Northumberland County Council

Report to the Audit Committee on the 2011 Audit

Draft Final Report

Contents

Key findings

We have pleasure in setting our report to the Audit Committee of Northumberland County Council ("the Council") for the year ended 31 March which updates our draft report of 28 September 2011. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2011.

This summary is not intended to be exhaustive but highlights the most significant matters to which we would like to bring your attention. It should, therefore, be read in conjunction with the report and the appendices thereto.

	Description	Detail
Completion of the audit and the auditor's report		
Significant delays were experienced **Deadline for reporting was not met** **The accounts were signed on 6 October 2011**	Significant delays were experienced in the completion of the audit which resulted in a number of issues remaining outstanding at 30 September 2011. Consequently, the deadline for reporting of 30 September 2011 was not met. The accounts were signed with an unmodified opinion on 6 October 2011. As communicated in our Draft Report to the Audit Committee on the 2011 Audit dated 28 September 2011, this report intends to update the Audit Committee on our final findings and opinions following the resolution of all outstanding matters.	

Key findings (continued)

	Description	Detail
Key findings on audit risks		
A number of material adjustments arose as a result of our testing on key audit risks **Management have corrected these adjustments with the exception of those detailed in Appendix 1** **We have obtained representations that the uncorrected misstatements are immaterial to the users of the accounts**	The key audit risks we identified in our Audit Plan are set out below with our audit findings: 1. ***Group consolidation*** – adjustments corrected with respect to harmonisation of accounting policies and elimination of intra-group balances; 2. ***First time adoption of IFRS –*** prior year figures had been incompletely reworked, notably with respect to grants, and current year changes to accounting policies had not always been correctly adopted. Management have adjusted the financial statements for the errors identified. 3. ***Property, plant and equipment and investment property revaluations*** – adjustments corrected with respect to revaluations and classification; 4. ***Classification and valuation of assets held for sale*** – adjustments corrected with respect to revaluations and classification; 5. ***Change in LGPS assumption from RPI to CPI*** – there are no matters to bring to your attention. 6. ***Grant income recognition –*** adjustments corrected with respect to grant income recognition; 7. ***Valuation of Icelandic bank investments*** – the Council have highlighted their departure from the LAAP guidance as an area of significant management judgment; 8. ***Valuation of unequal pay and single status provisions*** – uncorrected misstatement relating to the over-provision of unequal pay and corrected adjustment relating to single status; 9. ***Bad debt provisioning of council tax and housing debtors*** – provisions appear reasonable; 10. ***Valuation and completeness of redundancy provisions*** – provision appears reasonable***;*** 11. ***Recognition of PFI schemes*** – we have reviewed the models behind the PFI/LIFT schemes and there are no matters to bring to your attention from our testing; 12. ***Proposed cost saving plans –*** there are no matters to bring to your attention; and 13. ***Management override of controls*** – there are no matters to bring to your attention. More details of our findings on audit risks are given in Section 1.	Section 1

Key findings (continued)

	Description	Detail
Identified misstatements and disclosure deficiencies		
Council / Group materiality was set at £7.6m (2010: £7.8m) **HRA materiality was set at £0.9m (2010: £0.8m)**	**Council / Group Audit** The Council and Group audit materiality was set at £7.6m (2010: £7.8m). The basis for this remains unchanged from that communicated in the Audit plan. We report to the Audit Committee on all misstatements greater than our calculated clearly trivial threshold (CTT) and other adjustments that are qualitatively material. The CTT is £380,000 for 2010/11 (prior year: £390,000). A number of misstatements have been identified, predominantly relating to property, plant and equipment, provisions and group accounting. A number of disclosure deficiencies were also identified and communicated to management. Identified uncorrected misstatements increase expenditure by £0.6m (2010: decrease expenditure by £6.4m), increase net assets by £5.8m (2010: £6.4m) and increase prior year reserves by £6.4m. Management has concluded that the total impact of the uncorrected misstatements, both individually and in aggregate, is not material in the context of the financial statements taken as a whole. Details of recorded audit adjustments are included in Appendix 1. We draw to your attention that there were significant adjustments recorded in relation to Property, plant and equipment, Grants and Group accounting. **Housing revenue account audit** The Housing revenue account (HRA) audit materiality was set at £0.9m (2010: £0.8m). The basis for this remains unchanged from that communicated in the Audit plan. The CTT for 2010/11 is £44,000 (prior year: £40,000). A number of disclosure deficiencies were identified and corrected by management.	Appendix 1

Key findings (continued)

	Description	Detail
Control observations arising from the final audit visit		
	We identified a number of recommendations from our final audit visit which build upon the recommendations identified in our Planning report and communicated to the Audit Committee on 30 June 2011. Further detail is to be included in our Governance Report to be presented to the Audit Committee on 09 December 2011. Significant recommendations are: 1. quality assurance processes for the accounts and WGA including management review of the working papers supporting the accounts; 2. preparation of group accounts: reconciliation of intra-group balances prior to consolidation; 3. preparation of group accounts: harmonisation of accounting policies; 4. hosting of Homes for Northumberland financial transactions within the NCC accounting system; 5. review of suspense account reconciliations and accounts presentation; 6. review of the working papers prepared by external parties which support the financial statements; 7. unequal pay provision calculation; 8. extending member assurance arrangements to the group subsidiaries; and 9. property, plant and equipment working papers and understanding of CIPFA Code.	Refer to Governance Report to the Audit Committee dated 09 December 2011
Accounting policies and financial reporting		
	In the course of our audit of the financial statements, we considered the qualitative aspects of the financial reporting process, including items that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the financial statements. We have nothing to report in these areas. The financial statements have to be prepared in accordance with the CIPFA Code of Practice on Local Authority Accounting in UK 2010/ 11 (the 'Code') which has been revised to be in line with IFRS. Our findings with respect to the financial statement restatement are detailed in Section 1.	Section 1

Key findings (continued)

