audit 2001/2002

Final Accounts Memorandum

Salford City Council

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DISTRICT AUDIT

Reference:	SA002-11-2002
Date:	March 2003

Introduction

The Audit Commission Act 1998 and the Code of Audit Practice require the external auditors to give an opinion as to whether the statement of accounts presents fairly the financial position of the Council and its income and expenditure for the year in question.

We gave an unqualified opinion on the 2001/2002 accounts on 20 December 2002. This memorandum sets out the findings of the final accounts audit and, where appropriate, makes recommendations to improve future accounts.

Main conclusions

The Council is required to prepare and approve its accounts by the end of September each year. Last year the Authority was late in preparing its accounts and they were only approved by Council towards the end of November. However, this year considerable efforts have been made to improve the timeliness of the accounts. As a result they were available by 31 August, which is one month ahead of the statutory deadline, and were approved on 17 September 2002.

The Authority is to be congratulated on this achievement. The earlier closedown of accounts will mean that the Council is well placed when the whole of government accounts are introduced and the statutory deadline is brought forward. We understand that the Council is aiming to further improve the timeliness of the 2002/2003 accounts.

During the audit we agreed a number of amendments to the accounts although none of the changes impacted on the surplus for the year disclosed in the consolidated revenue account. However, the amendments did lead to a £1.553m reduction in school balances from £2.698m to £1.145m. The main reason for this was an adjustment to reflect internal debtors that had not been matched by corresponding internal creditors within the schools.

Our audit also identified several other significant issues that need to be addressed, some of which have been raised in the past. The main ones are that:

- regular bank account reconciliations have not been carried out during the year although the reconciliation was brought up to date as part of the year end process
- the level of bad debts provision against council tax and sundry debtors appears to be inadequate although, in the case of sundry debtors, further work is being done by the Council to quantify this
- capitalisation of ‘grey’ areas has been extended to the boundary of what is reasonably allowable for such items
- reconciliations between grant debtors/creditors included in the accounts and the grant claims submitted to the government departments are not carried out in all cases.

We acknowledge that the Council is attempting to address some of the issues raised. For example, officers are aiming to carry out a full bank reconciliation at 31 December 2002 and then to undertake monthly reconciliations throughout 2003/2004. Furthermore additional contributions to the council tax and sundry debtor bad debt provisions have been earmarked in the 2002/2003 and 2003/2004 budgets. We support these proposals.

With regard to capital, the original intention was that during 2003/2004 the Council would cease to capitalise some of these ‘grey’ areas of expenditure. However, the recent revenue support grant settlement means that resources are going to be tight for the foreseeable future and de-capitalisation is unlikely in 2003/2004 but the medium term financial strategy does provide for this to be unwound. We will therefore be carrying out a more in-depth review of the 2001/2002 capitalisations early in the new year so that we can give the Authority our initial view of any future proposals in this area.

The final accounts working papers were of a similar standard to previous years. Whilst on the whole documents were available to support the figures in the accounts, these were not always available at the start of the audit and had to be produced on request. We will be working with the Council to help to ensure that the required documentation is available at the same time as the accounts in future.

The way forward

The detailed findings from our audit are outlined in the remainder of this report. Attached is an agreed Action Plan for taking our recommendations forward.

Cash and bank

1. The bank reconciliation forms a vital control which underpins the whole accounting process, proving that the cash entries in the ledgers are complete. During our audit we found that:
   - the bank reconciliation was not completed regularly during the course of the year
   - the bank reconciliation was completed for the whole year as part of the final accounts closedown. We are happy that the reconciliation at the year end proves that all the transactions passing through the bank accounts have been accounted for in the ledgers although we found evidence that, if regular reconciliations had been carried out, an imbalance would have been corrected earlier than was the case
   - no bank reconciliations had been completed in 2002/2003 although much of the preparatory work which forms part of the bank reconciliation has been done. We understand that a full reconciliation did take place at 31 December 2002.

Other bank accounts

2. In addition to the main accounts, there are numerous bank accounts with relatively small balances that are held within the City of Salford group. Corporate Accountancy does not have a comprehensive list of all the bank accounts that have been opened in the name of the City of Salford. Consequently they are unable to ensure that all bank accounts are properly accounted for and included in the accounts. Internal Audit is currently undertaking an exercise to identify all such accounts and review the controls that are exercised over them.
3. Partly as a result of these poor controls a £398,000 bank balance has been included twice in the accounts. This resulted in bank balances and school reserves being overstated by £398,000 and the accounts were amended to correct this error.

Recommendations	
R1	The full bank reconciliation at 31 December 2002 should be undertaken as planned and further reconciliations completed on monthly basis on a future.
R2	Corporate Accountancy should exercise a central control over bank accounts to ensure that: • there is a central record of bank accounts • all additional bank accounts are warranted • regular reconciliations are carried out.

