

Annual governance report

Herefordshire Council

Audit 2010/11

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We also help public bodies manage the financial challenges they face by providing authoritative, unbiased, evidence-based analysis and advice.

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Ladies and Gentlemen

2010/11 Annual Governance Report

I am pleased to present the results of my audit work for 2010/11.

I discussed and agreed a draft of my report with the Chief Officer (Finance and Commercial Services) in September 2011 and updated it as issues were resolved.

My report sets out the key issues that you should consider before I complete the audit.

It asks you to:

- consider the matters raised in the report before approving the financial statements;
- approve the letter of representation on behalf of the Council before I issue my opinion and conclusion;
- agree your response to the proposed action plan; and
- agree to adjust the error in the financial statements I have identified, which management has declined to amend or set out the reasons for not amending the error.

Yours faithfully

Elizabeth Cave
District Auditor

September 2011

Key messages

This report summarises the findings from the 2010/11 audit which is substantially complete. It includes the messages arising from my audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.

Table 1: **Key messages – financial statements**

Financial statements	Results
Unqualified audit opinion	Yes
No important weaknesses in internal control	Yes

Table 2: **Key messages – value for money**

Value for money	
Proper arrangements to secure value for money	Yes

Audit opinion

1 Before I give my opinion on the financial statements, there are a few actions which must be completed. In particular, I will need to obtain a signed letter of representation from the Council relating to areas where I am reliant on management opinion for the accounting treatment for certain items in the accounts. Subject to these items, I expect to issue an unqualified opinion on the financial statements.

Financial statements

2 2010/11 was the first year the Council was required to prepare financial statements under International Financial Reporting Standards (IFRS). In general this project was very well managed.

3 As a consequence of the audit, management have made a number of changes to the accounts initially authorised for issue.

4 I am very grateful for the very good co-operation I received from your staff.

Value for money

5 I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against criteria specified by the Audit Commission. I intend to issue an unqualified conclusion stating that the Council had adequate arrangements to secure economy, efficiency and effectiveness in the use of resources.

Independence

6 I can confirm that I have complied with the Audit Practice Board's ethical standards for auditors, including ES 1 (revised) – Integrity, Objectivity and Independence. The Audit Practice has a process for identifying any relationships which could result in a threat to independence, objectivity and integrity. There are no such relationships to report to you.

7 The Audit Commission's Audit Practice has not undertaken any non-audit work for the Council during 2010/11.

Next steps

This report identifies the key messages that you should consider before I issue my financial statements opinion, value for money conclusion, and audit closure certificate. It includes only matters of governance interest that have come to my attention in performing my audit. My audit is not designed to identify all matters that might be relevant to you.

8 I ask the Audit and Governance Committee to:

- consider the matters raised in this report before approving the financial statements
- approve the letter of representation on behalf of the Council before I issue my opinion and conclusion;
- agree your response to the proposed action plan; and
- agree to adjust the error in the financial statements I have identified, which management has declined to amend or set out the reasons for not amending the error.

Financial statements

The Council's financial statements and annual governance statement are important means by which the Council accounts for its stewardship of public funds. As Council members you have final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements and the annual governance statement.

Opinion on the financial statements

9 Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements. Appendix 1 contains a copy of my draft audit report.

Key areas of judgement and audit risk

10 In planning my audit I identified specific risks and areas of judgement that I have considered as part of my audit.

Table 3: **Key areas of judgement and audit risk**

Issue or risk	Finding
Preparation of 2010/11 financial statements under International Financial Reporting Standards (IFRS) required the restatement of 2009/10 opening and closing balances. This involved a mixture of full and partial retrospective recognition of the new standards	I maintained a watching brief and liaised closely with officers throughout the period of the Council's IFRS plan. I audited the re-stated balances as soon as they became available. The restated figures are materially correct.
I expected there to be risks in restating the accounts to comply with IFRIC4 (contracts that contain a lease) and in particular issues to consider for the Maylord Shopping Centre lease and leaseback and FOCSA refuse collection contract.	I performed audit procedures to ensure that all material Council contracts have been evaluated for embedded leases as defined by IFRIC4. I concluded that the Council review was materially complete. I substantively tested new leases to ensure compliance with IAS17 and found the accounting treatment to be materially correct.

