsibilities.

1. **Collection Fund** – The draft financial statements presented for audit contained an error within 'Income collectable from business ratepayers' and 'Payments to the national pool'. Both elements were

overstated by £9,159,000 as a result of errors in the use of spreadsheets.

- This highlights a weakness in the review process adopted and the level of scrutiny regarding the reasonableness of the balances disclosed. Such an increase against prior year balances would only appear reasonable if the Council had made significant increases in the rates charged to businesses. A control recommendation has been included in Appendix D.

2. **Fixed Assets/Capital Accounting** – Our audit highlighted a number of accounting errors in this area and these have been included in the Summary of adjusted misstatements (Appendix B). These are as follows;

- Balances in the asset register did not reconcile to the financial statements;
- Incorrect calculation of CFR/MRP;
- Incorrect accounting treatment for the impairment of the land and buildings for Kirkby Baths; and
- Debtor not raised to reflect the capital disposal of St Kevin's playing field.

In addition, the following control weakness has been identified and a recommendation included in Appendix D.

- Testing of capital disposals identified seven assets that were not included on the asset register that were found to be “windfall assets” resulting from the sale of the housing stock. This casts some doubt over the completeness and accuracy of the fixed asset register and increases the risk that the financial statements could be misstated. Management have confirmed that the asset register held by Estates is not formally reconciled to the accounting information held by the Financial Services Division, however, this will be undertaken.

**3. Debtors/Creditors** – A number of errors have been identified following the completion of our review of Debtors and Creditors. These are as follows;

- There are currently credit balances of £140,000 included within Debtors resulting in year end balances being understated; and
- Unrecorded liabilities testing identified one missed accrual for £449,000 plus VAT.

In addition, the following control weaknesses have been identified and recommendations included in Appendix D.

- The returned debtor confirmation from Mersey Waste highlighted five balances not invoiced by the Council. At the year end the majority of the income had been accrued, however these balances dated back to November 2005. Invoices were not issued until August 2006.
- Detailed testing within Debtors and Creditors proved problematic in terms of obtaining supporting documentation for journal transactions. It appears that the necessary supporting information is not present at the point of review, therefore reducing the level of control and increasing the time taken to audit these balances.

**4. Reserves** – Our review of the Council’s reserves highlighted two issues, these are as follows;

- The disclosure note for reserves movements does not reconcile to the ‘Contributions to Earmarked Reserves’ on the face of the Consolidated Revenue Account. Further investigation by the Council has identified errors in the process for excluding contributions to reserves from the BVACOP analysis of total service cost for both 2005/06 and the prior year.

The Council are heavily dependent on the use of spreadsheets for pulling together the financial statements and this error highlights a weakness in the review process. A control recommendation has been included in Appendix D.

- The Council has implemented a more stringent policy in respect of establishing earmarked reserves. The Council has approved £6.7 million of service budget transfer to earmarked reserves to fund future cost pressures, therefore significantly reducing the reported surplus for the year.

Members have been made aware of this policy, and we feel it is essential that management continues to inform Members of the rigorous annual reviews of all earmarked reserves and continually keeps members aware of the impact of this policy.

**5. Housing and Council Tax Benefit** – Our review of the classification of Housing and Council Tax Benefit Income and Expenditure highlighted a disclosure error that has been in place for a number of years. The BVACOP clearly specifies that these balances should be included under ‘Housing Services’ not ‘Central Services to the Public’. The individual lines in the cost of services analysis will need restating for 2005/06 and the prior year which will result in income of £65 million and expenditure of £66 million being adjusted, but there is no effect on the overall cost of services disclosed.

### **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 have set out above details of the control weaknesses that we have identified as part of our audit.

All control weaknesses have been documented in detail in Appendix D with recommendations for improvement.

### **Accounting practices**

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

We have made comments above regarding the Council's use of spreadsheets in pulling together the financial statements. Errors in the use of spreadsheets have resulted in two significant errors being identified which highlight a significant control weakness at the point of review. We have recommended in Appendix D that the Council reviews the level of reliance placed on spreadsheets, however where this is necessary a rigorous review needs to be performed to confirm the accuracy of the formulas used.

# 3. 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
- Mandatory Data Quality Review work
- Review of the Statement on Internal control
- Audit of the Best Value Performance Plan

## Use of Resources Conclusion

Under the new Code of Audit Practice we are required to provide a conclusion on the Authority'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 2005 as part of the CPA process and updated as necessary, our Local Government data quality work, and other information that came to our attention during the course of our audit work.

We intend to issue an unqualified use of resources conclusion. Details of our conclusion for each of the criteria specified by the Code of Practice are set out in Appendix C.

## Data Quality work

We are currently finalizing our Data Quality review and are communicating with relevant officers on an ongoing basis.

