

Annual Governance Report

Durham County Council

Audit 2007/08

September 2008



Contents

Summary	3
Financial statements and Annual Governance Statement	5
Value for money	13
Formal audit powers	14
Independence	15
Appendix 1 – Letter of representation	17
Appendix 2 – Summary of non-trivial adjustments	20
Appendix 3 – Independent auditor's report	22
Appendix 4 – Value for money criteria	26
The Audit Commission	28

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 non-executive directors/members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

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

Purpose

- 1 This report summarises the findings from our 2007/08 audit, which is substantially complete. It identifies the key issues that you should consider before we issue our opinion, conclusion and certificate.
- 2 This report includes only matters of governance interest that have come to our attention in performing our audit. Our audit is not designed to identify all matters that might be relevant to you.

Financial statements

- 3 Our work on the financial statements is substantially complete, and we propose to issue an unqualified audit opinion.
- 4 The financial statements have been amended to reflect the following:
 - The Council is required to reflect any controlling interests in its financial statements. The financial statements were amended to include group accounts to reflect the net assets of Durham County Waste Management Company Limited and County Durham Development Company Limited;
 - The Council is required to reflect future pension fund liabilities in its financial statements and uses a professional actuary to calculate these figures. Due to the short time scales involved, the actuary projected asset values based on actual assets as at 28 February which were significantly different to the outturn at the year end (£50.2m). The actuary provided revised pensions' liability figures using the actual assets at the year end and the financial statements were amended by £27.2m; and
 - The Council is required to carry out a review for impairment (reduction in asset value) of fixed assets if events, or changes in circumstances, indicates that the carrying amount of the fixed asset may not be recoverable. The financial statements originally included a reduction in asset value of £6.26m for one school which was incorrect. The financial statements now show the correct valuation which reflects an increase in value of £111,000.

Value for Money

- 5 Our work on the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources is now complete. We propose to issue an unqualified conclusion on the use of resources.

Next steps

6 We ask the Council to:

- consider the matters raised in the report before approving the financial statements;
- agree to adjust the financial statements as set out in our recommendations;
- approve the representation letter on behalf of the Council before we issue our opinion, conclusion and certificate; and
- agree the proposed action plan.

Financial statements and Annual Governance Statement

- 7 The Council's financial statements and Annual Governance Statement are important means by which the Council account's for its stewardship of public funds. As Council members you have final responsibility for the financial statements and Annual Governance Statement. It is therefore important that you consider our findings before you adopt the financial statements and the Annual Governance Statement.
- 8 In planning our audit we identified specific risks and areas of judgement that we have focused on during our audit. We report to you the findings of our work in those areas.
- 9 In addition, auditing standards require us to report to you:
- the draft representation letter which we are asking management and you to sign;
 - our views about the Council's accounting practices and financial reporting;
 - any errors in the financial statements;
 - any expected modification to our report;
 - any weaknesses in internal control; and
 - certain other matters.

Key areas of judgement and audit risk

- 10 In planning our audit we identified key areas of judgement and audit risk that we have considered as part of our audit. Our findings are set out in Table 1.

Table 1 Key areas of judgement and audit risk

Issue or risk	Finding
Risks arising from changes to technical requirements in the 2007/08 statements, particularly changes to the 2007 Statement of Recommended Practice (SORP) for financial instruments and the requirement to produce an Annual Governance Statement for the first time.	We have established an ongoing dialogue with officers, and technical questions were discussed on a regular basis, including the impact of new requirements arising from the SORP. We reviewed the Annual Governance Statement and supporting evidence during our audit and all changes were dealt with effectively.

- 11 Working papers were provided promptly and were once again of a high standard.
- 12 We have found officers helpful and responsive to the queries we have raised, and we appreciate the assistance that has been provided in enabling us to undertake our audit work effectively.

