Darlington Borough Council

2009/10 Report to those charged with governance

September 2010

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

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

Executive Summary

The purpose of this report

This report summarises the results of our 2009/10 audit. It sets out:

- Matters arising from our audit of the financial statements which we are required to report to you under the Audit Commission's Code of Audit Practice and International Standard on Auditing (UK & Ireland) 260 - "Communication of audit matters with those charged with governance";
- The results of our work under the Code of Audit Practice, to support the Value for Money conclusion; and
- An audit fee update.

Financial Statements

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

- Valuation of shares held in related companies;
- Assets held under operating leases;
- Aged debtor and creditor reports;
- Fixed asset register; and
- Change in inflation basis for pensions.

We ask the Audit Committee to consider the draft management representation letter (Appendix D) and confirm that Members are comfortable with the representations proposed, including those in respect of unadjusted misstatements.

Financial statements

Accounts

As at today's date (13 September 2010), we have completed substantially all of the audit work on the Authority's accounts, with the exception of:

- The receipt of a number of external confirmations of investment and loan balances;
- A review of the disclosure adjustments associated with the recent change of the inflation basis for pensions;
- A final audit review of the final draft of the accounts to ensure that all agreed amendments have been processed; and
- A review of a number of service concessions to determine whether the assets used to deliver the relevant services should be included in the Council's balance sheet.

We will update the Audit Committee again if any significant matters arise through completion of the outstanding work.

The draft management representation letter is attached for your consideration in Appendix D.

We anticipate issuing an unqualified audit opinion on the financial statements.

Accounting Issues

A number of accounting issues were identified and addressed during the audit. The most significant of these issues are set out below:

Valuation of shareholdings in related companies

Darlington Borough Council (DBC) accounts as a long term investment for a proportion of the shares in Newcastle International Airport Limited (NIAL). These shares have not yet been legally transferred to DBC and are currently in the name of Durham County Council. The value of the shareholding has been written down to £97,000 during 2009/10 from £184,000 at 31 March 2009. We consider that the value of these shares is overstated and we have therefore raised an adjustment (see adjustment 4 in Appendix A) for this.

The Council also holds a proportion of the shares in Durham Tees Valley Airport and Premier Waste Management. We are satisfied that these investments are valued correctly in the Council's balance sheet. However, they should be kept under review going forward given changes in the ownership of Durham Tees Valley Airport and general changes in the economy.

Assets held under operating leases

During 2009/10 as part of an asset register 'clean-up' exercise, DBC removed assets from the register which had a total net book value of £1,794,027. Within this total was an amount of £1,290,495 which related to the North Road Station Museum. This was written out of the asset register because the building is occupied under an operating lease and management believed that it had incorrectly been included on the register.

We established that the amount capitalised related to additions/enhancements that had been made to the building by the Council during the period 2007 to 2009. Such expenditure can be capitalised. Management therefore agreed to reinstate the capital costs on the fixed asset register.

We have raised a control recommendation (ref 3 in Appendix C) for the asset to be depreciated over the shorter of the asset life or remaining life of the lease on the building.

Aged debtor and creditor reports

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 difference in debtors at 31 March 2010 between the aged debt listing and the ledger is £183,057, and the difference in creditors is £14,706. These balances are not material to the financial statements. Additionally, our year end work focused on a breakdown of the debtor and creditor balances as per the accounts which were at 31 March 2010. This testing confirmed the completeness and accuracy of these listings so we are satisfied that the balances in the accounts are materially accurate.

As a result of this issue, the provision for doubtful debts has been based on an inaccurate aged debt value (i.e. based on the report run on 13 April 2010). The impact on the provision is wholly immaterial.

We have raised a recommendation (ref 2) regarding the production of aged debtor and creditor listings in Appendix C.

Fixed asset register

During 2009/10 an exercise was performed by DBC to review assets with a nil net book value to confirm their existence and utilisation. However, from a sample of eight assets with a nil net book value 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 that had a nil net book value but that had not been verified by the authority.

We have raised a control recommendation (ref 1 in Appendix C) concerning the need to perform a complete verification exercise each year.

Change in inflation basis for pensions

A recent Government announcement has confirmed that it will move to the use of the Consumer Price Index (rather than the Retail Price Index) as the measure of price inflation for public sector pension schemes. We have considered the implications and drawn down the following conclusions in relation to the Local Government Pension Scheme:

- The announcement should be treated as an event after the balance sheet date, even before the required legislation has been enacted.
- It is a non-adjusting event because it does not change the conditions that applied at 31 March 2010.
- As CPI is usually substantially lower than RPI, there is the potential for a significant fall in the calculated pension liability – it is the Actuary's current view that CPI will be approximately 0.7% per annum less than RPI over the long term.
- If material, a note to the accounts will be required describing the nature of the event and an estimate of its financial effect (or a statement that such an estimate cannot be made).
- The accounting treatment for the change will be that of a negative past service cost recognised in the Income and Expenditure Account in full in the year in which it occurs, i.e. at the next year end.

