

Annual Governance Report

July 2006



Annual governance report

Herefordshire Council Council

Audit 2005/06

External audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services.

Audit in the public sector is underpinned by three fundamental principles:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements but also value for money and the conduct of public business; and
- auditors may report aspects of their work widely to the public and other key stakeholders.

The duties and powers of auditors appointed by the Audit Commission are set out in the Audit Commission Act 1998 and the Local Government Act 1999 and the Commission's statutory Code of Audit Practice. Under the Code of Audit Practice, appointed auditors are also required to comply with the current professional standards issued by the independent Auditing Practices Board.

Appointed auditors act quite separately from the Commission and in meeting their statutory responsibilities are required to exercise their professional judgement independently of both the Commission and the audited body.

Status of our reports to the Authority

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

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

Copies of this report

If you require further copies of this report, or a copy in large print, in Braille, on tape, or in a language other than English, please call 0845 056 0566.

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Purpose of this report

- 1 We are required by the Audit Commission's statutory Code of Audit Practice for Local Government bodies (the Code) to issue a report to those charged with governance summarising the conclusions from our audit work. For the purposes of this report, the Authority's Audit Committee is considered to fulfil the role of those charged with governance and references to the Audit Committee should be read as such.
- 2 We are also required by professional auditing standards to report to the Audit Committee certain matters before we give our opinion on the financial statements. The section of this report covering the financial statements fulfils this requirement.
- 3 This is our annual governance report covering the audit of the Authority for the year ended 31 March 2006 and is presented by the District Auditor.
- 4 The principle purposes of the report are:
 - to reach a mutual understanding of the scope of the audit and the respective responsibilities of the auditor and the Audit Committee;
 - to share information to assist both the auditor and those charged with governance to fulfil their respective responsibilities; and
 - to provide the Audit Committee with recommendations for improvement arising from the audit process.
- 5 The Audit Commission has circulated to all audited bodies a Statement of Responsibilities of Auditors and Audited Bodies that summarises the key responsibilities of auditors. Our audit has been conducted in accordance with the principles set out in that statement.

Scope of the report

- 6 In undertaking our audit, we comply with the statutory requirements of the Audit Commission Act 1998 and the Code. Auditors' responsibilities are to review and report on, to the extent required by the relevant legislation and the requirements of the Code:
 - the Authority's financial statements; and
 - whether the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
- 7 Our risk assessment and planned response to the key audit risks was summarised in our audit and inspection plan. A summary of our responsibilities and audit approach is included in Appendix 1. The annual governance report summarises the significant findings, conclusions and recommendations arising from our audit work. The results of our inspection work, and our separate grant claims' certification programme, will be reported in the Relationship Manager Letter later in the year.

- 8 We have issued separate reports during the year having completed specific aspects of our programme, which are listed in Appendix 2. Appendix 3 provides information about the fee charged for our audit and Appendix 4 sets out the requirements in respect of independence and objectivity.

Key messages

Financial statements

- 9 Our work on the financial statements is now substantially complete. We anticipate being able to issue an unqualified opinion by 30 September 2006. The audit went very smoothly. There was an improvement in working papers and officers were more responsive to audit queries. The audit was substantially complete on 4th August which is significant achievement for the Council. The Council is keen to further improve this important process and with that in mind we will be shortly issuing a document setting out any improvements which can be made in working papers and other parts of the process. We are also issuing a memorandum which contains more detail on our findings from this audit to assist officers.

Use of resources

- 10 Our work on the Authority's arrangements to secure economy, efficiency and effectiveness is now completed for 2005-06. A full review was carried out during the financial year 2005-06, follow up work has been completed recently to check progress. We anticipate being able to issue an unqualified conclusion on the use of resources by 30 September 2006.
- 11 A full Use of Resource assessment will be carried out during September and October 2006 to assess your Use of Resources for the financial year 2006-07.

Financial statements

- 12 We are required to give an opinion on whether the Authority's financial statements present fairly:
- the financial position of the Authority as at 31 March 2006 and its income and expenditure for the year then ended

Status of the audit

- 13 Our work on the financial statements is now substantially complete.

Matters to be reported to the Audit Committee

- 14 We have the following matters to draw to the Audit Committee's attention.

Expected modifications to the auditor's report

- 15 On the basis of our audit work, subject to the satisfactory conclusion of any work outstanding reported above, we currently propose to issue an unqualified audit report.

