

# Annual governance report

Council of the Isles of Scilly

Audit 2010/11

**The Audit Commission is a public corporation set up in 1983 to protect the public purse.**

**The Commission appoints auditors to councils, NHS bodies (excluding NHS Foundation trusts), police authorities and other local public services in England, and oversees their work. The auditors we appoint are either Audit Commission employees (our in-house Audit Practice) or one of the private audit firms. Our Audit Practice also audits NHS foundation trusts under separate arrangements.**

**We also help public bodies manage the financial challenges they face by providing authoritative, unbiased, evidence-based analysis and advice.**

# Contents

<b>Key messages</b> .....	<b>3</b>
Audit opinion .....	3
Financial statements .....	3
Value for money .....	4
Other matters .....	4
Audit fees .....	4
Independence .....	4
<b>Financial statements</b> .....	<b>5</b>
<b>Value for money</b> .....	<b>13</b>
<b>Other matters</b> .....	<b>15</b>
<b>Appendix 1 Independent auditor's report to Members of the Council of the Isles of Scilly</b> .....	<b>17</b>
<b>Appendix 2 Amendments to the draft financial statements</b> .....	<b>21</b>
<b>Appendix 3 Unadjusted misstatements in the financial statements</b> .....	<b>22</b>
<b>Appendix 4 Draft letter of representation</b> .....	<b>23</b>
<b>Appendix 5 Findings from the review of material information systems</b> ....	<b>27</b>
<b>Appendix 6 Glossary</b> .....	<b>29</b>
<b>Appendix 7 Action Plan</b> .....	<b>31</b>

Ladies and Gentlemen

### **2010/11 Annual Governance Report**

I am pleased to present the results of my audit work for 2010/11.

I discussed and agreed a draft of my report with the Chief Executive and Director of Finance and Resources on 6 September 2011 and updated it as issues have been resolved.

My report sets out the key issues that you should consider before I complete the audit.

It asks you to:

- consider the matters raised in the report before approving the financial statements;
- note the adjustments to the financial statements set out in this report (appendix 2);
- agree to adjust the errors in the financial statements I have identified, which management has declined to amend or set out the reasons for not amending the errors (appendix 3);
- approve the letter of representation on behalf of the Council before I issue my opinion and conclusion (appendix 4); and
- agree your response to the proposed action plan (appendix 7).

Yours faithfully

Patrick Jarvis  
District Auditor

September 2011

# Key messages

**This report summarises the findings from the 2010/11 audit which is substantially complete. It includes the messages arising from my audit of your financial statements and the results of the work I undertake to assess your arrangements to secure value for money in your use of resources.**

Table 1: **Key messages – financial statements**

<b>Financial statements</b>	<b>Results</b>	<b>Page</b>
Unqualified audit opinion	Yes (subject to satisfactory clearance of outstanding matters)	5
Important weaknesses in internal control	Control environment – adequate Scope for further improvements in internal control	9

Table 2: **Key messages – value for money**

<b>Value for money</b>	<b>Results</b>	<b>Page</b>
Proper arrangements to secure value for money	Yes	13

## Audit opinion

**1** My work on the audit is largely complete. Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements. Appendix 1 contains a copy of my draft audit report

## Financial statements

**2** This was the first year of presenting the Council's financial statements in accordance with International Financial Reporting Standards (IFRS). As with most councils, I identified a number of disclosure errors and amendments which reflect the greater levels of disclosure and detail required by IFRS.

## Value for money

3 I intend to issue an unqualified conclusion stating that the Council had adequate arrangements to secure economy, efficiency and effectiveness in the use of resources. In the area of strategic asset management I will include a report by exception in my report. I am pleased to report that I identified improvement in the arrangements for risk management and internal control during 2010/11 which enable me to assess arrangements as adequate.

4 Appendix 1 contains the wording of my draft report.

## Other matters

5 I received two formal objections to the 2009/10 financial statements. These were about the Council's purchase of a property in 2009/10 to provide additional accommodation. I reviewed the arrangements surrounding this purchase and concluded that there were not grounds for upholding these objections. I also identified subsequent improvements made by the Council in these arrangements.

## Audit fees

6 The agreed audit fee for the 2010/11 audit was £65,000. The amount of testing required for this year's audit increased due to:

- preparing the financial statements under IFRS increased the number of disclosures and the amount of audit work required; and
- the additional substantive testing required during the audit to reduce the risk of material misstatement to an acceptably low level.

7 I will review the audit fee at the end of my audit. A formal objection raised by a local member of the public on the 2010/11 financial statements will also involve extra audit fees.

8 I also responded to two objections from local electors on the 2009/10 financial statements. These required detailed review of the supporting documentation, interviews with Council staff and the objectors, extensive correspondence and the involvement of specialist legal advice on both the background to the objection and the conclusion of my work. The fee for these objections is £18,700. This is a reduced fee to reflect the special circumstances of the Council.

