

Annual Governance Report

Durham County Council

Audit 2006/07

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.
- 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 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

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

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

Copies of this report

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

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Purpose of this document

- 1 In accordance with the Audit Commission's Code of Audit Practice (the Code), this report provides a summary of the work we have carried out during our 2006/07 audit of accounts, the conclusions we have reached and the recommendations we have made to discharge our statutory audit responsibilities to those charged with governance (in this case the County Council) at the time they are considering the financial statements.
- 2 In preparing our report, the Code requires us to comply with the requirements of International Standards on Auditing (United Kingdom & Ireland) – ISA (UK&I) - 260 'Communication of Audit Matters to Those Charged With Governance', by reporting to you matters relating to the audit of the financial statements. 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.
- 3 We are also required to communicate to you the Audit Commission's requirements in respect of independence and objectivity, and these are set out at Appendix 1.
- 4 This report has been prepared for presentation to the County Council (the Council) on 25 September 2007. Members are invited to:
 - consider the matters raised in the report before we give our opinion;
 - approve the representation letter on behalf of the County Council and those charged with governance before we issue our opinion; and
 - consider amending the financial statements for unadjusted misstatements, significant qualitative aspects of financial reporting and any recommendations for improvement in the action plan (none in this case).
- 5 Our work during the year was performed in line with our plan. We have issued separate reports during the year having completed specific aspects of our programme, which are listed in Appendix 2.

Key messages

- 6 Our work on the financial statements (including the pension fund) is now complete. We propose issuing an unqualified audit opinion on 25 September 2007 (a draft report is attached at Appendix 3).
- 7 In our view, the Statement on Internal Control (SIC) has been prepared in accordance with proper practice specified by CIPFA and is consistent with the findings from our audit.
- 8 Our work on the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources is now complete. We propose issuing an unqualified Value for Money conclusion on 25 September 2007 (a draft report is attached at Appendix 3).

Audit status

- 9 At the date of issue of this report our detailed audit is complete.
- 10 The Council has again taken a positive and constructive approach to our audit and we would like to take this opportunity to express our appreciation for the Council's assistance and co-operation.

Accounts and Statement on Internal Control

- 11 Our work on the financial statements is now complete.
- 12 Auditors are required to obtain written confirmation of certain representations from management and those charged with governance before an audit report is issued, such as acknowledgement of responsibility for the fair presentation of the financial statements in accordance with the applicable financial reporting framework and responsibility for the design and implementation of internal control to prevent and detect error.
- 13 The auditor should also obtain written representations from management on matters material to the financial statements when other sufficient appropriate audit evidence cannot reasonably be expected to exist.
- 14 The final draft of the letter of representation has been attached as Appendix 5.

Unadjusted misstatements

- 15 We are required to report to you all unadjusted misstatements that we have identified during the course of our audit, other than those that are clearly trivial.
- 16 There are no unadjusted misstatements for us to bring to the attention of members.

Adjustments to the financial statements

- 17 We are also required to bring to your attention misstatements that have already been corrected by management where we consider them relevant to your wider governance responsibilities. These are recorded in full at Appendix 6.
- 18 The most significant items relate to adjustments to the balance sheet:
 - for a fixed asset totalling £4.050m which is no longer owned by the Council; and
 - for the omission of Sure Start capital grants of £7.69m from the Government Grants Deferred balance.
- 19 A note has been added to the accounts referring to the fact that on 25 July 2007 the Secretary of State announced that she was minded to implement a proposal for a single unitary council for County Durham if and when the Local Government and Public Involvement in Health Bill 2007 is enacted.
- 20 A number of headings on the cash flow statement have been revised although there has been no significant impact on the overall 'decrease in cash' on the bottom line of this primary statement.

Accounting practices and financial reporting

- 21 We are also required to report to you our view on the qualitative aspects of the Council's accounting practices and financial reporting and have set out below our observations on key issues affecting the Council.
- 22 Together with officers, we identified a number of areas where the Council could improve disclosure within the accounts in line with the Statement of Recommended Practice (SORP) and the accounts have been amended to reflect these improvements. In particular, officers have amended the following narrative disclosures included in the financial statements:
- clarification of the total amount earmarked in reserves in respect of Equal Pay and;
 - adding a note to the Income and Expenditure account to indicate the presentational impact of the change in Education funding.
- 23 We will be issuing a more detailed final accounts memorandum to officers shortly. This will highlight recommendations to be considered for 2007/08 as well as listing all trivial and non-trivial misstatements.