	Description	Detail
Annual governance statement (AGS)		
	The Annual Governance Statement ('AGS') covers all significant corporate systems, processes and controls, spanning the whole range of a Council's activities, including in particular those designed to ensure that: • the Council's policies are implemented in practice; • high quality services are delivered efficiently and effectively; • the Council's values and ethical standards are met; • laws and regulations are complied with; • required processes are adhered to; • financial statements and other published performance information are accurate and reliable; and • human, financial, environmental and other resources are managed efficiently and effectively. Our review is directed at: • considering the completeness of the disclosures in the governance statement and whether it complies with proper practice as specified by CIPFA; and • identifying any inconsistencies between the disclosure and the information that we are aware of from our work on the financial statements and other work relating to the Code of Audit Practice. We have reviewed the Council's AGS in line with the requirements above. We note that the preparation of the accounts has been impacted by the level of resource available within finance and this has resulted in the audit not progressing in line with our expectations. Management have included comments surrounding this within their AGS. We further noted that the draft AGS did not extend to group entities nor include commentary for the information governance issue within the Pension Scheme; the necessary narrative was added to rectify this omission. We have concluded that the AGS now includes all appropriate disclosures and is consistent with our understanding of the Council's governance arrangements and internal controls derived from our audit work.	

Key findings (continued)

	Description	Detail
Value for money audit		
Financial resilience **Prioritisation of resources**	From 2010/11 auditors are required to base their value for money conclusion on two criteria determined by the Audit Commission: • financial resilience; and • prioritising resources. Our work is based on a risk assessment using risk factors and other guidance issued by the Commission and involves consideration of adequacy of processes and arrangements in place. In line with the guidance, our work is "light touch" and does not involve assessment of effectiveness of those arrangements or consideration of decisions made by the Council. The key value for money ('VFM') audit risks we identified in our Audit plan are set out below with our audit findings: 1. ***the development of corporate arrangements for strategic planning and the integration with financial planning to target resources to priority areas**:* arrangements to identify and manage cross-cutting issues within the Transformation Programme should be strengthened and further work is required to develop corporate project management arrangements; 2. ***the integration of needs assessments into planning processes and decision-making**:* progress has continued and will be further developed in the ongoing work to map policies and business intelligence; 3. ***the delivery of financial targets and the management of reduction in resources**:* although pressure areas exist within the budget these are being actively managed and budget pressures are offset to achieve a forecast balanced position; 4. ***the management and resolution of equal pay claims and single status implementation**:* progress continues to be made although risks remain; 5. ***the implementation of revised corporate performance management arrangements**:* work is continuing to build on progress achieved in the year; 6. ***effective member challenge**:* new structures are in place to better focus scrutiny activity. There is scope to improve the effectiveness of the Audit Committee;	Section 2

Key findings (continued)

	Description	Detail
Value for money audit (continued)		
Financial resilience **Prioritisation of resources**	7. ***asset management, estate rationalisation and the management of backlog maintenance****:* significant progress has been achieved in assessing the condition of the estate. Further progress will be dependent on strategic decisions and progress in the Transformation Programme; 8. ***Adequacy of Information Services and technology resources to support delivery of services and the Transformation programme****:* significant progress has been made in addressing key areas of concern such as security issues and resilience, and the recent restructuring of the service should strengthen capacity. Our VFM conclusion work is completed and we propose to issue an unqualified conclusion on the Council's achievement of value for money.	Section 2
Independence		
Independence	We have communicated to you separately in our publication entitled "Briefing on audit matters" those additional items which we are required to report upon in accordance with International Standards on Auditing (UK & Ireland). The document also provides details of the safeguards and procedures we have in place to ensure our independence and objectivity. We confirm we are independent of Northumberland County Council and its subsidiaries.	Publication provided as part of our Audit plan.
Management representations		
	The representation letter was circulated with our Report dated 28 September 2011 and has now been signed on behalf of the Council.	

1. Key audit risks

The results of our audit work on key audit risks are set out below:

Group consolidation	
Preparation of consolidated accounts	For the financial statements ending 31 March 2011, there is a requirement to present consolidated accounts reflecting the control relationship with Homes for Northumberland Ltd (formerly Blyth Valley Housing) and Arch (Commercial Enterprise) Ltd (formerly Wansbeck Life Ltd) which in turn has a control relationship over Arch (Housing) Ltd (formerly Northern Coalfields Property Company Ltd). This is the first year that the Council has sought to present a consolidated set of financial statements. Key issues in relation to consolidation include: • preparation of consolidated accounts including prior year comparatives; • harmonisation of accounting policies within the group; and • identification and elimination of intra-group transactions.
Deloitte response	We have reviewed the Council's consolidation working papers and noted the following: • management had failed to resolve mis-matched balances between the Council and its subsidiaries prior to consolidation resulting in intra-group balances not being fully eliminated on consolidation. The confirmed balances from the subsidiaries were not reconciled to the Council's balances; as a result management had not identified the mis-match nor considered the impact on the valuation of Council only balances. • management had not performed a review of accounting policies in the subsidiaries in order to identify whether any adjustments were required to harmonise the accounting policies for Group reporting. This has led to audit adjustments in relation to Property, plant and equipment and Capital grants accounting.
Deloitte conclusion	**Management have processed the identified audit adjustments. Process recommendations in relation to the preparation of the group consolidation are discussed within the separate Governance Report to be presented to the Audit Committee on 09 December 2011.**

1. Key audit risks (continued)

First time adoption of IFRS	
Requirement to report under the Code	The Council is required to prepare their accounts for the year ended 31 March 2011 in accordance with the CIPFA Code of Practice on Local Authority Accounting in UK 2010/ 11 (the 'Code') which has been revised to be in line with IFRS. Compliance with the Code requires the restatement of comparatives and the application of new accounting policies going forward. Whilst the transition to the Code represents a fundamental change to the reporting framework and presentation of the financial statements key areas of focus were likely to include: • changes to the classification of finance and operating leases; • recognising an accrual for employees' untaken annual leave entitlement at the year end; • property, plant and equipment componentisation; • segmental reporting; and • school grants income recognition. The Council has taken steps to complete the IFRS restatement work, including engaging with external consultants.
Deloitte response	We have reviewed the revised accounting policies against the Code to ensure compliance and audited the restatement of the comparatives under the Code. Through our audit procedures we noted that the prior year figures had been incompletely reworked, notably with respect to grants, and current year changes to accounting policies had not always been correctly adopted. As a result a number of material audit adjustments were noted and the Council was required to perform additional procedures in order to complete the restatement of prior year figures.
Deloitte conclusion	**Management have processed the identified audit adjustments.**

