

BABERGH DISTRICT COUNCIL

FROM: Director of Finance

REPORT NUMBER **H113**

TO: Overview and Scrutiny
(Stewardship) Committee

DATE OF MEETING: 30 September 2008

EXTERNAL AUDITOR'S ANNUAL GOVERNANCE REPORT

1. **PURPOSE OF REPORT**

To inform the Committee of the external auditor's review of the 2007/08 Council's Financial Statements and associated matters. To advise Members on the key issues arising from this.

2. **RECOMMENDATIONS**

2.1 That Members consider the matters that have been identified in the Annual Governance report, particularly in relation to the material misstatement issue, and the associated risks.

2.2 That, in the event of the Committee accepting that there is a material misstatement, the necessary amendments to the Council's 2007/08 Statement of Accounts be reported to Council.

The Committee will need to consider what recommendations it wishes to make to the Council.

3. **FINANCIAL IMPLICATIONS**

3.1 There are no financial implications to report.

4. **RISK MANAGEMENT**

4.1 The report links to the Council's Significant Business Risk No. 7 – Financial, Performance and Risk Management. The following risks are associated with the report.

Risk Description	Likelihood	Seriousness or Impact	Mitigation Measures
The Committee do not accept that there has been a material misstatement in the Accounts.	TBA	Could be critical, including qualification of the accounts	Discussion needed with external auditors on the options available to the Council.

Risk Description	Likelihood	Seriousness or Impact	Mitigation Measures
Future processes and arrangements are not strengthened in order to ensure the accounts are completed in accordance with all accounting and audit requirements	Low	Critical	Regular updates on accounting developments and focussed discussions with the external auditors on key issues.

5. **KEY INFORMATION**

- 5.1 This year's audit has been affected by a number of issues, including staff changes in the Finance Team and it being the first year that the accounts have been audited by PKF, who will present their Governance report. The key points will be explained by David Eagles from PKF.
- 5.2 Subject to finalising their work, it is hoped that there will be an unqualified opinion on the Accounts and the Use of Resources Value for Money conclusion.
- 5.3 However, this year an important matter has arisen in relation to what is, in the auditor's opinion, a material misstatement in the Council's accounts. This has been discussed at length but there remains a difference of opinion on whether this should be regarded as such. The auditor is quite clear that it is and the reasons will be explained fully at the meeting.
- 5.4 It is accepted that the auditor makes the final judgement on what is regarded as material.
- 5.5 However, this has been very carefully considered by your officers and we feel that there is a significant degree of doubt over the matter. The following arguments have been put to PKF but this has not altered their opinion:
- We accept that accounting guidance was not followed but believe that our approach is not necessarily in conflict with the main accounting Code and Statement of Recommended Practice (SORP)
 - Accounting guidance notes do not have the same weight as the SORP in our view. They are 'intended to assist practitioners and others with the application of the SORP's requirements. They are not intended in any way to be prescriptive or interpretive.'
 - In addition, the SORP says that guidance notes 'do not form part of the hierarchy of accounting provisions that authorities are required to follow' and that they 'assist practitioners in their own application of the SORP's requirements, without binding them in any way to their own professional duty to interpret the accounting requirements'
 - It should not be regarded as a material misstatement as it is a technical accounting issue that does not impact on the reader's overall understanding or users of the accounts

- Nor does the change impact on the Council's overall financial position, the actual deficit/use of reserves for the year or the Balance Sheet
 - We have still, therefore, satisfied the overriding SORP requirement that the Accounts 'present fairly' the financial position of the authority
 - Relevant extracts from the SORP on the treatment of overhanging premiums and discounts are set out in Appendix A.
- 5.6 Members clearly do not have the technical knowledge or expertise to fully understand the details in Appendix A. What it shows, however, is that the main SORP only requires the entries relating to Overhanging Premiums and Discounts to be put through the Income and Expenditure Account, which we have done.
- 5.7 Having considered the matter at length and weighing up all of the issues, although we fully accept that there is a good case for changes to the accounts to be made, we do not agree that this should be regarded as, in the overall context of the Council's Accounts, a material misstatement.
- 5.8 We have suggested to the auditors that we are happy to add a detailed disclosure note to the accounts explaining that we have not followed the accounting guidance in LAAP Bulletin 72 and that it is a prior-year adjustment. This has not been accepted.
- 5.9 There are a number of other matters raised in the report and comments on these have been provided to PKF. Officers will deal with the issues as necessary. Members will be advised further on these, including any updates from the external auditor at the meeting.
- 5.10 Members are asked to consider the report and, specifically, the material misstatement issue, which will have an impact on the Council's Use of Resources assessment.

6. **APPENDICES**

Appendix A – SORP extracts

Appendix B – PKF Annual Governance Report.

7. **BACKGROUND PAPERS REFERRED TO:**

None

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SORP EXTRACTS

Overhanging Premiums and Discounts

Paragraph 4.35:

This says “the difference between the carrying amount of the extinguished financial liability and the consideration paid to extinguish it plus any transaction costs (ie the gain or loss) should be recognised **in the Income and Expenditure Account.**”

Footnote 14 says, “The charge to taxation in respect of this should be in accordance with legislation.” This reflects the governing principle that the I&E a/c receives GAAP compliant charges, with the statutory/regulatory over-ride being shown in the Statement of the Movement on the General Fund Balance (STMGFB).