Issue or risk	Finding
On 1 April 2010 the Council implemented the ACADEMY cash receipting and allocation system	I documented and evaluated the new system, identified key IT and management controls and obtained assurance from relevant internal audit testing. Controls were operating satisfactorily.
Clarified auditing standards applicable from 2010/11 required auditors to obtain more assurance of the operation of the IT control environment. Our technical specialist IT auditor identified that the Council's firewall baseline settings had not been documented and that firewall settings change control procedures are informal.	Internal Audit agreed to follow up on this issue and to follow up on the cash and payroll system access control weaknesses also identified. These were documentation weaknesses and I concluded the IT control environment was low risk in relation to my audit opinion. No further procedures were necessary.

Errors in the financial statements

11 I am required to report all 'non trivial' errors and uncertainties that have been identified by my audit which have not been amended before I issue my Opinion. Trivial items for this audit are defined as those below £40,000. During the audit, management agreed to make a number of adjustments to the accounts. I have not reported these in detail as they have been corrected in the revised financial statements being presented for approval.

12 . There was not a common pattern to these errors to report to you. There were a few errors relating to the implementation of International Accounting Standards but in general the implementation of this significant change was very well managed. Some errors related to the complexity of the existing fixed asset register and management are confident that the implementation of the new asset register will reduce the scope for error significantly. The overall net impact of the corrections made was to decrease total comprehensive income and expenditure by around £73,000 and reduce net assets by £592,000 and reserves by £322,000. There was no impact on the General Fund balance. The impact of the corrections made to the restated 2009/10 comparatives was to reduce both total comprehensive income and expenditure and net assets by £415,000.

13 There was only one error which management declined to amend. The Comprehensive Income and Expenditure Statement reports £3.784m of expenditure and £2.371m of income for 'other services'. My testing indicated that the majority of these balances are overheads of the Deputy Chief Executives Directorate which, due to pressures of time, were not recharged to 'BVACOP' headings eg Adult Social Care and Children and Educational Services. I am satisfied that this does not materially misstate the position.

Recommendation

R1 The Committee should consider agreeing to adjust the error in the financial statements I have identified that management has declined to amend or set out the reasons for not amending the error.

Important weaknesses in internal control

14 There are no material weaknesses in internal control but there is one issue that I would like to draw to your attention.

15 During 2010/11 the reconciliation between the ledger and payments made to care homes through the ISIS systems had not been carried out. When drawn to their attention at year-end, management carried out this reconciliation which demonstrated that the net payments initiated in the ISIS system agree to the income and expenditure recorded in the accounts. In future this reconciliation should be carried out at regular intervals during the year.

16 This is the only weakness that I identified during the audit that is relevant to preparing the financial statements. I am not expressing an opinion on the overall effectiveness of internal control.

Recommendation

R2 Carry out regular reconciliations between the ISIS system and the general ledger.

Quality of your financial statements

17 I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statement disclosures.

18 Table 4 overleaf contains the issues I want to raise with you.

Table 4: **Accounting practices, policies and estimates and financial statement disclosures**

