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Government and Public Sector

Darlington Borough Council

Report to those charged with governance (ISA 260 (UK&I))

2011/12 Audit

September 2012

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

September 2012

Dear Sirs

We are pleased to enclose our report to the Audit Committee in respect of our audit of Darlington Borough Council "the Authority" for the year ended 31 March 2012, the primary purpose of which is to communicate the significant findings arising from our audit.

The scope and proposed focus of our audit work was summarised in our audit plan, which we presented to the Audit Committee in March 2012. We have subsequently reviewed our audit plan and concluded that our original risk assessment remains appropriate.

We have completed the majority of our audit work and expect to be able to issue an unqualified audit opinion on the financial statements on 28 September 2012. At the time of writing, there are some outstanding matters, where our work has commenced but is not yet finalised, such as our review of subsequent events. We will provide an oral update on these matters at the meeting on 28 September 2012.

We look forward to discussing our report with you on 28 September 2012.

Yours faithfully

PricewaterhouseCoopers LLP

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

In April 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and of audited bodies'. It is available from the Chief Executive of each audited body. 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 to be expected of the audited body in certain areas. Our reports and management letters are prepared in the context of this Statement. 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.

Executive summary

The purpose of this report

Under the Auditing Practices Board's International Standard on Auditing (UK and Ireland) 260 (ISA (UK&I) 260) - "Communication of audit matters with those charged with governance" we are required to report to those charged with governance on the significant findings from our audit before giving our audit opinion on the accounts of the Authority. As agreed with you, we consider that "those charged with governance" at the Authority are the Audit Committee.

This letter contains the significant matters we wish to report to you arising from all aspects of our audit programme of work in accordance with ISA (UK&I) 260.

Our audit work during the year was performed in accordance with the plan that we presented to you on 23 March 2012. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. Accordingly, the audit does not ordinarily identify all such matters.

We have set out below what we consider to be the most significant matters that we have discussed with you in the course of our work.

Significant matters

As a result of the audit, a number of adjustments and presentational changes have been made to the draft financial statements, the majority of which relate to the valuation of fixed assets. Further detail is included in the response to the risk assessment table starting on page three.

We have discussed a draft version of this document with Elizabeth Davison and Peter Carrick on 15 August 2012. We will discuss the matters contained within this letter with the Audit Committee on 28 September 2012.

Please note that this report will be sent to the Audit Commission in accordance with the requirements of its standing guidance.

We would also like to take this opportunity to express our thanks for the co-operation and assistance we have received from the management and staff of the Authority throughout our work.

Audit approach

Response to our risk assessment

We raised a number of risks in our audit plan where we detailed the work we would perform as part of our audit approach. We performed procedures at interim and year end to address each of these risks and ensure that the financial statements are free from material misstatement.

We provide an update of the work performed below. Risks are categorised as follows:

●	*Significant*	Risk of material misstatement due to the likelihood, nature and magnitude of the balance or transaction. These require specific focus in the year.
●	*Elevated*	Although not considered significant, the nature of the balance/area requires specific consideration.
●	*Normal*	We perform standard audit procedures to address normal risks in all other material financial statement line items (these other risks are not detailed in this report).

Risk	Significant / elevated risk	Reason for risk identification	Audit response
Recognition of revenue and expenditure including the impact of the economic downturn	● *Significant*	Under ISA (UK&I) 240 there is a (rebuttable) presumption that there are risks of fraud in revenue recognition. We extend this presumption to the recognition of expenditure in local government. There is a risk that the Authority could adopt accounting policies or treat income and expenditure transactions in such a way as to lead to material misstatement in the reported financial position. The Authority is likely to be experiencing increased pressures on many of its budgets as economic conditions have worsened. Budget holders may feel under pressure to try to push costs into future periods, or to miscode expenditure to make use of resources intended for different purposes. Local government bodies continue to be expected to make significant efficiency savings over the coming years, on top of those already delivered. There is a risk that savings plans may not be robust or based on long term solutions which could result in short term, year-end actions to ensure that the targets are met. Whilst we know the Authority have	We have understood and evaluated controls relating to this risk and have tested key controls to confirm they are operating effectively. We have considered the accounting policies adopted by the Authority and subjected income and expenditure to the appropriate level of testing to identify any material misstatement. We have reviewed the Authority's budget monitoring processes to identify any areas of concern. We have also given specific consideration to this risk when carrying out cut-off testing. As part of our value for money work, we have considered the Authority's savings plans and consider their robustness. We have also met with individual department directors as well as key finance staff to discuss their progress in delivering the MTFP as well as the future direction for the Authority. We have also considered the accounting implications of any savings plans and have considered the impact of the efficiency challenge on the recognition of both income and