Systems of internal control

- 24 As part of our audit, we consider the systems of accounting and financial control and report to you any material weaknesses identified. Our audit identified the need to eliminate some weaknesses in the systems of accounting and financial control which we are reporting to you, including the following:
- ensuring there is a process in place for review of the asset register to check for completeness;
 - reviewing the production and presentation of the bank reconciliations and ensuring that contra entries between them are evidenced;
 - ensuring there is a robust review of exception reports produced from the new payroll system, ResourceLink;
 - improving the reconciliation process between the payroll system and the general ledger; and
 - addressing IT control environment weaknesses, including the production of an overarching IT strategy.

- 25** 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. Detailed and other recommendations for improvement to systems of internal control have been made in our separate payroll and interim opinion reports. Recommendations will also be contained in our final accounts memorandum to be issued to the Treasurer shortly.
- 26** We have also reviewed whether the SIC has been prepared in accordance with proper practice specified by CIPFA and is consistent with the findings from our audit. We have noted that more corporate ownership is being taken of the production and review of the SIC. A key recommendation for next year is that the SIC should incorporate those activities carried out by third parties on the Council's behalf.

Use of resources - Value for Money Conclusion

Work performed

- 27 The Code requires us to reach a conclusion on whether we are satisfied that the Council has proper arrangements in place for securing economy, efficiency and effectiveness in its use of resources - the value for money conclusion. In meeting this responsibility, we review evidence that is relevant to the Council's corporate performance management and financial management arrangements across a range of criteria specified by the Audit Commission. Our work to support our conclusion included the following elements:
- use of resources assessment;
 - data quality work; and
 - the best value performance plan.
- 28 Details of our conclusion for each of the criteria specified by the Audit Commission are set out in Appendix 4.

Use of resources assessment

- 29 We are currently completing our use of resources assessment and will discuss the outcome with the relevant officers in due course.

Data quality work

- 30 We are currently finalising our data quality review and will report our findings to the relevant officers in due course.

Best value performance plan

- 31 Our work in respect of the Council's 2006/07 Best Value Performance Plan (BVPP) was reported in the 2006 annual audit and inspection letter. No recommendations were made to the Audit Commission or the Secretary of State.

Audit fee update

- 32 We reported our fee proposals as part of the Audit Plan for 2006/07. The table below reports the outturn fee against that plan. For Members' information it also provides a comparison with the fees charged in 2005/06 and the planned fee for 2007/08.

Table 1

Actual 2005/06 £	Audit area	Planned fee 2006/07 £	Actual fee 2006/07 £	Plan 2007/08 £
132,300	Audit of Financial statements	152,000	152,000*	157,500*
44,400	Use of resources (including BVPP)	45,900	45,900*	57,700*
12,300	Data quality	11,900	11,900*	12,500*
0	Whole of government accounts	2,500	2,500**	2,500**
0	National Fraud Initiative	0	0	1,200**
189,000	Total audit fee	212,300	212,300	231,400
68,000	Certification of claims and returns estimate	68,000	68,000*	55,000

* Fee agreed locally

** Fee set nationally by the Audit Commission

- 33 The analysis above shows that our audit fee has been contained within the totals you have already agreed.
- 34 The outturn on inspection fees will be reported in the annual audit and inspection letter.

Appendix 1 – The Audit Commission’s requirements in respect of independence and objectivity

- 1 We are required to communicate the following matters to those charged with governance:
 - the principal threats, if any, to objectivity and independence identified by the auditor, including consideration of all relationships between the Council, 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 audit team and which are required to be disclosed under auditing and ethical standards.

Appendix 2 – Audit reports issued

Planned output	Planned date of issue	Actual date of issue	Addressee
Audit plan	March 2006	April 2006	Officers
Audit of BVPP 2006/07	October 2006	October 2006	Officers
Data Quality	September 2007	TBA	Officers
Opinion Interim report	July 2007	August 2007	Officers
Payroll report	July 2007	August 2007	Officers
Annual governance report	25 September 2007	25 September 2007	Members
Opinion on financial statements	25 September 2007	TBA	Members
Value for Money conclusion	25 September 2007	TBA	Members
Final accounts memorandum	October 2007	TBA	Officers
Use of Resources	October 2007	TBA	Officers
Annual Audit and Inspection Letter 2007 (including direction of travel assessment)	December 2007	TBA	Members

Appendix 3 – Proposed auditor’s report

Independent auditor’s report to the Members of Durham County Council

Opinion on the financial statements

I have audited the financial statements and the pension fund accounting statements of Durham County Council for the year ended 31 March 2007 under the Audit Commission Act 1998. The financial statements comprise the Explanatory Foreword, Income and Expenditure Account, Balance Sheet, Statement of Total Recognised Gains and Losses, Cash Flow Statement and the related notes. The pension fund accounts comprise the Fund Account, the Net Assets Statement and the related notes. The financial statements and pension fund accounts the have been prepared under the accounting policies set out within them.