1. Key audit risks (continued)

Non-current asset revaluations	
Revaluations of non-current assets	Under the Code, assets carried at fair value are required to be revalued with sufficient regularity to ensure that the carrying amount does not differ materially from fair value and as a minimum should have a valuation every five years. Due to the level of management judgment applied to the revaluation assumptions and the issues identified in previous periods with respect to the valuation of non-current assets, we have deemed the revaluation to be a specific risk.
Deloitte response	**<u>Other land & buildings, PFI and surplus assets valuations</u>** We have selected a sample of revaluations from the year end non-current assets and obtained the supporting valuation documentation from the asset management team. Our internal valuation specialists (Drivers Jonas Deloitte) have reviewed the assumptions for a sub-set of these valuations. We were largely satisfied with the sample of valuations; however, we believe that the valuers could have placed more reliance on comparable market evidence to support their valuations. **<u>Council dwellings valuation</u>** Council dwellings are required to be valued using the Existing Use Value – Social Housing (EUV–SH) basis. The valuations will be subject to annual reviews and full revaluations on a rolling programme, covering different parts of the stock every year, or every five years for the whole stock. The Blyth council housing stock was fully revalued at 01/04/2010. The EUV–SH basis is calculated as the value of the property assuming vacant possession, with an adjustment factor to reflect occupation by a secure tenant. Our internal valuation specialists (Drivers Jonas Deloitte) reviewed the valuation of the most significant beacon asset. Following this review we are satisfied that the valuation has been undertaken in line with the appropriate guidance. The Alnwick council housing stock was subject to a review rather than full revaluation. The review should comprise the movement in the open market value of vacant possession properties with similar archetypes to the Alnwick housing stock and a review of the movements in the secure tenant adjustment factor. Through our audit procedures we noted that the valuation of the Alnwick housing stock had been incorrectly calculated: • the movement in open market value applied in the revaluation related to an incorrect period; and • the change in North East secure tenant adjustment factor from 51% to 37% had not been included in the calculation.

1. Key audit risks (continued)

Non-current asset revaluations (continued)	
Deloitte response	The impact of this error was a £53m decrease in the net book value of Council dwellings, comprising a £46m decrease in Comprehensive income and expenditure and £7m decrease in the Revaluation reserve. The £46m impact on the Comprehensive income and expenditure statement is adjusted through the Movement in reserves statement to mitigate the impact on the general fund balance.
Deloitte conclusion	**Management have processed the identified audit adjustments. Process recommendations in relation to the preparation of the Property, plant and equipment are discussed within the separate Governance Report to be presented to the Audit Committee on 09 December 2011.**

Classification and valuation of assets held for sale	
IFRS 5 definition of assets held for sale and valuation of reclassified assets	The IFRS definition (IFRS 5 Non-current Assets Held for Sale and Discontinued Operations) is stricter with respect to classification than the previous SORP; therefore, given the errors found in previous periods have related to overstatement there is an increased risk that the Council will have incorrectly reclassified assets to 'assets held for sale'. There have been a number of issues detected in previous years concerning the valuation of assets identified as surplus assets held for disposal.
Deloitte response	**<u>Classification of assets held for sale</u>** We noted a number of assets classified within the ‘held for sale’ category which do not meet the required Code definition for this classification. The common area of deviation from the Code was in respect to assets which are not anticipated to be sold within 12 months, which in some cases reflects prevailing market conditions. **<u>Valuation of assets held for sale</u>** We noted that the accounting treatment for the revaluation of assets held for sale was not compliant with the requirements of the Code, specifically: • an upwards revaluation of £7m was recognised. Per the Code, upwards revaluations can be recognised only to the extent that they reverse a previous downwards revaluation charged to the Surplus or deficit on the provision of services which has not previously been reversed; and • a downwards revaluation of £11.8m was offset against the revaluation reserve. The Code requires these to be recognised in the Comprehensive income & expenditure statement and then reversed to the Capital adjustment account to mitigate the impact on the general fund balance.
Deloitte conclusion	**Management have processed the identified audit adjustments. Process recommendations in relation to the preparation of the Property, plant and equipment are discussed within the separate Governance Report to be presented to the Audit Committee on 09 December 2011.**

1. Key audit risks (continued)

Change in LGPS assumption from RPI to CPI	
Valuation of pension deficit	In the June 2010 budget, the Government announced that future increases in public-sector pensions would be linked to changes in the consumer prices index (CPI). Historically such pensions were linked to increases in the retail prices index (RPI). This would apply to increases due from April 2011. The change in assumptions will impact the defined benefit obligation at the year end.
Deloitte response	We have reviewed the assumptions made by the actuary in valuing the Council's share of the assets and liabilities of the pension fund. We have also consulted with our own in-house actuaries to determine whether the assumptions are reasonable and within expected ranges.
Deloitte conclusion	**The assumptions used by the actuary are within expected ranges and therefore appear reasonable.**

Grant income recognition	
Recognition of grant income against granting conditions	Under auditing standards we are required to assume a risk of fraudulent misstatement of the financial statements as a result of management manipulation of income recognition. In the case of the Council this has been identified as being connected to the recognition of grant income before the granting conditions have been met.
Deloitte response	Due to the change in the Code, whereby grants are recognised in the deficit or surplus on provision of services depending on the point at which grant conditions are met and the expenditure is incurred, we have selected a sample of both income and capital grants received in the period. It was noted that management had not correctly applied the change in accounting policy stipulated in the Code for income recognition resulting in an increase in income recognised in 2011/12. These adjustments were in addition to those discussed above in relation to the same issue in the IFRS restated comparative balance sheets.
Deloitte conclusion	**Management have processed the identified audit adjustments.**

