

# Annual governance report

Gateshead Council

Audit 2010/11



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# Key messages

This report summarises the findings from the 2010/11 audit which is substantially complete. It includes the messages arising from my audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.

	Our findings
Unqualified audit opinion	✓
Proper arrangements to secure value for money	✓

## Audit opinion and financial statements

- A full set of IFSR restated statements was presented for audit by the deadline, with supporting working papers.
- There is one unadjusted misstatement for you to consider before I give my opinion.

## Value for money

- The Council's performance continues to improve and it has arrangements in place to manage financial risks and improve value for money.
- Robust budget plans have been approved and Fit for Future is in progress to deliver financial savings and service improvements.
- Longer term financial planning could support achievement of the Council's priorities.

# Before I complete my audit

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## I confirm to you

My report includes only matters of governance interest that have come to my attention in performing my audit. My audit is not designed to identify all matters that might be relevant to you.

### Independence

I confirm that I have complied with the Auditing Practices Board's ethical standards for auditors, including ES 1 (revised) - Integrity, Objectivity and Independence. I can also confirm there were no relationships resulting in a threat to independence, objectivity and integrity.

The Audit Commission's Audit Practice has not undertaken any non-audit work for the Council during 2010/11.

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## I ask you to confirm to me

### I ask the Accounts Committee to:

- take note of the adjustments to the financial statements which are set out in this report (appendix 2);
  - approve the letter of representation, provided alongside this report, on behalf of the Council before I issue my opinion and conclusion;
  - consider the unadjusted misstatement (appendix 3); and
  - agree the action plan (appendix 5).
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# Financial statements

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- A full set of statements was presented for audit by the deadline, with supporting working papers.
- There is one unadjusted misstatement for you to consider before I give my opinion.

## Opinion on the financial statements

Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements. Appendix 1 contains a copy of my draft report.

## Errors in the financial statements

There were some minor errors in the draft statements, including inconsistencies between notes and statements, which were amended to ensure consistency and to improve presentation. They had no impact on reserves or the Council's net worth. The main changes were:

- exceptional items (change in pension index and housing valuation factor) separately shown on face of the comprehensive income and expenditure statement;
- comparative 2009/10 Housing Revenue Account line in Comprehensive Income and Expenditure Statement amended so consistent with the Housing revenue Account;
- financial instruments notes amended to exclude NNDR and council tax;
- inconsistencies in cash flow statement amended, statement also amended to reflect changes in balance sheet;
- accounting policies updated to include the date of asset valuations and a policy on Euro transactions;
- changes to Notes to ensure revenue expenditure funded as capital under statute is inconsistently shown to include capitalised redundancy costs;
- more detailed explanation provided on contingent liabilities; and
- pensions disclosures amended.

Officers have agreed to review processes to identify ways to reduce the number of such errors next year.

Appendix 2 summarises the corrected misstatements. The main adjustments relate to reporting of the cash balance, which was initially shown as the actual balance at the bank on 31 March, with issued cheques and BACs included as creditors. This was a change in the way cash was previously accounted for, and after discussions officers agreed to revert to the previous accounting treatment.

There is one uncorrected misstatement which members need to consider before I give my opinion. This is explained in appendix 3 and is as follows.

- The statements include expenditure on redundancies for all of the cases approved by 31 March 2011. The expenditure on redundancies approved after 31 March 2011, some £5 million, is included in 2011/12. As all of the redundancies arise from the Council's decision in 2010/11 to offer redundancy, the total estimated costs, including the £5 million, should have been included in 2010/11.

## Recommendations

**R1** Amend the misstatement, or explain why an amendment is not appropriate.

**R2** Discuss all proposed changes in accounting treatment with us before statements are prepared.

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# Financial statements

The Council's financial statements and annual governance statement are important means by which the Council accounts for its stewardship of public funds. As Council members you have final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements and the annual governance statement.

In planning my audit I identified specific risks and areas of judgement that I have considered as part of my audit.