As stated in paragraph 4.39:

“The Income and Expenditure Account should reflect the SORP requirements. The effect of applying the regulations/statutory guidance should be accounted for through the Statement of Movement on the General Fund Balance. The difference between the amount charged or credited in the year **to the Income and Expenditure Account in accordance with the SORP** and the amount charged or credited to the General Fund in accordance with regulations and statutory guidance should be debited or credited to the General Fund Balance with the double entry going to the Financial Instruments Adjustment Account such that the General Fund is charged or credited with the amount that accords with the applicable regulations/statutory guidance.”

Paragraph 4.40 states:

“The above regulations/statutory guidance also cover premiums and discounts on an authority’s Balance Sheet on 31 March 2007. Accounting for the effects of these regulations is covered by paragraph 4.85, Step 7”

Paragraph 4.79 states:

“any resulting adjustment” ... “should be treated as a prior year adjustment”.
(Prior period adjustments would normally impact on the I&E account).



Accountants &
business advisers

Babergh District Council

**Report to those charged with
governance**

September 2008

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- A Draft letter of representation
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Code of Audit Practice and Statement of Responsibilities of Auditors and Audited Bodies

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission contains an explanation of the respective responsibilities of auditors and of the audited body. Reports and letters prepared by appointed auditors are addressed to members or officers. They 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.

1 Executive Summary

1.1 This report summarises the results of the work completed to date for the 2007/08 financial year and is presented to Members in accordance with the provisions of International Auditing Standard 260 (ISA 260), which requires us to communicate our audit findings to “those charged with governance”, prior to issuing our opinion on your Statement of Accounts and our conclusion on the adequacy of your arrangements for securing economy, efficiency and effectiveness in your use of resources (our VFM conclusion).

Findings and conclusions

1.2 A summary of audit findings and conclusions is included in the table below:

Area of audit	Findings & Conclusion
Accounts	
Key financial systems	The key financial systems are adequate as a basis for preparing the financial statements and no significant control weaknesses were identified that impacted on our opinion.
Statement of Accounts	<p>One material error was identified as a result of our audit work. The Council is unable to re-present the amended pages of the Statement of Accounts until 21 October 2008 and so will miss the statutory deadline for publishing audited accounts of 30 September.</p> <p>Some non-trivial, but not material, errors have been identified and these are detailed in Appendix B.</p> <p>Some information required to complete our audit remains outstanding at the time of drafting this report. Should these result in any significant issues, we will update Members accordingly.</p> <p>We are satisfied that the Annual Governance Statement is not inconsistent or misleading with other information we are aware of from our audit of the Statement of Accounts.</p> <p>Subject to satisfactory completion of the outstanding work, we anticipate issuing an unqualified opinion on the Statement of Accounts.</p>
Use of Resources	
Use of resources judgements	<p>We are in the process of completing the initial phase of our use of resources judgements to assist with the provision of the VFM conclusion. At this stage, we have not undertaken sufficient work to satisfy ourselves that the Council has at least adequate arrangements in place.</p> <p>A verbal update will be provided at the Overview and Scrutiny (Stewardship) Committee meeting.</p>
Data Quality	Management arrangements in place for data quality are “adequate” for VFM conclusion purposes.
Best Value Performance Plan	We issued an unqualified opinion on the 2007/08 BVPP.
VFM Conclusion	Based on the work undertaken to date we expect to issue an unqualified VFM conclusion, subject to our detailed work on the Use of Resources judgements noted above.

Acknowledgement

1.3 We would like to thank the staff of the Council for the co-operation and assistance provided to us during the audit.

2 Introduction

- 2.1 Our Annual Audit and Inspection Plan for 2007/08 outlined the work we would be carrying out at Babergh District Council (the Council) in order to meet our responsibilities under the Audit Commission's Code of Audit Practice.
- 2.2 This report summarises the results of our audit work completed to date in respect of the Council's Statement of Accounts and the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources.
- 2.3 Our report is presented to Members in accordance with the provisions of International Auditing Standard 260 (ISA 260) which requires us to report certain matters to "those charged with governance", prior to issuing our opinion on the Statement of Accounts and conclusion on the adequacy of your arrangements for securing economy, efficiency and effectiveness in your use of resources.

Findings

- 2.4 Detailed recommendations in response to issues identified by our audit have been provided separately to officers.
- 2.5 In this report we do not provide a comprehensive statement of all weaknesses that may exist in the accounting and control systems, but only those matters which have come to our attention as a result of the audit procedures performed. We have not restated recommendations already made by Internal Audit.

Status of our report to the Council

- 2.6 This report has been prepared for Members' and Officers' information only and is not intended to include every matter that may have come to our attention. We accept no responsibility for any reliance that might be placed on it for any purpose by third parties, to whom it should not be shown without our prior written consent.

Independence

- 2.7 We confirm that we are not aware of any relationships that may bear on our independence and objectivity as auditor and that our independence declaration, included in the Annual Audit and Inspection Plan 2007/08, has remained valid throughout the period of the audit.

3 Accounts

Requirements

- 3.1 The Council is required to publish an audited Statement of Accounts in accordance with proper practices as set out in CIPFA/LASAAC's Code of Practice on Local Authority Accounting in the United Kingdom 2007: A Statement of Recommended Practice (SORP). The Director of Finance is responsible for the preparation of the accounts in accordance with the SORP.
- 3.2 The Code of Audit Practice requires us to provide an opinion on whether the Statement of Accounts presents fairly the financial position of the Council and its income and expenditure for the year, and whether it has been properly prepared in accordance with appropriate legislation.

