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28 September 2007

Members of the Governance and Scrutiny Committee
East Ayrshire Council
Council Headquarters
London Road
Kilmarnock
KA3 7BU

Dear Members

East Ayrshire Council
Audit of Financial Statements 2006/2007

International Standard on Auditing 260 (ISA 260) *Communication of audit matters with those charged with governance* requires auditors to communicate matters relating to the audit of the financial statements to those charged with governance of a body in sufficient time to enable appropriate action. ISA 260 requires me to highlight:

- the integrity and objectivity of the audit engagement lead and audit staff;
- the nature and scope of the audit, including any limitations, and the form of reports expected to be made;
- expected modifications to the audit report;
- the representation letter, that the auditor requested the Director of Finance to sign;
- unadjusted misstatements (other than those which are clearly trifling);
- material weaknesses in the accounting and internal control systems identified during the audit;
- views about the qualitative aspects of accounting practices and financial reporting; and
- matters specifically required by other auditing standards to be communicated and any other matters relevant to the audit.

A summary of my findings in respect of these issues is shown at Appendix A to this letter.

In my view, 9 issues require to be brought to your attention regarding the appropriateness of the Council's accounting policies or accounting estimates and judgements, the timing of transactions, the existence of any material unusual transactions or the potential effect on the financial statements of any uncertainties. These issues are shown at Appendix D.

This letter includes only those matters of governance interest that have come to our attention as a result of the performance of the audit. An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. The letter has been prepared for the use of East Ayrshire Council and no responsibility to any third party is accepted.

Finally, I would like to express my thanks to members of the Council and Council staff for your help and assistance during the audit of this year's accounts which has enabled me to certify the accounts by the Controller of Audit's target date.

Yours sincerely



Peter Tait
Assistant Director Audit (Local Government)

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Appendix A

East Ayrshire Council
2006/07 Financial Statements Audit

ISA 260 - *Communication of audit matters with those charged with governance*

ISA 260 issues to be highlighted:

The integrity and objectivity of the audit engagement lead and audit staff and the nature and scope of the audit.	Information on the integrity and objectivity of the audit engagement lead and audit staff, and the nature and scope of the audit, were outlined in the Audit Risk Analysis and Plan submitted to the Risk and Scrutiny Group on 24 April 2007 and in the Code of Audit Practice prepared by Audit Scotland in March 2007.
Expected modifications to the audit report.	My anticipated audit report (Appendix B) is unqualified.
The representation letter, that the auditor requested the Director of Finance to sign.	Included at Appendix C
Unadjusted misstatements (other than those which are clearly trifling.)	None
Material weaknesses in the accounting and internal control systems identified during the audit.	No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the accounts. Opportunities to improve internal control, however have been reported to the Council during the year in reports to management. The more significant issues will be highlighted in the Report to Members on the 2006/07 audit.
Views about the qualitative aspects of accounting practices and financial reporting.	Included at Appendix D
Matters specifically required by other auditing standards to be communicated and any other matters relevant to the audit.	None

Appendix B

East Ayrshire Council
2006/07 Financial Statements Audit

Proposed auditor's report – Subject to the processing of amendments agreed at clearance meeting of 20 September 2007

Independent auditor's report to the members of East Ayrshire Council and the Accounts Commission for Scotland

I certify that I have audited the financial statements of East Ayrshire Council and its group for the year ended 31 March 2007 under Part VII of the Local Government (Scotland) Act 1973. These comprise the Income and Expenditure Account, Statement of Movement on the General Fund Balance, Statement of Total Recognised Gains and Losses, Balance Sheet and Cash-Flow Statement, the Housing Revenue Account Income and Expenditure Account, Statement of Movement on the HRA Balance, the Council Tax Income Account, the Non-Domestic Rate Income Account, the Trust Fund accounts, the Common Good Fund accounts and the Group Accounts and the related notes. These financial statements have been prepared under the accounting policies set out within them.

This report is made solely to the parties to whom it is addressed in accordance with the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 123 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Executive Head of Finance and Asset Management and auditor

The Executive Head of Finance and Asset Management's responsibilities for preparing the financial statements in accordance with applicable laws and regulations and the Code of Practice on Local Authority Accounting in the United Kingdom 2006 - A Statement of Recommended Practice (the 2006 SORP) are set out in the Statement of Responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission.

