

Government and Public Sector

# Darlington Borough Council

2009/10 Annual Audit Letter

November 2010

The Members  
Darlington Borough Council  
Town Hall  
Feethams  
Darlington  
County Durham  
DL1 5QT

November 2010

Ladies and Gentlemen

We are pleased to present our Annual Audit Letter summarising the results of our 2009/10 audit. We look forward to presenting it to Members.

Yours faithfully

PricewaterhouseCoopers LLP  
Encs

***Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies***

*The 'Statement of responsibilities of auditors and of audited bodies' issued by the Audit Commission in April 2008 applies to our 2009/10 audit of Darlington Borough Council under the Code of Audit Practice for Local Government Bodies issued by the Audit Commission in July 2008. A copy of the statement is available from the Chief Executive of Darlington Borough Council. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is expected of the audited body in certain areas. Our reports and management letters are prepared in the context of this Statement and the Code of Audit Practice. Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the audited body and no responsibility is taken by auditors to any Member or officer in their individual capacity or to any third party.*

# Contents

**Section**

Introduction..... 4  
Audit findings ..... 5  
Pensions..... 9  
Matters for future accounting periods ..... 11

# Introduction

## The purpose of this letter

The purpose of this letter is to provide a high level summary of the results of the 2009/10 audit work we have undertaken at Darlington Borough Council that is accessible for Members and other interested stakeholders.

We have already reported the detailed findings and recommendations from our audit work to those charged with governance in the following reports:

- Audit opinion for 2009/10 financial statements, incorporating the conclusion on Value for Money;
- Report to those charged with Governance (ISA (UK&I) 260); and
- Annual Certification Report 2008/09.

We have collated the recommendations made in these reports in a summary report to management. The matters reported here are those that we consider to be the most significant for the Authority.

## Scope of work

Our audit work is conducted in accordance with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission.

The Authority is responsible for preparing and publishing its financial statements, including the Annual Governance Statement. It is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

As auditors we are responsible for:

- forming an opinion on the financial statements;
- reviewing the Authority's Annual Governance Statement;
- forming a conclusion on the arrangements that the Authority has in place to secure economy, efficiency and effectiveness in its use of resources; and
- undertaking any other work specified by the Audit Commission.

# Audit findings

## Accounts

We audited the Authority's accounts in line with International Standards on Auditing (UK & Ireland) and issued an unqualified audit report on 30 September 2010.

We found that the draft accounts submitted for audit and the supporting working papers were of high quality.

We identified a total of seven misstatements in the draft accounts. Two of these were adjusted by management prior to publication of the Statement of Accounts. The remaining five misstatements (which totalled £287,000) were not material individually or in aggregate.

## Conclusion on Use of Resources

We were required to issue a conclusion on the adequacy of the Authority's arrangements for ensuring economy, efficiency and effectiveness in its use of resources.

We issued an unqualified conclusion on the Authority's arrangements for its Use of Resources on 30 September 2010.

## Comprehensive Area Assessment

Following the government announcement to abolish comprehensive area assessment (CAA), all work on Use of Resources for Comprehensive Area Assessment ceased at the end of May. Therefore, we have not completed this work as planned however we can report that there were no significant matters arising from our work which we feel should be reported to Members.

## Annual Governance Statement

Local Authorities are required to produce an Annual Governance Statement (AGS) which is consistent with guidance issued by CIPFA / SOLACE. Darlington Borough Council's 2009/10 AGS was published with the Statement of Accounts.

We reviewed the process adopted by the Council to collate the evidence used to support the AGS. We also considered the content of the Statement to ensure that it complied with CIPFA / SOLACE guidance and to determine whether it was misleading or inconsistent with other information known to us from our audit work. We found no areas of concern.

