

# Annual governance report

Gateshead Council

Audit 2011/12



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# Key messages

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**This report summarises the findings from the 2011/12 audit which is substantially complete. It includes the messages arising from my audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.**

## **Financial statements**

As at 24 September 2012 I expect to issue an unqualified audit opinion.

The draft statements were available by the deadline, with supporting working papers. Officers responded promptly to my queries.

I agreed amendments with officers, the most significant being changes in upward and downward revaluations arising from newly componentised assets.

## **Value for money (VFM)**

I expect to conclude that you have made proper arrangements to secure economy, efficiency and effectiveness in your use of resources.

2011/12 was a challenging year. The Council has responded well to the reduced level of funding available. Sound financial plans are in place and are regularly updated, and performance was maintained. There are on going challenges in 2012/13 to secure further savings, which were communicated to the public in budget consultations.

## **Certificate**

I expect to issue my certificate at the same time as my opinion and VFM conclusion.

# Before I give my opinion and conclusion

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

## **Independence**

I have complied with the Auditing Practices Board's ethical standards for auditors, including ES 1 (revised) - Integrity, Objectivity and Independence.

I am not aware of any relationships that may affect the independence and objectivity of the Audit Commission, the audit team or me, that I am required by auditing and ethical standards to report to you.

The Audit Commission's Audit Practice has not undertaken any non-audit work for the Council during 2011/12.

## **I ask the Accounts Committee to:**

- take note of the adjustments to the financial statements included in this report (appendix 2);
- approve the letter of representation (appendix 3) on behalf of the Council, before I issue my opinion and conclusion; and
- agree your response to the proposed action plan (appendix 5).

# Financial statements

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The Council's financial statements and annual governance statement are important means by which the Council accounts for its stewardship of public funds. As elected 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.

## Opinion on the financial statements

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

## Uncorrected errors

There are a small number of errors which have not been corrected. They arose mainly from transactions close to the year end:

- income was not accrued
- estimated amounts due to/from government departments were not updated to reflect the returns made to the departments.

## Recommendations

**R1** All relevant staff should be reminded to consider income due which has not yet been invoiced.

**R2** Actual grant/claims made to government departments should be used in the statements rather than estimated amounts.

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## Corrected errors

Appendix 2 provides details of the larger identified errors which have been corrected. They arose mainly from the treatment of asset revaluations where an asset was split into its component parts for the first time. None of the amendments had any impact on the General Fund.

In addition, presentational changes were made to improve information available to readers of the statements and to fully reflect the Code of Practice on Local Authority Accounting requirements.

## Significant risks and my findings

I reported to you in my January 2012 Audit Plan the significant risks that I identified relevant to my audit of your financial statements. In Table 1 I report to you my findings against each of these risks.

Table 1: **Risks and findings**

Risk	Finding
<p><b>Waste PFI</b></p> <p>A joint scheme with South Tyneside and Sunderland councils was agreed in April 2011. Whilst this will not be operational for several years, it will need to be fully disclosed in 2011/12 statements. The scheme may not be properly accounted for leading to disclosures being materially misstated</p>	<p>The statements disclose details of the scheme and the costs to the Council once operational in 2014.</p>
<p><b>Foundation and Academy Schools</b></p> <p>Several schools have moved from Council control and others are considering their position. Disposal of assets may not be properly accounted for so accounts may be materially misstated</p>	<p>The Council has appropriately accounted for disposal of schools transferring to foundation and academy status.</p>
<p><b>Funding of services when PCT demises</b></p> <p>Council operates services in conjunction with PCT, or with contributions from PCT. It is not yet clear what the arrangements will be when the PCT demises in 2013.</p>	<p>The Council has continued to liaise with the PCT on the transfer and funding of services. There was no 2011/12 impact.</p>

## Risk

The Council may suffer reduced income and be unable to balance its budget.

The Council is aware of future PCT arrangements and partnerships being reviewed. Gateshead GP consortium (GATNET) is involved in meetings

Some risk to financial health remains

### Financial health/redundancy costs

The Council budget requires £31 million savings in 2011/12 plus a further £38 million in the years 2012-2014.

- Fit for Future programme/PACE reviews may not deliver savings so reserves may be required beyond planned level, with impact on financial health. VFMC impact if poor financial management and inadequate resources to deliver Vision 2030. 2011/12 spending (as at November 2011) is over budget.
- any redundancies and exit packages may not be correctly disclosed and accounted for so accounts may be materially misstated

### Systems weaknesses identified in 2010/11

Our 2010/11 audit identified weakness in the following systems.

