

Darlington Borough Council

2007/08 Report to those charged with governance



The Audit Committee
Darlington Borough Council
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Ladies and Gentlemen

2007/08 Report to those charged with governance

We are pleased to present our report on the results of our audit work for 2007/08. We hope that the information contained in this report provides a useful source of reference for members.

Yours faithfully

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

In March 2005 the Audit Commission issued a revised version of the ‘Statement of responsibilities of auditors and of audited bodies’ which applies to the 2007/08 audit. 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

This report summarises the results of our 2007/08 audit of accounts.

It includes the issues arising from our audit of the financial statements and those issues which we are formally required to report to you under the Audit Commission's Code of Audit Practice and International Standard of Auditing (UK & Ireland) (ISA(UK&I)) 260 - "Communication of audit matters with those charged with governance".

It also includes the results of the work we have undertaken on 'Use of Resources' under the Code of Audit Practice, to support our formal conclusion in this area.

Our work during the year was performed in line with the plan that we presented to you in June 2008.

We have set out below the most important issues and recommendations that we have discussed with officers in the course of our work.

Status of our work

We are pleased to report that our programme of detailed audit work as set out in our plan is close to completion. The detailed findings of this work are described below and the audit differences identified are shown in the tables attached. The main areas where we still have work to complete are:

- Bank and Cash – we have yet to receive confirmation from the bank of a balance held by Alliance and Leicester. We are following this up along with assistance from the Council.
- Investments – we have yet to receive investment confirmations from Alliance and Leicester (Call Account) and Barclays.
- Borrowing – we have yet to receive a loan confirmation from KBC.
- Review of the Annual Governance Statement to ensure that the disclosures are in line with relevant up to date guidance.
- As part of our work on post balance sheet events we will be undertaking a review to determine whether recent events in the wider economy have any impact on the Council that should be reflected in the financial statements, particularly in relation to pension investments.

Financial Statements

At the time of writing, our audit of the financial statements is nearing completion. This report sets out the findings up to 16 September 2008. Any significant issues arising after this date but before the conclusion of the audit will be raised with the Council as appropriate.

Our audit work has identified a small number of proposed adjustments to the draft financial statements approved by Members on 27 June 2008. A number of these adjustments have been agreed with officers in Finance and will be reflected in the final, audited, financial statements. There remain a small number of unadjusted misstatements which should be considered by the Audit Committee. These misstatements are set out in Appendix A to this report.

All of the other misstatements identified in the course of our audit have been corrected by management. The main adjustments arose following interpretation of new technical guidance on the implementation of the Revaluation Reserve and these have been discussed and corrected by management.

The Council's response to developments in financial reporting will remain pertinent going forward as the implementation of International Financial Reporting Standards will result in a significant challenge for the Council.

The following key issues have arisen from the 2007/08 audit and have been discussed further in this report:

- Timing and accounting for revaluations, particularly in relation to council dwellings;
- Treatment of capital expenditure not increasing book value of assets and the associated timing of impairment reviews;
- Write-out of significant Government Grant Deferred balances;
- A significant number of fully depreciated assets remain on the fixed asset register;
- Accounting for loss on disposal of fixed assets in the incorrect period;
- Basis of valuation of shares held in Newcastle Airport and the associated categorisation as Available for Sale Financial Instruments; and

- Management's decision not to provide for current known outstanding equal pay claims.

Use of Resources

We are currently continuing work on our Use of Resources assessment.

Electors' queries on the accounts

To date there have been no formal objections to the 2007/08 accounts.

Financial statements

Accounts

We are nearing the completion of the audit of the Authority's accounts in line with the Code of Audit Practice and Auditing Standards. We anticipate issuing an unqualified audit opinion on the financial statements.

Accounting Issues

We bring to your attention, in Appendix A, the misstatements which have been discovered as part of our audit and have not been adjusted in the financial statements. All remaining misstatements were agreed with management and concluded during our clearance meeting on 28 August 2008. These have been adjusted in the revised version of the Statement of Accounts. Significant adjusted misstatement can be found in Appendix B. The key adjustments and accounting issues arising from our audit are detailed below:

Revaluation and Impairments in capital accounting

There were some accounting and disclosure errors noted in the entries for revaluations and impairments. The key issues are summarised as follows:

- The Council wrote off accumulated depreciation on a number of assets which were impaired. The impairments were the result of a consumption of economic benefit and the effect was to write off £14.4m of expenditure in year that did not increase the pound-for-pound value of the asset. The correct accounting treatment for this

should have been to treat the impairments as depreciation at the time they were incurred. As a result there was a disclosure adjustment of £6,236k from the "depreciation written-back" line into the "revaluations and restatements" line in the fixed asset note.

- This issue noted above was caused by the timing of impairment reviews undertaken by the Council. The assets had not been valued correctly prior to the enhancements: this would have indicated that the assets were impaired and that the additional expenditure was correcting these impairments.
- We have agreed with the Council that an additional line should be added to the fixed asset note for downward revaluations charged to the Income and Expenditure account. This line reflects assets which have taken a genuine downward revaluation, rather than an impairment of expenditure not increasing the pound-for-pound value of assets. This amendment provides additional clarity to the accounts.
- The balance in the revaluation reserve for disposed assets totalling £3,466k had not been written-out to the Capital Adjustment Account following the disposal of those assets. This has been discussed with management and has been corrected in the final accounts.