Provision for redundancy payments

The draft accounts omitted any liabilities for redundancy payments. However, in our view, decisions on a number redundancies had advanced by the year-end to the point where provisions should have been made for the potential costs.

The value of the proposed adjustment is not material (see ref 5 in Appendix A).

Errors in the accounts

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 clearly trivial nature. We regard misstatements less than £1,000 as clearly trivial. The unadjusted misstatements are set out in Appendix A to this report.

We also bring to your attention the significant misstatement detailed above in relation to the North Road Station Museum, which has been corrected by management. We consider you should be aware of all adjustments in fulfilling your governance responsibilities.

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. There are no issues that we would consider “material” in this context, however, for completeness, the issues that we have raised are set out in Appendix C to this report.

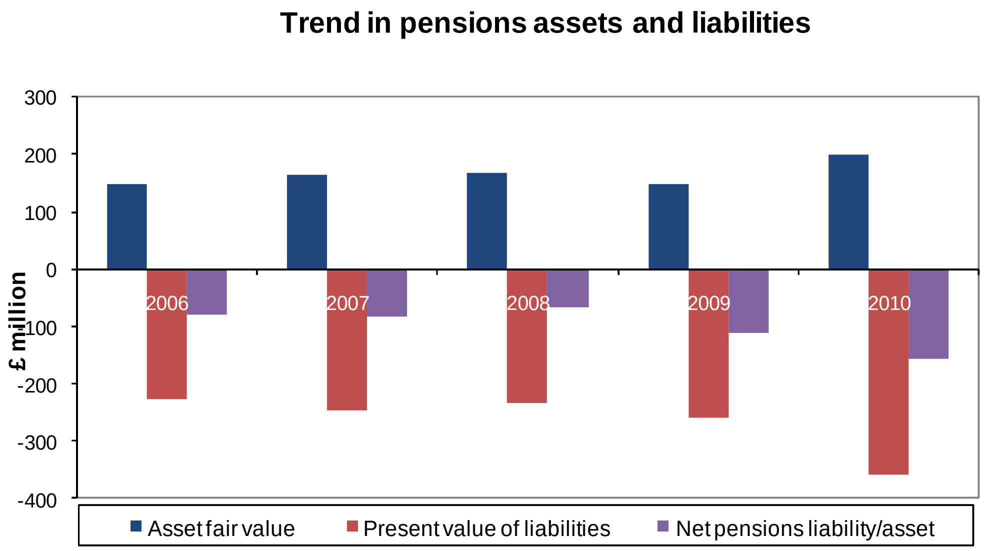
Accounting practices

We are also required to report to you our view on qualitative aspects of the Authority’s accounting practices and financial reporting. The financial statements were prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2009 (the SORP). We believe that the following matter should be brought to the attention of members:

Pensions estimate

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

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



(Note that the 2010 liability presented here is based on RPI rather than CPI. This means that it has been calculated on a consistent basis with the other years disclosed in the chart).

A full actuarial valuation for the scheme as at 31 March 2010 is underway. Current indications are that an increased level of employer contributions may be needed across the sector to make up scheme shortfalls. The extent of any contributions increase will depend on the magnitude of the shortfall and the period over which it is recovered. Decisions concerning the recovery period should take into account prudence and the likelihood that longer recovery periods will increase the real cost to the scheme and employer.

The importance of assumptions

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

As consulting actuary to the Audit Commission, PwC meets all the local government scheme actuaries annually to gain an understanding of the methodology and assumptions they use. The table below sets out the principal assumptions used by your actuary in 2009/10 and 2008/09 and the impact of changes in assumptions on the gross pension liability.

	2009/10	2008/09	Approximate impact of change in assumption
Discount Rate	5.5%	6.6%	Decrease of 0.1% increases liability by 2%
Inflation rate	3.9%	3.6%	Increase of 0.1% increases liability by 2%
Rate of salary increase	5.4%	5.1%	Increase of 0.1% increases liability by 0.5%
Life expectancy at 65 (years)			
Male age 65	21.2	21.1	Increase of 1 year increases liability by 4%
Female age 65	23.3	23.2	
Returns on assets			
Equities	8%	7%	
Government Bonds	4.5%	4.%	
Corporate Bonds	5.5%	5.8%	
Property	8.5%	6%	
Cash	0.7%	1.6%	

