

Annual governance report

Gosport Borough Council

Audit 2010/11



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Key messages

This report summarises the findings from the 2010/11 audit which is 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	
Significant weaknesses in internal control	
Proper arrangements to secure value for money	

Audit opinion and financial statements

The Council dealt successfully with the challenges posed by the implementation of International Financial Reporting Standards (IFRS) in 2010/11. Re-stating the accounts to comply with the requirements of IFRS is a complex task, which has caused significant difficulties for a number of local government bodies. Despite concerns over capacity to deal with IFRS reported in my opinion plan, my review has confirmed that your financial statements were prepared satisfactorily and supported by good quality working papers. A number of amendments are required to meet the more onerous IFRS disclosure requirements and adjust for expenditure which has recently been identified as fraudulent. These are set out in Appendix 2.

I have identified a small number of qualitative aspects of your financial reporting that I wish to draw to your attention. These are detailed on page 18 of this report. Key is the arrangements supporting the disclosure of lease rentals in the accounts. Poor internal controls over the review of leases could mean that values disclosed in the accounts are understated. Further audit work has confirmed the understatement to be in the region of £215,000 which is not material.

I plan to issue an unqualified opinion on the financial statements by the statutory deadline of 30 September 2011.

Weaknesses in internal control

I noted significant internal control weaknesses in your general IT controls and some weaknesses in the new COA e-financials accounts payable and debtors systems. Management have confirmed that they have already begun to strengthen internal controls and have also agreed to strengthen their responses to my IT action plan. I have raised recommendations for improvement in the detail of this report.

During the year the Council suffered an internal fraud identified in July 2011 which is currently under investigation. Management are pursuing an insurance claim and anticipate no loss to the Council.

Value for money

I intend to issue an unqualified value for money conclusion stating that the Council has proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

The Council has reviewed its corporate priorities and identified new strategies to help it manage its financial position in the medium term. Officers and political leaders have taken tough decisions and acted promptly to address the financial challenges faced by the Council which is on course to deliver its savings plans.

The Council takes a strategic approach to prioritisation of resources and achievement of cost reductions through improved efficiency and productivity. It has made good progress in delivering its savings plans through staff reductions and a major contract procurement exercise. The Council acknowledges that it has low levels of reserves, but has plans to address this over the medium term. This means it has less flexibility than councils with larger reserves to manage the financial challenges it faces in the current economic climate.

The Council also needs to move its low housing rents closer to the government's notional rent levels over the period to 2016/17. Its new Housing Revenue Account (HRA) business planning model aims to help it do this.

The Council has an ambitious capital programme of over £38 million over the period to 2014/15. Capital receipts, maturing investments and borrowing will be required to fund it over the medium term. There was significant slippage in the 2010/11 capital programme, the key factor being delays to the new landing stage project. Robust management will be required to ensure capital projects are delivered on time to minimise the impact on revenue and ensure effective use of cash resources.

Maintaining robust governance arrangements as financial resources and staff numbers reduce significantly is very important. Whilst good progress is being made against plans strong governance, risk management and financial management arrangements are required going forward. The Council is introducing new performance management and risk management arrangements in 2011/12 to strengthen existing financial management arrangements. As staff numbers reduce members and officers should ensure they continue to receive regular and timely monitoring information to facilitate effective scrutiny and challenge of the Council's operational and financial performance.

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.

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

I ask you to confirm to me

I ask the Standards and Governance Committee to:

- take note of the adjustments to the financial statements which are set out in this report (Appendix 2);
 - note there are no errors in the financial statements which management has declined to amend (Appendix 3);
 - 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 6).
-

I ask you to note the additional audit fee

I ask the Standards and Governance Committee to:

- note that additional audit fees (estimated at £7,000) will be required as additional audit work has been required to provide audit assurance over the completeness of expenditure in the accounts given the internal fraud; and
 - respond to questions received from two members of the public.
-

Financial statements

Subject to satisfactory completion of the remainder of my audit work, I plan to issue an unqualified opinion on the financial statements.

Opinion on the financial statements

My work on the financial statements is now complete. I plan to issue an unqualified audit opinion on the 30 September 2011, the statutory deadline. Appendix 1 contains a copy of my audit report.

Implementation of International Financial Reporting Standards (IFRS)

This is the first year the Council has been required to prepare financial statements under IFRS. Preparing IFRS accounts has involved a significant amount of work for the Council's finance team, including

- review of transactions to identify the appropriate accounting treatment under the new framework;
- restatement and reformatting of all the prime statements;
- restatement of the comparatives for both 1 April 2009 and 31 March 2010; and
- production of a number of new disclosure notes.

Re-stating the accounts to comply with the requirements of IFRS is a complex task, which has caused significant difficulties for many local government bodies. Both the level of disclosure and size of financial statements have increased significantly because of the introduction of IFRS. For example, your accounts have increased by approximately 25 per cent in length compared to the previous period. Given our previous concerns over capacity within the finance department, you have performed well in producing financial statements which comply with the requirements of IFRS in accordance with your planned timetable.

Errors in the financial statements

I detected a number of errors during the course of the audit that I am required to draw to your attention. Under international auditing standards I am required to report all non-trivial errors to those charged with governance irrespective of whether the Council has adjusted the financial statements or not.

My audit of the Council's accounts seeks to ensure the accounts are materially correct and present a true and fair view of the financial transactions of the Council in 2010/11. Materiality is defined in the glossary of this report. I set the threshold of materiality for the audit at £1,485,000. I also set, under International Standards on Auditing, a threshold below which I judge any errors to be 'trivial' and do not seek any amendments to the accounts. The

trivial threshold for my audit was set at £14,000. Any errors in excess of £14,000 are classes as non trivial errors and are reported to those charged with governance irrespective of whether the Council has adjusted the financial statements or not.

My audit identified some errors and internal inconsistencies in the disclosure of figures in the accounts. I also recommended a number of presentational changes. Management agreed to adjust the financial statements for all of the amendments I recommended. All non-trivial amendments (over £14,000) are in appendix 2 for information.

Management also identified an internal fraud which impacted on reported expenditure in 2010/11 and 2011/12 and this has been promptly and properly dealt with. Whilst the value of fraudulent transactions was not in itself material in each year, the value was non trivial and requires reporting in this report. Correction of the fraudulent expenditure also impacts on the Council's reported results. Management has agreed to amend the financial statements. The correction required is summarised in Appendix 2. The Council are pursuing full recovery.

Currently there are no unadjusted errors.