I report my opinion as to whether the financial statements present fairly the financial position of the local authority and its group in accordance with applicable laws and regulations and the 2006 SORP, and have been properly prepared in accordance with the Local Government (Scotland) Act 1973. I also report if, in my opinion, the Foreword is not consistent with the financial statements, if the local authority has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I review whether the Statement on the System of Internal Financial Control reflects the authority's compliance with the SORP. I report if, in my opinion, it does not comply with the SORP or if it is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered, whether the statement covers all risk and controls. Neither am I required to form an opinion on the effectiveness of the local authority's corporate governance procedures or its risk and control procedures.

I read the other information published with the financial statements, and consider whether it is consistent with the audited financial statements. This other information comprises only the Explanatory Foreword by the Executive Head of Finance and Asset Management and the Corporate Governance Assurance Statement by the Leader of the Council and the Chief Executive. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with Part VII of the Local Government (Scotland) Act 1973 and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board as required by the Code of Audit Practice approved by the Accounts Commission. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Executive Head of Finance and Asset

Management in the preparation of the financial statements, and of whether the accounting policies are appropriate to East Ayrshire Council and its group's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In my opinion

- the financial statements present fairly, in accordance with applicable laws and regulations and the 2006 SORP, the financial position of East Ayrshire Council and its group as at 31 March 2007 and its income and expenditure for the year then ended; and
- the financial statements have been properly prepared in accordance with the Local Government (Scotland) Act 1973.

*Peter Tait CPFA
Assistant Director of Audit (Local Government)*

*Audit Scotland
7th Floor
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East Kilbride
G74 1LW*

28 September 2007

East Ayrshire Council
2006/07 Financial Statements Audit

Mr Peter Tait
Assistant Director of Audit (Local Government)
Audit Scotland
7th Floor
Plaza Tower
East Kilbride
G74 1LW

Dear Mr Tait

EAST AYRSHIRE COUNCIL - 2006/07 FINANCIAL STATEMENTS

This representation letter is provided in connection with your audit of the financial statements of East Ayrshire Council and its group for the year ended 31 March 2007 for the purpose of expressing an opinion as to whether the financial statements present fairly the financial position of East Ayrshire Council and its group as at 31 March 2007 and its income and expenditure for the year then ended.

I confirm to the best of my knowledge and belief, and having made appropriate enquiries of the Chief Executive and Corporate Management Team, the following representations given to you in connection with your audit of East Ayrshire Council for the year ended 31 March 2007.

Legality of Financial Transactions

1. The financial transactions of East Ayrshire Council are in accordance with the relevant legislation and regulations governing its activities. All known or possible non-compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to you, together with the actual or contingent consequences which may arise.
2. The Local Government in Scotland Act 2003 prescribed the financial objective that each statutory trading account should break even over a rolling three year period. I can confirm that proper accounting practice has been applied in arriving at the cumulative surplus position for each of the three statutory trading accounts operated by the Council and that they have each achieved the statutory financial objective.

Accounting Policies

3. All material accounting policies adopted are as shown in the Statement of Accounting Policies. The Council has reviewed its accounting policies and estimation techniques having regard to the concepts and qualitative characteristics set out in the Code of Practice on Local Authority Accounting in the United Kingdom 2006.

Going Concern

4. The accounts of East Ayrshire Council and its group have been prepared on a going concern basis. For the year ending 31 March 2007 the Council's share of the net liabilities of its associates totalled £193.218 million. The group balance sheet discloses net assets of £133.947 million. This position reflects, in the main, the combined deficit on the pensions schemes operated by Strathclyde Police Joint Board and Strathclyde Joint Fire and Rescue Board. I have reviewed the group's ability to continue as a going concern. In my opinion, it is reasonable to assume continuing funding streams to joint boards, increased pension contributions and continuing local government finance settlements. It is therefore, in my view, appropriate that the financial statements have been prepared on a going concern basis.

Assets

General

5. The assets shown in the books and accounts at 31 March 2007, other than assets which are employed under finance leases, were owned by East Ayrshire Council.
6. For the year ended 31 March 2007, title deeds for properties owned or mortgaged to East Ayrshire Council were held by the Council and that all such deeds were in order.
7. Expenditure on the purchase of furniture, office equipment and computer equipment and software below £x,xxx has been charged to the income and expenditure account. Items costing more than £x,xxx have been treated as fixed assets.