## Independence

9 I can confirm that I have complied with the Audit Practice Board's ethical standards for auditors, including ES 1 (revised) – Integrity, Objectivity and Independence. I can also confirm there were no relationships resulting in a threat to independence, objectivity and integrity.

10 The Audit Commission's Audit Practice has not undertaken any non-audit work for the Council during 2010/11.

# Financial statements

**The Council's financial statements and annual governance statement are important means by which the Council accounts for its stewardship of public funds. As Council members you have final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements and the annual governance statement.**

## Opinion on the financial statements

**11** My work on the audit is largely complete although work is outstanding in the following areas.

- Restatement of opening balances under International Financial Reporting Standards (IFRS), and in particular changes to property, plant and equipment in prior years and the current year.
- Elements of the Comprehensive Income and Expenditure Statement (CIES) and related disclosure notes.
- Disclosure of leases and long-term creditors.

**12** Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements. Appendix 1 contains a copy of my draft audit report.

## Key areas of judgement and audit risk

**13** In planning my audit I identified specific risks and areas of judgement set out in table 3 that I have considered as part of my audit.

---

Table 3: **Key areas of judgement and audit risk**

Issue or risk	Finding
The implementation of International Financial Reporting Standards (IFRS) presents a significant opinion risk to the Council if it does not comply with the revised requirements or the accounts contain material error.	My audit to date of the restated accounts did not identify any material errors. There were a number of amendments to the financial statements.

---

Issue or risk	Finding
<p>Audit work already undertaken identified that some key controls did not work effectively throughout 2010/11. This requires us to take a substantive testing approach rather than place reliance on controls.</p>	<p>My audit required additional work due to my applying a substantive testing approach rather than place reliance on controls.</p>
<p>Although the Finance staff complement is increased there have been further staff changes in the department during the 2010/11 financial year. This, coupled with capacity issues elsewhere in the Council in areas where information is required for the financial statements, could affect the ability to deliver these in accordance with IFRS.</p>	<p>Your Finance team produced a set of financial statements in accordance with IFRS by the due date. There were relatively few changes to the core financial statements although, as with most other councils, there were a number of changes to the notes to the accounts.</p>
<p>The Council's arrangements for calculation of housing benefit and council tax subsidy use a stand-alone system run by Cornwall Council.</p>	<p>My work is ongoing in this area.</p>

**14** I am also required to consider the risk of financial misstatement due to material fraud and address this through my programme of testing. This is a requirement at all audits. Table 4 sets out the findings of my work.

Table 4: **Audit risk from fraud**

Issue or risk	Finding
<p>My review focused on the following.</p> <ul style="list-style-type: none"> <li>■ Review critical accounting judgements and key sources of estimation uncertainty within accounting policies.</li> <li>■ Transactions involving members and officers.</li> <li>■ Processes for identifying, assessing and reporting related party transactions and arrangements to minimise risk of omitted related party transactions.</li> </ul>	<p>My audit identified no areas of inappropriate use of accounting judgements and estimation</p> <p>Council leave policy issues (covered under 'internal control')</p> <p>Although I identified no areas of concern, arrangements to make this information available through the Council's website to local taxpayers need strengthening.</p>



## Recommendations

- R1** Review signposting of access via the Council's website to the register of interests to further promote transparency and include this link in the financial statements.
- R2** Ensure all related party disclosures also cover related parties held by member and officer families.
- 

**15** A number of local residents have contacted me to express concerns about the reasonableness of pay awards made to Chief Officers. I cover these in more detail in the section on 'Other matters' in this report at page 15.

### Errors in the financial statements

**16** I have discussed the findings from my audit of the financial statements with the Director of Finance and Resources. These are set out below.

**17** Firstly I set out those adjustments that affect the Council's financial position and secondly those that are technical adjustments to the financial statements but with no impact on the Council's overall financial position. In appendix 2 I disclose items corrected by the Director of Finance and Resources and in appendix 3 less important items that either do not require amendment or where the Council has not made the adjustment.

### Adjustments to the main financial statements

#### Comprehensive Income and Expenditure Statement (CIES)

**18** Impairment of council houses due to a change in the vacant possession discount rate has led to a material change in the value of council houses. This is an exceptional item that should be presented separately in the Comprehensive Income and Expenditure Statement (as it is relevant to an understanding of the Council's financial performance).

- 19** Depreciation on fixed assets was understated by £64,000.
- £72,000 understatement resulting from applying an incorrect useful economic life for the incinerator (a similar issue produced a £12,000 error in 2009/10).
  - A formula error in the fixed asset register (on reclassified assets) caused an overstatement in total depreciation of £8,000.

## Recommendation

- R3** Amend the accounts for the errors identified.
-

## **Movement in reserves Statement (MiRS)**

**20** In the MiRS, the transfers to/from earmarked reserves showed a net balance of £12,000 (ie showing a reserve of £12,000). The transfers should be between the reserves and the total nil.