Systems, risks and materiality

- 3.3 In carrying out this work we consider:
- the extent to which your accounting and internal control systems are a reliable basis from which to prepare the accounts
 - the robustness of your accounts preparation processes.
- 3.4 In carrying out this review, we have considered the environment within which those controls operated and evaluated specific controls that respond to significant risks. Following our evaluation, we assessed whether we would be placing reliance on particular controls and, where reliance was to be placed, conducted testing of the relevant controls.
- 3.5 Your key financial systems are:
- Main Accounting System
 - Cash and bank
 - Payments and creditors
 - Income and debtors
 - Payroll and employment costs
 - Information technology
 - Council tax
 - Housing and council tax benefits
 - NNDR
 - Housing rents income
 - Investments and investment income
- 3.6 We also considered the risk of material misstatements, including the risk of fraud and error, which may have an impact on our opinion. This required us to:
- review the adequacy of the financial systems for accounting for transactions
 - review internal controls that are designed to prevent, or detect and correct, misstatements in the accounts
 - review the arrangements for preparing the Statement of Accounts
 - select and test transactions and balances, including review of significant balances against expectations and substantiate individual items
 - assess the significant estimates and judgements made by officers in preparing the accounts
 - consider the adequacy of presentation and disclosures included in the Statement of Accounts.

Reporting to those charged with governance

- 3.7 In accordance with the requirements of auditing standards, auditors are required to communicate relevant matters relating to the audit to “those charged with governance”.
- 3.8 In particular we are required to report:
- qualitative aspects of accounting practices and financial reporting
 - final draft letter of representation to be agreed by management and those charged with governance
 - unadjusted misstatements
 - expected modifications to the audit report
 - material weaknesses in accounting and internal control systems identified during our work
 - matters required to be communicated by other ISAs
 - any other audit matters of governance interest.
- 3.9 Our comments in each of these areas are set out below:

Accounting practices and financial reporting

The accounts preparation process, completeness of audit trail and working papers

Preparation and approval of the accounts

- 3.10 The draft accounts were approved by the Council on 26 June 2008, in line with the statutory timetable. The audit was scheduled to commence on 11 August 2008 to give sufficient time for the Council to complete any working papers supporting the draft accounts that officers had not been able to finalise by the date of approval.

Steps taken to address first year “learning curve” issues

- 3.11 The primary accounts audit risks associated with changing auditors relate to:
- auditors not being familiar with who to speak to when investigating items and
 - authorities not preparing working papers required for audit, or officers not being available at necessary points in time.
- 3.12 As part of our planning for the audit, we prepared and sent to the Council on 15 April 2008 a detailed document request (the Records Required List) which outlined the information that we required to complete the audit. It is important to highlight that the working papers referred to in the List are not required solely to assist the audit, but are necessary working papers to support the draft Statement of Accounts put before Members for approval by the June deadline. The List was discussed with lead officers at one of our scheduled liaison meetings on 23 April 2008.
- 3.13 The pro-forma included a request to identify the “preparing officer” for each working paper, or an alternative officer where the preparer might not be able to explain the working paper, or issues related to the working paper. We also requested a schedule setting out holiday and other planned absences of these key contacts, so we could plan our work around these dates.
- 3.14 The combination of the List, including key contacts, and the absence schedule was intended to mitigate the two, key risk areas set out above.

- 3.15 The Council provided us with some files of working papers on 11 August 2008. However, the information was not complete. Issues were identified with the Collection Fund working papers which were not in accordance with the Records Required List or easy to follow. Problems were also encountered due to the delayed receipt of the debtor and creditor information file which was not provided until the end of the second week of the audit. Some key reconciliations had not been completed in advance of our visit, for example, the payroll system reconciliation to the general ledger and stock number reconciliation between the accounts and housing system.
- 3.16 Contact details provided did not necessarily set out the preparer, but rather the collator. Consequently, additional audit time was spent resolving questions raised as the collator of the working papers was not necessarily the preparer and could therefore not always respond.
- 3.17 The Council has experienced staff changes and capacity issues that have been addressed through the use of external contractors during the closedown period. The preparers of the accounts were, as a result, different to last year. The unavailability of the key contractor, and also key contacts' annual leave hampered our audit progress in the early weeks, but the Council secured additional time from the contractor in the latter stages to enable the audit to be completed.
- 3.18 Although we appreciate that every effort was made by the Council to maximise assistance provided to auditors when those key contacts were available, the early absences caused delays in our audit.

Analytical review

- 3.19 Analytical review is an approach whereby target figures are assessed to determine whether they are in accordance with expected values and/or variances to, say, previous year figures are understood. This approach is a mandatory audit tool at various stages of the audit, but should also be a key quality control tool for preparers of accounts.
- 3.20 The Council provided, as requested, an analytical review in the preliminary stages of the audit. However, this was not on the basis previously discussed and agreed with officers at our 29 July 2008 liaison meeting and, therefore, additional work had to be undertaken to comply with our requirements.

Conclusion

- 3.21 The matters referred to above effected the efficiency of the audit and had a significant impact on the audit timetable. In addition, it increased the number of queries raised by the audit team that led to increased demand on finance staff time. The Finance Department and other officers were responsive and worked to address queries when available and we appreciate the co-operation afforded by them.
- 3.22 Overall, there is scope for improvement to the Council's processes for preparing the accounts and for supporting the audit processes. Through our regular liaison with finance staff, we will work together to secure improvements and agree a way forward to deliver a more efficient audit to be provided.

