AUDIT COMMITTEE

The Audit Committee will have met earlier on 20th May. A verbal report will be given by the Vice-Chairman, Jackie Stark. Formal minutes of the meeting will be brought to the Finance and Resources Committee in due course.

A copy of the BDO Stoy Hayward Audit Management Letter is attached for information (not discussion by this committee).

A copy of the Minutes of the Audit Committee meeting held on 19th March is also attached.

PAUL BAKER
Secretary to the Finance & Resources and Audit Committees

HEALTH PROFESSIONS COUNCIL

AUDIT COMMITTEE

MINUTES OF PRIVATE MEETING

of the Audit Committee held at Park House, 184 Kennington Park Road, London, SE11 4BU on Wednesday 19th March 2003

PRESENT

Dr Sandy Yule, Chairman
Mrs Jackie Stark, Vice-Chairman
Ms Ann Foster
Mr Daniel Ross (co-opted)

Mr David Robinson (BDO Stoy Hayward)
Mr Michael Kyriakides (BDO Stoy Hayward)

Mr Paul Baker FCA (Secretary)

1 APOLOGIES FOR ABSENCE

1.1 There were no apologies for absence.

2 APPROVAL OF AGENDA

2.1 The Draft Agenda was adopted as the Agenda for the Meeting.

2 APPROVAL OF NOTES OF THE MEETING OF THE PROPOSED AUDIT COMMITTEE HELD ON 8th November 2002

2.1 With the exception of the term "designate" against Sandy Yule's name, the Notes were approved.

3 MATTERS ARISING (not otherwise dealt with on the Agenda)

4.1 Jackie Stark raised a question concerning Section 4 of Note 6.1 "The Audit Committee and its relationship with BDO Stoy Hayward." She questioned that there should be "mis-statements identified by the audit that have not been adjusted by management".

4.2 David Robinson explained that there might be immaterial amounts where alteration or correction would not be insisted upon in the accounts. Normally anything of material size would be adjusted prior to audit completion.

5 TERMS OF REFERENCE

5.1 The draft Terms of Reference previously circulated were discussed.

5.2 It was agreed that in normal circumstances only an hour should be needed for discussions with the auditors and that for practical terms 1½ hours should be set aside. If there were particular problems the meeting could be extended.

5.3 The Committee AGREED the Terms of Reference.

SUBJECT TO FINANCE & RESOURCES COMMITTEE RATIFICATION

6 STANDING ORDERS

6.1 The draft Standing Orders previously circulated were discussed

6.2 It was agreed that paragraphs 30 and 36, which referred to public access to meetings should be eliminated. All meetings were to be held in private (as advised by the Solicitor)

6.3 It was agreed that in paragraph 22 "off" should be replaced by "of".

6.4 With these exceptions, it was AGREED that the Standing Orders be adopted.

SUBJECT TO FINANCE & RESOURCES COMMITTEE RATIFICATION

6.5 Appointment of Vice-Chairman
Under paragraph 8 a Vice-Chairman could be appointed and it was unanimously AGREED that Mrs Jackie Stark be appointed as Vice-Chairman of the Committee.

6.6 It was AGREED that there should be an indication on the website that all meetings of the Audit Committee would be held in private and why.

6.7 It was noted that originally the Committee might have thought that its work might have included other matters than financial ones and it was noted that the agreed Terms of Reference restricted the Committee to only those. The Chairman of the Finance & Resources Committee had confirmed this to Sandy Yule, who agreed that he would take this matter up again with the Finance & Resources Committee. David Robinson indicated that from his experience audit committees tended to restrict themselves to financial matters but often had this increased by internal agreement.

7 FINANCIAL RISKS

7.1 The tabled paper, being an extract of the financial risks from the Chief Executive's risk assessment due to be put forward to the Privy Council, was NOTED and AGREED.

7.2 Ann Foster emphasised the current risks within the investment portfolio (and pension fund portfolio), reminding the meeting of the need to minimize risk by over-exposure to equities in the current financial climate. This would be mitigated by regular presentations by the investment managers and constant review of the parameters.