## **Balance sheet**

**21** The Housing Revenue Account balance of £296,000 on the balance sheet is still disclosed separately rather than in usable reserves. The Council has not adjusted for this because it will amend to include in usable reserves next year.

## **Adjustments to the notes to the financial statements and other technical adjustments**

**22** The following adjustments are technical adjustments to the financial statements which have no impact on the Council's overall financial position.

## **Note 7.2 – capital commitments**

**23** The capital commitment for the new school disclosed in Note 7.2 was overstated by £1.302 million. The correct figure should be £16.538 million.

## **Note 10 – financial instruments**

**24** I identified the following errors.

- Cash and cash equivalents were not included within the financial instrument note.
- Inconsistencies with the CIES in the treatment of interest charges (CIES – £27,000) and interest income of £5,000 (£39,000 in CIES).

## **Notes 13 – debtors and Note 15 – creditors**

**25** The Council has not prepared a breakdown of the 2008/09 debtor and creditor figures in notes 13 and 15 respectively but only the total. It is a requirement that all balance sheet notes require a third comparative for the 2009 restated figures. This is because the Council is unable to provide an analysis of the breakdown of the creditors figure.

## **Audit fees**

**26** The analysis is incorrect: inspection fees of £6,000 should be nil and grant claims £5,000 should be £11,000.

## **Recommendation**

**R4** Amend the notes to the financial statements to correct the errors identified.

---

## Important weaknesses in internal control

**27** I reported the findings of my review of material information systems to the July 2011 Policy and Resources Committee. Appendix 5 sets out my findings. I therefore undertook additional substantive testing during the audit of the accounts to reduce the risk of material misstatement to an acceptably low level.

**28** I also identified the following during my review of the financial statements. Table 5 contains the issues I want to raise with you.

Table 5: **Important weaknesses in internal control**

Description of weakness	Potential effect	Management action
The Council's leave policy is not being adhered to in respect of time taken off in lieu and taken forward into future years. Some staff have accrued significant leave which will either need to be taken or paid when leaving the Council.	Financial impact to the Council – there are a number of staff with significant amounts of accumulated leave which are significant in monetary terms.	Ensure compliance for all staff with the Council's policy on taking and carrying forward leave.
There are no formal contracts in place with Cornwall Council for administration of the: <ul style="list-style-type: none"> <li>■ Pension Fund; and</li> <li>■ benefits service.</li> </ul>	Without a contract there is limited redress to responding to issues arising from problems with either arrangement.	Establish formal arrangements for these material service organisations.
The Council, as employer, must accrue for teachers' leave.	Understatement of leave and the financial impact to the Council.	Include teachers' leave accrual in the financial statements.

**29** These weaknesses are only those I identified during the audit that are relevant to preparing the financial statements. I am not expressing an opinion on the overall effectiveness of internal control.

## Recommendations

- R5** Ensure compliance for all staff with the Council's policy on taking and carrying forward leave.
- R6** Establish formal arrangements for all arrangements with service organisations.
- R7** Include teachers' leave accrual in the financial statements.
- 

### Quality of your financial statements

**30** I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statement disclosures.

**31** This was the first year of presenting the Council's financial statements in accordance with International Financial Reporting Standards (IFRS). As with most councils, I identified a number of disclosure errors and amendments which reflect the greater levels of disclosure and detail required by the movement to IFRS. Table 6 contains the issues I want to raise with you.

---

Table 6: **Accounting practices, policies and estimates and financial statement disclosures**

Issue	Finding
The Council included in its IFRS restatement of prior year accounts adjustments to the asset register that were actually adjustments resulting from errors.	Amend the accounts to show adjustments from errors and not as due to IFRS restatement.
Note 26 – capital grants – additional disclosure needed – Capital grant funding for 2009/10 and 2010/11 was applied in 2009/10 to fund the purchase of a property in 2009/10.	Include additional disclosure.
Note 33.3 – Pensions comparatives – in the sections 'proportion of assets held within...' and 'long term expected rate...' the Council included the 2008/09 comparatives instead of the 2009/10 figures.	Amend to include the heading 2009/10 and to show 2009/10 figures (instead of 2008/09).

---

Issue	Finding
<p>The Council did not make a prior period adjustment for the fire fighters pension reserve/liability; it was restated at 31/3/10 but not from the opening 31/3/09 balance sheet (from where the PPA should be made). The amount involved is not material.</p>	<p>Include additional disclosure note to explain the position (that sets out the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected)</p>
<p>Negative past service cost – caused by basing annual pension increases on consumer price index rather than the retail price index – was disclosed as 'non-distributed costs'.</p>	<p>Amend/rename to clearly show what it actually is 'pensions negative past service cost'.</p>
<p>Disclosure of activities for trading accounts can be improved by providing details of individual reserve balances and a commentary on the ongoing prospects for the activity.</p>	<p>Include additional disclosure on the reserves and future prospects for each trading activity.</p>

## Recommendation

**R8** Amend the disclosure notes to the accounts for the points identified.

### Significant difficulties encountered during the audit

- 32** The amount of testing required for this year's audit increased due to:
- preparing the financial statements under IFRS increased the number of disclosures and the amount of audit work I am required to review; and
  - the additional substantive testing required during the audit to reduce the risk of material misstatement to an acceptably low level.
- 33** I will discuss the audit process in detail with the Finance team on completion of the audit to identify improvements for future years.