## Key audit risk and our findings

Key audit risk	Finding
<b>1. Reserves</b> The Council may use its reserves for purposes other than that authorised when reserve set up.	Reserves were used in accordance with plans and approved by members.
<b>2. Pay costs</b> Unequal pay claims and redundancy costs may be incorrectly accounted for.	Equal pay costs have been properly provided for (updating 2009/10) but the costs of redundancy are understated.
<b>3. International Financial Reporting Standards (IFRS)</b> The Council may not produce IFRS compliant statements.	Considerable work was carried out to ensure that restated accounts were available for audit in June. Regular discussions were held with us to consider issues, and draft restatements were prepared for early audit review. The Council has complied with the new standards (except as reported above in respect of redundancy costs).
<b>4. Investments</b> The at risk investment may be incorrectly accounted for.	The Council has followed accounting requirements and recognised the impairment.

Key audit risk	Finding
<p><b>5. Joint services</b> The Council may be unable to continue services provided jointly with the PCT, once PCTs no longer exists.</p>	<p>Work with PCT is continuing and no issues have arisen to date.</p>
<p><b>6. Group accounts</b> The Council may not consider if group accounts are required.</p>	<p>A detailed assessment has been carried out, confirming that group accounts are not required for 2010/11.</p>
<p><b>7. New revenues/benefits system</b> The new system may not be implemented properly, leading to material misstatements.</p>	<p>There were some reporting issues with implementation, but this has not lead to material misstatements.</p>
<p><b>8. 200910 errors</b> The Council may not correct previously identified errors.</p>	<p>2009/10 errors were corrected.</p>

# Financial statements

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## Significant weaknesses in internal control

### **I did not identify any significant weaknesses in your internal control**

I did not identify any significant weaknesses during the course of the audit that are relevant to preparing the financial statements.

I have separately reported on other weaknesses identified. I have agreed an action plan with officers to:

- review and improve authorisation of low value journals;
- carry out more timely checks of registrar information to ensure Care First records are up to date;
- improve documentation evidencing checks on rent levels; and
- check amendments made to payroll records.

I am not expressing an opinion on the overall effectiveness of internal control.

# Financial statements

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## Quality of your financial statements

**The financial statements were presented for audit by the deadline, with supporting working papers. Several amendments were made to correct errors and omissions.**

I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statements disclosures.

The draft statements, restated to reflect IFRS requirements, were presented for audit by the 30 June deadline. Working papers were available to support the statements, following the agreed protocol. Requests for additional working papers were dealt with promptly, as were audit queries.

In addition to the matters raised elsewhere in this report, these are the issues I want to raise with you, to further improve future financial statements.

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## Accounting practices, policies, estimates and financial closures

Issue	Findings and recommendations
<p><b>1. Compensated absences accrual</b></p> <p>Employees do not always take their full entitlement to annual leave within the financial year, so the Council must recognise the amount due for untaken leave.</p>	<p>A detailed exercise, covering a representative sample of employees, was carried out to estimate the value of unpaid leave due to employees in 2008/09 and 2009/10. This exercise was not done for 2010/11, rather the previous sample was updated. Whilst the estimate is not material, this approach does not accurately reflect the changes in the number, pay and location of employees in 2011/12, due to the large redundancy programme.</p> <p>The estimate should be based on an up to date, representative sample of employees.</p>
<p><b>2. Debtors and creditors</b></p> <p>The full value of all debtors and creditors should be included in the statement, with netting off only in limited circumstances. Internal balances should be excluded from the statements.</p>	<p>Due to the current accounting structure, some balances and transactions are included in the ledger as a negative debtor rather than as a creditor, or as a positive debtor rather than a creditor. These were not adjusted when preparing the statements, so there is some (immaterial) understatement of both debtors and creditors (no net effect). Balances between services and trading accounts are included in the ledger to aid financial management. They were not excluded from the financial statements, so overstating both debtors and creditors (not material and no net impact).</p>