The Council's accounts were supported by a comprehensive electronic file of working papers, which provided a good audit trail for testing. The accounts were produced and signed by the S151 officer before the 30 June 2011 deadline and presented for audit on 1 July 2011. This was a good achievement given implementation of IFRS in 2010/11.

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. These are detailed below.

Key audit risk and our findings

Key audit risk	Finding
<p>Implementation of IFRS</p> <p>All councils were required to produce their 2010/11 financial statements under International Financial Reporting Standards (IFRS). The new standards required restatement of both opening and closing balances from the previous year as well as additional disclosures. Due to the complexity of the changes involved I considered this to be a significant risk area. Councils which were not well prepared for the new requirements would not succeed in preparing the necessary information in time.</p> <p>As this was a major change in accounting, I tested whether your financial statements comply in all material respects with the requirements of IFRS.</p>	<p>I monitored the Council's IFRS implementation throughout 2010/11. Progress against the Council's implementation plans was assessed as "red- not on track" in January 2011. The key reasons for this assessment were the slippage in the IFRS implementation plans and concerns over staff capacity within the Finance department to implement such a major change in accounting. Following my assessment good progress was made by the Council. On the 8 April 2011, the Council provided me with its accounting policies under IFRS, and on 15 April 2011, the Council provided its draft of the 2010/11 statement of accounts which included the 2009/10 IFRS adoption figures. I carried out a high level review and fed back my comments to the Council. The Council produced its full IFRS compliant accounts by the 30 June deadline. These were of a good standard and supported by comprehensive electronic working papers. I have, however, noted a number of disclosure errors, and errors of internal inconsistency. Most of these were of a relatively minor nature. These are noted in appendix 2 of this report.</p>

Key audit risk

The introduction of new financial systems

In 2010/11 the Council introduced new financial systems. The COA e-financials information system went live from 1st of April 2010. COA e-financials provides the general ledger, accounts receivable and accounts payable systems.

The risks to my opinion were two fold:

- opening balances are not completely or accurately transferred; and

-income and expenditure during the year is not recorded with the result that the income and expenditure is mis-reported in the financial statements.

Finding

I carried out audit work to document the system changes and assess the impact on my audit. This included tests of the accuracy and completeness of opening information transferred and transactions processed during the year.

I am satisfied that opening balances were transferred completely and accurately to the new COA e-financial systems. However, my work identified weaknesses in internal controls in the accounts payable system, the debtors system and in the general ledger system (journal controls). My findings are reported later in this report.

As I could not fully rely on system controls in the new systems additional substantive audit procedures were required at year end to provide the audit assurance required. This included increasing my audit sample sizes, checking expenditure passing through the accounts payable system to supporting documentation, as well as checking all material year end journals and a sample of journals during the year to supporting information.

I also carried out a review of your general IT controls. There is scope to improve system access controls, password security and general IT controls. I reported my findings in my opinion plan to management in April 2011. My findings are also reported in detail in the next section of this report along with management comments on the agreed action plan.

Following further consideration of our report on IT security, management acknowledge there is scope to further improve IT access controls and agreed to revisit and strengthen their response to my IT action plan.

I plan to use my IT expert to review general IT controls again in 2011/12 to assess the effectiveness of the system changes and internal controls implemented by management in response to the internal fraud.

Management restructure costs

A significant management restructure was undertaken by the Council during 2010/11. The risk to my opinion is that the Council fails to account for redundancy and exit packages accurately or completely in its 2010/11 accounts.

I reviewed your accounting treatment and I am satisfied that it complies with recommended accounting requirements.

Key audit risk

Debtors

The system controls in the new system have operated effectively for part of the year only. I need assurance over the full year.

Finding

I carried out additional audit work to gain assurance the debtors values are correctly stated in the accounts. I am satisfied that income and debtors values are materially accurate in the Council's accounts.

Significant weaknesses in internal control

I noted significant internal control weaknesses in your general IT controls and in the new COA e-financials accounts payable and debtors systems.

A material weakness in internal control is a deficiency in design or operation which could adversely affect the Council's ability to record, process, summarise and report financial and other relevant data.

The weaknesses reported here 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.

The reliable operation of internal controls in the main financial systems provides assurance to management and members. It also allows me to complete my audit more efficiently. However, where weaknesses in internal control have been identified I am not able to rely on the operation of controls to gain assurance for my audit opinion. I therefore need to take a more time consuming substantive audit approach. I was unable to rely fully on internal controls in the following areas. Additional audit processes were carried out to gain the audit assurance I required.

- General ledger (journal controls);
- Accounts payable;
- Debtors – controls operated for part of the year only.

My work to test financial controls was co-ordinated with that of Internal Audit to maximise efficiency and minimise any duplication of effort. I was able to rely on the work of Internal Audit which was delivered on time and to an acceptable standard. I also asked internal audit to help me with some of the additional substantive testing on expenditure passing through the accounts payable system required as a result of the internal fraud.

Internal control issues and my audit findings

Description of weakness	Potential effect	Management Comments
<p>1. General ledger</p> <p>Partial controls assurance was received on journals and suspense accounts as internal system controls did not operated consistently through year given system changes and changes of personnel.</p>	<p>Income and expenditure could be mis-classified and mis-stated in the financial statements. Substantive audit processes were required at year end to provide the audit assurance required.</p>	<p>The new COA e-financial system will be fully operational in 2011/12. Appropriate training will be given to staff to mitigate the risks arising from changes in personnel.</p>
<p>2. Debtors</p> <p>The following key system controls were operational for part of the year only.</p> <ul style="list-style-type: none"> ■ The invoice request form must be signed by an authorised signatory. ■ For periodic income (such as quarterly rent) a periodic invoice request form must be completed for the first invoice period (or e-mail for leaseholders set up). <p>In addition control weaknesses were noted by IA during the year. These have been reported to those charged with governance and are not repeated here.</p> <p>I carried out specific audit work to test that income had been accounted for correctly. 34 out of 35 of the sample were correctly classified. However, one failed, a debtor of £20,000 was a swimming grant relating to 2009/10 to Gosport Recreation Centre. As such it should not be</p>	<p>Income could be mis – classified and mis-stated in the financial statements.</p>	<p>The next version of the COA e-financial systems will be implemented during 2011/12. The debtor system will change and internal controls will be further strengthened.</p> <p>IA identified a number of weaknesses in the debtors system and management action is in progress to address their findings.</p>