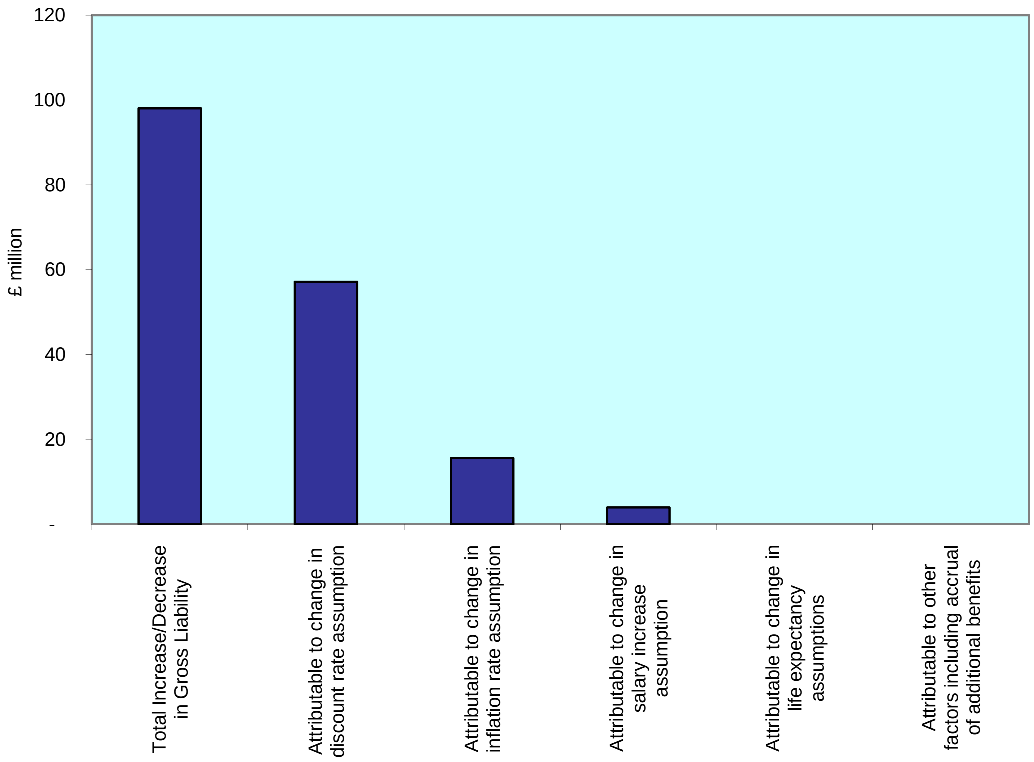
Typical assumptions used by actuaries for local government pension schemes are shown below. The actuary for the Durham County Council Pension Fund is Hewitt.

	Hewitt	Barnett Waddingham	Hymans Robertson	Mercer
Discount Rate	5.50%	5.50%	5.50%	5.60% - 5.70%
Inflation rate	3.80% - 3.90%	3.90%	3.80%	3.30% - 3.50%
Rate of salary increase	5.30% - 5.40%	4.90% - 5.90%	5.30%	4.55% - 4.75%
Life expectancy at 65 (years)				
Male age 65	20.0 - 23.2	19.1 - 21.5	18.4 - 22.6	20.4 - 22.1
Female age 65	22.0 - 25.1	22.1 - 24.6	21.7 - 26.0	23.2 - 25.0
Male age 45	22.2 - 25.6	20.0 - 22.5	20.3 - 24.7	21.3 - 23.1
Female age 45	24.1 - 27.4	23.0 - 25.8	23.7 - 28.2	24.1 - 25.9
Returns on assets				
Equities	8.00%	6.50% - 8.00%	7.80%	7.50%
Government Bonds	4.50%	4.50%	5.00%	4.50%
Corporate Bonds	5.50%	5.50%	5.00%	5.20%
Property	8.50%	5.50% - 7.00%	5.80%	6.50%
Cash	0.70%	3.00%	4.80%	0.50%

It is important that management understand and appropriately influence the assumptions underpinning the net pension liability.

The chart below sets out an indication of the impact of this year's pension liability assumptions. It shows a break down of the movement in gross pensions liability and shows that changes to discount rate and inflation assumptions make up almost the entire increase in gross liability for the year. This highlights the importance of decisions taken regarding the pensions assumptions.

Change in gross pensions liability



Note that this graph is indicative of typical changes only, as we have not had access to the actuary's working papers and have not taken benefit changes or special events (e.g. past service costs, settlements or curtailments) into consideration.

The Authority also participates in the Teachers' Pension Scheme, which is a multi-employer defined benefit scheme where the individual employers' share of the assets and liabilities of the scheme cannot be identified. Therefore, the Authority accounts for this scheme as a defined contribution scheme under FRS 17 'Retirement benefits'. It recognises contributions payable for the year in the income and expenditure account but does not include a pension liability in the balance sheet for benefits earned by Authority employees.

If you would like to discuss pensions issues or assumptions for pensions estimates further, please contact either Simon Clegg, Paul Harrison or Janet Eilbeck.

Other matters

We have received a number of queries from electors relating in particular to the Pedestrian Heart scheme in Darlington. We have completed our responses to these queries and have also issued a letter to the Director of Corporate Services and the Chief Executive. Our work focused on:

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

We have reviewed the circumstances surrounding the delays and overspends arising from the contractor striking the gas main through discussions with officers and reviews of documentation held by the Council, including expert and legal reports.

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

Notwithstanding this, we are aware that the delays and overspends associated with the scheme have caused considerable concern to the residents of Darlington and we have considered whether there is a need to issue a public interest report on the Pedestrian Heart project. We have concluded that there would be little public benefit in such a report because:

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

Accounting and audit matters

As part of the planning process we identified significant and other risks which were reported to you as part of our External Audit Plan. We have set out below the work undertaken as part of the external audit in relation to the risks identified.

