

Annual Governance Report

September 2006



# Annual governance report

**Gateshead Council**

**Audit 2005/06**

External audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services.

Audit in the public sector is underpinned by three fundamental principles:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements but also value for money and the conduct of public business; and
- auditors may report aspects of their work widely to the public and other key stakeholders.

The duties and powers of auditors appointed by the Audit Commission are set out in the Audit Commission Act 1998 and the Local Government Act 1999 and the Commission's statutory Code of Audit Practice. Under the Code of Audit Practice, appointed auditors are also required to comply with the current professional standards issued by the independent Auditing Practices Board.

Appointed auditors act quite separately from the Commission and in meeting their statutory responsibilities are required to exercise their professional judgement independently of both the Commission and the audited body.

### **Status of our reports to Gateshead Council**

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

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

### **Copies of this report**

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For further information on the work of the Commission please contact:

Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ

Tel: 020 7828 1212 Fax: 020 7976 6187 Textphone (minicom): 020 7630 0421

[www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)

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## Purpose of this report

- 1 We are required by the Audit Commission's statutory Code of Audit Practice for Local Government bodies (the Code) to issue a report to those charged with governance summarising the conclusions from our audit work. For the purposes of this report, the Authority's Accounts Committee is considered to fulfil the role of those charged with governance and references to the Accounts Committee should be read as such.
- 2 We are also required by professional auditing standards to report to the Authority certain matters before we give our opinion on the financial statements. The section of this report covering the financial statements fulfils this requirement.
- 3 This is our annual governance report covering the audit of the Authority for the year ended 31 March 2006 and is presented by the District Auditor.
- 4 The principle purposes of the report are:
  - to reach a mutual understanding of the scope of the audit and the respective responsibilities of the auditor and the Authority;
  - to share information to assist both the auditor and those charged with governance to fulfil their respective responsibilities; and
  - to provide the Authority with recommendations for improvement arising from the audit process.
- 5 The Audit Commission has circulated to all audited bodies a Statement of Responsibilities of Auditors and Audited Bodies that summarises the key responsibilities of auditors. Our audit has been conducted in accordance with the principles set out in that statement.

## Scope of the report

- 6 In undertaking our audit, we comply with the statutory requirements of the Audit Commission Act 1998 and the Code. Auditors' responsibilities are to review and report on, to the extent required by the relevant legislation and the requirements of the Code:
  - the Authority's financial statements; and
  - whether the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
- 7 Our risk assessment and planned response to the key audit risks was summarised in our audit plan. A summary of our responsibilities and audit approach is included in Appendix 1. The annual governance report summarises the significant findings, conclusions and recommendations arising from our audit work.

- 8** We have issued separate reports during the year having completed specific aspects of our programme, which are listed in Appendix 2. Appendix 3 provides information about the fee charged for our audit and Appendix 4 sets out the requirements in respect of independence and objectivity.

## Key messages

### Financial statements

- 9 Our work on the financial statements is now substantially complete. We anticipate being able to issue an unqualified opinion on 29 September 2006 (a draft report is attached at Appendix 5).

### Use of resources

- 10 Our work on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources is now substantially complete. We anticipate being able to issue an unqualified conclusion on the use of resources by 29 September 2006 (a draft report is attached at Appendix 5).

## Financial statements

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

## Status of the audit

- 12 Our work on the financial statements is now substantially complete. We plan to issue an unqualified audit opinion on 29 September 2006, following approval of the amended statements by the Accounts Committee and the receipt of the letter of representation.

## Matters to be reported to the Accounts Committee

- 13 We have the following matters to draw to the Accounts Committee's attention.

### Expected modifications to the auditor's report

- 14 On the basis of our audit work, we currently propose to issue an unqualified audit report. A draft audit report is attached at Appendix 5.

### Uncorrected misstatements

- 15 There are no uncorrected misstatements in the financial statements from issues identified at audit.

### Adjusted misstatements

- 16 To assist you in fulfilling your governance responsibilities, we are required to consider reporting adjusted misstatements to you where these are significant or material. These are shown in Table 1 below. A complete listing of all amendments has been provided to officers.

