



Accountants &  
business advisers

**Hastings Borough Council**

**Annual Governance Report**

**2010/11**

September 2011

DRAFT

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### **Code of Audit Practice and Statement of Responsibilities of Auditors and Audited Bodies**

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission contains an explanation of the respective responsibilities of auditors and of the audited body. Reports and letters prepared by appointed auditors are addressed to members or officers. They are prepared for the sole use of the audited body and no responsibility is taken by auditors to any Member or officer in their individual capacity or to any third party.

# 1 Executive summary

- 1.1 This report sets out our findings from the audit of Hastings Borough Council (the Council'). Auditing standards and the Audit Commission's Code of Audit Practice require that we report to those responsible for financial governance and financial reporting (those charged with governance) the key findings of our audit of the accounts and use of resources prior to issuing our opinion on the financial statements and value for money conclusion.
- 1.2 A summary of our findings and conclusions is shown in the table below.

Area of audit	Findings and Conclusions
<b>Financial statements</b>	
<b>Financial statements</b>	<p>The Council has effectively managed the transition to financial reporting under International Financial Reporting Standards (IFRS) and correctly restated comparative figures in the financial statements.</p> <p>Management has made assumptions regarding the fair value of the Council's borrowings. We are satisfied such judgements are reasonable and follow the requirements of the CIPFA IFRS Code of Practice. We have sought management's representation on this matter.</p> <p>No material errors were identified as a result of our audit work. The Council amended the accounts for certain non-trivial errors identified by our audit. These amounted to £563,000 and arose because the Council had included debit amounts within Amounts Payable on the balance sheet. The errors were compensating and did not affect the level of the Council's balances or reserves. Other non-trivial but not material errors have been identified and these are detailed in Appendix C.</p> <p>We have also suggested a number of amendments to disclosures and aspects of the presentation of the financial statements. Most suggested amendments have been made though we are continuing to discuss emerging issues with management as our outstanding work is completed.</p> <p>Some areas of our work remain outstanding at the time of drafting this report. Should these result in any significant issues, we will provide an update to the Audit Committee at its meeting on 26 September.</p> <p>We are satisfied that the Statement of Accounts is not inconsistent with the financial statements that we have audited.</p> <p>Subject to satisfactory completion of our outstanding work, we anticipate issuing an unqualified 'true and fair' opinion on the financial statements.</p>
<b>Internal Control</b>	<p>We identified a small number of areas where deficiencies in internal controls should be improved or where the control environment could be strengthened. For example:</p> <ul style="list-style-type: none"> <li>• controls over the award of discounts to council taxpayers and subsequent verification that taxpayers remain entitled to such discounts should be strengthened and consistently applied</li> <li>• evidence of management authorisation of software upgrades operating the Council's payroll system should be retained for audit scrutiny.</li> </ul>
<b>Annual Governance Statement</b>	<p>We are satisfied that the Annual Governance Statement (AGS) is not inconsistent or misleading with other information we are aware of from our audit of the financial statements.</p>

Area of audit	Findings and Conclusions
<b>Use of Resources</b>	
<b>Value For Money conclusion</b>	<p>We are satisfied that, in all significant respects, the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2011.</p> <p>This is based upon the following two Audit Commission criteria:</p> <ul style="list-style-type: none"><li>• the organisation has proper arrangements in place for securing financial resilience</li><li>• the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.</li></ul> <p>We will be issuing an unqualified value for money conclusion.</p>

## 2 Introduction

- 2.1 This report summarises our findings from the audit of Hastings Borough Council (the Council) for the year ended 31 March 2011. Our report is presented to the Council in accordance with the provisions of International Standards in Auditing ISA (UK and Ireland) and known as ISAs. In particular, our report meets the requirements of ISA 260 *Communication with those charged with governance*, which requires us to report key findings from the audit to those charged with governance and ISA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*. Our report is also presented in accordance with the Audit Commission's *Code of Audit Practice*.
- 2.2 The above ISAs (ISA 260 and ISA 265) require that we report to those responsible for financial governance and financial reporting (those charged with governance) the key findings of our audit of the financial statements (the Council's accounting statements) and use of resources prior to issuing our opinion on the financial statements and value for money conclusion. At Hastings, those charged with governance are the Audit Committee.
- 2.3 The contents of this report have been discussed and agreed with the Deputy Chief Executive and Director of Corporate Resources and we have reported to management other non-significant findings from our audit. Recommendations in response to the key findings identified by our audit are provided in the action plan at appendix A. These recommendations have been discussed with appropriate officers and responses are included in the action plan where appropriate.
- 2.4 We would highlight that in this report we do not provide a comprehensive statement of all weaknesses that may exist in the financial and operational systems, but only those matters which have come to our attention as a result of the audit procedures performed. We have not restated weaknesses already reported by Internal Audit unless these are significant weaknesses.

### Fee outturn

- 2.5 The Audit Commission's *Standing Guidance for Auditors* requires us to report the outturn fee position for the year against the budgeted fee included within your Audit Plan. The table below sets out this analysis:

Audit plan 2010/11	Planned and Actual Fee £2
Financial statements	70,000
Value for Money conclusion	37,000
<b>Subtotal audit</b>	<b>107,000</b>
Audit of grant claims and other Government returns (estimate January 2011)	45,950
<b>Total (estimate)</b>	<b>£152,950</b>

- 2.6 A number of the grant claim and other returns we are required to audit are currently being reviewed or do not require certification until 30 November 2011. The fee therefore remains an estimate at this time.
- 2.7 Internal Audit is completing the detailed work involved in auditing the Housing and Council Tax Benefit subsidies grant claim. The fee for the audit of grant claims and other Government returns will therefore be reduced compared to the estimated amount previously reported to management. The final position will be reported in our grant claims report to be issued in December 2011.