<table>
<tr><th>Matter identified in the audit plan</th><th>Work performed</th></tr>
<tr><td>Financial standing

The Council is likely to be experiencing increased pressures on many of its budgets as economic conditions have worsened. The following factors may impact upon the Council and its financial standing:

• the need to achieve challenging efficiency targets across the board;
• existing budget pressures within Adult Services are forecast to continue;
• significant capital expenditure plans countered by reduced capital receipts income;
• increased demand on services resulting from the economic downturn and demographic pressures; and
• the valuation of fixed assets and investments related to current economic uncertainties.</td><td>We have performed the following procedures to address these risks:
• assessed the valuation of fixed assets and investments;
• tested cut-off procedures to ensure transactions are recognised in the correct period;
• substantively tested significant accounting estimates to ensure that balances are appropriate and complete; and
• reviewed proactive anti-fraud procedures, operational controls and the results of any fraud investigations in the year.

We have also monitored the financial position of the council to ensure that financial standing is not compromised as part of our assessment of going concern.</td></tr>
<tr><td>Introduction of IFRS – Accounting for PFI schemes

Local Government will adopt International Financial Reporting Standards (IFRS) in full in 2010/11. Project planning for this transition is already well underway at the Council. Processes need to ensure that information required for the transition (e.g. comparatives for the 2010/11 statements) can be collected efficiently and effectively during the 2009/10 closedown.

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

Currently the Council does not recognise the assets within this scheme on its Balance Sheet. It is likely that these assets will come on balance sheet for 2009/10 under the new accounting arrangements. This change will involve some complex accounting adjustments, including prior period adjustments to show the position as if these requirements had applied since the beginning of the PFI scheme.</td><td>We have reviewed the outputs of the work performed by the Council, with support from its advisers, in calculating and accounting for the adjustments required to bring the PFI assets on to the balance sheet.</td></tr>
</table>

Matter identified in the audit plan	Work performed
Management override of controls In considering the risk of fraud within an organisation we are required to consider the scope for management to override controls leading to material incorrect or fraudulent transactions being reported in the accounts.	We have considered the potential for management override in our review of internal controls and our work with internal audit. We also performed the following audit procedures designed to address the risk of management override: • testing the appropriateness of journal entries and other adjustments; • review of the reconciliation of key control accounts; • testing of accounting estimates; and • understanding the business rationale for significant transactions.
Revenue recognition There is a rebuttable presumption established in auditing standards that revenue recognition is a significant risk for all external audits. Recognition of revenue is an area of financial reporting which can be judgemental and is therefore open to manipulation, for example by recognising revenue prematurely or failing to recognise revenue in the proper year.	We considered income recognition as part of our testing of income balances to ensure that appropriate accounting principles had been applied. Specific tests included: • reviewing significant contracts entered into by the Council to ensure that revenue was recognised in the appropriate period; and • examining transactions occurring around the year end to ensure they were accounted for in the correct period.
Accounting for council tax Accounting guidance for Local Authorities (documented in the 2009 Local Government SORP) has changed the requirements for the way in which Council Tax income and debtors and creditors should be accounted for in the 2009/10 financial statements. Officers will need to ensure that they are familiar with the new requirements.	We have reviewed the prior period adjustments that have been made in response to the change in requirements. We also performed procedures to assess compliance with the changes: these were included in the testing of debtors, creditors and reserves.
Contract management Ineffective contract management and ongoing monitoring of contract performance could result in inefficiencies and reduced value for money. In particular recent contractual overruns on the Pedestrian Heart scheme have led to questions being raised by electors in this area.	We reviewed the circumstances surrounding the delays and overspends on the Pedestrian Heart contract (see pages 8-9) We have also reviewed contract information relating to the Authority's PFI scheme. We have raised several control recommendations that are included in Appendix C.

<table>
<tr><th>Matter identified in the audit plan</th><th>Work performed</th></tr>
<tr><td>Retirement benefits

There are two important aspects of FRS 17 accounting that are influenced by the current economic climate:

• Discount rates – as the market for high quality corporate bonds has become shallower, problems have arisen in establishing discount rates for FRS 17 purposes.

• Valuation of scheme assets – the same guidance for determining values for financial assets applies to pension fund assets. Problems have arisen in earlier years where actuaries have used estimates for returns on assets based on trends before the year-end that have proven to be materially inaccurate. The current instability of the markets makes recurrence of this problem likely in 2009/10. The Council will need to ensure that out-of date figures are identified and corrected.</td><td>We reviewed the assumptions used by the actuary as part of our work on pensions to obtain assurance that these were reasonable.

We liaise closely with the Audit Commission, the auditors of the local government pension scheme administered by Durham County Council, to determine whether there may be any material errors in the pension fund balances.</td></tr>
<tr><td>Involvement in other entities

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

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

If there has been a significant deterioration in the results and balance sheet of entities that have not previously been consolidated on the grounds of materiality, the decision not to consolidate may need to be revisited.</td><td>We have reviewed the position of all entities in which the Council retains an interest and we are satisfied that the current accounting treatment remains appropriate.</td></tr>
</table>

Value for Money in the Use of Resources

Work performed

We have concluded on the Authority's arrangements for achieving economy, efficiency and effectiveness in its use of resources.