Risk	Significant / elevated risk	Reason for risk identification	Audit response
		developed robust procedures to manage the impact of reduced central funding thus far, there remain ongoing pressures on the financial position in the medium to long term. There are also risks in relation to financial reporting that the requirement to report particular financial results overrides financial reporting best practice.	expenditure. The conclusion of our work has been that the Authority has appropriately recognised both income and expenditure within the Statement of Accounts.
Management override of controls	● *Significant*	ISA (UK&I) 240 requires that we plan our audit work to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk that management may override controls in order to manipulate the financial statements. In any organisation, management may be in a position to override the financial controls that are in place. A control breach of this nature may result in a material misstatement. We are required to consider management override of controls as a significant risk every year and adapt our audit procedures accordingly. However, our view is that the risk is exacerbated in 2011/12 because of the ongoing financial pressures facing local authorities. We consider the following to be the key areas in which management override of controls may occur to manipulate the financial results: • Recognition of revenue and expenditure; • Manipulation of journal postings to the ledger; • Recognition and measurement of provisions; • Management estimates; and • Capitalisation of revenue costs.	**General approach**: We gained an understanding of and evaluated internal control processes and procedures as part of our planning work. We designed and performed procedures in relation to the business rationale for significant transactions. Our audit procedures also included an unpredictable element that varies year on year. **Recognition of revenue and expenditure**: See above. **Manual journal postings**: We reviewed the appropriateness of manual journals processed during the year. In doing so we used Computer Assisted Audit Techniques which helped us identify riskier journals whilst also allowing us to rebuild the trial balance from transaction listings. **Provisions**: We ensured that recognition criteria was met for any material provisions and that the value of the liability recognised is appropriate. We have had discussions with the Authority's legal and HR teams to ensure that all provisions have been accounted for. Specific potential liabilities are discussed later in this report. **Management estimates**: We carefully considered any management estimates and assessed whether they were subject to bias.

Risk	Significant / elevated risk	Reason for risk identification	Audit response
			Capitalisation of revenue costs: We reviewed controls around the capitalisation of expenditure and performed detailed testing on capital additions in year. No issues were noted in our testing performed.
Capital developments and valuation of property plant and equipment	● *Significant*	Property, plant and equipment (PPE) represents the largest balance in the Authority's balance sheet. The Authority measures its properties at fair value involving a range of assumptions and the use of external valuation expertise. ISAs (UK&I) 500 and 540 require us, respectively, to undertake certain procedures on the use of external expert valuers and processes and assumptions underlying fair value estimates. Specific areas of risk include: • The accuracy and completeness of detailed information on assets. • Whether the Authority's assumptions underlying the classification of properties are appropriate. • Whether properties that are not programmed to be revalued in the year might have undergone material changes in their fair value. • The valuer's methodology, assumptions and underlying data, and our access to these. Furthermore, in 2011/12 we know that a number of local schools previously controlled by the Authority have subsequently achieved Academy status and are therefore now independent. This will lead to a significant write-out of these assets from the Authority's balance sheet which will need to be accounted for and disclosed appropriately within the Statement of Accounts.	We have audited additions, disposals, and impairments and considered the accounting treatment of PFI services as part of our audit work. We have worked with the Authority in determining the appropriate treatment for assets where the carrying value may not be appropriate. In particular we have discussed how the Authority can ensure that the impact of valuation movements is considered across the whole portfolio of assets, and not simply those subject to specific valuation in year. Further detail has been included later in this report. For Academy schools which needed to be written out of the Authority's balance sheet, we have discussed the appropriate accounting treatment and ensured this has been appropriately applied. Further detail has been included in the section below however no significant issues were identified throughout our work and the accounting treatment and presentation applied by the Authority in the Statement of Accounts is appropriate.