## Independence

- 2.8 We confirm that we are not aware of any relationships that may bear on our independence and objectivity as auditors and that our independence declaration, included in our Audit Plan for 2010/11, has remained valid throughout the period of the audit
- 2.9 We would like to thank Council staff for their co-operation and assistance provided throughout the audit.

## 3 Financial statements

### Requirements

- 3.1 We are required to provide an opinion on whether your financial statements give a true and fair view of your financial position and income and expenditure and whether they have been prepared properly, in accordance with appropriate legislation and relevant accounting guidance.
- 3.2 We carry out procedures designed to obtain sufficient appropriate audit evidence to determine with reasonable confidence whether the financial statements are free from material misstatement and evaluate the overall presentation in order to ascertain whether they have been prepared in accordance with relevant legislation and accounting standards.
- 3.3 We identify the principal areas of risk of material misstatement from our knowledge of the Council, of the environment in which it operates and from discussions with management. We address these risks by carrying out appropriate audit procedures.
- 3.4 In carrying out our work we determine and apply a level of materiality. Consequently the audit cannot be relied upon to identify *all* risks or potential and actual misstatements. Materiality is the expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole, or specific individual elements of the financial statements as appropriate, such as the senior officer remuneration report.
- 3.5 We are also required to set a second level of materiality (known as “performance materiality”) which is to be used when planning and performing the audit. This has to be set at a level lower than the materiality for the financial statements as a whole so as to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.
- 3.6 We are required to report to you all uncorrected misstatements that relate to the current financial year (including those arising in previous periods that have an effect on the current year financial statements) and the effect that they have individually, or in aggregate, on the auditors’ report, except for those that are clearly trivial. For reporting purposes, we consider misstatements of less than £30,000 to be trivial to the financial statements, unless the misstatement is indicative of fraud. We will request that any non-trivial uncorrected misstatements be corrected.

### Reporting to those charged with governance

- 3.7 We report to you:
- our assessment of and response to **significant risks** in the financial statements
  - significant qualitative aspects of **accounting practices** including the application of the applicable **financial reporting framework**
  - significant difficulties that we **have** encountered during the course of the audit
  - significant matters discussed, or subject to correspondence with management or other employees
  - material **misstatements** that have been **corrected by management**
  - **uncorrected misstatements**
  - **written representations** that we are requesting from you which includes the final draft letter of representation to be agreed by management and those charged with governance
  - significant deficiencies in **accounting and internal control systems** identified during our work

- matters required to be reported by **other auditing standards**
- any **other audit matters of governance interest** relevant to the financial reporting process.
- expected modifications to the **audit report**

3.8 We have highlighted in the items above those areas where we have communicated issues arising from our audit. Our comments in these areas are set out in order below.

### ***Significant risks of material misstatement in the financial statements***

3.9 Auditing standards require that we bring to your attention areas that require additional or special audit consideration and are, therefore, considered a significant risk. These may include weaknesses in controls or areas requiring a higher degree of judgement by management.

3.10 We reported to you our risk assessment in the 2010/11 Audit Plan issued in December 2010. The significant audit risks identified during our risk assessment and communicated to you, along with our audit response to those risks, are set out below:

#### **Management override**

3.11 Management override refers to the ability of management to manipulate accounting records and prepare fraudulent financial statements by overriding what might appear to be effective internal controls. Management is in a unique position to perpetrate or conceal the effects of fraud through recording fictitious journal entries, inappropriately adjusting assumptions and changing judgments used to estimate account balances, engaging in complex transactions that are structured to misrepresent the financial position, and altering records and terms related to significant and unusual transactions. Therefore, we are required to consider management override of controls to be a significant risk in all audit engagements under auditing standards as discussed in our Audit Plan.

3.12 Our review of management journals and accounting estimates did not indicate any material management bias or override of controls in preparing the financial statements. We have reviewed material accounting estimates identified as having high estimation uncertainty or subject to a significant degree of judgement and further detail is provided in the section on Appropriateness of management accounting estimates below.

#### **Implementation of International Financial Reporting Standards (IFRS)**

3.13 The introduction of IFRS as the financial reporting framework for local authorities requires a review of material classes of transactions, balances and disclosures where the accounting treatment differs from that previously recognised under the UK GAAP based SORP. This requires restatement of the opening balances at 1 April 2009, restatement of the 2009/10 accounts and review of the correct accounting treatment of transactions in 2010/11.

3.14 The Council has put in place appropriate arrangements to adopt IFRS and to restate its previous UK GAAP based accounts. Our review confirmed that it has appropriately applied IFRSs in the production of its financial statements, including changes in accounting standards, new format of the financial statements, additional disclosure requirements and restated comparative information, although some amendments to the draft financial statements have been made as detailed in the section on Misstatements corrected by management below.

3.15 The key changes introduced by IFRS that are applicable to the Council, including the Council's response to these changes, are set out below.

