

# Luton Borough Council

## Annual Report to Those Charged With Governance (ISA 260)

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September 2011



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# 1. Executive summary

## Purpose of this report

This report has been prepared for the benefit of discussion between Grant Thornton UK LLP and the Audit and Governance Committee of Luton Borough Council (the Council). The purpose of this report is to highlight the key issues arising from the Council's financial statements for the year ending 31 March 2011.

This report meets the mandatory requirements of International Standard on Auditing 260 (ISA 260) to report the outcome of the audit to 'those charged with governance', designated as the Audit and Governance Committee. The requirements of ISA 260, and how we have discharged them, are set out in more detail at Appendix A.

The Council is responsible for the preparation of financial statements which record its financial position as at 31 March 2011, and its income and expenditure for the year then ended. We are responsible for undertaking an audit and reporting whether, in our opinion, the Council's financial statements present a true and fair view of the financial position.

Under the Audit Commission's Code of Audit Practice we are also required to reach a formal conclusion on whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

## Audit conclusions

### Financial statements opinion

We were presented with substantially complete draft financial statements on 30 June 2011, in accordance with the national deadline. The majority of supporting working papers were of an acceptable standard and the financial statements have been compiled in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 (the Code), based on International Financial Reporting Standards (IFRS).

Based on our work to date, a number of adjustments have been identified to the financial statements, the most significant being:

- the recognition of additional grant and contribution revenue of £5.5m in the prior year and £2.4m in the current year respectively, due to errors identified in the Council's IFRS restatement exercise;
- amendments to the consideration of pension scheme gains and outstanding liabilities in the financial statements;
- revisions to the recognition accounting entries for the Challney Girls High School Private Finance Initiative (PFI) scheme completed in year due to errors identified in the financial model; and
- the misclassification of circa £24m of investment balances as "cash equivalents" under the disclosure requirements of the Code.

The issues identified have a wide ranging impact to the Council's income and expenditure position and the Council's reported assets and liabilities.

In addition to our work, the senior finance team identified a number of misstatements as part of the preparation of the financial statements, the most significant of these was:

- the identification of a previously unrecognised creditor of £4.2m following cancellation of Building Schools for the Future (BSF) projects.

The key messages arising from our audit of the Council's financial statements are:

- the need to undertake a comprehensive exercise to update and ensure the accuracy, integrity and consistency of non-current asset information, supported by the introduction of dedicated financial ledger module;
- to consider and revise current procedures for identifying and recognising grant contributions against the requirements of the Code;
- to undertake a specific exercise to review and restructure the current financial ledger system coding and cost centre structure, in particular to ensure the future inclusion of IAS 19 entries; and
- to review current working paper and financial closedown arrangements to identify potential efficiencies for ongoing reporting under IFRS, including an appropriate consideration of terms of engagement with contributors such as non-current asset valuers

We anticipate providing an unqualified opinion on the Council's financial statements, following approval by the Audit and Governance Committee on 21 September 2011.

### Value for Money Conclusion

In providing the opinion on the financial statements we are required to reach a conclusion on the adequacy of the Council's arrangements for ensuring economy, efficiency and effectiveness in its use of resources (the Value for Money Conclusion).

We are pleased to report that, based on our review of the Council's arrangements, we propose to give an unqualified Value for Money conclusion.

Further details of the outcome of the financial statements audit and our value for money review are given in sections 2 and 3 respectively.

### The way forward

Matters arising from the financial statements audit have been discussed with the Head of Corporate Finance. We have made a number of recommendations, which are set out in the action plan at Appendix C. This has been discussed and agreed with the Head of Corporate Finance and the senior finance team.

### Use of this report

This report has been prepared solely for use by the Council to discharge our responsibilities under ISA 260, and should not be used for any other purpose. We assume no responsibility to any other person. This report should be read in conjunction with the Statement of Responsibilities and the Council's Letter of Representation.

### Acknowledgements

We would like record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

**Grant Thornton UK LLP**  
**21 September 2011**

## 2. Key audit issues

### Matters identified at the planning stage

We have not altered or changed our planned approach to the audit which was communicated to you in our Audit and Approach Memorandum dated June 2011.

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

Issue	Audit areas affected	Work completed	Assurances gained / Issues Identified
Accounting under IFRS	All areas of the financial statements	<ul style="list-style-type: none"><li>• A specific review of the Council's preparedness for IFRS could not be completed in advance of the main audit as the Council failed to present its methodology or workings prior to the submission of the draft financial statements</li><li>• We have maintained ongoing liaison with the senior finance team regarding emerging IFRS issues and potential impacts to the financial statements</li><li>• Our substantive audit procedures have focused on the high risk areas identified as a result of the transition to IFRS, in particular property, plant and equipment (PPE) and income recognition</li></ul>	<ul style="list-style-type: none"><li>• Our review of opening balances and the restated balance sheet identified a number of misstatements within the Council's restatement workings, in particular in respect of the recognition of historic grant contributions and the classification of "cash equivalents"</li><li>• As part of its restatement workings the senior finance team identified a misstatement relating to REFCUS expenditure (revenue expenditure funded from capital under statue) that should have been capitalised on the Council's balance sheet in the year ended 31 March 2010. This has been disclosed in the financial statements.</li><li>• The omission of a small number of disclosures required by IFRS and the Code were notified to and rectified by the Council during the course of our work.</li></ul>