1. Key audit risks (continued)

Valuation of Icelandic bank investments	
Impairment review of Icelandic bank investments	The Council holds a number of investments in collapsed Icelandic banks. The carrying value at 31 March 2011 is £10m (2010: £10m). Based on the remaining value of the investments and that their treatment continues to be a matter of public interest, we judge these investments to be material both in nature and value. The accounting and disclosure guidance set out within the LAAP are highly prescriptive and therefore there is a risk that the investments could be incorrectly stated due to misinterpretation of the guidance. Prior to the audit and issue of LAAP 82 update 4, management highlighted, that in light of the continuing uncertainty over recoverability, they were not minded to reverse the previously recognised impairments.
Deloitte response	We have obtained the working papers prepared by Sector in relation to the Icelandic investments and reviewed these to ensure compliance with the accounting treatment prescribed within the latest LAAP (LAAP 82 update 4) guidance. Our audit procedures noted that the treatment of Icelandic bank investments is inconsistent with LAAP 82 update 4 with respect to the assumed recoverability of the Glitnir investment. On 1 April 2011, the Reykjavik District Court issued a verdict that Local Authority claims qualified for priority under Article 112 of the Icelandic Bankruptcy legislation. The LAAP guidance was updated to recommend that the assumed recoverability of the Glitnir and Landsbanki investments should be increased with the caveat that the verdict was subject to appeal in the Icelandic Supreme Court. Management has chosen to account for the Landsbanki investment based on priority status; however, the Glitnir recoverability assumption remains that of non-priority status. This treatment is inconsistent with the LAAP guidance; applying the guidance would result in the carrying value of Icelandic bank investments increasing by £6.1m. Management have confirmed that the reason for this treatment, which is consistent with the prior year, is because, in their view, there remains uncertainty over the priority status of the Council's investments which will only be resolved once the ongoing legal process has run its course. The LAAP guidance is not mandatory and the Council have disclosed their departure from this guidance within the financial statements on the grounds that the recoverability remains uncertain until the final verdict is issued by the Icelandic Supreme Court. We obtained an analysis of uncertainty prepared by the Council legal department in order to support this assertion. Management have added a disclosure highlighting this as an area of significant management judgment and a specific management representation was received on this point.
Deloitte conclusion	**Management have provided the necessary analysis to support their assumption and included additional disclosures within the accounts to highlight that the assumption is subject to uncertainty.**

1. Key audit risks (continued)

Valuation of unequal pay and single status provisions	
Unequal pay and single status provisions	There is a material provision in the opening balance sheet (£20m) for the estimated liability resulting from unequal pay claims brought by employees seeking compensation for lost back pay. The calculation is highly subjective given the number of cases and the difference in settlement values between cases. The Council is in the process of negotiating a settlement for the transition to single status pay scales. This should reduce the potential for any future claims regarding unequal pay; however, the process may lead to new claims of historically unequal pay.
Deloitte response	**Unequal pay provision** The unequal pay provision at 31 March 2011 is £18.8m. The movement from the prior year is due to a payment on account to HMRC for the social security element of settled claims. There have been no settlements or payments to claimants during 2010/11. Management have been unable to provide either a breakdown of the total provision by individual or provide a calculation to support the provision valuation; we would recommend that management seek to implement such a process. We have assessed the valuation of the provision by performing a sensitivity analysis based on available data, for example, the number of outstanding claims being tracked by legal services and the average historic and forecast settlement values. In relation to the forecast settlement values, we have sought to take reliance on the work performed by Internal Audit. As a result of our testing, we have concluded that the provision remains overstated by £5.3m. The proposed adjustment has not been corrected by Management – refer to unadjusted misstatements detailed in Appendix 1. **Single status provision** We have made enquires of the legal and finance department regarding the current position of single status. We have noted that employment contracts moving towards single status were not signed as at 31/03/2011; these are anticipated to be processed throughout 2011/12 pending the results of the Union ballots. We have reviewed the Internal Audit report in relation to single status and selected a sample of individuals to agree to underlying payroll data in order to gain assurance over the integrity of the single status modelling spreadsheet. The Council provided for the future pay protection costs of those staff whose salaries will be reduced as part of their process to equalise all salaries across departments based on skill levels. Having sought advice from our technical specialists we concluded that the protection costs do not meet the definition of a provision or an onerous contract under IAS 37. An adjustment was recorded to reverse the £7.2m provision (Appendix 1).
Deloitte conclusion	**The Single status provision has been corrected for the audit adjustment proposed. The overstatement to the Unequal pay provision (£5.3m) is uncorrected in the final accounts (refer to Appendix 1). We have obtained representations that the Council believes this adjustment to be immaterial to the users of the accounts.**

1. Key audit risks (continued)

Bad debt provisions relating to council tax and housing	
Level of management judgement applied in provisioning for council tax **Housing bad debt provision calculated by Homes for Northumberland**	Council Tax provisioning is a matter of management judgement and as such there is a risk of fraudulent manipulation or bias within the selection of the accounting policy in order to enable management to influence the reported financial position. The bad debt provision for Housing debtors is calculated by Homes for Northumberland Limited. This is communicated to the Council and is posted to the accounts without a formal review of the calculation. Given that Homes for Northumberland is being consolidated with the Council for the first time in 2011, there is an increased risk of management bias in the calculation of the provision in order to improve the reported financial position for the consolidated set of financial statements.
Deloitte response	We have obtained the Council's working papers for the Council Tax provision, and Homes for Northumberland workings in relation to the housing rental debtor. We noted that in the prior year the Council prepared the bad debt provision based on historic recoverability percentages resulting in a general bad debt provision. The current year provision is based on the more recommended basis of reviewing the debtors' ledgers and providing for specific debts based on ageing.
Deloitte conclusion	**The bad debt provision appears reasonable.**

Valuation and completeness of redundancy provisions	
Redundancy provisions	The Council is in the process of consulting on a cost saving exercise in order to deliver the medium and long term budget savings. This may result in additional redundancies. Consequently there is a risk around the completeness and valuation of redundancy provisions.
Deloitte response	We have obtained a breakdown of the redundancy provision and tested this for completeness by comparing to records maintained by HR of individuals who agreed redundancy prior to 31/03/2011. We have selected a sample of individuals and agreed their provision value to the supporting signed settlement calculation and confirmed that the calculation is in accordance with the redundancy calculation matrix communicated to staff on the Council intranet. For those individuals who have received dispensations differing to the matrix we have sought to understand the business rationale.
Deloitte conclusion	**The redundancy provision appears reasonable.**