Risk	Significant / elevated risk	Reason for risk identification	Audit response
Impact of service redesign and transition to delivering more services through externally commissioned providers	● *Elevated*	Current economic conditions continue to result in changes in how the Authority operates and the way in which it provides services. Many Authorities are considering new arrangements for commissioning services through other providers and Darlington continue to explore this. In addition we know the Authority continue to explore the potential for sharing services and working more collaboratively with other Authorities in the region to generate efficiencies through economies of scale and shared experience and best practice. These changes could lead to significant contracts being signed increasing the need for robust contract management arrangements, an area where the Authority has had concerns in the past. In addition the Authority will need to ensure that the implications of collaborative working are appropriately reflected in the accounts (for instance shared costs where posts are split between more than one Authority).	We have reviewed significant contracts that have been taken out during the year to ensure that these have been correctly accounted for. At the time of writing we are also in the process of planning and performing a review of new capital contracts, building on work performed in this area by Internal Audit. We will utilise the findings and work of Internal Audit and do not plan to repeat this. Instead we plan to supplement this with a review of specific contracts and will report the findings of our work verbally to the Audit Committee. The Authority has yet to embark on significant collaborative working although some shared posts exist and plans are in place to expand this with Hartlepool and Redcar and Cleveland Authorities. We will ensure we continue to monitor the position of these arrangements moving forward.
Accounting for potential liabilities arising from ongoing claims/ contractual disputes	● *Elevated*	The Authority continues to closely monitor and actively manage a small number of ongoing claims and contractual disputes. The stage of these disputes, the likely outcome and the measurable cost of settlement can all determine when a liability should be recognised in the Authority's accounts and to what degree. Many of these claims and disputes are drawing closer to conclusion to the point where liabilities will need to be recognised and in some cases may even crystallise. It is therefore important that the Authority seek ongoing legal advice and monitor the situation of all such claims right up to the point the accounts are signed and that liabilities are accounted for and disclosed as appropriate.	We have continued to discuss the position of any ongoing claims and contractual disputes with the Assistant Director of Resources and the finance team as well as seeking separate confirmations from the Authority's independent legal advisors. We have reviewed the status of all claims and considered legal advice sought with regard to the likely outcomes. Following our work and enquiries we are satisfied that the Authority has appropriately provided for all potential liabilities.

Significant audit and accounting matters

ISA (UK&I) 260 requires us to communicate to you relevant matters relating to the audit of the financial statements sufficiently promptly to enable you to take appropriate action.

Audit status

Accounts

We have completed our audit, subject to the following outstanding matters:

- focused work on capital contracts as detailed above;
- approval of the financial statements and letters of representation; and
- completion procedures including subsequent events review which are the final elements of work performed right up to the point of signing allowing all events within that period to be fully reflected in the Statement of Accounts.

Subject to the satisfactory resolution of these matters, the finalisation of the financial statements and their approval by those charged with governance we expect to issue an unqualified audit opinion.

Misstatements and significant audit adjustments

We are required to report to you all unadjusted misstatements which we have identified during the course of our audit, other than those of a trivial nature. These misstatements are described in Appendix 1 to this report.

Qualitative aspects of accounting practices

Significant accounting principles and policies

Significant accounting principles and policies are disclosed in the notes to the financial statements. We will ask the Audit Committee to represent to us that they have considered the selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the entity's financial statements.

Accounting matters

<u>Component accounting</u>

One aspect of the transition to IFRS is the componentisation of property, plant and equipment. In order to calculate materially accurate depreciation figures, the Authority has broken up major assets into their component parts where these have substantially different useful lives.

The Authority's depreciation policy has been updated to reflect the treatment of assets which have been componentised.

We have discussed component accounting with the Authority and have gained an understanding of the components used and their associated useful lives. We have also reviewed calculations performed by the Authority and have not identified any issues.

Valuation of property, plant and equipment and accounting for Academy schools

The Authority carries out a rolling programme that ensures that all Property, Plant and Equipment required to be measured at fair value is revalued at least every five years. All valuations were carried out internally by the Authority's valuation team who will bring in the support of external valuers as required.

We discussed the valuation process in detail with management prior to the audit commencing. In line with the requirements of the IFRS Code, assets are required to be held at fair value which involves assessing all assets within the Authority's portfolio to ensure they are materially accurate. As such, where the Authority adopts a rolling programme of valuations (assessing all assets at least once in a 5 year cycle) the factors considered in arriving at these valuations are considered across all assets not specifically valued. Where factors arise which may cause the fair value to be misstated, the carrying value of affected assets should be adjusted. Equally the principles of componentisation are now applied to all assets. This involves splitting assets into their component parts (where applicable) and attributing a useful life to each individual component which accurately reflects its individual expected lifespan.

Discussions with the finance team and the valuer meant an appropriate approach has been developed to ensure the above principles are applied. We have reviewed the accounting entries of a sample of revalued assets and have considered the appropriateness of assumptions that have been applied in determining valuations. For example, we have held discussions with the Authority's internal valuer, consulted external guidance available and have agreed data used in valuation calculations to third party sources. We have also confirmed the appropriateness of key assumptions with PwC's valuation experts.

In addition to the above, management have also ensured that the asset lives of all assets have been reviewed to ensure they are appropriate and reflect the actual period of expected future usage of those assets. This did lead to adjustments to lives in some instances with the asset register amended to reflect these changes. Our audit work did identify a limited number of errors in the posting of the revised lives to the register; the associated adjustment has been made however this was not material.