**Leases under IFRIC 4 (lease type arrangements) and IAS 17 (leases)**

- 3.16 IAS 17 increases the qualitative criteria to be applied in assessing whether a lease is a finance lease or an operating lease and requires that land and buildings are considered separately for the purposes of the lease calculations. IFRIC 4 requires arrangements or a series of transactions that convey the right to use an asset to be reviewed to assess whether they meet the definition of a lease in IAS 17 (and subsequent inclusion as a finance lease or operating lease).
- 3.17 The Council has reviewed its leases and other contractual arrangements and recognised additional finance lease liabilities and corresponding property, plant and equipment with a carrying value of £520,000 as at 31 March 2011. Comparative amounts have been restated accordingly. In addition, as part of this exercise, the Council has re-considered whether any of its contractual arrangements meet the specific criteria for service concessions in IFRIC 12, which the Council was required to comply with from 2009/10. No new arrangements were identified by the Council which required the application of IFRIC 12 in the year.
- 3.18 Based on our work completed to date, we are satisfied that the Council has appropriately assessed whether its contractual arrangements contain the substance of a lease and property leases have been reviewed for separate leases of land and buildings.

**Investment properties under IAS 40**

- 3.19 IAS 40 requires that investment properties are now separately disclosed and measured at fair value, with valuation gains or losses identified in the Comprehensive Income and Expenditure Statement.
- 3.20 The Council has identified its investment properties and obtained appropriate valuations for inclusion in the financial statements. A valuation gain of £233,000 in the current year has been recognised in the Comprehensive Income and Expenditure Statement (and reversed out of the General Fund to the Capital Adjustment Account through the Movement in Reserves Statement as required under the Code). We are satisfied that the Council has appropriately classified and valued its investment properties at fair value.

**Component accounting for assets under IAS 16 (Property, plant and equipment)**

- 3.21 IAS 16 requires that depreciation is calculated based on significant components of property, plant and equipment, and that an estimate of the carrying value of the replaced components in additions for the year should be de-recognised in the accounts. The Council is required to apply this change prospectively from 1 April 2010.
- 3.22 The revaluations of the Council's land and buildings performed during 2010/11, which form part of the rolling programme of valuations, have been prepared on a component basis where appropriate. These will, in accordance with the Council's accounting policy, be subject to separate depreciation in 2011/12. We are satisfied the Council has appropriately componentised the assets revalued during the year.

**Impairments resulting from a clear consumption of economic benefits under IAS 36**

- 3.23 IAS 36 requires that all impairment losses, whether arising from general price falls or the economic consumption of assets, are taken initially to the revaluation reserve to the extent that any balance is available. Previously, the SORP required economic consumption impairment losses to be charged to expenditure even if there was a revaluation reserve balance available for that asset from previous revaluation gains.
- 3.24 The Council did not have any economic consumption impairment losses since formation of the revaluation reserve therefore no IFRS adjustment was required in this regard.

**Employee benefits under IAS 19**

- 3.25 IAS 19 requires that all employee benefits are accounted for as they are earned by the employee, which results in the recognition of employee accumulating compensated absences, such as untaken holiday pay, as an accrual in the financial statements.
- 3.26 The Council has accrued for short term accumulating compensated absences of £282,000 r as at 31 March 2011 and comparative amounts have been restated to include estimated accruals. We are satisfied that the Council has applied a reasonable approach for determining the value of untaken holiday pay and that the calculations and assumptions applied follow guidance issued by CIPFA.

**Government grants and other contributions under IPSAS 23**

- 3.27 Grants and contributions for revenue and capital purposes are now required to be recognised as income immediately, where grant conditions have been met or there is a reasonable assurance that grant conditions will be met, rather than being deferred and released to revenue to match expenditure or depreciation.
- 3.28 The Council has reviewed its grants income and balances previously held in a Government r grants deferred account' under rthe 2009 SORP and has reversed amounts that do not qualify for recognition as receipts in advance to the Capital Adjustment Account. The Council has now recognised all grants received in the Comprehensive Income and Expenditure Statement.
- 3.29 The Council has reversed capital grants recognised in the Comprehensive Income and Expenditure Statement from the General Fund to the Capital Adjustment Account where the grant has been spent, and to a capital grant unapplied reserve where the expenditure has not yet been incurred.
- 3.30 We are satisfied that management's judgements in respect of the recognition or deferral of grant receipts are not unreasonable and that the Council has correctly accounted for grant receipts.

**Group accounting requirements**

- 3.31 IFRS places greater emphasis on the ability to control rather than actual control in deciding whether entities should be included in group accounts of a parent entity. The Council has reviewed its interests in other entities and concluded that it does not have significant influence over any other organisation by way of power to participate in their financial and operating policies that would have a material impact on its financial statements. We are therefore satisfied that there is no requirement for group financial statements to be prepared.

**Operating segment disclosures under IFRS 8**

- 3.32 IFRS 8 introduces a requirement for inclusion of segmental reporting disclosures in the financial statements based on internal financial management budgets and the removal of certain Code adjustments, such as capital charges, based on subjective analysis.
- 3.33 The Council has disclosed operating segmental information in the form of principal departments based on the budget monitoring information regularly reported to the Council, the Cabinet and the Senior Management Team (the Council's rchief operating decision makers'). We are currently confirming the departmental income and expenditure analysis reconciles to the total cost of services in the Comprehensive Income and Expenditure Statement.

## ***Accounting practices and financial reporting framework***

- 3.34 The Council's 2010/11 financial statements have been prepared in accordance with the 2010 Code of Practice on Local Authority Accounting in the United Kingdom and have, in all material respects, correctly applied the relevant accounting policies.
- 3.35 The key change introduced by the Code of Practice was the introduction of an IFRS based set of financial statements, resulting in a number of significant changes to accounting practice. The impact of IFRS is commented on in detail in the preceding paragraphs.
- 3.36 The Council's financial statements closely follow the template for local authority financial statements prepared by CIPFA. However, we have noted some departures from the expected presentation of the financial statements or notes and other disclosures not presented in accordance with the Code. These are reported in the 'misstatements corrected by management' section at paragraph 3.46 below.

