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Government and Public Sector

Darlington Borough Council

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

30 September 2011

2010/11 Audit

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The Audit Committee
Darlington Borough Council
Town Hall
Feethams
Darlington
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23 September 2011

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 2011, 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 April 2011. We have subsequently reviewed our audit plan and concluded that our original risk assessment remains appropriate with the exception of an additional risk in relation to valuation of property, plant and equipment being included for reasons explained later in this document. The procedures we have performed in response to our assessment of significant audit risks are detailed in the 'Audit approach' section.

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 30 September 2011. At the time of writing, the key outstanding matters, where our work has commenced but is not yet finalised, are only in relation to our completion procedures. Further detail is included on page 12. We will provide an oral update on these matters at the meeting on 30 September 2011.

We look forward to discussing our report with you on 30 September 2011. Attending the meeting from PwC will be Neil Austin and Simon Clegg.

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 Auditing Standard (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 Darlington Borough Council ('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 1 April 2011. 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 the Authority's officers during the course of our work.

Significant matters

Please refer to page 11 for a summary of the significant matters and findings following completion of the 2010/11 audit.

We have discussed a draft version of this document with Elizabeth Davison and Peter Carrick on 20 September 2011. We look forward to discussing the matters contained within this letter with the Audit Committee on 30 September 2011.

Please note that this report will be sent to the Audit Commission in accordance with the requirements of their 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*	There is a rebuttable presumption set out in ISA 240 that revenue recognition is a risk for all external audit clients. 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. This will include the treatment of deferred income and in particular deferred grants where the treatment under IFRS is different to that under UK GAAP. 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 are expected to make significant efficiency savings over the next	We gained an understanding of and evaluated controls relating to this risk and tested key controls to confirm they are operating effectively. We 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 performed specific testing on deferred grants as part of the IFRS restatement exercise to confirm these grants have been treated appropriately. We reviewed the Authority's budget monitoring processes to identify any areas of concern. We considered relevant risks identified when carrying out cut-off testing. As part of our value for money work as well as our work on financial standing, we considered the entity's savings plans and their robustness.

Risk	**Significant / elevated risk**	**Reason for risk identification**	**Audit response**
		three years. 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. There are also risks in relation to financial reporting that the requirement to report particular financial results overrides financial reporting best practice.	We also considered the accounting implications of any savings plans and we would continue to welcome discussions regarding any new or unusual proposals going forward. In particular, we have considered the impact of the efficiency challenge on the recognition of both income and expenditure. We have not identified any matters which would lead us to conclude income or expenditure has not been appropriately recognised in the accounts.
Management override of controls	● *Significant*	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 2010/11 because of the 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 – especially redundancy 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. **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. In relation to redundancy provisions, we identified at the planning stage a risk that inappropriate liabilities may be recognised in 2010/11 to avoid capitalisation caps in 2011/12.

Risk	Significant / elevated risk	Reason for risk identification	Audit response
			We therefore conducted targeted work to validate that the redundancies accounted for in 2010/11 are appropriate to the year of account. **Management estimates**: We carefully considered any management estimates and assessed whether they are subject to bias. **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.
The first year of reporting under IFRS	● *Elevated*	The transition to IFRS involves both new and considerably revised financial statements and an increase in the depth of disclosures required in the notes to the accounts. There is a risk of material errors in the restatements and reclassifications required in preparing the accounts in their new format and of material omissions of information required to be disclosed by the new Code of Practice on Local Authority Accounting.	We have worked closely with the Authority to ensure that you are aware of the main differences between IFRS and UK GAAP and have helped any accounting issues on a timely basis. We performed a review of restated statements to identify disclosure issues at the planning stage of the audit. We have communicated the results of this review to management to enable them to take action to address issues as appropriate. During the final audit stage we performed an independent 'hot review' of the financial statements and disclosures. Our reviews have identified some disclosure amendments and changes to the accounts, all of which have been reflected by management in the final version.