Equal pay and other claims

The Authority has received and continue to receive claims for unequal pay. Whilst some claims remain disputed, certain cases have progressed and are reaching a point where settlements may be imminent, and indeed in many cases have been made. The Authority has appropriately provided within the Statement of Accounts for the likely cost of settlement of those claims where legal advice suggests a liability is likely. The cost of settlement on the General Fund has been deferred until that settlement is actually made.

Local Authority Housing Finance

As Members will be aware, changes to the financing arrangement for the Housing Revenue Account ('HRA') mean that responsibility is now devolved to local authorities to manage themselves. This process is known as Self-Financing of Authority Housing Services. A debt settlement has therefore occurred in year which will replace the former Housing Subsidy arrangements and for Darlington was calculated to be an additional £33m of borrowings. This has been presented separately on the face of the Comprehensive Income and Expenditure Statement as well as the HRA in line CIPFA guidance.

Management representations

The final draft of the representation letter that we are requesting management and those charged with governance to sign is attached in Appendix 3.

Related parties

The Authority is required to include details of all related party transactions within the Statement of Accounts. Disclosure has been made in note 36 of the accounts. As part of our audit procedures we have reviewed declarations of interest provided by Members and officers of the Authority.

No issues were noted with reference to related parties.

Audit independence

We are required to follow both the International Standard on Auditing (UK and Ireland) 260 (Revised) "*Communication with those charged with governance*", UK Ethical Standard 1 (Revised) *"Integrity, objectivity and independence*" and UK Ethical Standard 5 (Revised) *"Non-audit services provided to audited entities"* issued by the UK Auditing Practices Board. Together these require that we communicate at least annually with you regarding all relationships between PricewaterhouseCoopers LLP in the UK and other PricewaterhouseCoopers' firms and associated entities ("PwC") and the Authority , its members and senior management and its affiliates ("the Group") that, in our professional judgement, may reasonably be thought to bear on our independence and objectivity.

For the purposes of this letter we have made enquiries of all PricewaterhouseCoopers' teams whose work we intend to use when forming our opinion on the truth and fairness of the financial statements.

We have not identified any potential issues in respect of independence.

Fees

Our audit fees for the year were in line with our expectations as presented our Audit Plan. No additional fees have been charged.

Rotation

Rotation ensures a fresh look without sacrificing institutional knowledge. Rotation of audit engagement partners, key partners involved in the audit and other staff in senior positions is reviewed on a regular basis by the lead audit engagement partner.

The APB Ethical Standards require key partners involved in an audit to rotate at least every 7 years. We therefore have no current issues with regard to rotation.

There are no other APB Ethical Standards specific requirements for other partners and senior staff members to rotate. However, PwC's own policy would generally expect other partners and senior staff to rotate after 10 years.

Gifts and hospitality

We have not identified any significant gifts or hospitality provided to, or received from, Members or officers of the Authority.

Conclusion

We hereby confirm that in our professional judgement, as at the date of this document:

- we comply with UK regulatory and professional requirements, including the Ethical Standards issued by the Auditing Practices Board; and
- our objectivity is not compromised.

Accounting systems and systems of internal control

It is the responsibility of the Authority to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. As auditors, we review these arrangements for the purposes of our audit of the financial statements and our review of the annual governance statement. There are no significant matters that we wish to bring to your attention.

Annual Governance Statement

Local Authorities are required to produce an Annual Governance Statement (AGS), which is consistent with guidance issued by CIPFA / SOLACE: 'Delivering Good Governance in Local Government'. The AGS was included alongside the financial statements.

We reviewed the AGS to consider whether it complied with the CIPFA / SOLACE 'Delivering Good Governance in Local Government' framework and whether it is misleading or inconsistent with other information known to us from our audit work. We found no areas of concern to report in this context.

Economy, efficiency and effectiveness

Our value for money code responsibility requires us to carry out sufficient and relevant work in order to conclude on whether the Authority has put in place proper arrangements to secure economy, efficiency and effectiveness in the use of resources.

In accordance with guidance issued by the Audit Commission, in 2011/12 our conclusion is based on two criteria:

- The organisation has proper arrangements in place for securing financial resilience; and
- The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

As in 2010/11, we have determined a local programme of audit work based on our audit risk assessment, informed by these criteria and our statutory responsibilities.

The work we have undertaken has focused on the following:

- Procedures around setting the Medium Term Financial Plan and significant savings proposals required; and
- Procedures in place for monitoring the identified savings.

We anticipate issuing an unqualified value for money conclusion.

Internal controls

Reporting requirements

We are required to report to management and those charged with governance any deficiencies in internal control that we have identified during the audit. From our audit work performed, there have been no significant deficiencies in internal control identified which require reporting to the Audit Committee.