7.3 The adherence to tendering procedures was noted. The formal tendering level needed setting as soon as possible.

7.4 The risk analysis was a live document and needs at least annual review.

8 PROPOSED AUDIT WORK

8.1 David Robinson tabled his paper, which is set out in these minutes for completeness.

Audit Strategy Document

We are about to commence the first audit of Health Professions Council for the year ending 31 March 2003 and have agreed a timetable with Paul Baker. Our audit fieldwork will commence on 22 April 2003 and will culminate in the Finance Committee considering and approving the accounts for the year ending 31 March 2003 on 20 May 2003.

We have considered our audit strategy and consider that the major financial risk areas for Health Professions Council are as follows:

1. *The collection systems following the trail from registered registrants through to invoicing, cash collection and onward to banking.*

2. *Revenue recognition by ensuring that the revenue is allocated to the correct accounting period.*

3. *Ensuring that the tendering procedures with regard to expenditure are being adhered to.*

4. *Ensuring that all expenditure is authorised in accordance with HPC's procedures.*

5. *Ensuring that the cheque signatory procedures are adhered to.*

6. *Reviewing the IT system to ensure that there is adequate password control, data back-up and disaster recovery.*

7. *Reviewing major areas of expenditure in the Profit & Loss Account and in particular, legal costs and ensuring that lawyers' unbilled legal costs are accrued for in HPC's accounts.*

8. *Ensuring that HPC does not face litigation with regard to any "incompetence".*

9. *Reviewing the investment portfolio to ensure that the value included in HPC's accounts is the market value and that income on those investments has been properly accounted for.*

10. *Reviewing the accounting policies to ensure that they are appropriate for HPC.*

11 *Considering the value of the freehold property contained in the accounts.*

12 *Reviewing HPC's forecasts for the next year to ensure that after taking account of any borrowing facilities, the company has adequate funds in order to meet its liabilities as and when they fall due, i.e. to ensure that HPC is a going concern.*

8.2 The paper was considered very helpful and showed that not everything covered was financial, although most matters carried a financial element.

8.3 It was AGREED that a programme of Internal Audit work could be set after the external audit of the Financial Statements ending 31st March 2003.

9 ANY OTHER BUSINESS

9.1 There was no other business.

10 DATE AND TIME OF NEXT MEETING

10.1 The next meeting was confirmed as Tuesday May 20th at 10 a.m. at a venue to be determined.

Signed ……………………………………. (Chairman)

Date …………………………..

Health Professions Council
Report to the Audit Committee
For the year ended 31 March 2003

BDO Stoy Hayward
Chartered Accountants

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Introduction

Scope of our engagement

We are engaged as the first auditors to the Health Professions Council (HPC) and its charitable subsidiary The Professions Supplementary to Medicine Charitable Trust (PSMCT).

Our terms of engagement are set out in our letter of engagement.

Purpose of the report

The purpose of this report is to provide you with feedback from our annual audit of HPC and its subsidiary. It highlights and explains the key audit and accounting issues which have arisen during the course of our work and which we wish to draw to the attention of the committee.

This report was prepared using the information obtained during the course of our external audit of the financial statements for the year ended 31 March 2003, together with discussions with staff.

Status of the audit

Audit status as at 14 May 2003

We confirm that:

- We have substantially completed our audit work of the HPC, after having spoken to various members of the finance department.
- No material adjustments are proposed to the HPC financial statements, excepting presentational amendments.
- No unadjusted errors have been identified.
- Timetable for completion:

  20 May 2003 Finance & Resources Committee Meeting

  4 June 2003 Council meeting

We would like to take this opportunity to thank the staff of HPC for their time and assistance.

Based on our audit work to date, we expect to issue an unqualified audit report.

Outstanding areas

The following areas, which may impact on the financial statements, remain outstanding at the date of this report:

- Confirmation of bank approval of the requested £1m overdraft. If the bank wishes to secure it against the freehold property, details of this will also be required.
- Confirmation from the Department of Health that £252k of the new grant for 2003/04 is to be allocated to 2002/03 capital expenditure. Currently the additional £252k, has been included as a debtor at the year-end and in creditors as 'Capital grant receivable', awaiting release over the period of depreciation of the registration system.
- Confirmation of the decision made by HPC whether to request that another £73k of the £1.125m grant from the Department of Health for 2003/04 to be allocated to 2002/03 revenue expenditure. If this is decided upon, we will require confirmation from the Department of Health that this has been agreed. If this adjustment is made it would cover some of the additional revenue costs and would therefore reduce the deficit for the year by £73k.
- Post balance sheet event review to date and signed off.