Risk	Significant / elevated risk	Reason for risk identification	Audit response
Transition to commissioning organisation	● *Elevated*	Current economic conditions are resulting in change 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 pursue this area. 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.	We have reviewed significant contracts that have been taken out during the year and ensured that these have been correctly accounted for. In addition, we have followed up on the work we performed on contract management in 2009/10 to ensure that recommendations have been addressed and monitoring processes are being followed as appropriate. While improvements can still be made, we have noted progress against all of our recommendations (see further below). No issues have been noted with contracts reviewed in the year.
Redundancy provision	● *Elevated*	Terminating the contracts of senior staff could be high profile and costly. Common issues that may arise include: • Contract of employment; • Reasons for termination; • Entitlement on severance, ex-gratia agreements and discretionary benefits; • Value for money; and • Compromise agreements, gardening leave, pay in lieu of notice, and confidentiality and clawback clauses.	We have reviewed any redundancy, severance and ex-gratia payments as part of our work on the accounts, including consideration of the legality and value for money of any such payments. We also performed testing to ensure that relevant staff have been removed from the payroll.
Valuation of property, plant and equipment	● *Elevated*	Property, plant and equipment represent a significant balance in the Authority's accounts with different classes of assets requiring different valuation methods to be applied. Component accounting has also had an impact on the valuation of certain assets. Impairment charges of £113M were charged to Income and Expenditure in 2010/11. *NB. This risk was not included in our Audit Plan; however, when*	We have considered the reasonableness of valuation methods adopted in the year in relation to external guidance available e.g. RICS guidance. We have reviewed accounting entries made and have challenged and considered the appropriateness of assumptions applied in calculating asset valuations. For example, we have discussed rationale with the Authority's internal valuer, have agreed data to external sources, have made use of external

Risk	Significant / elevated risk	Reason for risk identification	Audit response
		considering the scale of valuation movements and the assumptions involved it was considered necessary to increase the risk in relation to valuation from a 'normal' to an 'elevated' risk.	guidance and have confirmed key assumptions applied with PwC valuation experts. Some errors were noted in calculations performed; however, there was no material impact for the accounts. See page 13 for further detail.

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.

Accounts

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

- approval of the financial statements and letters of representation; and
- completion procedures including subsequent events review.

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.

Accounting issues

Implementation of IFRS

In 2010/11 the Authority has experienced reporting the Statement of Accounts under IFRS for the first time. This has involved significant changes in the presentation of the financial statements and related notes due to the increased level of disclosures required.

The revised accounting standards have impacted upon the Authority's accounts in a number of areas such as:

- the reclassification of certain property types and the treatment of revaluation gains;
- use of the new terms such as 'Cash and Cash Equivalents' to include cash and certain short term investments;
- certain leases now appear on the Balance Sheet;
- capital grants which are unconditional being accounted for immediately through income and expenditure rather than being held on the balance sheet; and
- the accrual for short term accumulating absences, in particular in relation to teaching staff.

We have worked closely with the Authority to ensure you are aware of the key differences between UK GAAP and IFRS and we have helped resolve any accounting issues.

We have reviewed the restated financial statements and have also performed a 'hot review' of the accounts and related disclosures. The restatement of the accounts and the subsequent recommendations arising from our review has led to the accounts looking very different to their previous presentation under the old SORP. Some key changes include:

- the presentation of the main financial statements and in particular the inclusion of the Movement in Reserves Statement which encompasses the requirements of the previous Statement of Movement in the General Fund Balance;
- the presentation of 3 years financial information for the balance sheet and associated notes;
- a new note for the transition to IFRS showing the transactions processed in each key area to go from the previously stated UK GAAP position to the updated IFRS position; and

- additional information throughout the financial statements, such as notes detailing the movements on each of the unusable reserves and a new note highlighting the changes between accounting basis and funding basis under regulations.

Component accounting

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

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 with input from external valuers as and when required.

The primary factor behind the revaluation loss incurred in the year is the adverse conditions affecting all building assets in the current economic climate. Another reason for the loss is the significant reduction to the Social Housing stock adjustment factor from 51% to 37%, in line with guidance issued by the Department for Communities and Local Government.

We have considered the revaluation of assets and in particular schools and dwellings in the year. 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.

The net impact of adjustments proposed is wholly immaterial. We have agreed with management that no adjustments will be made to the accounts because all errors noted related to schools and as the schools in question have converted to academy status post year end they will be written out of the accounts in 2011/12. However, we did note a number of calculation errors which had been made in the process and recommend that management ensure that valuation calculations are reviewed for reasonableness going forward and that there is a clear audit trail made available at the time of the audit.

Valuation of shareholdings in related companies

The Authority has been awarded a proportion of the shares in Newcastle International Airport, however these have not yet been transferred to the Authority as the current owners require various approvals to transfer shares. The shareholding is currently valued at £0.1M. We consider that the value of these shares is overstated and we have therefore raised an adjustment – see Appendix 1.

The Authority also holds a proportion of shares in Durham Tees Valley Airport and Premier Waste Management. We are satisfied that the values of these investments are not materially misstated in the Balance Sheet; however, valuations should be reviewed on a regular basis going forward, for example, to reflect changes in the economy.