Internal debtors

4. The debtors within the accounts include internal debtors which are sums of money owed to directorates by other directorates within the Council. Agreeing internal debtors to the corresponding internal creditor is an important part of the closedown process. This allows debtors and creditors in the balance sheet to be shown net of internal indebtedness and so show the Council’s true indebtedness. It also acts as an important check to ensure that both entries are included correctly in the revenue accounts.

5. There has been an imbalance between internal debtor and creditors for several years although it has not been possible to quantify it. However this year the Council has gone some way toward completing the reconciliation and the working papers presented for audit show that there are charges of over £1m omitted from the revenue accounts. This is because internal debtors of this value are included within the figures but the corresponding creditors are not.

6. An exercise is needed to confirm that all the internal recharges are valid and, if so, to raise the corresponding creditor. As school balances are the most likely area for the adjustment we agreed and these balances would be amended in the accounts.

Recommendations	
R3	The reason for the difference between internal debtors and creditors at 31 March 2002 should be investigated and, based on the results of this exercise, the necessary correcting entries made to the accounts.
R4	Internal debtors and creditors should be coded separately within the ledger to facilitate the netting down exercise.
R5	Intra authority balances should be agreed regularly throughout the year by all directorates, including individual schools, to facilitate the year end processes.

Grant debtors

7. Within the various debtors on the balance sheet are amounts owed by government departments in settlement of grants. Our audit showed that the supporting working papers do not always contain an explanation of the differences between the amount shown on the ledger and that included on the relevant grant claim. In addition we found that several grant debtors were incorrectly stated, the main ones being the:

- housing benefits subsidy debtor which was understated by £277,293 and consequently the General Fund income was understated by the same amount
- e-government pathfinder grant debtor which was understated by £146,000 and consequently the General Fund income was understated by the same amount
- housing subsidies creditor which was understated by £529,000 and consequently HRA income was overstated by the same amount. The Authority routinely maintains a provision in the HRA for errors on this claim. The year end balance of £300,000 on this provision therefore partly offsets the overstatement
- creditors described as ‘owed to the DfES’ which include amounts owed to individual schools. Clearly these do not relate to an external body. However, from the information available, it is not possible to establish whether they have been taken into account as part of the internal debtor/creditor adjustments.

Recommendation	
R6	The final accounts working papers should show clearly where balances relating to grant claims are included and how they reconcile to the amounts disclosed on the grant claim.

Bad debt provisions

8. The Council are required to assess the collectability of outstanding debts and to make provision in the accounts for those debts that they consider cannot be collected. It is good practice to make the provision based on a review of each debt outstanding at the end of the year. Due to the number of debts outstanding, officers have not assessed debts individually but have made provisions by applying percentages to groups of debts. Whilst we are unable to accurately assess the adequacy of the provisions because of the way they are made up, we are concerned that they appear to be inadequate.

9. In the case of council tax, the debt outstanding at year end is £15,840,000 and the bad debt provision £2,870,000. In our view, based on historic collection rates, another £2,860,000 should be provided. We acknowledge that the Council is trying to address this problem by declaring an annual deficit of £1,000,000 on the collection fund in order to increase the provision. This is £500,000 more than in the previous year. We support the commitment to continue with this approach and if possible to increase the amount further to make up the shortfall.

10. With regard to sundry debtors, the balance outstanding at 31 March 2002 was £8.6m. £4.3m of this debt had been outstanding for more than three months, including £2.2m which was over two years old. The bad debt provision of £2.5m included in the accounts appears to be inadequate given the size and age of the debts. We appreciate that the Authority is taking steps to review very old debt and this should help to ascertain whether or not the bad debt provision is adequate.

11. We acknowledge that the Council is also planning to increase the sundry debtor provision through additional contributions of £500,000 in each of the next two years. The Council is to be congratulated for these plans. Once again we would support the commitment to continue with this approach and to accelerate the contribution if the opportunity arises.

Recommendation	
R7	The bad debt provision for sundry debts should be based on the likelihood of recovery of each individual debt, particularly if these have been outstanding for some time.

Fixed assets

12. Items are charged to fixed assets when they have a useful life in excess of twelve months and the Authority will benefit from them in the future. These items are then depreciated so that service accounts are charged over the life of the asset. The 2001/2002 accounts include fixed assets with a value of £838m and in the year £52m of new assets were added.

13. Part of the Authority's financial recovery plan has been to capitalise, on a temporary basis, 'grey' areas of expenditure that have previously been charged to revenue but could be viewed as being either capital or revenue. Our review of capital expenditure as part of the final accounts audit showed that these capitalisations have now been extended to the limit of what is reasonably allowable for such items.

14. A considerable amount of expenditure, over £2,000,000, was capitalised at the end of the closure process and was all categorised as land and buildings. A brief review of the items capitalised showed that some of the expenditure could have been revenue and that some of the items were not land and buildings.