Fixed Assets

8. All fixed assets are appropriately classified. The net book amount in the balance sheet was arrived at:
 - (i) after taking into account all material capital expenditure on additions thereto but not expenditure properly chargeable to revenue;
 - (ii) after the amounts at which the land and buildings were stated in the balance sheet were properly calculated in accordance with the approved bases of valuation and fairly represented the values at 31 March 2007, and no properties were omitted from or duplicated in the valuation;
 - (iii) after deducting the cost and accumulated depreciation relating to items sold or scrapped;
 - (iv) after providing for depreciation and obsolescence on bases and at rates calculated to reduce the net book value of each asset to its estimated residual value by the end of its probable useful life.
9. The Council owns intangible assets in the form of software licences. Intangible assets have been separately identified in the balance sheet.

10. At 31 March 2007, East Ayrshire Council had £xxx,xxx obligations under finance leases.

Council Houses

11. The value of council houses in the balance sheet is based on 13,596 houses owned by the Council as at 31 March 2007 and valued in accordance with the "beacon" method.

Stocks

12. The Council's stocks have been valued at weighted average cost and all stocks are included in the financial statements.

Other Current Assets

13. On realisation, in the ordinary course of East Ayrshire Council's business, the other current assets in the balance sheet are expected, in my opinion, to produce at least the amounts at which they are stated. In particular adequate provision has, in my opinion, been made against all amounts owing which are known or may be expected to be irrecoverable.

Liabilities

General

14. All liabilities have been provided for in the books of account, including the liability for all purchases for which title has passed prior to 31 March 2007.

Contingent Liabilities

15. All known significant contingent liabilities arising either under formal agreements or through informal undertakings have been provided for or disclosed in a note to the balance sheet.

Provision for Losses

16. Provisions have been made in the accounts for all losses of material amounts which have resulted, or may be expected to result, by legal action or otherwise, from events which had occurred by the balance sheet date, and of which the Council could reasonably be expected to be aware.

Commitments

17. There were no other commitments for capital expenditure as at 31 March 2007 other than those disclosed in the notes to the financial statements.

Loans Fund

18. I confirm that all borrowings are compliant with the provisions of the Local Government (Scotland) Act 1975.

19. The Council has £xx.xx million of unamortised premiums arising from the early repayment of PWLB debt refinanced using "lender option, borrower option" (LOBO) arrangements. The premium has been amortised to revenue over the period of the replacement loans, as permitted by the SORP, because I consider that the overall economic effect of the original and replacement borrowing is substantially the same. In reaching this view I have taken into account:

- the definition of the term 'overall economic effect' offered by the SORP guidance notes;
- the expected stability of interest rates over the period of replacement borrowing;
- that there is no evidence that lenders have sought in practice to impose significant interest rate increases or that authorities have refused to accept any increases; and,
- the issue of new guidance by the Scottish Executive covering 2007/08 and subsequent financial years.

Pension assets and liabilities

20. Changes to the Local Government Pension Scheme permit employees retiring on or after April 2006 to take an increase in their lump sum payment on retirement in exchange for a reduction in their future annual pensions. On the advice of the Council's actuaries I have assumed that 25% of employees retiring after 6 October 2006 will take advantage of this change to the pension scheme. The Council's actuaries have advised that this will reduce the value of the Council's pension liabilities by £4.681 million.

Other Matters

21. Except as disclosed in the financial statements, the results for the period were not materially affected by:
- (i) transactions of a sort not usually undertaken by East Ayrshire Council;
 - (ii) circumstances of an exceptional or non-recurrent nature;
 - (iii) charges or credits relating to prior periods;
 - (iv) any change in the basis of accounting.
22. I confirm the completeness and adequacy of the information provided at note 3 to the financial statements regarding the identification of related parties.
23. All common good assets and liabilities and revenue transactions have been properly separated from the Council's single entity accounts and are reflected within the common good accounts. Similarly, all assets and liabilities and revenue transactions relating to charitable trusts managed by the Council have been properly separated from the Council's single entity accounts and are reflected within the trust fund accounts.
24. I acknowledge the schedule of matters arising from the audit brought to my attention by the auditor. I can confirm that I have amended the accounts for those which, even though not material in this context, I regarded as significant.

General

25. I acknowledge my responsibility, and that of East Ayrshire Council, for the financial statements. All the accounting records requested have been made available to you for the purposes of your audit. All material agreements and transactions undertaken by East Ayrshire Council have been properly reflected in the financial statements. All other records and information have been made available to you, including minutes of all Council and other meetings.
26. Disclosure has been made in the financial statements of all matters necessary for them to present fairly the transactions and state of affairs of East Ayrshire Council for the year ended 31 March 2007.
27. I have disclosed to the auditor all known allegations of fraud or suspected fraud affecting the financial statements. There have been no irregularities involving management or employees, other than those already communicated to the auditor, who have a significant role in internal control or that could have a material effect on the financial statements.