Uncorrected misstatements

- 16 Excluding those misstatements that are 'clearly trivial' (as defined in professional auditing standards), there no uncorrected misstatements.

Adjusted misstatements

- 17 To assist you in fulfilling your governance responsibilities, we are required to consider reporting adjusted misstatements to you where these are material. We therefore draw your attention to the list of material and significant misstatements that management has adjusted in Table 2 below. A complete listing of all other amendments made at audit has been provided to officers.

Table 1 Adjusted misstatements in the financial statements

Details of material and/or significant adjustments made to the financial statements

Issue	Value of misstatement £	Impact on surplus/(deficit)
Balance Sheet: Short term borrowing	+£12m	None

Issue	Value of misstatement £	Impact on surplus/(deficit)
Balance Sheet: Long term borrowing	-£12m	None
Balance Sheet: Intangible Assets	-£986k	None
Balance sheet: Tangible assets	+£986k	None

Recommendations

R1 Continue to actively review accounts prior to presentation to the auditor to ensure that the accounts presented are free from material misstatement.

Qualitative aspects of accounting practices and financial reporting

- 18 Our audit includes consideration of the qualitative aspects of the financial reporting process, including matters that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the financial statements.
- 19 We have the following matter to draw to the Audit Committee's attention:
- Assets - Hillside is included within the asset register as a non operational asset and is valued by the Council's own valuer at £1. The District Valuer has placed a value for the PCT of £2.2m. Further consideration should be given to Hillside and ensuring that it is valued on an adequate basis which is in accordance with relevant guidelines.

Recommendations

R2 Consider further the valuation of Hillside to ensure that it reflects its operational value to Herefordshire Council.

Material weaknesses in internal control identified during the audit

- 20 We did not find any material weaknesses during our audit but have noted that the Statement of Internal Control has been changed to take into account the weaknesses which were reported on by Internal audit in relation to the Council tax and housing benefits system.

- 21 We have not provided a comprehensive statement of all weaknesses which may exist in internal control or of all improvements which may be made, but have addressed only those matters which have come to our attention as a result of the audit procedures we have performed.

Matters specifically required by other auditing standards

- 22 Other auditing standards require us to communicate with you in other specific circumstances including:
- where we suspect or detect fraud;
 - where there is an inconsistency between the financial statements and other information in documents containing the financial statements; and
 - non-compliance with legislative or regulatory requirements and related authorities.

We have nothing to report to you.

Any other matters of governance interest

- 23 Finally, we are required to report any other matters that we believe to be of governance interest. We report these matters in Table 2 below.

Table 2 Other matters of governance interest

There is one other matter that we would like to bring to the attention of those charged with governance

Area	Auditor responsibility	Impact
Pooled Budgets	Our recent report to the Audit Committee on pooled budgets highlighted some areas of governance interest. In addition during the financial statements audit we found that the Learning Disabilities pooled budget agreement has not been updated since 2002. There was difficulty in reconciling end of year balances between the two parties. There have been protracted delays in the PCT settling invoices with the Council. We understand that the PCT still owes £1 million from 2005/2006.	Potentially overstated debtor in the accounts although the Council assures us that only a small proportion of this amount is in dispute.
Severance Arrangements	We reviewed the severance payments	Any future redundancies will be properly approved.

Area	Auditor responsibility	Impact
	made in 2005/06 and had some concerns around the governance arrangements. The Council has now approved revised arrangements which address our concerns.	

Recommendations

R3 Review pooled budget arrangements with the PCT in particular to ensure that:

- *Agreements are updated*
- *Reconciliation processes are tightened*
- *Outstanding debtors are paid promptly*

Letter of representation

- 24 We obtain written representations from management as an acknowledgement of its responsibility for the fair presentation of the financial statements and as audit evidence on matters material to the financial statements. The text of the required letter of representation is included at Appendix 5.

Next steps

- 25 We are drawing these matters to the Audit Committee's attention so that:
- you can consider them before the financial statements are approved and certified;
 - the representation letter can be signed on behalf of the Authority and those charged with governance before we issue our opinion on the financial statements; and
 - the Committee has the opportunity to amend the financial statements for the unadjusted misstatements/significant qualitative aspects of financial reporting issues identified above. Should you choose not to amend the financial statements, in accordance with the ISA (UK and Ireland) 260, we request that you extend the representation letter to explain why you are not adjusting the financial statements. We ask that the letter specifically details the misstatements and/or qualitative aspects of reporting to which it relates, either in the body of the letter or in a document appended to it.