**Table 1 Adjusted misstatements in the financial statements**

Details of significant adjustments made to the financial statements

<b>Issue</b>	<b>Value of adjustment £</b>	<b>Impact on surplus £</b>
Depreciation accumulated from previous years had incorrectly been included in the accounts and deducted from the revalued asset value for council dwellings at 1 April 2005, understating the net book value by £80.2m. Fixed assets and the corresponding adjustment to the fixed assets restatement account were amended. The previous year's figures were also amended.	£80.2m	£0
An internal insurance premium was charged to the net cost of services instead of the actual cost of claims in the year. The actual cost was £4.9m less. This was corrected, reducing the net cost of services, with a contribution to earmarked reserves.	£4.9m	£0
Adjustment to General Reserve amended to show a reduction in earmarked reserves, increasing the reported surplus for 2005/06 prior to transfer to the General Reserve.	£1.5m	£1.5m
Adjustments to formula grant initially shown as a prior year adjustment were amended to reflect the change in the 2005/06 consolidated revenue account.	£0.1m	(£0.1m)
The amount provided for future additional pensions liability was amended to show as part of earmarked reserves instead of a provision, to account for the transaction in line with accounting standards' requirements	£4.5m	£0

**17** The impact of these changes was as follows:

- The net cost of services was reduced by £4.9m
- The contribution from earmarked reserves of £1.5m was changed to a £1.9m contribution to reserves
- The general fund surplus was increased from £923k to £2.3m (the general reserve balance has not changed).

## **Qualitative aspects of accounting practices and financial reporting**

- 18 Our audit includes consideration of the qualitative aspects of the financial reporting process, including matters that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the financial statements. We have no matters which we wish to report to you on the qualitative aspects of the financial reporting process.

## **Material weaknesses in internal control identified during the audit**

- 19 Our audit identified no material weaknesses in systems of accounting and financial control which we should report to you.
- 20 We have not provided a comprehensive statement of all weaknesses which may exist in internal control or of all improvements which may be made, but have addressed only those matters which have come to our attention as a result of the audit procedures we have performed.

## **Matters specifically required by other auditing standards**

- 21 Other auditing standards require us to communicate with you in other specific circumstances including:
- where we suspect or detect fraud;
  - where there is an inconsistency between the financial statements and other information in documents containing the financial statements; and
  - non-compliance with legislative or regulatory requirements and related authorities.

We have no matters which we wish to report to you concerning the above.

## Any other matters of governance interest

- 22 Finally, we are required to report any other matters that we believe to be of governance interest. We report these matters in Table 2 below.

**Table 2 Other matters of governance interest**

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

Area	Auditor responsibility	Comment
Statement of internal control (SIC)	The auditor reviews the SIC for compliance with the requirements of proper practice as specified by CIPFA and consistency with other information from the audit of the financial statements.	The arrangements for the production of the SIC were improved significantly for the 2005/06 audit, and comply with CIPFA guidance.
Whole of Government Accounts' consolidation pack	The auditor is responsible for issuing a report on the consistency of the Authority's consolidation pack with the statutory financial statements.	Our work on the consolidation pack will start shortly and we expect to issue our report in line with the government deadline of 6 October 2006.

## Letter of representation

- 23 We obtain written representations from management as an acknowledgement of its responsibility for the fair presentation of the financial statements and as audit evidence on matters material to the financial statements. The text of the required letter of representation is included at Appendix 6.

## Next steps

- 24 We are drawing these matters to the Accounts Committee's attention so that:
- you can consider them before the financial statements are approved and certified;
  - the representation letter can be signed on behalf of the Authority and those charged with governance before we issue our opinion on the financial statements.

## Use of resources

### Value for money conclusion

- 25** The Code requires us to reach a conclusion on whether we are satisfied that the Authority has proper arrangements in place for securing economy, efficiency and effectiveness in its use of your resources (the value for money conclusion). In meeting this responsibility, we review evidence that is relevant to the Authority's corporate performance management and financial management arrangements. Our work in reaching the value for money conclusion is integrated with our work on the use of resources assessment. The use of resources assessment is a qualitative assessment of the effectiveness of the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources. The five areas we make assessments on are; financial statements, financial management, financial standing, internal control and value for money.
- 26** We have completed our work in relation to the use of resources and there are no matters which we wish to draw to the attention of the Accounts Committee.

## Use of auditors' statutory powers

- 27 Auditors are required to consider the exercise of certain statutory powers during the course of the audit, as summarised in Table 2 below.