Draft representation letter

- 13 Before we issue our opinion, auditing standards require us to obtain from you and management, written representations that:
 - you acknowledge your collective responsibility for preparing financial statements in accordance with the applicable financial reporting framework;
 - you have approved the financial statements;
 - you acknowledge your responsibility for the design and implementation of internal controls to prevent and detect fraud and error;
 - you have told me the results of your assessment of the risk that the financial statements might be materially misstated because of fraud;
 - you have told me any actual or suspected fraud by management, employees with significant roles in internal control or others (where the fraud could have a material impact on the financial statements);
 - you have told me of any allegations of fraud, or suspected fraud, affecting the financial statements communicated by employees, former employees, regulators or others;
 - you have told me about all known actual or possible non-compliance with laws and regulations whose effects should be considered when preparing financial statements;
 - you have assessed the reasonableness of significant assumptions, including whether they appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the Council where relevant to the fair value measurements or disclosures;
 - you are satisfied that all related parties requiring disclosure in the financial statements have been disclosed and that the disclosure is adequate;
 - you are satisfied that the individual or collective impact of errors we have identified, but that you have not corrected, is not material; and
 - cover areas where other sufficient appropriate evidence cannot reasonably be expected to exist, for example the completeness of the disclosure of contingent liabilities.
 - a specific representation that there is no contingent liability other than the contingent liability recognised in note 28 of the financial statements for the ongoing costs associated with Equal Pay and Job Evaluation.
- 14 Appendix 1 contains the draft of the letter of representation we seek from you.

Accounting policies and financial reporting

- 15 We consider the qualitative aspects of your financial reporting. Table 2 contains the issues we want to raise with you.

Table 2 Accounting practice and financial reporting

Issue or risk	Finding
<p>The Council had made a number of prior period adjustments (PPAs) in the draft accounts submitted for audit. In total, these reduced the total net worth on the balance sheet for 2006/07 by £28.5m.</p> <p>Under Financial Reporting Standard FRS3 requirements, a PPA should be made only where there has been a change of accounting policy or a fundamental error in a prior period which is material, and some of the PPAs in the Council's accounts did not fall within this definition.</p>	<p>We have not requested any amendments for the PPAs, but it would be advisable for the Council to discuss any proposed PPAs in future years with the auditor prior to completing the draft accounts. This would allow for early consideration and an audit view on the appropriateness of any proposed PPAs.</p>
<p>There has been a material revaluation to the Council's fixed assets during 2007/08 amounting to £418m in total. This was mainly due to the impact of schools being revalued for the first time in five years, in line with the Council's rolling revaluation programme.</p>	<p>Our review of the reasons for the revaluations and testing of individual assets did not highlight any significant issues. However, there is a need to ensure, notwithstanding any rolling programme, that the balance sheet is materially accurate each year.</p>

Issue or risk	Finding
<p>There are specific criteria set out in the SORP and accounting standards FRS15 for the capitalisation of expenditure on fixed assets. The SORP definition of "capital expenditure" states that such expenditure must:</p> <ul style="list-style-type: none"> • lengthen substantially the useful life of the asset; or • increase substantially the open market value of the asset; or • increase substantially the extent to which the asset can or will be used for the purposes of or in conjunction with the functions of the Council. 	<p>Our sample testing of fixed asset additions (capital expenditure in year) found two items where capital expenditure on one school did not meet the SORP requirements and appeared to relate more to revenue expenditure on repairs and maintenance (re-pointing work and re-felting a roof).</p> <p>The explanation given for the capitalisation of this expenditure was that the school's revenue budget was overspent.</p> <p>In addition reference was made to "capital grant" being received by the school from a government department. However, this does not automatically mean the expenditure is capital for the accounts purposes.</p> <p>The result of extrapolating the impact of the inappropriate capitalisation of these two items across the total capital expenditure on schools was not material, so no amendment has been made to the accounts.</p>

Recommendations
<p>R1 The Council needs to ensure that any proposed prior period adjustments in future years meet the requirements of accounting standards, and should discuss proposals with the auditor prior to completing the draft accounts to allow early consideration of appropriateness of treatment.</p>
<p>R2 The Council should ensure that significant categories of assets are revalued more regularly rather than once every five years. This should ensure that the balance sheet is materially accurate every year and help to reduce the risk of significant fluctuations in asset values, as seen in the 2007/08 accounts.</p>
<p>R3 The Council should ensure that all capital expenditure included in the accounts, particularly enhancements to schools, complies with the SORP definition of capital expenditure. In particular, a review should be carried out of any expenditure financed from capital grant to ensure that it is appropriate to treat this expenditure as capital in the accounts.</p>

Errors in the financial statements

- 16 We identified several errors in the financial statements and reported these to management (other than those of a trivial nature). Management have agreed appropriate amendments to the accounts for the issues reported below.