Description of weakness	Potential effect	Management Comments
<p>classified as part of the debtor balance for 2010/11. Extrapolation of the error amounts to £91,000. As the value is clearly not material I did not ask management to amend the accounts.</p>		
<p>3. Accounts payable system</p> <p>A number of weaknesses were identified relating to the authorisation and processing of creditor payments.</p> <p>Working with Internal audit additional audit work was undertaken. Expenditure through the accounts payable system was substantively tested to supporting documentation at year end. All of the 27 payments in the test sample were verified as genuine, correctly classified and reported within the correct financial year.</p>	<p>Controls ensure payments made are for valid purchases. Controls are likely to prevent and detect material misstatement of expenditure in the financial statements.</p>	<ul style="list-style-type: none"> ■ Lessons will be learnt from the ongoing special investigation. The next version of the COA e-financial systems will be implemented during 2011/12. This will enhance internal system controls and system exception reporting functionality. ■ IT access controls will be reviewed and enhanced in 2011/12. ■ Routine IA checks will be implemented on bank account changes. ■ Staff will be reminded of the importance of regular budget monitoring processes in identifying unexpected and unusual payments. ■ A formal contracts register will be considered to strengthen controls over procurement. ■ Staff and member awareness seminars are planned to promote a greater awareness of the importance of password security, and an awareness of inherent system risks within the key financial systems of the Council. ■ Seminars will also promote an awareness of the Council's whistle blowing policies. ■ The Council fraud and corruption strategy has recently been reviewed and approved (July 2011). ■ The Council agreed to reflect this incident as an adjusting post balance sheet event in the 2010/11 financial statements, and review its annual governance statement.

Description of weakness	Potential effect	Management Comments
<p>The year end bank reconciliation for the online account was not signed off as complete and did not agree back to the amount included in the financial statements, however the difference of £236 was clearly trivial.</p>	<p>Bank reconciliations are an essential check to confirm completeness of financial reporting. They are capable of 100% reconciliation.</p>	
<p>3. General IT controls</p> <p>1. IT Entity level controls</p> <p>Due to the small size of the IT department there is high dependency on individuals and no succession plan is in place.</p> <p>Many tasks and responsibilities are shared amongst the team and most of the IT officers have privileged / administrator level access on network operating system, DB and network devices.</p> <p>There is no vetting process in place for the IT staff.</p> <p>Adequate policies and procedures are in place meeting the government connect requirements but there is scope to extend these policies further to make them more comprehensive.</p> <p>Incident and problem management processes are not formally documented.</p> <p>There is no formal process of IT risk management. No IT risk register is maintained.</p>	<p>IT entity level controls are controls over the operating responsibilities of the IT department. Weaknesses in this area could impact on the validity and accuracy of financial reporting.</p>	<p>The Council shares knowledge and back up between two staff, and applications knowledge is shared between two different staff.</p> <p>The Council accepts that due to the size of the department many tasks are shared. This risk is due to resource pressure.</p> <p>All council staff are vetted at time of recruitment. Some IT staff are also covered by the Government Connect Code of Connection (Co-Co) standards vetting procedures. This could be rolled out to cover all IT staff.</p> <p>The Council meets the Government Connect Code of Connection.</p> <p>Problem management is covered by the use of Track-it and vendor supported Helpdesk system, IT Security Incidents are covered by IT Security policy in place as part of Co-Co compliance</p> <p>Awaiting development of the risk module on Covalent.</p>

Description of weakness	Potential effect	Management Comments
<p>2. Access security controls.</p> <p>Most of the IT officers have privileged / administrator level access on network operating system, DB and network devices. There is a risk unauthorised changes can be made.</p> <p>A number of IT officers have access to COA e-financials production environment. Whilst for COA e-financial there have been no significant changes to the system since its implementation there is a risk that any changes made may go undetected in the absence of formal procedures and stringent controls.</p> <p>Access control procedures are not documented.</p> <p>Whilst reviewing a list of network (Active Directory) users, we found that 105 of 932 users have non-expiring passwords. This includes both system IDs (agents etc.) as well as named IDs - this is a high number and should be justified for named IDs. This users figure of 932 reflects the fact that employers use a number of systems and have a separate system log in for the various systems in use.</p>	<p>These are the mechanisms that specify what users on a system can and cannot do. Weaknesses in these controls can compromise the integrity of the data through unauthorised access, malicious intent or fraud.</p>	<p>There are limited staff resources so unauthorised changes could be traced back to the originator using other means.</p> <p>2/7 is the minimum we need to continue to provide support to the end user.</p> <p>Under implementation COA project team are making changes.</p> <p>Accepted, under review. Note that some ID's are required for system processes.</p>
<p>3. Data centre and network controls.</p> <p>Data centre key physical and environmental controls could be improved.</p> <p>Visitors log is not maintained.</p>	<p>These controls protect the computers, system programmes and communications equipment that stores and processes the data necessary to</p>	<p>Will review on a cost versus risk basis.</p> <p>Will implement. All visitors are escorted currently.</p> <p>Accepted risk. The previous gas solution was removed because it</p>

Description of weakness	Potential effect	Management Comments
<p>Smoke detector is installed but there is no automatic fire suppression system. One fire extinguishing cylinder is placed near the server rack.</p> <p>Network and backup controls are adequate.</p> <p>No Business Continuity Plan (BCP) or Data Recovery Plan was provided to the auditor.</p> <p>No record that operating system software and key application systems have been fully restored from backup media in the current accounting period.</p>	<p>support business operations. Insufficient controls over processing accuracy may result in inaccurate financial results and loss of integrity, confidentiality and availability of the business critical IT systems and data.</p>	<p>was a health and safety concern.</p> <p>Agree</p> <p>IT have a BCP plan that acts as their DR Plan. In addition, GBC have a contract with ICM to restore key systems from the Wilmott Lane Depot.</p> <p>This is correct but the recovery mechanism works as IT have restored data from back up tapes in this period.</p>
<p>4. Program change controls, new systems acquisition and development.</p> <p>Program change procedures are not formally documented though all changes / problems are logged on to the supplier support system as well as the Council's internal help desk system.</p>	<p>These controls reduce the risk of introducing errors to financial systems and data.</p>	<p>IT use the Track-it system (problem/fix system). IT application support team have their diaries.</p>
<p>5. End user controls</p> <p>Notification of leavers using the e-financials system.</p> <p>There is scope to strengthen controls further in this area by automatically sending a copy of each leaver form from HR to IT. Currently leavers are identified from salary monitoring prints reviewed on an ad hoc basis. There can be a delay between the actual leaving date and</p>	<p>End user computing is the term applied to small scale office-system developments by user departments, e.g. spreadsheets developed by the Finance department as part of the financial reporting process. An assessment of the general controls applied</p>	<p>Strengthening the leaver notification process from HR to ensure all key system administrators (set up a local group) are notified through a formal email once the leaver has terminated their employment.</p>

Description of weakness	Potential effect	Management Comments
removal of leavers from the system.	to end user computing is required to gain assurance that there will be no adverse impact on the financial statements.	