**Table 3 Use of statutory powers**

Issue	Auditor responsibility	Impact
Section 8 reports	Section 8 of the Act requires that auditors should consider whether, in the public interest, they should report on any matter that comes to their attention in the course of the audit so that it may be considered by the body concerned or brought to the attention of the public.	There have been no section 8 reports in respect of the financial year 2005/2006.
Section 11 recommendations	To consider whether a written recommendation should be made to the audited body requiring it to be considered and responded to publicly.	There have been no s11 recommendations.
Best value	To consider whether to recommend that the Audit Commission should carry out a best value inspection of the Authority under section 10 of the Local Government Act 1999 and/or that the Secretary of State should give a direction under section 15 of that Act.	Our work in respect of the Authority's 2005/2006 Best Value Performance Plan (BVPP) was reported in the 2005 annual audit and inspection letter. No recommendations were made to the Audit Commission or the Secretary of State.

## Closing remarks

- 28 This report has been discussed and agreed with the Strategic Director, Finance and ICT and will be presented at the Accounts Committee meeting on 29 September 2006.
- 29 The Authority has taken a positive and constructive approach to our audit and I would like to take this opportunity to express my appreciation for their assistance and co-operation.

**Lynne Snowball**  
**District Auditor**

September 2006

# Appendix 1 – Audit responsibilities and approach

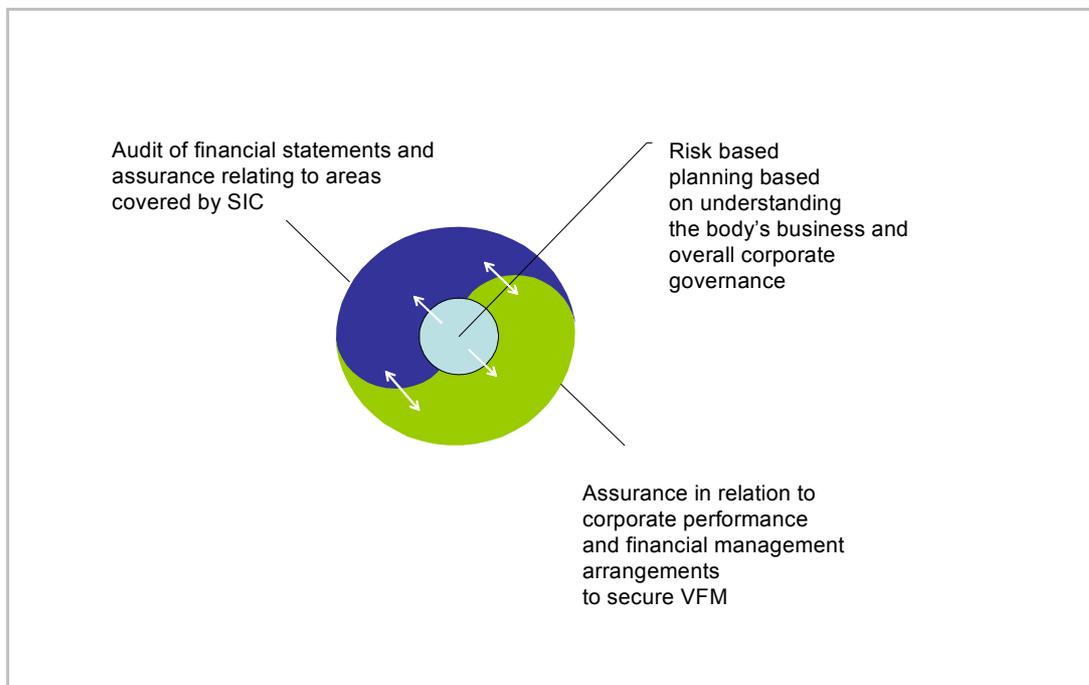
## Audit objectives

- 1 Our objective as your appointed auditor is to plan and carry out an audit that meets the requirements of the Code of Audit Practice. We adopt a risk-based approach to planning our audit, and our audit work has focused on the significant risks that are relevant to our audit responsibilities.

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### Figure 1 Code of Audit Practice

Code of practice responsibilities



## **Approach to the audit of the financial statements**

- 2** In our approach to auditing the financial statements, we adopt a concept of materiality. Material errors are those which might be misleading to a reader of the financial statements. We seek, in planning and conducting our audit of the accounts, to provide reasonable assurance that your financial statements are free of material misstatement. In planning our work we considered the arrangements of the Authority which had most impact on our opinion. These included:
  - the standard of the overall control environment and internal controls;
  - reliance on internal audit;
  - the likelihood of material misstatement occurring from material information systems; or a material error failing to be detected by internal controls;
  - any changes in financial reporting requirements; and
  - the effectiveness of procedures for producing the financial statements and supporting material.
- 3** The results of the above feed into our risk assessment which determines the level and type of testing undertaken on each element of the financial statements.

