

Annual governance report

ITEM 6

Norwich City Council

Audit 2010/11



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Traffic light explanation

Red  Amber  Green 

Key messages

This report summarises the findings from the 2010/11 audit which is significantly 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	◆
Significant weaknesses in internal control	◆

Audit opinion and financial statements

- At 29 November I have not issued my opinion on the Council's financial statements. The implementation of International Financial Reporting Standards (IFRS) has had a significant impact on the Council's ability to prepare their financial statements. A number of adjustments and disclosure corrections are currently being agreed with officers. Aspects of my work are still ongoing and I will provide an update to the 14 December Audit Committee. Given that my work is not yet complete I have currently provided an amber rating in the findings table above.
- The arrangements for resolving the volume of errors in the financial statements and audit queries has proved challenging for the

Council. Some working papers were incomplete at the start of the audit and did not provide the level of information needed for my audit.

Value for money

- My initial assessment suggests that the Council's arrangements are adequate. However my work on the financial statements audit is not yet complete and I have not yet been able to affirm that the audited general fund balance will not be adversely impacted by the audit adjustments. To the extent that it is, I will need to consider the impact on the Council's financial resilience. I will provide an update to the 14 December Audit Committee. Given that my work is not yet complete I have currently provided an amber rating in the findings table above.

Weaknesses in internal control

- I continue to have some concerns regarding the design or operation of controls at the Council. The issues I have previously raised regarding the effectiveness and capacity of the in-house Internal Audit function remains ongoing.

Before I complete my audit

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 can 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.

During the year the Audit Commission's Audit Practice undertook non-audit work for the Council for a fee of £28,600. We reviewed the Council's landlord services.

Fees

As a consequence of the issues found during the course of my audit, and discussed later in this report, additional fees of £51,000 have already been agreed with the Head of Finance and a further fee will be required on completion of the audit. Total audit fees are therefore likely to be higher than in 2009/10, and are significantly higher than those included in the audit plan. I will provide a further update at the 14 December Audit Committee meeting.

I ask you to confirm to me

I ask the audit 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; and
- agree your response to the proposed action plan (Appendix 5).

Financial statements

At 29 November I have not yet issued my opinion on the Council's financial statements. The implementation of International Financial Reporting Standards (IFRS) has had a significant impact on the Council's ability to prepare their financial statements in line with the Accounts and Audit (England) Regulations 2011. A number of adjustments, some material, and disclosure corrections are currently being agreed with officers. Aspects of my work are still ongoing and I will provide an update to the 14 December Audit Committee.

Background to the financial statements audit

The Accounts and Audit (England) Regulations 2011 require the responsible financial officer to sign and date the financial statements and certify that it presents a true and fair view by 30 June. The Council failed to meet this deadline. The Head of Finance signed the financial statements on 28 July and submitted them to us for audit. I comment later in this report on issues with the quality of the financial statements presented for audit. These issues have resulted in the need for further versions of the financial statements and a protracted audit process. At 29 November the Council is working on a further revision to the financial statements.

Norwich City Council, along with all local authorities and police authorities, were required to prepare their financial statements in line with International Financial Reporting Standards (IFRS) for the first time in 2010/11. IFRS requirements differ significantly in several respects from UK Generally Accepted Accounting Practice (UK GAAP) which authorities have prepared their financial statements under previously.

IFRS adoption has been a significant exercise because the CIPFA Code requires retrospective adoption of the new standards covering areas such as leases, and the recognition of grant income and balances. This has required finance officers to reconsider their lease agreements and, where necessary, retrospectively restate accounting entries from the beginning of these agreements. To prepare for IFRS, councils have needed robust project plans to ensure they can collect and review the necessary information to restate balances, often with considerable lead-in times. In some areas of the financial statements, significant judgements are required in interpreting international standards and their applicability to local circumstances.

IFRS implementation has also created significant pressure on resources for councils due to the need for additional disclosures relating to the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 based on International Financial Reporting Standards (the Code).

The delay in preparing an auditable set of financial statements has clearly been impacted by the requirement to apply IFRS, and the need to present restated comparatives. Much of the financial statements preparation process lies with the Chief Accountant and this has not been a sufficient resource under these circumstances.

Status of the financial statements audit

At 29 November my team has completed most of the audit work but members should be aware that:

- There remain many areas where work with officers is ongoing to resolve audit queries. Given that the volume of outstanding points remains high I have not included a comprehensive list of residual work in this Annual Governance Report.
- My team is still in the process of agreeing audit errors and uncertainties with officers.
- Audit work on the restated 2009/10 Cash Flow Statement and Capital Adjustment Account has not started as officers have not yet provided an auditable version. I understand that officers are progressing this. Additionally, my work on the 2010/11 Cash Flow Statement and Movement in Reserves Statement is ongoing and my team has yet to fully discuss issues arising with officers.
- The completeness of provisions is still a matter where further work is required. I await a working paper to support the additional provision the Council is proposing in respect of the New Deal grant claim as an element of the grant receipt may need to be refunded to the Department for Communities and Local Government (DCLG). I am also considering the debtor and creditor balances associated with Connaught whose debts have been taken over by Morgan Sindall. Morgan Sindall is in ongoing negotiations with the Council regarding amounts payable following the collapse of Connaught. Further discussions with officers is required and I will need to establish if any management representations are necessary.
- The Council is currently revisiting the PFI model and associated financial statement entries. Further information is provided at page 24.
- Audit work on the revised financial instruments disclosures is ongoing. My team is discussing a number of emerging issues on the disclosures with officers.
- Audit work on the Council's Capital Financing Requirement and linked disclosures in the financial statements is ongoing. Initial findings suggest that there are a number of errors and my team is discussing the issues with officers.
- Evidence is still required to support the Council's approach to accounting for components of property and council dwellings since April 2010. The most significant potential impact is the need to derecognise elements of dwellings when improvements such as kitchens and bathrooms have been capitalised. No derecognition adjustments have been made in the latest version of the financial statements and I await the Council's rationale for this.
- The financial statements initially showed no movement from the prior year for the Rent Allowance Recovery balance in long term debtors (£1,032,000). There is no change to the provision against this debtor. I have questioned this with officers and need to consider the latest position.

- A number of further changes to the financial statements are required to both the IFRS restated comparatives and the 2010/11 figures as a result of the errors I have detected. I will then need to understand the audit trail from the financial statements presented to me for audit on 28 July to the final version for signature and ensure that the general ledger reflects this. This will include a review of the matters raised with the Council based on a high level review of the 28 July financial statements to ensure that issues have been addressed to my satisfaction. Because of the volume of changes, the number of issues in our review of the financial statements, and the complexities of the restatements under IFRS this is expected to be a time consuming process.
- My audit team are also clearing residual matters arising from the review process carried out by myself and the Audit Manager. These review processes remain ongoing as residual work is completed.

At 29 November I am unable to say that all matters which I consider to be significant to my audit opinion have been fully considered or, where appropriate, included in this report. My team will continue to work with officers to resolve issues and complete the outstanding work. I intend to present an updated Annual Governance Report to the Audit Committee on 14 December. This will show the latest position and provide further information on both the conclusions I have reached and any further issues I have detected. I will also agree with the Audit Committee an appropriate way forward should any matters arise after the 14 December meeting which I consider need to be brought to the attention of the members.