- Receipt of signed representation letter (see appendix 1).
- A copy of the original letter or agreement from the Department of Health for the 2002/03 grant, detailing any conditions, or lack thereof, placed on the grant to the HPC.
- Solicitors' letter from Ormerods.

Financial analysis

	HPC Year ended 31/03/03 £	HPC BUDGET 31/03/03 £	CPSM Year ended 31/03/02 £
Fee income	**4,002,154**	3,977,300	3,708,453
Grant income	**1,816,452**	2,000,000	-
Other income	**88,424**	119,000	62,067
Total income	**5,907,030**	6,096,300	3,770,520
Payroll costs	**1,886,813**	1,710,454	1,506,151
Grant-funded expenditure	**2,227,689**	2,000,000	-
Other administrative expenditure	**2,686,209**	2,857,810	2,086,396
Total expenditure	**6,800,711**	6,568,264	3,592,547
(Deficit) / surplus	**(893,681)**	(471,964)	177,973
Unrealised losses on investments / revaluation	**(514,492)**	-	(269,857)
Retained deficit for period	**(1,408,173)**	(471,964)	(91,884)

The financial results of HPC have been compared to the 2003 budgeted values as well as the predecessor organisation the Council for Professions Supplementary to Medicine (CPSM) previous year's results.

Income commentary

The number of registrants has continued to rise in the year-ended 2003 and is expected to continue to do so in the future. This has resulted in an increase in fee income, despite the setting back of the date for the scheduled fee increase and the participation of new professions.

Grant income and expenditure are new items the HPC as a result of the Department of Health granting funding to set up and establish the new HPC, as well as bring the offices up to the required capacity and quality. These amounts will be lower in future years as the majority of the additional work required to set-up the new organisation and establish new procedures was completed in the year-ended 2003. Budgeted grant income was however £250K higher than budget.

Other income is mainly income from the investments held, which has remained fairly consistent, less any loss on disposals, which was lower in 2003 than 2002.

Expenditure commentary

Payroll costs were significantly higher in 2003 as a number of additional employees were taken on for the administration of the new organisation, as well as one-off tasks including the running of the various consultation events and organising the appointment of 'partners'. Two employees also left in the year, resulting in large redundancy costs and corresponding recruitment fees and which explains most of the difference between the actual cost and budget.

Grant expenditure was new, as discussed above. However the costs of establishing the organisation lead to an adverse budgeted variance of £227K that is as yet unfunded and has to be paid out of the Council's reserves. The refurbishment costs of the building have been included in expenditure and has not been capitalised on the basis that these works do not enhance the value of the freehold.

The increase in general administrative expenses as compared to CPSM is partly a result of the increased registrants and partly a result of the reorganised and expanded activities of the organisation as the new HPC, although the actual costs were well within the budget.

In total HPC made an operating deficit of £894K which is broadly due to the additional costs in the restructuring of the organisation and the launch of HPC. Also included above is the £514K unrealised loss on investments.

Financial Position as at 31 March 2003	**HPC as at 31/03/03 £**	CPSM as at 31/03/02 £
Tangible fixed assets	**2,691,908**	1,564,026
Investments	**1,322,147**	2,146,012
Debtors	**1,037,192**	77,076
Cash at bank	**504,924**	1,300,067
Creditors	**(2,309,166)**	(549,859)
Deferred Income	**(2,238,563)**	(2,120,919)
Net Assets	**1,008,442**	2,416,615
Accumulated Fund	**1,008,442**	2,416,615

The balance sheet of HPC has also been compared to the CPSM balance sheet as at 31 March 2002 as shown above.

The increase in tangible fixed assets from the previous year is mainly due to the capitalisation of the new registration system.

Investments have significantly decreased as a result of the downturn of the stock market currently resulting in unrealised losses in investments as already highlighted above.

Debtors have increased to over £1 million as a result of the inclusion of physiotherapist debtors in the region of £500K as the monies were due for their subscriptions before the 31 March 2003. It also includes £325K of grants for 2003 yet to be received from the Department of Health.

Cash has reduced significantly to just over £500K at 31 March 2003 and this has occurred mainly due to the deficit over expenditure over income which has not been covered by grant expenditure.