1. Key audit risks (continued)

Private finance initiative (PFI) schemes	
Change to the PFI model for the existing waste PFI. **Addition of fire PFI scheme.**	The Council has a significant PFI scheme relating to waste processing. During the year ended 31 March 2011 an issue was noted in the underlying valuation model supporting the accounting entries for the PFI scheme and consequently the model was reworked. Given the complexity of the model, a risk has been raised around the valuation of the assets and liabilities on balance sheet at the year end. In addition a further PFI scheme concerning the Fire and Rescue Service commenced during 10/11. A risk has been raised around the valuation of the assets and liabilities recognised in relation to this scheme.
Deloitte response	**Waste PFI** The waste tonnage and inflation projections have been updated within the PFI model. The impact to the estimated future payments is an increase of £14.5m. We have obtained the updated model and sought to understand the changes. We have reviewed the outputs of the model against the expected profile of PFI assets and liabilities. **Fire PFI** We have obtained the Cooperation agreements between the Council and the Operators in order to judge whether the scheme does meet the definition of a PFI and should therefore be accounted for on the Council's balance sheet. We obtained the financial models and agreed the inputs to underlying data and reviewed the outputs for reasonableness over the life of the PFI scheme. We noted that the scheme was brought on balance sheet at £13.5m and impaired to £2m. We consulted with our internal PFI specialists to conclude that the initial recognition value of construction costs was appropriate. The revaluation was reviewed by our internal valuation specialists and we have concluded that whilst the valuation appears prudent, the Valuers documentation would benefit from being supported by comparable market sales data.
Deloitte conclusion	**No significant issues were noted with respect to the valuation of the PFI assets and liabilities.**

1. Key audit risks (continued)

Proposed cost saving plans	
Assessment of financial standing and resilience	As part of the audit it is necessary to assess the Council's financial standing. Given the current pressure upon Council budgets due to the Government spending review, there is a risk that the medium term financial plan may contain unrealistic assumptions around achievable savings and thereby increase the risk of financial reporting manipulation.
Deloitte response	Our work on financial resilience has critically examined the medium term financial plan, the proposal for cost savings in the year 2011/12 and the extent and depth of credible planning underpinning the financial plan. Based upon this work we have considered the implications for our assessment of financial standing.
Deloitte conclusion	**Our response to this risk is discussed within our value for money conclusion in Section 2.**

Management override of controls	
Presumed risk of management override of controls	International Standards on Auditing (UK and Ireland) requires the auditors to perform certain audit procedures to respond to the risk of management's override of controls. In addition to the procedures above we are required to design and perform audit procedures to respond to the risk of management's override of controls.
Deloitte response	We have performed the following: • understood and evaluated the financial reporting process and the controls over journal entries and other adjustments made in the preparation of the financial statements, and tested the appropriateness of a sample of such entries and adjustments; • reviewed accounting estimates for bias that could result in material misstatement due to fraud, including whether any differences between estimates best supported by evidence and those in the financial statements, even if individually reasonable, indicate a possible bias on the part of management; • a retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements; and obtained an understanding of the business rationale of significant transactions that we became aware of that were outside the normal course of business or that otherwise appeared to be unusual given our understanding of the organisation and its environment. In addition, we performed detailed testing over certain expenditure populations. For the sample of expenditure items selected we obtained the supporting documentation and challenged management regarding the rationale for the posting.
Deloitte conclusion	**No issues of management override were noted in the testing performed.**

2. Value for money conclusion

From 2010/11 the Audit Commission has introduced new requirements for local value for money ("VFM") audit work at councils. This year, auditors are required to give their statutory VFM conclusion based on the following two criteria:

- proper arrangements in place for securing financial resilience: work to focus on whether the Council has robust systems and processes to manage risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future; and,
- proper arrangements for challenging how economy, efficiency and effectiveness are secured: work to focus on whether the Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

We have determined our local programme of work based on our risk assessment, which is informed by a series of risk factors determined by the Audit Commission. There were no changes to our risk assessment as reported to the Audit Committee in June.

It should be noted that the work carried out was light touch, in line with Audit Commission guidance, focusing on updating our understanding of arrangements and controls in place. As arrangements have previously been assessed as adequate and we are not aware of any changes, we did not carry out detailed testing of the implementation of those controls in the current year.

Development of corporate arrangements for strategic planning and the integration with financial planning to target resources to priority areas	
Corporate planning **Transformation programme**	Having successfully achieved transition following the local government reorganisation (LGR) on 1 April 2009, the Council needs to deliver the improvements and efficiencies of transformation. Critical to this are the successful implementation of the revised corporate planning processes and the Transformation programme. Failure to do so could result in a lack of clarity in priorities and resources not being directed in line with those priorities. Effective project management procedures for each workstream and project within the overall programme will also be key to successful delivery.
Deloitte response	We carried out a high level review of the corporate planning process, including consideration of how the priorities feed down into service planning. Programme management arrangements and the adequacy of monitoring procedures were reviewed. We have also considered the progress achieved in establishing corporate project management arrangements and how these are being implemented across the organisation. Progress has continued to be made in developing the corporate planning process and service plans are all in place. Work is ongoing to further develop business management, map policies and the co-ordination and better use of information / intelligence. Arrangements for the management of the Transformation Programme have been established but are still developing, as are arrangements for monitoring progress. Whilst certain measures are in place to manage cross-cutting issues (such as ICT representation on each Board) there appears to be significant reliance on the Transformation Board and arrangements to identify and address cross-cutting matters at a lower level are less clear. The Transformation Team provide support to those projects / workstreams where scope to add value is identified but are not involved in all areas and capacity is limited so are not in a position to fulfil this role. Consideration should be given to the need to strengthen arrangements in relation to cross-cutting issues.

2. Value for money conclusion (continued)

Development of corporate arrangements for strategic planning and the integration with financial planning to target resources to priority areas (continued)	
Deloitte response	*The Northumberland Way* sets out the principles and approach to project management in relation to the Transformation Programme. It is intended that this will be rewritten to address project management more generally and this will be rolled out as the corporate approach. We note that this is fairly high level and further detailed guidance / tools will be required. We are aware that robust project management is in place within the organisation so good practice examples are already available to share. No issues impacting our VFM conclusion have been identified.