Issue	Findings and recommendations
<p>3. Prepayments</p> <p>Amounts paid, which relate to the following financial year, should be included in the statements as prepayments.</p>	<p>Debtors and creditors should be shown gross and exclude all internal balances.</p> <p>No review was carried out to identify any prepayments, as the Council do not expect to pay in advance. Our cut off testing identified one amount included in the wrong financial year.</p> <p>Close down procedures should identify prepayments.</p>
<p>4. Prior period adjustments</p> <p>Audited statements should be amended only where there has been a material change in accounting policy or error.</p>	<p>As part of the IFRS implementation, detailed ledger and fixed asset register review was carried out. This identified some small errors, not due to IFRS, which have been reflected as prior period adjustments affecting 2008/09 and 2009/10.</p> <p>Prior period adjustments should not be made for non material errors.</p>
<p><b>5. Accounting policies</b></p> <p>Policies are vital to the understanding of the statements.</p>	<p>Policies are included as an appendix rather than as an integral part of the statements.</p> <p>Include policies in a more prominent position, as part of the statements.</p>
<p><b>6. Revaluation</b></p> <p>Non current assets must be valued at least every five years. All assets of the same class must be revalued within a short time.</p>	<p>The Council values all high value assets annually.</p> <p>Ensure all assets of the same class are valued together.</p>
<p><b>7. Cut-off</b></p> <p>Receipts and payments close to the end of the financial year should be considered to ensure they are accounted for in the right year.</p>	<p>Our testing identified one payment relating to 2011/12 which was included in 2010/11.</p> <p>Officers should be reminded of cut-off requirements.</p>
<p><b>8. Exceptional items</b></p> <p>Material items should be shown separately on the face of the comprehensive income and expenditure statement where this is relevant to understanding the authority's financial performance.</p>	<p>Two exceptional items (impairment from change in social housing adjustment factor and change in pensions index) are not shown separately in the comprehensive income and expenditure. To understand the change in financial performance of HRA and non distributed costs, the reader must refer to Note 6. The provision for voluntary redundancy costs (of a much lower value) is separately disclosed.</p> <p>Exceptional items should be shown on the face of the comprehensive income and expenditure statement.</p>

# Financial statements

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## Letter of representation

Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements.

I have provided a draft letter for consideration.

# Value for money

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**I am required to conclude whether the Council put in place proper corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money conclusion.**

I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against two criteria specified by the Audit Commission. My conclusion on each of the two areas is set out below.

I intend to issue an unqualified conclusion stating that the Council had proper arrangements to secure economy, efficiency and effectiveness in your use of resources.

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## Value for money criteria and our findings

Criterion	Findings
<p><b>1. Financial resilience</b></p> <p><b>The organisation has proper arrangements in place to secure financial resilience.</b></p> <p>Focus for 2010/11:</p> <p>The organisation has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.</p>	<p>The Council has sound financial governance arrangements. The Cabinet takes responsibility for the financial health for the Council, with scrutiny from other members. Training in local government finance is given to new members and those who ask for it. This helps members to understand and manage financial risks.</p> <p>There is good understanding throughout the Council of the need for sound financial management. All managers are actively involved in the Fit for Future programme. The Council has carried out a review of spending plans considering how it will deal with the current economic climate and reductions in grant income. Seminars and briefings were held with members to ensure they fully engaged in budget setting. There was widespread public consultation via Council News and the internet.</p>

## Criterion

## Findings

Budget information is produced on a timely basis and is monitored by budget holders, senior managers and members. Corrective action is identified and action plans developed to address issues. A strong internal control environment has been built up.

The Medium Term Financial Strategy supports and is aligned with the corporate plan and strategic vision. Both the Plan and Strategy were updated in 2011. A comprehensive and balanced budget was set, which included realistic savings plans. Financial management could be further improved by planning on a longer basis, perhaps five to ten years rather than the three years covered by the current Strategy, and making more use of financial modelling.