Use of resources

Value for money conclusion

- 26 The Code requires us to issue reach a conclusion on whether we are satisfied that the Authority has proper arrangements in place for securing economy, efficiency and effectiveness in its use of your resources (the value for money conclusion). In meeting this responsibility, we will review evidence that is relevant to the Authority's corporate performance management and financial management arrangements. Our work in reaching the value for money conclusion is integrated with our work on the use of resources assessment. The use of resources assessment is a qualitative assessment of the effectiveness of the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources. The five areas we make assessments on are; financial statements, financial management, financial standing, internal control and value for money.
- 27 We completed our work in relation to the use of resources and reported this to the Council. There are no further matters which we wish to draw to the attention of the Audit Committee. We anticipate being able to issue an unqualified conclusion on the use of resources by 30 September 2006.

Use of auditors' statutory powers

- 28 Auditors are required to consider the exercise of certain statutory powers during the course of the audit, as summarised in Table 5 below.

Table 3 Use of statutory powers

Insert text

Issue	Auditor responsibility	Impact
Section 8 reports	Section 8 of the Act requires that auditors should consider whether, in the public interest, they should report on any matter that comes to their attention in the course of the audit so that it may be considered by the body concerned or brought to the attention of the public.	There have been no section 8 reports in respect of the financial year 2005/2006.
Section 11 recommendations	To consider whether a written recommendation should be made to the audited body requiring it to be considered and responded to publicly.	There have been no s11 recommendations.
Best value	To consider whether to recommend that the Audit Commission should carry out a best value inspection of the Authority under section 10 of the Local Government Act 1999 and/or that the Secretary of State should give a direction under section 15 of that Act.	Our work in respect of the Authority's 2005/2006 Best Value Performance Plan (BVPP) was reported in the 2005 annual audit and inspection letter. No recommendations were made to the Audit Commission or the Secretary of State.

Closing remarks

- 29 This report has been discussed and agreed with the Director of Resources. A copy of the memorandum will be presented at the Audit Committee on 22 September 2006.
- 30 The report makes only three recommendations. An action plan is included at Appendix 6, which includes responses from management and indicative target dates for the implementation of that recommendation.
- 31 The Authority has taken a very positive and constructive approach to our audit and I would like to take this opportunity to express my appreciation for the Authority's assistance and co-operation.

Elizabeth Cave
District Auditor

September 2006

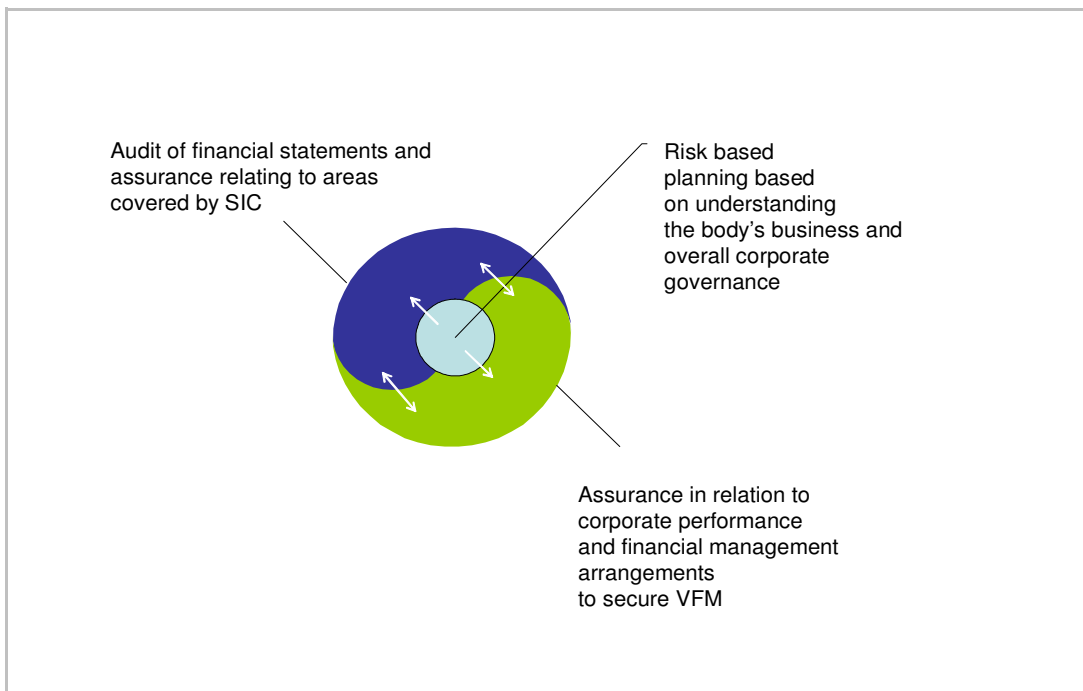
Appendix 1 – Audit responsibilities and approach