Recommendations

- R1** Further strengthen internal controls in the debtors system as soon as possible. This may be achieved by implementing the planned new debtors system in 2011/12 and addressing the recommendations reported by internal audit.
- R2** Strengthen internal controls within the accounts payable and budget monitoring systems.
- R3** Strengthen general IT controls to reduce the risk of unauthorised system access.
- R4** Complete and sign off bank reconciliations promptly, and ensure all differences are investigated and corrected.

Financial statements

Quality of your financial statements

I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statements disclosures. The Council's financial statements were of a satisfactory standard and were supported by good quality working papers. In particular, you have coped well with the requirement to produce statements that comply with IFRS for the first time. I have identified a small number of qualitative aspects of your financial reporting that I wish to draw to your attention.

I am satisfied that these issues were identified in the process of producing the financial statements and are not caused by underlying accounting errors.

Quality issues

Issue	Findings and recommendations
<p>1. Leases records</p> <p>Lessor rental values disclosed in the accounts are understated.</p>	<p>Poor internal controls over the review of leases could mean that lessor rental values disclosed in the accounts are understated. My review of operating leases which support the financial information disclosed in Note 32 of the financial statements where the council is the lessor, confirmed there are a significant number of properties where there are either:</p> <ul style="list-style-type: none">■ no lease in place or no lease details known, but rental income has been received in 2010/11; or■ no current lease in place, the lease has expired but lease income has been received in 2010/11; or■ a current lease exists but no rent is being charged. <p>It is very important that accurate lease records exist when calculating the figures for the financial statements under IFRS. In Note 32 only the annual lease payment is included so where there is no lease in place, or no current lease in place, no values are included in the operating leases income figures for one year to 5 years and more than 5 years. Therefore, the figures in Note 32 are understated. In the absence of up to date lease records it is</p>

Issue

Findings and recommendations

difficult to estimate these figures accurately. However, further audit work has confirmed the understatement to be in the region of £215,000 which is not material.

Internal Audit highlighted this matter in their review of fixed assets and management are taking action to increase officer capacity in property services to address this matter urgently.

I also checked the date of the last rent reviews and there are a number of properties where the rent has not been reviewed for a considerable length of time (e.g. since 2000 in some cases). With the current levels of inflation the council could be losing significant amounts of income if the rent is not increased in line with RPI on a regular basis.

2. Accounting policies

Significant revision to accounting policies has been required to reflect IFRS.

My review of accounting policies confirmed that the Council's accounting policies are in line with the Code and IAS8, but have yet to receive formal approval by the P&O Committee. This is planned for September 2011.

3. Provision for bad debts

The bad debt provision of £1.4m is netted off against current debtors only as the Council considers all uncollected debts to be collectable within 12 months.

Under IFRS the Council is required to disclose corporate debtors as either current debtors (less than 1 year) or long term corporate debtors (more than 1 year).

It follows therefore that the Council's provision for bad debts should also be set off against both short term and long term debtors. Currently the bad debt provision of £1.4m is netted off against current debtors only. The Council are currently analysing their bad debts by type of debtor to assess if there are significant bad debts relating to long term debtors.

This adjustment is a disclosure issue only and has no impact on the Council's outturn position.

4. Analysis of creditors

Additional analysis codes are required to ensure disclosures are appropriate.

Testing of receipts in advance highlighted that some items would have been more appropriately disclosed in the 'other LA' category within creditors. Discussion with officers confirmed that during 2010/11 the Council had not used sufficient analysis codes to facilitate separate reporting of each creditor into the relevant disclosure category. In 2011/12 the Council plan to create sub-analysis codes so that creditor amounts can be correctly assigned on a real-time basis. Alternatively, the Council could undertake a single analysis exercise as part of the year-end close-down procedures to ensure that creditors are fully analysed over relevant categories.

Issue	Findings and recommendations
<p>5. Fixed assets register</p> <p>To ensure completeness of the new fixed asset register in 2011/12 reconcile it to property records.</p>	<p>When reviewing property records as part of the accounts close down Officers realised that there were 20 assets with a net book value of £685,000 identified as being investment properties which were either included at zero value in the fixed asset register in previous years and required reanalysis; or were omitted from the fixed asset register in previous years. With the implementation of the new e-financials fixed asset module during 2011/12 the council should reconcile the fixed asset register in full with its property records to ensure completeness.</p>
<p>6. Depreciation of infrastructure assets</p> <p>The Council did not review the assets lives, residual values, or depreciation method for infrastructure assets.</p>	<p>Depreciation is an estimate and as such the Council should be able to demonstrate that it has reviewed the basis of this estimate each year. I recommend Council include a review of the asset life, residual value, and depreciation method for all asset types as part of its close down plan. I note that a new fixed asset register will be introduced during 2011/12 and the Council will review all asset information as it is transferred to the new system including assets lives, residual values, or depreciation method.</p>
<p>7. Council Tax and NNDR control account</p> <p>Officers need to evidence their prompt review of control account reconciliations.</p>	<p>My audit work identified scope to improve the timeliness of authorising of the Council Tax reconciliation. In my earlier systems testing the P12 reconciliation was not appropriately authorised by a senior officer and this was still the case as at the time of the audit in August.</p> <p>Control account reconciliations are essential system controls and should be subject to a senior officer review in a timely manner.</p>

Recommendations

- R5** Confirm whether the Council legally has the right to continue to collect lease rentals when no lease exists or the lease has expired.
- R6** Review all properties where there are no known lease details or the lease has expired and re-negotiate a lease as soon as possible.
- R7** Review all properties rents to ensure rents are in line with Council policy and deliver value for money. Where no rent is being paid the Council should ensure that lessees are eligible for peppercorn rents under the Council's current policies.
- R8** Approve formally your accounting policies.

Recommendations

- R9** Review the arrangements for classifying bad debts for 2011/12 and consider whether the bad debt provision should be split between current and long term debtors.
- R10** Ensure the council's financial reporting systems can provide sufficient analysis of creditors to meet CIPFA Code reporting requirements.
- R11** Reconcile the new fixed asset register with property records in full in 2011/12 to ensure completeness and accuracy of the new fixed asset register.
- R12** Review asset life, residual value, and depreciation method for all asset types as part of the annual accounts close down plan.
- R13** Review and evidence Council Tax and NNDR control account reconciliations in a timely manner.
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Letter of representation

Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements. A copy of the draft letter of representation prepared by management was presented with this report for your approval. A copy is included in Appendix 5. It will be signed as close as possible to the date of the audit opinion.