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

Respective responsibilities of the Treasurer and auditors

The Treasurer’s responsibilities for preparing the financial statements, including the pension fund accounts, in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2006 are set out in the Statement of Responsibilities.

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

I report to you my opinion as to whether the financial statements and the Pension Fund accounts present fairly, in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2006:

- the financial position of the Council and its income and expenditure for the year; and
- the financial transactions of the pension fund during the year and the amount and disposition of the fund's assets and liabilities, other than liabilities to pay pensions and other benefits after the end of the scheme year.

I review whether the statement on internal control reflects compliance with CIPFA's guidance 'The statement on internal control in local government: meeting the requirements of the Accounts and Audit Regulations 2003' issued in April 2004. I report if it does not comply with proper practices specified by CIPFA or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered, whether the statement on internal control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the Council's corporate governance procedures or its risk and control procedures

I read other information published with the financial statements, and consider whether it is consistent with the audited financial statements. This other information comprises only the Annual Report. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

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

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

Opinion

In my opinion:

- The financial statements present fairly, in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2006, the financial position of the Council as at 31 March 2007 and its income and expenditure for the year then ended; and
- The pension fund accounts present fairly, in accordance with the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2006, the financial transactions of the pension fund during the year ended 31 March 2007, and the amount and disposition of the fund's assets and liabilities as at 31 March 2007, other than liabilities to pay pensions and other benefits after the end of the scheme year.

Steve Nicklin
District Auditor

Audit Commission
Nickalls House
Metro Centre
Gateshead
Tyne & Wear
NE11 9NH

Date

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

Authority’s Responsibilities

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

Under the Local Government Act 1999, the Council is required to prepare and publish a best value performance plan summarising the Council’s assessment of its performance and position in relation to its statutory duty to make arrangements to ensure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.

Auditor’s Responsibilities

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

I am required by section 7 of the Local Government Act 1999 to carry out an audit of the Council’s best value performance plan and issue a report:

- certifying that I have done so;
- stating whether I believe that the plan has been prepared and published in accordance with statutory requirements set out in section 6 of the Local Government Act 1999 and statutory guidance; and
- where relevant, making any recommendations under section 7 of the Local Government Act 1999.

Conclusion

I have undertaken my audit in accordance with the Code of Audit Practice and having regard to the criteria for principal local authorities specified by the Audit Commission, I am satisfied that, in all significant respects, Durham County Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2007.

Best Value Performance Plan

I issued my statutory report on the audit of the Council’s best value performance plan for the financial year 2006/07 by 31 October 2006. I did not identify any matters to be reported to the Council and did not make any recommendations on procedures in relation to the plan.

Certificate

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

Steve Nicklin
District Auditor

Audit Commission
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Gateshead
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Date

Appendix 4 – Value for money conclusion

The Audit Commission has published, in accordance with the Code of Audit Practice, 12 criteria on which auditors are required to reach a conclusion on the adequacy of an audited body's arrangements for economy, efficiency and effectiveness in its use of resources.

The Code criteria are linked to the use of resources assessment (UoR) key lines of enquiry (KLoEs). A score of Level 2 or higher under the KLoEs will result in an assessment that the Council has adequate arrangements in place for the purposes of the Code criteria. The Code criteria and the linked KLoEs are shown in the table below.

Code Criteria	Description	Associated UoR KLoE	VFM Conclusion
1	The body has put in place arrangements for setting, reviewing and implementing its strategic and operational objectives.	N/A	Adequate
2	The body has put in place channels of communication with service users and other stakeholders including partners, and there are monitoring arrangements to ensure that key messages about services are taken into account.	N/A	Adequate
3	The body has put in place arrangements for monitoring and scrutiny of performance, to identify potential variances against strategic objectives, standards and targets, for taking action where necessary, and reporting to members.	N/A	Adequate
4	The body has put in place arrangements to monitor the quality of its published performance information, and to report the results to members.	LG DQ KLoEs	Adequate

5	The body has put in place arrangements to maintain a sound system of internal control.	4.2	Adequate
6	The body has put in place arrangements to manage its significant business risks.	4.1	Adequate
7	The body has put in place arrangements to manage and improve value for money.	5.2	Adequate
8	The body has put in place a medium-term financial strategy, budgets and a capital programme that are soundly based and designed to deliver its strategic priorities.	2.1	Adequate
9	The body has put in place arrangements to ensure that its spending matches its available resources.	3.1	Adequate
10	The body has put in place arrangements for managing performance against budgets.	2.2	Adequate
11	The body has put in place arrangements for the management of its asset base.	2.3	Adequate
12	The body has put in place arrangements that are designed to promote and ensure probity and propriety in the conduct of its business.	4.3	Adequate

Appendix 5 – Management representation letter

Steve Nicklin
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Durham County Council and Pension Fund - Audit for the year ended 31 March 2007

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other officers of Durham County Council, the following representations given to you in connection with your audit of the Council's financial statements for the year ended 31 March 2007.

