

Annual Governance Report

27 September 2006



Annual governance report

Stevenage Borough 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 Council

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

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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 Council'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 Council for the year ended 31 March 2005 and 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 Council's financial statements; and
 - whether the Council 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 completed to date. The results of our inspection work, and our separate grant claims' certification programme, will be reported in our Annual Audit and Inspection 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 for year ended 31 March 2005 (2004/05) is substantially complete and remains in progress for year ended 31 March 2006 (2005/06).
- 10 There are still some outstanding issues to be resolved. In particular, we are continuing discussions with the Council on the accounting treatment of a £2.6 million repayment to English Partnerships for a liability incurred in financial year ended 31 March 2001. This impacts on our opinions for both 2004/05 and 2005/06. The Council anticipates receiving a decision from the Department for Communities and Local Government (DCLG) on a capitalisation direction for this transaction by 30 September 2006. We therefore anticipate being in a position to conclude on any necessary adjustments to the financial statements and modifications to our audit report by the end of October, at which point we will issue our opinions for both 2004/05 and 2005/06.
- 11 Our audit of the 2005/06 financial statements remains in progress. In particular, on work on fixed assets, debtors, creditors, consolidated revenue account, housing revenue account and cash and bank reconciliation has not been finalised, though work is in progress on all areas. We have reported to this committee any matters arising to date.
- 12 Should any further matters arise in concluding the outstanding work that require reporting, we will raise them with the Chair of this committee. We will issue an updated version of this report, including our proposed opinions, to the Chair of this committee in advance of the issue of our opinions.

Use of resources

- 13 Our work on the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources is now substantially complete. We anticipate being able to issue an unqualified conclusion on the use of resources by end of October 2006.
- 14 Should any further matters arise in concluding the outstanding work that require reporting, we will raise them with the Chair of this committee.

Financial statements

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

Status of the audit

- 16 Our work on the financial statements for year ended 31 March 2005 is substantially complete and remains in progress for year ended 31 March 2006 (2005/06).
- 17 There are still some outstanding issues to be resolved. In particular, we are continuing discussions with the Council on the accounting treatment of a £2.6 million repayment to English Partnerships for a liability repaid in financial year ended 31 March 2001. This issue arose during our audit of the Council's financial statements for financial year ended 31 March 2005 (2004/05) and was reported to those charged with governance in October 2005 and included in our Annual Audit and Inspection Letter in May 2006. We have yet to issue our opinion on the financial statements for 2004/05. Any adjustments arising from our 2004/05 audit will have implications for our opinion on the 2005/06 financial statements.
- 18 The Council is awaiting a decision from the Department for Communities and Local Government (DCLG) on a capitalisation direction. This is expected by 30 September 2006. Subject to the outcome of this decision, we will be reviewing any proposed adjustments to the financial statements before concluding our testing and forming our audit opinion for 2004/05 and 2005/06.
- 19 Our audit of the 2005/06 financial statements remains in progress. In particular, on work on fixed assets, debtors, creditors, consolidated revenue account, housing revenue account and cash and bank reconciliation has not been finalised, though work is in progress on all areas. I have also yet to complete my final review. We have reported to this committee any matters arising to date.
- 20 Should any further matters arise in concluding the outstanding work that require reporting, we will raise them with the Chair of this committee.
- 21 We anticipate issuing our audit opinion for 2004/05 and 2005/06 by the end of October 2006 and will issue a further version of this report; including our proposed opinions, to the Chair of this committee on conclusion of our work and in advance of the issue of our opinions.

Matters to be reported to the Audit Committee

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

Expected modifications to the auditor's report

- 23 On the conclusion of our outstanding work referred to in paragraph 16 to 21, we will report to the Chair of this Committee any modifications to our auditor's report on the 2004/05 and 2005/06 financial statements.

Uncorrected misstatements

- 24 Our audit identified the following misstatements in the financial statements that management; at this stage, has decided not to adjust. Excluding those misstatements that are 'clearly trivial' (as defined in professional auditing standards), these are set out in Table 1 below.

Table 1 Uncorrected misstatements

Misstatements that management, at this stage, have decided not to adjust

Issues	Value of misstatement £	Impact on surplus/ (deficit) £
<p>Our audit of Hertfordshire County Council's pension fund identified that the value of the fund has been understated by £32.4million representing 1.6% of the schemes assets. This is representative of a timing difference between the actuarial fund valuation and the closure of financial statements and represents a County wide issue. Stevenage Borough Council's share of the understatement is £1.33 million.</p> <p>Any adjustments to the financial statements will need to be made to the actuarial gains and losses in the statement of total recognised gains and losses.</p> <p>We have raised this issue with management and, at this stage the Council is not proposing to amend the financial statements until further clarification is obtained of the error.</p>	£1.33 million	nil

Recommendations

R1 Consider amending the draft financial statements for the uncorrected misstatement identified in Table 1.