Our work to support this Value for Money conclusion comprised the following elements:

- Work performed on the key lines of enquiry (KLoEs) specified by the Audit Commission as underpinning the Value for Money conclusion. This includes Use of Resources assessment work undertaken to the end of May.
- Review of the Annual Governance Statement

Value for Money Conclusion

Under the Code of Audit Practice we are required to provide a conclusion on the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources. The conclusion is based on the adequacy of the Authority's arrangements to meet criteria issued by the Audit Commission. Since 2008/09, selected Key Lines of Enquiry (KLoEs) have formed the criteria for the Value for Money conclusion. These are listed in Appendix B.

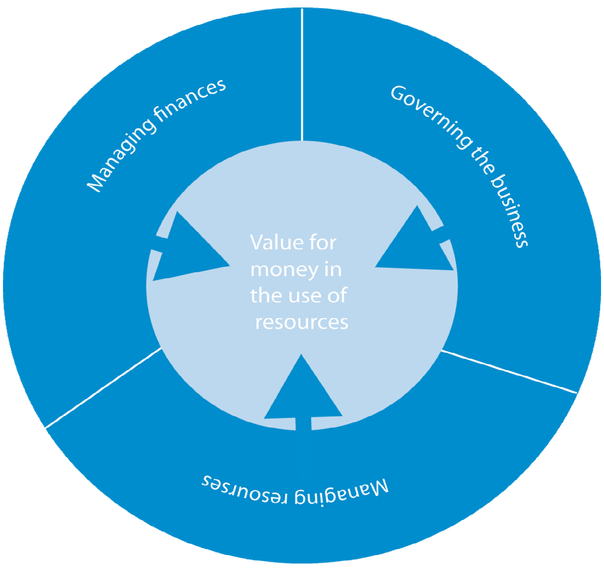
We intend to issue an unqualified value for money conclusion.

Use of resources

In May this year, the government announced its intention to abolish comprehensive area assessment (CAA). Shortly afterwards, we were instructed by the Audit Commission to halt all work on the Use of Resources assessment.

Therefore we cannot report Use of Resources scores, as this work was not completed. However, the work undertaken has informed our Value for Money conclusion.

The Use of Resources assessment reviewed the Authority's arrangements against the specified KLOEs for the Authority (Appendix B). These are grouped into three themes, which form the Use of Resources framework. This is illustrated below. The assessment focussed on the Authority's achievements, outputs and outcomes, rather than the Authority's processes.



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 in the financial statements.

CIPFA recently issued a statement on The Role of the Chief Financial Officer in Local Government 2010[1] , which makes recommendations about:

- the Chief Finance Officer's position in an authority's leadership,
- their involvement in and ability to influence key business decisions
- their responsibility for promotion of good financial management,
- their role in leading and directing a finance function which is resourced to be fit for purpose, and
- the qualifications and experience required of a Chief Finance Officer.

The recommendations of the statement are expected to be consolidated into the CIPFA/Solace Framework "Delivering Good Governance in Local Governance" over the next year. In the meantime, CIPFA has recommended a voluntary "comply or explain" approach in the 2009/10 AGS. This means the AGS is expected to include either:

- a confirmation that the authority's financial management arrangements conform to the CIPFA Statement, or
- an explanation of why they do not and how the authority delivers the same impact.

The Authority has included this information in the AGS. As auditors, we are not required to report on this aspect of the AGS for 2009/10.

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.

[1] http://www.cipfa.org.uk/pt/download/role_of_CFO_in_LG_2010_WR.pdf

Current and future developments

We provide regular accounting and technical updates for the Authority through annual training events and our periodic accounting publication for local government 'Authority on Accounting'.

International Financial Reporting Standards (IFRS) implementation for 2010/11 accounts

The adoption of International Financial Reporting Standards (IFRS) represents a significant change in financial reporting in the UK public sector. The process has already started for local authorities, as this year's SORP adopted the new accounting arrangements for PFI and service concessions, while previous SORPs have adopted IFRS style accounting for financial instruments.

The IFRS-based Code of Practice on Local Authority Accounting (the IFRS-based Code), will complete the transition process and applies to local authority accounts from 1 April 2010. As well as preparing the 2010/11 accounts under the IFRS-based Code, authorities must restate their balance sheet at the point at which the Code is adopted (1 April 2009), and present restated comparatives for 2008/09.

The format of the financial statement will change, with the Income and Expenditure Account and Statement of Total Recognised Gains and Losses being combined to form a new Comprehensive Income and Expenditure Statement. In addition, the Statement of Movement on the General Fund Balance will be replaced by the new Movement in Reserves Statement.

As well as these changes to the format of statements, there will be significantly increased levels of disclosure in the notes to the account and certain items may be brought onto the balance sheet for the first time.