At 31 March 2011 the Council held £15.994 million in its General Reserve (excluding schools balances) and £23.1 million in earmarked reserves. This is £27.6 million less than a year earlier. Use of reserves was planned, including funding voluntary redundancies as part of achieving longer term budget reductions. 2011/12 and future plans include further use of reserves to support expenditure while the Fit for Future Programme is implemented. It is recognised that using reserves is not a long term solution and that reductions in spending need to be delivered. This is being proactively managed.

The three year Medium Term Financial Strategy sets out clear assumptions, supporting Council priorities. There is extensive consultation with the public and members are engaged in the process. The impact of the current economic climate is reflected both in the Strategy and in other plans, such as the Council's ten-point plan to support local businesses. Some scenario planning has been undertaken, to reflect expected reductions in grant funding but this has been limited because of the uncertainty around grant funding.

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### **2. Securing economy efficiency and effectiveness**

**The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.**

The Council and its partners reviewed Vision 2030, following extensive consultation, to take account of changed economic conditions. A new three year corporate plan focuses on priorities.

There is a robust process in place for reviewing services, which involves LEAN improvement and efficiency tools. The Council has a good understanding of its costs. Areas of high spending are subject to rigorous examination, with increasing use of benchmarking. The Council has used the Audit Commission VFM profile for several years.

## Criterion

Focus for 2010/11:

The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

## Findings

It uses its analysis to challenge service provision and there are examples of improvements in value for money across the Council. Overall costs are average to high but most services and outcomes are good. The Council has a good understanding of the reasons for costs being above average, where this is the case. Adult social care is one area where high costs are not matched by good quality and care outcomes. The Council has plans to address the problems it has identified.

Alternative models of delivery are being considered as part of the Fit for the Future programme and PACE Reviews. There has been collaborative procurement for many years through NEPO as well as specific procurement partnerships with neighbouring councils, such as the recently agreed waste management contract. The Council works very effectively in partnership with other sectors, especially the NHS.

The Council has embarked on a programme of asset disposal. Improved utilisation of the Civic Centre has enabled release of buildings elsewhere, which will reduce costs and improve service delivery.

# Appendix 1 – Draft audit report

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## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF GATESHEAD COUNCIL**

### **Opinion on the Authority accounting statements**

I have audited the accounting statements of Gateshead Council for the year ended 31 March 2011 under the Audit Commission Act 1998. The accounting statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, the Housing Revenue Account, the Movement on the Housing Revenue Account Statement and Collection Fund and the related notes. These accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of Gateshead Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010.

### **Respective responsibilities of the Strategic Director, Finance & ICT and auditor**

As explained more fully in the Statement of the Strategic Director, Finance & ICT Responsibilities, the Strategic Director, Finance & ICT is responsible for the preparation of the Authority's Statement of Accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom. My responsibility is to audit the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practice's Board's Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Authority's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Authority; and the overall presentation of the accounting statements. I read all the information in the explanatory foreword to identify material inconsistencies with the audited accounting statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

## **Opinion on accounting statements**

In my opinion the accounting statements:

- give a true and fair view of the state of Gateshead Council's affairs as at 31 March 2011 and of its income and expenditure for the year then ended; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

## **Opinion on other matters**

In my opinion, the information given in the explanatory foreword for the financial year for which the accounting statements are prepared is consistent with the accounting statements.

## **Matters on which I report by exception**

I have nothing to report in respect of the governance statement on which I report to you if, in my opinion the governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007.

## **Conclusion on Authority's 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 review regularly the adequacy and effectiveness of these arrangements.

### **Auditor's responsibilities**

I am required under Section 5 of the Audit Commission Act 1998 to satisfy myself that the Authority has made proper arrangements 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 relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

I report if significant matters have come to my attention which prevent me from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. 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.

## **Basis of conclusion**

I have undertaken my audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2010, as to whether the Authority has proper arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

The Audit Commission has determined these two criteria as those necessary for me to consider under the Code of Audit Practice in satisfying myself whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2011.