The deadline for the submission of the audited Whole of Government Accounts (WGA) consolidation pack was 30 September 2011. Given the ongoing revisions to the financial statements the audit deadline for WGA has not been met. I will establish if the National Audit Office still require me to perform this work as soon as the financial statements are audited.

Opinion on the financial statements

Given the volume of outstanding work I am not yet able to confirm the form of my audit opinion. However, as at 29 November I am optimistic that I will be able to resolve issues sufficiently to provide an unqualified opinion on the financial statements. Appendix 1 contains a copy of my draft report on the basis that it is unqualified.

Errors in the financial statements

I noted a significant number of misstatements during the course of my audit. As noted above, I am awaiting a further draft of the financial statements before I can check that all non-trivial misstatements have been corrected. I anticipate, based on the Council's approach in previous years, the financial statements will be amended for all the non-trivial misstatements. Given this I have not included any uncorrected misstatements at Appendix 3, although at 29 November I am still agreeing a number of my audit errors and uncertainties with officers. I will provide an update to the Audit Committee on 14 December. Should any non-trivial misstatements not be corrected I will need to bring them to your attention and ask you to correct them. Should you decide not to amend you will need to tell me why in the representation letter.

The draft statements also contained a high number of disclosure errors relating to the requirements of the Code.

Material errors identified to date are shown in appendix 2. As my work is ongoing I will provide an update to the Audit Committee on 14 December.

Associated disclosure notes have also been amended for material errors. This includes the note which supports the Movement in Reserves Statement where I detected a number of errors and inconsistencies.

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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
<p>1. International Financial Reporting Standards (IFRS)</p> <p>Councils are now required to prepare financial statements under the International Financial Reporting Standards (IFRS), as adopted by the Code of Practice on Local Authority Accounting in the United Kingdom (Code of Practice).</p> <p>There is a risk the 2010/11 financial statements do not meet the new requirements.</p>	<p>I have reviewed and tested whether the Council has:</p> <ul style="list-style-type: none">■ identified those transactions and balances affected by the transition to IFRS;■ adopted and correctly applied accounting policies that comply with the requirements of the Code and IFRS;■ appropriately restated 2009/10 transactions and balances in accordance with the adopted accounting policies and IFRS; and■ made all appropriate disclosures in accordance with adopted accounting policies and the requirements of the Code and IFRS. <p>At 29 November my audit work is continuing in respect of the last two points.</p>
<p>The Council has a large leased asset portfolio. Officers identified a number of leasing arrangements which were individually significant and/or unusual, and asked that I comment on the proposed accounting treatments.</p>	<p>I considered the Council's proposed accounting treatments on specific leases and provided officers with my view of their proposals. In some instances I agreed with the Council that they revise such items in the financial statements At 29 November my work is continuing to ensure that these changes have been appropriately made.</p>

Key audit risk

Finding

The Council has not kept an overall contracts register. There is a risk the Council may not identify arrangements that contain a lease, and therefore not account for the arrangements in line with International Financial Reporting Interpretations Committee 4 (IFRIC 4). The Chief Accountant has carried out some work to identify such arrangements, and is creating a register based on the work she has done so far, but there is a residual risk that arrangements could have been missed

I also considered the Council's overall review of lease arrangements where it acts as the lessor. This aspect of my audit has been protracted as I considered that there were some weaknesses with the documentation of the review and aspects of the approach. Officers have agreed that six additional lease reclassifications from operating to finance lease are required. At 29 November my work is not yet complete as these have yet to be reflected in a new version of the financial statements. My team is now completing my planned audit work on the Council's leases as both lessee and lessor, and I will provide a further update to the Audit Committee on 14 December.

This work remains in progress, and I will provide a further update to the Audit Committee on 14 December.

2. Prior year financial statements preparation

The 2009/10 audit was protracted due to the number of audit issues arising, including technical accounting issues, arithmetical errors and internal inconsistencies. I reported material and significant amendments to the financial statements in my Annual Governance Report. Working papers, although improved from 2008/09, were not fully fit for purpose, particularly those supporting the Council's property, plant and equipment and related capital transactions.

I have carried out a highly substantive audit approach in 2010/11 to ensure that material errors in the 2009/10 financial statements have not recurred.

As I set out earlier in this report, my audit has again been protracted due to a large number of accounting and disclosure issues in the financial statements. As a result of this, significant additional work has been carried out beyond that envisaged in the audit plan. I continue to have concerns about the adequacy of working papers and the impact of this on my ability to carry out an efficient audit. As a consequence, additional fees have already been agreed with the Head of Finance and a further fee will be required on completion of the audit.

Key audit risk	Finding
	<p>Total audit fees are therefore likely to be higher than in 2009/10, and are significantly higher than those included in the audit plan, which assumed that the financial statements issues found in 2009/10 would not recur. Further information on this is provided at page 5.</p> <p>I requested that the Annual Governance Statement be updated to refer to the lack of progress on addressing issues on financial statements preparation.</p>
<p>3. Internal controls</p> <p>Our cumulative knowledge and updated systems walkthroughs in 2010/11 confirmed there were some continuing weaknesses in both the design and the operation of some controls, including the role of Internal Audit. This continues to limit my ability to rely on systems controls to provide audit assurance. Further strengthening of the underlying control environment is required.</p>	<p>I have carried out additional substantive audit testing to address the gaps in controls assurance in 2010/11.</p> <p>I have also considered Internal Audit's findings in terms of risks for my audit opinion. This has not resulted in any change to my audit approach.</p> <p>Weaknesses in internal control arrangements that I detected as part of my work are considered in the following section of this report.</p>
<p>4. Creditors, provisions and contingencies</p> <p>We were aware of correspondence on the following:</p> <ul style="list-style-type: none"> ■ from the Department of Communities & Local Government (CLG) regarding settlement of the New Deal grant claims. The Council has provided CLG with an independent accountant's report covering the issues raised in the annual certification work to try to secure an agreed position with CLG; and ■ a supplier dispute. 	<p>At 29 November my work on both the New Deal position and the supplier dispute is continuing. See comments at page 7 of this report. I will provide a further update to the Audit Committee on 14 December.</p>

Key audit risk	Finding
<p>5. Property, plant and equipment</p> <p>The Council is in a partnership with the Homes and Communities Agency involving providing Council land on which affordable homes can be built.</p> <p>The Council has identified structural issues with the St. Andrews car park and an asset impairment may be required.</p> <p>The Council has not previously obtained a split of its housing valuations between buildings and land. Land is usually non-depreciable. There is a risk the Major Repairs Allowance (MRA), which the Council has historically used as a proxy for depreciation of its Council housing, is not a valid basis for its depreciation charge. The Council should carry out further consideration of the reasonableness of the use of the MRA as a proxy for depreciation using the estimated buildings value and economic lives as a basis.</p>	<p>I assessed the current partnership arrangement and do not consider there are any issues with the Council considering to recognise the ownership of the land.</p> <p>I also considered the appropriateness of the accounting transactions and disclosures associated with the arrangement. As a result approximately £22 million of assets shown as investment property in the 28 July financial statements have been reclassified to assets held for sale in the restated 2009 balance sheet. This is because the definition of investment property is more stringent under IFRS.</p> <p>I considered and accepted the Council's basis for not including any impairment against the St. Andrews car park.</p> <p>I considered and accepted the Council's rationale for using the MRA as a proxy for depreciation of its Council housing.</p>
<p>6. Grant claims - general</p> <p>Audit work was not likely to be complete on the Council's grants before I reach my opinion on the financial statements.</p>	<p>Where grant claim work is not complete I have carried out sufficient initial testing to provide sufficient assurance for my opinion on the financial statements. My work detected the following issues:</p> <ul style="list-style-type: none"> ■ The Council did not consider the audited housing benefits grant position for 2009/10 when preparing the financial statements. The audited claim had reduced the amount payable by the Department of Work and Pensions (DWP) by £596,000 and creditors were understated by this amount.