### Significant matters that were discussed or subject to correspondence with management

#### Balance Sheet – property, plant and equipment (PPE) – primary schools

**34** The Council has not included the four primary schools on the off islands in its asset register. The ownership for these is complex as they are on Duchy land and are church-owned schools but the Council pays for their upkeep and the teaching staff.

**35** The Council has not obtained a valuation for these properties for 2010/11. The Council does not consider the current guidance on the disclosure of such assets is sufficiently clear to confirm that these are required to be included on the Council's balance sheet. The current insurance value of these four properties is £2.2 million but it is assumed the valuation of the properties would be significantly less. The Council has made an additional disclosure about these properties in the 2010/11 financial statements and, if required, will ensure their valuation for 2011/12.

## Recommendation

**R9** Include a disclosure note on the four primary schools and the basis for the exclusion in the balance sheet under property, plant and equipment.

---

### Other significant matters relevant to the financial reporting process

**36** There were no other significant matters subject to discussion or correspondence with management.

### Letter of representation

**37** Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements. Appendix 4 contains the draft letter of representation.

# Value for money

**I am required to conclude whether the Council put in place proper corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money conclusion.**

**38** I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against five criteria specified by the Audit Commission. Table 7 sets out my conclusion on each of the five areas.

Table 7: **Value for money conclusion criteria assessments**

<b>Criterion</b>	<b>Finding</b>
Financial planning and financial health	Adequate
Understanding costs and achieving efficiencies	Adequate
Financial reporting	Adequate
Use of information	Adequate
Risk management and internal control	Adequate

*Source: Audit Commission*

**39** I intend to issue an unqualified conclusion stating that the Council had adequate arrangements to secure economy, efficiency and effectiveness in the use of resources. Appendix 1 contains the wording of my draft report.

**40** In 2009/10 I assessed the criterion around risk management and internal control as inadequate due to:

- a number of control weaknesses in material financial systems; and
- the failure to obtain an independent market valuation for a property purchased in 2009/10.

**41** I am pleased to report that, while I remain unable to place reliance on the operation of controls for the whole year, I identified improvements in the controls over the material financial systems during 2010/11 which enable me to assess arrangements as adequate. Also, the Council obtained an independent valuation for the property purchased in 2009/10. I cover this matter in more detail in the 'Other matters' section of this report.

## Criterion assessed under report by exception

**42** The Audit Commission requires me to report by exception where significant matters come to my attention, which I consider to be relevant to proper arrangements to secure economy, efficiency and effectiveness in your use of resources.

**43** I acknowledge improvements in your arrangements for strategic asset management. The outstanding element is to bring these developments into line with your overall strategic asset management strategy and your medium term financial strategy to demonstrate the arrangements are embedded. I set out identified weaknesses in your arrangements to the criterion for strategic asset management in table 8.

Table 8: **Value for money conclusion criterion under report by exception**

Criterion	Finding
Strategic asset management	Although I identified an improvement in overall arrangements, these are not yet sufficiently embedded. Updating the current draft asset management strategy to 'dovetail' with the medium term financial strategy should provide this.

## Recommendations

**R10** Update the medium term financial strategy in the light of the current financial constraints in the public sector and wider economy.

**R11** Raise the level from £2,500 at which virements should go to the Full Council to allow greater flexibility in the management of budgets.

**R12** Ensure prior years' annual audit letters (AALs) are included and clearly signposted on the Council's website and updated with future year AALs.

**R13** Improve further strategic asset management arrangements through refreshing and updating the asset management strategy to bring into alignment with the medium term financial strategy.



## Other matters

**44** I received two formal objections to the 2009/10 financial statements. These were about the Council's purchase of a property in 2009/10. The Council paid £100,000 for the purchase. I reviewed the arrangements surrounding this purchase and concluded that there were not grounds for upholding these objections. I also identified subsequent improvements made by the Council in these arrangements. Table 9 shows the subsequent action taken by the Council.

Table 9: **Action taken by the Council to address weaknesses identified**

Conclusion and recommendation	Subsequent action taken by the Council
Ensure revised business cases are shared with the relevant Committee.	Revised business cases will be presented in future to the relevant Committee.
Ensure an independent valuation is obtained in any future property purchases.	<p>Report to Policy and Resources Committee on 14 July 2011 to amend Financial Regulations as follows.</p> <p>'Chief Officers must ensure and be able to demonstrate that the Council of the Isles of Scilly obtains value for money in any purchasing activity and that purchasing accords with service priorities and where appropriate the procurement plan. Any property purchase, whether or not as part of a tender or contractual procedure, must be backed with a value for money assessment, part of which will be an independent valuation of the property.'</p> <p>Valuation of the property at £115,000 as at 1 April 2010 obtained from District Valuer.</p>
With the exception of the recommendations above the Council followed due process in the purchase of the property.	Amended Financial Regulation 55.4 to allow for a 'timeout' of 24 hours to enable consideration of such decisions by members.