## **Approach to audit of arrangements to secure value for money**

- 4** The scope of these arrangements is defined in paragraph 20 of the Code as comprising:
  - corporate performance management; and
  - financial management arrangements.
- 5** Our conclusion is informed and limited by reference to relevant criteria covering specific aspects of audited bodies' arrangements, specified by the Code.

- 6 In planning audit work in relation to the arrangements for securing economy, efficiency and effectiveness in the use of resources, we considered and assessed relevant significant business risk. Significance is defined by the Code as 'a matter of professional judgment and includes both quantitative and qualitative aspects of the risk'.
- 7 The potential sources of assurance when reaching the value for money conclusion include:
  - the Authority's whole system of internal control as reported in its statement on internal control;
  - results from statutory inspections or the work of other regulators, (whether by the Commission or other regulators), etc.;
  - links to the financial statements' audit, including review of internal audit, the SIC and budgetary control arrangements; and
  - other work necessary to discharge our responsibilities.

## Appendix 2 – Audit reports issued

**Table 4**

<b>Planned output</b>	<b>Planned date of issue</b>	<b>Actual date of issue</b>	<b>Addressee</b>
Audit and inspection plan	March 2005	April 2005	Audit Committee
Annual governance report	September 2006	September 2006	Accounts Committee
Opinion on financial statements	September 2006	September 2006	Accounts Committee
Value for money conclusion	September 2006	September 2006	Accounts Committee
Final accounts report	October 2006	Planned for October 2006	Officers
ICT security follow up	March 2006	March 2006	Council
Children and young people's services	August 2006	August 2006	Council
Responding to the Civil Contingencies Act	Plan to finalise September 2006	Draft issued July 2006	Council
Review of e-Procurement	Plan to finalise October 2006	Draft issued March 2006	Council
Review of procurement	Plan to finalise October 2006	Draft issued July 2006	Council

## Appendix 3 – Fee information

**Table 5**

<b>Fee estimate</b>	<b>Plan 2005/06</b>	<b>Actual 2005/06</b>
Audit		
Accounts	162,000	162,000
Use of resources	73,000	73,000
<b>Total audit fee *</b>	<b>235,000</b>	<b>235,000</b>
Voluntary improvement work	0	0

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

## **Appendix 4 – The Audit Commission’s requirements in respect of independence and objectivity**

- 1** We are required by standards to communicate the following matters to the Authority:
  - the principal threats, if any to objectivity and independence identified by the auditor, including consideration of all relationships between the Authority, directors and the auditor;
  - any safeguards adopted and the reasons why they are considered to be effective;
  - any independent partner review;
  - the overall assessment of threats and safeguards; and
  - information about the general policies and processes for maintaining objectivity and independence.
- 2** We are not aware of any relationships that may affect the independence and objectivity of the team, and which are required to be disclosed under auditing and ethical standards.

## **Appendix 5 – Independent auditor’s report to the Members of Gateshead Metropolitan Borough Council**

### **Opinion on the financial statements**

I have audited the financial statements of Gateshead Metropolitan Borough Council for the year ended 31 March 2006 under the Audit Commission Act 1998, which comprise the Consolidated Revenue Account, the Housing Revenue Account, the Collection Fund, the Consolidated Balance Sheet, the Statement of Total Movements in Reserves, the Cash Flow Statement, and the related notes. These financial statements have been prepared under the accounting policies set out within them.

This report is made solely to Gateshead Metropolitan Borough 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 Chief Finance Officer and auditors**

The Chief Finance Officer’s responsibilities for preparing the financial statements in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2005 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 present fairly the financial position of the Authority in accordance with applicable laws and regulations and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2005.

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’ published on 2 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 Authority’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 Explanatory Foreword. 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 Authority in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Authority’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 2005, the financial position of the Authority as at 31 March 2006 and its income and expenditure for the year then ended.