Summary of significant internal control deficiencies – 2010/11 update

Updated reponses have been noted in relation to prior year's recommendations.

2010/11 Recommendation	Management's response	2011/12 Update and Status
Unrecorded liabilities When testing for unrecorded liabilities it was noted that an item above the accruals limit had not been accrued at year end. There is a risk that year end liabilities are understated.	The procedures will be reviewed to ensure cut-off errors are minimised.	***Status:* Closed** As part of the audit work performed, three issues were noted where amounts relating to 2011/12 had not been recorded as liabilities at year end, however these items were below the de minimis accruals limit set.
Payroll Authorisation and Key Control Process In relation to starters and leavers, several authorisation and key control processes designed to prevent fraudulent entries were identified from testing performed. Some of these processes include the signing of official paper forms by two payroll officers; however, a number of the forms tested (14 from 50 in total) did not contain all of the required signatures. There is therefore a risk that starters and leavers are incorrectly recorded on the payroll system.	The XEN6-'Change of Personal Details' form which has been identified as not being consistently signed is due to the form having a dual purpose. The form is used during the new starter process and for changes to existing employee personal details. If the form is used during the new starter process then signatures are completed on the main form XEN2-'Notification of New Starter' in the payroll module section which covers all of the payroll input. Both forms are always required for a new starter. If the form is used solely for a change to existing employee details then the form is completed and authorised fully. The new starter process will be reviewed to ensure all forms are signed where indicated.	***Status:* Closed** From testing performed around the authorisation process during the 2011/12 audit, no issues were noted relating to the authorisation of new starters.

2010/11 Recommendation	Management's response	2011/12 Update and Status
Contract Management As Members are aware, we performed a review of the Darlington Schools PFI project to assess contract management arrangements which are in place to address the risk of fraud. It was found that: ▪ Roles and responsibilities for contract monitoring are not formally documented; ▪ The vandalism clause within the contract is ambiguous and therefore it is possible that costs charged to the authority are overstated. The Authority does not fully validate charges raised by the contractor; ▪ The quality of performance information received from the contractor (facilities management reports and annual service reports) is considered to be poor. At present no penalties have been imposed to address the issues related to poor management information; ▪ A limited number of performance deductions have been processed in the year despite performance issues being noted; ▪ The energy consumption of the new building significantly exceeds the original estimates of energy consumption set at the design stage. This could be errors in the estimation process or could be the result of the building not being constructed to the correct specification, and the reason should be investigated further; and ▪ Income from third party use of school sites (out of hours) could be understated as minimal monitoring is performed by the Authority.	The Head of Educational Services within the People group has developed an action plan, including appropriate timescales, to address the issues raised in order to support the establishment of an effective, robust, integrated contract monitoring regime.	***Status:* Partially completed** We have again followed up this recommendation during a meeting with the Head of School & Pupil Support Services within the People group. In 2011 it was clear that improvements had been made in terms of contract monitoring processes and procedures. In addition the process of communication between the Authority, the School and the Operator had improved leading to a reduced number of disputes, improved reporting and more effective challenge from the Authority. There have been developments in the current year. It has been noted that many of the updated processes are still being embedded and relationships between all parties are still developing. There have also been staffing changes in this area as well as investment in specialist support provided by North Tyneside Council. Further, the Education Village has achieved Academy status and therefore many of the aspects of the management of the scheme (for instance utility costs) will become their responsibility. A dedicated role is in place at the schools to manage the interaction between the relevant parties. These updates are expected to deliver positive outcomes however we appreciate that the management of this contract remains a key challenge for the Council. As such, we have held detailed discussions with the Head of Corporate Assurance and plan to perform a joint piece of work in following up the progress of these actions in early 2013. This work will be scoped with all relevant parties.

Risk of fraud

We discussed with the Audit Committee their understanding of the risk of fraud and corruption and any instances thereof when presenting our Audit Plan.

In presenting this report to the Audit Committee we seek members' confirmation that there have been no changes to their view of fraud risk and that no additional matters have arisen that should be brought to our attention. A specific confirmation from management in relation to fraud is included in the letter of representation.

Fees update

Fees update for 2011/12

We reported our fee proposals as part of the Audit Plan for 2011/12.

Our actual fees were in line with our proposals.

Recent developments

Accounting developments

There are a number of minor updates to the CIPFA Code of Practice on Local Authority Accounting in the UK 2011/12.

The main accounting change relates to the adoption of the requirements of FRS 30 Heritage Assets in the CIPFA Code. This requires heritage assets to be measured at valuation in normal circumstances, and permits authorities to use the measurement and disclosure principles of FRS 30 for Community Assets.