Integration of needs assessments into planning processes and decision-making	
Joint strategic needs assessment (JSNA)	At the time of our audit last year, work was ongoing to strengthen the JSNA and improve the linkage between this and the planning processes. Previously, detailed analysis had been undertaken and good understanding of needs developed, but it was not clear how this then impacted plans, priorities and decision-making. This will be particularly important in the current economic climate and in light of increasing financial pressures.
Deloitte response	Progress has continued in the development of the JSNA and this will be picked up within the ongoing work in mapping policies and business intelligence, with the intention that these are used to inform medium-long term planning.

Delivery of financial targets and the management of reduction in resources	
Financial planning and efficiency plans	Following the Government's comprehensive spending review and the extent of the reduction in the funding settlement announced in December, the Council is facing severe financial pressures over the next few years and particularly in 2011/12. Efficiency plans are in place to achieve the target for 2011/12 and are being developed for 2012/13. Difficulties were encountered in Local Services with the consolidation of budgets from the district councils so work is ongoing to fully understand and challenge those budgets.
Deloitte response	We reviewed a sample of initiatives to assess the reasonableness of the quantification of savings to be achieved, and the processes for identifying and addressing any costs of implementation. The latest monitoring reports identify several areas of pressure, particularly within Local Services where extensive work has been ongoing to review budgets on a line by line basis. Management are now confident that the underlying position has now been clarified and information is now available to inform the decisions required to address the pressure areas. No issues impacting our VFM conclusion have been identified.

2. Value for money conclusion (continued)

Delivery of financial targets and the management of reduction in resources (continued)	
Deloitte response	Whilst we note that there are risks surrounding the achievement of savings plans, these are clearly detailed within the quarterly performance reports and are being actively managed. No issues impacting our VFM conclusion have been identified.

Equal pay claims and single status implementation	
Management of equal pay claims and single status implementation	Delays have been encountered in the successful settlement of equal pay schemes and implementation of single status. The affordability of solutions in these areas, and the robustness of assumptions built into budget assumptions are critical to the Council's financial resilience.
Deloitte response	Progress in these areas has been achieved although risks are still significant. As detailed in Section 1, our financial audit work on the accounts suggests that the provision for equal pay claim is overstated based on evidence available at the current time. It should be noted that the provision in the accounts must be determined in line with accounting standards and this will not necessarily be the appropriate basis for budgeting purposes. No concerns have therefore been identified in relation to the medium term financial strategy and no issues impacting our VFM conclusion have been identified.

Implementation of revised corporate performance management arrangements	
Corporate performance management arrangements	Robust performance management arrangements will be critical to monitor the impact of budget savings on the delivery of services and to ensure that resources are aligned to priorities. These were under development at the time of our audit last year and the quality of information feeding into the corporate processes was variable across the different directorates.
Deloitte response	We have reviewed progress achieved in the implementation of the revised corporate performance management arrangements. Within this we considered whether the new arrangements are fit for purpose and the adequacy of quality assurance procedures over the information feeding into the corporate reporting processes. A new framework has been established and monitoring arrangements previously assessed as adequate are still in place. We note that work was ongoing to populate the Performance Plan management information system. We will revist this area to assess progress as part of our 2011/12 audit. No issues impacting our VFM conclusion have been identified.

2. Value for money conclusion (continued)

Effectiveness of member challenge	
Scrutiny arrangements **Audit Committee effectiveness**	At the time of our audit last year, the roles and functions of scrutiny were evolving and developing in response to concerns over the effectiveness of the previous arrangements. The effectiveness of member challenge, both in terms of performance and targeting resources, and maintaining robust governance arrangements, is key during the current period of change and increasing financial pressures.
Deloitte response	Arrangements for planning Scrutiny activity have been revised to improve the focus of work whilst managing the burden placed on the organisation in supporting the Scrutiny function. These arrangements will facilitate greater alignment of activity with priorities whilst retaining flexibility to respond to issues arising during the course of the year. There is scope to strengthen the effectiveness of the Audit Committee. The level of contribution from members of the committee is variable and there is a lack of robust challenge in some areas of governance arrangements. We recognise that it is difficult for members without direct experience in governance to challenge in a proactive rather than reactive way. Anticipated changes in the national audit arrangements together with the extent of change within the organisation and increasing pressure on resources, mean that the role of the audit committee is more important than ever. Consideration should be given to introducing independent members with appropriate skills and experience to supplement those of elected members. No issues impacting our VFM conclusion have been identified.

Asset management, estate rationalisation and the management of backlog maintenance	
Asset management strategy	At the time of our audit last year, extensive work was still required to address post-LGR issues, both in terms of assessing the estate and developing a revised asset management strategy. In addition, backlog maintenance was significant and the economic environment would make any estate rationalisation more difficult to achieve.
Deloitte response	Significant progress has been achieved in assessing the condition of the estate and this has been set out in the business case for estates transformation. Further progress will be dependent on strategic decisions and progress in the Transformation Programme. No issues impacting our VFM conclusion have been identified.

2. Value for money conclusion (continued)

Adequacy of Information Services and technology resources to support delivery of services and the Transformation programme	
IS strategy **IS restructure and investment**	The Information Services function has been underfunded and there have been concerns over the effectiveness of the infrastructure and systems. An Information Service strategy has been developed and the department restructured during the year. Effective ICT processes are critical to many of the initiatives within the Transformation programme and improving efficiency in service delivery.
Deloitte response	We have considered progress against the Council's action plan to address the concerns in the Service and its capacity to support these initiatives. Significant progress has been made in addressing key areas of concern such as security issues and resilience (please note we have not carried out any testing of these developments). We understand that such improvements in the service are enabling the transfer of resource to more strategic activities as intended in the recent restructuring of the service which should strengthen capacity to support Transformation. No issues impacting our VFM conclusion have been identified.