Government Grant Deferred balance written-out

In the year, the Council has written-out Government Grant Deferred totalling £35,635k. The accounting treatment was discussed with PwC and agreed as correct however there is an issue related to how the adjustment has arisen.

As we discussed above, a significant level of capital expenditure incurred by the Council does not increase the pound-for-pound value of assets. Some of this expenditure has been financed by government grant. The associated grant balance has however not been taken to the Income and Expenditure to offset against the write off of the spend. As such, a Government Grant Deferred balance had built up that cannot be fully attributed to assets. After detailed analysis by the Council, a balance of £35m was identified as not having an associated asset on the balance sheet and therefore no associated depreciation against which the grant can be written down.

The Council has made an adjustment to reserves in year to correct this issue.

Accounting for loss on disposal

The Council has reflected a loss on disposal of fixed assets in the current year of £684k. The majority of this balance relates to assets actually disposed of in 2005/06 and 2006/07 in which One North East had an interest. The element of the consideration due to One North East should have been reflected in calculating the a losses on disposal in the years of disposal (2005/06 and 2006/07), rather than in the year the proceeds were actually paid over (2007/08) as has been the case.

As this balance is below materiality PwC would not require a Prior Period Adjustment to the financial statements however, the incorrect accounting treatment has been raised with the Council.

Investment – NIAL Holdings

The Council currently hold an investment in Newcastle International Airport valued at £855,000 based on the balance sheet value of the Airport at 31/12/06. Following the refinancing of the Airport's balance sheet, were this valuation method to be applied to the current balance sheet then the investment would be valued at £nil. PwC suggests an adjustment to revalue this investment back to cost as an appropriate proxy for the current fair value as per the SORP. This treatment is consistent with that required for assets held in the 'Available for Sale Financial Instruments' Reserve.

The Council has agreed and adjusted the valuation to £1,540k.

Sundry Debtors

Sundry debtors of £2,381k were incorrectly classified as prepayments. The balance has been adjusted by management.

Landfill Allowance Trading Scheme (LATS)

LATS debtor and creditor balances were overstated by £257k. This was agreed with officers and these balances have been adjusted in the accounts.

Cash Flow Statement

A balance of £2,130k in relation to the repayment of borrowing using capital receipts was incorrectly netted-off the 'Sale Proceeds' line in the Cash Flow Statement. On review of the SORP and discussion with officers it was agreed that this balance should be taken to the 'Payments for Capital Schemes' line in the statement.

Systems of internal control

We are required to report to you any material weaknesses in the accounting and internal control systems identified during the audit. We will issue a separate report to officers in due course on those control recommendations

that we have identified as part of our audit, of which the most significant are that:

- Senior officers should keep under review fixed asset and investment balances against accounting requirements, which have recently changed.
- Management should bring forward the assessment process in the rolling programme of asset revaluation, so that they regularly consider the condition of properties, altering asset lives or making impairments as appropriate. This means that when enhancement work is undertaken, a decision can be taken on whether value has been added and work capitalised where appropriate. This will also ensure that housing stock valuations can be reflected in the accounts on a timely basis.

Additional recommendations arising from our audit can be found in the accounting practices section below.

Accounting practices

We are also required to report to you our view on qualitative aspects of the Authority's accounting practices and financial reporting and have set out below our observations on key issues affecting the Authority.

- Valuations for Housing Stock are not carried out until June/July, after the approval of the accounts. If the Council is to ensure that any material movements in valuation are reflected in the accounts on a timely basis, these valuations should be conducted in time for the year end accounts.
- Bad debt write-offs were included in the accounts despite not having been authorized by Cabinet. In future, approval should be sought in advance of the draft accounts being approved.
- A number of the VAT returns were submitted after the deadline. To avoid the risk of fines being incurred for late submission, the Council should ensure that VAT returns are submitted promptly.
- In relation to Government Grant Deferred (see also above), the

Council needs to ensure that all government grants are directly attributed to assets and are written down to the Income and Expenditure account in line with the treatment of the asset itself.

- In our review of the Cash Flow Statement we have identified one balance that could not be fully substantiated by the Council. The balance in question is 'accruals adjustment' in the cash flow note. The Council should introduce procedures to ensure that all of the figures can be substantiated for future years' accounts.
- The Fixed Asset Register includes a number of assets which have been fully depreciated. For the purposes of maintaining up to date accounting records, the Council should ensure that any assets which are fully depreciated and no longer in use are removed from the register.

Use of Resources conclusion

Work performed

In accordance with the Code of Audit Practice, we are in the process of carrying out work to form a conclusion on the Council's arrangements for achieving economy, efficiency and effectiveness in its use of resources. The work to support our conclusion comprises the following elements:

- Use of Resources assessment for CPA;
 - Financial Reporting;
 - Financial Management;
 - Financial Standing;
 - Internal Control;
 - Value for Money;
- Mandatory Data Quality Review work;
- Review of the Statement on Internal control; and
- Audit of the Best Value Performance Plan.

