

Audit Commission annual report and accounts

April 2005 to March 2006

The Audit Commission is an independent body responsible for ensuring that public money is spent economically, efficiently and effectively, to achieve high-quality local services for the public. Our remit covers around 11,000 bodies in England, which between them spend more than £180 billion of public money each year. Our work covers local government, health, housing, community safety and fire and rescue services.

As an independent watchdog, we provide important information on the quality of public services. As a driving force for improvement in those services, we provide practical recommendations and spread best practice. As an independent auditor, we ensure that public services are good value for money and that public money is properly spent.

For further information about the Audit Commission, visit our website at www.audit-commission.gov.uk

AUDIT COMMISSION ACT 1998

Report and accounts of the Audit Commission, prepared to Sch.1 clause 14 (2) of the Audit Commission Act 1998, showing the Income and Expenditure for the year ended 31 March 2006 and Balance Sheet as at 31 March 2006, together with the Report of the Comptroller and Auditor General thereon.

Presented pursuant to Act 1998, Sch 1, clause 14 (2)

Audit Commission annual report and accounts

April 2005 to March 2006

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Audit Commission annual report and accounts Year ending 31 March 2006

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Audit Commission annual report and accounts Year ending 31 March 2006

This Statement of Account has been prepared in a form directed by the Secretary of State, with the approval of the Treasury, in accordance with paragraphs 11(1) and 11(2) of Schedule 1 to the Audit Commission Act 1998.

Brief history and statutory background

The Audit Commission for Local Authorities in England and Wales (the Commission) was established on 21 January 1983 by the Local Government Finance Act 1982. The Commission is a corporate body and began operations on 1 April 1983. On 1 October 1990 it assumed responsibility for the external audit of the National Health Service and its name was changed to the Audit Commission for Local Authorities and the National Health Service in England and Wales. A consolidating Act, the Audit Commission Act 1998, was given Royal Assent in June 1998.

The Commission's responsibilities were then amended by the Local Government Act 1999, the Local Government Act 2003 and the Health and Social Care (Community Health and Standards) Act 2003.

Under the 1999 Act, auditors appointed by the Commission audit local authorities' best value performance plans (BVPPs) and the Commission is responsible for inspecting authorities' compliance with the requirements of Part 1 of the Act. The Local Government Act introduced a duty for the Commission to report on its findings in relation to the performance of English local authorities and a power to inspect registered social landlords.

The Health and Social Care (Community Health and Standards) Act 2003 transferred responsibility for carrying out national value for money studies in relation to the National Health Service, save for those concerning financial management, to the Commission for Healthcare Audit and Inspection (Healthcare Commission) from 1 April 2004. The Audit Commission may assist the Healthcare Commission, or have functions delegated to it, however the two Commissions must cooperate in relation to matters for which they both have responsibility. Similarly, the Commission must cooperate with the Commission for Social Care Inspection in relation to studies of social care.

Under the Public Audit (Wales) Act 2004 the Audit Commission's audit and inspection functions in Wales were transferred to the Auditor General for Wales. The transfer to the new body, the Wales Audit Office (WAO), was implemented on 1 April 2005.

During the year the Commission's status was changed from a Non Departmental Public Body to a Public Corporation. This was done by the Office for National Statistics in conjunction with the Cabinet Office for the purpose of government classification of public sector bodies.

At March 2006 the Commission's sponsoring department was the Office of the Deputy Prime Minister (ODPM). Since then this has changed to the Department for Communities and Local Government.

Commissioners during the period of review

All comments relating to the Commissioners reflect their activities during the year ended 31 March 2006.

Sir Michael Lyons, Acting Chairman from 24 January 2006

Sir Michael is Chairman of the English Cities Fund and a Non Executive Director of Mouchel-Parkman plc. He acts as a strategic consultant to a range of public and private organisations and is currently leading an inquiry into the future role and funding of local government for the Deputy Prime Minister and Chancellor. Earlier independent reviews covered the Management of Public Assets and Relocation. He was formerly Chief Executive of Birmingham City Council. He was previously Honorary Professor of Public Policy at the University of Birmingham.

James Strachan, Chairman to 23 January 2006

James Strachan's career spans the private, public and voluntary sectors. He is a non-executive Director of Legal and General, Chairman of RNID and a Trustee of Somerset House. After reading economics and English at Cambridge, he worked in the City for 14 years both as a commercial and investment banker, becoming Managing Director of Merrill Lynch in London and a Board member of Merrill Lynch International. Since 1994 he has worked in the voluntary and public sectors. He has been a Board member of Ofgem, the energy regulator; the National Lottery's Community Fund; the Disability Rights Commission and Save the Children. He has also been both a Trustee and Chief Executive of RNID. He is a Leadership Patron of the National College of School Leadership. Having been a professional photographer and journalist, he is now an Honorary Fellow of the University of the Arts, London.

Steve Bundred

Steve has been Chief Executive of the Audit Commission since 1 September 2003.

Prior to joining the Audit Commission, Steve was Executive Director of the Improvement and Development Agency for local government and before that worked for the London Borough of Camden, joining as Director of Finance in 1992 and becoming Chief Executive in 1995. Steve has also previously worked for Lewisham and Hackney councils and London University's Birkbeck College. From 1999-2005 he was a Board member of the Higher Education Funding Council for England and Chair of its Audit Committee. He continues to be a member of the Council of City University and is a Fellow of the RSA.

As Chief Executive, Steve is also part of the Management Team.