Issue	Audit areas affected	Work completed	Assurances gained / Issues Identified
London Luton Airport	Group Accounts & Financial Performance	<ul style="list-style-type: none"> <li>Discussions have been held with the auditors of London Luton Airport (LAA) in respect of work being carried out to assist us with the audit of the Council's group accounts consolidation.</li> </ul>	<ul style="list-style-type: none"> <li>We received confirmation from the LAA auditor that the accounts had been signed off and had not been subject to qualification or significant amendment. We are satisfied that there are no material implications for our audit of the group accounts.</li> </ul>
Revaluation of fixed assets	Property, plant and equipment	<ul style="list-style-type: none"> <li>We confirmed that general controls relating to PPE activity and valuation are implemented and are operating sufficiently</li> <li>We reviewed information recorded within the Council's asset management systems and made direct enquiries of the Valuer to determine the appropriateness of assumptions applied as part of the adopted valuation methodology as well as the completeness and accuracy of any information used to perform valuation calculations, including non-financial information.</li> <li>We reviewed the approach to valuation activity undertaken during the year to ensure that it had been conducted and recorded in the financial statements in accordance with IAS 16, Property, Plant and Equipment.</li> </ul>	<ul style="list-style-type: none"> <li>Our review of PPE records and the associated accounting practices applied identified a number of issues regarding the consistency and integrity of non-current asset records due to the nature of how these are maintained by the Council, however, no material errors were identified</li> <li>Depreciation continues to be applied to a number of assets using inappropriate methodologies that are inconsistent with the Council's stated accounting policies</li> <li>Appropriate accounting entries to reserve accounts were not processed in relation to valuations in accordance with IAS 16, in part due to the current ledger coding structure</li> <li>The approach to rolling valuation schedules should be reviewed to ensure ongoing compliance with accounting standards and the Code</li> </ul>

Issue	Audit areas affected	Work completed	Assurances gained / Issues Identified
Use of estimates and judgements	All areas of the financial statements	<ul style="list-style-type: none"> <li>• We have discussed with the senior finance team the likely areas where estimates and judgements will be used and the requirement to ensure that these are clearly documented and evidenced</li> <li>• We reviewed the accounting policies and disclosures for areas where critical accounting judgements and estimation techniques would be used</li> <li>• The calculations and assumptions supporting significant estimates were reviewed as part of our tests of detail to consider any potential unidentified impact on the financial statements.</li> </ul>	<ul style="list-style-type: none"> <li>• The areas where calculations and assumptions were reviewed included allowances made for doubtful amounts, certain accruals and prepayments and valuation of property, plant and equipment (PPE)</li> <li>• We concluded that adequate disclosures had been made in respect of areas where material estimates and critical judgements have been made in the financial statements</li> <li>• Recommendations for improvement to the documentation and evidencing of estimates and critical judgements have been made as part of recommendations set out in Appendix C</li> </ul>
Financial performance pressure	All areas of the financial statements	<ul style="list-style-type: none"> <li>• Regular discussions have been held with management on financial performance, use of reserves and medium term financial planning.</li> <li>• Detailed review of performance for the year against budget and the use of general reserves during the year.</li> <li>• Review of the medium term financial planning in conjunction with our Value for Money (VfM) work.</li> <li>• Sample testing to ensure expenditure and liabilities are recorded in the correct period.</li> <li>• Discussions surrounding commitments made by the Council and recognition of provisions in the accounts.</li> </ul>	<ul style="list-style-type: none"> <li>• Our VfM work on the Council's Financial Resilience provided assurance that financial performance in year, and financial planning in the medium term were satisfactory, for the purposes of our audit opinion.</li> <li>• Our sample testing of expenditure and liabilities, including financial commitments and provisions, identified a number of adjustments which are set out in this report (Appendix B).</li> </ul>