## **The financial statements preparation process**

- 3.37 The requirement for Members to approve the draft financial statements by 30 June was removed by the Accounts and Audit Regulations 2011. However the regulations did introduce the requirement for the Responsible Financial Officer to sign and present the financial statements for audit by 30 June 2011. Hastings' financial statements were certified and presented for audit on 28 June 2011. The Council performed well in producing draft accounts which comply with IFRS in almost all areas in advance the Government's deadline.
- 3.38 As part of our planning for the audit, we prepared a detailed document request which outlined the information that we would require to complete the audit. The Council provided us with files of comprehensive working papers on 6 July 2011, in line with the agreed timetable.

## **Appropriateness of management accounting estimates**

- 3.39 We review material accounting estimates identified as having high estimation uncertainty or which are subject to a significant degree of judgement by management, and assess the reasonableness of the assumptions applied by management when deciding whether to recognise amounts in the accounts or the value that these are recognised at.

## **Valuation of property, plant and equipment**

- 3.40 Land and buildings are required to be carried at fair value which is either existing use value, depreciated replacement cost for specialised properties or open market value. The Council revalues land and buildings where material changes in the value have occurred in the year or as a minimum every five years as part of a rolling programme. The Council does not adjust for price indices between formal valuations, which the Code accepts as accepted practice.
- 3.41 Valuations completed in 2010/11 have separately identified any significant components and plant by value and separate useful economic lives have been allocated to each component. Individual components, in accordance with the Council's accounting policy, will be subject to separate depreciation from 2011/12.
- 3.42 Valuation reports for land and buildings and useful economic lives are prepared by an independent valuer with specialist knowledge and experience valuing local authority estates, having regard to local prices and the public sector. Management accepts the valuation information provided by the expert and valuation adjustments are made to the financial statements where required.
- 3.43 We are satisfied the valour is suitably independent of the Council, objective and experienced in undertaking this work. Our review of the valuations provided, when compared to other price index information available, and useful economic lives allocated to buildings and significant components showed that they are not unreasonable.

**Recoverability of debtor balances**

- 3.44 The Council calculates the annual allowance for the impairment of debtors based on its assessment of recoverability. Management reviews all debts, and specific amounts considered irrecoverable are included in the annual impairment amount. Most categories of the Council's debtors are not subject to substantial fluctuation and management applies percentages to the aged profile of these debts, based on past experience and future expectations of recoverability, to estimate the allowance for doubtful debts.
- 3.45 We have reviewed the methodology applied by the Council in estimating the allowance for doubtful debts and we are satisfied it is reasonable.

**Misstatements corrected by management**

- 3.46 Our audit has not identified any material misstatements. Management has, however, made a number of corrections to the draft financial statements including disclosures and presentation, as shown below.

**Amendments made to the balance sheet****Trade Receivables understated by £563,000****Trade Payables understated by £563,000**

- 3.47 Our audit of amounts included within the Trade Receivables balance on the Council's balance sheet identified a number of credit balances which reduced the overall Trade Receivables amount by £563,000. On further enquiry, management agreed the amounts should be disclosed within the Trade Payables balance. The Trade Receivables balance and the Trade Payables balance were therefore increased by £563,000 for the following transactions:
- amounts payable in respect of government grants (total £173,167)
  - amounts payable for Housing Benefit (expenditure of £76,274 identified in a holding account pending payment on 1 April 2011)
  - rental income received in advance of the amount being invoiced by Hastings (£67,675)
  - non-Domestic Rates balance payable to Government (£245,204).

**Other disclosures**

- 3.48 We identified a small number of departures from the expected presentation of the financial statements or where notes and other disclosures had not been presented in accordance with the Code. The principal amendment made are:
- the value of capital commitments disclosed within the financial statements
  - further details about related party transactions, including the value of such transactions
  - removal of disclosures about Trading Operations which are no longer required
  - inclusion of an additional note supporting the cash flow statement to ensure compliance with the requirements of the Code and International Accounting Standard (IAS) 7
  - change in disclosure of the amount held in respect of accumulated absences as a creditor and not as a provision (as recorded in the draft financial statements)
  - Inclusion of a post balance sheet event note on the receipt of a concessionary fares claim from Stagecoach for £126,000 and the transfer of responsibilities to East Sussex County Council from 1 April 2011
  - amendments to the financial instruments note to more fully follow the IFRS Code.
- 3.49 We have discussed these with the Council and appropriate amendments have been made to the accounts.

## **Identified misstatements**

- 3.50 As part of our audit approach, all material balances were subject to audit testing and agreement, on a sample basis, to supporting documentation. To assist you in fulfilling your governance responsibilities, which include maintaining oversight of the financial reporting process and the system of internal control we have set out below the misstatements identified during our audit.

## **Uncorrected non-trivial misstatements**

- 3.51 We set out below, and at Appendix B where appropriate, all of the non-trivial misstatements which we noted during the course of our audit and which management do not intend to adjust. We will provide an update at the Audit Committee meeting should we identify any additional non-trivial misstatements in completing our outstanding work.
- 3.52 We will obtain written representation from the Audit Committee of the reasons for not making the adjustments set out below and included at Appendix C.