Other developments

Public Service Reform

Open Public Services.

In July the Coalition set out, in a White Paper, its agenda for more 'Open Public Services'. Rising demand for public services, reduced government spend and the need for a leaner, more efficient public sector, means public service reform is central to the Coalition's agenda.

In its White Paper, the Government has signalled a shift to an "open public sector", with more diverse providers, greater citizen choice and increased competition.

The larger challenge for government will not be setting out the vision, but making change happen across substantial parts of the public sector which will in turn present challenges for local authorities as they look to commission more services. Some areas for consideration include:

- For public services to open up, citizens need to be empowered with meaningful information and have a say in the way services are run, suppliers need to have real incentives and a level playing field, and government must set a strong regulatory framework, with a focus on outcomes.

- For open public services to be accountable to citizens, the following three powers should be devolved and aligned: decision-making, delivery and budget-setting.

- The public spending squeeze means government should look again at using private sector know-how and capital to finance the public services and infrastructure of the future.

- As part of this, government may consider charging for more public services to raise revenue and manage demand.

HRA Reform

Reforming the HRA

On 1 April 2012, the Government abolished the Housing Revenue Account subsidy system and introduced self-financing for council housing. This represented one of the most radical reforms of public housing policy for many years, and the effects were far reaching.

Under the new system, it is forecast that over the next 30 years councils will control over £300bn of rental income, and they could build up some £50bn of new investment capacity (£25bn in today's money). They will have increased capacity to invest in housing assets but at the same time they will be responsible for long term investment planning and will have to work within centrally imposed funding constraints. In a time of funding cuts and weak market confidence, the HRA reform was seen by some councils as a viable means of delivering much needed investment in new and improved social and affordable housing.

The HRA subsidy system redistributed significant resources annually between local and central Government. Through the HRA subsidy system the rental income was paid to Government, in return for which some £5bn of allowances for management, maintenance and investment was paid to councils.

Government then met the cost of £21bn of council housing debt. Under the previous system, which was widely regarded as complex and unfair, councils did not have any certainty as to what level of funding they will receive from one year to the next and were consequently unable to properly manage new housing stock.

The new system was implemented in April 2012. Under the new system, councils keep the rental income they generate and are responsible for deciding how they use it to meet their local housing needs. In return for this councils are allocated a share of some £28bn of debt. Unlike previous housing debt this is "real" debt that they are responsible for managing and servicing.

Local financial Impact

With HRA reform, the financial picture will change fundamentally because:

- Councils are able to keep the net rental income that their housing generates (rental income less associated management, maintenance and investment costs).
- Funding for management, maintenance and repairs included in the new system is 14 per cent higher than under the current subsidy system – an increase of more than £500m per year.
- In return, councils are allocated a level of debt that they are responsible for servicing and managing from their net rental income.

To meet the new responsibilities of HRA reform and to make the most of the financial freedoms that follow, councils have had to:

- Develop new long term asset management plans;
- Identify investment needs; and
- Develop short, medium and long term funding solutions.

Appendices

Summary of uncorrected misstatements

We have identified the following significant misstatements during our audit of the financial statements that have not been adjusted by management:

No	Description of misstatement (factual, judgemental, projected)	Income statement		Balance sheet		Adjusted
		Dr £'000	Cr £'000	Dr £'000	Cr £'000	
1	***Depreciation expense*** Being an overstatement of the depreciation expense. Dr Balance Sheet – Accumulated Depreciation Cr I&E - Depreciation expense		489,983	489,983		No
2	***Reclassification of trade debtors*** Being the reclassification of debit balances on the purchase ledger. Dr Accounts receivable Cr Accounts Payable			187,736	187,736	No
Total uncorrected misstatements		**-**	**489,983**	**677,719**	**187,736**	

Audit reports issued in 2011/12

We have issued, or will issue, the following reports in relation to the 2011/12 audit:

- 2011/12 Audit Plan – presented to the Audit Committee in March 2012;
- 2011/12 ISA260 Report to those charged with governance (this report); and
- Audit Opinion for the 2011/12 Statement of Accounts and the Value for Money (VfM) conclusion.

Draft letter of representation

PricewaterhouseCoopers LLP
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Newcastle upon Tyne
NE1 8HW

Dear Sirs

This representation letter is provided in connection with your audit of the Statement of Accounts of Darlington Borough Council (the "Authority") for the year ended 31 March 2012 for the purpose of expressing an opinion as to whether the Statement of Accounts gives a true and fair view, and has been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom and the Best Value Accounting Code of Practice.

My responsibilities as Director of Resources for preparing the financial statements are set out in the Statement of Responsibilities for the Statement of Accounts. I am also responsible for the administration of the financial affairs of the Authority. I also acknowledge that I am responsible for making accurate representations to you.