Issue	Audit areas affected	Work completed	Assurances gained / Issues Identified
<b>Accounts closedown and production</b>	<b>All areas of the financial statements</b>	<ul style="list-style-type: none"> <li>• We issued our Arrangements Letter detailing working paper requirements to the Council in February 2011 and agreed a timetable for the audit as part of the Accounts Audit Memorandum.</li> <li>• There has been on-going liaison with the Council throughout the year regarding the approach to high risk accounting areas identified from accounts planning, however, a specific review of the Council's preparedness for IFRS could not be completed in advance of the main audit as the Council was unable to complete and present its methodology or workings prior to the submission of the draft financial statements, due to staff resource constraints.</li> <li>• We have worked with the Council throughout the audit and raised any issues resulting from our work as they arose.</li> </ul>	<ul style="list-style-type: none"> <li>• A number of adjustments have been made to the financial statements as a result of our work, however, these were mainly to correct the classification of balances in the balance sheet. Adjustments made to the financial statements and unprocessed are detailed in the following report section and listed in Appendix B</li> <li>• The status of prior year recommendations raised in our last report to those charged with governance were considered and a number of instances were identified where these remained outstanding with equivalent audit findings identified in the current year.</li> <li>• There remains scope for improvement in a number of the Council's working practices. We will continue to work with the senior finance team to ensure that it continues to improve in this area. Recommendations are set out in Appendix C</li> </ul>
<b>Accounting for schools</b>	<b>Property, plant and equipment</b>	<ul style="list-style-type: none"> <li>• The de-recognition of Denbigh High School and Challney Boys High School during the 2010/11 financial year has been reviewed following their reclassification to Academy School status.</li> <li>• The accounting applied to other schools still within the local authority accounting boundary has been reviewed to ensure that income/expenditure and balance sheet amounts have been accounted for correctly.</li> </ul>	<ul style="list-style-type: none"> <li>• The in-year derecognition of schools granted Academy status in year is considered to be materially correct</li> <li>• No material errors have been identified with respect to the accounting practice applied to schools still within the local authority accounting boundary, although minor errors were identified in relation to grant contributions</li> </ul>



### Status of the audit

We carried out our audit broadly in accordance with the proposed timetable and deadlines communicated to you in our Audit Approach Memorandum. However, whilst the working papers provided in support of the draft financial statements were largely of an acceptable standard, a number of delays were experienced and additional restatement requirements identified during the course of our review.

Our audit is substantially complete, although we are finalising our procedures in the following areas:

- review of journal transactions processed in year;
- review and confirmation of movements in reserves and equity accounts;
- review of the final cash flow statement and supporting notes;
- review of the final version of the financial statements subsequent to the processing of agreed audit amendments;
- obtaining and reviewing the Council's letter of representation; and
- updating our post balance sheet events review, to the date of signing the accounts

We anticipate providing an unqualified opinion on the Council's financial statements, following approval by the Audit and Governance Committee on 21 September 2011.

A number of issues arose during the course of the audit, which whilst not considered to still represent a material unadjusted impact to the reported financial performance, should be considered by the Audit and Governance Committee. These are set out in the following paragraphs. Where appropriate, we have made recommendations for improvement, as set out in the agreed action plan at Appendix C.

### Matters arising from the financial statements audit

#### IFRS restatement exercise

The Council was unable to prepare a 1 April 2009 restated opening balance sheet, restated financial statements for the year ended 31 March 2010 or supporting workings to external audit in advance of the audit of the financial statements for the year ended 31 March 2011 under IFRS, in line with CIPFA recommended best practice transition guidance.

In addition satisfactory restatement workings were not provided on commencement of the audit of the financial statements for the year ended 31 March 2011 for a number of key high risk areas including, the recognition of grants and contributions and lease restatement workings.

Our review of opening balances and the restated balance sheet identified a number of misstatements within the Council's restatement workings, in particular in respect of the recognition of historic grant contributions and the classification of "cash equivalents". The misstatements identified result in the recognition of additional grant and contribution revenue of £5.5m in the prior year and £2.4m in the current year respectively and material reclassifications of amounts disclosed as "cash equivalents".

As part of its restatement workings the senior finance team identified a misstatement relating to REFCUS expenditure that should have been capitalised on the Council's balance sheet in the year ended 31 March 2010. This has been disclosed accordingly in the financial statements.

The omission of a number of disclosures required by IFRS and the Code were notified to and rectified by the Council during the course of our work, including additional accompanying disclosures to support amounts disclosed in the Cash Flow Statement.

### **Recognition of grant and contribution income within the Comprehensive Income and Expenditure Account**

Where previously amounts received would have been deferred and offset against associated expenses as they were incurred, revised requirements of the Code now require the recognition of grant and contribution income within the Comprehensive Income and Expenditure Statement as soon as any conditions attached to these amounts by the granting body or individual can be evidenced to have been met.

As part of our review of restated and current year balances it was highlighted that the Council does not yet have sufficient appropriate processes in place to review and identify the conditions attached to all significant grants and contributions and to report the current status of grant funded schemes at the time of preparing the financial statements. The lack of these processes increases the risk and likelihood of incorrect accounting entries being applied in future periods.

### **Non-current asset information and financial ledger records**

Our testing highlighted a number of issues regarding the consistency and integrity of non-current asset records between the financial statements and supporting notes, underlying financial ledger accounts, Fixed Asset Register (FAR) and the Council's separate estate management asset records. No adjustment has been made for unresolved differences of £40k on the basis of materiality.

As per management's response to the audit recommendations raised in our last report to those charged with governance, the Council intends to procure and implement a module to the existing financial ledger system to enable the integration of the currently separately held FAR. However, the Council was unable to implement this in time to support the preparation of the financial statements for the year ended 31 March 2011.

