

Angela Cassels BA CPFA
Assistant Director of Audit (Local Government)
7th Floor
Plaza Tower
East Kilbride
G74 1LW

Telephone:
01355 619200

Fax:
01355 619201

Website:
www.audit-scotland.gov.uk

14 September 2006

Members of the Audit and Performance Review Committee
West Dunbartonshire Council
Garshake Road
Dumbarton
G82 3PU

Dear Members

Audit of West Dunbartonshire Council Annual Accounts 2005/06

International Standard on Auditing 260

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 letters that the auditor requested the Head 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 matter relevant to the audit.

I therefore wish to highlight the following issues:

- 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 Audit and Performance Review Committee 8th March 2006 and in the Code of Audit Practice prepared by Audit Scotland in July 2001;
- the Local Government in Scotland Act 2003 requires significant trading operations to break even over a three year rolling period. The first three year period ended in 2005-06 and the accounts disclose that of the trading operations reporting results for three years, only one trading operation, Catering Services, failed to achieve the statutory break even financial requirement (£624,000 deficit per the unaudited financial statements). This was due to the cost of equal pay settlements. I have referred to this matter by way of an explanatory paragraph in my auditor's report;
- a copy of the representation letter which audit requested be signed by the Head of Finance is attached to this letter;
- there is one known financial misstatement which has not been adjusted in the accounts. Details are appended to this letter. This misstatement is not material to the financial statements; and
- 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, will be highlighted in the final report to members on the 2005/06 audit.

In my view 6 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.

- a number of significant changes have been made to the draft 2005/06 financial statements submitted for audit. These relate to the following:
 - equal pay: £1.6 m has been charged to the revenue account to cover the cost of equal pay payments made to employees after 31st March 2006 and the estimated value of the compensation awarded to those employees who have not accepted the council's offer and are pursuing their claim through tribunals; and
 - voluntary severance costs: £800,000 has been charged to the revenue account to cover the related costs of those employees offered voluntary severance from the council. These costs are chargeable to 2005/06 as the council was committed to making these payments before the year end.

The net effect of the above adjustments is to increase the general fund surplus in 2005/06 by £2.4 million. As the equal pay and severance costs had already been earmarked from the original surplus included in the draft financial statements, the above adjustments do not change the value (£1.708 million) of funds being carried forward to 2006/07 available for other purposes.

- the accounts include as part of creditors £4 million relating to unspent grants at the year end. These grants are ring fenced funds and are being carried forward to 2006/07. It is my view that in accordance with proper accounting practice, these balances should be shown as part of the closing general fund balance and be earmarked for use in 2006/07. This accounting practice was also raised with members in 2004/05. I am still considering my view on this and

West Dunbartonshire Council 2005/06

whether I will be asking for the accounts to be changed. I will update the Committee at the meeting on 20 September;

- the 2005/06 financial statements reported the consolidated position of the West Dunbartonshire Council Group (council plus associate entities) for the first time in accordance with recommended accounting practice. As at 31 March 2006, the Group reported net liabilities of £61.836m, mainly due to the pension liabilities relating to joint boards and committees. The council has stated that the financial position of these associate boards and committees remain assured and remains sound. The Group financial statements have therefore been presented on a going concern basis; and
- lender option borrower option loans (LOBOs) are variable rate loans whereby, if the lender decides to change the interest rate at certain predetermined dates, the borrower has the option whether to accept the change or repay the loan principal. There is currently a debate over the appropriate accounting treatment of LOBOs, specifically whether the characteristics of a LOBO require any premium arising from a restructuring exercise to be recognised immediately rather than over the life of the replacement borrowing. This is an issue which applies to a number of local authorities. As at 31 March 2006 the council had premiums valued at £10.915 million, incurred on previous debt restructurings where the replacement loan was a LOBO. The council are writing off these premiums over the average term of the replacement loans.

As included in the representation letter signed by the Head of Finance, this approach has been taken because the council considers that the overall economic effect of the original and replacement borrowing is substantially the same. In reaching this view the council has taken into account:

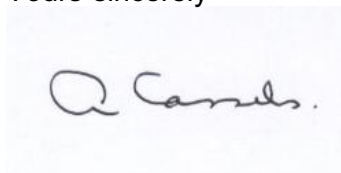
- the definition of the term 'overall economic effect' offered by the SORP guidance notes;
 - the expected stability of interest rates over the period of replacement borrowing ;
 - that there is no evidence that lenders have sought in practice to impose significant interest rate increases or that authorities have refused to accept any increases; and
 - they expect the loans to run to maturity.
- at the time of writing this letter, audit had only recently been provided with supporting working papers reconciling the balance on sundry debtors and the cash received from non domestic rates. There are values on these papers which will need to be reviewed further by audit. As these are important reconciliations which provide me with assurance on the accuracy of the non domestic rates and debtors balances, our audit checks will have to be satisfactorily completed before I can issue my auditor's report.
 - the council has an agreed target for holding general fund reserves of 2% of gross expenditure (£4.1m for 2006/07). The need to fund equal pay and voluntary severance packages has reduced the general fund to £1.708 m, a level substantially below that recognised as prudent by members. We understand that the council plan to restore the level of balances over the next three years and that the contingent balance of £3.036 million included in the 2006/07 revenue budget provides for a projected surplus of £ 0.736 million.

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 West Dunbartonshire 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 the help and assistance received during the audit of this year's accounts which has enabled me to certify the accounts by the Controller of Audit's target date.

West Dunbartonshire Council 2005/06

Yours sincerely

A rectangular box containing a handwritten signature in black ink. The signature appears to read "A Cassels." with a period at the end.

Angela Cassels
Assistant Director of Audit (Local Government)

Enc

**WEST DUNBARTONSHIRE COUNCIL
SCHEDULE OF UNADJUSTED ERRORS
2005/2006**

	CRA Expenditure	Creditors
Understatement of creditors relating to a payment to a contractor	£87,281	£87,281
OVERALL EFFECT	Expenditure understated by £87,281	£87,281 understated