## **Cash and Cash Equivalents and Trade Receivables**

### **Cash and cash equivalents understated £ 17,000 Trade Receivables overstated by £ 17,000**

- 3.53 Audit of entries within the Trade Receivable line of the financial statements has identified a balance of £217,000 being due to the Council. The transaction relates to a combination of cash collected on the Council's behalf by an external contractor and cheques currently being processed by the Council's bank, these having been collected and forwarded to them by the cash collection company. The contract states cash receipts should be transferred into the Council's bank account within five working days of collection, and cheques forwarded to the Council's bank for deposit on the day after collection. The balance at year end therefore involves both the cheques still being processed and cash collected in the five working days leading up to 31 March 2011.
- 3.54 The IFRS Code of Practice expects local authorities to identify cash and cash equivalent amounts. By way of example, an investment made for a period of less than three months is now considered to be a cash equivalent amount. The IFRS Code does not state the basis of accounting for cash held on the Council's behalf by external contractors though IAS 7 (*Statement of Cash Flows*) does state that cash comprises cash on hand and demand deposits. A more appropriate disclosure of such transactions would appear to be disclosure as part of the cash and cash equivalents amount in the Balance Sheet.

## **Classification of Trade Payables – note 16 opening balance**

### **Central Government Trade Payables understated £200,000 Public Corporation Trade Payables overstated £200,000**

- 3.55 An error made in posting a journal means the central government trade payables balance in the 2009/10 accounts is understated by £200,000 and the public corporation trade payables balance is overstated by £200,000. The error affects the classification of trade payables balance as at 31 March 2010 (creditors opening balance) disclosed at note 16 and does not affect the balance sheet.

## **Other misstatements**

### **Euro currency bank account - £14,000**

- 3.56 It is standard practice (wherever possible) for external auditors to seek external confirmation of significant balances held by third parties. Typically this relates to bank balances, short term investments and external loan values. The third party confirmation received from the Co-operative bank included several balances, the majority of which agreed to the bank reconciliations performed by Hastings. However, the confirmation also included a Euro

currency account which management confirmed had not been included in the financial statements.

- 3.57 The account is used to receive Euro currency amounts, prior to the transfer to the Council's principal bank account, at which point it is exchanged into sterling and included within the accounts. While the balance on the account at year end is trivial, with only a small number of transactions during the year, the balance on the account should be included in the financial statements.

### ***Written representations***

- 3.58 We are required by ISAs to obtain written confirmation from you of certain representations that have been made during the course of our audit. The draft letter of representation has been attached as Appendix C. We do not anticipate any changes being required before providing our opinion on the financial statements.

### ***Accounting and internal control systems***

- 3.59 We have reviewed the Council's key financial and operational systems which contribute to the preparation of materially accurate financial statements. The purpose of the audit is for us to express an opinion on the financial statements. Our audit is not designed to identify all deficiencies in the system of internal control or to identify all improvements which might be necessary to address the deficiencies identified.

- 3.60 The audit included consideration of internal controls relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and we report only those deficiencies that have come to our attention as a result of our audit work and that we have concluded are of sufficient importance to merit your attention.

- 3.61 The financial systems we have considered are:

- Main accounting
- Cash and bank
- Payments and creditors
- Other income and debtors
- Payroll and employment costs
- Council tax
- Housing and council tax benefits
- National Non Domestic Rates
- Investments and investment income
- Information technology

- 3.62 Where possible, we sought to use the work of Internal Audit and thereby avoid unnecessary duplication of audit effort. Internal Audit has satisfactorily carried out a comprehensive programme of work and we were able to place reliance on their work for the testing of the effectiveness of specific controls.

- 3.63 We noted some areas where deficiencies in internal controls should be improved or where the control environment could be strengthened. We have restated deficiencies in internal controls previously reported by Internal Audit where we consider these to be significant.

### ***Single Person Discount awarded to council taxpayers***

- 3.64 Our audit of the Council's material financial systems included a review of arrangements for awarding and confirming on-going entitlement to single person discount (SPD) of council tax. The Council's financial operating procedures expect such discount to be awarded only when an application is received. On-going entitlement is assessed through the data-matching information provided to Hastings through the Audit Commission's national fraud initiative (NFI), where entitlement is checked to data from the electoral roll.

- 3.65 Audit testing of the on-going entitlement to SPD identified three instances from a total sample of 40 cases where the claimant should not have maintained entitlement to discount. The situation arose because relevant data was not available through the Government's NFI

at the time. The Council should explore the possibility of introducing further procedures to confirm continuing eligibility for SPD.

#### **Payroll standing data – software upgrades**

- 3.66 The Council's financial operating procedures require evidence of amendments to the payroll system standing data (for instance software upgrades or patches) to be authorised by management and evidence retained for audit scrutiny. While the results of our detailed review of payroll transactions confirmed such upgrades had been effected correctly, the Council had not retained evidence the software upgrades had been authorised by management.