The development and implementation of this module should continue to be prioritised and accompanied by a comprehensive exercise to ensure the integrity and data quality of information used for its establishment. An additional coding and structure review should also be undertaken in relation to the rest of the financial ledger system to remove references to outdated accounting practices and enable the appropriate recording of associated postings to the Capital Adjustment Account (CAA) and Revaluation Reserve with a consistent equivalent level of detail.

The success of such an exercise will be dependant on explicit project planning, supported by appropriate oversight and the allocation of sufficient dedicated resources to ensure delivery within a timescale to support the preparation of the financial statements for the year ended 31 March 2012.

### **Depreciation**

Our testing highlighted that the depreciation method applied to a number of assets continues to be inconsistent with the Council's stated accounting policies and IAS 16 as reported in prior periods, in that the methodology applied is to depreciate major plant and equipment, and some schools assets, at a percentage of 1-5% of the depreciation applied to the main building asset. This treatment is not considered to reflect an appropriate consideration of the consumption of economic benefits in relation to the life and use of the assets thus depreciated.

An adjustment has not been proposed, as we have calculated that the potential error is not material to the financial statements for the year ended 31 March 2011. We further expect that the implementation of an appropriate dedicated ledger module will help ensure an appropriate treatment of non-current asset balances in future accounting periods.

### **Instructions to valuers**

Separate non-current asset records are currently maintained by the finance department and Capital Asset Management (CAM) team, in the form of excel spreadsheets. Asset records do not currently employ consistent unique asset identification numbers.

The rolling programme of valuations is determined by the CAM team, without direct instruction from the senior finance team. Our review suggests that the current tranching work programme adopted by the CAM team, and directly communicated to any external valuers employed, may not be fully compliant with the requirements of IFRS and the Code in subsequent years. The requirements state that a rolling valuation programme is acceptable only where this is conducted by whole 'class' of asset, and only where any indication of a significant change in market values has not been identified, in which case an appropriate review should be undertaken.

The asset classes reviewed as part of valuations performed at 1 April 2010 were Schools and Investment Properties. Our review highlighted that the review of Investment Properties undertaken by the Councils internal valuers excluded four Housing Revenue Account (HRA) properties in error. An appropriate valuation report has not been provided by the internal valuers.

### **'Cut off' of capital expenditure**

During our audit we identified £3m of capital expenditure relating to activity undertaken in the prior year, which had not been capitalised or recognised as a capital creditor in the financial statements for the year ended 31 March 2010. However, as it has been established that sufficient doubt existed at the time of incurring the expenditure regarding the settlement of the outstanding amount with the contractor, no adjustment

has been proposed to the recognition of the amount in the current year, subject to this being accompanied by additional narrative disclosure.

Our review also highlighted an ongoing issue regarding the identification of in year capital expenditure, which may lead to potential incorrect 'cut off' recognition i.e. capital expenditure is recorded to capital ledger codes when it is incurred on a 'cash' basis, which may be significantly removed from the relevant transaction date where amounts are held in dispute prior to payment and therefore does not directly support robust accruals and commitment based accounting.

### **Challney Girls High School PFI scheme**

Our review of the financial and operators models for the Challney Girls High School PFI scheme identified a number of variances between our expected accounting entries, and those recorded by the Council as supported by the financial model. The principle cause of the differences has been identified as the inappropriate inclusion of inflation in the calculation of the Internal Rate of Return (IRR) and the impact of this on the schedule of future payments (Note 42 in the accounts).

We also noted from our review of capital expenditure and financing that no PFI entries have been included in the Council's calculation of the Capital Financing Requirement (CFR), per the requirements of the Code and supporting guidance notes. The senior finance team has chosen to make additional narrative disclosures in the financial statements to support its decision not to include these entries.

### Building Schools for the Future (BSF)

Following the Government cancellation of BSF wave 6 projects, capital costs of £4.2m already incurred by the Council have since required to be recognised as a revenue expense, as these amounts will no longer be able to be capitalised against completed assets. The Council has therefore recognised these amounts as an additional closing balance sheet liability for payments due to the Luton Learning Community Partnership.

A contingent asset has been disclosed in relation to future compensation expected from Government for the value of the costs incurred.

### Other accounts issues arising

In addition to the matters raised above, there were a number of other misstatement and presentational changes that arose during the course of our audit that have been made to the financial statements:

- restatement of the £59.8m past service cost negative credit resulting from the Government's decision to change the index used to increase pensions from RPI to CPI from 'Actuarial (gains)/losses' to within Net Cost of Services;
- restatement of 'Other liabilities' on the balance sheet to separately disclose the outstanding pension liability of £180,391k (31 March 2010: £348,467k);
- a series of amendments to the capital financing note due to inconsistencies with underlying records and correct accounting practice; and
- a number of other minor amendments were processed to the explanatory foreword, main financial statements and the supporting disclosure notes in order to ensure the general consistency of information presented within the financial statements, in particular changes brought about by the transition to IFRS or revised requirements of the Code, and to enhance their interpretation by general readers and users of the published statements.

### Misstatements

In addition to our work, the senior finance team identified a number of misstatements as part of the preparation of the financial statements, the most significant of these was:

- the identification of a previously unrecognised creditor of £4.2m following cancellation of Building Schools for the Future (BSF) projects.