I confirm that the following representations are made on the basis of enquiries of other chief officers and members of the Authority with relevant knowledge and experience and, where appropriate, of inspection of supporting documentation sufficient to satisfy myself that I can properly make each of the following representations to you.

I confirm, to the best of my knowledge and belief, and having made the appropriate enquiries, the following representations:

Financial Statements

- I have fulfilled my responsibilities, for the preparation of the Statement of Accounts in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom; in particular the financial statements give a true and fair view in accordance therewith.

- All transactions have been recorded in the accounting records and are reflected in the financial statements.

- Significant assumptions used by the Authority in making accounting estimates, including those surrounding measurement at fair value, are reasonable.

- All events subsequent to the date of the financial statements for which the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom requires adjustment or disclosure have been adjusted or disclosed.

- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to this letter.

Information Provided

- I have taken all the steps that I ought to have taken in order to make myself aware of any relevant audit information and to establish that you (the Authority's auditors) are aware of that information.

- I have provided you with:

- Access to all information of which I am aware that is relevant to the preparation of the financial statements such as records, documentation and other matters, including minutes of the Authority, the Cabinet and Audit Committee and relevant management meetings;
- Additional information that you have requested from us for the purpose of the audit; and
- Unrestricted access to persons within the Authority from whom you determined it necessary to obtain audit evidence.

- So far as I am aware, there is no relevant audit information of which you are unaware.

Fraud and non-compliance with laws and regulations

- I acknowledge responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.

- I have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

- I have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the Authority and involves:

  - Management;
  - Employees who have significant roles in internal control; or
  - Others where the fraud could have a material effect on the financial statements.

- I have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the Authority's financial statements communicated by employees, former employees, analysts, regulators or others.

- I have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.

I am not aware of any instances of actual or potential breaches of or non-compliance with laws and regulations which provide a legal framework within which the Authority conducts its business and which are central to the Authority's ability to conduct its business or that could have a material effect on the financial statements.

I am not aware of any irregularities, or allegations of irregularities including fraud, involving members, management or employees who have a significant role in the accounting and internal control systems, or that could have a material effect on the financial statements.

Related party transactions

I confirm that we have disclosed to you the identity of the Authority's related parties and all the related party relationships and transactions of which we are aware.

Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of Section 3.9 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

We confirm that we have identified to you all senior officers, as defined by the Accounts and Audit Regulations 2011, and included their remuneration in the disclosures of senior officer remuneration.

Employee Benefits

I confirm that the Authority has made you aware of all employee benefit schemes in which employees of the Authority participate.

Contractual arrangements/agreements

All contractual arrangements (including side-letters to agreements) entered into by the Authority have been properly reflected in the accounting records or, where material (or potentially material) to the financial statements, have been disclosed to you.

Litigation and claims

I have disclosed to you all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements and such matters have been appropriately accounted for and disclosed in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom.

Taxation

I have complied with UK taxation requirements and have brought to account all liabilities for taxation due to the relevant tax authorities whether in respect of any direct tax or any indirect taxes. I am not aware of any non-compliance that would give rise to additional liabilities by way of penalty or interest and I have made full disclosure regarding any Revenue Authority queries or investigations that we are aware of or that are ongoing.

In particular:

- In connection with any tax accounting requirements, I am satisfied that our systems are capable of identifying all material tax liabilities and transactions subject to tax and have maintained all documents and records required to be kept by the relevant tax authorities in accordance with UK law or in accordance with any agreement reached with such authorities.
- I have submitted all returns and made all payments that were required to be made (within the relevant time limits) to the relevant tax authorities including any return requiring us to disclose any tax planning transactions that have been undertaken the Authority’s benefit or any other party’s benefit.
- I am not aware of any taxation, penalties or interest that are yet to be assessed relating to either the Authority or any associated company for whose taxation liabilities the Authority may be responsible.

Bank accounts

I confirm that we have disclosed all bank accounts to you.

Assets and liabilities

The Authority has no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

In my opinion, on realisation in the ordinary course of the business the current assets in the balance sheet are expected to produce no less than the net book amounts at which they are stated.

We have no plans or intentions that will result in any excess or obsolete stock, and no stock is stated at an amount in excess of net realisable value.

The Authority has satisfactory title to all assets and there are no liens or encumbrances on the Authority’s assets, except for those that are disclosed in the financial statements.

I confirm that we have carried out impairment reviews appropriately, including an assessment of when such reviews are required, where they are not mandatory. I confirm that we have used the appropriate assumptions with regard to those reviews.