**45** A number of members of the public contacted me to express concern and raise questions over pay rises awarded to Chief Officers. These came into effect from the beginning of 2010/11. I have responded to these questions and have carried out work as part of my review of the 2010/11 financial statements.

**46** I have now received two formal objections from local electors on a number of issues including the pay rises. I will respond to these accordingly but, in the interim, I am unable to issue my certificate of completion on the audit.

# Appendix 1 Independent auditor's report to Members of the Council of the Isles of Scilly

## **Opinion on the Authority and firefighters' pension fund accounting statements**

I have audited the accounting statements and the firefighters' pension fund accounting statements of the Council of the Isles of Scilly for the year ended 31 March 2011 under the Audit Commission Act 1998. The accounting statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, the Housing Revenue Account, the Movement on the Housing Revenue Account Statement and Collection Fund and the related notes. The firefighters' pension fund accounting statements comprise the Fund Account, the Net Assets Statement and the related notes. These accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of the Council of the Isles of Scilly in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010.

## **Respective responsibilities of the Director of Finance and Resources and auditor**

As explained more fully in the Statement of the Director of Finance and Resources' Responsibilities, the Director of Finance and Resources is responsible for the preparation of the Authority's Statement of Accounts, including the firefighters' pension fund accounting statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom. My responsibility is to audit the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Authority's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Authority; and the overall presentation of the accounting statements. I read all the information in the explanatory foreword to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

## **Opinion on accounting statements**

In my opinion the accounting statements:

- give a true and fair view of the state of the Council of the Isles of Scilly's affairs as at 31 March 2011 and of its income and expenditure for the year then ended;
- give a true and fair view of the financial transactions of the firefighters' pension fund during the year ended 31 March 2011 and the amount and disposition of the fund's assets and liabilities as at 31 March 2011, other than liabilities to pay pensions and other benefits after the end of the scheme year; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

## **Opinion on other matters**

In my opinion, the information given in the explanatory foreword for the financial year for which the accounting statements are prepared is consistent with the accounting statements.

## **Matters on which I report by exception**

I have nothing to report in respect of the governance statement on which I report to you if, in my opinion the governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007.

## **Conclusion on Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources**

### **Authority's responsibilities**

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

## **Authority's responsibilities**

I am required under Section 5 of the Audit Commission Act 1998 to satisfy myself that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires me to report to you my conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

I report if significant matters have come to my attention which prevent me from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. I am not required to consider, nor have I considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

## **Basis of conclusion**

I have undertaken my audit in accordance with the Code of Audit Practice, having regard to the criteria for other local government bodies published by the Audit Commission in October 2010.

I planned my work in accordance with the Code of Audit Practice. Based on my risk assessment, I undertook such work as I considered necessary to form a view on whether, in all significant respects, the Authority had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

## **Conclusion**

On the basis of my work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2010, I am satisfied that, in all significant respects, the Council of the Isles of Scilly put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2011.

## **Report by exception**

The Audit Commission's guidance also requires me to report by exception on any other significant additional matters that come to my attention and which I consider to be relevant to proper arrangements to secure economy, efficiency and effectiveness in the use of resources. Such a matter has come to my attention relating to a significant weakness in the Authority's arrangements for managing assets effectively to help deliver strategic priorities and service needs. I identified that the Authority had not developed its draft asset management strategy during the year to ensure this covered a number of significant projects the Authority is undertaking. Effective strategic asset management assists the Authority's members and officers in making decisions, including those that affect the Authority's priorities and available resources. Without an overall strategic approach, these priorities might not be achieved and resources used effectively.

### **Delay in certification of completion of the audit**

The audit cannot be formally concluded and an audit certificate issued until I have completed my consideration of matters brought to my attention by local authority electors. I am satisfied that these matters do not have a material effect on the financial statements or a significant impact on my value for money conclusion.

Patrick Jarvis  
Officer of the Audit Commission  
Audit Commission  
Collins House  
Bishopstoke Road  
Eastleigh  
Hampshire  
SO50 6AD

30 September 2011

## Appendix 2 Amendments to the draft financial statements

I identified the following misstatements during my audit and management have adjusted the financial statements. I bring them to your attention to help you in fulfilling your governance responsibilities.