CIPFA /SOLACE review of Delivering Good Governance in Local Governance Framework

CIPFA has issued an Application Note to Delivering Good Governance in Local Government as an addendum to the CIPFA /SOLACE Governance Framework Delivering Good Governance in Local Government. The guidance builds on the Statement on the role of the Chief Financial Officer in Local Government published by CIPFA. The Statement recommends that the CFO should be a member of the leadership team, with a status at least equivalent to other members. It sets out the key features of the role that CIPFA expects the CFO to play as well as outlining the skills and personal attributes required for successful performance.

The Application Note is intended to be a temporary measure that will operate for the financial years 2009/10 and 2010/11 during which time CIPFA aims to carry out a full review of the CIPFA/SOLACE Framework including consultation.

CIPFA consultation: Statement on the role of the Head of Internal Audit in public service organisations

CIPFA's consultation on the draft Statement on the role of the Head of Internal Audit in public service organisations closed on 10 September. The statement is intended to raise the profile and clarify the role of the Head of Internal Audit (HIA). It sets out best practice for HIAs to aspire to and for Audit Committees and others to measure internal audit against. The proposed principles-based framework is intended to apply to all HIAs in the UK, irrespective of the particular part of the public services in which they work. The Statement draws on the best practice and regulatory requirements in public services, as well as the requirements of CIPFA, other professional accountancy bodies' and the Institute of Internal Auditors' codes of ethics and professional standards.

CLG consultation on the future of council housing

In March 2010, the Department for Communities issued a prospectus "Council Housing - A Real Future". This contains proposals for putting the HRA on a self-funding basis that will involve the abolition of HRA Subsidy. Instead, authorities would fund their expenditure from rental income. The mechanism that will ensure equity between authorities is a reallocation of housing debt, based on an assessment of the level at which servicing will be affordable from individual HRAs. It will be crucial to get the opening debt figure correct if the HRA is to achieve the break-even target effectively.

There is no target implementation date for the proposals. However, authorities have been encouraged to consider the new skills and capacity they might need for the new arrangements and to test the opening debt figure proposed for them. The consultation exercise is being endorsed by the new Government (although without any commitment to the views expressed in the consultation document).

Capital finance regulation changes

Amendments made in 2010 to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 have effect for 2010/11 as follows:

- The regulation allowing authorities to defer the revenue impact of Equal Pay back payments until cash is paid has been extended from 31 March 2011 to 31 March 2013.

- Purchase of shares in the Local Authorities' Property Fund (LAPF) can no longer be regarded as capital expenditure.

- Capital receipts may now be used to:

  - finance costs of disposals for non-housing disposals, up to a maximum of 4% of the capital receipts generated, and

  - to settle obligations arising on the disposal of an asset in relation to agreements made at the time the asset was acquired.

Government spending review

The Government has published details of reductions to individual local authority grant allocations for 2010-11, which will contribute £1.166bn of local government savings in 2010/11. The changes include measures to remove ring fencing of certain grant streams. The grant reductions are part of a total of £6.2bn cross government savings in 2010/11 intended to tackle the UK's deficit in order to restore confidence in the economy and support the recovery. At the same time the government will work in partnership with local authorities to implement a council tax freeze in 2011/12.

The distribution and level of grants from 2011-12 onwards will be considered in the autumn Spending Review with further cuts and removal of ring fencing expected.

Carbon reduction commitment (CRC)

This mandatory emissions trading scheme started in April 2010. It aims to promote energy efficiency and help reduce carbon emissions. It is UK-wide, covering large businesses and public sector organisations. Authorities with an annual spend of more than £400,000 - 500,000 on electricity each year are likely to be in the scope of CRC.

All participants must monitor energy use and file an annual return with the Environment Agency which sets out their energy usage. They will then have to purchase allowances from the Government to use energy in the following year. The Government will compare the energy efficiency of each participant by ranking them in a published league table. The monies collected through the sale of allowances will then be returned to the participants, but with those who perform better in the league table receiving a bonus and those who perform badly suffering a penalty. Consequently there will be a cash flow impact for all participants, but both a reputational risk (via their standing in the league table) and financial downside for the poor performers.

The first annual reporting year is April 2010 – March 2011 and the first sale of allowances will take place in April 2011 – March 2012. Organisations that are required to participate fully in the scheme will need to consider how to account for the purchase of allowances, the obligation to deliver allowances and the receipt of revenue recycling payments

Clarity International Standards on Auditing (UK & Ireland)

The Auditing Practices Board (APB) has issued 33 Clarity ISAs (UK &I), based on the IAASB's Clarity International Standards on Auditing (ISAs), effective for audits of financial statements for periods ending on or after 15 December 2010.

A number of the standards have been completely revised and new requirements have been introduced. There are approximately one-third more explicit requirements applying to entity audits and extra new requirements that apply to group audits, with about half of the total increase resulting from clarification of the existing standards, and about half relating to new requirements designed to improve audit quality and, consequently, financial reporting.

The actual impact on cost of audits will depend on a variety of factors such as the effectiveness of current execution; the size and complexity of the entity; and how effectively we can work with you to obtain any additional information needed to enable us to perform the required procedures.