### ***Other auditing standards***

#### **Risks of material misstatement due to fraud (ISA 240)**

- 3.67 The primary responsibility for ensuring your internal control frameworks are sufficient to prevent and detect material fraud and corrupt practices lies with management and those charged with governance.
- 3.68 We have a responsibility to give specific consideration to the potential risk of material misstatement of your financial statements due to fraud and error, including the risk of fraudulent financial reporting. In order to identify risks of material misstatement due to fraud, and the controls you have put in place to mitigate those risks, we have:
- discussed your anti fraud and corruption arrangements with officers and those charged with governance
  - considered the extent to which the work of Internal Audit is designed to detect material misstatements in the accounts arising through fraud
  - made enquiries regarding any instances of actual fraud you wish to bring to our attention.
- 3.69 Management confirmed there are no known or reported material frauds or corruption experienced by the Council during the year ended 31 March 2011 and we did not identify any significant fraud risks that affected our audit programme. There are no other matters arising from our work that we are required by other auditing standards to bring to the attention of those charged with governance.

### ***Other matters of governance interest***

#### **Fair Value of loan payable to PWLB (note 25)**

- 3.70 The Council has one loan outstanding with the Public Works Loan Board (PWLB). As at 31 March 2011 the PWLB confirmed the amount of loan outstanding was £9.5 million and that the 'fair value' of the loan (that is the amount at which the asset could be bought or sold in a current transaction between willing parties) amounted to £10.2 million.
- 3.71 PWLB loans are carried in the Balance Sheet at amortised cost and the fair value of loans is required to be disclosed in a Balance Sheet note. This requires a calculation of the net present value of the cash flows that are scheduled to take place over the remaining life of the loan. For fixed rate loans (as provided to the Council by the PWLB) the fair value will be different from the amortised cost if the fixed rate is different from prevailing interest rates. The position arises because a fixed rate will often mean paying more or less interest when compared to a variable rate. The fair value therefore measures the net present value of the notional interest gain or loss.
- 3.72 The IFRS Code provides two options for the comparator PWLB interest rate available: the rate available for new borrowing or the early repayment rate. The Council has determined the fair value of the loan should be the rate available for new borrowing rather than the early repayment rate. In calculating the fair value amount, the Council has followed advice

provided by its financial consultants. The consultants calculated the fair value of the loan at £9.079 million and the amount is disclosed at note 25. Management has provided its representation over the fair value approach taken.

### **Annual governance statement**

- 3.73 The Council has a responsibility to publish an Annual Governance Statement, including the outcome of a review of its effectiveness, with its 2010/11 financial statements.
- 3.74 We have reviewed the Annual Governance Statement and the supporting review of effectiveness that has been undertaken and we are satisfied that the Statement is not inconsistent with the evidence provided in the review of effectiveness and our knowledge of the Council.

### **Audit report**

- 3.75 Subject to satisfactory resolution of the outstanding issues and final clearance of the audit, we anticipate issuing an unqualified audit opinion on the accounts. We will provide a verbal update on these outstanding issues at the Audit Committee.

## 4 Use of Resources

- 4.1 We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the Council's use of resources (value for money, or "VFM").
- 4.2 In accordance with our Audit Plan, our principal work in arriving at our value for money conclusion was comparing the Council's performance against characteristics specified by the Audit Commission in its guidance to auditors. The focus of our work in 2010/11 involved reviewing the financial resilience of the organisation and its arrangements for securing economy, efficiency and effectiveness in the use of resources.
- 4.3 Our financial resilience work considered the Council's arrangements for financial governance, financial planning and financial control. Our review of economy, efficiency and effectiveness considered the Council's arrangements for prioritising resources and improving efficiency and productivity.
- 4.4 The key issues arising from our work are summarised below.

### ***Financial resilience***

- 4.5 The Council has continued to involve stakeholders in developing its financial plans, with strong leadership shown on financial matters by both the Cabinet and the Senior Management Team. The annual budget preparation and medium term financial planning processes consistently reflect Hastings priority areas for service improvement and delivery.
- 4.6 The Council has continued to manage its resources effectively throughout the year, with net expenditure on services amounting to £2 million less than the revised budget amount. The majority of the underspend (£1.7 million) arose because of reduced spending on projects resourced from the Government's Area Based Grant. Based on its financial performance and financial strategies, the Council decided to increase the level of the general reserve by £500,000 to £1.7 million as at 31 March 2011, further strengthening the overall financial position.
- 4.7 The Council has taken action to refresh its priorities and identify the scope for spending reductions following the Government's Comprehensive Spending Review and the 2011 to 2013 financial settlement. The 2011/12 budget is balanced although it requires the Council to secure efficiency savings of about £1.9 million by 31 March 2012. The Council supported the development of its efficiency plans through the detailed service and financial planning review completed as part of its Priorities, Income and Efficiencies Review (PIER) methodology. When combined with the two year transitional funding the Council has secured, the efficiency programme is enabling the Council to shift resources based on its priorities.

### ***Challenging economy, efficiency and effectiveness***

- 4.8 Our previous use of resources work concluded the Council has an effective programme of value for money service reviews (the PIER process), which aims to review costs and identify improvement required in service performance. The process continues to underpin the integrated service and financial planning approach. The Council understands the impact of its expenditure plans on future service performance, with achievement monitored in regular reports to the Council's Executive and Scrutiny Committee's.
- 4.9 The 2011/12 PIER process prioritised the financial challenges facing the Council and the outcome of the Council's 'Big Conversation' with stakeholders for action. The Council's detailed response has considered various options for the future delivery and investment in services, informed by comprehensive cost analyses and benchmarking. It has resulted in some significant changes to the provision of services across Hastings, including shared services with another District Council, commencing a transformation process in respect of

the customer contact centre, changes to accommodation and the development of 'smarter' working arrangements.

