

LONDON BOROUGH OF HARROW

Meeting:	Overview and Scrutiny Committee
Date:	25 November 2003
Subject:	Statement of Accounts 2002-2003 Report of the External Auditor
Key decision:	No
Responsible Chief Officer:	Executive Director (Business Connections)
Relevant Portfolio Holder:	Finance and Human Resources and Performance Management
Status:	Part 1
Ward:	N/A
Enclosures:	Appendix: Summary of SAS 610 Requirements

1. Summary

- 1.1 This report sets out the requirement for a body of the Council to receive the external auditor's report on the Statement of Accounts 2002-2003 and proposes that the Committee agree to set up an Accounts Approval Sub-Committee.

2. Recommendations

The Committee is asked:

- 2.1 to establish an Accounts Approval Sub-Committee, comprising 5 Members, with delegation to consider and deal with the External Auditor's report on the Statement of Accounts;
- 2.2 to appoint the membership and reserve membership of the Sub-Committee;
- 2.3 to appoint a Chair of the Sub-Committee in accordance with Overview and Scrutiny Procedure Rule 11.2;
- 2.4. to report the establishment of the Sub-Committee to the next Council meeting on 22 January 2004 in accordance with Overview and Scrutiny Procedure Rule 4.3.

REASON: To consider the auditor's report to enable the Statement of Accounts to be signed off and published by the statutory date of 31 December 2003

3. Consultation with Ward Councillors

- 3.1 Not applicable.

4. **Policy Context (including Relevant Previous Decisions)**

4.1 None.

5. **Relevance to Corporate Priorities**

5.1 All.

6. **Background Information**

Statement of Audit Standards Requirements

- 6.1 The Council is required to publish its audited Statement of Accounts by 31 December 2003. In previous years the authority has met this statutory deadline and those that have failed to do so have been listed by ODPM.
- 6.2 The external auditor is required for Accounts for the year ending 31 March 2003 to comply with the Statement of Audit Standards 610 (SAS 610). The SAS was originally drafted to cover corporate governance issues in the private sector but the Audit Commission agreed that the principles were to be applied to local authorities with full implementation for the financial year from 2002/2003. A summary of the main requirements is set out in the Appendix.
- 6.3 The immediate requirement is that the Auditor should issue to the body "charged with governance" a report on his findings on the Accounts and discuss these with the body before he formally signs off the Accounts for the year. The SAS identifies those charged with governance in a local authority as "the full Council, audit committee (where established), any other committee with delegated responsibility for approval of the financial statements". It should be noted that this report is in addition to the Audit Management Letter which will be received after the audit has been completed.

Content of Report

- 6.4 As this is a new requirement the exact format of the letter is not known but in accordance with the code summarised in the Appendix it is expected to cover the following:
- expected modifications to the auditor's report on the financial statements including for example the intended qualification of the Accounts
 - misstatements in the financial statements that have been brought to management's attention but not actioned (this applies to all unadjusted misstatements other than those which are considered "clearly trifling")
 - if those charged with governance refuse to make the requested adjustments to obtain a written representation explaining the reasons for not making the adjustments
 - material weaknesses in the accounting and internal control systems identified during the audit that have been corrected by management without those charged with governance being advised
 - qualitative aspects of accounting practices and financial reporting
 - any other matters relating to the Audit

Meeting of relevant body

- 6.5 To meet the statutory timetable it is essential that a meeting of the relevant body is held prior to Christmas.
- 6.6 The Cabinet as the "Executive" cannot approve the Accounts and therefore could not receive the report.
- 6.7 It is therefore proposed that the Overview and Scrutiny Committee appoint 5 of its members as a Sub-Committee with delegation to consider and deal with the Report.
- 6.8 In accordance with the Committee's Procedure Rules, the Committee is also requested to appoint a Chair of the Sub Committee.
- 6.9 The Auditor is still in discussion with the officers on a number of issues before he can finalise his findings. It is suggested that the meeting be held in either the week commencing 8 December 2003 or the week commencing 15 December 2003.
- 6.10 This is intended to be a temporary solution to ensure compliance. It is proposed that for next year proposals be made for delegating to a committee approval of the Accounts. This will be subject to a future report.

7. Consultation

- 7.1 None required.

8. Finance Observations

- 8.1 This is a report from the Executive Director (Business Connections).

9. Legal Observations

- 9.1 None.

10. Conclusion

- 10.1 The new requirements under the SAS 610 requires a "body charged with governance" to consider the Auditor's findings before he signs off the accounts. It is proposed that this be delegated temporarily to a newly formed Accounts Approval Sub-Committee.