Table 3 Errors in financial statements

Issue	Finding
Pension fund liability	<p>The Council is required (under Financial Reporting Standard FRS17) to reflect future pension fund liabilities in its financial statements and uses a professional actuary to calculate these figures. Due to the short time scales involved, the actuary projects asset values as at 31 March 2008 based on actual assets as at 28 February. The actuary's projected assets figure was significantly lower than the assets shown in the Pension Fund accounts as at 31 March 2008. Following identification at audit of this significant difference (£50.2m), the actuary was requested to provide revised pensions' liability figures using the actual assets at 31 March 2008.</p> <p>The impact of the amendments on the financial statements was a £27.2m decrease to the Pensions Liability and Pension Reserve shown on the Balance Sheet, and an increase to the actuarial gain shown in the Statement of Total Recognised Gains and Losses.</p>
Group accounts	<p>The Council is required to reflect any controlling interests in its financial statements. The financial statements submitted for audit did not contain group accounts to reflect the net assets of Durham County Waste Management Company Limited and County Durham Development Company Limited. Ongoing discussions since the year end resulted in management agreeing to incorporate group accounts into the financial statements.</p>
Asset valuation	<p>The Council is required to carry out a review for impairment of fixed assets if events, or changes in circumstances, indicates that the carrying amount of the fixed asset may not be recoverable. The financial statements originally included an impairment (or reduction in value) for a school of £6.26m schools impairment which should have actually been an increase in value of £111,000. The financial statements have been adjusted accordingly.</p>

- 17 Management has agreed to adjust the financial statements as set out in Appendix 2. A number of amendments have been identified and agreed with officers.

- 18 We are reporting these issues to you, to enable you to discharge your governance responsibilities and approve the revised financial statements.
- 19 A small number of amendments have also been made to various notes to the accounts in respect of trivial issues. These were agreed with management but have not been detailed within this report.

The audit report

- 20 We plan to issue an unmodified report including an unqualified opinion on the financial statements. Appendix 3 contains a copy of our draft report.

Material weaknesses in internal control

- 21 We have identified weaknesses in the design or operation of an internal control that might result in a material error in your financial statements which has not been reported to you. These weaknesses are set out in Table 4.

Table 4 Weaknesses in internal control

Issue or risk	Finding
<p>A key control within the Payroll system is that exception reports are generated and reviewed and that outputs are checked for overall reasonableness. This should provide assurance over the completeness and accuracy of payroll data.</p> <p>The audit risk is that any incorrect or fraudulent claim identified within the exception report is not sufficiently investigated, resulting in it being processed.</p> <p>A £2.9m error was identified by the Council during 2007/08. This related to the overpayment of expenses in May 2007 and was immediately recovered. However, the occurrence of this error indicates that this control has not been operating effectively throughout the account period. This issue has previously been reported to those charged with governance.</p>	<p>Our testing of payroll system controls identified that exception reports were produced but there was no evidence of them being reviewed. We have been told that exceptions are not always fully investigated due to sheer volume.</p> <p>A mitigating control, identified by the Council, was the introduction of exception reports of high or low gross and net pay. However, our testing and additional testing found that again there was insufficient evidenced of these being satisfactorily reviewed.</p> <p>These findings, together with the £2.9m error during the year, meant that we were unable to gain sufficient assurance regarding the effectiveness of these controls. This impacted on our risk assessment for the audit of the accounts. Consequently we carried out additional testing, including detailed payroll analytical review procedures. Our additional testing provided sufficient assurance on the payroll transactions for opinion purposes.</p>

Issue or risk	Finding
<p>Another key control within the Payroll system is that data entered into the system is validated through appropriate authorisation.</p> <p>The audit risk is that inaccurate or fraudulent entries could be made and the supporting documentation destroyed or removed to prevent detection. There is also the associated audit risk of a lack of an audit trail.</p>	<p>During our testing we found significant weaknesses within this control as we were unable to obtain sufficient supporting documentation to support the data entered into the payroll system. Out of a sample of 20 items there were 3 items where officers were unable to provide the supporting documentation. The reason for this was that the payroll department had archived the majority of the documentation relating to 2007/08 and the documentation required for testing could not be located.</p> <p>This further impacted on our risk assessment for the audit of the accounts and we were required to undertake additional testing to obtain our assurance.</p>

Recommendations

- R4** The Council should ensure that effective controls are in place within the Payroll system so that exception reports are generated and reviewed and outputs are checked for overall reasonableness. In particular:
- a standard practice/procedure for the investigation of exception reports with a set level of evidencing;
 - all exception reports should be signed and dated by the investigating officer as evidence of review and to ensure that an audit trail is maintained; and
 - to reduce the number of exceptions produced and requiring investigation, the parameters of the threshold may need to be reviewed to ensure that it is set at the appropriate level.
- R5** The Council should ensure that payroll documentation relating to the financial year to be audited is retained until the audit has been completed and then stored in such a manner that it can be easily and quickly retrieved.