## Audit work in response to risks identified

In our planning risk assessment we identified the following areas for audit focus in 2009/10:

- **Introduction of IFRS (Accounting for PFI schemes):** Local Government will adopt International Financial Reporting Standards (IFRS) in full in 2010/11. Project planning for this transition is already well underway at the Council. Information required for the transition (e.g. comparatives for the 2010/11 statements) was collected during the 2009/10 closedown.

The 2009 Local Government SORP applicable for the 2009/10 accounts required that PFI schemes be accounted for under IFRS guidance. The Council has one PFI scheme - the Education Village and Harrowgate Hill Primary School.

These assets came on to the Council's balance sheet for 2009/10 under the new accounting

arrangements. This change involved some complex accounting adjustments, including prior period adjustments to show the position as if these requirements had applied since the beginning of the PFI scheme.

We reviewed the outputs of the work performed by the Council, with support from its advisors, in calculating and accounting for the adjustments required to bring the PFI assets on to the balance sheet.

- **Accounting for council tax:** Accounting guidance for Local Authorities (documented in the 2009 Local Government SORP) changed the requirements for the way in which Council Tax income and debtors and creditors should be accounted for in the 2009/10 financial statements.

We reviewed the prior period adjustments that have been made in response to the change in requirements.

We also assessed compliance with the changes in our testing of debtors, creditors and reserves.

- **Contract management:** Ineffective contract management and ongoing monitoring of contract performance could result in inefficiencies and reduced value for money. In particular contractual overruns on the Pedestrian Heart scheme have led to questions being raised by electors in this area. We reviewed the circumstances surrounding the delays and overspends on the Pedestrian Heart project (see below).

We have also reviewed contract information relating to the Authority's PFI scheme.

- **Retirement benefits:** There are two important aspects of accounting for retirement benefits that are influenced by the current economic climate:
  - Discount rates - as the market for high quality corporate bonds has become shallower, problems have arisen in establishing discount rates for the purposes of accounting for retirement benefits.
  - Valuation of scheme assets - the same guidance for determining values for financial assets applies to pension fund assets. Problems have arisen in earlier years where actuaries have used estimates for returns on assets based on trends before the year-end that have proven to be materially inaccurate. The current instability of the markets makes recurrence of this problem likely in 2009/10. The Council will need to ensure that out-of date figures are identified and corrected.

We reviewed the assumptions used by the actuary as part of our work on pensions to obtain assurance that these were reasonable.

We also liaised closely with the Audit Commission, the auditors of the local government pension scheme administered by Durham County Council, to determine whether there were any material errors in the pension fund balances that affected our audit of Darlington Borough Council's accounts.

We did not identify any matters which required adjustments to be made to the Council's retirement benefit accounting entries. For further detail on pension arrangements please see the "Pensions" section below from page 9.

- **Involvement in other entities:** Current economic conditions could have resulted in changes in how an entity in which the Council has an interest is funded or to how it makes key financial and operating decisions.

These changes could be significant to decisions about whether the entity is included in group accounts and, if so, the basis for consolidation.

If there had been a significant deterioration in the results and balance sheet of entities that have

not previously been consolidated on the grounds of materiality, the decision not to consolidate may have needed to be revisited.

We reviewed the position of all entities in which the Council retains an interest and we were satisfied that the current accounting treatment remained appropriate.

### National Fraud Initiative

As part of our overall programme of work at the Council, we also performed a review of progress against the National Fraud Initiative (NFI). This work was mandated by the Audit Commission and involved a review of progress made by the Council in following up any possible fraud matches.

The Audit Commission has recently published the NFI outcomes for all participants and the impacts it has claimed for Darlington Borough Council are as follows:

NFI Area	Impact (£)
Housing Benefit	32,419
Payroll and other investigations	1,170
Additional Housing Benefit	9,600
Additional employee questions	5,000
Adhoc overpayments	6,779
Creditors	3,878
Late savings	138,822
<b>Total</b>	<b>197,668</b>

### Electors' questions

We have received a number of questions from electors during the year. In particular, there was continuing interest in the Council's management of the Pedestrian Heart scheme and the delays and overspend that occurred when the contractors struck a gas main. We have completed our responses to these queries and have also issued a letter to the Director of Corporate Services and the Chief Executive setting out our findings.