I acknowledge my responsibility under the relevant statutory authorities for preparing the financial statements which present fairly and for making accurate representations to you. I acknowledge my responsibilities under the relevant statutory authorities to prepare the Council's accounts in accordance with proper practices as defined in relevant legislation or guidance.

I believe that the amended financial statements are free from material misstatements, including omissions. I also believe that the aggregated effect of uncorrected financial misstatements identified during the audit is immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Specific representations

- All significant year-end control and suspense accounts have been fully reconciled.
- All provisions disclosed in the financial statements comply with the requirements of Financial Reporting Standard (FRS) 12 '*Provisions, Contingent Liabilities and Contingent Assets*'.
- The Council intends to continue to hold its long term investments and they are valued correctly with regards to market quotations and other information.

- There are no other material amounts relating to unfunded liabilities, curtailments or settlements of past service costs relating to pension provision other than those which have been properly recorded and disclosed in the financial statements, including the group accounts.

Supporting records

All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Council have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of all Council meetings, have been made available to you.

Fixed assets

The net book values at which fixed assets are stated in the consolidated balance sheet are arrived at after taking account of:

- revaluations undertaken during the year;
- disposals during the year;
- impairments in value identified during the year, which have been carried out in accordance with the requirements of Financial Reporting Standard (FRS) 11 *'Impairment of Fixed Assets and Goodwill'*;
- all capital expenditure on additions during the year, but no expenditure properly chargeable to revenue; and
- depreciation, calculated on bases and at rates to reduce the value of each asset to its estimated residual value by the end of its estimated useful life.
- Appropriate systems are in place to ensure that all tangible fixed assets are disclosed in the financial statements and to ensure that the Council holds title to all fixed assets disclosed in the financial statements.

Contingent liabilities

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

- there is no significant pending or threatened litigation, other than that already disclosed in the financial statements;
- there are no material commitments or contractual issues, other than those already disclosed in the financial statements; and
- no financial guarantees have been given to third parties, other than those already disclosed in the financial statements.

Law, regulations and codes of practice

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

The body has complied with all aspects of contractual arrangements that could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of regulatory authorities that could have a material effect on the financial statements in the event of non-compliance.

Assets

The following have been properly recorded and when appropriate adequately disclosed in the financial statements:

- losses arising from sale and purchase commitments;
- agreements and options to buy back assets previously sold; and
- assets pledged as collateral.

Irregularities

I acknowledge my responsibility for the design and implementation of internal control systems to prevent and detect error. There have been no:

- irregularities involving management or employees who have significant roles in the system of internal accounting control;
- irregularities involving other employees that could have a material effect on the financial statements;
- communications from regulatory agencies concerning non-compliance with, or deficiencies on, financial reporting practices which could have a material effect on the financial statements.

Post balance sheet events

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

The Council has no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

Group Accounts

The Council has not prepared group accounts as we believe that the amounts involved are not material to the fair presentation of the Council's financial position or the understanding of the accounts by the reader.

Related party transactions

I confirm the completeness of the information provided regarding the identification of related parties. The identity of, and balances and transactions with, related parties have been properly recorded and where appropriate, adequately disclosed in the financial statements.

Signed on behalf of Durham County Council

Signed:

Name:

Position:

Date:

Appendix 6 – Summary of adjusted misstatements

The following misstatements were identified during the course of our audit and the financial statements have been adjusted by management. We bring them to your attention to assist you in fulfilling your governance responsibilities. There are no amendments to the Income and Expenditure account.

Amendments to the Balance Sheet			
Adjusted misstatements	Nature of Adjustment	Dr £000	Cr £000
Fixed asset restatement Reserve	Asset incorrectly included in balance sheet which was sold in 2004/05	4,050	
Fixed assets			4,050
Capital Financing Account	Omission of Sure Start capital grants from Government Grants Deferred balance.	7,691	
Government Grants Deferred			7,691
Net effect on Balance Sheet	Reduction in Net Worth		11,741
Reclassifications within the Balance Sheet			
Adjusted misstatements	Nature of Adjustment	Dr £000	Cr £000
Cash in hand - petty cash	Incorrect setting off of cash in hand and bank overdraft balances	1,084	
Bank overdraft			1,084
Debtors - other debtors	Insurance provision overstated due to non-adjustment for internal fire insurance amount		889
Provision		889	
Long-term investments	Misclassification of loans to Police and Darlington Borough Council.		1,302
Long-term debtors		1,302	
Debtors	Formula error in production of balance sheet		718
Creditors		718	
Net effect on Balance Sheet		0	0