The UK Bribery Bill

The UK Government introduced the Bribery Bill into the House of Lords on 19 November 2009. The Bill seeks to enhance the UK's anti-bribery legislation, which is widely perceived as out of date and has been subject to serious criticism internationally.

The Bill replaces previous offences with a general bribery offence and a specific offence relating to bribery of foreign public officials (both of which are applicable to individuals and UK-registered companies). It also introduces the specific corporate offence of failing to prevent bribery, which is designed to make companies and other corporate bodies responsible for bribery committed on their behalf. The key potential liability relates to failure to prevent active bribery for and on behalf of the corporate body by its employees, agents or subsidiaries. Bodies found to have committed any bribery offence could face unlimited fines, while individuals could face a maximum 10 year prison sentence and/or an unlimited fine

Audit plans and fee update

Audit Plan

We issued our Audit Plan for 2009/10 and presented it to Members in March 2010.

Other than curtailment of CAA Use of Resources work in May 2010, the plan has not been changed in any significant respect.

In this report we comment only on those areas where we believe we need to communicate with those charged with governance.

Audit fees update for 2009/10

We reported our audit fee proposals in the fee letter issued in May 2010.

Our actual fees are expected to be in line with our proposals.

Our fees charged were:

	2009/10 Expected Outturn	2009/10 Fee proposal
Financial Statements	£139,550	£139,550
Use of Resources/VFM conclusion (work conducted in 2009)	£71,350	£71,350
Whole of government accounts	£2,400	£2,400
Total audit fee	**£213,300**	**£213,300**
Certification of claims and returns	£30,700	£35,000
Total fee	**£244,000**	**£248,300**

However, the proposed scale of fees does not include provision for:

- Review of changes to the accounting treatment of private finance initiative (PFI) or public private partnership (PPP) schemes arising from the transition to IFRS. The Audit Commission's guidance on fee scales recognises that the scope, and therefore the costs, of such reviews will depend upon the nature and complexity of the scheme and may need to be reflected in a variation to the fee. Some additional audit time has been incurred in reviewing the accounting treatment for the Education Village and Harrowgate Hill Primary School PFI scheme in Darlington. This will be charged at the hourly rate equivalent to the scale rates mandated for grant return work.

- Electors' questions: above a small amount of time set aside within the fee estimate, work on matters raised by members of the public is separately chargeable to the Council. Following the conclusion of our audit we will calculate the amount payable in respect of the queries received this year.

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	Consolidated Revenue Account		Balance Sheet	
		Dr £'000	Cr £'000	Dr £'000	Cr £'000
1	Overstatement of capital assets as a result of inappropriate capitalisation of revenue items.	Expenditure 78			Fixed Assets 78
2	Overstatement of debtors and income as a credit note was raised post year-end and not accrued for.	Income 15			Debtors 15
3	Correction of capital items treated as revenue expenditure		Expenditure 12	Fixed Assets 12	
4	Overstatement of the value of the shares held In Newcastle Airport.			Reserves 97	Long term investments 97
5	Correction of underprovision for redundancies not recognised in the year.	Expenditure 206			Provisions 206
	Net effect	299	12	109	396

We also identified the following significant misstatements during our audit which management have corrected, but which we consider should be communicated to you to assist you in fulfilling your governance responsibilities:

	Adjusted Misstatement	Consolidated Revenue Account		Balance Sheet	
		Dr £'000	Cr £'000	Dr £'000	Cr £'000
1	To reinstate the value of the North Road Station Museum assets which had been incorrectly written out of the accounts.		Loss on disposal 1,290	Fixed Assets 1,290	
2	Accrued interest on long term borrowings to be treated as a current liability, and restate all interest payable from creditors to borrowings.			Long term borrowing 714 Creditors 66	Temporary borrowing 780
	Net effect	0	1,290	2,070	780

Appendix B: Value for Money conclusion criteria

The Audit Commission publishes Code of Practice criteria on which auditors are required to reach a conclusion on the adequacy of an audited body's arrangements for economy, efficiency and effectiveness in its use of resources. The criteria are linked to Key Lines of Enquiry (KLoEs). The Commission specifies which KLOEs will form the 'relevant criteria' for the VFM conclusion for each type of body each year. The table below shows the KLoEs specified for the conclusion in 2009/10 and 2008/09.

Managing Finances

Key Lines of Enquiry		Specified in 2009/10	Specified in 2008/09
1.1	Does the organisation plan its finances effectively to deliver its strategic priorities and secure sound financial health?	✓	✓
1.2	Does the organisation have a sound understanding of its costs and performance and achieve efficiencies in its activities?	✓	✓
1.3	Is the organisation's financial reporting timely, reliable and does it meet the needs of internal users, stakeholders and local people?	✓	✓

Governing the Business

Key Lines of Enquiry		Specified in 2009/10	Specified in 2008/09
2.1	Does the organisation commission and procure quality services and supplies, tailored to local needs, to deliver sustainable outcomes and value for money?	✓	✓
2.2	Does the organisation produce relevant and reliable data and information to support decision making and manage performance?	✓	✓
2.3	Does the organisation promote and demonstrate the principles and values of good governance?	✓	✓
2.4	Does the organisation manage its risks and maintain a sound system of internal control?	✓	✓