Key audit risk

Finding

- Officers were unable to explain the differences between housing benefit income and expenditure in the financial statements and the same income and expenditure in the Council's Housing and Council Tax Benefit Subsidy Claim to the Department of Works and Pensions (DWP). The net differences across the three benefit types were £157,000, with expenditure on rent allowances showing the biggest difference of £472,000. I consider that it is unlikely that there is a material error in the financial statements in this regard, but recommend that the year end position is reconciled.

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Financial statements

Significant weaknesses in internal control

I continue to have some concerns regarding the design or operation of controls at the Council. The issues I have previously raised regarding the effectiveness and capacity of the in-house Internal Audit function remains ongoing.

These weaknesses are only those I identified during the course of the audit that are relevant to preparing the financial statements. I am not expressing an opinion on the overall effectiveness of internal control.

Internal control issues and our findings

Description of weakness	Potential effect	Management action
<p>1. Information on leases</p> <p>The Council has a significant number of properties that it leases. IFRS adoption has been a significant exercise because the CIPFA Code requires retrospective adoption of the new standards covering areas such as leases. This has required finance officers to review lease agreements and, where necessary, restate accounting entries from the beginning of these agreements onwards. This has been an onerous exercise.</p> <p>I raised some concerns with officers about the comprehensiveness of the initial review of leases, including concerns that it was difficult to assess the comprehensiveness of the assessment when compared to the database controlled by Asset and City Management.</p>	<p>Financial entries and disclosures in the financial statements in connection with lease liabilities may be incomplete or inaccurate.</p> <p>Potential operational difficulties if leases cannot be located.</p>	<p>Officers should consider if there is one database or lease register that could be used to provide all of the lease information that the Council needs. If not then more robust links between the property databases and the information used by finance, including the fixed asset register should be developed.</p> <p>Effective arrangements and processes should be in place so that service and legal departments understand and provide what finance officers need to ensure the financial statements are complete and accurate for lease arrangements. For example, a generic form could be completed by departments as part of the procurement process.</p>

Description of weakness	Potential effect	Management action
<p>Officers have recently completed additional work to help assure me that the review was robust and complete, and I am currently completing my work on lease classification and disclosures. The Council reclassified six leases from operating to finance as a result of their additional work.</p> <p>Information on leases is spread across a number of departments and is used for a number of purposes. My team was provided with three different working papers on leases for different aspects of the audit. All purported to include current rental figures but all were inconsistent. There is a danger that different areas of the Council could be using information that is not fully up to date. Underlying lease information is sometimes difficult to locate. Examples supporting this include:</p> <ul style="list-style-type: none"> ■ the Council has not been able to locate three leases we requested as part of our audit testing; and ■ finance officers were unaware that the Council had entered into a 99 year leaseback for part of the Livestock Market following its disposal. They were equally unaware that £800,000 of contingent disposal proceeds were yet to be received, and the financial statements were adjusted for this. 		<p>Similarly where the Council is the lessor the asset management department could complete a log of all changed and new leases which they provide to finance on a regular basis.</p> <p>The Finance function should be provided with copies of sales agreements, and any side agreements, such as leasebacks as a matter of course.</p> <p>Efforts should be made to locate misplaced leases.</p>

Description of weakness	Potential effect	Management action
<p>2. Valuation processes for property plant and equipment and investment property</p> <p>In my 2009/10 Annual Governance Report I noted weaknesses in the instruction process to obtain appropriate asset valuations. In 2009/10 I recommended:</p> <p><i>‘Consider, annually, whether valuation instructions are fit for purpose and contain accurate up to date information. In particular, review schedules of property to be valued for accuracy and consistency with the fixed asset register before the valuation takes place.’</i></p> <p>I have ongoing concerns. Instructions given to the external district valuer have not been updated since 2008 despite some implications from the implementation of IFRS. No formal instructions were given to internal valuers.</p> <p>Specific points arising are:</p> <ul style="list-style-type: none"> ■ The district valuer was not asked to consider significant components of other buildings valued in 2010/11. Component accounting is required under IFRS so that information should be being gathered as valuations are carried out. ■ Although the district valuer valued housing dwellings and shops he did not value garages. 	<p>Whilst my work has not detected material valuation errors early action was not taken in making valuation instructions explicit and fit for purpose.</p> <p>The impact of any change in fair value of investment property would have to be accounted for through the comprehensive income and expenditure statement.</p>	<p>Officers should ensure early consideration is given to what valuation information is required from the district valuer and internal valuers, and ensure that instructions are comprehensive. Numbers of properties, including garages should be fully reconciled to ensure that valuations are accurate.</p> <p>The close down process should be revised to include an annual assessment of the fair value of investment property even when there is no intention to formally revalue.</p>

Description of weakness	Potential effect	Management action
<ul style="list-style-type: none"> Two council dwellings which were sold before the year end had not been updated in the Academy housing rents system until after the year end. <p>The Code requires investment property to be carried at fair value reflecting market conditions at the balance sheet date. I noted that officers had not considered the carrying value of investment property that had not been revalued in 2010/11 to ensure that it was not materially different from fair value.</p>		
<p>3. Fixed asset register</p> <p>My 2009/10 Annual Governance Report, and earlier reports, commented on weaknesses in the spreadsheets used as a fixed asset register. I continue to have these concerns.</p> <p>The following issues arising from my testing support this:</p> <ul style="list-style-type: none"> Property descriptions are not always comprehensive. For example, the brought forward valuation of one property was understated. The property comprised a library and a cottage but the valuations provided by the district valuer only valued the Library. When the cottage was disposed of the finance team detected that there was no value attached to the cottage in the fixed asset register. 	<p>The weaknesses put the Council in danger of misstating entries connected with property, plant and equipment (previously 'fixed assets') in the financial statements.</p> <p>The longer these issues are unresolved the more time will be needed to unwind them.</p> <p>The financial statements presented for audit were misstated by £689,000 due to differences between the fixed asset register and the statements.</p>	<p>Review the adequacy of the current system for recording fixed assets against the accounting requirements driven by the Code. Consider the merits of investing in bespoke software.</p> <p>Review the descriptions on the current fixed asset register and ensure that land is separated from other assets. Check that all depreciable assets have been identified and are being depreciated over their useful lives.</p> <p>Fully reconcile the fixed asset register and general ledger and ensure that the financial statements reflect the reconciled position when preparing the 2011/12 financial statements.</p>