15. As the Council's overall financial position is going to remain tight for the foreseeable future, the opportunities to de-capitalise as originally planned are going to be limited. We have therefore agreed that we will carry out a more in-depth review of 2001/2002 capitalisations early in the new year so that we can give the Authority our initial view on any future proposals in this area.

16. We also identified two items charged as assets, a £305,000 contribution to the GMPTA and a £60,000 contribution to risk management, which were clearly not fixed assets and agreed that the accounts would be amended to charge them to revenue instead.

17. The fixed asset note for council dwellings shows depreciation of £16.786m and a depreciation revaluation of the same amount. For presentational purposes this revaluation should have been shown as a cost revaluation instead and the accounts were amended to reflect this change. The situation arose because council houses were revalued at the end of the year instead of the beginning. If the revaluation had taken place at the beginning of the year there would have been no need for the adjustment.

Capital financing

18. Capital expenditure can be financed in a number of different ways. When the accounts were being produced officers were in negotiation with the Highways Agency to finance £766,000 of expenditure with a Supplementary Credit Approval (SCA). The accounts assumed that the SCA would be given. Subsequently the SCA was not given and we therefore agreed that the accounts would be amended to show an additional £766,000 of unfunded expenditure.

19. After the above adjustment, the accounts show £2,345,000 of capital expenditure as being unfunded. If this expenditure was unfunded it would be in breach of capital regulations. It is in fact funded by capital grants that the Authority had not received at the 31 March 2002 but reasonably expected to receive in the following year. The accounts were therefore amended to show that the majority of this expenditure had been financed by accrued capital grants.

20. Capital expenditure is accounted for on an accruals basis but is financed on a cash basis. The capital expenditure in the accounts includes £116,000 for charges raised by City Building Services on the Housing Revenue Account (HRA). As the bills were not paid by the HRA at the 31 March, officers considered this to be accrued expenditure that did not need to be financed in the year. However, the expenditure was not accrued by the Council, merely by the HRA, and so should have been financed in the year.

Deferred charges

21. The accounts include a deferred charge in respect of stock discounts which is being written down over the life of the stock issue. Part of the write down, £74,000 each year, is charged to the HRA and appears to remain in the HRA. Such a write down to revenue is not a permitted debit to the HRA in terms of the Local Government Housing Act 1989. In the Audit Commission's view, the write down of HRA deferred charges directly to the Capital Financing Reserve would not be an unreasonable approach. We have discussed this matter with the HRA accountant who has agreed to review the treatment in future years.

Recommendation	
R8	The Council should review the way in which deferred charges in respect of stock discounts are written down in the HRA.

Stock and work in progress

22. The accounts include stock and work in progress of £1,275,627. Our audit of this item showed that:

- the analysis of stock was incorrect as provisions were overstated by £83,860 with a compensating understatement of stocks and stores
- the accounts include internal work in progress of £116,000 which should have been netted off with a consolidation adjustment
- there are provisions for future losses of £81,367 which, like internal work in progress, should have been netted off with a consolidation adjustment
- the stock certificate of £419, 371 supplied by Social Services contains the following statement 'the stock valuation is not a true valuation as the computer system (SCOTT) does not allow for depreciation or write off of stock'.

Recommendations
R9 Internal work in progress and provisions for future losses should be netted off with a consolidation adjustment.
R10 An accurate certificate should be obtained for Social Services stock.

Housing revenue account

23. The HRA expenditure includes a charge for the cost of capital. This charge should be based on 6% of the opening value of operational assets. The charge in Salford's HRA is based on 6% of the closing value of operational assets meaning that it is understated by £1,229,000. The accounts were therefore amended to reflect the correct charge. However as there is a compensating adjustment to the transfer to the Asset Management Revenue Account there is no impact on the surplus for the year.

Recommendation
R11 Council dwellings should be valued at the 1 April each year and the capital charges to the HRA based on this valuation.

Trust funds

24. The Council administers a number of trust funds and, for the past four years, has been trying to establish who the trustees are. Some progress has been made but there are still a number of funds for which the Council does not have the required information. Until this is established the Council cannot be sure that it is complying with the Accounting Code of Practice and the Charities Act in their disclosures and audit regimes.

Recommendations
R12 The Council should establish who the trustees of each fund are and subsequently ensure that they comply with the Accounting Code of Practice and Charities Act in their disclosures and the audit regime.

Status of our reports to the Council

Our reports are prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission. Reports are prepared by appointed auditors and addressed to non-Executive Directors/Members or officers. They are prepared for the sole use of the audited body, and no responsibility is taken by auditors to any Director/Member or officer in their individual capacity, or to any third party.

APPENDIX 1

DA Head A

DA Head B

DA Head C

DA Head D