Application of accounting policies

- 3.23 The key changes introduced by the 2007 SORP were:
- the introduction of a revaluation reserve, with a “Year 1” nil opening balance
 - the introduction of the Capital Adjustment Account which replaces the Fixed Asset Restatement Account and the Capital Financing Account
 - the introduction of Financial Reporting Standards (FRS) 25, 26 and 29 relating to the accounting treatment for financial instruments
- 3.24 The following issues arose in relation to the above:
- treatment of the over-hanging debt premia, which is discussed later in this report;
 - the revaluation reserve has been used to account for right to buy discounts repaid which is not appropriate for a pure revaluation reserve; and
 - opportunities for improvement to the completeness of disclosures were noted in respect of the implementation of FRS 25, 26 and 29. The Council has made appropriate amendments to the disclosures to address these matters.

Testing of transactions and balances

- 3.25 As part of our audit, all material balances were subject to testing. The following matters have arisen from our work which we bring to your attention:
- Accounting treatment for the over-hanging debt premia
 - Fixed assets
 - Cut-off errors

Over-hanging debt premia

- 3.26 If debt is repaid earlier than the scheduled date and has borne a comparatively unfavourable rate of interest, then the issuer may charge a “premium” on repayment as compensation for the loss of scheduled interest at the comparatively high rate. This is similar to early repayment penalties on domestic mortgages. The Council repaid its debt early when it became debt-free in 2003, and incurred a premium at that time.
- 3.27 Under the 2007 SORP, the accounting treatment of these balances has been changed depending on the timing and consequential borrowing of the Authority. In the Council’s circumstances, the premium arose when it became debt free in 2003 and therefore relates to prior years not included within these financial statements (i.e. before 1 April 2006, which is the opening date for the 2006/07 comparatives included in the accounts).
- 3.28 “Over-hanging” premia are defined as those for which there was either never a qualifying replacement loan or modified financial liability or for which the loan or liability has been derecognised. Here, going debt-free, there was never a replacement loan.
- 3.29 The SORP guidance notes and subsequent information issued by CIPFA have provided clarification on the accounting entries required to comply with the SORP. As the transactions relate to previous years, it would not be appropriate to reflect the transaction in the 2007/08 Income and Expenditure Account and the SORP provides for transitional arrangements without the need to restate the 2006/07 balance sheet. The clarification requires the transaction to go through the Statement of the Movement on the General Fund Balance and then be reversed out to the Financial Instruments Adjustment Account with no Income and Expenditure account, or net General Fund (Council Tax payers’), impact.

- 3.30 This treatment was clarified by a specific bulletin issued by CIPFA Local Authority Accounting Panel, "LAAP Bulletin 72", issued in March 2008, which stated:
- Since the publication of the SORP and the related Guidance Notes, it has become apparent that a number of different views have emerged regarding the interpretation of the 2007 SORP's transitional provisions for premiums and discounts arising prior to 1 April 2006. **This bulletin is intended to clarify the position for all premiums and discounts, enabling authorities to comply with the requirements of the SORP.** The bulletin sets out the appropriate accounting treatment without setting out the reasons for this interpretation. This is because including this discussion would make the bulletin more difficult for practitioners to follow. Instead, this discussion is included as an annex to this bulletin.*
- 3.31 Our audit work highlighted material errors within three primary financial statements (the Income and Expenditure account, the Statement on the Movement on the General Fund Balance and the Statement of Total Recognised Gains and Losses, but all are as a result of the same transaction, so we consider this to be a single material misstatement.
- 3.32 The Council, in its 2006/07 financial statements, included £1,198,000 on its balance sheet for deferred premiums on early repayment of debt. The Council has written this out of the balance sheet via the Income and Expenditure Account (a £1,290,000 charge consisting of the £1,198,000 above and other balances), thereby materially affecting the reported deficit on the face of this primary statement. Consequently the deficit reported in the Income and Expenditure Account is overstated by £1.29m which then affects the reported deficit and net movement on the Statement of the Movement on the General Fund Balance and the reported deficit on the face of the Statement of Total Recognised Gains and Losses (STRGL).
- 3.33 The change in accounting treatment causes an imbalance in the STRGL because the correction of the transaction means that the write-down does not pass through the Income and Expenditure account and is therefore a reconciling item in the "Other" line of the STRGL. Presentational amendments have also been made to the note analysing component movements within the Statement of the Movement on the General Fund Balance.

Fixed assets

- 3.34 Our review highlighted a number of issues with fixed assets. The Council had not reconciled the housing stock numbers on the housing system to the numbers included within the accounts. This was undertaken during the audit process and a difference of 1 was found as a property had not been marked as sold on the housing system that had been disposed of. The difference was, therefore, satisfactorily explained but the Council should ensure that records are reconciled on at least an annual basis going forward.
- 3.35 The Council maintains a listing of all the assets it owns to support balances included within the accounts. The 2007 SORP introduced a Revaluation Reserve noted above which requires a detailed fixed asset register to be held on an asset by asset basis to ensure disposals are appropriately accounted for and balances relating to that specific asset can be removed from the accounts when an asset is disposed of. The Council's fixed asset register only has one line for the housing stock which is made up of a number of houses that are subject to revaluations and depreciation on an annual basis. With the introduction of the Revaluation Reserve from 1 April 2007, the Council needs to ensure it has accurate records on an asset by asset basis to correctly account for disposals and movements within the reserve. A recommendation has been made at Appendix A.