Issue	Finding
Pension Fund Liability	<p>The actuary's estimate of the Pension Fund Liability in the Council's Comprehensive Income and Expenditure Statement and balance sheet did not recognise approximately £276,000 of early retirement costs which are associated with (and additional to) the liability for £774,000 of redundancy costs which have been accrued in the accounts. The Authority should ensure that if any significant early retirement costs arise in future years, the actuary is asked to value those liabilities in the year that they arise so that they may be reflected in the accounts in that year. However I am satisfied that the actuary's estimate of pension costs arising in 2010/11 is not materially misstated, and the liability will be recognised in the year after the next triennial valuation by the actuary to the Worcestershire Local Government Pension Fund.</p>
General Fund bad debt provision	<p>General Fund (trade and other) debtors outstanding at 31 March 2011 were £23.6m. In 2009/10 I recommended that the Council set up a bad debt provision for certain General Fund debtors outstanding at year-end. I was pleased to see that the Council has done this. However unlike the provisions the Council created for other debts such as Council Tax, NNDR and housing benefits, there is currently no established basis for this provision. Typically this involves setting aside a proportion of debt arrears as irrecoverable depending on its age and is likely to increase the provision for older debts. I am satisfied that the fair value of General Fund debtors is not materially misstated.</p>
Redundancy provision	<p>In calculating the redundancy provision of £774,000, the Council did not assess whether some of this provision should have been classified instead as creditor balances owing to the likelihood of these payments being made at the time the accounts were put together. However this is an immaterial classification issue only and will not affect the net cost of services reported in the Comprehensive Income and Expenditure account.</p>

Recommendations

- R3** The Authority should ensure that if any significant early retirement costs arise in future years, the actuary is asked to value those liabilities in the year that they arise so that they may be reflected in the accounts in that year.
- R4** The Authority should establish a basis for calculating a bad debt provision relating to General Fund debtors.
- R5** In future years consider whether any items included in provisions should be more accurately shown as creditors.
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Letter of representation

19 Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements. Appendix 2 contains the draft letter of representation.

Value for money

I am required to conclude whether the Council put in place proper corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money conclusion.

20 I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against two criteria specified by the Audit Commission. My conclusion for each of the areas is set out below.

Table 5: **Value for money conclusion criterion assessment**

Criterion	Finding
The Authority has proper arrangements in place for securing financial resilience.	I have reviewed your medium term financial planning (MTFP) within the context of the impact of the comprehensive spending review. Drilling down to source data where appropriate, I found your financial planning assumptions to be reasonable. The Authority is tackling the issue of continuing overspending in Adult Social Care but this significant risk will need to be closely monitored.
The Authority has proper arrangements for challenging how it secures economy, efficiency and effectiveness.	Arrangements are operating effectively. The Authority's transformation programme is identifying and delivering improvements in economy, efficiency and effectiveness.

21 I intend to issue an unqualified conclusion stating that the Council had adequate arrangements to secure economy, efficiency and effectiveness in the use of resources. Appendix 1 contains the wording of my draft report. I will report in more detail on this work in my annual audit letter shortly.

Appendix 1 Draft independent auditor's report to Members of Herefordshire Council

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HEREFORDSHIRE COUNCIL

Opinion on the Authority accounting statements

I have audited the accounting statements of Herefordshire Council for the year ended 31 March 2011 under the Audit Commission Act 1998. The accounting statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement and Collection Fund and the related notes. These accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of Herefordshire Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010.

Respective responsibilities of the Chief Officer (Finance and Commercial Services) and auditor

As explained more fully in the Statement of the Chief Officer's (Finance and Commercial Services) Responsibilities, the Chief Officer (Finance and Commercial Services) is responsible for the preparation of the Authority's Statement of Accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom. My responsibility is to audit the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Authority's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Authority; and the overall presentation of the accounting statements. I read all the information in the explanatory foreword to identify material inconsistencies with the audited accounting statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on accounting statements

In my opinion the accounting statements:

- give a true and fair view of the state of Herefordshire Council's affairs as at 31 March 2011 and of its income and expenditure for the year then ended; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

Opinion on other matters

In my opinion, the information given in the explanatory foreword for the financial year for which the accounting statements are prepared is consistent with the accounting statements.

Matters on which I report by exception

I have nothing to report in respect of the governance statement on which I report to you if, in my opinion the governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007.

Conclusion on Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources

Authority's responsibilities

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

Auditor's responsibilities

I am required under Section 5 of the Audit Commission Act 1998 to satisfy myself that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires me to report to you my conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

I report if significant matters have come to my attention which prevent me from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. I am not required to consider, nor have I considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Basis of conclusion

I have undertaken my audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2010, as to whether the Authority has proper arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

The Audit Commission has determined these two criteria as those necessary for me to consider under the Code of Audit Practice in satisfying myself whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2011.