I planned my work in accordance with the Code of Audit Practice. Based on my risk assessment, I undertook such work as I considered necessary to form a view on whether, in all significant respects, the Authority had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

## **Conclusion**

On the basis of my work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2010, I am satisfied that, in all significant respects, Gateshead Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2011.

## **Certificate**

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

[Signature]

Steve Nicklin  
District Auditor

Nickalls House  
Metro Centre  
Gateshead  
NE11 9NH

September 2011

# Appendix 2 – Amendments to the draft financial statements

I identified the following misstatements during my audit and management have adjusted the financial statements. I bring them to your attention to aid you in fulfilling your governance responsibilities.

		Comprehensive income and expenditure statement		Balance sheet	
Adjusted misstatement	Nature of adjustment	Dr £000s	Cr £000s	Dr £000s	Cr £000s
Cash	Previously shown net of overdraft			385	
Overdraft	Unpresented cheques and BACs,				15,574
Creditors	As above			15,189	
Long term creditor	PFI liability shown net of finance lease amount due to Council				1,137
Long term debtor	As above			1,137	
Short term debtors	Positive grant balance netted off credit balance			970	
Long term creditors	As above				970
Construction contracts	Represents internal work in progress rather than external contracts				3,034
Inventories	As above			3,034	

# Appendix 3 – Unadjusted misstatements to the financial statements

I identified the following misstatements during my audit, [including uncorrected misstatements from earlier years,] but management has not adjusted the financial statements. I bring them to your attention to help you in fulfilling your governance responsibilities and ask you to correct these misstatements.

If you decide not to amend, please tell me why in the representation letter. If you believe the effect of the uncorrected errors, individually and collectively, is immaterial, please reflect this in the representation letter. Please attach a schedule of the uncorrected errors to the representation letter.

Unadjusted misstatement	Nature of required adjustment	Comprehensive income and expenditure statement		Balance sheet	
		Dr £000s	Cr £000s	Dr £000s	Cr £000s
Short term provisions	Excludes cost of redundancies approved after 31 March 2011, but arising from the Council's 2010 decision to instigate a redundancy programme.	5,253			5,253

# Appendix 4 – Glossary

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## **Annual governance statement**

A statement of internal control prepared by an audited body and published with the financial statements.

## **Audit closure certificate**

A certificate that I have completed the audit following statutory requirements. This marks the point when I have completed my responsibilities for the audit of the period covered by the financial statements.

## **Audit opinion**

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

## **Opinion**

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

## **Materiality and significance**

The Auditing Practices Board (APB) defines this concept as ‘an expression of the relative significance or importance of a particular matter for the financial statements as a whole. A matter is material if its omission would reasonably influence users of the financial statements, such as the addressees of the auditor’s report; also a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. We cannot define materiality mathematically, as it has both numerical and non-numerical aspects’.

The term 'materiality' applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

'Significance' applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

### **Weaknesses in internal control**

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or a combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

### **Value for money conclusion**

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

The Code of Audit Practice defines proper arrangements as corporate performance management and financial management arrangements that form a key part of the system of internal control. These comprise the arrangements for:

- planning finances effectively to deliver strategic priorities and secure sound financial health;
- having a sound understanding of costs and performance and achieving efficiencies in activities;
- reliable and timely financial reporting that meets the needs of internal users, stakeholders and local people;
- commissioning and buying quality services and supplies that are tailored to local needs and deliver sustainable outcomes and value for money;
- producing relevant and reliable data and information to support decision making and manage performance;
- promoting and displaying the principles and values of good governance;
- managing risks and maintaining a sound system of internal control;
- making effective use of natural resources;
- managing assets effectively to help deliver strategic priorities and service needs; and
- planning, organising and developing the workforce effectively to support the achievement of strategic priorities.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

# Appendix 5 – Action plan

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## Recommendations

### Recommendation 1

Amend the misstatement, or explain why an amendment is not appropriate.

Responsibility

Priority

Date

Comments

### Recommendation 2

Discuss all proposed changes in accounting treatment with us before statements are prepared.

Responsibility

Priority

Date

Comments

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