Cut-off errors

- 3.36 During our detailed testing of debtors, we identified that a number of invoices, though individually trivial, had been accounted for in the incorrect financial year. In our original sample we found 2 errors out of a sample of 20, one for bulky waste collection income not included in 2007/08 and one for 2008/09 shared ownership lease rent incorrectly included within income. As a result, additional audit testing was undertaken to ensure that balances were not materially misstated within the accounts. An additional 3 errors were identified, again related to waste and lease rent.
- 3.37 Included within Appendix B is an extrapolated error for a non-trivial, but not material, amount as we were able to satisfy ourselves that the potential error would not materially misstate the accounts.

Adequacy of disclosures

- 3.38 A number of amendments have been made to the accounts as follows:
- correction of the material error noted above;
 - additional narrative regarding the basis of the fixed asset valuations and date of last valuation;
 - additional narrative in note 8 of the accounts to explain the significant loss on disposal of assets;
 - cash-flow notes have been amended so they start from the correct deficit figure reported on the face on the Income and Expenditure Account;
 - additional narrative regarding the risk exposure of the Council in relation to its borrowing and investments held; and
 - updated pension note disclosure to reflect 2007/08 actuary information as 2005/06 information shown.

Letter of representation

- 3.39 The draft letter of representation has been attached as Appendix A. It is possible that there may be changes being required in clearing the remaining issues before providing our opinion on the Council's Statement of Accounts, and so we will provide a verbal update at the Overview and Scrutiny (Stewardship) Committee meeting.

Unadjusted misstatements

- 3.40 We set out at Appendix B all of the non-trivial misstatements which we noted during the course of our audit that have not been adjusted to date in the final accounts that will be subject to re-approval.
- 3.41 We will obtain written representation, both from the Director of Finance and on behalf of the Overview and Scrutiny (Stewardship) Committee, of the reasons for not making the amendments noted in Appendix B.

Audit report

- 3.42 At the time of drafting this report, we are proposing to issue an unqualified opinion on the Statement of Accounts (as set out in Appendix C). However, the requirement to seek re-approval of the accounts by full Council due to the material error identified is likely to result in a late audit opinion being issued, and so we will not be able to provide this in accordance with the statutory deadline of 30 September.
- 3.43 There are also, at the time of drafting this report, some outstanding matters on the audit that could have an impact on our proposed audit report. These are:
- Some additional documentation for the Income & Expenditure variances;
 - Abbey National bank confirmation; and
 - Clearance of review comments.
- 3.44 We will provide a verbal update on these matters at the presentation of this report to the Overview and Scrutiny (Stewardship) Committee.

Accounting and internal control systems

Key financial systems and consideration of the risk of fraud and error

- 3.45 We have reviewed the key financial systems in place across the Council, which contribute to the preparation of a materially accurate Statement of Accounts, to assess the extent to which we can place reliance on them for this purpose.
- 3.46 Under Auditing Standards we also have a responsibility to give specific consideration to the potential risk of material misstatement in the Statement of Accounts due to fraud and error, including the risk of fraudulent financial reporting.
- 3.47 The primary responsibility for ensuring that your internal control frameworks are robust enough to prevent and detect material fraud and corrupt practices lies with management and those charged with governance.
- 3.48 Our approach to the audit of the financial systems has involved considering key control areas for each system and satisfying ourselves that they are operating as intended and are sufficient to prevent material misstatements within the Statement of Accounts. In assessing the reliability of systems as a basis for providing financial information, systems notes were prepared for each financial system and we have evaluated the controls within those systems, with particular focus on assessing whether the controls in place to mitigate significant risks are suitably designed and operating as intended to meet their objective.
- 3.49 In order to identify the fraud risks, and the controls you have put in place to mitigate those risks, we have:
- discussed your anti fraud and corruption arrangements with officers and those charged with governance
 - considered the extent to which the work of Internal Audit is designed to detect material misstatements in the accounts arising through fraud
 - made inquiries regarding instances of actual fraud you have identified.

Reliance on the work of Internal Audit

- 3.50 Where possible, we have placed reliance on Internal Audit's work and thereby avoided unnecessary duplication of audit effort. To ensure this approach was valid, we have undertaken the following:
- reviewed Internal Audit's working papers and reports
 - considered the robustness of the key financial systems on the evidence of this work
 - rely on Internal Audit's evaluation of controls and re-perform a sample of their testing of the effectiveness of controls, to ensure that their conclusions are soundly based
 - considered Internal Audit's review of the effectiveness of internal control.