Financial reporting	
Significant delays have been experienced **Some weaknesses have been noted**	As noted earlier in this report significant challenges have been experienced in the completion of the audit. Contributing to the delays have been the following issues: • material issues and adjustments noted within property, plant and equipment; • material issues and adjustments noted with the IFRS restatement; • preparation of group accounts and extension of the AGS to cover the group subsidiaries; • some agreed working papers were not prepared; and • lack of local ownership and management review of work outsourced to third parties.
Deloitte response	We have considered the factors outlined above and in view of: • management's commitment to learn the lessons from the current year process; • management's plans to address the resourcing issues which have contributed to the issues encountered this year; and • the additional disclosure included within the governance statement acknowledging the weakness in this area; and We have concluded we are able to issue an unqualified VFM conclusion in respect of financial reporting. We will revisit this issue in 2011/12 and consider implications for subsequent years' conclusions should remedial action prove ineffective.

2. Value for money conclusion (continued)

The VFM conclusion

Under the Code, auditors are required to include a positive conclusion in their statutory audit report as to whether they are satisfied that, in all significant respects, the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. The conclusion has regard to the criteria specified by the Commission and we do not consider all aspects of the Authority's arrangements. This conclusion is given within our audit report on the Council's accounts.

We are required to report if, in our judgement, matters come to our attention which are significant enough to prevent us from concluding that proper arrangements are in place in the areas considered. In such a circumstance, we qualify our conclusion in relation to particular criteria, either on an 'except for' basis (i.e. the Council has put in place proper arrangements except for…) or in the form of an 'adverse' conclusion (i.e. the Council has not put in place arrangements in that…).

Having considered the Council's progress in each of the key areas outlined above we propose to issue an unqualified value for money conclusion.

3. Independence

As part of our obligations under International Standards on Auditing (UK & Ireland) and the Companies Act, we are required to report to you on the matters listed below.

Confirmation	We confirm that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and our objectivity is not compromised. If the audit committee wishes to discuss matters relating to our independence, we would be happy to arrange this.
Non-audit services	In our opinion there are no inconsistencies between APB Revised Ethical Standards for Auditors and the company's policy for the supply of non audit services or of any apparent breach of that policy.
Fees	We summarise below our proposed audit fees, excluding fees in respect of grant certification, payable by Northumberland County Council and as discussed with management, set out by work stream:

Area of work	£ 2010/11	£ 2009/10
Audit of the financial statements including group accounts and WGA return	468,625	507,000
Audit of the pension scheme	36,000	36,000
Additional Audit work in our capacity as appointed auditor	0	64,500
Advisory Services in respect of Smart Benefits	0	83,000
Advisory Services in respect of Corporate Restructuring	25,000	0
Total	529,625	690,500

4. Responsibility statement

The Audit Commission published a 'Statement of responsibilities of auditors and of audited bodies' alongside the Code of Audit Practice. The purpose of this statement is to assist auditors and audit bodies by summarising, in the context of the usual conduct of the audit, the different responsibilities of auditors and of the audited body in certain areas. The statement also highlights the limits on what the auditor can reasonably be expected to do.

Our report has been prepared on the basis of, and our work carried out in accordance with, the Code and the Statement of Responsibilities, copies of which have been provided to the Authority by the Audit Commission.

The audit may include the performance of national studies developed by the Audit Commission, where the auditors are required to follow the methodologies and use the comparative data provided by the Commission. Responsibility for the adequacy and appropriateness of these methodologies and the data rests with the Audit Commission.

While our report includes suggestions for improving accounting procedures, internal controls and other aspects of your business arising out of our audit, we emphasise that our consideration of the Council's system of internal financial control was conducted solely for the purpose of our audit having regard to our responsibilities under Auditing Standards and the Code of Audit Practice. We make these suggestions in the context of our audit but they do not in any way modify our audit opinion, which relates to the financial statements as a whole. Equally, we would need to perform a more extensive study if you wanted us to make a comprehensive review for weaknesses in existing systems and present detailed recommendations to improve them.

Any conclusion, opinion or comments expressed herein are provided within the context of our opinion on the financial statements and our conclusion on value for money as a whole, which was expressed in our auditors' report.

We view this report as part of our service to you for use, as Members, for corporate governance purposes and it is to you alone that we owe a responsibility to its contents. We accept no duty, responsibility or liability to any other person as the report has not been prepared, and is not intended, for any purpose. It should not be made available to any other parties without our prior written consent.

If you intend to publish or distribute financial information electronically or in other documents, you are responsible for ensuring that any such publication properly presents the financial information and any report by us thereon, and for the controls over and security of the website. You are also responsible for establishing and controlling the process for electronically distributing accounts and other information.

Deloitte LLP

Chartered Accountants

Newcastle
06/10/2011

For your convenience, this document has been made available to you in electronic format. Multiple copies and versions of this document may therefore exist in different media - in the case of any discrepancy the final signed hard copy should be regarded as definitive. Earlier versions are drafts for discussion and review purposes only.

Appendix 1: Audit adjustments

Uncorrected misstatements

The following uncorrected misstatements were identified during the course of our review:

As stated in our Audit plan, we only report to you uncorrected misstatements that are not clearly trivial which includes greater than £380,000 for the Council and Group financial statements and greater than £44,000 for the Housing revenue account.

		(Credit) / charge to income & expenditure account £	Increase/ (decrease) in net assets £	(Increase)/ decrease in reserves £	(Increase)/ decrease in opening reserves £
Unequal pay provision (Section 1)					
DR Unequal pay provision	**[1]**		(1,094,728)		
CR Income & Expenditure account		1,094,728			
DR General fund				1,094,728	
CR Capital adjustment account				(1,094,728)	
Single status provision	**[2]**	(450,471)	450,471		
Unrecorded liability	**[3]**				
DR Property, plant & equipment			181,005		
CR Accruals			(181,005)		
PFI liability	**[4]**		487,000		
DR Long term creditors			(487,000)		
CR Short term creditors					
Total misstatements brought forward relating to 2010 items:	**[5]**		6,416,411		(6,416,411)
Total		**644,257**	**5,772,154**	**0**	**(6,416,411)**

Appendix 1: Audit adjustments (continued)

Uncorrected misstatements

We have obtained written representations from the Council confirming that after considering all these uncorrected items, both individually and in aggregate, in the context of the consolidated financial statements taken as a whole, no adjustments are required.