Audit objectives

- 1 Our objective as your appointed auditor is to plan and carry out an audit that meets the requirements of the Code of Audit Practice. We adopt a risk-based approach to planning our audit, and our audit work has focused on the significant risks that are relevant to our audit responsibilities.

Figure 1 Code of Audit Practice

Code of practice responsibilities



Approach to the audit of the financial statements

- 2 In our approach to auditing the financial statements, we adopt a concept of materiality. Material errors are those which might be misleading to a reader of the financial statements. We seek, in planning and conducting our audit of the accounts, to provide reasonable assurance that your financial statements are free of material misstatement. In planning our work we considered the arrangements of the Authority which had most impact on our opinion. These included:
 - the standard of the overall control environment and internal controls;
 - reliance on internal audit;
 - the likelihood of material misstatement occurring from of material information systems; or a material error failing to be detected by internal controls;
 - any changes in financial reporting requirements; and
 - the effectiveness of procedures for producing the financial statements and supporting material.
- 3 The results of the above feed into our risk assessment which determines the level and type of testing undertaken on each element of the financial statements. The keys risks that we identified include:
 - Risk of misstatement due to the new Academy system implementation; and
 - Risk of misstatement due to the valuation of assets as non operational.

Approach to audit of arrangements to secure value for money

- 4 The scope of these arrangements is defined in paragraph 20 of the Code as comprising:
 - corporate performance management; and
 - financial management arrangements.
- 5 Our conclusion is informed and limited by reference to relevant criteria covering specific aspects of audited bodies' arrangements, specified by the Code.

- 6 In planning audit work in relation to the arrangements for securing economy, efficiency and effectiveness in the use of resources, considered and assessed relevant significant business risk. Significance is defined by the Code as 'a matter of professional judgment and includes both quantitative and qualitative aspects of the risk'.
- 7 The potential sources of assurance when reaching the value for money conclusion include:
 - the Authority's whole system of internal control as reported in its statement on internal control;
 - results from statutory inspections or the work of other regulators, for example, corporate assessments, service assessments (whether by the Commission or other regulators), etc.;
 - work specified by the Audit Commission, for example, the use of resources assessments, and data quality work;
 - links to the financial statements' audit, including review of internal audit, the SIC and budgetary control arrangements; and
 - other work necessary to discharge our responsibilities.

Appendix 2 – Audit reports issued

Table 4

Planned output	Planned date of issue	Actual date of issue	Addressee
Audit and inspection plan	15 May 2006	15 May 2006	Management
Interim audit memorandum	4 August 2006	4 August 2006	Management
Annual governance report	22 September 2006	22 September 2006	Audit Committee
Opinion on financial statements	28 September 2006		The Authority
Value for money conclusion	28 September 2006		The Authority
Final accounts memorandum	22 September 2006	22 September 2006	Management
Use of resources assessments	December 2005	December 2005	Management
Pooled budgets	May 2006	May 2006	Audit Committee
E-government	May 2006	May 2006	Audit Committee

Appendix 3 – Fee information

Table 5

Fee estimate	Plan 2005/06	Actual 2005/06
Audit		
Accounts	122,000	122,000
Use of resources	53,100	53,100
Total audit fees**	175,100	175,100
Voluntary improvement work*	0	0

** The outturn on inspection and grant certification fees will be reported in the Relationship Manager Letter

Appendix 4 – The Audit Commission’s requirements in respect of independence and objectivity

- 1** We are required by the standard to communicate following matters to the Audit Committee:
 - the principal threats, if any to objectivity and independence identified by the auditor, including consideration of all relationships between the Authority, directors and the auditor;
 - any safeguards adopted and the reasons why they are considered to be effective;
 - any independent partner review;
 - the overall assessment of threats and safeguards; and
 - information about the general policies and processes for maintaining objectivity and independence.
- 2** We are not aware of any relationships that may affect the independence and objectivity of the team, and which are required to be disclosed under auditing and ethical standards.