Financial statements

Significant matters that were discussed with management

International standards of auditing require that I report to you significant matters discussed with management during the audit. There were two significant matters discussed with officers during the year:

- Accounting arrangements for Portchester Crematorium Joint Committee; and
- The Audit Commission Fraud and Corruption survey.

Portchester Crematorium Joint Committee

Historically the district council partners of the Joint Committee have not prepared group accounts (on grounds of materiality) but Portsmouth City Council has prepared group accounts. Each member council has a 25% interest in this Joint Committee. For 2010/11, I noted that Portchester Crematorium's asset base had increased significantly. The Committee now has gross assets of around £5.5 million, and net assets of £4.5 million. The 25% interest in these assets brings the Councils share close to my indicative materiality levels for the audit of your financial statements. I accept this is only an indicator of 'importance' and not a absolute test.

The decision as to which accounting treatment to adopt is that of each Council. I asked management to provide a clear statement setting out the thought process and judgements behind its decision not to adopt group accounts in 2010/11.

Officers confirmed the Council does not propose to prepare group accounts on the grounds of materiality. Gosport's interest in the PCJC represents less than 1% of the net worth of Gosport's balance sheet. In addition, a full Statement of Accounts is needed to produce group accounts and under the Audit and Accounts Regulations 2011, PCJC falls under the small entity accounting regime. In 2010/11 it has produced an annual return rather than full Statement of Accounts.

Officers also considered the risks facing the Council. The PCJC operates a crematorium which is a discretionary service and not statutory. PCJC is not a listed body under Part 1 of the Local Government Act and therefore cannot undertake to enter into borrowing or investing on their own under the Prudential Code. Therefore there are no risks of PCJC producing off-balance sheet financing.

Officers were satisfied that the Council's accounts fully disclosed its relationship with PCJC in Note 29, Related Parties.

I considered these arguments carefully, on both qualitative and quantitative grounds and, in my professional view, the Council has presented a persuasive argument supporting the decision not to prepare group accounts. In making this decision, I am particularly swayed by the crematoriums inability to take advantage of the borrowing freedoms set out in the prudential code. Therefore there is no risk of significant 'off balance sheet' finance

that is not disclosed. This reduces the operational risk to the Council of its associate relationship. I have not asked the Council to prepare group accounts for PCJC for 2010/11.

Audit Commission Fraud and Corruption Survey

The Audit Commission regularly publishes reports on fraud and corruption entitled “Protecting the Public Purse”. These are based on information gathered by its annual fraud and corruption surveys of local government and related bodies.

Councils were required to complete the 2010/11 survey by 31 May 2011. I was asked to review this information by 29 July 2011. The Council updated its original information in the light of a material internal fraud discovered in July 2011. Key messages from the survey responses for your Council are set out below: I wish to bring them to your attention as there has been no formal reporting of internal fraud to those charged with governance in 2010/11.

During 2010/11 there were:

- 80 cases of housing benefit and council tax benefit fraud cases with a value of £8,878;
- cases of council tax fraud but numbers and values were not recorded;
- one fraud where an officer abused his position in 2010/11, requiring formal reporting to the Audit Commission (AF70 return);
- Prosecutions: There were 20 during the year, of which 18 were found guilty;
- No fraud cases involved Councillors.
- The Council had a whistle blowing policy but did not actively raise awareness of it among staff and members.
- Those Charged with Governance (TCWG) do not review the whistle blowing policy annually.
- The Council has fidelity guarantee insurance, and made one claim which will cover two financial years 2010/11 and 2011/12.
- There was no annual report to TCWG on fraud and corruption activity for 2010/11 which also assessed the effectiveness of the Council's arrangements. In previous years the Internal Audit Annual Report has included this information. It did not in 2010/11 but will in future years.

Recommendations

R14 Present an annual summary of the Council's anti fraud and corruption activities to those charged with governance to facilitate scrutiny and challenge.

R15 Review annually the effectiveness of the Council's whistle blowing, fraud and corruption strategy and other related policies.

Other significant matters relevant to the reporting process

Members of the public have the right to ask the auditor questions about the accounts. I am currently considering two questions raised by members of the public. These relate to:

- The dial a ride scheme; and
- Taxi licence fees.

This work is currently in progress. I will report the results of this work as soon as I have completed my enquiries. I anticipate this work will complete in September 2011. If it does not my audit opinion and certificate may be delayed as I am unable to certify closure of the Council's financial statements when there are outstanding challenge issues.

Audit fees

I ask the Standards and Governance Committee to note that additional audit fees will be required currently estimated at £7,000. This figure is the best estimate at this time and may change if I can not complete the outstanding work as quickly as anticipated. I have carried out additional audit work over the completeness of expenditure in the accounts given the internal fraud; and to respond to questions received from two members of the public.

In my opinion plan presented to the June 2011 Committee I set out the proposed audit fee of £122,500 for my opinion audit work. This fee was based on my estimation of the work required to meet my statutory responsibilities. At that time I did not anticipate the matters noted above which have required additional audit work. I have worked with Internal Audit where possible to keep the additional audit fees to a minimum.

The Commission has a statutory duty to prescribe scales of fees under section 7 of the Audit Commission Act and section 12 of the Local Government Act. Annually the Audit Commission consults widely on its proposed audit fees and publishes its work programme and scale of fees. In law, audit fees are not a fee for audit services, but a levy to fund the costs of the Commission, out of which it meets the costs of audits and its other statutory functions. It has a statutory duty to cover its costs, taking one year with another.

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 conclusion on each of these areas is set out below.

I intend to issue an unqualified conclusion stating that in 2010/11 the Council had proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

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 good understanding of its financial position. Members scrutinise and challenge performance and hold officers to account. The Council is introducing new performance management and risk management arrangements in 2011/12 to strengthen existing arrangements.</p> <p>The Council has refreshed its corporate priorities in 2010/11 and 2011/12 and reviewed and updated its medium term financial plan because of these priorities and the current economic climate.</p> <p>The Council achieved a £239,000 budget under spend in 2010/11 despite significant budget pressures. It also reduced the deficit position on its collection fund in year from £676,000 at start of year to £394,000 at year end by reducing its cost base in year. This represents good performance given the current economic climate and has been achieved despite worsening</p>

collection rates due to the economic situation. Collection rates for council tax worsened slightly from 97.3% in 2009/10 to 97.1% in 2010/11 and NNDR rates moved from 99% to 97.5% over the same period.