Description of weakness	Potential effect	Management action
<ul style="list-style-type: none"> ■ It was not clear from the fixed asset register whether depreciation was being accounted for on all items of property, plant and equipment – for example, no depreciation was charged on rent to mortgage property that had been reclassified as property plant and equipment under IFRS. <p>Although the fixed asset register had been reconciled to the general ledger it was not reconciled to the signed statements presented for audit.</p>		
<p>4. Control account and other reconciliations</p> <p>At the time of my systems audit (April 2011) I found that the monthly Accounts Payable to General Ledger reconciliation had not been reviewed and approved since October 2010. I found similar issues in my 2009/10 audit and reported it to you in my 2009/10 Annual Governance Report.</p> <p>There were also material differences in the reconciliation of the Collection Fund Account to the general ledger when the financial statements were presented for audit.</p>	<p>Control account reconciliations are key controls to ensure the completeness and accuracy of the general ledger used to generate the financial statements. As such, monthly reconciliations should be reviewed by a senior member of the finance team to ensure that they are accurate and that reconciling items (which could indicate fraud or other error) are being resolved on a timely basis.</p> <p>Preparing financial statements where there are material unreconciled amounts in annual reconciliations such as that supporting the Collection Fund increases the risk that the financial statements may contain material errors.</p>	<p>Senior finance staff should ensure that a key control account reconciliation review schedule is set and adhered to.</p> <p>Build appropriate time into the closedown plan to ensure that key annual reconciliations are adequately prepared.</p>

Description of weakness	Potential effect	Management action
<p>5. IT environment</p> <p>The Council's general IT environment requires improvement. Our review detected:</p> <ul style="list-style-type: none"> ■ access controls were not robust. From a sample of five new users on PARIS, manager authorization could not be found for three; ■ leaver controls were not robust. One leaver had not had their PARIS access disabled; ■ password controls in Oracle are weak. There are no password complexity requirements built in and users are allowed an unlimited number of password attempts; and ■ the Council does not have an end user computing policy. End user computing is the term applied to small scale office-system developments by user departments such as spreadsheets developed by the Finance department as part of the financial reporting process. 	<p>Appropriate access controls and passwords prevent unauthorised access to the Council's systems. Setting people up on the systems without appropriate manager approval means that users could have inappropriate access to certain systems. Similarly, failure to promptly disable access for leavers could leave the Council open to inappropriate system access. Complex passwords and access blockage where passwords have been incorrectly input a number of times also protect the Council against inappropriate system access.</p> <p>The absence of formal controls over spreadsheets increases the risk that Excel workbooks used in the production of the financial statements could include undetected errors. Our work did find an error in a spreadsheet used initially for the valuation of garages, although this was not ultimately used in the financial statements. Our grants certification work also detected another logic error in a spreadsheet which required an amendment to the grant claim.</p>	<p>Senior officers should reinforce the need to ensure approval for new users is received before they are given access to the Council's systems. The reasons for failing to disable system access for leavers should be investigated and improvements to either the notification process or processing of notifications should be secured.</p> <p>Obtain improvements to the requirements for setting passwords and for blocking access following repeated access fails from the service provider.</p> <p>Agree an end user computing policy and ensure this is adhered to.</p>

Description of weakness	Potential effect	Management action
<p>6. Internal Audit</p> <p>As set out in my audit plan, my last comprehensive review of the in-house internal audit function (2008/09) identified some weaknesses in arrangements. The action plan to address the weaknesses has not been fully implemented, and I was again unable to place any reliance on the work of internal audit as an effective internal control as a result of this.</p> <p>The in-house internal audit function has failed to fully deliver its audit plan for a number of years. The in-house internal audit resource continues to be used on reactive work on the New Deal historical claims issues and the Council continues to outsource a number of the financial systems reviews to other providers.</p>	<p>Internal Audit's work is vital in ensuring that controls are robust and appropriately applied. Their findings are key in supporting the Council's Annual Governance Statement.</p> <p>The inability to rely on the work of internal audit can have an impact on external audit fees. However, other risks at the Council already result in a heavily substantive audit approach so this has not had a significant impact in 2010/11.</p>	<p>Complete the actions arising from my 2008/09 review to ensure that the Internal Audit function is fit for purpose.</p> <p>Consider the current backlog position on internal audit work and form a plan to address this.</p>

Recommendation
<p>R1 Consider if there is one database or lease register that could be used to provide all of the lease information that the Council needs. If not then more robust links between the property databases and the information used by finance, including the fixed asset register should be developed.</p>
<p>R2 Revise arrangements and processes so that service and legal departments understand and provide what the finance function need to ensure the financial statements are complete and accurate for lease arrangements. For example, a generic form could be completed by departments as part of the procurement process. Similarly where the Council is the lessor the asset management department could complete a log of all changed and new leases which they provide to finance on a regular basis. The Finance function should be provided with copies of sales agreements and any side agreements such as leasebacks as a matter of course.</p>
<p>R3 Locate misplaced leases and ensure these are logged and secured in the Council's deeds safe.</p>

R4	Give early consideration to what valuation information is required from the district valuer and internal valuers, and ensure that instructions are comprehensive. Numbers of properties, including garages should be fully reconciled to ensure that valuations are accurate.
R5	Update the close down process to include an annual assessment of the fair value of investment property even when there is no intention to formally revalue.
R6	Review the adequacy of the current system for recording fixed assets against the accounting requirements driven by the Code of Practice. Consider investing in bespoke software.
R7	Review the descriptions on the current fixed asset register and ensure that land is separated from other assets. Check that all depreciable assets have been identified and are being depreciated over their useful lives.
R8	Fully reconcile the fixed asset register and general ledger and ensure that the financial statements reflect the reconciled position when preparing the 2011/12 financial statements.
R9	Senior finance staff should ensure that a control account reconciliation review schedule is set and adhered to.
R10	Build appropriate time into the closedown plan to ensure that key annual reconciliations, such as that for the Collection Fund, are adequately prepared.
R11	Reinforce the need to ensure approval for new users is received before access to the Council's systems is given. Investigate the reasons for failing to disable system access for leavers and make necessary improvements to either the notification process or processing of notifications.
R12	Obtain improvements to the requirements for setting passwords and for blocking system access following repeated access fails from the service provider
R13	Introduce an end user computing policy and procedures to ensure that: <ul style="list-style-type: none"> ■ any developed spreadsheet for financial reporting is risk assessed and formally authorised for use; ■ end user developed spreadsheets/documents are stored on a network drive and backed up; ■ spreadsheets/documents are secured with password control and located on a restricted network drive; and ■ changes to spreadsheets/documents are documented and follow standard change control procedures at the Council.
R14	Complete the actions arising from my 2008/09 review of internal audit to ensure that the internal audit function is fit for purpose.
R15	Consider the current backlog position on internal audit work and form a plan to address this.

Financial statements

Quality of your financial statements

I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statements disclosures. There are a number of issues I want to raise with you.