Our work focused on:

- value for money issues related to the overspend on the project; and
- data management arrangements at the Council.

We have reviewed the circumstances surrounding the delays and the overspend that occurred through discussions with officers and reviews of documentation held by the Council, including expert and legal reports.

Both the overspend and poor information retention by the Council could have influenced our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness in the use of resources. However, we have concluded that, in the context of the overall sound arrangements that the Council has in place to secure value for money and the more robust data quality arrangements that are now in place, we would not qualify our value for money conclusion.

Notwithstanding this, we are aware that the delays and overspends associated with the scheme have caused considerable concern to the residents of Darlington and we have considered whether there is

a need to issue a public interest report on the Pedestrian Heart project. We concluded that there would be little public benefit in such a report because:

- Much of the relevant information that we would include in a public interest report is already in the public domain. Resources Scrutiny (15th December 2006, 12th November 2009) and Cabinet (6th October 2009) minutes are available on the website of Darlington Borough Council and present an open and detailed review of the management of the scheme.
- There has been significant press coverage of the Pedestrian Heart. The initial article reporting the gas main problem was published in the Northern Echo on 18th February 2006. Developments on the scheme were reported regularly throughout the project in the local press. The Northern Echo published an article on 2nd October 2009 which set out in detail the key points from the Ward Hadaway legal document and the areas of concern around the management of the Pedestrian Heart.
- The Council has taken steps to improve the management of large capital projects.
- In response to the risks arising from the Pedestrian Heart scheme, we have reviewed the management of some more recent projects at the Council and the results indicate that the new arrangements are generally robust.



# Pensions

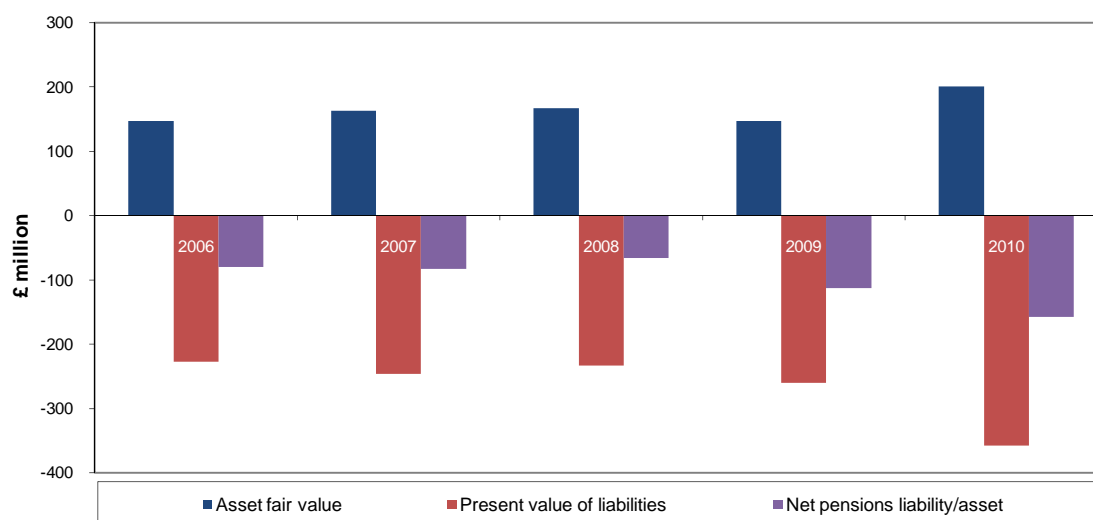
## Pensions estimate

The most material estimate included in the accounts is for pension liabilities in respect of employees who are members of the Durham County Council Pension Fund. The scheme is administered by Durham County Council. The net pensions liability at the balance sheet date is £156,950,000. This is an increase of £43,910,000 on the previous year.