Jim Coulter

Jim was Chief Executive of the National Housing Federation for 17 years until retiring in June 2005 and before that he had a similar role at Leeds Federated Housing Association. He is now Chair of Bridging Newcastle Gateshead, the housing market renewal pathfinder, and a member of the North East Regional Housing Board. He has been a past Board member of Shelter and Chair of Homeless Network and has served on a number of ODPM project boards.

Dr Jennifer Dixon

Jennifer is Director of Health Policy at the Kings Fund. She has held numerous posts in health, including Policy Adviser to the Chief Executive of the NHS. She has a background in clinical medicine and holds a PhD in Health Services Research. She is also a Board member of the Healthcare Commission.

Sheila Drew Smith OBE

Sheila is an independent management consultant on business development and related management governance issues. She is a Board Member of the Housing Corporation where she chairs the Registration Committee, and of the South East Regional Housing Board. She was the part-time executive Chair of Tower Hamlets Housing Action Trust until its statutory end date of 2004/05.

Roger Hoyle, to 30 June 2005

Roger worked in the NHS for over 30 years – most recently as Chief Executive of the Liverpool Health Authority. In 2003 he took early retirement and now chairs, part time, the Greater Merseyside Learning and Skills Council.

Councillor Peter Jones

Peter is a retired investment banker. He has been Conservative Leader of East Sussex County Council since 2001. Among other roles, he is Chairman of Sussex Police Authority, and Deputy Chairman of the South East England Development Agency.

Dr Pauleen Lane

Pauleen is Mayor of Trafford Metropolitan Borough Council and lecturer in Geotechnical Engineering and Computation at the University of Manchester. She is the Vice-Chair of English Partnerships and a Board member of the North West Development Agency.

Sir Thomas Legg KCB QC

Tom began as a barrister and then served in the Lord Chancellor's Department (now the Department of Constitutional Affairs) in various posts and as its Permanent Secretary from 1989 to 1998. Since then, he has held a portfolio of part-time appointments, including being Chairman of the Hammersmith Hospital NHS Trust and an external member of the House of Commons Audit Committee. He is also a consultant to Clifford Chance, and Chairman of the London Library.

David Moss

David was Chief Executive of Southampton University Hospitals NHS Trust from 1993 to 2004. A qualified accountant, he has held several senior finance and general management positions within the NHS. He is currently on secondment to the Department of Health as Programme Director for NHS Pay Reform. He is also a reviewer for the Healthcare Commission.

Tim Parker

Tim was appointed Chief Executive of the AA in October 2004. He has previously been Chief Executive at Kwik-Fit, Clarks and Kenwood Appliances. Tim is a Non-Executive Director of Boots plc and was, until recently, a Non-Executive Director of Legal & General Group plc.

Brian Pomeroy CBE

Brian was the Senior Partner of Deloitte Consulting until 1999 when he took up a number of public, voluntary and private sector appointments. He is currently Chairman of the Treasury's Financial Inclusion Taskforce and a member of the National Lottery Commission. He was formerly Chair of Centrepont and Homeless Link, and an independent member of the Council of Lloyd's.

Professor Peter C Smith

Peter is Director of the Centre for Health Economics at the University of York, having previously worked at Cambridge University and in local government. He has held numerous posts as adviser to governments and international agencies, and has published widely on economic aspects of public services.

Councillor Chris White

Chris was elected to Hertfordshire County Council to represent central St Albans in 1993. He was Leader of the Liberal Democrat Group from 1994 to 2003, resuming the leadership in 2005. He was Deputy Leader of the Council and has also been a member of the Hertfordshire Police Authority. Since 1998 Chris has been Leader of the Liberal Democrats of the East of England Regional Assembly. He also chairs the LGA Regeneration Board.

Members' appointment dates

	Appointment start date	Appointment end date
Professor Sir Michael Lyons Acting Chairman from 24/1/06	1/11/03	31/10/06
James Strachan Chairman to 23/1/06	5/11/02	23/01/06
Steve Bundred	1/11/03	See note 1 below
Jim Coulter	1/04/05	31/03/08
Dr Jennifer Dixon	1/11/03	30/04/09
Sheila Drew Smith OBE	1/05/04	30/04/07
Roger Hoyle	1/01/02	30/06/05
Cllr Peter Jones	1/11/03	30/04/09
Dr Pauleen Lane	1/12/00	30/04/06
Sir Thomas Legg KCB QC	1/04/05	31/03/08
David Moss	1/04/01	30/06/07
Tim Parker	3/01/06	31/03/08
Brian Pomeroy CBE	1/05/03	30/04/09
Professor Peter Smith	1/11/03	30/04/09
Cllr Chris White	1/06/05	31/05/08

Note 1: This ex-officio appointment will be coterminous with his appointment as Chief Executive.

Board member interests

The following disclosure relates to Commissioners at March 2006 who are in a position of influence resulting from being elected to, receiving remuneration from, or being appointed to any organisation:

- where the Commission appoints the auditor or inspects the body;
- where there are specific statutory responsibilities to cooperate, for example Healthcare Commission;
- that is a central government department; and
- that is a provider or receiver of significant services to or from the Commission.