Accounting practices, policies, estimates and financial closures

Issue	Findings and recommendations
1. Quality of the financial statements The financial statements submitted for audit were late, contained a significant number of errors and missing or inaccurate disclosure requirements. There were a number of internal inconsistencies. I provided a significant list of issues based on an initial review of the financial statements. Additional issues have been detected as the audit has progressed.	<p>The Accounts and Audit (England) Regulations 2011 require the responsible financial officer to sign and date the financial statements and certify that it presents a true and fair view by 30 June. The Council did not meet this deadline as a number of accounting issues and disclosures were still being determined. The Head of Finance signed the financial statements on 28 July and submitted them to us for audit. The financial statements included balancing figures in the 2010/11 Consolidated Income and Expenditure Statement (CIES) and Movement in Reserves Statement (MiRS) (£245,000), and in the 2009/10 MiRS (£1,488,000).</p> <p>Our initial review of the statements detected a high number of errors, omissions (including notes supporting the restated 2009 balance sheet) and internal inconsistencies and we fed back a list of issues to officers. Based on our concerns we decided to defer certain areas of our audit work (e.g. cash flow statement and associated notes, Movement in Reserves Statement (MiRS), financial instruments disclosures). Additional issues with the 28 July financial statements were detected as we carried out the planned audit work. A second version of the financial statements was not provided to us until 3 November. This later version of the statements is currently being considered in terms of the changes made against our expectations. It also contained some omissions, most notably the 2009/10 IFRS restated cash flow statement and Capital Adjustment Account note, and lease disclosures.</p>

Issue	Findings and recommendations
	<p>Officers are currently working on further revisions, which I have yet to review, to the financial statements principally in terms of:</p> <ul style="list-style-type: none"> ■ revised treatment for six leases which officers have agreed are finance rather than operating leases; ■ revised treatment of the deferred consideration which formed an element of the livestock market disposal; ■ an additional creditor for the Housing Benefits claim in 2009/10 following completion of our certification work; ■ an additional provision for the potential repayment of New Deal grant monies received in earlier years; ■ revised classification of grant income which had not been accounted for in accordance with the new Code of Practice on Local Authority Accounting (the Code); and ■ the inclusion of a Movement on the Housing Revenue Account Statement which is required under the Code. <p>We continue to work through the 3 November revised set of statements and complete our remaining audit work. A further revision of the financial statements is required. Officers are preparing this and I will update the Audit Committee on the latest position at the 14 December meeting, including the overall impact on the general and housing revenue funds.</p> <p>The delay in preparing an auditable set of financial statements has been significantly impacted by the requirement to apply IFRS, and the need to restate the comparative figures in the financial statements. Much of the financial statements preparation process lies with the Chief Accountant and this has clearly not been a sufficient resource under these circumstances. Senior officers need to reflect on the financial statements preparation and audit processes and determine what changes need to be put in place to prevent these issues recurring in 2011/12. The Audit Committee has a role to play in ensuring it is assured that appropriate improvements are being made.</p>

Issue	Findings and recommendations
<p>2. Related party disclosures</p> <p>The Council's processes for capturing disclosable related party transactions need to be improved.</p>	<p>Completion of declarations of interests by Council members is inconsistent based on disclosures on the Council's website. Despite the Council previously giving training to members on this issue, it appears that some refresher training would be beneficial if members and officers are not to fail, unwittingly, to disclose their interests in business transacted by the Council.</p> <p>The officers' assessment of member related parties also needs to be improved. I agreed one addition to the related party transaction note, and I am considering officer representations regarding there not being a requirement to disclose certain transactions with organizations where service level agreements are in place. I will provide a further update to the Audit Committee on 14 December.</p>
<p>3. Group financial statements assessment</p> <p>The Council does not produce group financial statements on the basis that any group interests would not have a material impact. However, the Council did not fully update its group financial statements assessment to ensure that this was still a valid assumption. The definition of a group relationship is slightly different under IFRS.</p>	<p>The Council had previously assessed its partnership interests in 2008/09. The assessment had not been updated for key partnerships which the Council had entered into since then and that could potentially constitute a group relationship.</p> <p>Officers have recently revisited this and I am currently completing my assessment.</p>
<p>4. Accounting policies</p> <p>A number of accounting policy amendments have arisen as a result of IFRS.</p>	<p>The CIPFA Code of Practice guidance notes included an example set of policies. Officers had not appropriately tailored some accounting policies in the financial statements, such as: back pay arising from unequal pay claims; the holiday accrual element of the employee benefits policy; the Private Finance Initiative policy; and the provisions policy.</p>

Issue	Findings and recommendations
<p>5. Private Finance Initiative (PFI)</p> <p>The Council continues to recognise the planned lifecycle costs as included in the PFI accounting model as capital additions within its financial statements.</p> <p>To be treated as capital expenditure, the Council need to be able to demonstrate it meets the IAS 16 criteria. Where expenditure has been paid in advance for works not carried out, then the Council should treat this as a prepayment. However, if the Council cannot demonstrate the expenditure is capital, it should be charged as an expense to the general fund.</p> <p>Lifecycle costs to date recognised through the model to date are material at £4,164,000. Additions in 2010/11 are £793,000.</p> <p>The 28 July statements included a material omission from the Borrowings and Investments disclosure note (note 15) in relation to PFI liabilities. Other elements of the note were not completed correctly in respect of the PFI arrangements. There were also errors and omissions from the Private Finance and Initiatives note (note 38).</p>	<p>In my 2009/10 Annual Governance Report I agreed the following recommendation with the Council to be completed by December 2010:</p> <p><i>“Continue to work with Steria to obtain details of the lifecycle costs actually incurred to date, and continue to do so annually. Update the PFI model to account for the actual lifecycle additions.”</i></p> <p>The Council has only very recently obtained information on actual lifecycle costs incurred by the operator. It needs to assess whether they meet the recognition criteria of IAS 16 and update the model accordingly. I understand that this is in progress at 29 November 2011.</p> <p>In 2009/10, the Council provided a supporting document profiling the additions and contract changes to compare against the actual payments. The value anticipated for 2010/11 was £8,101,000 however the amount actually paid was £6,111,000, a difference of nearly £2 million. It is therefore not currently clear if the 2010/11 unitary payment includes the repayment of capital for lifecycle additions incurred in year.</p> <p>I will continue to progress these issues with officers and provide an update to the 14 December Audit Committee.</p>

Issue

6. Leases assessment and related issues

As noted earlier the Council reviewed its lease portfolio under IAS 17. As part of the assessment it considered whether the present value of the minimum lease payments represented substantially all of the fair value of the assets being leased at the inception of those leases.

The interest rate used by officers was the rental yield percentage of industrial property in Norwich at quarter 4 of 2010, 7.76 per cent. Given that the Bank of England base rate was above that level before November 1992 it is highly unlikely that this rate would have been available to lessees at the time. It is unlikely therefore to be an accurate reflection of the interest rates implicit in the lease agreements entered into before that period.

The Council has entered into leases in relation to assets at the Norwich Airport Industrial Estate. Many of these leases contain reversionary interests in the industrial buildings on the estate. The value of these buildings has not been included in the balance sheet to date. As a result investment property may be understated. The valuer last valued these assets in 2006 and does not currently consider that the buildings should be included due to 'the very significant length of time unexpired in respect of these ground leases'. However supporting information on leases suggests that some of these leases may have relatively short unexpired periods.