Like many Councils the level of reserves fell during 2010/11 to meet staff termination costs and other restructuring costs. At 31 March 2011 it had useable general fund balances and reserves of £2,408,000 (GFB of £890k+ RFR of £518k+ GF other of £1000k), which is in line with budget expectations. However, the Council's level of reserves is low compared to most other local authorities. This means it has less flexibility than councils with larger reserves to manage the financial challenges it faces in the current economic climate. Its medium term financial plan aims to ensure that the Council maintains an adequate level of general reserves to meet unforeseen events and reduce vulnerability to significant fluctuations in Council Tax levels.

The Council has developed a 30 year Housing Revenue Account (HRA) business planning model which highlights major issues and pressures affecting the HRA. In particular the level of future rent increases, maintaining adequate balances and meeting the costs of maintenance and improvement of the housing stock. Currently council house rents are lower than the government calculated notional rents by around £2.74 per week. The government assumes the Council charges notional rents when it allocates HRA subsidy. This means that there is an annual loss to the HRA by not charging notional rent levels of £454,000. The Council needs to move its housing rents closer to the notional rent levels over the period to 2016/17. Its HRA business planning model aims to help it do this.

The HRA working balance at 31 March 2011 of £439,000 is significantly lower than the target of £800,000. The balance should improve in 2011/12 to £700,000 provided anticipated expenditure pressures can be managed. The medium term financial plan aims to improve working balances over the medium term.

The Council has an ambitious capital programme of over £38 million over the period to 2014/15. Capital receipts, maturing investments and borrowing will be required to fund it over the medium term. The capital programme for 2010/11 was budgeted at £11 million. Actual spend totalled £7million as slippage totalled £4.3million. This level of slippage (39% of the initial budget) is significant. However, £2.6 million slippage related to the new ferry landing stage, which was delayed by a few weeks only.

Criterion

Findings

Robust management will be required to ensure capital projects are delivered on time to minimise the impact on revenue and ensure effective use of cash resources.

The Council recognises the importance of effective risk management arrangements to manage its significant business risks. Further development of the risk management process remains a key priority of the Council and significant resource has been earmarked for this purpose. The Council has an agreed Risk Management Strategy in place. All capital schemes are risk assessed as part of the scheme approval process. Risk registers are in use at both departmental and corporate levels. The Corporate Risk Management Group regularly reviews and monitors the corporate risk register and assesses the effectiveness of planned actions to reduce and manage the risks identified.

The Council is strengthening its business planning and underpinning risk management and governance arrangements. These new arrangements should provide an effective process for continuing achievement of financial resilience and value for money in 2011/12. However, some of the underpinning arrangements, including those for managing risks and savings, are still under development and will need continued focus in 2011/12.

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.

The Council takes a strategic approach to setting priorities and achieving cost cuts through improved efficiency and productivity.

The Council has reviewed its corporate priorities and identified new strategies to help it manage its financial position in the medium term. Officers and political leaders have taken tough decisions and acted promptly to address the financial challenges faced by the Council which is on course to deliver its savings plans. My work has confirmed that:

- the council used responses to public consultations to inform its 2011/12 budget;
- there is evidence that the council has based its budget decisions for 2011/12 on appropriate information on local needs and delivery costs;
- there is evidence that the council has used options appraisal via its financial models to evaluate proposals for spending reductions in 2011/12; and
- the council has challenged the way services are delivered (for example, through consideration of whether services are best delivered in-house, outsourced or through shared service arrangements).

Significant efficiencies were built into the 2010/11 budget. Debt restructuring, staff

Criterion

Findings

reductions and lower administration and support service costs reduced the required 2010/11 budget by more than £300,000.

In 2010/11 the Council had a saving plan of £410,000. During the year good progress has been made by reducing staff costs in year so the Council received the impact of cost reductions as early as possible. Staff reductions have been made in three waves during the year. In total the Council has removed 11% of its staff or 46 posts (40 FTEs) in just over a year against an establishment of 346. The senior management team has also reduced from ten to six posts in the last two years. Opportunities for further management cost reductions are likely to arise in future years. The full impact of staff savings will impact in 2012/13. Payroll costs in 2012/13 will reduce by over £800,000.

The Council also increased fees and charges in the middle of 2010/11 to ensure it maximised its income and obtained the impact as early as possible.

The Comprehensive Spending Review reduced the Council's grant for 2011/12 by 11.9% with a further reduction to come in 2012/13. As a consequence, savings in the order of £1.5 million are required from the Council's general budget over the next 2 years.

In response the Council has reviewed its corporate priorities and identified new strategies to help it manage its financial position in the medium term. A revised medium term financial plan was approved in June 2011. A new council committee structure and a new constitution were introduced in early 2011/12. Revised management structures have also been drafted to support the new committee structures. These actions are designed to support the delivery of the council's savings plans in 2011/12 and 2012/13.

Significant savings will also arise in 2011/12 and future years as a result of the major contracts procurement exercise in 2010/11 which covered the main council services. The new service contracts take effect from 1 April 2011, and savings built into 2011/12 budget total £300,000. These contracts will deliver improved service specifications and are expected to save Council around £10 million over the next 10 to 15 yrs.

The Council continues to investigate opportunities for service efficiencies, for example through shared services arrangements with the other local District Councils (e.g. shared internal audit services).

Maintaining robust governance arrangements as financial resources and staff numbers

Criterion

Findings

reduce significantly is very important. Whilst good progress is being made against plans strong governance, risk management and financial management arrangements are required going forward. The Council is introducing new performance management and risk management arrangements in 2011/12 to strengthen existing financial management arrangements. As staff numbers reduce members and officers should ensure they continue to receive regular and timely monitoring information to facilitate effective scrutiny and challenge of the Council's operational and financial performance.

Recommendations

- R16** Bring the level of general fund and housing revenue reserves in line with those held by other local councils over the medium term through robust management of the Council's finances.
- R17** Implement the planned enhancements to risk management arrangements during 2011/12.
- R18** Minimise the revenue impact of any slippage through strong management of the capital program.
- R19** Review reporting arrangements to ensure Members and officers continue to have regular and timely monitoring information to facilitate effective scrutiny and challenge of the Council's operational and financial performance.

Report by exception

The Audit Commission requires me to report by exception where significant matters come to my attention, which I consider to be relevant to proper arrangements to secure economy, efficiency and effectiveness in your use of resources.

Earlier in this report I noted the impact of weak arrangements for the management of leases as this impacted on the financial disclosures in the accounts. These weak arrangements also impact on my value for money assessment. During 2010/11 the Council did not have proper arrangements in place to effectively manage leases and the failure to carry out regular rent reviews suggests that the Council is not maximising income from property.