Professor Sir Michael Lyons Acting Chairman from 24 January 2006. Steve Bundred	Contract with the ODPM personally and via Sir Michael Lyons Consulting. Contract with KPMG for advisory services. Board member of Higher Education Funding Council for England (HEFCE) to 30 September 05. During the year his wife worked on contract for the London Borough of Hounslow.
Jim Coulter Dr Jennifer Dixon Sheila Drew Smith OBE	Chair of Bridging Newcastle Gateshead. Board member of the Healthcare Commission. Non Executive Board member of the Housing Corporation. Member of the SE Regional Housing Board. Member of the Central List of Independent Assessors for the Office of the Commissioner for Public Appointments.
Cllr Peter Jones	Leader of East Sussex County Council. Chairman of Sussex Police Authority. Deputy chairman of South East England Development Agency
Dr Pauleen Lane	Elected Member at Trafford MBC Governing Body of ELEVATE – East Lancashire Housing Market Renewal Pathfinder. Member of the NW Regional Housing Board.
Sir Thomas Legg KCB QC David Moss	Chairman, Hammersmith Hospitals NHS Trust. Employed by Southampton University Hospitals NHS Trust. Seconded from there as Programme Director for NHS Pay Reform at the Department of Health, and also seconded to the Healthcare Commission as a Reviewer.
Tim Parker Brian Pomeroy CBE	None Member of the Central List of Independent Assessors for the Office of the Commissioner for Public Appointments. Chairman of the Treasury's Financial Inclusion Taskforce.

Professor Peter Smith	Contracts with Healthcare Commission, Department for Education and Skills, Department of Health and the Home Office. Chair, Advisory Board, UK Centre for the Measurement of Government Activity (Office for National Statistics).
Cllr Chris White	Member of Hertfordshire County Council. His wife is a member of St Albans City & District Council.

Senior managers during the period of review

Steve Bundred as Chief Executive is the Commission's chief officer and holds the statutory title of 'Controller of Audit'. The Board has delegated authority for the day-to-day management of the Commission to the Chief Executive. He therefore has responsibility for the overall organisation, management and staffing and for its procedures in financial and other matters including conduct and discipline. He discharges this responsibility through his management team who meet on a regular basis throughout the year.

The Audit Commission's management team during the year to 31 March 2006 was:

Tracey Dennison

Managing Director, Human Resources

Tracey was previously Assistant Chief Executive (Personnel) at Camden Council. She is a fellow of the Chartered Institute of Personnel and Development.

Frances Done CBE

Managing Director, Local Government

Frances was Chief Executive of Manchester 2002 Ltd, the organising committee of the Commonwealth Games. She trained as an accountant with KPMG and has worked for the Housing Corporation. She was Treasurer and later both Chief Executive and Treasurer of Rochdale MBC.

Andy McKeon

Managing Director, Health

Andy was the Director of Policy and Planning at the Department of Health. During his time at the Department he was also head of primary care, and played a central role in the development of a number of white papers.

Richard Peel to 5 January 2006

Managing Director, Communications and Public Reporting

Richard held previous senior communications roles at a range of organisations including Ofcom, the Independent Television Commission, England and Wales Cricket Board and the BBC. Since he left the Commission, Richard's post has been filled on a temporary basis pending a permanent appointment.

Peter Wilkinson

Managing Director Strategy and Resources

Peter has been at the Audit Commission since 1990, and a Director since 1995. Peter has worked in the local government, health and police sectors.

Changes post March 2006

With the introduction of new Strategic and Management Plans, the Chief Executive reviewed his management team to ensure the structure was fit for purpose and made the following changes.

Managing Director, Policy, Research and Studies – a new post to consolidate the studies functions across the Commission including knowledge management. Peter Wilkinson will establish this directorate.

Managing Director, Audit – a new post to strengthen our core audit activity within Commission decision making and to ensure we are at the cutting edge of best practice. Martin Evans will join the management team in this capacity.

Managing Director, Corporate Services – this new directorate will focus on the delivery of corporate services covering business planning and finance, estates and facilities, procurement, business information services and legal services. The directorate is being led on an interim basis by Jeremy Boss.

The other four managing director positions remain largely unchanged: Managing Director, Local Government, Community Safety and Housing; Managing Director, Health; Managing Director, Human Resources; and Managing Director, Communications and Public Reporting.

Auditor Details

This Financial Statement is audited by the Comptroller and Auditor General and he has not provided any other service to the Commission during the period. The audit fee is disclosed in Note 7.

The Accounting Officer confirms that:

- there is no relevant audit information of which the auditors are unaware;
- he has taken all the steps he ought to ensure that he is aware of all relevant audit information; and
- he has taken all the steps he ought to establish that the auditors are aware of the information.

The Management Commentary

Nature of the business

The Audit Commission is an independent public body responsible for ensuring that public money is spent economically, efficiently, and effectively in the areas of local government, housing, health, community safety and fire and rescue services.

Our principal activities are the audit of local authorities and NHS bodies, inspection of local authorities (including working with other regulators) and development and publication of national studies. These account for 96.8 per cent of our income, of which 85.9 per cent is fee generated and 14.1 per cent funded by government grants. The Commission also has income streams from bank interest, sales of publications and reimbursement for staff seconded to other organisations.

We have a duty, taking one year with another, to ensure that our income is not less than our expenditure. We are audited by the National Audit Office (NAO).

We operate under a Corporate Governance Framework, which is reviewed and approved by the Board annually. This framework also requires us to review Board effectiveness, produce and maintain a scheme of executive delegation and strive for excellence in corporate governance.

The Commission's activities are analysed in note 2 to these accounts.

Future challenges

We operate in a highly dynamic environment of public policy, scrutiny and expectation. The coming year will present us with a number of challenges against a backdrop of further major reform of the public sector.

Our Strategic Plan 2006 sets out our ambitions for how we will help improve public services and ensure the success of the forthcoming changes to the regulatory environment.