- Care First.
- Payroll (changes not checked/authorised by HR).
- Journals (not all authorised).

This resulted in the need for substantive testing as full assurance could not be gained from controls testing.

An action plan was agreed in 2010/11. Risk remains that weaknesses have not been addressed.

## Finding

Overall the Council's budget was slightly overspent. Significant savings were achieved in year and balances remain at a sound level.

Redundancies and exit packages were correctly disclosed and accounted for.

Some progress has been made, as reported in the Annual Governance Statement, in adult social care systems.

There was an action plan in place to address the payroll issue by the end of September 2012. Officers confirm that it has been implemented.

Arrangements for journals are to be addressed as part of the main accounting system upgrade later this year.

## Risk

### Leases

New leases may not be properly accounted for

### Accounting for joint arrangements

The Council has many joint arrangements, which may be incorrectly accounted for. The Council reviews joint working annually to update the accounting process (assessing if group accounts are required). Some companies are being wound up in 2011/12.

Risk remains that the Council may not account for individual bodies correctly.

### Issues from 2010/11 Statements audit

Statements could be materially misstated, or the level of testing needed could be increased, if issues identified in 2010/11 are not addressed:

- compensated absences accrual not properly estimated;
- debtor/creditor balances netted off;
- no review for prepayments/cut off;
- non material prior period adjustments;
- accounting policies included as appendix;
- revaluation of high value assets annually; and
- exceptional items not all shown on face of CIES

### Management override

There is always a risk that management can override controls to manipulate financial performance

## Finding

Arrangements are in place to consider leases, although there were no major new leases in year.

The Council reviewed its arrangements and concluded that group accounts were not required. The Council still needs to review each body to ensure it is properly reflected in the statements.

Most of the issues have been addressed:

- the compensated absences accrual was based on a sample of employees;
- there is still some netting off of balances;
- there were no non material prior period adjustments;
- whilst there was no specific review to identify prepayments, there is evidence that pre payments are included in the statements;
- accounting policies are included as a note to the statements;
- high value assets were revalued, asset categories and the policy are to be clarified; and
- exceptional item is shown on HRA

There is no indication that controls or accounting processes have been manipulated.



## Recommendation

**R3** Ensure that debtor and creditor balances are shown gross in the statements.

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### Significant weaknesses in internal control

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. My responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

I have tested the controls of the Council only to the extent necessary for me to complete my audit. I am not expressing an opinion on the overall effectiveness of internal control. I have reviewed the Annual Governance Statement and can confirm that:

- it complies with the requirements of CIPFA/SOLACE Delivering Good Governance in Local Government Framework; and
- it is consistent with other information that I am aware of from my audit of the financial statements.

### Other matters

I am required to communicate to you significant findings from the audit and other matters that are significant to your oversight of the Council's financial reporting process including the following:

- qualitative aspects of your accounting practices :
- matters specifically required by other auditing standards to be communicated to those charged with governance. For example, issues about fraud, compliance with laws and regulations, external confirmations and related party transactions: and
- other audit matters of governance interest

I am reporting the following.

Table 2: **Other matters**

Issue	Finding
Accounting policy 1i (government grants and other contributions)	The Council has disclosed that it has not complied with the Code in respect of unspent, non-conditional revenue grant income. Income is understated, and creditors overstated, by £1.4 million. The Council could have set up an earmarked reserve to ensure the grant was only available to match expenditure, as it has done where the value of unspent grant is greater. The reasoning for this is set out in the accounting policy. The Council should follow the Code when accounting for grants.
Related party transactions – note 15	I have evaluated the Council’s arrangements for identifying and disclosing related parties within its financial statements. Whilst arrangements are in place to identify transactions with elected members, six councillors did not complete the declarations which form part of the process, despite reminders. Councillors should be reminded of the importance of completing annual declarations.
Insurance provision (Note 24)	The Council provides for the estimated costs of meeting its insurance excess on settled claims. The provision is long term, and at 31 March represents the assessment of the amount likely to be paid. Any amounts paid in the year are met directly from revenue rather than from the provision, so no element of the provision is accounted for as short term. The provision appears to be more akin to an earmarked reserve than a provision. Officers have agreed to review the operation of the provision in 2012/13.

## Whole of Government Accounts

Alongside my work on the financial statements, I have also reviewed and will report to the National Audit Office on your Whole of Government Accounts return. The extent of my review and the nature of my report were specified by the National Audit Office. I have no matters to report.