Steps taken to address first year "learning curve" issues

- 3.51 The primary systems audit risks associated with changing auditors relate to:
- auditors not being familiar with local process designs, or with who to speak to when investigating issues
 - lack of clarity over areas where reliance on Internal Audit's work will be sought
 - differing approaches to acceptable sample sizes
 - lack of clarity over expected timing of review work, including the timing of Internal Audit work and the extent to which testing coverage is achieved of controls operating throughout the financial year.
- 3.52 Our first step in addressing these issues was to arrange and attend a preliminary introduction and familiarisation meeting in January 2007 (2 months before formal appointment). This was followed up with a tri-partite meeting involving key Council officers, PKF and the outgoing Audit Commission auditors on 10 April 2007, and subsequently by a specific approach and reliance meeting with the interim Head of Internal Audit. This meeting specifically covered timing of work, controls we planned to rely on (supported by our "Control Evaluation Schedules" for every key financial system) and testing sample sizes.
- 3.53 The first listed risk should be addressed both by the provision of clear systems notes which describe how systems operate and also the relevant officers involved. We also clearly exclude initial familiarisation time from fee budgets, such that this element is borne by the firm as a recognised part of hand-over. This latter specifically included all handover meetings described above.
- 3.54 Some shortcomings were identified during the course of our review and detailed recommendations have been provided separately to officers. We understand that the outcome of our early meetings and documentation provided was lost in transition when the Head of Internal Audit returned from maternity leave in July 2007.
- 3.55 Internal Audit did undertake additional testing and obtained copies of documentation we required in order to complete this phase of our work and we are grateful for the co-operation provided by Internal Audit during this phase of our work.
- 3.56 We have discussed the process with the Head of Internal Audit and discussed our expectations going forward. Copies of documentation we completed this year have also been provided to facilitate a more efficient audit next year and minimise the risk of additional workload at the year end for Internal Audit.

Conclusion on the adequacy of financial systems

- 3.57 The Council's key financial systems are generally adequate as a basis for preparing the Statement of Accounts and no significant control weaknesses were identified as a result of our audit.
- 3.58 However, the following control weaknesses were noted that should be addressed by management and which required additional audit effort (for example, notably increasing sample sizes of linked substantive tests) in providing our opinion on the Statement of Accounts:
- Some lack of segregation of duties between ordering and authorising the purchase of goods and services;
 - Expenditure codes were not always confirmed as correct by the authorising officer;
 - Goods and services were not always confirmed as received prior to the invoice being processed;
 - Authorisation controls for the raising of debtors were found to be ineffective in relation to the Building Control department; and
 - Council Tax discounts review procedures were not in place throughout the year to ensure the validity of discounts awarded.

Matters required to be reported by other auditing standards

- 3.59 There are no other matters arising from our work that we are required by other auditing standards to bring to the attention of those charged with governance.

Other audit matters of governance interest

Annual Governance Statement

- 3.60 In June 2007 CIPFA, in conjunction with the Society of Local Authority Chief Executives (SOLACE), published Delivering Good Governance in Local Government: Framework. This framework, and the accompanying guidance notes, replaces the previous CIPFA/SOLACE framework, Corporate Governance in Local Government – A Keystone for Community Governance: Framework, which was published in 2001.
- 3.61 The framework applies to all local government bodies and is directly relevant to a number of use of resources Key Lines of Enquiry (KLOE), in particular the three internal control KLOE.
- 3.62 Of particular importance is the introduction through the CIPFA/SOLACE framework, from 2007/08, of an integrated "annual governance statement". This subsumes the requirements of Regulation 4(2) of the Accounts and Audit Regulations 2003 (as amended by the Accounts and Audit (Amendment)(England) Regulations 2006) for the production of a statement on internal control (SIC).
- 3.63 The framework reflects the Commission's own definition of corporate governance as:
"... about how local government bodies ensure that they are doing the right things, in the right way, for the right people, in a timely, open, honest and accountable manner. It comprises the systems and processes, and cultures and values, by which local government bodies are directed and controlled and through which they account to, engage with and, where appropriate, lead their communities."
- 3.64 The Council has a responsibility to publish a Governance Statement, including the outcome of a review of its effectiveness, with its 2007/08 Statement of Accounts.
- 3.65 We have reviewed the Annual Governance Statement and the supporting review of effectiveness that has been undertaken and we are satisfied that the Statement is not inconsistent with the evidence provided in the review of effectiveness and our knowledge of the Council.

4 Use of Resources

- 4.1 The Audit Commission's Code of Audit Practice requires us to be satisfied that proper arrangements have been made by the Council to secure economy, efficiency and effectiveness in the use of resources (value for money).

Value for money conclusion

- 4.2 Our VFM conclusion is based on considering the results of the Use of Resources Key Lines of Enquiry (KLoE) assessment and the results of the Data Quality management arrangements (Stage 1) assessment. The conclusion also draws on the results of local risk based audit work, as well as consideration of the Council's processes underpinning its review of the effectiveness of its controls as described in the Annual Governance Statement.
- 4.3 The Use of Resources KLoE assessment work has not yet commenced but will have been sufficiently completed to enable the delivery of the VFM conclusion in September. It will be finalised in November 2008, as required by the Audit Commission's timetable for quality assurance. A detailed report of findings will be provided to Officers later in the year.
- 4.4 The Data Quality management arrangements assessment has been sufficiently completed to enable the delivery of the VFM conclusion and will be finalised in October 2008, as required by the Audit Commission's timetable. A detailed report of findings will be provided to Officers later in the year.
- 4.5 This work will contribute to forming our overall conclusion on your arrangements to secure economy, efficiency and effectiveness in the use of resources, as audited bodies are required to reach expected minimum requirements in each of the 12 VFM conclusion criteria reviewed, to achieve an unqualified opinion.

Proposed conclusion

- 4.6 Our work in this area has yet to commence and therefore we are unable to conclude on this area. However, based on our knowledge of the Council gained through attendance at Committee meetings, handover information provided by the Audit Commission which included supporting documentation for last years assessment and through liaison, we anticipate giving an unqualified VFM conclusion.
- 4.7 A draft conclusion is included in Appendix C. We will provide a verbal update to the Overview and Scrutiny (Stewardship) Committee at the meeting.