The plan sets out five strategic objectives:

- to raise standards of financial management and financial reporting;
- to challenge public bodies to deliver better value for money;
- to encourage continual improvement in public services so they meet the changing needs of diverse communities and provide fair access for all;
- to promote high standards of governance and accountability; and
- to stimulate significant improvement in the quality of data and the use of information by decision makers.

The government has announced plans to merge 11 public services inspectorates into 4. By simplifying and clarifying the core responsibilities of each inspectorate, the objective is to remove unnecessary duplication and deliver more strategic and more effective regulation. We believe that regulation will continue to play an essential role, providing assurance to the public, and driving improvement.

This will bring new challenges and opportunities for the Audit Commission. We are well placed to undertake a coordination role in respect of local services inspection that will enable us to capitalise on our experience from coordinating the CPA regime, but will also demand that we work in more innovative ways to make the most of this integrated approach.

Other challenges include the broadening role of local public bodies and the greater emphasis on improving services in ways that people recognise and value.

Increasingly, local public bodies are commissioning services from a variety of public, private and not-for-profit suppliers, as well as providing services themselves. We must ensure that our regulatory regime evolves to keep pace with these developments.

Given the drive to tailor services around peoples needs, we must also ensure that our regulatory regime is sufficiently user focused. For example, our assessments of performance and improvement will need to extend beyond organisational boundaries to reflect the public's experience of the totality of services within a locality.

There will be a continuing need to maximise the positive impact of our work, while reducing both the burden of regulation on public bodies and increasing our own value for money.

We enjoy a good reputation among senior stakeholders, as shown in our perception survey last year. Among the strengths valued by stakeholders, independence, evidence-based reporting, and our core priorities of audit, assurance, and value for money reporting were specifically cited. We have a high-calibre workforce, committed to the improvement of public services, which contributes to the Commission's strong brand both nationally and locally.

Efficiency continues to be a key priority. The budget for the 2006/07 year has been prepared on the basis of delivering further efficiency savings to offset the costs of implementing International Auditing Standards.

In addition, we are undertaking an internal review of costs to identify and eliminate waste and to improve efficiency. We are also reviewing all investment options to ensure clear consistency with the strategic objectives.

The Commission's role in conservation of resources

The Commission is committed to implementing the principles set out in the Government's sustainable development strategy. The Commission has adopted a number of approaches to minimise its impact on the environment, and to encourage local public bodies and housing associations to do the same.

Specific measures include:

- undertaking environmental performance assessment using the BREEAM Index for all new office buildings and, where possible, adopting naturally ventilated building solutions;
- utilising office furniture produced from sustainable sources supplied by manufacturers with Forest Stewardship Council (FSC) or comparable European accreditation;

- undertaking environmental assessments of suppliers as part of our procurement procedures;
- printing all national reports on 100 per cent recycled and chlorine-free paper (75 per cent post-consumer waste and 25 per cent from mill broke and virgin fibres) and increasingly use stationery from fully recycled sources;
- agreeing home working contracts for some staff to minimise home to workplace travel;
- changing printing strategy to default to double-sided printing;
- encouraging the use of video conferencing to limit business travel where this is possible;
- encouraging staff to use public transport where appropriate. All London staff are offered an annual travel card. Consideration is given to how accessible public transport is for all new property locations;
- providing alternatives to the use of a car, for example we support the Bike to Work Scheme by providing staff with cycle loans;
- providing incentives to encourage the selection of leased cars with a low environmental impact, currently taken up by 12 per cent of eligible staff; and limiting choice to cars with an engine size of two litres or less producing less than 225gms/km of carbon dioxide; and
- supporting regional activities with some regional offices nominating an environmental champion to lead on local recycling activities and promote environmental sustainability.

Development and performance of the business

A year in action

We make sure that 11,000 public bodies in England, which between them spend £180 billion of public money every year, provide well-run, value for money services.

Alongside this we provide information on the quality of local services; work with public bodies to improve their services and produce reports with practical recommendations for improvement.

April 2005

The new Wales Audit Office is created by the merger of Audit Commission in Wales and the National Audit Office in Wales.

Our new *Code of Audit Practice*, with a greater emphasis on how public bodies achieve value for money, is published. This defines our audit work with public sector bodies, ensures better reporting of audit results and focuses on audit's contribution to improvement.

May 2005

Over 8,000 schools give their views on their council and other services for children and young people in our annual *Schools Survey*. The results are used to inform service improvements.

The new *Approach to Service Inspections* places a stronger emphasis on improved outcomes for users of services and value for money in local housing, environment and culture service inspections.

We publish our first best practice review of the work of nine market renewal pathfinders in the North and the Midlands. These reviews aim to improve value for money in these complicated programmes of work.

June 2005

Our *Financial Management in the NHS 2003/04* report, produced in partnership with the National Audit Office (NAO), calls for improved financial management to meet the challenges NHS reform will bring.

Our stand at the NHS confederation annual conference showcases our improvement investigator tools, which allow NHS organisations to compare their own spending with similar bodies to identify where costs may be above average.

A problem-solving tool to help managers improve services to children and young people is the latest addition to the Improvement Network website.

Our report, *Financing Council Housing*, calls for a review of the funding system to strengthen local accountability and encourage and reward performance. Steve Bundred speaks on 'Financing Council Housing' at the Chartered Institute of Housing (CIH) annual conference and exhibition and around 900 delegates visit our stand.