22 We have not provided a comprehensive statement of all weaknesses which may exist in internal control, nor of all improvements which may be made. We have reported only those matters which have come to our attention because of the audit procedures we have performed.

Other matters

23 We have identified the following matters that we require you to consider.

Table 5 Other matters

Issue or risk	Finding
The Council completes the accounts for the Pension Fund, figures from which are used by the actuary to provide other bodies with the required disclosures for the pension fund liability and FRS17 pension fund reserve.	The timeliness of the Pension Fund accounts will be of increased significance in 2008/09 due to the demise of the district councils under local government reorganisation and the earlier deadline for the probation accounts.

Recommendation

R6 The Council should consider arrangements and opportunities for earlier preparation of the Pension Fund accounts to assist with the availability of appropriate information to other bodies

Value for money

- 24 We are required to conclude whether the Council put in place adequate corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. We assess your arrangements against twelve criteria specified by the Commission. Our conclusion is informed by our work on Use of Resources, a scored judgement reported to the Audit Commission. Our conclusions on each of the twelve areas are set out in Appendix 4 for completeness.
- 25 We have assessed the arrangements of the Council as being met in all twelve areas and we therefore propose to issue an unqualified conclusion.

Formal audit powers

26 We have:

- a power to issue a public interest report. We do so where we believe this is necessary to draw a matter to your attention, or to that of the public;
- a power to apply to court for a declaration that an item in the Council's accounts is contrary to law;
- a power to issue an advisory notice. An advisory notice requires the Council to meet and consider the notice before:
 - making a decision that might give rise to unlawful expenditure; or
 - taking an unlawful course of action that would give rise to a loss; or
 - making unlawful entry in the accounts; and
- a power to seek judicial review of a decision of the Council.

27 We have not and do not propose to exercise these powers.

Independence

- 28 The Code of Audit Practice and the APB's Ethical Standards with which auditors must comply require that auditors act, and are seen to act, with integrity, objectivity and independence.
- 29 We confirm that we comply with the APB's Ethical Standards, that we are independent and that our objectivity is not compromised.
- 30 We communicate to you:
- any relationships between us and the Council, its members and senior management that might affect our objectivity and independence and any safeguards put in place;
 - total fees charged to you for audit and non-audit services; and
 - our arrangements to ensure independence and objectivity.

Relationships with the Council

- 31 We have identified no relationships that might affect objectivity and independence.

Audit fees

- 32 We reported our fee proposals as part of the Audit Plan for 2007/08. The table below reports the outturn fee against that plan.

Table 6 Audit fees

	Plan 2007/08	Actual 2007/08
Financial statements and Annual Governance Statement	157,500	157,500
Value for Money	70,200	70,200
Whole of government accounts	2,500	2,500
National Fraud Initiative	1,200	1,200
Total Audit Fees	231,400	231,400

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- 33 The analysis above shows that we contained our audit fee within the totals you have already agreed.

Our arrangements to ensure independence and objectivity

- 34 We have comprehensive procedures to ensure independence and objectivity. These are outlined in Table 7.

Table 7 Arrangements to ensure independence and objectivity

Area	Arrangements
Independence policies	<p>Our policies and procedures ensure that professional staff or an immediate family member:</p> <ul style="list-style-type: none"> • do not hold a financial interest in any of our audit clients; • may not work on assignments if they have a financial interest in the client or a party to the transaction or if they have a beneficial interest in a trust holding a financial position in the client; and • may not enter into business relationships with UK audit clients or their affiliates. <p>Our procedures also cover the following topics and can be provided to you on request:</p> <ul style="list-style-type: none"> • the general requirement to carry out work independently and objectively; • safeguarding against potential conflicts of interest; • acceptance of additional (non-audit) work; • rotation of key staff; • other links with audited bodies; • secondments; • membership of audited bodies; • employment by audited bodies; • political activity; and • gifts and hospitality.
Code of Conduct	The Code of Conduct forms part of the terms and conditions of all Audit Commission employees. The Code of Conduct states that staff have to comply with ethical guidance issued by their relevant professional bodies.
Confidentiality	All staff are required to sign an annual undertaking of confidentiality as a condition of employment.