As part of its restatement workings the senior finance team also identified a misstatement relating to REFCUS expenditure that should have been capitalised on the Council's balance sheet in the year ended 31 March 2010. This has been disclosed accordingly in the financial statements

A number of misstatements were identified as a result of the audit work performed, the most significant of these are:

- the recognition of additional grant and contribution revenue of £5.5m in the prior year and £2.4m in the current year respectively, due to errors identified in the Council's IFRS restatement exercise;
- movement of the £59.8m pension past service cost negative credit from 'Actuarial (gains)/losses' to within Net Cost of Services; and
- revisions to the recognition accounting entries for the Challney Girls High School Private Finance Initiative (PFI) scheme completed in year due to errors identified in the financial model.

All adjusted and unadjusted misstatements are set out at Appendix B.

The auditor is required to communicate all uncorrected misstatements, other than those considered to be clearly trivial, to the entity's management and to request that management corrects them.

Our audit identified the following amendments to the financial statements that have not been processed by management on the grounds of materiality. The unadjusted misstatements relate to:

- the revisions to the recognition accounting entries for the Challney Girls High School Private Finance Initiative (PFI) scheme completed in year due to errors identified in the financial model;
- understatement of depreciation and impairment charges within the Housing Revenue Accounts (HRA) of £200k;
- a difference of £277k between the reported HRA deficit and the net cost of Local Authority Housing Services included in the Comprehensive Income and Expenditure Statement;
- the calculation of HRA charges for capital as part of government subsidy has been performed using an incorrect rate of interest, resulting in a £397k overstatement of negative subsidy;
- unresolved differences between asset records and accounting entries of £40k; and
- a difference in grant revenue relating to Sure Start between amounts recognised in the statement of accounts and the final certified return of £136k.

The expected impact of the unadjusted misstatements would be an increase to the reported deficit on the provision of services.

### Evaluation of key controls

#### Internal Controls

We have undertaken sufficient work on key financial controls for the purpose of designing our programme of work for the financial statements audit. Our on-going work in auditing the accounts has identified minor control deficiencies in a small number of areas including:

- timeliness of in year reconciliations, in particular creditor sub-ledgers and non-current asset records.

We have discussed these issues with management and made recommendations for improvement which are detailed in Appendix C.

#### Review of IT

We performed a high level review of the general IT control environment as part of the overall review of the internal control system and concluded that there were no material weaknesses within the IT arrangements that could adversely impact on our audit of the accounts.

#### Review of internal audit

We periodically review the Internal Audit function for compliance with requirements of the 2006 CIPFA Internal Audit Standards. Our most recent review in March 2011 concluded that Internal Audit met these requirements.

This work supports our review of the Annual Governance Statement (AGS) which in turn informs our Value for Money (VfM) conclusion in the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources and our audit of the financial statements.

We note that the Annual Internal Audit Report 2010/11 states that an 'adequate' level of assurance can be provided in respect of the system of internal control in place during the year. This opinion provides an element of assurance to the Council about its overall governance arrangements.

### Management of the risk of fraud

We have sought assurances from the Head of Corporate Finance and the Chair of the Audit and Governance Committee in respect of processes in place to identify and respond to the risk of fraud at the Council.

From these enquiries we have established that the Council considers there are adequate processes in place to mitigate against the risk of fraud occurring at the Council and that those charged with governance have sufficient oversight over these processes to give them the assurances they require in this area.

### Annual Governance Statement (AGS)

We have examined the Council's arrangements and processes for compiling the AGS. In addition, we read the AGS and considered whether the statement is in accordance with the requirements of the Code and consistent with our knowledge of the Council.

We reviewed the draft AGS provided to us as part of the draft financial statements and noted a small number of proposed amendments to its structure and content, which were communicated to management.

### Foreword to the Accounts

We have examined the Council's foreword to the accounts and concluded that it was in line with the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11, subject to a number of minor amendments which were discussed with management.

### Follow Up of prior year recommendations

We have reviewed those areas where the Council's arrangements were considered to need improvement in the prior year and found that sufficient actions or development had not been made in the following

areas, as reflected by the nature of matters identified during the course of the financial statements audit:

- the prioritisation of development of its asset management system;
- the obtaining of valuation reports in support of all valuation exercises;
- the appropriateness of depreciation methodologies;
- the creation of a central leases register;
- cut off arrangements,
- a detailed review of the accounting for grants and contributions; and
- ensuring the consistency and integrity of its financial closedown working arrangements

We have discussed these issues with management and made recommendations for improvement which are detailed in Appendix C.

### Public challenge matters

At the time of writing we have received no questions or objections in respect of the financial statements for the year ended 31 March 2011 that prevent us from issuing our audit certificate.

### Next steps

The Audit and Governance Committee is required to recommend to Council the financial statements for the year ended 31 March 2011. In forming its conclusions the Committee's attention is drawn to the adjustments to the financial statements and the required Letter of Representation.