The *Information and Communication Technology (ICT) Fraud and Abuse* report identifies the risks public bodies face as a result of the development of new technologies. The report highlights a 'culture of complacency' and warns that public bodies failing to ensure staff understand ICT rules and policies risk undermining the effectiveness of their ICT security arrangements.

We attend the Chartered Institute of Public Finance Association (CIPFA) conference. Around 400 delegates who visit the stand try out our interactive tools on changing organisational culture.

July 2005

We hold our inaugural annual lecture and debate at the British Museum with a keynote speech by Sir Michael Bichard on 'Is public service reform delivering?'

Our auditors issue 300 opinions on accounts produced by NHS bodies. Twenty one percent of accounts have to be changed due to errors identified as a result of the audit process.

The results of our first CPA assessment of all 46 fire and rescue authorities are published. These scores set a benchmark for future improvement.

Our *Stewardship and Governance 2004* report finds that in 2003/04 councils and health bodies failed to make financial management a priority, with twenty four percent of local authorities having to resubmit accounts due to significant errors found by auditors.

We challenge delegates at the Local Government Association (LGA) with an interactive quiz on *CPA The Harder Test*. The quiz aims to test their knowledge of the new CPA guidelines. Around 500 delegates visit the stand to take part.

Fitness for Purpose in the 21st Century, a joint report with the Improvement and Development Agency (IDeA), discusses the framework within which local authorities have to work and aims to stimulate discussion on how best they can tackle new political, operational and financial issues.

August 2005

In partnership with the Office of the Deputy Prime Minister, the Department for the Environment Food and Rural Affairs and the Local Government Association we publish a national set of quality of life indicators, which can help local authorities and their partners develop a snapshot of key quality of life issues in their area.

September 2005

We strengthen our role as the single largest auditor of NHS foundation trusts (FTs) with the establishment of a Trust Practice. The new practice will focus on our support programme for NHS trusts during their transition to foundation status. By March 2006 we are working with 13 foundation trusts.

Managing the Financial Implications of NICE Guidance shows that variations in the quality of care patients receive will continue until financial management in the NHS is improved. It identifies steps that trusts and PCTs can take to improve planning, budgeting and monitoring arrangements.

October 2005

Our auditors issue 403 opinions on accounts produced by local government bodies. But 30 per cent of local government accounts are delayed by fundamental errors in the accounts identified as a result of the audit process.

Our new Area Profiles website is launched, bringing together quality of life information on each area alongside inspection scores for public services, and residents' views. See www.areaprofiles.audit-commission.gov.uk

Our study into the government's Supporting People programme finds that a clear national framework and a long-term financial commitment is needed if improvements to services for some of the country's most vulnerable people are to be maintained.

Governing Partnerships: Bridging the Accountability Gap urges local public bodies to take a much harder look at whether the partnerships they are involved in are delivering improved services and value for money.

Early Lessons from Payment by Results, the first full review of the payment by results (PBR) system, finds that while trusts and PCTs recognise the potential benefits of PBR, it is exposing weaknesses in financial and performance management and information systems.

November 2005

Auditors issue use of resources assessments, including an explicit judgement on value for money, at 150 single tier and county councils. These assessments focus on whether councils have sound financial management to ensure they have the resources to support their plans to improve services.

Our report, *World Class Financial Management*, challenges providers of public services to learn from international examples of world class financial management in areas such as governance, planning and reporting.

We launch the consultation on our new *Strategic Plan 2006-08* including a series of internal conferences to canvass the views of more than 900 staff.

The Efficiency Challenge report on revenues and benefits identifies potential savings for councils of £140 million a year, and outlines ways in which this could be achieved with good practice examples.

We complete our internal Widening the Net project which provides broadband access to over 250 sites and 300 home workers, improving efficiency and cutting our costs.

December 2005

CPA – the Harder Test, our annual assessment of council performance in single tier and county councils, shows that CPA has helped drive improvement in councils. Fewer councils than ever before are in the lowest two CPA categories .

Two reports are published jointly with the NAO which look at the ways in which public services are delivered, examine the nature of the links between partners in public service delivery chains, and explore how these can be made more efficient and effective. The first, *Building More Affordable Homes*, finds that most local authorities believe they will not meet the need for affordable housing in the next three years, despite planned investment of £3.3 billion.

The second, *Delivery Chain Analysis for Bus Services* in England, identifies the steps that can be taken by the government and local authorities to improve bus services and attract more people to travel on buses.

January 2006

Our Fire CPA report brings together learning from the individual corporate assessments for the 46 fire and rescue authorities (FRAs) in England. It shows that nearly half (47 per cent) of FRAs are categorised overall as good or excellent. However, although FRAs are working towards modernisation, the pace of change varies substantially between authorities.

February 2006

Tackling Childhood Obesity, a joint report by the Audit Commission, the Healthcare Commission and the NAO, calls for urgent action to be taken by the government to ensure that the target to halt the rise in obesity in children under 11 is met.

We launch the first of four innovation and efficiency tool kits to help housing associations and local authorities meet the government-wide drive for savings of £835 million to feed back into housing services. See www.audit-commission.gov.uk/housingefficiency

The Planning System report finds that there is a national shortage of experienced planners in the public sector. The report includes innovative good practice from local authorities taking radical approaches to addressing heavy workloads.

March 2006

Auditors issue use of resources assessments (including a specific judgement on value for money) at 238 district councils. These focus on whether councils have sound financial management to ensure they have the resources to support their plans to improve services.

Our discussion paper, *The Future of Regulation in the Public Sector*, asks government to shape the future role and structure of regulation to fit its far-reaching public services reforms. It sets out ten principles which should inform the design of regulatory regimes.