11. Background Papers

- 11.1 SAS 610

12. Author

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SAS 610: COMMUNICATION OF AUDIT MATTERS TO THOSE CHARGED WITH GOVERNANCE

Background

1. There have been significant developments in corporate governance, resulting in the introduction of new corporate governance arrangements by many organisations. In the light of these developments, the Auditing Practices Board (APB) issued a revised SAS 610 (Communication of audit matters to those charged with governance) in June 2001.
2. The Audit Commission and audit suppliers agreed, at the Technical Issues Group held on 4 December 2001, that the principles of SAS 610 would be applied wherever possible for financial year 2001/02, with full implementation for financial year 2002/03.

Implications of SAS 610 for audits of NHS & local government bodies

3. The SAS provides definitions of 'those charged with governance' and 'management'.
4. SAS 610.5 requires auditors to communicate to those charged with governance a number of findings from the audit, including expected modifications to the auditors' report, unadjusted misstatements, material weaknesses in the accounting and internal control systems, and their views about the qualitative aspects of the body's accounting practices and financial reporting.

Application of SAS 610 to audits of local government bodies

Definition of 'those charged with governance'

5. The SAS defines those charged with governance as 'those persons entrusted with the supervision, control and direction of an entity'
6. In local government sectors, it is proposed that the definition of those charged with governance, for the purpose of SAS 610, covers the following:
 - (a) Local authority – the full council, audit committee (where established), any other committee with delegated responsibility for approval of the financial statements;
7. The SAS indicates that communication to audit committees, where they are established, forms only part of the auditors' overall obligation to communicate effectively to those charged with governance.

Definition of 'management'

8. The SAS defines management as 'those persons who have executive responsibility for the conduct of the entity's operations and the preparation of its financial statements'.
9. In local government sectors, it is proposed that the definition of management covers the following:
 - (a) Local authority – chief executive (as Head of Paid Service), chief finance officer/director of finance (RFO), Monitoring Officer, other senior officers;

10. For the purposes of the implementation of SAS 610, it is proposed that the RFO is included under the definition of 'management'. Although the RFO has statutory responsibilities in respect of the financial statements, including the duty to certify that they 'present fairly', it is considered that this is 'executive responsibility' as defined in the SAS, as the financial statements are still subject to approval by members, i.e. those charged with governance.

Definition of 'relevant matters relating to the audit'

11. The SAS defines relevant matters relating to the audit as 'such matters arising from the audit of financial statements as the auditors believe to be both important and relevant to those charged with governance in overseeing the financial reporting process'.
12. Although the SAS only formally applies to the audit of the financial statements, the *Code of Audit Practice* requires auditors of local government bodies to carry out duties additional to those relating to the giving of an opinion on the financial statements. The requirements of SAS 610 do not remove or affect auditors' specific reporting responsibilities under the *Code*.

Disclosure of relationships that may bear on the auditor's independence

13. In order to comply with best practice and also to ensure a uniform approach for audit clients, the latest *Standing Guidance for Auditors* (November 2002) includes full application of the provisions of SAS 610.3 to audits of local government bodies from 2002/03 onwards. In determining which relationships and related safeguards to disclose, auditors would consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the *Code of Audit Practice* and *Standing Guidance for Auditors* in relation to independence and objectivity.

Findings from the audit

Expected modifications to the auditors' report

14. SAS 610.5 requires auditors to discuss any expected modifications to the auditors' report on the financial statements with those charged with governance. In practice, this means that a qualification of the audit opinion, for example, would have to be discussed with those charged with governance before it is finalised in order to ensure that they are aware of the reasons for it and have the opportunity to provide any further information and explanations in respect of the matter(s) giving rise to the qualification.

Unadjusted misstatements

15. In circumstances where auditors identify misstatements in the financial statements, bring these to the attention of management, but they are not subsequently adjusted, SAS 610.5(b) requires such unadjusted misstatements to be communicated to those charged with governance with a request that the adjustments are made. This does not just apply to material misstatements but to all unadjusted misstatements, other than those which are 'clearly trifling'. The SAS emphasises that this is not another expression for 'immaterial', and that a smaller order of magnitude will be applied than the materiality thresholds used in the audit.
16. If those charged with governance refuse to make the requested adjustments, the auditors are required by SAS 610.6 to seek to obtain a written representation explaining the reasons for not making the adjustments brought to their attention. It is unlikely that those charged with governance in NHS and local government bodies will be accustomed to

supplying such representations to the auditors explaining potentially technical issues and, therefore, may be reluctant to commit themselves in writing.

Material weaknesses in the accounting and internal control systems

17. Material weaknesses in the accounting and internal control systems identified during the audit are required to be communicated by the auditor where they have been corrected by management without the knowledge of those charged with governance. A 'material weakness' is defined in the SAS as '...a deficiency in design or operation which could adversely affect the entity's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements'. Such matters may have previously only been reported to management for corrective action and, if satisfactorily resolved, not necessarily reported to those charged with governance.

Qualitative aspects of accounting practices and financial reporting

18. In the course of the audit of the financial statements, auditors consider the qualitative aspects of the body's accounting practices and financial reporting process, and the SAS requires that the auditors' views on such matters are discussed in an open and frank manner with those charged with governance.