Statutory report on the 2007/08 Best Value Performance Plan

- 4.8 The audit of the Best Value Performance Plan 2007/08 ("BVPP") was completed in 2007 and we reported that the Council had prepared and published its BVPP in all significant respects in accordance with section 6 of the Local Government Act 1999 and statutory guidance issued by the Government. An unqualified opinion was issued on 19 December 2007.
- 4.9 No recommendations have arisen from this work.

5 Fee information

5.1 We are required to disclose an analysis of the planned and actual audit fees for the year and provide an explanation for any significant variations for each element of our work.

5.2 The proposed audit fees were set out in the Annual Audit and Inspection Plan 2007/08:

Audit plan 2007/08	Planned fees £	Actual fees £
Code of Audit Practice		
Accounts	59,550	59,550*
Planning & Reporting	10,715	10,715
Use of Resources**	32,645	32,645
Subtotal audit	102,910	102,910
Inspection	5,900	5,900
Total audit and inspection	5,900	5,900
Grants***	-	-
Questions and objections	-	-
Total	£108,810	£108,810

5.3 * The audit is not complete at the time of drafting this report and a number of delays and issues have been encountered during the course of the audit, as described in section 2 of this report. As a consequence, additional audit resource has been needed, and additional fees will be incurred. An update will be provided at the meeting if the audit has been concluded.

5.4 ** £21,000 of this element was billed by the previous auditors, the Audit Commission for the 2006/07 data quality assessment and 2007/08 Use of Resources Assessment.

5.5 *** Grants work relating to the 2007 year end was billed by the previous auditors, the Audit Commission. Work on the 2008 grants work has yet to commence and therefore no figure has been included in this analysis. Outturn for 2007/08 grants will be reported in the 2008/09 Final report to those charged with governance when an accurate final position can be reported.

Appendix A: Draft letter of representation

PKF (UK) LLP
16 The Havens
Ransomes Europark
Ipswich
Suffolk
IP3 9SJ

XX September 2008

Dear Sirs

Statement of Accounts of Babergh District Council for the year ended 31 March 2008

1 Representations of the Director of Finance

I confirm to the best of my knowledge and belief, and having made appropriate enquiries of other officers and members of the Council, the following representations given to you in connection with your audit of the Council's Statement of Accounts.

2 Responsibility for the Statement of Accounts

I acknowledge as the Director of Finance and s151 Officer my responsibilities for the Statement of Accounts.

3 Completeness of information

All the accounting records have 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 accounting records. All other records and related information, including minutes of all management and committee meetings (held during the year and up to the date of this letter) have been made available to you.

4 Internal control

I acknowledge my responsibility for the design, implementation and maintenance of internal control relevant to the preparation and presentation of the Statement of Accounts that are free from misstatement, whether arising from fraud or error.

5 Fraud

I have disclosed to you the results of my assessment of the risk that the Statement of Accounts could be materially misstated as a result of fraud.

I am not aware of any fraud or suspected fraud affecting materially the Statement of Accounts, nor have any allegations of fraud or suspected fraud been communicated to me by employees, former employees, councillors, regulators or others which might affect materially the Statement of Accounts.

6 Compliance with law and regulations

I am not aware of any possible or actual instances of non-compliance with laws or regulations which are central to the Council's ability to carry on business or which would otherwise have a potentially material effect on the Statement of Accounts.

7 Transactions with related parties

I confirm that I have put in place appropriate arrangements to identify related party transactions.

I am satisfied that the disclosure in the Statement of Accounts of related party transactions is appropriate and complete and contains all the elements necessary for an understanding of the Statement of Accounts.

8 Contingent liabilities

I am not aware of any significant contingent liabilities, including pending claims, proceedings or litigation involving the Council.

9 Uncorrected misstatements

You have brought to my attention uncorrected misstatements in the Statement of Accounts as listed in Appendix 1 to this letter. I do not wish to correct these misstatements as I consider them to be immaterial to the view given by the Statement of Accounts.

10 Pension fund assumptions

I confirm that the actuarial assumptions underlying the valuation of the Local Government Pension Scheme (LGPS) scheme liabilities, as applied by the scheme actuary, are reasonable and consistent with my knowledge of the business. These assumptions include:

- Rate of inflation 3.6 %
- Rate of increase in salaries 5.1 % (Real 1.5 %)
- Rate of increase in pensions 3.6 %
- Rate for discounting scheme liabilities 6.9% (Real 3.2 %)

I also confirm that the actuary has applied up-to-date mortality tables for life expectancy of scheme members in calculating scheme liabilities.

11 Subsequent events

There have been no events since the balance sheet date which necessitate revision of the figures included in the Statement of Accounts or inclusion of a note thereto where revisions of the Accounts have not been made or notes not included. Should any material events occur, which may necessitate revision of the figures included in the Statement of Accounts or inclusion of a note thereto, I will advise you accordingly.

Yours faithfully

Barry Hunter CPFA
Director of Finance

*Representations of the Council***1 Responsibility for the Statement of Accounts**

We acknowledge our responsibilities to make arrangements for the proper administration of the Council's financial affairs and to approve the Statement of Accounts.

2 Uncorrected misstatements

We have considered the uncorrected misstatements in the Statement of Accounts as listed in Appendix 1 to this letter together with the explanations provided by the Director of Finance for not correcting these misstatements, and we consider them to be immaterial to the view given by the Statement of Accounts.