[1] This represents the judgmental adjustment we have proposed to reduce the unequal pay provision to the level supported by the number of outstanding claims and previous settlement values. Refer to further discussion in Section 1.

[2] Adjusting error between the Single status provision model used to generate the provision for the accounts, and the revised model obtained during our audit procedures which had been updated for errors in the calculation.

[3] Adjustment proposed for an unrecorded property, plant and equipment asset addition and the corresponding accrual. The adjustment above relates to the known unrecorded asset and liability, this error extrapolates over the total population to give a £542,676 likely error. Neither adjustment has been corrected.

[4] Error in the presentation of the PFI liability between short and long term.

[5] This represents the total uncorrected adjustments from the 2010 yearend audit. A detailed schedule of these has been presented previously. All errors have been addressed by management in year and hence the correction is between opening reserves and Income and Expenditure reported in year.

Appendix 1: Audit adjustments (continued)

Recorded audit adjustments – 10/11 financial statements (excluding carry forward impact from 09/10 restatement adjustments)

		(Credit) / charge to income & expenditure account £	Increase/ (decrease) in net assets £	(Increase)/ decrease in reserves £	(Increase)/ decrease in opening reserves £
Property, Plant & Equipment					
Council dwellings **(Section 1)**	**[1]**	46,196,716	(52,938,987)	6,742,271	
Assets held for sale **(Section 1)**		11,759,208	(6,985,430)	(4,773,778)	
CofE Academy sites – valuation and ownership adjustments		35,651,706	(32,115,737)	(3,535,969)	
Single status provision					
Protection costs provision **(Section 1)**	**[3]**	(7,157,000)	7,157,000		
Total – Council only financial statements		**86,450,630**	**(84,883,154)**	**(1,567,476)**	
Group accounts					
Harmonisation of subsidiary accounting policies **(Section 1)**	**[4]**	3,638,859	1,560,846	(5,199,705)	
Total – Group financial statements		**90,089,489**	**(83,332,308)**	**(6,767,181)**	

[1] A number of adjustments were identified within property, plant and equipment. The most significant of which are detailed above and resulted in a combined £93.6m reduction in the asset value.

[2] The Council had not correctly applied the Code requirements with respect to the treatment of grants. There is a mitigating impact on General Fund through a transfer in the Movement in Reserves Statement.

[3] The Single Status protection costs provision did not meet the definition of an onerous contract and as such an adjustment was made to reverse the value. There is a mitigating impact on General Fund through a transfer in the Movement in Reserves Statement.

[4] Adjustment in relation to the harmonization of accounting policies for the subsidiaries (UK GAAP accounting basis) on consolidation with the Council (CIPFA Code accounting basis).

Appendix 1: Audit adjustments (continued)

Recorded audit adjustments – 09/10 IFRS restated financial statements

		(Credit) / charge to income & expenditure account £	Increase/ (decrease) in net assets £	(Increase)/ decrease in reserves £	(Increase)/ decrease in opening reserves £
Grants					
Capital grants **(Section 1)**	**[2]**	(13,080,611)	13,080,611	-	-
Revenue grants **(Section 1)**		13,749,000	-	-	(13,749,000)
Total – Council only financial statements		**668,389**	**13,080,611**	**-**	**(13,749,000)**
Group accounts					
Harmonisation of subsidiary accounting policies **(Section 1)**	**[3]**	1,800,022	3,185,489	(2,012,710)	(2,972,801)
Total – Group financial statements		**2,468,411**	**16,266,100**	**(2,012,710)**	**(16,721,801)**

Appendix 1: Audit adjustments (continued)

Disclosure deficiencies

Auditing standards require us to highlight significant disclosure deficiencies to enable audit committees to evaluate the impact of those matters on the financial statements.

We noted one uncorrected disclosure deficiency:

- The total income and total expenditure reported in Note 5 Amounts Reported for Resource Allocation Decisions does not agree to the corresponding figures within the SOCIE. Management communicated that this was due to internal recharging which they have been unable to isolate and extract.

We obtained a representation that the Council believes that the deficiency is not material to the users of the accounts.

Appendix 2: Important future developments

For reference, the following development may impact the financial statements of the Council or its subsidiaries:

Bribery act 2010

Background

The public sector falls within the scope of the Bribery Act 2010, which came into force on 1st July 2011. Specifically, public sector organisations, including the Authority can commit offences in these sections of the Act:

- Section 1 – bribing another person;
- Section 2 – offences relating to being bribed; and
- Section 6 – bribing a foreign public official.

If a public sector organisation commits any of those offences then senior officers can be personally liable if it was committed with their consent or connivance. On conviction under the Act an individual may be sentenced to up to 10 years in prison. An organisation may be subject to an unlimited fine.

The new offence of a commercial organisation failing to prevent bribery (set out in Section 7) only applies to incorporated companies and partnerships that carry on a business in the UK. However, bodies created by statute as corporate bodies could fall within the scope of the offence.

Most of the commentary on the Act has focused on the new Section 7 offence, and in particular on the defence available to an organisation if it can show that it had in place 'adequate procedures' designed to prevent bribery. The Government published guidance for consultation on what will constitute adequate procedures for the purposes of the Act.

Unfortunately, this guidance does not consider the definition of a commercial organisation set out in the Act. In light of this lack of clarity, public sector organisations that believe they could fall within the definition should consider how the draft guidance could be adapted to reflect their own organisational structures and practices.

Impact

Most public authorities already have bribery procedures in place and while this will help in the prevention and detection of bribery in the public sector and where it works alongside the private sector, it will not make public body staff immune to involvement in situations where bribery may occur. Clearly, the public sector will be expected to play its part in reporting any suspicious activity in the private sector.

The Bribery Act should be considered by the Council as part of the Corporate Risk Assessment, and the Code of Conduct should be revised to incorporate it. Additionally, to ensure that the Council is prepared for the Act, it should:

- update procurement documentation and precedent contracts to refer to the new provisions;
- consider making changes to procurement practices. For example it would be embarrassing for the Authority if a contractor was found to have committed an offence relating to services provided to or on behalf of a public authority. An explicit right to terminate a contract in these circumstances would show that the Authority had tried to prevent such actions and was able to deal with the breaches effectively.