Adjusted misstatements

- 25 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 amendments has been provided to officers.

Table 2 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)
<p>The unaudited financial statements include £4 million in debtors and the usable capital receipts reserve relating to proceeds from the disposal of the London Road depot. Our audit enquiries identified that the £4 million proceeds are to be received subject to a vacant possession clause in the contracts to be settled during 2006/07 financial year.</p> <p>We have agreed with management that this transaction represents a contingent asset, in accordance with financial reporting standard 12. Adjustments will be made to the financial statements to remove £4 million from debtors and the usable capital receipts reserve, and include a disclosure note to the Consolidated Balance Sheet on the nature of the contingent asset.</p>	£4 million	nil
<p>Service accounts and the capital financing account have been charged a £2.8 million for the impairment for Caxton Way (as a consumption of economic benefits).</p> <p>Our enquiries and review of the valuation report indicate that the impairment relates to market valuation and should be charged to the fixed asset restatement account.</p>	£2.8 million	nil

Issue	Value of misstatement £	Impact on surplus/(deficit)
We have agreed with management that the appropriate adjustments will be made to the financial statements.		

Qualitative aspects of accounting practices and financial reporting

- 26 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. We have the following issue to report to you covering our 2004/05 and 2005/06 audit of financial statements:
- We have as yet been unable to reach an agreement with management regarding the accounting treatment of a £2.6 million repayment to English Partnership for the financial year ended 31 March 2001. It is our view that the liability should have been repaid from revenue sources and not through provision for credit liabilities. Were the Council to correct the financial statements for revenue financing of £2.6 million repayment to English Partnership, this would have a significant impact on the Council's general fund balance and overall financial standing. We reported to this Committee in May 2006 the basis of our audit view and next steps. The Council has applied for a capitalisation direction from the DCLG to enable any corrections to the accounts to be made from capital resources. It is expected that a decision on the capitalisation direction will be received by 30 September 2006. Subject to the outcome of the capitalisation direction, the Council will be proposing additional adjustments to the 2004/05 and 2005/06 financial statements which we will need review and substantiate before concluding our work and forming our audit opinion. We expect to conclude our work by the end of October 2006 and will report any further matters to the Chair of this Committee before issuing our opinion.

Material weaknesses in internal control identified during the audit

- 27 Our audit has identified no material weaknesses in systems of accounting and financial control which we should report to you at this stage.
- 28 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

29 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 no issues to report to you at this stage.

Any other matters of governance interest

30 Finally, we are required to report any other matters that we believe to be of governance interest. We report these matters in Table 3 below.

Table 3 Other matters of governance interest

There are a number of other matters that we would like to bring to the attention of those charged with governance

Area	Auditor responsibility	Impact
Statement of internal control (SIC)	The auditor reviews the SIC for compliance with the requirements of proper practice as specified by CIPFA and consistency with other information from the audit of the financial statements.	We reviewed the SIC and concluded that this complied with disclosure requirements and was consistent with our knowledge of the Council.

Area	Auditor responsibility	Impact
Whole of Government Accounts' consolidation pack	The auditor is responsible for issuing a report on the consistency of the Authority's consolidation pack with the statutory financial statements.	<p>We have arrangements in place to review the Council's consolidation pack by 6 October 2006. However, in view of our outstanding matters referred to at paragraph 18 to 22, we will be unable to issue our report on the consistency of the pack by 6 October 2006. We cannot do this until we have issued our opinion on the 2004/05 and 2005/06 financial statements. The Council are still required to submit the unaudited consolidation pack with an explanation for the delay in the auditors report by 6 October 2006.</p> <p>We will be liaising with management to agree the process for submitting the consolidation pack and reporting.</p>

Letter of representation

- 31 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. We are aware that arrangements will be made for a written letter of representation to be received by management and those charged with governance at a point close to our issuing the opinion on 2004/05 and 2005/06 financial statements. We will provide an example of the text of the required letter closer to the date of issue of the opinions.

Next steps

32 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;
- arrangements can be made for the representation letter can be signed on behalf of the Council 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; and
- the Committee can agree that any further matters arising from the conclusion of our work, including any further amendments to the accounts or modification to the auditor's report are agreed with the Chair of this Committee before we issue our opinion on the financial statements.