Creditors has increased considerably on last year as the un-amortised element capital grant for the purchase for the new registration system (currently in fixed assets) has been included within creditors, as is higher trade creditors reflecting the refurbishment costs that have yet to be paid.

The accumulated funds at 31 March 2003 for HPC is £1,008,442. Given that the budget for 2004 estimates that HPC will have a deficit of £500K, reserves is projected to therefore be £500K at 31 March 2004.

The ongoing deficit, may lead to cash flow problems, and although this will be addressed by a £1 million overdraft facility, the committee should be aware of the cash flow situation during the year, and that HPC should be trading within the facilities available.

Emerging accounting issues

1. Implications of current developments: external

The purpose of this section is to set out areas where we believe that HPC may exploit opportunities or should take care to avoid potential financial problems.

5.1 International Accounting Standards

The committee should be made aware of international harmonisation of accounting standards. Current moves by the UK Accounting Standards Board (ASB) to harmonise UK accounting standards with those of the International Accounting Standards Board (IASB), together with the compulsory adoption of the latter by Eurozone countries by 2005, suggest that HPC may wish to seek early adoption.

These recent moves by the ASB are set out at (a) and (b) below. Their provisions are described in summary form, although not all will be of immediate relevance to HPC.

(a) Recent Financial Reporting Exposure Drafts (FREDs)

The ASB has issued seven financial reporting exposure drafts (FREDs), all aimed at achieving convergence between UK GAAP and International Accounting Standards by 2005.

We have highlighted the exposure drafts that we believe to be of future relevance to HPC.

Relevant to HPC

FRED 25 'Related Party Disclosures'

FRED 25 proposes replacing FRS 8 'Related party disclosures' with its international counterpart.

The definition of a related party is not quite as comprehensive as that contained in FRS 8. In addition, the FRED does not require the names of transacting related parties to be disclosed.

FRED 27 'Events After the Balance Sheet Date'

FRED 27 proposes replacing SSAP 17 'Accounting for post balance sheet events' with its international counterpart.

The adoption of a stricter definition of 'adjusting events' would mean that for, example, dividends declared after the balance sheet date could not be recognised as a liability.

FRED 29 'Property, Plant and Equipment; Borrowing Costs'

FRED 29 includes the provisions of the proposed improved version of IAS 16 'Property, Plant and Equipment' and IAS 23 'Borrowing Costs'. It will replace FRS 15 'Tangible Fixed Assets'.

The proposals have much in common with FRS 15, although there are certain differences notably in the method of valuation and the reporting of revaluation surpluses and deficits and are discussed further below:

Basis of valuation

The international exposure draft requires revaluation to *fair value*, whereas FRS 15 requires revaluation to *current value.*

IAS 16 states that the fair value of land and buildings, plan and equipment is usually its market value. Where there is no evidence of market value because of the asset's specialised nature, depreciated replacement cost should be used instead.

FRS 15, on the other hand, defines current value in terms of the 'value to the business' model, which is the valuation model that the ASB has preferred hitherto for including assets at current values. The value to the business model seeks to provide a value that is relevant to economic decision-making, being the loss that the entity would suffer if it were deprived of the asset. Under the value to the business model, current value is the lower of replacement cost and recoverable amount. FRS 15 reflects this valuation basis by requiring:

a) non-specialised properties to be valued on the basis of existing use value (EUV), with the addition of notional directly attributable acquisition costs where material;
b) specialised properties to be valued on the basis of depreciated replacement cost; and
c) properties surplus to an entity's requirements to be valued on the basis of open market value (OMV), with a deduction, where material, for expected directly attributable selling costs.

Where OMV is materially different from EUV, the reasons for the difference should be disclosed in the notes to the accounts.

FRS 15, therefore differs from IAS 16 in requiring non-specialised properties to be valued at EUV. IAS 16 states that fair value is usually 'market value', which many would take to be OMV. An important practical effect of the difference arises where OMV is greater than EUV because, say, it reflects the possibility of the property being developed for an alternative use. FRS 15 does not permit the higher value for alternative use to be reflected in an entity's balance sheet (unless the property is surplus to the entity's requirements), although it does require information about the higher value to be disclosed in the notes. IAS 16 does not restrict to EUV the value that is reflected in the balance sheet. It is also possible for OMV to be less that EUV, for example, where a property has been adapted to the needs of the current occupier and there is little prospect of finding a buyer in the market who could use those adaptations. In such a case, IAS 16 would require OMV to be used (unless the property were regarded as specialised, in which case, as explained above, depreciated replacement cost would be used).