The recommendations made earlier in this report apply and are not repeated here.

Appendix 1 – Draft audit report

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF GOSPORT BOROUGH COUNCIL

Opinion on the Authority accounting statements

I have audited the accounting statements of Gosport 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, the Housing Revenue Account, the Movement on the Housing Revenue Account Statement, the 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 Gosport 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.

Respective responsibilities of the Director of Finance and auditor

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Authority's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Authority; and the overall presentation of the accounting statements. I read all the information in the

explanatory forewordⁱ 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 Gosport Borough 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, Gosport 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

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

Patrick Jarvis, Officer of the Audit Commission

Audit Commission, Suite 2, Ground Floor, Bicentennial Building, Southern Gate, Chichester, West Sussex, PO19 8EZ

T 0844 798 1717 F 0844 798 1705 www.audit-commission.gov.uk

Date:

Appendix 2 – Amendments to the draft financial statements

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

The financial statements submitted for audit were complete and internally consistent in the majority of areas. However, I identified some casting errors in the accounts, some internal inconsistencies and some errors in the classification of items. Management agreed to amend the statements to resolve all the issues I highlighted.

The key adjustment impacting on the financial statements related to correction of fraudulent capital and revenue expenditure of £146,263. This impacted on a number of statements and disclosures and changes the reported outturn.

I recommended some presentational changes to the financial statements to disclose two exceptional items separately on the face of the comprehensive income and expenditure statement and the housing revenue account. These related to the following mandated changes in 2010/11:

- the large impairment of housing stock values due to a decrease in the housing discount factor applied in the valuation of council dwellings from 45 percent to 32 percent; and
- the gain from the recalculation of the pension past service cost using the CPI instead of the RPI.

I also identified some disclosure errors which have been discussed with officers and summarised in Appendix 2.

My technical team reviewed the accounts and identified a number of internal inconsistencies with information within the main statements and supporting notes, or between different notes within the financial statements. These have also been discussed with officers who agreed to investigate and amend them. The amendments affected the following:

- the explanatory foreword;
- movement in reserves statement for 2009/10 and 2010/11
- Comprehensive income and expenditure statement

- Note 8 Financing and investment income
- Note 13 Intangible assets
- Note 15 Nature and extent of risks arising from financial instruments
- Note 22 Capital adjustment account
- Note 22 Revaluation reserve.
- Note 23 Reconciliation with amounts reported internally.

The key amendments are detailed in the table below:

		Comprehensive income and expenditure statement		Balance sheet	
Adjusted misstatement	Nature of adjustment	Dr £000s	Cr £000s	Dr £000s	Cr £000s
Comprehensive income and expenditure statement (CIES): Classification error: Negative Past Service Costs arising as a result of the change from RPI to CPI for future pension increase of £9,458K were correctly classified as non distributed costs in the statement but were adjusted in error on the Corporate & Democratic Core line instead of the Central Services to the Public line. This classification error has no impact on the reported results.	Corporate & Democratic Core	9,458			
	Central Services to the Public		9,458		
Comprehensive income and expenditure statement (CIES): Exceptional items. I requested the following items be classified as exceptional items on the face of the	Non distributed costs	9,458			
	Exceptional item		9,458		
	HRA impairment loss	42,936			

**Comprehensive income and
expenditure statement**

Balance sheet

CIES due to their nature and size. Non distributed costs of £9,458K Housing Revenue Account impairment loss of £42,936K This reclassification has no impact on the reported results.	Exceptional item	42,936
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**Correction of fraudulent entries
in 2010/11**

Expenditure of £146,263 during 2010/11 was identified as being fraudulent. To correct this, expenditure has been written out of the accounts in anticipation of recovery. Amendments were required to both capital and revenue expenditure. The changes impact on the CIES, Balance sheet, Movement in Reserves statement (MIRS), Capital adjustment account (CAA) and VAT control.

Disclosure errors and omissions

Movement in reserves statement

The statement was amended to include the transfers to/from earmarked reserves notes, as required by the Cipfa Code of Practice on Local Authority Accounting in the United Kingdom (the Code).

Comprehensive Income and Expenditure statement

The 2009/10 figure for surplus/deficit on revaluation of property plant and equipment differed to that reported in Note 22 Revaluation reserve by £209,000. Officers agreed to investigate this internal inconsistency.

Cash flow statement.

The cash flow statement did not have a note disclosing separately the interest received, paid and the dividends received as required by the Cipfa Code of Practice on Local Authority Accounting in the United Kingdom (the Code).

Annual governance statement

Management agreed to update the disclosures in the AGS to ensure that internal control weaknesses highlighted by the internal fraud were detailed. The AGS also needs to be signed before I can issue my audit opinion. This is planned for September 2011.

Note 12 Investment properties

Additional disclosures were made to disclose the use of an expert, the method and significant assumptions applied in determining the fair value.

Note 21 Useable reserves

Additional disclosures were required to highlight the transfers to and from earmarked reserves as required by the Code.

Note 23 Segmental analysis

The note included information relating to the reserve movement and how it has been funded. This information is not required as its purpose is to reconcile the note back to the CIES. Management agreed to remove this additional information.

Note 34 Pensions

The disclosure of IAS19 information was amended to ensure it complied with the disclosure requirements set out in the Code.

Note 35 Contingent assets

Management agreed to reflect as contingent assets outstanding VAT claims of £630,920.

Note 27 External Audit Costs

This note was overstated by the inclusion of £71,000 of audit fees for grant claim work which related to the previous year, and £9,000 of inspection fees accrued in error. The note has been restated.

Note 38 Events after the balance sheet date

This note has been amended to refer to the internal fraud identified in July 2011.

Note 29 Related Party Transactions

Management agreed to extend this note to identify the member who supplied carpets to the Council and rents an office to the Council.

Note 8 Finance and investment income and expenditure

Debt restructuring discount of £40,000 had been netted off incorrectly in this note. It had been applied (as a negative) to: Interest payable and similar charges including finance lease rentals payable and debt restructuring premiums. It should have been applied to Interest Income including finance lease rentals receivable and debt rescheduling discounts.

Other minor disclosure errors

I reported a number of minor disclosure errors such as casting errors, missing text, page numbers, out of date references e.g. STRGL, or incorrect note references which officers agreed to amend. These impacted on the following:

- Accounting policies
 - Note 10 Adjustments between accounting basis and funding basis under regulations
 - Note 15: Nature and extent of risks arising from financial instruments
 - Note 19 Creditors
 - Note 25 Members allowances
 - Note 26: Officer remuneration
 - Note 31: Impairment losses
 - Note 32 Leases
 - Note 34: Pensions
 - Housing Revenue Account Note 2, Note 7, Note 13, Note 14, and Note 15
 - Collection fund.
-

Appendix 3 – Unadjusted misstatements to the financial statements

There are no unadjusted errors.