# Value for money

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

I assess your arrangements against the two criteria specified by the Commission. In my Audit Plan I reported to you the significant risks that were relevant to my conclusion. I have set out below my conclusion on the two criteria, including the findings of my work addressing each of the risks I identified.

I intend to issue an unqualified conclusion stating that the Council has proper arrangements to secure economy, efficiency and effectiveness in its use of resources. I include my draft conclusion in appendix 1.

Table 3: **Value for money conclusion criteria and my findings**

Criteria	Risk	Findings
<p><b>1. Financial resilience</b></p> <p>The organisation has proper arrangements in place to secure financial resilience.</p> <p>Focus for 2011/12:</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>Failure to deliver savings identified in financial plans.</p>	<p>The Council has a medium term financial plan covering three years, which it updates annually and which reflects the savings required to balance the budget over the period. Overall, the 2011/12 budget was delivered and reserves remain at a robust level. Challenges remain in delivering the budgets, with savings of £37m identified. There was detailed consultation with the public and interested parties on the 2012/13 budget.</p>

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

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

Focus for 2011/12:

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

**Risk**

Failure to identify and address high cost and/or low performance services.

**Findings**

The Council continues to use benchmarking where available to compare its costs and performance. PACE reviews have been implemented, achieving savings. It does not appear that performance levels have been reduced, as most 2011/12 targets were achieved.

# Fees

## I reported my planned audit fee in the January 2012 Audit Plan.

I will complete the audit within the planned fee.

Table 4: Fees

	Planned fee 2011/12 (£)	Expected fee 2011/12 (£)
Audit	287,100	287,100
Claims and returns	40,900	40,900
Non-audit work	0	0
<b>Total</b>		

The fee for claims and returns work is for work on claims and returns relating to 2011/12.

# Appendix 1 – Draft independent auditor’s report

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## INDEPENDENT AUDITOR’S REPORT TO THE MEMBERS OF GATESHEAD COUNCIL

### Opinion on the Council’s financial statements

I have audited the financial statements of Gateshead Council for the year ended 31 March 2012 under the Audit Commission Act 1998. The financial statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement and the 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 2011/12.

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

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

As explained more fully in the Statement of the Strategic Director, Finance and ICT responsibilities, the Strategic Director, Finance and ICT is responsible for the preparation of the Statement of Accounts, which includes the financial 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. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practices Board’s Ethical Standards for Auditors.

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

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial 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 and adequately disclosed; the reasonableness of significant accounting estimates made by the Strategic Director, Finance and ICT; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the explanatory foreword to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

## **Opinion on financial statements**

In my opinion the financial statements:

- give a true and fair view of the financial position of Gateshead Council as at 31 March 2012 and of its expenditure and income for the year then ended; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

## **Opinion on other matters**

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

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

I report to you if:

- in my opinion the annual governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007;
- I issue a report in the public interest under section 8 of the Audit Commission Act 1998;
- I designate under section 11 of the Audit Commission Act 1998 any recommendation as one that requires the Authority to consider it at a public meeting and to decide what action to take in response; or
- I exercise any other special powers of the auditor under the Audit Commission Act 1998.

I have nothing to report in these respects.

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

### **Respective responsibilities of the Council and the 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.

I am required under Section 5 of the Audit Commission Act 1998 to satisfy myself 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 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 Council 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 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**

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 2011, 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 me to consider under the Code of Audit Practice in satisfying myself 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 2012.

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 Council 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 2011, I am satisfied that, in all significant respects, Gateshead Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2012.



## **Certificate**

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

*[Signature]*

Steve Nicklin  
District Auditor  
Nickalls House  
Metro Centre  
Gateshead  
NE11 9NH

# Appendix 2 – Corrected errors

I identified the following errors during the audit which management have addressed in the revised financial statements.

		Statement of comprehensive income and expenditure		Balance sheet	
Item of account	Nature of error	Dr £'000s	Cr £'000s	Dr £'000s	Cr £'000s
Downward revaluation charged to CIES	Existing value of asset not allocated between components for newly componentised assets		18236		
Surplus on revaluation of assets		18236		17265	
Revaluation Reserve Capital Adjustment Account					17265
Expenditure treated as capital under statute	Loans to external bodies for capital purposes treated as REFCUS, more appropriately long term debtors		3637		
Long term debtors				3601	
Capital Adjustment Account	Repayment in year			36	3637
Gain from disposal of assets		36			

# Appendix 3 – Draft letter of management representation

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## **Gateshead Council - Audit for the year ended 31 March 2012**

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other directors of Gateshead Council, the following representations given to you in connection with your audit of the Council's financial statements for the year ended 31 March 2012.