I planned my work in accordance with the Code of Audit Practice. Based on my risk assessment, I undertook such work as I considered necessary to form a view on whether, in all significant respects, the Authority had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Conclusion

On the basis of my work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2010, I am satisfied that, in all significant respects, Herefordshire Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2011.

Certificate

I certify that I have completed the audit of the accounts of Herefordshire Council in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.

Elizabeth Cave
District Auditor

Audit Commission
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West Mercia Police HQ
Hindlip Hall
PO Box 55
Worcs
WR3 8SP

30 September 2011

Appendix 2 Draft letter of representation

Mrs Elizabeth Cave
West Mercia Police Authority HQ
Room 24
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Worcester
WR3 8SP

Herefordshire Council – Audit for the year ended 2010/11

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other officers, the following representations given to you in connection with your audit of Herefordshire Council's financial statements for the year ended 2010/11.

Compliance with the statutory authorities

I have fulfilled my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with the Code of Practice for Local Authority Accounting in the United Kingdom which give a true and fair view of the financial position and financial performance of the Council, for the completeness of the information provided to you, and for making accurate representations to you.

Uncorrected misstatements

The effects of uncorrected financial statements misstatements summarised in the attached schedule are not material to the financial statements, either individually or in aggregate.

Supporting records

All relevant information and access to persons within the entity has been made available to you for the purpose of your audit, and all the transactions undertaken by the Council have been properly reflected and recorded in the financial statements.

Irregularities

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

I also confirm that I have disclosed:

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

- my knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others; and
- the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

Law, regulations, contractual arrangements and codes of practice

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

Transactions and events have been carried out in accordance with law, regulation or other authority. The Council has complied with all aspects of contractual arrangements that could have a material effect on the financial statements in the event of non-compliance.

All known actual or possible litigation and claims, whose effects should be considered when preparing the financial statements, have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

Accounting estimates including fair values

I confirm the reasonableness of the significant assumptions used in making the accounting estimates, including those measured at fair value.

Related party transactions

I confirm that I have disclosed the identity of Herefordshire Council's related parties and all the related party relationships and transactions of which I am aware. I have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirement of the framework.

Subsequent events

All events subsequent to the date of the financial statements, which would require additional adjustment or disclosure in the financial statements, have been adjusted or disclosed.

Signed on behalf of Herefordshire Council

I confirm that the this letter has been discussed and agreed by the Council

Signed

Name

Position

Date

Appendix 3 Glossary

Annual governance statement

A statement of internal control prepared by an audited body and published with the financial statements.

Audit closure certificate

A certificate that I have completed the audit following statutory requirements. This marks the point when I have completed my responsibilities for the audit of the period covered by the financial statements.

Audit opinion

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

Opinion

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

Materiality (and significance)

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter for the financial statements as a whole. A matter is material if its omission would reasonably influence users of the financial statements, such as the addressees of the auditor’s report; also a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. We cannot define materiality mathematically, as it has both numerical and non-numerical aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

'Significance' applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

Weaknesses in internal control

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or a combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

Value for money conclusion

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

The Code of Audit Practice defines proper arrangements as corporate performance management and financial management arrangements that form a key part of the system of internal control. These comprise the arrangements for:

- planning finances effectively to deliver strategic priorities and secure sound financial health;
- having a sound understanding of costs and performance and achieving efficiencies in activities;
- reliable and timely financial reporting that meets the needs of internal users, stakeholders and local people;
- commissioning and buying quality services and supplies that are tailored to local needs and deliver sustainable outcomes and value for money;
- producing relevant and reliable data and information to support decision making and manage performance;
- promoting and displaying the principles and values of good governance;
- managing risks and maintaining a sound system of internal control;
- making effective use of natural resources;
- managing assets effectively to help deliver strategic priorities and service needs; and
- planning, organising and developing the workforce effectively to support the achievement of strategic priorities.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

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- any director/member or officer in their individual capacity; or
- any third party.



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