Redundancies

Due to the current economic climate, the Authority is encountering the challenges posed by significant reductions in Government funding. Redundancy costs (to be incurred as part of the savings programme) are expected to be in the region of £5M. We understand the Authority has a capitalisation directive for £0.8M which means the other £4.2M will need to be funded from revenue. Approximately £2.4M has been charged to revenue in 2010/11 which will ultimately be funded by the Redundancy and Decommissioning Reserve.

We have reviewed and tested redundancy payments made in the year, including consideration of the legality and value for money implications of any such payments. We also performed testing to ensure staff have been removed from the payroll and have assessed the reasonableness of year end provisions.

Change in inflation measure for pensions

With effect from 1 April 2011, increases to local government pensions in payment and deferred pensions are linked to annual increases in the Consumer Prices index (CPI), rather than the Retail Prices Index (RPI). Over the long term CPI increases are likely to be lower than RPI increases, therefore a reduction in defined obligation on the Balance Sheet is realised.

This reduction, which amounts to £37M, has been recognised as a negative past service cost in the Comprehensive Income and Expenditure Statement as is also shown as an adjustment in the Movement in Reserves Statement.

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.

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.

Judgments and accounting estimates

The following significant judgments or accounting estimates were used in the preparation of the financial statements:

- pensions valuations and assumptions used to generate the IAS19 accounting entries;
- valuation of property, plant and equipment and componentisation and depreciation of assets where appropriate; and
- calculation of provisions and accruals including the bad debt, equal pay and redundancy provisions.

We will request written representations from management to confirm the reasonableness of judgments and accounting estimates made.

Material risks and exposures

The potential effect of the following material risks and/or exposures were required to be disclosed in the financial statements:

- The current economic climate makes it uncertain that the Authority will be able to sustain its current spending on repairs and maintenance, bringing into doubt the useful lives assigned to assets.

- The Authority has made a provision of £0.7M for the settlement of claims for back pay arising from the Equal Pay initiative, based on the number of claims received and an average settlement amount. It is not certain that all valid claims have yet been received by the Authority or that precedents set by other authorities in the settlement of claims will be applicable.
- Estimation of the net liability to pay pensions depends on a number of complex judgments relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets.
- At 31 March 2011, the Authority has a balance of sundry debtors of £6.4M and it was deemed appropriate that an impairment of doubtful debts of 10.8% was appropriate. In the current economic climate; however, it is uncertain whether such an allowance is sufficient.

The above uncertainties have been disclosed in the accounts within Note 14 'Assumptions made about future and other major sources of estimation uncertainty'.

We have reviewed each of the estimates noted above throughout the audit process and deem them to be reasonable in light of currently available information.

Supplementary matters

We have received a query from a local resident with regard to a planning application. We are currently finalising our response to this enquiry and we do not expect it to have any implications for our audit conclusions.

Management representations

The draft of the representation letter that we are requesting management and those charged with governance to sign is attached in Appendix 2.

Related parties

As stated in Note 36, the Authority is required to disclose material transactions with related parties – bodies or individuals that have the potential to control or influence the Authority or to be controlled or influenced by the Authority. Related parties fall under the following categories:

- Central Government;
- Members;
- Senior Officers; and
- Other Organisations.

We have tested related party transactions and have not identified any issues.

Audit independence

We confirm that, in our professional judgment, as at the date of this document, we are independent auditors with respect to the Authority and its related entities, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit engagement leader and the audit staff is not impaired.

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.

We report internal control issues separately to management and action plans have been agreed with officers. Included below is a summary of our key recommendations from both the current and previous years along with management responses in each area.

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 accompanied 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 you have 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 2010/11 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.

Unlike in previous years, we have not been required to reach a scored judgment in relation to these criteria and the Audit Commission has not developed 'key lines of enquiry' for each criteria. Instead, we have determined a local programme of audit work based on our audit risk assessment, informed by these criteria and our statutory responsibilities.

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. In our professional judgment, we believe the following matters should be brought to your attention.

Summary of significant internal control deficiencies – 2010/11

Deficiency	Recommendation	Management's response
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.	It is recommended that procedures are reviewed to minimise the risk of cut-off errors.	Agreed. The procedures will be reviewed to ensure that cut-off errors are minimised.
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.	All paper forms should be reviewed and signed by the relevant officers going forward as appropriate.	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.