Findings and recommendations

The interest rate used in this calculation was incorrect and could have led to incorrect judgements as to whether older leases were finance or operating leases, although this is only one factor that is taken into consideration. Officers should consider revisiting the calculations for older leases during 2011/12 to ensure that lease classifications remain appropriate. The historic Bank of England base rates in force when each lease was taken out adding a suitable premium to reflect the increased risk of entering a lease agreement would be a better estimate.

The valuation of investment property is an accounting estimate and whilst I do not consider that any misstatement would be material I recommend that the next time these properties are revalued the valuer is specifically asked (on an asset by asset basis) to consider whether the reversionary interest in the building is significant. This will be the case where the buildings have residual lives that significantly exceed the lease term.

Recommendation

- R16** Urgently review the issues that contributed to a delay in the preparation of a set of certified financial statements and consider what changes need to be made to ensure the issue is not repeated in 2011/12. This should result in an Action Plan which should be monitored on a regular and timely basis to ensure the appropriate improvements are made. Appraise the Audit Committee of progress on a regular and timely basis.
- R17** Carry out an appropriate management review of the financial statements before the financial statements are presented for audit. This should include analytical review to detect areas of concern, arithmetical checks, internal consistency checks, cross referencing checks and checks to confirm that the disclosure requirements of the Code have been met.
- R18** Consider whether IFRS training should be extended within the finance function. Ensure that plans are in place to keep up to date with IFRS developments and emerging financial reporting issues.
- R19** Give refresher training to Council members and officers on related party interests.
- R20** Improve the working paper used to generate the related party transactions note. Ensure that all interests disclosed by Council members are included, carrying out a cross check to the members' register of interests and disclosures on the Council's intranet step. Include a rationale of why the disclosed interest does or does not constitute a related party under International Accounting Standard 24 (IAS24). Where interests should potentially be disclosed, provide a clear rationale as to whether separate disclosure in the related party transactions note is required. This must include consideration of materiality to both parties.
- R21** Update the group financial statements assessment annually ensuring any new relationships are captured. Ensure this is fully IFRS compliant.
- R22** Revisit the lease calculations for older leases during 2011/12 using the historic Bank of England base rates in force when each lease was taken out, plus a suitable premium.
- R23** When the valuer next values the Airport Industrial Estate ask that the reversionary interests in the buildings contained in the leases are considered on an asset by asset basis to establish if the reversionary interest in the building is significant. Details of the lease including expiry dates will need to be provided to the valuer.

Financial statements

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.

A standard letter of representation is included at Appendix 4. At 29 November I am still considering whether I will need this to be supplemented by any specific management representations. Should officers choose not to amend all the audit errors referred to at Appendix 2, and you concur with the approach, you will need to tell me why in the representation letter. I will provide an update at the 14 December Audit Committee meeting.

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Value for money

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 findings on each of the two areas is set out below.

Given the volume of outstanding work on the financial statements audit as referred to earlier in this report, I am not yet able to confirm the form of my value for money conclusion in respect of the Council's arrangements to secure financial resilience. This is because I need to consider the extent of the financial adjustments on the Council's useable reserves. Appendix 1 contains a copy of my draft report on the basis that it is unqualified, but members should be aware of the residual risks associated with this.

Value for money criteria and our findings

Criterion	Findings
<p>1. Financial resilience</p> <p>The organisation has proper arrangements in place to secure financial resilience.</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 a savings and efficiency plan in place. It is delivering efficiency targets and making budget reductions to ensure the Council's financial position is sufficiently robust. Whilst the focus is on longer term financial solutions rather than short term financial fixes, the Council has had to modify its approach due to the late announcement of reduced grant settlements which outstripped the Council's estimates. The Council has planned to fund £1 million of revenue expenditure from reserves in 2011/12, in addition to saving £0.85 million from not filling vacancies and deferring expenditure. Its budget setting paper acknowledged that these were temporary measures to help balance the budget and to prevent cuts to front line services. The approach is reasonable in the face of the government's transformational changes.</p>

Criterion	Findings
	<p>The focus is now on further development of a programme to reshape the council and achieve the four years savings programme. The Head of Finance carries out a base need and probability-rated risk assessment to suggest the minimum prudent level of reserves. This is a reasonable approach, but the impact of any risk materialising in any particular year may compromise the Council's reserves position. The use of reserves to their prudent level to avoid cost savings increases the risk that the Council may be less able to deal with an unexpected hit on its finances, a risk it has clearly acknowledged in its corporate risk register.</p> <p>The Council has a good record of achieving budget savings in recent years. It acknowledges that, in the current financial environment, these are going to become harder to achieve. However it is currently in an under spend position for 2011/12. A "star chamber" approach involves managers and members in understanding the demands on the Council budget and where savings are needed. It also ensures that the parameters used for planning (such as service growth and demographics) are coherent across the whole planning exercise. The Council completes scenario planning and financial modelling at the initial budget planning stage. Regular meetings are held to identify solutions to close the budget gap, although the current gap is close to £1 million. However, there are a number of target areas aimed to close the gap and deliver a balanced budget for 2012/13.</p> <p>The Council has a significant asset base which impacts financial planning. Additional management resource, expertise and training has been brought in to support the delivery of the Asset Management plan and to start to address the service development and improvement issues raised by Internal Audit in 2009. A draft Corporate Asset Management Strategy was presented to Cabinet in July 2011, and this is a welcome development. There are potentially some significant 'wins' to be made from a more focussed approach to asset management. This is necessary given an identified need for over £6 million of urgent repairs and refurbishments to be carried out.</p> <p>Financial governance arrangements are more mixed. There is certainly good evidence of clear leadership from the Cabinet and senior management team on prioritising resources and spending reductions, and they understand the challenges faced. Reports to Cabinet set out the financial challenges and risks, and these are taken into account in setting budgets and the future priorities and shape of the Council.</p>

Criterion	Findings
	<p>The Head of Finance was included in the leadership team during 2010/11. I consider this to be a positive step. The Council is keen to secure wider agreement to development of its longer term plans in the face of reduced government funding and has carried out good consultation here, both internally and externally.</p> <p>However, a strong internal control environment is a key to supporting the Council's financial planning and overall governance arrangements. As noted earlier in my report, I continue to find weaknesses in the design and application of controls, including the effectiveness of the Internal Audit function. I have determined that these weaknesses are not significant enough to detract from the strong arrangements the Council has put in place to ensure that cost savings are made and that long term financial planning is robust. However, the Council should recognise and address these underlying weaknesses. The Audit Committee has a significant role to play in monitoring the necessary improvements.</p> <p>A key element of the Council's medium and long term financial planning is the level of useable reserves it has at its disposal. As my work on the financial statements audit is not yet complete I have not yet been able to affirm that the audited general fund balance will not be adversely impacted by the audit adjustments. To the extent that it is, I will need to consider the planned level of general fund reserve and the agreed minimum level. Given this, I am not yet able to confirm the form of my value for money conclusion in respect of the Council's arrangements to secure financial resilience. I will provide an update to the Audit Committee at the 14 December meeting.</p>

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

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.

There is evidence of strong leadership from senior management and Members to ensure that resources are prioritised and there is a focus on spending reductions.

Strategic priorities and ongoing activities are effectively challenged using a variety of techniques. The Council understands its costs and how these relate to performance. The Council is prepared to investigate longer term options in order to secure reductions. This has resulted in areas of business process redesign and some sharing of services such as the NPlaw arrangement with the County Council.