Managing Resources

Key Lines of Enquiry		Specified in 2009/10	Specified in 2008/09
3.1	Is the organisation making effective use of natural resources?	✗	✓
3.2	Does the organisation manage its assets effectively to help deliver its strategic priorities and service needs?	✓	✓
3.3	Does the organisation plan, organise and develop its workforce effectively to support the achievement of its strategic priorities?	✓	✗

Appendix C: Summary of recommendations raised during the audit

Ref	Recommendation	Management Response	Target Implementation Date
1	***Assets with a nil net book value*** During 2009/10 an exercise has been performed by DBC 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	March 2011
2	***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	March 2011

Ref	Recommendation	Management Response	Target Implementation Date
3	***Fixed assets held under 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.	March 2011

Ref	Recommendation	Management Response	Target Implementation Date
4	***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 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 Assistant Director (Planning and Resources) within the Children's Services Department 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.	As detailed in the action plan

Appendix D: Draft management representation letter

[Date]

To PricewaterhouseCoopers LLP
89 Sandyford Road
Newcastle upon Tyne
NE1 8HW

This representation letter is provided in connection with your audit of the financial statements of Darlington Borough Council for the year ended 31 March 2010.

Your audit is conducted for the purpose of expressing an opinion as to whether the financial statements of the authority give a true and fair view of the state of affairs of the authority as at 31 March 2010 and its income and expenditure and cash flows for the year then ended, and have been properly prepared in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009.

My responsibilities as Chief Financial Officer 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, 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:

Accounting records

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, including that:

- All the accounting records, whether for the purposes of financial reporting or any other purpose, have been made available to you for the purposes of your audit and all the transactions undertaken by the authority have been properly reflected and recorded in the accounting records.
- All other records and related information which might affect the fair presentation of, or necessary disclosure in, the financial statements, including minutes of the Council, the Cabinet and Audi Committee and relevant management meetings, have been made available to you and no such information has been withheld.

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

Accounting policies

I confirm that I have reviewed the authority's accounting policies and estimation techniques and, having regard to the possible alternative policies and techniques, the accounting policies and estimation techniques selected for use in the preparation of the financial statements are the most appropriate to give a true and fair view for the authority's particular circumstances, as required by the Code of Practice on Local Authority Accounting in the United Kingdom 2009**.**

Related party transactions

I confirm that the authority has disclosed all related party transactions relevant to the authority and that I am not aware of any other such matters required to be disclosed in the financial statements under the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom 2009.

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 with third parties have been properly reflected in the accounting records or, where material (or potentially material) to the financial statements, have been disclosed to you.

Laws and regulations

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.

Fraud

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

I have disclosed to you:

i) the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud

ii) my knowledge of fraud or suspected fraud affecting the authority involving:
   - members
   - management
   - employees who have significant roles in internal control, or
   - others where the fraud could have a material effect on the financial statements;

iii) my knowledge of any allegations of fraud, or suspected fraud, affecting the authority's financial statements communicated by members, employees, former employees, analysts, regulators or others.

Misstatements detected during the audit

I acknowledge my responsibility for the design and implementation of internal control to prevent and detect error.

I confirm that the financial statements are free from material misstatement, including omissions.

I confirm that the reason why the misstatements that you have brought to the attention of those charged with governance, the Audit Committee, in the attachment to this letter have not been adjusted in the financial statements is that those charged with governance believe their effect both individually and in aggregate is not material to the truth and fairness of the financial statements either taken as a whole or in connection with the ability properly to assess the performance and/or the financial position of the authority.

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.

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.

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 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. When appropriate, open positions in off-balance sheet financial instruments have also been properly disclosed in 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 Code of Practice on Local Authority Accounting in the United Kingdom 2009.

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 3.90%
- Rate of general long-term increase in salaries 5.40%
- Rate of increase to pensions in payment 3.90%
- Rate of increase to deferred pensions 3.90%
- Rate for discounting scheme liabilities 5.50%

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 £574,000 and this is deemed to be a reasonable assessment of any probable liability.

Other specific items

The Authority has not entered into any further Private Finance Initiative schemes which might affect the financial statements for 2009/10 other than the following projects:

- Education Village; and
- Harrowgate Hill Primary School,

Other than the amounts included in the table below, there are no plans for redundancies/early retirements that should have been brought to account.

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 prudent 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 Accounting Code of Practice 1996.

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.

......................………..........…..   ....

Chief Financial Officer   Date

For and on behalf of Darlington Borough Council.

[Table as in Appendix A to be attached]

In the event that, pursuant to a request which you have received under the Freedom of Information Act 2000 (as the same may be amended or re-enacted from time to time) or any subordinate legislation made thereunder (collectively, the "Legislation"), you are required to disclose any information contained in this report, we ask that you notify us promptly and consult with us prior to disclosing such information. You agree to pay due regard to any representations which we may make in connection with such disclosure and to apply any relevant exemptions which may exist under the Legislation to such information. If, following consultation with us, you disclose any such information, please ensure that any disclaimer which we have included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.