Lynne Snowball  
District Auditor

Audit Commission  
Nickalls House  
Metro Centre  
Gateshead NE11 9NH

September 2006

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

### **Authority’s Responsibilities**

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

Under the Local Government Act 1999, the Authority is required to prepare and publish a best value performance plan summarising the Authority’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 Authority 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 Authority has made such proper arrangements. I am not required to consider, nor have I considered, whether all aspects of the Authority’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 authority’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 I am satisfied that, having regard to the criteria for principal local authorities specified by the Audit Commission and published in August 2005, in all significant respects, Gateshead Metropolitan Borough Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2006.

### **Best Value Performance Plan**

I issued my statutory report on the audit of the Authority’s best value performance plan for the financial year 2005/06 on 20 September 2005. I did not identify any matters to be reported to the Authority and did not make any recommendations on procedures in relation to the plan.

### **Certificate**

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  
District Auditor

Audit Commission  
Nickalls House  
Metro Centre  
Gateshead NE11 9NH

September 2006

## Appendix 6 – Letter of representation

To:

Lynne Snowball  
District Auditor  
Audit Commission  
Nickalls House  
Metro Centre  
Gateshead  
NE11 9NH

### **Gateshead Council - Audit for the year ended 31 March 2006**

This representation letter is provided in connection with your audit of the financial statements of Gateshead Council for the year ended 31 March 2006 for the purpose of expressing an opinion as to whether the financial statements present fairly in all material respects the financial position of Gateshead Council as of 31 March 2006 and of the results of its operations and cash flows for the year then ended in accordance with CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom.

I acknowledge my responsibility for the fair presentation of the financial statements in accordance with CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom.

I acknowledge my responsibility for the design and implementation of internal control to prevent and detect error.

I believe that the effect of uncorrected financial misstatements aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

I have made available to you all books of account and supporting documentation and all minutes of meetings held during the period.

I believe that the financial statements are free of material misstatements, including omissions.

I confirm, to the best of our knowledge and belief, the following representations:

#### 1. Internal Control

There have been no irregularities involving management or employees who have a significant role in internal control or that could have a material effect on the financial statements.

## 2. Fixed Assets

The net book values at which the fixed assets are stated in the balance sheet are arrived at:

- a) after providing for depreciation on bases and at rates calculated to reduce the cost of each asset to its estimated residual value by the end of its estimated useful life;
- b) after taking account all capital expenditure on additions thereto, but no expenditure properly chargeable to revenue.

## 3. Current Assets

Current assets in the balance sheet are expected, in the opinion of the Strategic Director of Finance and ICT, to produce at least the amounts at which they are stated. Adequate provision has been made against all amounts owing to the Council, which are known to be irrecoverable.

## 4. Liabilities

All liabilities have been taken up in the accounting records, including the liability for the purchase to which title had passed prior to the stated date, and for all items included in stocks.

## 5. Commitments

There were no purchase commitments in excess of normal requirements. None of the Council's liabilities for the purchases arose under contracts containing 'reservation of title' clauses.

## 6. Contingent Liabilities

Contingent Liabilities relating to Section 117 of the Mental Health Act, Land at Bottle Bank and potential equal pay claims are shown in Note 21 to the Consolidated Balance Sheet.

I am not aware of any other contingent liabilities that ought to be disclosed in the financial statements.

## General representations

7. The Strategic Director of Finance and ICT considers that there is adequate insurance cover for all major risks.

8. The Strategic Director of Finance and ICT considers that the Council will have sufficient cash resources available to finance its operations at least for the following twelve months.

9. Council Members had no interest; present or future, in any contract with the Council during the year ended 31 March 2006.

10. Income and Expenditure Account

Except as disclosed in the accounts, the results for the period were not materially affected by:

- a) any change in the basis of accounting;
- b) circumstances of an exceptional or non-recurrent nature;
- c) charges or credits relating to prior years.

11. Group Accounts

I have not prepared group accounts as I 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.

12. Events Subsequent to the Date of the Balance Sheet

All events taking place between 31 March 2006 and the date of this letter which have assisted in accurately determining the Council's position at 31 March 2006, and its results for the year ended on that date, have been duly taken account. Since that date of the balance sheet, no event has occurred which, though properly excluded from the accounts, is of such importance that it should be disclosed.

If you have any queries about the contents of this letter, please contact either John Jopling, Head of Financial Management, on telephone number: 0191 433 3587, or myself on 0191 433 3582.

Yours faithfully

Strategic Director of  
Finance and ICT

Signed on behalf of Gateshead Metropolitan Borough Council