Table 10: **Adjusted misstatements**

Adjusted mis-statement	Comprehensive income and expenditure statement		Balance sheet	
	Dr £'000	Cr £'000	Dr £'000	Cr £'000
Description	Account entry and value			Account entry and value
Depreciation understated on incinerator	72			72
Error in depreciation calculation		8	8	
Movement in Reserves Statement	12			

*Source: Audit Commission*

## Appendix 3 Unadjusted misstatements in the financial statements

I identified the following misstatements during my audit, including uncorrected misstatements brought forward from earlier years, but management has not adjusted the financial statements. I bring them to your attention to help you in fulfilling your governance responsibilities and ask you to correct these misstatements. If you decide not to amend, please tell me why in the representation letter.

---

Table 11: **Unadjusted misstatements as disclosed in the letter of representation**

---

1. There is a difference between the surplus shown on the Comprehensive Income and Expenditure Statement (CIES) and the Movement in Reserves Statement (MiRS) on the surplus on provision of services

Surplus on provision of services in CIES = £6,212,000.

Surplus on provision of services in MiRS = £6,280,000.

Difference £68,000.

The difference is the schools balance held by the Council within an earmarked reserve in the MiRS note that is shown as a surplus on provision in MiRS. The auditor considers it should not be included in this line and that the 'other I&E' line would be more appropriate so that the surplus on provision lines within CIES and MiRS agree. As the amount is not material this remains unamended.

---

2. The Housing Revenue Account balance of £296,000 on the balance sheet is still disclosed separately rather than in usable reserves. The Council has not adjusted for this because it will amend to include in usable reserves next year.

---

3. The Council has not prepared a breakdown of the 2008/09 debtor and creditor figures in notes 13 and 15 respectively but only the total. The LAAP Bulletin 88 (paras 65 to 71) sets out the requirement that all balance sheet notes require a third comparative for the 2009 restated figures. This is because the Council is unable to provide an analysis of the breakdown of the creditors figure but has provided narrative to each of these notes to explain the overall changes to the 2008/09 figure.

---



## Appendix 4 Draft letter of representation

To: Patrick Jarvis  
Officer of the Audit Commission  
Audit Commission  
Collins House  
Bishopstoke Road  
Eastleigh  
Hampshire  
SO50 6AD

### **Council of the Isles of Scilly – Audit for the year ended 31 March 2011**

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other officers of the Council, the following representations given to you in connection with your audit of the Council's financial statements for the year ended 31 March 2011. All representations cover the Council's accounts and firefighters' pension fund accounts included within the financial statements.]

### **Compliance with the statutory authorities**

I have fulfilled my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with the Code of Practice for Local Authority Accounting in the United Kingdom which give a true and fair view of the financial position and financial performance of the Council, for the completeness of the information provided to you, and for making accurate representations to you.

### **Uncorrected misstatements**

Other than the above, the effects of uncorrected financial statements misstatements summarised in the attached schedule are not material to the financial statements, either individually or in aggregate.

These misstatements have been discussed with those charged with governance within the Council and the reasons for not correcting these items are set out in Appendix A.

### **Supporting records**

All relevant information and access to persons within the entity has been made available to you for the purpose of your audit, and all the transactions undertaken by the Council have been properly reflected and recorded in the financial statements.

## **Internal control**

I have communicated to you all deficiencies in internal control of which I am aware.

## **Irregularities**

I acknowledge my responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud or error.

I also confirm that I have disclosed:

- my knowledge of fraud, or suspected fraud, involving either management, employees who have significant roles in internal control or others where fraud could have a material effect on the financial statements;
- my knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others; and
- the results of my assessment of the risk that the financial statements may be materially misstated as a result of fraud.

## **Law, regulations, contractual arrangements and codes of practice**

I have disclosed to you all known instances of non-compliance, or suspected non-compliance with laws, regulations and codes of practice, whose effects should be considered when preparing financial statements.

Transactions and events have been carried out in accordance with law, regulation or other authority. The Council has complied with all aspects of contractual arrangements that could have a material effect on the financial statements in the event of non-compliance.

All known actual or possible litigation and claims, whose effects should be considered when preparing the financial statements, have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

## **Accounting estimates including fair values**

I confirm the reasonableness of the significant assumptions used in making the accounting estimates, including those measured at fair value.

## **Specific representations**

The Council confirms that:

- it has the rights and obligations over all assets disclosed in the financial statements; and
- fixed assets include buildings constructed on land that is not owned by the Council. The land is leased from the Duchy of Cornwall and the length of these leases varies, although some are on an annual rolling basis. For these rolling leases the Council has had assurances from the Duchy that there is no intention of not continuing to renew these leases;

- whilst it is unusual for a Council not to own the freehold to the land on which its assets are built, it is reasonable to continue to recognise these as assets and to depreciate them over their useful lives.

In addition to the general representations listed under 'Irregularities' in this letter, there are no frauds of which we are aware that have not been brought to your attention.