***Audit report (value for money conclusion)***

- 4.10 Our value for money conclusion is based on considering our overall risk assessment, focusing on the two criteria set by the Audit Commission, and the results of risk based audit work, as well as consideration of the processes underpinning your review of the effectiveness of your controls as described in your Annual Governance Statement.
- 4.11 We are satisfied that, in all significant respects, the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2011. We will be issuing an unqualified value for money conclusion.

## Appendix A: Action Plan

Conclusions from work	Recommendations	Priority	Management response	Responsibility	Timing
<b>Financial Systems</b>					
<p><b>Standing Payroll data</b></p> <p>The Council's financial operating r procedures require evidence of amendments to the payroll system standing data (for instance software upgrades or patches) to be authorised by management and evidence retained for audit scrutiny. While the results of our detailed review of payroll transactions confirmed such upgrades had been effected correctly, the Council had not retained evidence the software upgrades had been authorised by management.</p>	<p>Ensure evidence of management review of software upgrades is retained for audit scrutiny in accordance with financial operating procedures.</p>	Medium	Agreed	Management Information Officer	Immediate
<b>Financial statements</b>					
<p><b>Euro bank account - £14,0002</b></p> <p>The third party confirmation received from the Co-operative bank included a Euro currency account which had not been included in the financial statements. The account is used to receive Euro currency amounts, prior to the transfer to the Councils principal bank account. The balance at year end amounted to £14,000 and is trivial. ,</p>	<p>The Council should ensure when preparing the accounts that all bank accounts are included in the financial statements.</p>	High	Agreed	Chief Accountant	For Closedown of Accounts

## Appendix B: Uncorrected misstatements

The table below details the potential differences recorded during the audit that have not been adjusted for within the financial statements:

Uncorrected misstatements	Income Over/ (Under) £2	Expenses (Over)/ Under £2 0	Assets (Over)/ Under £2	Liabilities Over/ (Under) £2	Reserves Over/ (Under) £2
<b>Factual misstatements</b> None					
<b>Judgemental misstatements</b> Re classification of amounts as Cash and Cash Equivalents from Trade Receivables			216 (216)		
<b>Projected misstatements (extrapolation of errors)</b> None					
<b>Total net misstatements</b>	-	-			
- Net understatement of costs					
- Net overstatement of net assets			-	-	-

## Appendix C: Draft letter of representation

PKF (UK) LLP  
Farringdon Place  
20 Farringdon Road  
London  
EC1M 3AP

28 September 2011

Dear Sirs

### Financial statements of Hastings Borough Council for the year ended 31 March 2011

This representation letter is provided in connection with your audit of the financial statements of Hastings Borough Council for the year ended 31 March 2011 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view, have been properly prepared in accordance with the relevant financial reporting framework and have been prepared in accordance with the requirements of applicable law.

I confirm to the best of my knowledge and belief, and having made appropriate enquiries of directors and management of the Council, the following representations given to you in connection with your audit of the Council's financial statements:

#### FINANCIAL STATEMENTS

##### Responsibility for the financial statements

I acknowledge as the Deputy Chief Executive and Director of Corporate Resources and s151 Officer my responsibilities for the financial statements and for ensuring that these are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom.

##### Accounting policies

I confirm that the selection and application of the accounting policies used in the preparation of the financial statements are appropriate.

##### Significant assumptions

###### Pension fund assumptions

I confirm that the actuarial assumptions underlying the valuation of the Local Government Pension Scheme (LGPS) scheme liabilities, as applied by the scheme actuary, are reasonable and consistent with my knowledge of the business. These assumptions include:

- |  |       |
|--|-------|
| • Rate of inflation  | 2.8%  |
| • Rate of increase in salaries                                       | 5.1%  |
| • Rate of increase in pensions                                       | 2.8%  |
| • Rate for discounting scheme liabilities                            | 5.5%  |
| • Take up option to convert the annual pension into retirement grant | 50.0% |

I also confirm that the actuary has applied up-to-date mortality tables for life expectancy of scheme members in calculating scheme liabilities.

##### Loans and Borrowings

I confirm that the significant assumptions used in making accounting estimates, including those measured at fair value, are reasonable. Specifically, the judgements in assessing the fair value of the outstanding loans to the Public Works Loans Board (PWLB) are reasonable and in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom. The

Council has determined the fair value of the loan on the basis of the rate available for new borrowing and not the early repayment rate.

#### **Plans or intentions**

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

#### **Litigation and claims**

I am not aware of any pending claims, proceedings or litigation involving the Council.

#### **Related parties**

I confirm that related party relationships and transactions have been appropriately accounted for and disclosed in the financial statements in accordance with the requirements of the applicable financial reporting framework.

#### **Subsequent events**

There have been no events since the balance sheet date which necessitate revision of the figures included in the financial statements or inclusion of a note thereto. Should any material events occur, which may necessitate revision of the figures included in the financial statements or inclusion of a note thereto, I will advise you accordingly.

#### **Uncorrected misstatements**

You have brought to my attention uncorrected misstatements in the financial statements as listed in Appendix 1 to this letter. I do not wish to correct these misstatements as I consider them to be immaterial to the view given by the financial statements.

#### **Going concern**

I confirm that I am satisfied that it is appropriate for the financial statements to have been drawn up on the going concern basis. In reaching this conclusion I have taken into account all relevant matters of which I am aware, including the availability of working capital, levels of announced and forecast Government funding, constraints and ability to raise council taxes, assumption that the functions of the Council will continue in operational existence for the foreseeable future; and have considered a future period of at least one year from the date on which the financial statements will be approved.