### 3. Value for money

#### Value for money conclusion

In order for us to provide a positive conclusion, the Council needs to demonstrate proper arrangements in place for securing economy, efficiency and effectiveness in its use of resources.

The Audit Commission Code of Audit Practice 2010 describes the Council's responsibilities to put in place proper arrangements to:

- secure economy, efficiency and effectiveness in its use of resources
- ensure proper stewardship and governance
- review regularly the adequacy and effectiveness of these arrangements.

For the year ended 31 March 2011 we are required to give our conclusion based on the following two criteria specified by the Audit Commission:

- the Council has proper arrangements in place for securing financial resilience
- the Council has proper arrangements for challenging how it secures economy, efficiency and effectiveness

#### Programme of work - review of proper arrangements

Our work has encompassed a review against proper corporate performance and financial management arrangements as defined by the Code. The findings from our review against these arrangements are detailed below:

Code criteria	Work completed	Conclusion
Planning finances effectively to deliver strategic priorities and secure sound financial health	Refer to our review of financial resilience	Proper arrangements considered to be in place.

Code criteria	Work completed	Conclusion
Having a sound understanding of costs and performance and achieving efficiencies in activities	Refer to our review of financial resilience (see summarised findings reported on page 17)	Proper arrangements considered to be in place.
Reliable and timely financial reporting that meets the needs of internal users, stakeholders and local people	Reviewed as part of financial resilience work and our audit of the financial statements	Proper arrangements considered to be in place.
Commissioning and procuring services and supplies that are tailored to local needs and deliver sustainable outcomes and value for money	Considered as part of our risk assessment of the Council's arrangements to prioritise resources and improve efficiency and productivity (see page 18)	Proper arrangements considered to be in place.
Producing relevant and reliable data and information to support decision making and manage performance priorities	Reviewed as part of financial resilience work and considered as part of our risk assessment of the Council's arrangements to prioritise resources and improve efficiency and productivity	Proper arrangements considered to be in place.



Code criteria	Work completed	Conclusion
Promoting and demonstrating the principles and values of good governance	Refer to our review of Financial Resilience, review of the AGS	Proper arrangements considered to be in place.
Managing risks and maintaining a sound system of internal control	Refer to our review of Financial Resilience, review of the AGS and our review of internal audit	Proper arrangements considered to be in place.
Making effective use of natural resources	We have updated our prior year assessment through discussions with officers and a review of documentation.	Proper arrangements considered to be in place.
Managing assets effectively to help deliver strategic priorities and service needs	Considered as part of our risk assessment of the Council's arrangements to prioritise resources and improve efficiency and productivity (see summarised findings reported on page 18)	Proper arrangements considered to be in place.
Planning, organising and developing the workforce effectively to support the achievement of strategic priorities	Refer to our review of Financial Resilience. Considered as part of our risk assessment of the Council's arrangements to prioritise resources and improve efficiency and productivity.	Proper arrangements considered to be in place.

## Matters arising from the review of Value for Money

Key outcomes from our local programme of work are detailed below. Where we have identified areas of weakness in the Council's arrangements, recommendations to support improvements have been made and are detailed in Appendix C of this report.

### Securing Financial Resilience

We have completed a review to assess whether the Council has robust systems and processes in place to effectively manage its financial risks and opportunities and secure a stable financial position. We also have considered whether the Council's financial position should enable it to continue to operate for the foreseeable future.

To support our conclusion against this criteria we have undertaken a review which considered the Council's arrangements against three key areas. Our key findings against these are summarised as follows:

#### 1. Strategic Financial Planning

**Green**

- The Council strengthened its financial planning process in light of the Government's deficit reduction programme and took account of corporate priorities when setting what was a challenging budget.
- Savings of £20m have been identified for the year ending 31 March 2012, but there is significant further work required to identify a further £60m savings.
- The Council used a mixture of cross-cutting savings and departmental savings targets.
- The Corporate Leadership Management Team (CLMT) has managed and challenged the savings process effectively
- The Council will need to ensure it continues to monitor and successfully embed this approach.

#### 2. Financial governance

**Amber**

- The Council has a well established approach to financial governance that has a good track record.
- However, there are varying levels of financial management experience and ability in services
- The Council uses quarterly performance meetings, and separate accountability meetings, to provide a high degree of corporate control. The Council has refreshed its Personal Performance Assessment (PPA), to include financial management.
- However, as with many local authorities, failure to embed the necessary cultural and process changes could impact on financial resilience.
- There is an unusually high degree of dependency on the Section 151 Officer, as the primary source of guidance, challenge and leadership on strategic financial issues which presents a key risk to be managed.

#### 3. Financial control

**Amber**

- The Council has a robust approach to financial and performance management, and has a good track record in controlling costs.
- The Council demonstrates appropriate deployment of internal and external assurance mechanisms.
- Budgets are not profiled over the year, and we suggested that this be adopted to reflect seasonal fluctuations in budget monitoring.
- Recent reductions to the finance team resource (10%) from an already low base (e.g. CIPFA benchmark) has reduced its ability to maintain business as usual in the face of competing demands on its capacity.
- The new savings tracker should provide effective management information but needs to be aligned to the new corporate structure.
- The Council has introduced quarterly governance statement which has enhanced its approach to managing risk and internal control.