Appendix 5 – Letter of representation

Resources

Director: Mrs Sonia Rees CPFA

Mrs L. Cave,
District Auditor,
Rooms 13-18 and 24,
The Business Centre,
Blackpole Road,
Worcester.
WR3 8SQ

30th August, 2006

Your Ref:

Our Ref:

Please ask for: Mrs Sonia Rees

Direct Line / 01432 383519

Extension: 01432 340189

Fax: srees@herefordshire.gov

E-mail: .uk

Dear Liz,

LETTER OF REPRESENTATION AUDIT FOR THE YEAR ENDED 31ST MARCH, 2006

I confirm to the best of my knowledge and belief, and having made appropriate enquiries of other officers of the Authority, the following representations given to you in connection with your audit for the year ended 31st March, 2006.

Related party transactions

There are no other material transactions with related parties, other than those which have been properly recorded and disclosed in the financial statements.

Contingent liabilities

There are no other contingent liabilities, other than those which have been properly recorded and disclosed in the financial statements. In particular:

- There are no significant pending or threatened litigation, other than those already disclosed in the financial statements.
- There are no material commitments or contractual issues, other than those already disclosed in the financial statements.

Law, regulations and codes of practice

There are no instances of non-compliance with laws, regulations and codes of practice, likely to have a significant effect on the finance or operation of the Authority.

Post balance sheet events

Since the date of approval of the financial statements by Members of the Council, there have been no additional significant post balance sheet events that have occurred which would require additional adjustment or disclosure in the financial statements.

Specific representations

I draw your attention to the Private Finance Initiative contracts that the Council has entered into jointly with Worcestershire. I would make the following points:

Waste Management

As you are aware, this contract is currently subject to renegotiation. I have reviewed the disclosure included in the accounts on Page 8 of the Statement of Accounts and I am satisfied that this sufficiently reflects the position as at the date of this letter.

Further to the outcome of these negotiations it may be necessary to review the accounting and balance sheet treatment of the renegotiated PFI deal.

I am satisfied that the Council has earmarked sufficient reserves to meet potential liabilities under the existing contractual arrangements as at 31st March, 2006 and has appropriate plans in place to ensure sufficient budgetary provision in its financial strategy for the future.

Yours sincerely,

SONIA REES (MRS)
DIRECTOR OF RESOURCES

Appendix 6 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
8	R1 Continue to actively review accounts prior to presentation to the auditor to ensure that the accounts presented are free from material misstatement	2	Management	Yes	'The District Auditor found two items that needed adjustment in the draft Statement of Accounts presented for audit. This small number of changes demonstrates that existing procedures for reviewing the draft Statement of Accounts is effective. The Director of Resources will continue to ensure that the draft Statement of Accounts is actively reviewed prior to being presented for audit.'	September 2006
9	R2 Consider further the valuation of Hillside to ensure it reflects its operational value to Herefordshire Council	2	Management	Yes	'Herefordshire Council and District Audit staff spent a considerable amount of time in detailed technical discussion of the appropriate treatment of the Hillside property in the Council's accounts in both this and previous audits. Unfortunately, accounting codes of practice do not explain how assets that are deployed in the provision of pooled budget services should be valued for accounting purposes. The District Auditor plans to carry out further research during the	September 2006

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
					course of 2006/07 to see how other councils deal with this situation and the view taken by their auditors. This may or may not lead to further discussion on the accounting treatment for this asset in the future	
12	<p>R3 Review pooled budget arrangements with the PCT in particular to ensure that:</p> <ul style="list-style-type: none"> • Agreements are updated • Reconciliation processes are tightened • Outstanding debtors are paid promptly 	3	Management	Yes	<p>Action has already been taken to address these issues. The finance team for Adult & Community Services has been transferred to the Resources Directorate. Additional support in this area has been provided by the Assistant County Treasurer (Financial Policy & Audit). The new Head of Financial Services has now taken up post and will be providing further support to the team with a view to updating the agreements and ensuring reconciliation of year end figures with the PCT.</p> <p>'The Director of Resources requested that the PCT make a significant contribution to the outstanding debtors position on 7th September 2006 pending resolution of any queries they have with the debtor accounts in question.'</p>	September 2006