Reporting of revaluation gains and losses

Revaluation losses may in some cases be reported differently under the international exposure draft than they would be reported under FRS 15:

a) IAS 16 requires any revaluation loss that exceeds an existing revaluation surplus in respect of an asset to be recognised as an expense in the profit and loss account. FRS 15 requires a revaluation loss that exceeds an existing revaluation surplus in respect of an asset to be recognised in the statement of total recognised gains and losses to the extent that the asset's recoverable amount is greater than its revalued amount (ie there is no impairment). The IAS treatment has the advantage of being simpler to apply, although the UK's treatment is consistent with the value to the business model.
b) IAS 16 requires any revaluation loss to be charged to equity (equivalent to the statement of total recognised gains and losses) to the extent that there is an existing revaluation surplus in respect of the asset. FRS 15 requires any revaluation loss that is clearly caused by the consumption of economic benefits (ie an impairment) to be charged as an expense in the profit and loss account, regardless of whether there is an existing revaluation surplus in respect of the asset.

FRS 15 (paragraph 71) gives a special treatment to gains and losses on revaluation of assets held by insurance companies and insurance groups (including assets of the long-term business), as part of their insurance operations. For these, revaluation changes are required to be included in the profit and loss account rather than under the general revaluation rules. There is no corresponding special treatment in IAS 16. The ASB proposes, as a transitional measure, that the present exemption in FRS 15 should be retained in a new UK standard based on the international exposure draft pending the outcome of the IASB's projects on insurance and performance reporting.

(b) ASB Consultation Paper 'IASB Proposals to amend certain International Accounting Standards (IASs)'

The ASB has also issued a consultation document reproducing the IASB's text of six other IASs proposed for revision. The ASB is not proposing to implement these standards in the UK before 2005. However, it is requesting comments on the IASB's proposed improvements and on any other aspects of the standards that the ASB should request the IASB to review.

The six IASs addressed in this consultation document are:

IAS 1: 'Presentation of Financial Statements';
IAS 8: 'Accounting Policies, Changes in Accounting Estimates and Errors';
IAS 17: 'Leases';
IAS 27: 'Consolidated and Separate Financial Statements';
IAS 28: 'Accounting for Investments in Associates'; and
IAS 40: 'Investment Property'.

Audit Issues

Commentary on HPC performance with respect to the key risk areas:

1) *The collection systems following the trail from registered registrants through to invoicing, cash collection and onward to banking.*

   No problems identified during the audit. The walkthrough completed on registrants through to cash receipts worked as per the procedures manual. Testing on the different income streams suggested that all registrants were paying or being removed from the register.

2) *Revenue recognition by ensuring that the revenue is allocated to the correct accounting period.*

   Testing on income and deferred income balances suggested that revenue was correctly allocated over the period the fee relates to.

3) *Ensuring that the tendering procedures with regard to expenditure are being adhered to.*

   Per discussion with finance department, this is not yet being fully adhered to. Tendering is to be used for items over £30k: the tendering procedure was utilised for the refurbishment contract, however it was not used for the new registration system. 3 quotes are to be obtained for all items individually more than £1k. There was no evidence of this occurring as yet.

4) *Ensuring that all expenditure is authorised in accordance with HPC's procedures.*

   No problems identified during the audit. The walkthrough completed on expenditure showed expenditure being correctly authorised.

5) *Ensuring that the cheque signatory procedures are adhered to.*

   No problems identified during the audit.

6) *Reviewing the IT system to ensure that there is adequate password control, data back-up and disaster recovery.*

   Passwords are employed for both the registration and finance system. Back-ups are performed every night and the tape is taken off site. In the event of a disaster (i.e. theft, fire) HPC employ a recovery service company which has computers and the relevant hardware and software that will enable for the organisation to continue to operate within days. There is, however, no formal document for procedures to adopt in an event of a disaster, although we understand that is currently being worked on.