3 Annual Governance Statement

We confirm that the Council has conducted a review during the year of the effectiveness of its system of internal control. We are satisfied that the Annual Governance Statement appropriately reflects the circumstances of the Council and includes an outline of the actions taken, or proposed, to deal with significant internal control issues.

Yours faithfully

Cllr Busby

Chair of the Overview and Scrutiny (Stewardship) Committee

Signed on behalf of the Council

Note: Appendix 1 referred to in this letter relates to Appendix B in this report

Appendix B: Unadjusted misstatements

The table below details the potential differences recorded during the audit that are not adjusted for currently within the Statement of Accounts:

Unadjusted misstatements	Income Over/ (Under) £'000	Expenses (Over)/ Under £'000	Assets (Over)/ Under £'000	Liabilities Over/ (Under) £'000	Reserves Over/ (Under) £'000	Management comments
<p>Misstatements of fact (specific misstatements)</p> <p>Being the unreconciled difference between the benefits grant claim and the expenditure reported in the general ledger of the Council.</p> <p>Being the understatement of the Council's liabilities, which they have committed to pay at the year-end over the next 4 years.</p>		(50)	50			<p>Having considered the immateriality of the items no adjustments were made to the accounts at this late stage.</p> <p>Improvement actions to be put in place as part of next year's planning.</p>
<p>Likely misstatements (extrapolation of errors)</p> <p>A number of cut-off errors were identified during our testing of debtors. Errors were found that understated and overstated income and therefore the net effect has been extrapolated resulting in an extrapolated understatement.</p>	(33)		33			As above.
Total net misstatements	(33)	41	83	(91)		

Appendix C: Draft audit opinion

Independent auditor's report to the Members of Babergh District Council

Opinion on the financial statements

We have audited the Statement of Accounts and related notes of Babergh District Council for the year ended 31 March 2008 under the Audit Commission Act 1998. The Statement of Accounts comprise the Income and Expenditure Account, the Statement of the Movement on the General Fund Balance, the Balance Sheet, the Statement of Total Recognised Gains and Losses, the Cash Flow Statement, the Housing Revenue Account, the Collection Fund and the related notes. The Statement of Accounts has been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of Babergh District Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 36 of the Statement of Responsibilities of Auditors and of Audited Bodies prepared by the Audit Commission.

Respective responsibilities of the Director of Finance and auditor

The Director of Finance responsibilities for preparing the financial statements in accordance with relevant legal and regulatory requirements and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2007 are set out in the Statement of Responsibilities for the Statement of Accounts.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the accounting statements present fairly, in accordance with relevant legal and regulatory requirements and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2007 the financial position of the Authority and its income and expenditure for the year.

We review whether the governance statement reflects compliance with 'Delivering Good Governance in Local Government: A Framework' published by CIPFA/SOLACE in June 2007. We report if it does not comply with proper practices specified by CIPFA/SOLACE or if the Statement is misleading or inconsistent with other information we are aware of from our audit of the financial statements. We are not required to consider, nor have we considered, whether the governance statement covers all risks and controls. Neither are we required to form an opinion on the effectiveness of the Authority's corporate governance procedures or its risk and control procedures.

We read other information published with the Authority accounting statements, and consider whether it is consistent with the audited accounting statements. This other information comprises the Explanatory Foreword. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounting statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with the Audit Commission Act 1998, the Code of Audit Practice issued by the Audit Commission and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounting statements and related notes. It also includes an assessment of the significant estimates and judgments made by the Authority in the preparation of the accounting statements and related notes, and of whether the accounting policies are appropriate to the Authority's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the Statement of Accounts and related notes are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounting statements and related notes.

Opinion

In our opinion:

- The financial statements present fairly, in accordance with relevant legal and regulatory requirements and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2007, the financial position of the Authority as at 31 March 2008 and its income and expenditure for the year then ended.

Signature: _____ Date: _____

PKF (UK) LLP
16 The Havens, Ransomes Europark, Ipswich Suffolk, IP3 9SJ

Conclusion on 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 regularly to review the adequacy and effectiveness of these arrangements.

Auditor's Responsibilities

We are required by the Audit Commission Act 1998 to be satisfied that proper arrangements have been made by the Authority for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires us to report to you our conclusion in relation to proper arrangements, having regard to relevant criteria specified by the Audit Commission for principal local authorities. We report if significant matters have come to our attention which prevent us from concluding that the Authority has made such proper arrangements. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Conclusion

We have undertaken our audit in accordance with the Code of Audit Practice and having regard to the criteria for principal local authorities specified by the Audit Commission and published in December 2006, we are satisfied that, in all significant respects, Babergh District Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2008.

Best Value Performance Plan

We issued our statutory report on the audit of the Authority's best value performance plan for the financial year 2007/08 on 19 December 2007. We did not identify any matters to be reported to the authority and did not make any recommendations on procedures in relation to the plan.

Certificate

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

Signature: _____ Date: _____

PKF (UK) LLP
16 The Havens, Ransomes Europark, Ipswich Suffolk, IP3 9SJ

Appendix D: Reports issued in respect of 2007/08

Annual Audit and Inspection Plan	May 2007
Opinion on 2007/08 BVPP	December 2007
Suffolk wide Health inequalities / LAA (issued by the Audit Commission)	December 2007
Final report to those charged with governance	September 2008
Use of Resources report (issued by the Audit Commission)	
Data Quality report (issued by the Audit Commission)	

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