### **Securing Economy, Efficiency and Effectiveness**

We have reviewed whether the Council has prioritised its resources to take into account budget constraints and whether it has achieved cost reductions and improved productivity and efficiencies.

As well as a review against key risk indicators, we have drawn on the findings of our financial resilience review, updated our understanding of the Council's performance monitoring arrangements and reviewed performance against the Council's strategic objectives for the year ended 31 March 2011:

- We assessed the Council's performance against its strategic objectives as a measure of delivering value for money and found that, although performance levels varied across the services, with some targets not achieved, the Council had met the majority of its planned performance targets.
- We noted that past performance on the Use of Resources (UoR) indicated that the Council's arrangements for securing Economy, Efficiency and Effectiveness were 'adequate' in the year ended 31 March 2010. We have followed up our VfM report in the prior year and found that adequate progress has been made on the key recommendations
- Our review of Committee minutes and discussions with management throughout the year, did not indicate that the Council's ability to secure Economy, Efficiency and Effectiveness had been significantly altered or impaired.

### **Follow Up of prior year assessment**

We have reviewed those areas where the Council's arrangements were considered to need improvement in the year ended 31 March 2010. We are satisfied that adequate progress has been made. The following issues remain areas of focus for the Council:

- Managing sickness absence;
- Delivery of capital projects; and
- the non-current asset accounting system

### **Overall conclusion**

Subject to the successful completion of our review we expect to deliver an unqualified VfM Conclusion as follows:

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

# Appendices

## A. The reporting requirements of ISA 260

### **Purpose of report**

The purpose of this report is to highlight the key issues affecting the results of the Council and the preparation of the Council's financial statements for the year ended 31 March 2011.

The document is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK and Ireland) 260.

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

This report is strictly confidential, and although it has been made available to management to facilitate discussions, it may not be taken as altering our responsibilities to the Council arising under the terms of our audit engagement.

The contents of this report should not be disclosed with third parties without our prior written consent.

### **Responsibilities of the directors and auditors**

The directors are responsible for the preparation of the financial statements and for making

available to us all of the information and explanations we consider necessary. Therefore, it is essential that the directors confirm that our understanding of all the matters in this report is appropriate, having regard to their knowledge of the particular circumstances.

### **Clarification of the roles and responsibilities with respect to internal controls**

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

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

The Audit and Governance Committee should

ISAUK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the integrity and objectivity of the engagement team
- nature and scope of the audit work
- significant findings from the audit

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

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

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

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

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

### Independence and robustness

Ethical standards require us to give you full and fair disclosure of the matters relating to our independence. In this context we ensure that:

- the appointed audit partner and audit manager are subject to rotation every seven years;
- Grant Thornton, its partners and the audit team have no family, financial, employment, investment or business relationship with the Council;
- our fees paid by the Council do not represent an inappropriate proportion of total fee income for either the firm, office or individual partner; and
- at all times during the audit, we will maintain a robustly independent position in respect of key judgement areas

### Audit and non-audit services

Services supplied to the Council for the year ended 31 March 2011 are as follows:

£

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#### Audit services

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Statutory audit	300,000
Certification of claims and returns*	60,000

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\*the quoted fee for grant certification work is an estimate only and will be charged at published hourly rates

### Audit quality assurance

Grant Thornton's audit practice is currently monitored by the Audit Inspection Unit, an arm of the Financial Reporting Council which has responsibility for monitoring the firm's public interest audit engagements.

The audit practice is also monitored by the Quality Assurance Directorate of the ICAEW. Grant Thornton also conducts internal quality reviews of engagements.

Furthermore, audits of public interest bodies are subject to the Audit Commission's quality review process.

We would be happy to discuss further the firm's approach to quality assurance.

## B. Audit adjustments

### Adjustment type

**Misstatement** - A change in the value of a balance presented in the financial statements

**Classification** - The movement of a balance from one location in the accounts to another

**Disclosure** - A change in the way in which a balance is disclosed or presented in an explanatory note

### Adjustments to the financial statements

Adjustment type	£000	Account balance	Impact on financial statements
Misstatement	2,380	Taxation and non-specific grant income - year ended 31 March 2011	Comprehensive Income and Expenditure Statement - decrease to the Deficit on Provision of Services following recognition of increased grant revenue.  <i>NB. a corresponding accounting entry is made to reverse amounts out of the General Fund to the Capital Adjustment Account i.e. there is no impact to the General Fund.</i>
Misstatement	5,547	Taxation and non-specific grant income - year ended 31 March 2010	Comprehensive Income and Expenditure Statement - decrease to the Deficit on Provision of Services following recognition of increased grant revenue.  <i>NB. a corresponding accounting entry is made to reverse amounts out of the General Fund to the Capital Adjustment Account i.e. there is no impact to the General Fund.</i>
Misstatement	59,816	Actuarial gains/losses on pensions assets/liabilities	Comprehensive Income and Expenditure Statement - movement of pension past service cost negative credit from 'Actuarial (gains)/losses' to within Net Cost of Services  <i>NB. a corresponding accounting entry is made to reverse amounts out of the General Fund i.e. there is no impact to the General Fund.</i>
Misstatement	4,215	Other Liabilities	Balance Sheet - inclusion of additional liability of £4.2m in relation to scheme costs incurred to date on Building Schools for the Future (BSF) initiative  - a related contingent asset of £4.2m has been disclosed in the accounts in relation to recovery action on central government funding  <i>Adjustment results in a reduction in overall net worth, however, the increase in expense has been met from a transfer from reserves i.e. there is no impact to the General Fund.</i>