### **Compliance with the statutory authorities**

I have fulfilled my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom which give a true and fair view of the financial position and financial performance of the Council, for the completeness of the information provided to you, and for making accurate representations to you.

### **Uncorrected misstatements**

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

### **Supporting records**

I have made available all relevant information and access to persons within the Council for the purpose of your audit. I have properly reflected and recorded in the financial statements all the transactions undertaken by the Council.

### **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 the financial statements may be materially misstated as a result of fraud.

## **Law, regulations, contractual arrangements and codes of practice**

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

Transactions and events have been carried out in accordance with law, regulation or other authority. The Council has complied with all aspects of contractual arrangements that could have a material effect on the financial statements in the event of non-compliance.

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

## **Accounting estimates including fair values**

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

## **Other representations**

I confirm that:

- I have considered, and concluded there are no onerous contracts to disclose;
- I have considered and am satisfied that long term investments are appropriately valued; and
- year end creditors that remain unpaid are still appropriately valued and are valid creditors.

## **Related party transactions**

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

**Subsequent events**

I have adjusted for or disclosed in the financial statements all relevant events subsequent to the date of the financial statements.

Signed on behalf of Gateshead Council.

I confirm that this letter has been discussed and agreed by the Accounts Committee on 28 September 2012.

*Signature*

Name

Position

Date

# Appendix 4 – Glossary

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## **Annual Audit Letter**

Letter issued by the auditor to the Authority after the completion of the audit that summarises the audit work carried out in the period and significant issues arising from auditors' work.

## **Annual Governance Report**

The auditor's report on matters arising from the audit of the financial statements presented to those charged with governance before the auditor issues their opinion [and conclusion].

## **Annual Governance Statement**

The annual report on the Authority's systems of internal control that supports the achievement of the Authority's policies aims and objectives.

## **Audit of the accounts**

The audit of the accounts of an audited body comprises all work carried out by an auditor under the Code to meet their statutory responsibilities under the Audit Commission Act 1998.

## **Audited body**

A body to which the Audit Commission is responsible for appointing the external auditor.

## **Auditing Practices Board (APB)**

The body responsible in the UK for issuing auditing standards, ethical standards and associated guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

## **Auditing standards**

Pronouncements of the APB that contain basic principles and essential procedures with which auditors must comply, except where otherwise stated in the auditing standard concerned.

**Auditor(s)**

Auditors appointed by the Audit Commission.

**Code (the)**

The Code of Audit Practice for local government bodies issued by the Audit Commission and approved by Parliament.

**Commission (the)**

The Audit Commission for Local Authorities and the National Health Service in England.

**Ethical Standards**

Pronouncements of the APB that contain basic principles relating to independence, integrity and objectivity that apply to the conduct of audits and with which auditors must comply, except where otherwise stated in the standard concerned.

**Financial statements**

The annual statement of accounts that the Authority is required to prepare, which report the financial performance and financial position of the Authority in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom.

**Group accounts**

Consolidated financial statements of an Authority and its subsidiaries, associates and jointly controlled entities.

**Internal control**

The whole system of controls, financial and otherwise, that the Authority establishes to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

## **Materiality**

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor’s report; likewise a misstatement is material if it would have a similar influence. Materiality may also be considered in the context of any individual primary statement within the financial statements or of individual items included in them. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative 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**

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

## **Those charged with governance**

Those entrusted with the supervision, control and direction of the Authority. This term includes the members of the Authority and its Audit Committee.

## **Whole of Government Accounts**

A project leading to a set of consolidated accounts for the entire UK public sector on commercial accounting principles. The Authority must submit a consolidation pack to the department for Communities and Local Government which is based on, but separate from, its financial statements.



# Appendix 5 – Action plan

## Recommendations

### Recommendation 1

All relevant staff should be reminded to consider income due which has not yet been invoiced.

Responsibility

Priority

Date

Comments

### Recommendation 2

Actual grant/claims made to government departments should be used in the statements rather than estimated amounts.

Responsibility

Priority

Date

Comments

### Recommendation 3

Ensure that debtor and creditor balances are shown gross in the statements.

Responsibility

Priority

Date

Comments

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- any third party.