Use of resources

Value for money conclusion

- 33 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.
- 34 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.
- 35 The findings from our use of resources work, which was completed in March 2006 and covered the period 1 April 2005 to 31 October 2005 have been agreed with officers of the Council and were reported to this Committee in May 2006.
- 36 Our work in relation to our value for money conclusion considers the adequacy of the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2006, having regard to the twelve criteria for local government bodies specified by the Audit Commission and published in July 2005.
- 37 We have substantially completed our work in relation to the use of resources and there are no matters which we wish to draw to the attention of the Audit Committee at this stage. Should any further matters arise in concluding the outstanding work that require reporting, we will raise them with the Chair of this committee.

Use of auditors' statutory powers

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

Table 4 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

- 39 This report has been discussed and agreed with the Assistant Chief Executive (Finance) and Interim Head of Finance. A copy of the memorandum will be presented at the Audit Committee on 27 September 2006.
- 40 The Council has taken a positive and constructive approach to our audit and I would like to take this opportunity to express my appreciation for the Council's assistance and co-operation.

Debbie Hanson
District Auditor

September 2006

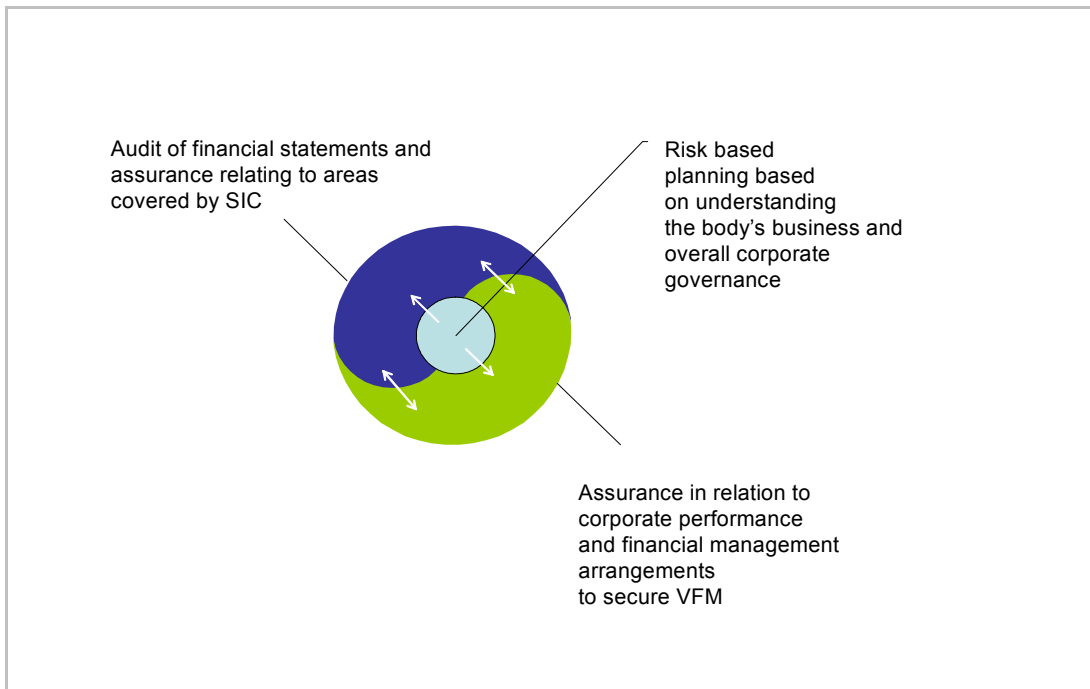
Appendix 1 – Audit responsibilities and approach

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 material misstatement from:
 - financing of capital expenditure;
 - recognition of debtors and creditors;
 - cash and bank reconciliation;
 - impairments; and
 - group accounting.

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 Council'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 5

Planned output	Planned date of issue	Actual date of issue	Addressee
Audit and inspection plan	April 2005	April 2005	Strategic Management Board and reported to Council Executive
Interim audit memorandum	July 2006	July 2006	Management
Annual governance report	September 2006	27 September 2006	Audit Committee
Opinion on financial statements	September 2006	TBC - expected to be end of October 2006	Council
Value for money conclusion	September 2006	TBC - expected to be end of October 2006	Council
Final accounts memorandum	November 2006	TBC	Management
Use of resources assessments	March 2006	March 2006	Strategic Management Board and Audit Committee
BVPP report	December 2005	14 December 2005	Council

Appendix 3 – Fee information

Table 6

Fee estimate	Plan 2005/06 (£)	Actual 2005/06 (£)
Audit		
Accounts	86,163	86,163 **
Use of resources	37,219	37,219 **
Total audit fees*	123,382	123,382
Voluntary improvement work	0	0

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

** As noted in this report, particularly paragraphs 18 to 22, we have not completed our audit of accounts and use of resources. We will need to revisit our actual fee levels on completion of this work and report reasons for any significant variances to management and through the Chair of this Committee if appropriate.

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.