Use of Resources Conclusion

Under the new Code of Audit Practice we are required to provide a conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources. This conclusion is reached by assessing the Council's arrangements against a set of criteria issued by the Audit Commission. Our conclusion will be based on the use of resources assessment for 2008 as part of the CPA process, our Local Government data quality work, and other information that comes to our attention during the course of our audit work.

We are not yet in a position to conclude on the arrangements in place. The assessments we have made to date are set out in Appendix C.

Data Quality work

We have completed our work on Data Quality following Audit Commission guidance. The work has involved a consideration of the data quality management arrangements in place and a detailed audit of a sample of performance indicators specified by the Audit Commission.

We concluded that the management arrangements are adequate.

Annual Governance Statement

Local Authorities are required to produce an Annual Governance Statement which is consistent with guidance issued by CIPFA/SOLACE. A governance statement was included in the financial statements.

We are in the process of reviewing the statement. We are content that it complies with CIPFA/SOLACE guidance. We have yet to consider whether the contents are misleading or inconsistent with other information that will be known to us when we complete our audit work.

Best Value Performance Plan

Our work on the 2007/08 Best Value Performance Plan (BVPP), issued by the Council in 2007, did not identify any issues.

Appendix A: Summary of unadjusted misstatements

We have identified the following errors during our audit of the financial statements that have not been adjusted by management. The Audit Committee are requested formally to consider the listed unadjusted errors and determine whether the accounts should be amended. If the errors are not adjusted we will require a written representation from you explaining your reasons for not making the adjustments.

Unadjusted Misstatement	Income and Expenditure Account		Balance Sheet	
	Dr	Cr	Dr	Cr
Overstatement of Debtors: Dr I&E Cr Government Debtors	5,112			5,112
Sundry debtors understated due to estimation on insurance claim Dr Sundry Debtors Cr I&E		29,986	29,986	
Reduce revaluation on disposal of HRA dwellings to reflect accurate beacon values: Dr Revaluation Reserve Cr FA			10,000	10,000
Net effect	5,112	29,986	39,986	15,112

Appendix B: Summary of significant adjusted misstatements

We have identified the following errors over £500k during our audit of the financial statements that have been adjusted by management, but which we consider should be communicated to you to assist you in fulfilling your governance responsibilities:

Adjusted Misstatement	Income and Expenditure Account		Balance Sheet	
	Dr	Cr	Dr	Cr
Sundry debtors wrongly classified as prepayments Dr Sundry debtors Cr Prepayments			2,381,101	2,381,101
Transfer revaluation reserve balance for disposed assets to CAA Dr Revaluation Reserve Cr CAA			3,466,000	3,466,000
Write back accumulated depreciation and downward revaluations for assets incorrectly revalued upon impairment of spend not adding value Dr Fixed Asset (via revaluation line) Cr Accumulated Depreciation			6,236,000	6,236,000
Net effect	0	0	12,083,101	12,083,101

Appendix C: Use of Resources conclusion

The Audit Commission has published 12 Code of Practice criteria on which auditors will be required to reach a conclusion on the adequacy of an audited body's arrangements for economy, efficiency and effectiveness in its Use of Resources.

Several of these Code criteria are linked to the CPA and Data Quality Review Key Lines of Enquiry (KLoEs). A score of Level 2 or higher under the KLoEs will result in an assessment of "adequate" for the purposes of the Code criteria. The Code criteria and the linked KLoEs are shown in the table below.

Code Criteria	Description	Associated KLoE	Use of Resources Conclusion
1	The body has put in place arrangements for setting, reviewing and implementing its strategic and operational objectives.	N/A	Adequate
2	The body has put in place channels of communication with service users and other stakeholders including partners, and there are monitoring arrangements to ensure that key messages about services are taken into account.	N/A	Adequate
3	The body has put in place arrangements for monitoring and scrutiny of performance, to identify potential variances against strategic objectives, standards and targets, for taking action where necessary, and reporting to Members.	N/A	Adequate
4	The body has put in place arrangements to monitor the quality of its published performance information, and to report the results to Members.	Data quality KLoEs	Adequate
5	The body has put in place arrangements to maintain a sound system of internal control	4.2	Audit work is continuing on this criterion

Code Criteria	Description	Associated KLoE	Use of Resources Conclusion
6	The body has put in place arrangements to manage its significant business risks.	4.1	Adequate
7	The body has put in place arrangements to manage and improve value for money.	5.2	Adequate
8	The body has put in place a medium-term financial strategy, budgets and a capital programme that are soundly based and designed to deliver its strategic priorities.	2.1	Adequate
9	The body has put in place arrangements to ensure that its spending matches its available resources.	3.1	Adequate
10	The body has put in place arrangements for managing performance against budgets.	2.2	Audit work is continuing on this criterion
11	The body has put in place arrangements for the management of its asset base.	2.3	Audit work is continuing on this criterion
12	The body has put in place arrangements that are designed to promote and ensure probity and propriety in the conduct of its business.	4.3	Adequate