The Council has consulted with staff and external stakeholders to inform these processes and the ultimate prioritisation of resources.

Arrangements to prevent the unintended impact of savings on activities or spending of other departments are in place. Business cases include an integrated impact assessment which considers the impact on other areas of the Council as well as other factors such as social and environmental factors. The transformation and efficiency programme also mitigates against unintended consequences of actions

The Council benchmarks its costs to inform its spending challenges, although this could be extended and made more visible across the Council. It works well to understand the resources that partners have. An example is the work it has done with the Homes and Communities Agency to facilitate capital developments. Further, it considers other organisations' good practice and learns from others.

Appendix 1 – Draft audit report

Independent auditor's report to the members of Norwich City Council

Opinion on the Authority accounting statements

I have audited the accounting statements of Norwich City 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 Norwich City 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 Head of Finance and auditor

As explained more fully in the Statement of the Head of Finance's Responsibilities, the Head of Finance 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 Practices 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 Norwich City 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, Norwich City 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 Norwich City Council in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.

Robert Murray

Officer of the Audit Commission

Audit Commission, 3rd Floor, Eastbrook, Shaftesbury Road, Cambridge, CB2 8BF

[Date]

Appendix 2 – Amendments to the draft financial statements

I identified the following material 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. At 29 November these misstatements are still being agreed with officers. I will provide an updated position at the 14 December Audit Committee.

Because of the need to restate opening balances some of the errors are in respect of the audited comparatives – where this is the case I have noted this in the table.

I have detected a further 23 misstatements that are not individually material. At 29 November my work on assessing the impact of these is continuing but their gross value is £12.8 million. Four of these adjustments will impact useable reserves with a net impact of £0.3 million on the general fund.

We have identified a further twelve adjustments that the Council detected after the financial statements were presented for audit on 28 July, although this position is being finalised with the Council at 29 November. The gross impact of these identified adjustments is £2.5 million and none are individually material. I anticipate that these adjustments will not impact useable reserves but will update the 14 December Audit Committee.

		Comprehensive income and expenditure statement		Balance sheet	
Adjusted misstatement	Nature of adjustment	Dr £000s	Cr £000s	Dr £000s	Cr £000s
Assets held for sale (short term)	1 April 2009 restated balance sheet	-		4,499	
Assets held for sale (long term)	Assets held for sale (Bussey Road and Livestock Market) as at 1 April 2009 are materially misclassified as non-current rather than current. Guidance indicates that the classification should be made on the basis of information at the time and not with the exercise of hindsight. As assets can only be classified as 'held for sale' if they are highly likely to be sold within one year they should normally be classified as current assets held for sale. Appendix B of IFRS 5 sets out the limited criteria under which an asset held for sale can be considered as a non-current asset held for sale. I do not consider these criteria are met.		-		4,499

		Comprehensive income and expenditure statement		Balance sheet	
Current assets held for sale	1 April 2009 restated balance sheet	-	-	22,050	
Investment property	Investment property was overstated as the Three Score development land did not meet the criteria of IAS 40 which states that investment property is held solely to earn rentals or for capital appreciation or both. I do not consider these criteria are met. The Council was trying to sell the land at 1 April 2009.				22,050
Property plant and equipment	2009/10 restated balance sheet	-	-	18,742	
Current assets held for sale	2009/10 adjustment to reflect the fact that the Land at Three Score is now part of the HCA agreement. Only £3.3 million continues to qualify as asset held for sale. The remainder represents surplus assets within property plant and equipment.				18,742
General fund share of non-distributed costs – debit £8,713k	2010/11 saw a £32 million past years service cost credit as part of the actuarial valuation adjustments under IAS 19. This is a result of a change in the way pensions are indexed (using the Consumer Price Index rather than the Retail Price Index).	-	-	-	-
Housing Revenue Account: share of other amounts included in the whole authority net cost of services, but not allocated to specific [HRA] services – credit £8,713k					

Movement in Reserves Statement –
HRA element – credit £8,713k
General fund element – debit
£8,713k

The Council initially allocated £8,713k of this to the HRA. Past service costs should only be allocated to the HRA where there is a 'reliable' basis of apportionment. I did not consider the apportionment method (using current staff split information) to be sufficiently reliable to allocate a past service cost. The Council's stated accounting policy is that past service costs are not allocated to the HRA.

This error impacts the face of the Housing Revenue Account and the Movement in Reserves Statement.

There is no impact on the Comprehensive Income and Expenditure Statement as this presents a consolidated position for the general and HRA funds.

There is also no impact on the HRA and general fund balances as IAS 19 adjustments are reversed out by the movement in reserves statement to avoid impact on council tax payers.

		Comprehensive income and expenditure statement		Balance sheet	
Finance lease debtor (1 April 2009 balance sheet)	1 April 2009 restated balance sheet. Would also impact on various categories in the 2010 and 2011 balance sheets (not shown here for simplicity) and the 2009/10 CIES (not shown here for simplicity). Reclassification of six of the Council's leases, as lessor, from operating to finance under IAS 17 following audit challenge regarding the Council's review of leases under IFRS. At 29 November we have yet to review the accounting adjustments proposed, I will update this position at the 14 December audit committee meeting..	-	-	[TBA]	-
Property Plant & Equipment (1 April 2009 balance sheet)		-	-	-	[TBA]
Capital Adjustment Account (1 April 2009 balance sheet)		-	-	[TBA]	-
Revaluation Reserve (1 April 2009 balance sheet)		-	-	[TBA]	-
Capital receipts deferred (1 April 2009 balance sheet)		-	-	-	[TBA]
General Fund (1 April 2009 balance sheet)		-	-	[TBA]	-
Operating lease income (2010/11 CIES)		[TBA]	-	-	-
Finance lease interest (2010/11 CIES)		-	[TBA]	-	-
There are additional disclosure implications in the financial statements.					
Taxation and non-specific grant income	2009/10 CIES has been similarly adjusted (not shown here for simplicity). Reclassification of various grants in the CIES following audit challenge (although Council had already identified inaccuracies in the 28 July financial statements which it was working through).	[TBA]		-	-
Gross income in various net cost of services lines			[TBA]		

The classification of grant income
has been revised under IFRS.

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Appendix 3 – Unadjusted misstatements to the financial statements

I await a further draft of the financial statements before I can check that all non-trivial misstatements have been corrected. I anticipate, based on the Council's approach in previous years, the financial statements will be amended for all the non-trivial misstatements we detect, although at 29 November I am still agreeing a number of the audit errors and uncertainties with officers. Given this I have not included any uncorrected misstatements here.

I will provide an update to the Audit Committee on 14 December.

		Comprehensive income and expenditure statement		Balance sheet	
Unadjusted misstatement	Nature of required adjustment	Dr £000s	Cr £000s	Dr £000s	Cr £000s

Appendix 4 – Draft letter of representation

To:

Robert Murray
Audit Commission
3rd Floor
Eastbrook
Shaftesbury Road
Cambridge, CB2 8BF

Norwich City Council - Audit for the year ended 31 March 2011

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other officers of Norwich City Council, the following representations given to you in connection with your audit of the Council's financial statements for the year ended 31 March 2011.