I confirm the Council has considered the approach to the disclosure of the primary school sites on the Council's balance sheet. The Council has considered the criteria set out in the Annex to CIPFA/LASAAC 'invitation to comment' document for and against inclusion of voluntary controlled schools and concluded that, in accordance with the preliminary view set out in the document, current assets used by voluntary controlled schools are not the assets of local authorities and do not require disclosure in the accounts.

I confirm that all unfunded liabilities (eg discretionary added years awarded to staff in the Local Government Pension Scheme and discretionary benefits awarded to teachers under the Teachers Pension scheme) are included within the IAS 19 liability figures.

### **Related party transactions**

I confirm that I have disclosed the identity of the Council of the Isles of Scilly related parties and all the related party relationships and transactions of which I am aware. I have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirement of the framework.

### **Subsequent events**

All events subsequent to the date of the financial statements, which would require additional adjustment or disclosure in the financial statements, have been adjusted or disclosed.

Signed on behalf of the Council of the Isles of Scilly

I confirm that this letter has been discussed and agreed by the Council on 29 September 2011.

Signed

Name

Position

Date

## APPENDIX A

### UNADJUSTED MISSTATEMENTS

1. There is a difference between the surplus shown on the Comprehensive Income and Expenditure Statement (CIES) and the Movement in Reserves Statement (MiRS) on the surplus on provision of services

Surplus on provision of services in CIES = £6,212,000.

Surplus on provision of services in MiRS = £6,280,000.

Difference £68,000.

The difference is the schools balance held by the Council within an earmarked reserve in the MiRS note that is shown as a surplus on provision in MiRS. The auditor considers it should not be included in this line and that the 'other I&E' line would be more appropriate so that the surplus on provision lines within CIES and MiRS agree. As the amount is not material this remains unamended.

2. The Housing Revenue Account balance of £296,000 on the balance sheet is still disclosed separately rather than in usable reserves. The Council has not adjusted for this because it will amend to include in usable reserves next year.

3. The Council has not prepared a breakdown of the 2008/09 debtor and creditor figures in notes 13 and 15 respectively but only the total. The LAAP Bulletin 88 (paras 65 to 71) sets out the requirement that all balance sheet notes require a third comparative for the 2009 restated figures. This is because the Council is unable to provide an analysis of the breakdown of the creditors figure but has provided narrative to each of these notes to explain the overall changes to the 2008/09 figure.

## Appendix 5 Findings from the review of material information systems

The review of material information systems assessed eight systems as effective (compared to only five in 2009/10).

System	Reliance on controls (from walkthrough)	If not 'yes' what is issue?	Recommendation for improvement
Overall IT environment		No issues identified from testing access to the network and material financial systems	Develop an IT strategy Review IT risks regularly Produce an IT security policy
Airport income	Yes – effective		
Benefits	Not assessed	More effective to carry out year-end substantive testing to 'dovetail' with grant claims work	Ensure appropriate review of reconciliations to general ledger and bank reconciliation
Cash receipting	Yes – effective		
Council tax	Yes – effective		
Creditors	Yes – effective		Evidence appropriate review of reconciliations
Debtors	Yes – effective		Evidence appropriate review of reconciliations
Fixed assets	Not assessed	Not assessed as Council's records updated at year-end	
General ledger	Partially effective only	General ledger was not in balance	Regular check that total debits equal total credits
Housing rents	Yes – effective		
National non-domestic rates	Yes – effective		Evidence appropriate review of reconciliations
Payroll	Partially effective only	No monthly reconciliation of payroll to the general ledger – also raised in 2008/09 and 2009/10	Reconcile to general ledger monthly

System	Reliance on controls (from walkthrough)	If not 'yes' what is issue?	Recommendation for improvement
Treasury management	Not assessed	More effective to substantive test at year-end	
Water and sewerage	Yes – effective		

## Appendix 6 Glossary

### **Annual governance statement**

A statement of internal control prepared by an audited body and published with the financial statements.

### **Audit closure certificate**

A certificate that I have completed the audit following statutory requirements. This marks the point when I have completed my responsibilities for the audit of the period covered by the financial statements.

### **Audit opinion**

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

### **Opinion**

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

### **Materiality (and significance)**

The Auditing Practices Board defines this concept as ‘an expression of the relative significance or importance of a particular matter for the financial statements as a whole. A matter is material if its omission would reasonably influence users of the financial statements, such as the addressees of the auditor’s report; also a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. We cannot define materiality mathematically, as it has both numerical and non-numerical aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

'Significance' applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

### **Weaknesses in internal control**

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or a combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

### **Value for money conclusion**

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

The Code of Audit Practice defines proper arrangements as corporate performance management and financial management arrangements that form a key part of the system of internal control. These comprise the arrangements for:

- planning finances effectively to deliver strategic priorities and secure sound financial health;
- having a sound understanding of costs and performance and achieving efficiencies in activities;
- reliable and timely financial reporting that meets the needs of internal users, stakeholders and local people;
- commissioning and buying quality services and supplies that are tailored to local needs and deliver sustainable outcomes and value for money;
- producing relevant and reliable data and information to support decision making and manage performance;
- promoting and displaying the principles and values of good governance;
- managing risks and maintaining a sound system of internal control;
- making effective use of natural resources;
- managing assets effectively to help deliver strategic priorities and service needs; and
- planning, organising and developing the workforce effectively to support the achievement of strategic priorities.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion. Due to the unique nature of the Council of the Isles of Scilly, not all of these criteria apply in any one year.