Summary of significant internal control deficiencies – 2009/10 Update

2009 / 10 Recommendation	Management's response	2010/11 Update and Status
Assets with a nil net book value During 2009/10 an exercise has been performed by the Authority to review assets with a nil net book value (NBV) to confirm their existence and continued utilisation. However, from a sample of eight assets with a nil NBV selected for testing by PwC, only one had been checked as part of this exercise. The listing that had been used by DBC as a basis for the verification work had not been updated within the last 12 months and therefore there were many assets missing that had a nil NBV but had not been verified by the Authority. We therefore recommend that the authority revises its process for reviewing assets with a nil NBV to ensure that there is an annual programme which includes all assets with a nil NBV.	Agreed - Procedures have been put in place to ensure compliance. Target implementation date: 31 March 2011.	***Status:* Closed** An exercise was undertaken in 2010/11 involving a review of all assets with a nil NBV to ensure compliance. Procedures are in place to ensure compliance in future years.
Debtor and creditor reconciliations The aged debtor and creditor reports were not run on 31 March 2010 and therefore it was not possible to reconcile the aged listings to the general ledger and therefore the values in the accounts. Procedures were undertaken to 'back track' through transactions since the year-end to get back to 31 March values, however this was not entirely possible and therefore unexplained differences exist. The unexplained differences were not considered to be material. It should be ensured that at each year end (i.e. on 31 March) the aged debtor and creditor reports are run and reconciled to the general ledger. Differences should be investigated thoroughly so that supporting evidence is complete and can be provided for audit.	Agreed - Procedures have been put in place to ensure compliance. Target implementation date: 31 March 2011.	***Status:* Closed** Both the debtor and creditor reports were run on 31 March and reconciled to the General Ledger.
Fixed assets held under		***Status:* Closed**

operating leases During 2009/10 as part of an asset register 'clean-up' exercise, DBC removed assets relating to the North Road Station Museum from the asset register as it is occupied under an operating lease. Management believed that the property had been incorrectly included on the register. On investigation into the detail of the value attributed to the assets it was identified that the value in fact related to additions and enhancements that had been made to the building. Management therefore agreed to reinstate this asset on the fixed asset register. We recommend that the assets attributed to the North Road Station Museum should be depreciated in line with the authority's policy, over the shorter of the life of the asset and the remaining life of the lease for the building.	Agreed. Target implementation date: 31 March 2011.	Assets were reinstated on Balance Sheet in 2010/11 and depreciated over the remaining life of the lease as appropriate.
Contract Management 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 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 followed up this recommendation during a meeting with the Head of Educational Services within the People group and his supporting team on 9 September 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 has improved leading to a reduced number of disputes, improved reporting and more effective challenge from the Authority. The appointment of an officer to a post on site at the school for 6 months also provided ongoing benefits and the Authority are looking to fill this post on a more permanent basis. However, it is clear that many of these processes are still

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.		being embedded and relationships between all parties are still developing. It is also not clear that the expertise is in place at all parties to manage the contract most effectively. As such we expect to maintain this recommendations with the expectation of doing a more detailed follow up in 2011/12.

Risk of fraud

Fraud

International Standards on Auditing (UK&I) state that we as auditors are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The respective responsibilities of auditors, management and those charged with governance are summarised below:

Auditors' responsibility

Our objectives are:

- to identify and assess the risks of material misstatement of the financial statements due to fraud;
- to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- to respond appropriately to fraud or suspected fraud identified during the audit.

We found no instances of fraud to report the audit committee. We have detailed weaknesses in the design or implementation of internal control to prevent and detect fraud in the "Internal Controls" section.

Management's responsibility

Management's responsibilities in relation to fraud are:

- to design and implement programmes and controls to prevent, deter and detect fraud;
- to ensure that the entity's culture and environment promote ethical behaviour; and
- to perform a risk assessment that specifically includes the risk of fraud addressing incentives and pressures, opportunities, and attitudes and rationalisation.

Responsibility of the audit committee

Your responsibility as part of your governance role is:

- to evaluate management's identification of fraud risk, implementation of antifraud measures and creation of appropriate "tone at the top"; and
- to investigate any alleged or suspected instances of fraud brought to your attention.

Fees update

Fees update for 2010/11

We reported our fee proposals as part of the Audit Plan for 2010/11.

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, mean 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 is set to abolish the Housing Revenue Account subsidy system and introduce self-financing for council housing. This represents one of the most radical reforms of public housing policy for many years, and the effects will be 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, HRA reform is seen by some councils as a viable means of delivering much needed investment in new and improved social and affordable housing.