Compliance with the statutory authorities

I have fulfilled 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 which give a true and fair view of the financial position and financial performance of the Council, for the completeness of the information provided to you, and for making accurate representations to you.

Uncorrected misstatements [IF REQUIRED]

The effects of uncorrected financial statements misstatements summarised in the attached schedule are not material to the financial statements, either individually or in aggregate.

These misstatements have been discussed with those charged with governance within the Council and the reasons for not correcting these items are as follows;

[reason 1]

[reason 2] etc

Supporting records

All relevant information and access to persons within the entity has 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 financial statements.

Irregularities

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

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;
- 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; and
- the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

Law, regulations, contractual arrangements and codes of practice

I have disclosed to you all known instances of non-compliance, or suspected non-compliance with laws, regulations and codes of practice, whose effects should be considered when preparing financial statements.

Transactions and events have been carried out in accordance with law, regulation or other authority. 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.

All known actual or possible litigation and claims, whose effects should be considered when preparing the financial statements, have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

Accounting estimates including fair values

I confirm the reasonableness of the significant assumptions used in making the accounting estimates, including those measured at fair value.

Specific representations [IF REQUIRED]

[]

[] etc

Related party transactions

I confirm that I have disclosed the identity of Norwich City Council's related parties and all the related party relationships and transactions of which I am aware. I have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirement of the framework.

Subsequent events

All events subsequent to the date of the financial statements, which would require additional adjustment or disclosure in the financial statements, have been adjusted or disclosed.

Signed on behalf of Norwich City Council

I confirm that this letter has been discussed and agreed by the Audit Committee on [date].

Signed

Name

Position

Date []

Appendix 5 – Action Plan

Recommendations

Recommendation 1

Consider if there is one database or lease register that could be used to provide all of the lease information that the Council needs. If not then more robust links between the property databases and the information used by finance, including the fixed asset register should be developed.

Responsibility

Priority High

Date

Comments

Recommendation 2

Revise arrangements and processes so that service and legal departments understand and provide what the finance function need to ensure the financial statements are complete and accurate for lease arrangements. For example, a generic form could be completed by departments as part of the procurement process. Similarly where the Council is the lessor the asset management department could complete a log of all changed and new leases which they provide to finance on a regular basis. The Finance function should be provided with copies of sales agreements and any side agreements such as leasebacks as a matter of course.

Responsibility

Priority High

Date

Comments

Recommendation 3

Locate misplaced leases and ensure these are logged and secured in the Council's deeds safe.

Responsibility

Priority Medium

Date

Comments

Recommendation 4

Give early consideration to what valuation information is required from the district valuer and internal valuers, and ensure that instructions are comprehensive. Numbers of properties, including garages should be fully reconciled to ensure that valuations are accurate.

Responsibility

Priority High

Date

Comments

Recommendation 5

Update the close down process to include an annual assessment of the fair value of investment property even when there is no intention to formally revalue.

Responsibility

Priority Medium

Date

Comments

Recommendation 6

Review the adequacy of the current system for recording fixed assets against the accounting requirements driven by the Code of Practice. Consider investing in bespoke software.

Responsibility

Priority High

Date

Comments

Recommendation 7

Review the descriptions on the current fixed asset register and ensure that land is separated from other assets. Check that all depreciable assets have been identified and are being depreciated over their useful lives.

Responsibility

Priority Medium

Date

Comments

Recommendation 8

Fully reconcile the fixed asset register and general ledger and ensure that the financial statements reflect the reconciled position when preparing the 2011/12 financial statements.

Responsibility

Priority High

Date

Comments

Recommendation 9

Senior finance staff should ensure that a control account reconciliation review schedule is set and adhered to.

Responsibility

Priority

High

Date

Comments

Recommendation 10

Build appropriate time into the closedown plan to ensure that key annual reconciliations, such as that for the Collection Fund, are adequately prepared.

Responsibility

Priority

High

Date

Comments

Recommendation 11

Reinforce the need to ensure approval for new users is received before access to the Council's systems is given. Investigate the reasons for failing to disable system access for leavers and make necessary improvements to either the notification process or processing of notifications.

Responsibility

Priority

High

Date

Comments

Recommendation 12

Obtain improvements to the requirements for setting passwords and for blocking system access following repeated access fails from the service provider

Responsibility

Priority

Medium

Date

Comments

Recommendation 13

Introduce an end user computing policy and procedures to ensure that:

- any developed spreadsheet for financial reporting is risk assessed and formally authorised for use;
- end user developed spreadsheets/documents are stored on a network drive and backed up;
- spreadsheets/documents are secured with password control and located on a restricted network drive; and
- changes to spreadsheets/documents are documented and follow standard change control procedures at the Council.

Responsibility

Priority

Medium

Date

Comments

Recommendation 14

Complete the actions arising from my 2008/09 review of internal audit to ensure that the internal audit function is fit for purpose.

Responsibility

Priority High

Date

Comments

Recommendation 15

Consider the current backlog position on internal audit work and form a plan to address this.

Responsibility

Priority High

Date

Comments

Recommendation 16

Urgently review the issues that contributed to a delay in the preparation of a set of certified financial statements and consider what changes need to be made to ensure the issue is not repeated in 2011/12. This should result in an Action Plan which should be monitored on a regular and timely basis to ensure the appropriate improvements are made. Appraise the Audit Committee of progress on a regular and timely basis.

Responsibility

Priority High

Date

Comments

Recommendation 17

Carry out an appropriate management review of the financial statements before the financial statements are presented for audit. This should include analytical review to detect areas of concern, arithmetical checks, internal consistency checks, cross referencing checks and checks to confirm that the disclosure requirements of the Code have been met.

Responsibility

Priority High

Date

Comments

Recommendation 18

Consider whether IFRS training should be extended within the finance function. Ensure that plans are in place to keep up to date with IFRS developments and emerging financial reporting issues.

Responsibility

Priority High

Date

Comments

Recommendation 19

Give refresher training to Council members and officers on related party interests.

Responsibility

Priority High

Date

Comments

Recommendation 20

Improve the working paper used to generate the related party transactions note. Ensure that all interests disclosed by Council members are included, carrying out a cross check to the members' register of interests and disclosures on the Council's intranet step. Include a rationale of why the disclosed interest does or does not constitute a related party under International Accounting Standard 24 (IAS24). Where interests should potentially be disclosed, provide a clear rationale as to whether separate disclosure in the related party transactions note is required. This must include consideration of materiality to both parties.

Responsibility	
Priority	High
Date	
Comments	

Recommendation 21

Update the group financial statements assessment annually ensuring any new relationships are captured. Ensure this is fully IFRS compliant.

Responsibility	
Priority	Medium
Date	
Comments	

Recommendation 22

Revisit the lease calculations for older leases during 2011/12 using the historic Bank of England base rates in force when each lease was taken out, plus a suitable premium.

Responsibility

Priority

Medium

Date

Comments

Recommendation 23

When the valuer next values the Airport Industrial Estate ask that the reversionary interests in the buildings contained in the leases are considered on an asset by asset basis to establish if the reversionary interest in the building is significant. Details of the lease including expiry dates will need to be provided to the valuer.

Responsibility

Priority

Medium

Date

Comments

Appendix 6 – Glossary

Annual governance statement

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

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