Appendix 1 – Letter of representation

To:

Lynne Snowball
District Auditor
Audit Commission
Nickalls House
Metro Centre
Gateshead
Tyne & Wear

Durham County Council - Audit for the year ended 31 March 2008

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other chief officers of Durham County Council, the following representations given to you in connection with your audit of the Council and Group's financial statements for the year ended 31 March 2008. All representations cover the Council and Group's accounts and Pension Fund accounts included within the financial statements.

Compliance with the statutory authorities

I acknowledge my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with the Code of Practice for Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice which present fairly the financial position and financial performance of the Council, Group and Pension Fund and for making accurate representations to you.

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.

Irregularities

I acknowledge my responsibility for the design and implementation of internal control systems to prevent and detect fraud or 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; or

- communications from regulatory agencies concerning non-compliance with, or deficiencies on, financial reporting practices which could have a material effect on the financial statements.

I also confirm that I have disclosed:

- my knowledge of fraud, or suspected fraud, involving either management, employees who have significant roles in internal control or others where fraud could have a material effect on the financial statements; and
- my knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

Law, regulations, contractual arrangements 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 Council 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.

Fair values

I confirm that the presentation and disclosure of the fair value measurements of material assets, liabilities and components of equity are in accordance with the financial reporting framework.

The measurement methods and significant assumptions used in determining fair value have been applied on a consistent basis, are reasonable and appropriately reflect the best estimate of fair value of assets and liabilities required to be disclosed by these standards.

Assets

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

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

Compensating arrangements

There are no compensating balancing arrangements with any of our cash or investment accounts.

Appendix 1 – Letter of representation

Contingent liabilities

There are no other contingent liabilities, other than the contingent liability recognised in note 28 of the financial statements for the ongoing costs associated with Equal Pay and Job Evaluation; In particular:

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

Related party transactions

I confirm the completeness of the information disclosed 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.

Post balance sheet events

Since the date of approval of the financial statements by 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.

Signed on behalf of Durham County Council

I confirm that this letter has been discussed and agreed by the Council on 23rd September 2008.

Signed

Name

Position

Date

Appendix 2 – Summary of non-trivial adjustments

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.

Item of account	Nature of adjustment	Dr £'000	Cr £'000	Other impact
Income and Expenditure account adjustments				
Net cost of services - Children's and Education Services	A £6.26m impairment to one asset was found to be incorrect		6,260	Also impacted on the Statement of Movement on the General Fund Balance (SMGFB) and the Statement of Total Recognised Gains and Losses (STRGL)
Net cost of services - Children's and Education Services	Schools' revenue contribution to capital expenditure financed from Dedicated Schools Grant had been charged to Income and Expenditure account rather than via the SMGFB.		4,714	Also impacted on the SMGFB and STRGL.
Net impact on I&E deficit for the year			10,974	
Balance sheet adjustments				
Liability related to defined benefit pension schemes	The Actuary's estimate of the Council's share of pension fund assets at 31 March was underestimated resulting in an understatement of the pension liability at the balance sheet date.	27,190		Also impacted on the STRGL and note 31.
FRS17 Pension reserve			27,190	

Appendix 2 – Summary of non-trivial adjustments

Item of account	Nature of adjustment	Dr £'000	Cr £'000	Other impact
Fixed assets - impairments	A £6.26m impairment to one asset was found to be incorrect and should have been an increase to the value of £110k.	6,260		Also impacted on the I&E account, SMGFB and STRGL (see above) and notes 15 and 27.
Fixed assets - revaluations		111		
Capital Adjustment Account			6,260	
Revaluation Reserve			111	
Fixed assets - additions	Expenditure on fixed assets that does not add value treated correctly as impairment, however fixed assets balance not adjusted.	2,894		Also impacted on note 15.
Fixed assets - impairments			2,894	Treatment in the I&E account unchanged.
Short-term borrowing	Accrued interest on loans should now be added to the carrying value rather than shown as previously within creditors.		2,528	Also impacted on notes 23 and 25.
Creditors		2,528		
Short-term investments	Accrued interest on investments should now be added to the carrying value rather than shown as previously within debtors	1,652		Also impacted on notes 23 and 24.
Debtors			1,652	
Net effect on Balance Sheet net worth		33,561		
2006/07 comparatives				
Net cost of services - Children's and Education Services	Schools' revenue contribution to capital expenditure financed from Dedicated Schools Grant had been charged to I&E account rather than via the SMGFB.		5,229	Also impacted on the SMGFB and STRGL.
Net impact on I&E deficit for the year			5,229	