## Statement on Internal Control

The Statement on Internal Control has been reviewed to assess whether it complies with the requirements of the SORP and whether it is consistent with other information known to us from our audit work. We have no matters to bring to the attention of members.

### **Best Value Performance Plan**

The Authority issued its 2005/06 Best Value Performance Plan (BVPP) in June 2005 which we subsequently audited. Our audit report on the BVPP was issued in December 2005 and was unqualified. Our work on the 2006/07 BVPP forms part of our 2006/07 audit work.

## 4. Audit fee update

### Audit fees update for 2005/06

We reported our fee proposals as part of the Audit Plan for 2005/06.

To reflect the Audit Commission work programme and fee scale proposals we increased the 2005/06 fee by 5% to incorporate the additional amount of work required by auditors to comply with the new International Standards in Auditing (UK and Ireland).

Our fees charged were:

	2005/06 Outturn	2005/06 Fee proposal
Accounts	£135,200	£128,750
Use of Resources	£90,550	£86,250
<b>Total</b>	<b>£225,750</b>	<b>£215,000</b>

# Appendix A: Audit reports issued in relation to the 2005/06 audit year

The following audit reports have already been issued in relation to the 2005/06 audit year:

- Use of Resources Report.

# Appendix B: Summary of adjusted misstatements

We identified the following misstatements during our audit which management have corrected, but which we consider should be communicated to you to assist you in fulfilling your governance responsibilities:

Adjusted Misstatement	Consolidated Revenue Account		Balance Sheet	
	Dr £000's	Cr £000's	Dr £000's	Cr £000's
<b>Balances in the asset register do not reconcile to the financial statements</b>				
Dr Fixed Assets Cr Fixed Asset Restatement Account			992	992
Cr Fixed Assets (Land and Buildings) Dr Infrastructure			40	40
<b>Reclassification of credit balances within the Accounts Receivable system</b>				
Dr Debtors Cr Creditors			140	140
<b>Debtor not raised to reflect capital disposal</b>				
Dr Debtors (Capital) Cr Capital Receipts			3,790	3,790

Adjusted Misstatement	Consolidated Revenue Account		Balance Sheet	
	Dr £000's	Cr £000's	Dr £000's	Cr £000's
<b>Incorrect accounting treatment of Land and Buildings impairment of Kirkby Baths</b>				
Dr Tangible Fixed Asset Account			2,283	
Cr Fixed Asset Restatement Account				2,283
Dr Service Revenue Account	2,283			
Cr Asset Management Revenue Account		2,283		
Dr Asset Management Revenue Account	2,283			
Cr Tangible Fixed Asset Account				2,283
Dr Capital Finance Account			2,283	
Cr Consolidated Revenue Account (Appropriations)		2,283		
<b>Absence of accrual for after date capital payment</b>				
Dr Tangible Fixed Asset Account			449	
Cr Creditors (capital)				449
<b>NET EFFECT</b>	<b>4,566</b>	<b>4,566</b>	<b>9,977</b>	<b>9,977</b>

# Appendix C: Use of Resources conclusion

The Audit Commission has published 12 Code of Practice criteria on which auditors will be 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	CPA Score	Use of Resources Conclusion
1	The body has put in place arrangements for setting, reviewing and implementing its strategic and operational objectives.	N/A	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	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	N/A	Adequate
4	The body has put in place arrangements to monitor the quality of its published performance information, and to report the results to members.	LG DQ KLoEs	2	Adequate
5	The body has put in place arrangements to maintain a sound system of internal control	4.2	3	Adequate

Code Criteria	Description	Associated KLoE	CPA Score	Use of Resources Conclusion
6	The body has put in place arrangements to manage its significant business risks.	4.1	3	Adequate
7	The body has put in place arrangements to manage and improve value for money.	5.2	3	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	3	Adequate
9	The body has put in place arrangements to ensure that its spending matches its available resources.	3.1	4	Adequate
10	The body has put in place arrangements for managing performance against budgets.	2.2	3	Adequate
11	The body has put in place arrangements for the management of its asset base.	2.3	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	4	Adequate

# Appendix D: Summary of recommendations

Page	Recommendation	Management Response	Target Implementation Date
5 & 6	<p><b>Year end review and challenge of the financial statements</b></p> <p>Two accounting errors identified during the course of the audit indicate that the financial statements have not been subject to sufficiently robust review regarding the reasonableness of the balances disclosed.</p> <p>The spreadsheet formula errors included within the Collection Fund and Reserves highlight a lack of independent review over year end processes. All working papers are evidenced as reviewed, however this does not include a challenge of the basis for calculation.</p> <p>We therefore recommend that a thorough review is undertaken over the use of spreadsheets in pulling together the financial statements. Where they are necessary, a robust review needs to take place in order to reduce the risk of misstatement.</p>	<p>The Council will review its approach to analysing data from the financial information system using spreadsheets in order to produce the final statement of accounts.</p> <p>The Borough Treasurer will ensure that the Council continues to develop and exploit the Oracle financial information system in order to automate the closure of accounts process further.</p> <p>Processes for challenge and quality assurance of the financial statements will also be improved to take account of the issues raised during the audit.</p> <p>The Borough Treasurer will also work with the Auditors to ensure that coding of expenditure remains in accordance with the BVACOP.</p>	<p>March 2007</p> <p>Ongoing</p> <p>March 2007</p> <p>January 2007</p>