### **INFORMATION PROVIDED**

#### **Completeness of information**

The Council has provided you with access to all information of which I am aware is relevant to the financial statements. The Council has provided you with all other information that you have requested from us and given you unrestricted access to persons within the Council from whom you determined it necessary to obtain audit evidence. All other records and related information, including minutes of all management and committee meetings (held during the year and up to the date of this letter) have been made available to you.

All transactions undertaken by the Council have been recorded in the accounting records and are reflected in the financial statements.

So far as I am aware, there is no information needed by you in connection with preparing your audit report (relevant audit information) of which you are unaware. I have taken all the steps that I ought to have taken in order to make myself aware of any relevant audit information and to establish that you are aware of that information.

#### **Internal control**

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

There have been no deficiencies in internal control other than that reported by Internal Audit or brought to my attention in the auditors' Annual Governance Reports, of which I am aware.

#### **Fraud**

I have disclosed to you the results of my assessment of the risk that the financial statements could be materially misstated as a result of fraud.

I have disclosed to you my knowledge of fraud or suspected fraud affecting the Council and of any allegations of fraud or suspected fraud affecting the financial statements communicated to me by employees, former employees, councillors, regulators or others.

#### **Compliance with laws and regulations**

I am not aware of any actual or possible instances of non-compliance with laws or regulations whose effects should be considered when preparing financial statements of the Council.

#### **Related parties**

I confirm that I have disclosed to you the identity of all the Council's related parties, related party relationships and transactions of which I am aware.

#### **Liabilities, contingent liabilities and guarantees**

There are no liabilities, contingent liabilities or guarantees to third parties other than those disclosed in the financial statements.

#### **Title to assets**

The Council has satisfactory title to all assets and there are no liens or encumbrances on the assets except for those disclosed in the financial statements.

#### **Contractual agreements**

The Council has complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance.

Yours faithfully

**Neil Dart**

Deputy Chief Executive and Director of Corporate Resources

***Representations of the Council***

We confirm to the best of our knowledge and belief, and having made appropriate enquiries of other officers and members of the Council, the following representations given to you in connection with your audit of the Council's financial statements.

**Responsibility for the financial statements**

We acknowledge our responsibilities to make arrangements for the proper administration of the Council's financial affairs and to approve the financial statements. The Director of Corporate Resources is responsible for the preparation of the financial statements in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom.

**Uncorrected misstatements**

We have considered the uncorrected misstatements in the financial statements as listed in Appendix 1 to this letter together with the explanations provided by the Deputy Chief Executive and Director of Corporate Resources for not correcting these misstatements, and we consider them to be immaterial to the view given by the financial statements.

**Annual Governance Statement**

We confirm that the Council has conducted a review during the year of the effectiveness of its system of internal control. We are satisfied that the Annual Governance Statement appropriately reflects the circumstances of the Council and includes an outline of the actions taken, or proposed, to deal with significant internal control issues.

Yours faithfully

**Councillor Matthew J Lock**  
Audit Committee Chair

Signed on behalf of the Council

**Note: Appendix 1 referred to in this letter relates to Appendix B in this report**

## Appendix D: Draft independent auditors report

### Independent auditor s report to the Members of Hastings Borough Council

#### *Opinion on the Council's accounting statements*

We have audited the accounting statements of Hastings Borough 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 and Collection Fund* and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 (based on International Financial Reporting Standards).

This report is made solely to the members of Hastings Borough 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. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Council and the Council's members as a body, for our audit work, for this report, or for the opinions r we have formed.

#### **Respective responsibilities of the Deputy Chief Executive and Director of Corporate Resources and auditor**

As explained more fully in the Statement of Responsibilities for the Statement of Accounts, the Deputy Chief Executive and Director of Corporate Resources is responsible for the preparation of the Council's Statement of Accounts, that include the accounting statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practice's Board's Ethical Standards for Auditors.

#### **Scope of the audit of the accounting 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 Council's circumstances and have been consistently applied r and adequately disclosed; the reasonableness of significant accounting estimates made by the Deputy Chief Executive and Director of Corporate Resources; and the overall presentation of the accounting statements. In addition, we read all the financial and non-financial information in the explanatory foreword to identify material inconsistencies with the audited accounting statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

#### **Opinion on accounting statements**

In our opinion the accounting statements:

- give a true and fair view of the state of Hastings Borough Council's affairsras at 31 March 2011 and of its income and expenditure for the year then ended; and
- have been properly prepared in accordance with applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2010/11.

#### **Opinion on other matter**

In our 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 we are required to report by exception**

We have nothing to report in respect of the governance statement on which we report to you if, in our 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 the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources***

We are required under Section 5 of the Audit Commission Act 1998 to satisfy ourselves that the Council 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 us to report to you our conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

**Respective responsibilities of the Council and auditor**

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

Our responsibility requires us to review and, where appropriate, examine evidence that is relevant to the Council's corporate performance and financial management arrangements. It therefore excludes arrangements relating specifically to the delivery of front-line services, unless we have identified a significant risk with implications for corporate arrangements.

We report if significant matters have come to our attention which prevent us from concluding that the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

**Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources**

We have undertaken our 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 Council 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 us to consider under the Code of Audit Practice in satisfying ourselves whether the Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2011.

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

**Conclusion**

On the basis of our work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2010, we are satisfied that, in all significant respects, Hastings Borough 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***

We certify that we have completed the audit of the accounts of Hastings Borough Council in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.

**Robert Grant**

for and on behalf of PKF (UK) LLP

London, UK

30 September 2011