Living Well in Later Life finds that public services often fail to consider the special needs of older people. Jointly produced by the Healthcare Commission, the Audit Commission and the Commission for Social Care Inspection, the report is a comprehensive assessment of services for older people.

Delivering Efficiently: Strengthening the Links in Public Service Delivery Chains draws on the three reports published jointly with the NAO in December and February. It analyses the ways in which public, private and voluntary bodies need to work together to deliver the government's priority targets and so provides evidence of what works well in advance of the Comprehensive Spending Review due in 2007.

Resources and relationships

People

As at 31 March 2006 we directly employed 2,023 staff (full-time equivalents) which at £114m represented our single biggest cost.

The quality, diversity and engagement of our staff and suppliers are fundamental to our success. Changes in the regulatory workload and increased efficiency require us to develop our staff so that they have the range and level of skills necessary.

We are committed to:

- developing staff to give them the skills to deliver our changing business;
- ensuring that staff numbers match structural and workload changes as we re-focus our activities; and
- increasing the diversity of our staff, particularly at senior levels, and increasing their capacity to address equality, diversity and user focus across our work programmes.

The Audit Commission is in the upper quartile of organisations investing in training and development. Our recruitment practices are based on Chartered Institute of Personnel and Development (CIPD) and industry best practice, in doing so we comply with part III of the Civil Service Commissioner's Recruitment Code. Additionally we are carrying out considerable work to increase recruitment via our website as recommended in the Code.

Diversity

Our overall aim last year was to improve and consolidate our strategic approach to diversity and equality. We commissioned an independent review of our own performance in this area that resulted in a 2 star rating, which is in keeping with an organisation that is at the beginning of integrating diversity and equality into its work.

We have established a Diversity Strategy Board (DSB) which reports to the Chief Executive and will oversee and scrutinise the development of the Commission's work in diversity and equality. The DSB is chaired by a member of the Audit Commission Management Team and comprises regional management representation and the chairs of each of the staff networks.

We have established a Policy Review Schedule and our Equality Impact Assessment (EIA) process which enables us to identify the effects and implications for our major functions in the context of race and disability equality and human rights. In Human Resources the EIAs look at all of the equality strands – gender, race, religion and belief, sexual orientation, age and disability.

We are becoming more outcome focused, for example each of the staff networks is sponsored by a member of the ACMT to support better equality issues at a leadership level. This year the Commission joined the top 100 gay-friendly organisations in the Stonewall Index, the only inspectorate or regulator to do so.

There has been an increase in the number of applicants and staff appointed from black and minority ethnic communities, disabled people and women. We will continue to target our recruitment in all posts to groups that are under-represented in the Commission.

CPA – the Harder Test is far more focused on the importance of diversity, equality, human rights and user focus.

Finally, we have launched a diversity and equality intranet page as a resource for the Commission and the new financial year will see the creation of an internet site and a staff network for part-time staff. We support and encourage staff networks and ensure there is good communication among our staff.

Financial review

The Commission has a duty to manage its affairs so that its income will, taking one year with another, be not less than its expenditure.

The Commission's income totalled £195.8m of which £162.9m related to fees and £26.9m related to grants received from government departments, together with sundry income of £6.0m. The Commission made a surplus of £1.9m in the period. This represented a surplus of £0.7m and a £1.2m adjustment to our pension cost following the application of Financial Reporting Standard 17.

Audit Commission annual report and accounts

The summary financial position is as follows:

	Total
	£000
Reserves brought forward	(65,579)
Results for the year	1,932
Adjustment shown in the Statement of Recognised Gains and Losses	47,901
Reserves carried forward	(15,746)

With a small actuarial surplus in the Pension Scheme at the last valuation date (March 2005) both the Scheme Trustees and the Commission consider that the Scheme is being adequately funded for its longer-term viability. The application of Financial Reporting Standard (FRS) 17 *Retirement benefits* has produced a pension liability of £38.4m on the Balance Sheet: substantially reduced from last year's deficit of £87.5m. Notwithstanding the pension deficit calculated under FRS 17, these accounts have been prepared and audited on a going concern basis. Full disclosure on the effects of the implementation of this accounting standard is shown in note 17 (reserves) and note 21 (pensions).

Local government audit and inspection activity generated £132.2m, a reduction of £22.7m in the year. NHS audit activity generated £57.5m, a reduction of £14.2m in the year. These reductions totalling £36.9m reflect the transfer of work to the WAO (£16.3m for the year ending March 2005) and the effects of changing regulation and improved efficiency. Other income received included deposit interest of £2.7m.

Staff and contractor costs represent over 60 per cent of our operating costs, totalling £114m for staff and £8.8m for contractors over the year. Average staff numbers have reduced by 204, 9% in the year, to 2,063. This reflects staff leaving due to the reduction of performance activity in local government and the transfer of staff to the WAO.

Audit appointments totalling 338 have been awarded to seven private accountancy firms: Baker Tilly, Deloitte and Touche, KPMG, Mazars Neville Russell, PKF, PricewaterhouseCoopers and RSM Robson Rhodes. The cost of these appointments was £40.4 m and represents 22% of the Commission's income.

We continue to ensure that a positive cash position is maintained to provide working capital requirements that are fully self-funded and interest payments avoided.

Post Balance Sheet events

There were no significant post Balance Sheet events that need to be separately reported.

Payment performance

The Commission aims to observe the principles of the Treasury's *Better Payment Practice Code* and pay undisputed invoices from its suppliers within 30 days. In the 12 month period, 91% of undisputed invoices were paid within 30 days (2004/5, 85%).