The chart below shows the trend in pension assets and liabilities attributable to the Authority over the last 5 years. The Authority is not required to recover this deficit immediately, but it is an important factor in the assessment of future employer's pension contributions.

It can be seen on the graph that the fair value of pension assets has increased by approximately £54m.

**Trend in pensions assets and liabilities**



As a result of the change in inflation basis for pensions, which has been treated as a non-adjusting post balance sheet event, it is expected that the net pension liability on a CPI basis would be reduced by approximately 10% as compared with the RPI basis.

We have reviewed the reasonableness of the assumptions underlying the pension liability in the accounts in accordance with ISA (UK&I) 540 'Audit of accounting estimates'. Overall we are comfortable with the net effect of the assumptions adopted.

It is important that management understand and satisfy themselves that the assumptions underpinning the net pension liability are appropriate.

The Authority also participates in the Teachers' Pension Scheme, which is a multi-employer defined benefit scheme where the individual employers' share of the assets and liabilities of the scheme cannot be identified. Therefore, the Authority accounts for this scheme as a defined contribution

scheme under FRS 17 'Retirement benefits'. It recognises contributions payable for the year in the income and expenditure account but does not include a pension liability in the balance sheet for benefits earned by Authority employees.

# Matters for future accounting periods

## Financial standing

During 2010/11 councils faced in-year reductions in government funding and the recent Comprehensive Spending Review set out, in broad terms, significant further cuts. This coincides with increasing demands arising from factors such as demographic changes and reductions in fees and charges resulting from the economic downturn.

The scale and coincidence of these pressures has the scope to jeopardise the financial standing of all councils and, nationally, a number of strategies are being considered and/or adopted to mitigate the financial risks including:

- Restructuring;
- Other approaches to cost reduction including shared services;
- Increasing income and commercialisation;
- Changes to the scope of services delivered;
- Approaches to the delivery of services;
- Application of financial reserves.

In future audits, we will continue to monitor the approaches taken by Darlington Borough Council to address existing financial pressures and we will assess the Council's financial resilience and financial standing.

## Transition to International Financial Reporting Standards (IFRS)

The Code of Practice on Local Authority Accounting in the United Kingdom 2010 will apply to next year's financial statements. The new Code is the first to be prepared under IFRS.

The Authority needs to ensure that it has a good grasp of the changes to accounting requirements under the new Code. The authority should now have systems in place to collect and process the information needed to prepare IFRS based accounts and should at this stage be well progressed with preparation of comparative information as at 1 April 2010 for next year's financial statements.

Our early work on the 2010/11 financial statements indicates that progress with IFRS transition is progressing well and, at this stage, we do not anticipate any problems with restating the opening balance sheet and the prior year comparative information.

In our experience the key features of a successful IFRS conversion project have proved to be:

- Completed impact analysis and comprehensive conversion plans;
- The commitment of key stakeholders in the organisation;
- Operational steering and technical groups;

- Cabinet/audit committee oversight;
- Regular progress reporting against the plan;
- The necessary project management resources; and
- Appropriate and timely training for all members and officers with IFRS involvement.

### Clarity International Standards on Auditing (UK & Ireland)

We will be required to apply Clarity International Standards on Auditing (ISAs) for UK and Ireland to next year's accounts audit for the first time.

The Clarity ISAs overhaul existing auditing standards, both improving clarity of existing standards and introducing new requirements designed to improve audit quality and financial reporting.

A number of standards have been completely revised. There will be approximately one-third more explicit requirements in the standards applying to our audit next year.

The actual impact on cost of the audit will depend on a variety of factors, including how effectively we can work with you to obtain additional information needed to enable us to perform the required procedures. The principal impacts are expected to be in the areas of estimates and related parties.