Financial Instruments

Details of all financial instruments, including derivatives, entered into during the year have been made available to you. Any such instruments open at the year end have been properly valued and that valuation incorporated into the financial statements. Where appropriate, open positions in off-balance sheet financial instruments have also been properly disclosed within the financial statements.

I confirm that all significant assumptions made in relation to fair value measurement and disclosures are reasonable and appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the Authority where relevant to the fair value measurements or disclosures.

All embedded derivatives have been identified and appropriately accounted for under the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

Where we have assigned fair values to financial instruments, we confirm that the valuation techniques, the inputs to those techniques and assumptions that have been made are appropriate, and reflect market conditions at the balance sheet date, and are in line with the business environment in which we operate.

Disclosures

The following have been properly recorded and, when appropriate, adequately disclosed in the financial statements:

- The identity of, and balances and transactions with, related parties.
- Losses arising from sale and purchase commitments.
- Agreements and options to buy back assets previously sold.
- Assets pledged as collateral.

We have recorded or disclosed, as appropriate, all arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and line of credit or similar arrangements.

We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent, and have disclosed in the financial statements all guarantees that we have given to third parties including oral guarantees made by the Authority on behalf of an affiliate, member, officer or any other third party.

Retirement benefits

All significant retirement benefits that the Authority is committed to providing, including any arrangements that are statutory, contractual or implicit in Authority's actions, wherever they arise, whether funded or unfunded, approved or unapproved, have been identified and accounted for and/or disclosed.

All settlements and curtailments in respect of retirement benefit schemes have been identified and properly accounted for.

The following actuarial assumptions underlying the valuation of retirement benefit scheme liabilities are consistent with my knowledge of the business and in my view would lead to the best estimate of the future cash flows that will arise under the scheme liabilities:

Rate of inflation	3.60%
Rate of general long-term increase in salaries	5.10%
Rate of increase to pensions in payment	2.60%
Rate of increase to deferred pensions	2.60%
Rate for discounting scheme liabilities	4.80%

The Authority participates in the Teachers' Pension Scheme that is a defined benefit scheme. We confirm that Authority's share of the underlying assets and liabilities of this scheme cannot be identified and as a consequence the scheme has been accounted for as a defined contribution scheme.

Provisions

Provisions for depreciation and diminution in value including obsolescence have been made against fixed assets on the bases described in the financial statements and at rates calculated to reduce the net book amount of each asset to its estimated residual value by the end of its probable useful life in the Authority's business. In this respect I am satisfied that the probable useful lives have been realistically estimated and that the residual values are expressed in current terms.

Full provision has been made for all liabilities at the balance sheet date including guarantees, commitments and contingencies where the items are expected to result in significant loss. Other such items, where in my opinion provision is unnecessary, have been appropriately disclosed in the financial statements.

Litigation

I am not aware of any pending or threatened litigation, proceedings, hearing or claims negotiations which may result in significant loss to the Authority. The Statement of Accounts include a provision for equal pay claims to the value of £2.239M and this is deemed to be an accurate assessment of any probable liability.

Other specific items

Other than the following projects:

- Education Village; and
- Harrowgate Hill Primary School,

the Authority does not have plans to enter into any further Private Finance Initiative schemes which might affect the financial statements for 2011/12.

Due to significant reductions in Government funding, the Authority expects to incur redundancy costs in the region of £5M. The Authority was given a capitalisation directive for £760,000 which will mean that the other £4.240M will need to be funded from revenue. Approximately £2.4M was charged to revenue in 2010/11 with the majority of the remainder charged in 2011/12 which will ultimately be funded from the Redundancy and Decommissioning Reserve. I confirm that this reflects the current position for the Authority.

The Authority has determined a prudent amount of revenue provision for the year under the Prudential Framework, including any voluntary sums over and above the Minimum Revenue Provision.

The Authority has determined a proper application of the statutory provisions for the neutralisation of the impact of Single Status provisions on the General Fund balance.

The Authority has assessed the impact of using the Major Repairs Allowance as an estimate for depreciation of Authority dwellings in the Housing Revenue Account and is satisfied that this amount is a reasonable estimate of the amount of depreciation charge for these assets.

The Authority holds investments in Newcastle Airport, Durham Tees Valley Airport and Premier Waste Management. The valuations of these investments reflect an appropriate market value and this value is reflected in the Statement of Accounts.

The Authority has considered its interests in other entities and is satisfied that group accounts do not need to be prepared in line with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

Subsequent events

There have been no circumstances or events subsequent to the period end which require adjustment of or disclosure in the financial statements or in the notes thereto.

As minuted by the Audit Committee at its meeting on 28 September 2012

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Director of Resources

For and on behalf of Darlington Borough Council