The Remuneration Report

Remuneration Policy

In determining the appropriate level of remuneration for members of the Audit Commission Management Team, the Commission has regard to:

- the need to attract and retain suitably qualified and experienced individuals to enable the Commission to fulfil its remit and responsibilities;
- market intelligence and specialist advice on national and regional labour markets; and
- official guidance, including the government's inflation target.

Currently there is no process for reviewing the base remuneration of members of the Management Team and it is planned that one will be introduced during the 2006/07 financial year.

Chief Executive's remuneration

The remuneration and contract terms of the Chief Executive and Managing Directors are determined by the Audit Commission Board in accordance with Schedule 1 of the Audit Commission Act 1998.

Composition of remuneration

The main components of the Management Team members' remuneration are:

- **Salary**
The basic salary for each Management Team member is determined by taking account of each person's responsibilities, record of achievement and experience, together with market analysis.
- **Other benefits**
All Management Team members (with the exception of the Chief Executive) are eligible for a lease car. Individuals can opt for an alternative transport allowance. A travel card for travel within London is also available.
- **Performance-related pay**
All Managing Directors are eligible to receive performance-related pay (PRP) up to a maximum of 10 per cent of salary. The award to an individual is determined by reference to a set of agreed targets and assessed by the Chief Executive. In the case of the Chief Executive, the assessment is undertaken by the Chairman and confirmed by the Audit Commission Board. Performance-related pay is pensionable and is reviewed every six months, except for the Chief Executive who has an annual review.

Chief Executive and Management Team appointments

	Date of appointment	Date of appointment to post	Contract
Steve Bundred, Chief Executive	01/09/03	01/09/03	Permanent
Tracey Dennison, Managing Director, Human Resources	17/11/03	17/11/03	Permanent
Frances Done CBE, Managing Director, Local Government	24/11/03	24/11/03	Permanent
Andy McKeon, Managing Director, Health	08/09/03	08/09/03	Permanent
Richard Peel, Managing Director, Communications & Public Reporting	05/01/04	05/01/04	Permanent ¹
Peter Wilkinson, Managing Director, Strategy and Resources	21/5/90	15/03/04	Permanent

Note 1: Richard Peel left the Commission on 5 January 2006. This role was undertaken by Geronimo Communications in the period to 31 March 2006 at a cost of £25,000.

Pension arrangements

The Chief Executive and Managing Directors are all eligible to be members of the Audit Commission Pension Scheme. This is a stand-alone defined benefit scheme with one level of benefit for all members, subject to the Inland Revenue Earnings Cap, where appropriate.

Steve Bundred's remuneration package includes a shared cost AVC arrangement in recognition of his earnings above the earnings cap.

Other terms of employment

Notice periods and provisions for compensation for early retirement are based on those for staff. The Commission will appoint on a fixed-term or permanent contractual basis as appropriate.

Chief Executive and Management Team remuneration details

	Year to 31 March 2006			Total	Year to 31 March 2006	Year to 31 March 2005
	Salary	PRP	Other benefits	(excluding pension contribution)	Pension contribution	(excluding pension contribution)
	£000	£000	£000	£000	£000	£000
Steve Bundred	189	17	0	206	29	195
Tracey Dennison	106	8	6	120	16	114
Frances Done CBE	150	10	0	160	16	156
Andy McKeon	146	12	5	163	16	157
Richard Peel ¹	117	0	1	118	12	155
Peter Wilkinson	148	12	1	161	16	156

Note 1: The figures relate to the period 1 April to the date of leaving. In addition to the disclosure above, Richard Peel received £81,000 as a non-contractual termination payment.

Chief Executive and Management Team pension entitlement details

	Real increase in pension at 60 £000's	Total accrued pension at 31 March 2006 ¹ £000's	Total accrued pension at 31 March 2005 £000's	Increase in transfer value £000's	Transfer value at 31 March 2006 £000's	Transfer value at 31 March 2005 £000's
Steve Bundred	1	44	42	62	741	678
Tracey Dennison	1	38	35	45	519	474
Frances Done CBE	1	3	2	25	56	30
Andy McKeon	3	56	52	107	895	788
Richard Peel ²	1	3	2	16	42	26
Peter Wilkinson	1	21	19	41	346	305

Note 1: The total accrued pension is that which would be paid annually on retirement at age 60, based on the person's service to March 2006.

Note 2: The real increase in pension figure relates to the period from 1 April 2005 to the date of leaving.

Commissioner remuneration policy

The remuneration of Commissioners is now determined by the Secretary of State for Communities and Local Government, and formerly by the Deputy Prime Minister.

Commissioners receive remuneration based on their time commitment, which is normally three days per month. Commissioners with extra portfolio responsibilities are paid on the basis of four days per month. The Chairman's remuneration is based upon an agreed weekly time commitment.

Current Board members receive no other remuneration benefits from the Audit Commission, nor (with the exception of Steve Bundred) are they members of the Audit Commission Pension Scheme.