Appendix 3 – Independent auditor's report

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

Opinion on the financial statements

I have audited the Council and Group financial statements, pension fund accounts and related notes of Durham County Council for the year ended 31 March 2008 under the Audit Commission Act 1998. The Council and Group financial statements comprise the Council and Group Income and Expenditure Account, the Council Statement of the Movement on the General Fund Balance, the Council and Group Balance Sheet, the Council and Group Statement of Total Recognised Gains and Losses, the Council and Group Cash Flow Statement and the related notes. The pension fund accounts comprise the Fund Account, the Net Assets Statement and the related notes. The Council and Group accounting statements and pension fund accounts have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of 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 auditor

The Treasurer's responsibilities for preparing the financial statements, including the pension fund accounts, in accordance with relevant legal and regulatory requirements and the Statement of Recommended Practice on Local Council Accounting in the United Kingdom 2007 are set out in the Statement of Responsibilities for the Statement of Accounts.

My responsibility is to audit the Council and Group financial statements, pension fund accounts and related notes 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 Council and Group financial statements and the pension fund accounts present fairly, in accordance with relevant legal and regulatory requirements and the Statement of Recommended Practice on Local Council Accounting in the United Kingdom 2007:

- the financial position of the Council and its income and expenditure for the year;
- the financial position of the Group 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.

Appendix 3 – Independent auditor's report

I review whether the governance statement reflects compliance with 'Delivering Good Governance in Local Government: A Framework' published by CIPFA/SOLACE in June 2007. I report if it does not comply with proper practices specified by CIPFA/SOLACE 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 governance statement covers all risks and controls. Neither am I 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 Council and Group financial statements, pension fund accounts and related notes and consider whether it is consistent with the audited Council and Group financial statements. This other information comprises the Explanatory Foreword. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the Council and Group financial statements, pension fund accounts and related notes. 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 Council and Group financial statements, pension fund accounts and related notes. It also includes an assessment of the significant estimates and judgments made by the Council in the preparation of the Council and Group financial statements, pension fund accounts and related notes, 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 Council and Group financial statements, pension fund accounts and related notes 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 Council and Group financial statements, pension fund accounts and related notes.

Opinion

In my opinion:

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

- The Group financial statements present fairly, in accordance with relevant legal and regulatory requirements and the Statement of Recommended Practice on Local Council Accounting in the United Kingdom 2007, the financial position of the Group as at 31 March 2008 and its income and expenditure for the year then ended; and
- The pension fund accounts and related notes present fairly, in accordance with the Statement of Recommended Practice on Local Council Accounting in the United Kingdom 2007, the financial transactions of the Pension Fund during the year ended 31 March 2008, and the amount and disposition of the fund's assets and liabilities as at 31 March 2008, other than liabilities to pay pensions and other benefits after the end of the scheme year.

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

Council'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 regularly to review the adequacy and effectiveness of these arrangements.

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.

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 and published in December 2006, 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 2008.

Appendix 3 – Independent auditor's report

Best Value Performance Plan

I have issued our statutory report on the audit of the Council's best value performance plan for the financial year 2006/07 on December 2007. 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.

Lynne Snowball

The Audit Commission, Nickalls House, Metro Centre, Gateshead, NE11 9NH

Date - 23 September 2008

Appendix 4 – Value for money criteria

Value for money criteria

- 35** 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.
- 36** The Code criteria are linked to the use of resources assessment 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 show in the table below.

Code Criteria	Description	Criteria met?
1	The body has put in place arrangements for setting, reviewing and implementing its strategic and operational objectives.	Yes
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.	Yes
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.	Yes
4	The body has put in place arrangements to monitor the quality of its published performance information, and to report the results to members.	Yes

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Code Criteria	Description	Criteria met?
5	The body has put in place arrangements to maintain a sound system of internal control.	Yes
6	The body has put in place arrangements to manage its significant business risks.	Yes
7	The body has put in place arrangements to manage and improve value for money.	Yes
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.	Yes
9	The body has put in place arrangements to ensure that its spending matches its available resources.	Yes
10	The body has put in place arrangements for managing performance against budgets.	Yes
11	The body has put in place arrangements for the management of its asset base.	Yes
12	The body has put in place arrangements that are designed to promote and ensure probity and propriety in the conduct of its business.	Yes

The Audit Commission

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, covering the £180 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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