7) *Reviewing major areas of expenditure in the Income and Expenditure Account and in particular, legal costs and ensuring that lawyers' unbilled legal costs are accrued for in HPC's accounts.*

   No problems identifed from the audit review of all major expenditure areas. Provision has been made for costs relating to ongoing legal cases. Lawyers' costs are accrued for as necessary.

8) *Ensuring that HPC does not face litigation with regard to any 'incompetence'.*

   We have found no instances during the course of our work of any activities, or procedures that could expose HPC to litigation arising from 'incompetence'

9) *Reviewing the investment portfolio to ensure that the value included in HPC's accounts is the market value and that income on those investments has been properly accounted for.*

   No problems identified during the audit. Investments and investment income appears to be correctly stated.

10) *Reviewing the accounting policies to ensure that they are appropriate for HPC.*

   Accounting policies appear reasonable.

Other internal control issues identified during the course of our audit

Below are the internal control weaknesses that we have identified during the audit. A more thorough investigation of the accounting and internal control procedures will be conducted by internal audit later this year.

Depreciation:
The depreciation policy for freehold buildings of 2% per annum has been applied to the total valuation figure for the land and buildings owned by the HPC. If the accounting standards are followed, the land should not be depreciated as land rarely loses any value over time. The land element of the revalued figure should be split out before depreciating, in order to avoid unnecessary over-depreciation.

Bankings:
The walkthrough completed on cash receipts showed a small difference (£4) between the amount entered on the system as the total receipts for the day and the amount actually banked. This difference had been noted, but not investigated. This is a proportionally small amount, however differences should be investigated or kept track of, to ensure this is not a problem over a longer period of time.

Staff services to the charitable trust (PSMCT):
HPC currently supplies staff to the charity for it to pursue its charitable objectives. However the 'supply of staff' may lead to a VAT liability for HPC for this supply. We recommend that if these members of staff actually work for the charity, then their contracts of employment be amended to reflect this. Indeed it would be appropriate for all contracts to cover work for both HPC and PSMCT.

Management Reporting
Current management reporting includes a budgeted balance sheet and income expenditure account but does not include a cash flow forecast. Given that working capital and cash availability will be crucial over the next year, we would recommend that a cash flow forecast be prepared and compared to the actual monthly cash position.

Custody of investments
Currently the investment advisors are the custodian of HPC's investments as they are held in a nominee account. The implication of this is that if there are internal control weaknesses present in the operations of the investment advisors there is a possibility that the investment funds of HPC may be misappropriated. In order to obtain assurance of state of internal controls present HPC should obtain a report on the internal controls of the investment advisors acting as custodian as directed by (FRAG 21/4). This report is verified by a firm of reporting accountants, who comment on the internal controls present in their report. *(since received)*

APPENDIX 1

DRAFT LETTER OF REPRESENTATION

TO BE TYPED ON YOUR HEADED NOTEPAPER

BDO Stoy Hayward
Emerald House
East Street
Epsom
Surrey
KT17 1HS

Dear Sirs

Financial Statements at 31 March 2003

We confirm to the best of our knowledge and belief, and having made appropriate enquiries of other directors and officials of the organisation, the following representations given to you in connection with your audit of the Council's financial statements for the year ended 31 March 2003.

We acknowledge as council members our responsibility for the financial statements which have been prepared for the Council. All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Council have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of all management and Council meetings have been made available to you. There were no loans, transactions or arrangements between the Council and its council members and their connected persons at any time in the year.

In relation to those laws and regulations which provide the legal framework within which our Council is conducted and which are central to our ability to conduct our Council, we have disclosed to you all instances of possible non-compliance of which we are aware and all actual or contingent consequences arising from such instances of non-compliance. There have been no events since the balance sheet date which either require changes to be made to the figures included in the financial statements or to be disclosed by way of a note. Should any material events of this type occur, we will advise you accordingly.

We are responsible for adopting sound accounting policies, establishing and maintaining internal control, to, among other things, help assure the preparation of the financial statements in conformity with generally accepted accounting principles and preventing and detecting fraud.

We confirm that the above representations are made on the basis of enquiries of management and staff with relevant knowledge and experience (and, where appropriate, of inspection of supporting documentation) sufficient to satisfy ourselves that we can properly make each of the above representations to you.

Yours faithfully

(Signed on behalf of the board of council)

Date: ....