## Appendix 7 Action Plan

### Recommendations

#### Recommendation 1

Review signposting of access via the Council's website to the register of interests to further promote transparency and include this link in the financial statements.

<b>Responsibility</b>	Director of Finance and Resources
<b>Priority</b>	High
<b>Date</b>	End March 2012
<b>Comments</b>	Clearer signposting will be made to the existing register of interests and this will be upgraded to tie in with recommendation 2 below.

#### Recommendation 2

Ensure all related party disclosures also cover related parties held by member and officer families.

<b>Responsibility</b>	Director of Finance and Resources
<b>Priority</b>	High
<b>Date</b>	End June 2012
<b>Comments</b>	Information on related parties held by families is currently disclosed for some officers and members and we will request this for all members and officers for the 2011/12 accounts.

#### Recommendation 3

Amend the accounts for the errors identified.

<b>Responsibility</b>	Director of Finance and Resources
<b>Priority</b>	High
<b>Date</b>	End September 2011
<b>Comments</b>	

#### Recommendation 4

Amend the notes to the financial statements to correct the errors identified.

<b>Responsibility</b>	Director of Finance and Resources
<b>Priority</b>	High
<b>Date</b>	End September 2011
<b>Comments</b>	

### Recommendation 5

Ensure compliance for all staff with the Council's policy on taking and carrying forward leave.

<b>Responsibility</b>	Full Council and management team
<b>Priority</b>	High
<b>Date</b>	End March 2012
<b>Comments</b>	We will reiterate the importance of compliance with the policy.

### Recommendation 6

Establish formal arrangements for all arrangements with service organisations.

<b>Responsibility</b>	Director of Finance and Resources
<b>Priority</b>	High
<b>Date</b>	End March 2012
<b>Comments</b>	

### Recommendation 7

Include teachers' leave accrual in the financial statements.

<b>Responsibility</b>	Director of Finance and Resources
<b>Priority</b>	High
<b>Date</b>	End September 2011
<b>Comments</b>	

### Recommendation 8

Amend the disclosure notes to the accounts for the points identified.

<b>Responsibility</b>	Director of Finance and Resources
<b>Priority</b>	High
<b>Date</b>	End September 2011
<b>Comments</b>	

### Recommendation 9

Include a disclosure note on the four primary schools and the basis for the exclusion in the balance sheet under property, plant and equipment.

<b>Responsibility</b>	Director of Finance and Resources
<b>Priority</b>	High
<b>Date</b>	End September 2011
<b>Comments</b>	An additional note to the existing disclosure will be made.

### Recommendation 10

Update the medium term financial strategy in the light of the current financial constraints in the public sector and wider economy

<b>Responsibility</b>	Director of Finance and Resources
<b>Priority</b>	High
<b>Date</b>	End March 2012
<b>Comments</b>	Work is underway to review the strategy as part of the wider strategic direction of the Council.

### Recommendation 11

Raise the level from £2,500 at which virements should go to the Full Council to allow greater flexibility in the management of budgets.

<b>Responsibility</b>	Director of Finance and Resources
<b>Priority</b>	High
<b>Date</b>	End March 2012
<b>Comments</b>	To form part of the wider updating of financial regulations.

### Recommendation 12

Ensure prior years' annual audit letters (AALs) are included and clearly signposted on the Council's website and updated with future year AALs.

<b>Responsibility</b>	Director of Finance and Resources
<b>Priority</b>	High
<b>Date</b>	End September 2011
<b>Comments</b>	2009/10 and 2007/08 AALs now on website in section with statement of accounts. Will ensure others are added.

### Recommendation 13

Improve further strategic asset management arrangements through refreshing and updating the asset management strategy to bring into alignment with the medium term financial strategy.

<b>Responsibility</b>	Chief Planning and Development Officer
<b>Priority</b>	High
<b>Date</b>	End March 2012
<b>Comments</b>	We have made considerable progress to making arrangements more robust over the control and prioritisation of asset management. Refreshing the asset management strategy and bringing this into line with the revised medium term financial strategy will provide the opportunity to 'dovetail' these arrangements.

If you require a copy of this document in an alternative format or in a language other than English, please call:  
**0844 798 7070**

© Audit Commission 2011.

Design and production by the Audit Commission Publishing Team.

Image copyright © Audit Commission.

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.



Audit Commission

1st Floor  
Millbank Tower  
Millbank  
London  
SW1P 4HQ

Telephone: 0844 798 3131

Fax: 0844 798 2945

Textphone (minicom): 0844 798 2946