Events Subsequent to the Date of the Balance Sheet

28. There have been no material events since the date of the balance sheet which necessitate revision of the figures in the financial statements, notes thereto, the statement on the system of internal financial control or contingent assets and liabilities.
29. Since the date of the balance sheet no events or transactions have occurred which, though properly excluded from the accounts, are of such importance that they should be brought to your notice.

Corporate Governance

30. I acknowledge, as proper officer under section 95 of the Local Government (Scotland) Act 1973, my responsibility for the systems of internal financial control. I confirm that I have reviewed the effectiveness of the systems of internal financial control and that the disclosures I have made are in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2006 and supporting guidance thereto.

Yours sincerely

Alexander McPhee

Executive Head of Finance and Asset Management

Issues to be brought to your attention:

- Group accounts - going concern:** The accounts of East Ayrshire Council and its group have been prepared on a going concern basis. For the year ending 31 March 2007 the Council's share of the net liabilities of its associates totalled £193.218 million. The group balance sheet discloses net assets of £133.947 million. This position reflects, in the main, the combined deficit on the pension schemes operated by Strathclyde Police Joint Board and Strathclyde Joint Fire and Rescue Board. The Executive Head of Finance and Asset Management has reviewed the group's ability to continue as a going concern and is of the opinion that, it is reasonable to assume continuing funding streams to joint boards, increased pension contributions and continuing local government finance settlements. He has, accordingly, taken the view that it is appropriate that the financial statements be prepared on a going concern basis.
- Overall financial position: (based on unamended accounts)** The Council made a net revenue surplus in 2006/07 of £8.3 million. The General Fund surplus now stands at £20.588 million. The Executive Head of Finance and Asset Management has confirmed that a substantial portion of this is earmarked for future use. Other reserve funds on the balance sheet total £23.775 million.
- Explanatory foreword:** The Code of Practice on Local Authority Accounting in the United Kingdom 2006 specifies that the Explanatory Foreword should include, *inter alia*, "Service expenditure, interest payable and other operating costs, income from grants, local taxpayers and other sources, compared in overall terms to the budget". It is our view that the format of the Explanatory Foreword should be reviewed for future years taking account of good practice evidenced in other councils' accounts.
- Significant trading organisations:** The Local Government in Scotland Act 2003 requires significant trading operations (STOs) to break even over a three year rolling period. The second three year period ended in 2006/07. During 2006/07 seven of the ten STOs reported in the 2005/06 accounts were re-designated as non-STOs. The Council's three remaining statutory trading operations have achieved their statutory financial objectives for the period ending 31 March 2007.
- Single Status/Equal Pay:** Equal pay compensation packages were agreed with relevant staff during 2005/06 and £4.7 million was recognised in that year's accounts. The Council continues to face potential additional equal pay claims from further groups of employees. No further provision has been made in respect of these further claims, however, the Executive Head of Finance and Asset Management has recognised the possibility of a contingency in a note to the accounts. The Council made good progress in introducing single status during the year and by 31 March had completed the exercise and consulted on the outcome. Implementation of the single status scheme was approved by Council on 22 March 2007. The scheme provided for backdating salary and wage adjustments to 1 April 2006. The accounts include £1.8 million in respect of the backdating.
- Capital slippage:** There has continued to be slippage against the capital programme in 2006/07. The final capital outturn report for 2006/07, shows capital spend of £21.618 million against a programme of £28.298 million. This represents completion of some 76% of the revised capital plan for the year.
- Bad debt provisions:** The Council makes provision against the non-collection of various types of debt. Depending on the nature of the debt, provisions are charged to the General Fund or Housing Revenue Account each year. Our view is that the level of bad debt provision in the balance sheet for council tax, council tax statutory additions, housing benefit overpayments and housing rechargeable repairs could be reduced. This is borne out by the collection rate already available for 2007/08. Management have agreed to review this for 2007/08.
- Council tax collection:** Similar to 2005/06 council tax collection has exceeded the budget by some £0.940 million. The budget setting process and rate of recovery should be reviewed in light of the Council's improving performance. Outstanding community charge debt is still being collected. Some £0.1 million was collected in 2006/07 (£0.114 million 2005/06). Estimates of community charge collection should be built into the annual budget.

9. **Council tax credit balances:** during the course of the audit credit balances totalling some £562,000 were included in the balance sheet, however, a proportion of this figure will relate to payments in advance. Management has agreed to review these balances as part of the overall review of bad debt provisions.