Appendix 4 – Glossary

Annual governance statement

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

Audit closure certificate

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

Audit opinion

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

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

Opinion

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

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

Materiality and significance

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

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

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

Weaknesses in internal control

A weakness in internal control exists when:

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

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

Value for money conclusion

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

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

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

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

Appendix 5 - Letter of representation

To: Patrick Jarvis
Appointed Auditor
Audit Commission
Collins House
Bishopstoke Road
Eastleigh
Hampshire
SO50 6AD

Gosport Borough Council- Audit for the 2010-2011 year ended 31 March 2011

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other officers of Gosport Borough 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. All representations cover the Council's accounts included within the financial statements.

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 and International Financial Reporting Standards which give a true and fair view of the financial position and financial performance of the borough council, for the completeness of the information provided to you, and for making accurate representations to you.

Uncorrected misstatements

I am not aware of any uncorrected financial misstatements in the financial statements.

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 borough council have been properly reflected and recorded in the financial statements.

Internal control

I have communicated to you all deficiencies in internal control of which I am aware.

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. I can confirm that management anticipate no loss to the Council arising from the fraud by a former employee that is currently the subject of ongoing Police investigations.

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 borough 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.

Related party transactions

I confirm that I have disclosed the identity of Gosport Borough Council 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.

Specific representations

I confirm that I have disclosed in accordance with the financial reporting framework:

- Plans or intentions that may affect the carrying value or classification of assets and liabilities;
- Liabilities, both actual and contingent; and
- Title to, or control over, assets, the liens or encumbrances on assets, and assets pledged as collateral.

In respect of the contingent assets disclosed I confirm that settlement of the outstanding VAT claims is dependent on future court action.

I can also confirm that management are satisfied the lease disclosures in Note 33 of the accounts are not significantly understated.

Signed on behalf of Gosport Borough Council

I confirm that the this letter has been discussed and agreed by the Council on

15 September 2011.

Signed

Name Peter Wilson

Position Deputy Chief Executive & Borough Treasurer

Date

Appendix 6 - Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
17	R1 Further strengthen internal controls in the debtors system as soon as possible. This may be achieved by implementing the planned new debtors system in 2011/12 and addressing the recommendations reported by internal audit.	3	Deputy Chief Executive and Borough Treasurer	Y	Implementation of the new debtors system is complete. IA monitor action taken against their audit recommendations.	October 2011
17	R2 Strengthen internal controls within the accounts payable and budget monitoring systems.	3	Deputy Chief Executive and Borough Treasurer	Y	Version 4 of the software has been installed which improves internal controls and reporting flexibility.	Implemented August 2011
17	R3 Strengthen general IT controls to reduce the risk of unauthorised system access.	3	Deputy Chief Executive and Borough Treasurer	Y	Facility on the system to prevent concurrent user log in has been activated.	Implemented August 2011
17	R4 Complete and sign off bank reconciliations promptly, and ensure all differences are investigated and corrected.	3	Deputy Chief Executive and Borough Treasurer	Y		December 2011
20	R5 Confirm whether the Council legally has the right to continue to collect lease rentals when no lease exists	3	Borough Solicitor	Y		December 2011

or the lease has expired.

20	R6 Review all properties where there are no known lease details or the lease has expired urgency and a re-negotiate the lease as soon as possible.	3	Housing Services Manager	Y	December 2011
20	R7 Review all properties rents to ensure rents are in line with Council policy and deliver value for money. Where no rent is being paid the Council should ensure that lessees are eligible for peppercorn rents under the Council's current policies.	3	Housing Services Manager	Y	March 2012
20	R8 Approve formally your accounting policies.	3	P&O Committee	Y	September 2011
21	R9 Review the arrangements for classifying bad debts for 2011/12 and consider whether the bad debt provision should be split between current and long term debtors.	2	Deputy Chief Executive and Borough Treasurer	Y	September 2011
21	R10 Ensure the council's financial reporting systems can provide sufficient analysis of creditors to meet CIPFA Code reporting requirements.	2	Deputy Chief Executive and Borough Treasurer	Y	March 2012
21	R11 Present an annual summary of the Council's anti fraud and corruption activities to those charged with governance to	3	Deputy Chief Executive and Borough Treasurer	Y	This was an oversight in 2010/11 and will be reported in the IA Annual Report for 2011/12 and routine quarterly reports from Q3 June 2012

	facilitate scrutiny and challenge.				2011/12.	
21	R12 Reconcile the new fixed asset register with property records in full in 2011/12 to ensure completeness and accuracy of the new fixed asset register.	3	Deputy Chief Executive and Borough Treasurer and Housing Services Manager	Y		March 2012
21	R13 Review asset life, residual value, and depreciation method for all asset types as part of the annual accounts close down plan.	3	Deputy Chief Executive and Borough Treasurer	Y		March 2012
23	R14 Review and evidence Council Tax and NNDR control account reconciliations in a timely manner.	3	Deputy Chief Executive and Borough Treasurer	Y		December 2011
23	R15 Review annually the effectiveness of the Council's whistle blowing, fraud and corruption strategy and other related policies.	3	Deputy Chief Executive and Borough Treasurer	Y	These policies were reviewed in 2011/12 (June 2011). Next review is planned for June 2012.	June 2012
29	R16 Bring the level of general fund and housing revenue reserves in line with those held by other local councils over the medium term through robust management of the Council's finances.	3	Deputy Chief Executive and Borough Treasurer	Y	The level of reserves is reviewed regularly during the year as part of budget setting and MTFP reviews. The level of HRA reserves will be increased as a priority.	March 2013
29	R17 Implement the planned enhancements to risk management arrangements during 2011/12.	3	Chief Executive	Y	Implementation is preceding via Co-valent system	March 2012
29	R18 Minimise the revenue impact of any slippage through strong	3	Deputy Chief Executive and Borough Treasurer	Y	Regular monitoring reports are prepared on the capital	Ongoing

management of the capital program.

program and presented to management team and members by the Financial Services Manager

29	R19 Review reporting arrangements to ensure Members and officers continue to have regular and timely monitoring information to facilitate effective scrutiny and challenge of the Council's operational and financial performance.	3	Deputy Chief Executive and Borough Treasurer	Y	March 2012
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