Currently the HRA subsidy system redistributes significant resources annually between local and central Government. In 2011 it is forecast that some 175 councils across England will collect almost £7bn of rent from the 1.8m homes in local authority ownership.

Through the HRA subsidy system the rental income is paid to Government, in return for which some £5bn of allowances for management, maintenance and investment is paid to councils.

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

The process of reform of the HRA subsidy system is set for implementation in April 2012.

Under the proposals, councils will keep the rental income they generate and will be responsible for deciding how they use it to meet their local housing needs. In return for this councils will be allocated a share of some £28bn of debt. Unlike current housing debt this will be "real" debt that they will be responsible for managing and servicing.

Local financial Impact

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

- Councils will be 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 will be allocated a level of debt that they will be 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, council will need to:

- Develop new long term asset management plans;

- Identify investment needs; and

- Develop short, medium and long term funding solutions.

Appendices

Summary of corrected and uncorrected misstatements

We are obliged to bring to your attention any unadjusted errors, which are not considered material, found during the course of the audit that have not been corrected, unless they are 'clearly trivial'. It was agreed with members of the Audit and Risk Committee in May 2011 that we are to report all proposed audit adjustments which management have not elected to change with a value greater than £100,000.

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

No	**Description of misstatement (factual, judgemental, projected)**		**Income statement**		**Balance sheet**		**Adjusted**
			Dr £'000	**Cr £'000**	**Dr £'000**	**Cr £'000**	
1	Dr Accounts Receivable Cr Accounts Payable Being an adjustment to reclassify debit balances noted on the purchases ledger.	F	-	-	108	108	No
2*	Dr Reserves Cr Long term investments Being an adjustment to reflect the overstatement of the shares held in Newcastle Airport.	J	-	-	97	97	No
Total uncorrected misstatements			**-**	**-**	**205**	**205**	

* Item 2 is below our reporting threshold but as a judgemental area this is has been included in the reporting to the Audit Committee.

We have also identified the following misstatements during our audit work which have been corrected by management in the final accounts and which we believe should be reported to the Audit Committee.

No	**Description of misstatement (factual, judgemental, projected)**		**Income statement**		**Balance sheet**		**Adjusted**
			Dr £'000	**Cr £'000**	**Dr £'000**	**Cr £'000**	
1	Dr Accounts Receivable Cr Accounts Payable Being adjustment to reverse a duplicate entry, which resulted in debtors being understated.	F	-	-	2,976	2,976	Yes
2	Dr Reserves – CAA Cr Reserves - UCR	F	-	-	441	441	Yes

	Being an adjustment to correct capital grant incorrectly applied twice.						
3	Dr Long term creditors Cr Short term creditors Being an adjustment to allocate the short term element of the PFI and finance lease liabilities to short term creditors on the balance sheet.	F			1,827	1,827	Yes
4	Dr Current liabilities (capital grants receipts in advance) Cr Long term liabilities (capital grants receipts in advance) Being an adjustment to reclassify capital grants received in advance to long term creditors in line with the requirements of the Code.	F			1,099	1,099	Yes
5	Dr Financing and investment income and expenditure Cr Cost of services Being an adjustment to reclassify the interest cost on the PFI scheme to financing and investment income rather than being charged to service lines.	F	1,150	1,150			Yes
Total corrected misstatements			**1,150**	**1,150**	**6,343**	**6,343**	

Draft letter of representation

PricewaterhouseCoopers LLP
89 Sandyford Road
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 2011 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 Darlington Borough Council 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 Council, 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	3.70%
Rate of general long-term increase in salaries	5.20%
Rate of increase to pensions in payment	2.80%
Rate of increase to deferred pensions	2.80%
Rate for discounting scheme liabilities	5.40%

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 £0.714M 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 2010/11.

Due to significant reductions in Government funding, the Authority expects to incur redundancy costs in the region of £5M. The Authority has been 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 has been charged to revenue in 2010/11 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 council 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 30 September 2011

……………………………….

Director of Resources

For and on behalf of Darlington Borough Council

In the event that, pursuant to a request which Darlington Borough Council has received under the Freedom of Information Act 2000, it is required to disclose any information contained in this report, it will notify PwC promptly and consult with PwC prior to disclosing such report. Darlington Borough Council agrees to pay due regard to any representations which PwC may make in connection with such disclosure and Darlington Borough Council shall apply any relevant exemptions which may exist under the Act to such report. If, following consultation with PwC, Darlington Borough Council discloses this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.