Adjustment type	£000	Account balance	Impact on financial statements
Classification	180,391	Other Liabilities	Balance Sheet - separate disclosure of the pensions liability and its exclusion from financial instruments balances in accordance with IAS 19 <i>No impact to net worth or deficit on provision of services</i>
Classification	24,440*	Cash and Cash Equivalents and Short Term Investments - year ended 31 March 2011	Balance sheet - decrease in 'Cash and Cash Equivalents' due to incorrect consideration of deposits with a greater than three months duration from inception which should be classified as 'Short Term Investments' <i>No impact to net worth or deficit on provision of services</i> <i>NB. There are equivalent reclassification adjustments to the prior year balance sheets</i>
Disclosure	n/a	Cash flow statement supporting notes	Additional supporting notes to the cash flow statement were disclosed in accordance with the requirements of the Code
Disclosure	n/a	Property, plant and equipment - revaluations	Additional disclosures have been made to report the details of the revaluations performed by both external and internal valuers recorded in the year ended 31 March 2011, as well as to reflect the nature of the changes to the valuation methodology applied to specialised buildings, in particular schools.

\* the impact of the final adjustments to Cash and Cash Equivalents are still subject to final confirmation by management and our audit completion procedures



## Unprocessed adjustments to the financial statements

Adjustment type	£000	Account balance	Impact on financial statements
Misstatement	397*	HRA Expenditure - Negative HRA subsidy payable	HRA Income and Expenditure Statement - decrease in the amount of negative HRA subsidy payable resulting in a decrease in the HRA deficit.
Misstatement	383**	PFI scheme recognition entries	Balance sheet - increase in the closing balance of the outstanding lease obligation at year end.  <i>NB. amendments would also be required to the nature of reported in year expense recognised in the Comprehensive Income and Expenditure Statement and supporting notes</i>
Misstatement	277*	Net cost of services - Local Authority Housing Services (HRA)	Comprehensive Income and Expenditure Statement - decrease in the net expenditure recognised within Net Cost of Services relating to a difference to the deficit position reported in the HRA
Misstatement	200*	Net cost of services - Local Authority Housing Services (HRA)	Comprehensive Income and Expenditure Statement - increase in the net expenditure recognised within Net Cost of Service to reflect understated depreciation and impairment charges
Misstatement	136	Net cost of services - Education and children's services	Comprehensive Income and Expenditure Statement - increase in income recognised within Net Cost of Services to reflect actual revenue relating to the Sure Start grant.

\* the impact of the unprocessed adjustments to the HRA are still subject to final confirmation by management

\*\* the impact of the unprocessed adjustment to PFI recognition accounting entries is still subject to final confirmation by management and the financial modellers of the scheme

## C. Action plan

### Priority

**High** - Significant effect on control system

**Medium** - Effect on control system

**Low** - Best practice

Rec No.	Recommendation	Priority	Management Comments	Implementation date and responsibility
1	The implementation of a dedicated non-current asset module should be prioritised and accompanied by a comprehensive exercise to ensure the integrity and data quality of information used for its establishment. This exercise should be supported by explicit project planning, with appropriate oversight and the allocation of sufficient dedicated resources to ensure delivery within a timescale to support the preparation of the financial statements for the year ended 31 March 2012.	High		
2	An additional coding and structure review should be undertaken in relation to the rest of the financial ledger system to enable the appropriate recording of correct postings to the Capital Adjustment Account (CAA) and Revaluation Reserve to an sufficient level of detail, as well as the future inclusion of IAS 19 entries within cost centres.	High		
3	The current methodology and working practices for the scheduling of future asset valuation activity, including instructions to external valuers, should be revisited to ensure ongoing compliance with IFRS and the requirements of the Code that all assets within an asset class are revalued and that an appropriate valuation exercise is carried out where conditions suggest a significant change in market values may have occurred.	High		

Rec No.	Recommendation	Priority	Management Comments	Implementation date and responsibility
4	Processes for the identification and accounting recognition of grants and contributions should be revisited to ensure ongoing compliance with the requirements of the Code of Practice.	Medium		
5	An exercise should be undertaken to review the current financial closedown arrangements, including the preparation of supporting working papers, to ensure efficient accounts preparation and ongoing compliance with the Code of Practice, in particular the support of critical judgements and estimates.	Medium		



Grant Thornton

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