Page	Recommendation	Management Response	Target Implementation Date
6	<p><b>Control over year end processes</b></p> <p>Our year end detailed transaction testing highlighted a significant amount of journals not supported by audit evidence at the point of review. We therefore recommend that all journals should be accompanied by appropriate evidence at the point it is reviewed prior to being posted. This will increase the level of control over year end processes and reduce the time taken to validate the transaction as part of the audit.</p>	<p>Review of journals by authorising officers requires the officer to be satisfied that such documentation is available and supports the entries. It is not a requirement for all documentation to be physically attached to the journal itself - electronic journals and the nature of many multiple entry journals make this impractical to achieve.</p> <p>The Borough Treasurer will reiterate the need for appropriate documentation to be retained and made available to auditors on request, and will consider options for enhancing documentation checks when journals are authorised.</p> <p>The Borough Treasurer will also review the closure of accounts process to examine options for more efficient use of journals and electronic document storage.</p>	<p>November 2006</p> <p>January 2007</p>
6	<p><b>Asset reconciliation</b></p> <p>In order to provide comfort over the completeness and accuracy of the fixed asset register, we recommend that the Council perform periodic asset reconciliations between Estates and Finance.</p>	<p>The Borough Treasurer will arrange for improved reconciliation between the Council's asset register and the information used to compile the statement of accounts.</p> <p>There will also be a review of the accounting policies for all fixed assets (including the approach to valuation of fixtures and fittings) to ensure full compliance with developments in the national recommended practice (SORP) for 2006/07.</p>	<p>March 2007</p> <p>March 2007</p>

Page	Recommendation	Management Response	Target Implementation Date
6	<p><b>Income recognition</b></p> <p>The returned debtor confirmation from Mersey Waste highlighted five balances not invoiced by the Council. This income relates to recycling rebates dating back to November 2005. The Council has accrued the majority of the income, however did not invoice Mersey Waste until August 2006.</p> <p>This highlights a weakness over prompt invoicing and cash collection. We therefore recommend that the Council reiterates the process for prompt invoicing and cash collection to the service accountants responsible.</p>	<p>A debtor provision was correctly calculated based upon information available at the time of closing the accounts – however due to staffing issues, delays occurred in raising invoices.</p> <p>All Directorates will be reminded of the need to improve the timeliness of raising invoices.</p>	November 2006
6	<p><b>Reserves policy</b></p> <p>During 2005/06 the Council implemented a more stringent policy in respect of establishing earmarked reserves. In 2005/06 £6.7million of service budgets was transferred to earmarked reserves to fund future identified cost pressures. We understand that this effectively smoothes the impact on the council tax payer, however this may distort the actual position for 2005/06 in terms of the surplus reported.</p> <p>We recommend that the Council continues to perform rigorous annual reviews of all earmarked reserves to confirm the ongoing need.</p>	<p>The Council has adopted its robust approach to the creation of reserves to ensure that prudent management of resources is accompanied by securing effective use of resources.</p> <p>The Borough Treasurer will continue to enforce rigorous monitoring and approval of reserves to maintain this policy.</p> <p>The Council does not consider the final surplus to be “distorted” as it accurately reflects the approved policy of Members. However the policy does have the impact of reducing the level of reported surplus that is added to general balances. This approach ensures that explicit reserves are approved by Members rather than maintaining un-earmarked general balances for unspecified future commitments.</p>	Ongoing

*In the event that, pursuant to a request which Knowsley Metropolitan Borough Council has received under the Freedom of Information Act 2000, it is required to disclose any information contained in this report, it will notify PwC promptly and consult with PwC prior to disclosing such report. Knowsley Metropolitan Borough Council agrees to pay due regard to any representations which PwC may make in connection with such disclosure and Knowsley Metropolitan Borough Council shall apply any relevant exemptions which may exist under the Act to such report. If, following consultation with PwC, Knowsley Metropolitan Borough Council discloses this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.*

*©2006 PricewaterhouseCoopers LLP. All rights reserved. PricewaterhouseCoopers refers to the United Kingdom firm of PricewaterhouseCoopers LLP (a limited liability partnership) and other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.*