Commissioner remuneration details

	<i>Year to 31 March 2006</i>	<i>Year to 31 March 2005</i>
	<i>£000</i>	<i>£000</i>
Commissioners in place at 31 March 2006		
Professor Sir Michael Lyons (Acting Chairman)	26	17
Jim Coulter	14	0
Dr Jennifer Dixon	14	13
Sheila Drew Smith OBE	14	12
Cllr Peter Jones	14	13
Dr Pauleen Lane	14	13
Sir Thomas Legg KCB QC	14	0
David Moss	14	13
Tim Parker	3	0
Brian Pomeroy CBE	18	17
Professor Peter Smith	14	13
Cllr Chris White	11	0
Steve Bundred (See above for remuneration details)		
Commissioners who left prior to 31 March 2006		
James Strachan	106	97
Roger Hoyle	3	13

Audit Commission annual report and accounts

James Strachan is entitled to a pension arrangement funded by the Audit Commission. As he was an appointee of the Secretary of State and not the Commission, he was not entitled to join the Commission's Pension Scheme. Separate arrangements have therefore been made for him that provides a similar level of benefit as employees. The cost of this Scheme is identical to that of the main Scheme with James Strachan contributing 6 per cent of remuneration and the Commission contributing 15.6 per cent: £11,000 (£13,000 for period ending March 2005). The Commission's contributions are included in the above disclosures. There is an FRS 17 value of unfunded liabilities accrued to 31 March 2006 of £63,000. This has not been provided for in the accounts for the year ended 31 March 2006.

A handwritten signature in black ink, appearing to read 'S Bundred', written over a horizontal line.

Accounting Officer Steve Bundred
Date 26 June 2006

Statement of Responsibilities

Board members' responsibilities

The Chairman is the leader of the Board. There are three main components to the Chairman's role:

- Strategic leadership – to lead the development and implementation of the Commission's strategy.
- External communications – to lead on the Commission's key relationships with government ministers, other senior politicians and advisers, chairs of public bodies and other organisations and the media.
- Corporate governance – to encourage high standards of propriety and promote the efficient and effective use of staff and other resources throughout the Commission. The Chairman presides at board meetings and ensures that these are held at regular intervals throughout the year and are accurately minuted.

Commissioners act collectively: they do not have individual executive authority. As individuals they are responsible for upholding the values and principles of the Commission and for contributing their personal skills, knowledge and experience to the Commission's work.

Other important responsibilities of Commissioners include:

- ensuring that high standards of Corporate Governance are observed at all times;
- ensuring that the Commission identifies and manages its risks effectively;
- subject to the requirement that the Commission maintains at all times its independence, ensuring that, in reaching decisions, the Board has taken into account directions issued by the Secretary of State and any relevant guidance issued by the sponsoring departments and had regard to any applicable government policy; and
- establishing and maintaining effective arrangements for the discharge of the Commission's functions, including delegating to staff within a clear framework of strategic control, consulting interested bodies on major developments and responding to their views, where appropriate establishing advisory and consultative bodies to inform the Commission's work, and facilitating good communication with external organisations and the public.

Statement of Accounting Officer's responsibilities

In accordance with paragraph 11(1) of Schedule 1 to the 1998 Act, the then Secretaries of State for Transport, Local Government and the Regions, Health and for Wales directed the Commission to prepare a Statement of Account. The accounts are prepared on an accruals basis and must show a true and fair view of the Commission's state of affairs at the period end and of its income and expenditure and cash flows for the accounting period.

In preparing the accounts the Commission is required to:

- observe the Accounts Direction issued by the Secretaries of State, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards have been followed, and disclose and explain any material departures in the financial statements; and
- unless inappropriate, prepare the financial statements on the going-concern basis.

The Chief Executive has been appointed Accounting Officer for the Commission. His relevant responsibilities as Accounting Officer, including his responsibility for the propriety and regularity of the public finances for which he is answerable and for the keeping of proper records, are set out in the Non-Departmental Public Bodies' Accounting Officer Memorandum issued by HM Treasury and published in Government Accounting.

Statement on internal control

Scope of responsibility

- 1.1. As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of the Commission's policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible in accordance with the responsibilities assigned to me in Government Accounting.

2. The purpose of the system of internal control

- 2.1. The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of Commission policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place in the Commission for the year ended 31 March 2006 and up to the date of approval of the annual report and accounts, and accords with Treasury guidance.

3. Capacity to handle risk

- 3.1. The Commission's structure has been designed to ensure it has the capacity to handle risks.

a) **The Board**

Commissioners are independent appointees of the Secretary of State, appointed usually for a three-year term which may be extended for a further three years. The Board has the ultimate responsibility for ensuring that the Commission identifies and manages its risk effectively. Under a clear governance framework, it takes decisions in the most significant areas of the Commission's areas of responsibility and reviews the major risks twice a year.

Because the Commission Board recognises its responsibilities to ensure there are robust arrangements for managing risk, reports to the Board address the financial, human resources and legal implications of issues, together with the explicit risks arising from the issue under consideration.

b) **The Management Team**

This Team has the responsibility for overseeing risk management within the Commission.

The culture of risk management within the Commission is determined at a strategic level. Each quarter the Management Team formally reviews all significant risks that have been identified and ensures that they have been fairly stated. It also considers risk as part of its decision-making processes and satisfies itself that the less significant risks are being actively managed by relevant departmental

managers, with the appropriate controls in place, and that these controls are working effectively.

The Management Team considers all significant papers for both the Board and the Audit Committee, to ensure all relevant factors are taken into account.

All issues in internal audit reports are discussed by the Management Team and the resulting actions agreed.

c) ***The Audit Committee***

The Audit Committee meets at least three times in a standard 12-month period, and met five times in the year under review. Its responsibilities are:

- To oversee the production of the Commission's annual accounts and to recommend them to the Commission for approval.
- To scrutinise and review:
 - the Commission's financial and accounting policies, practices and processes, including information and communication technology;
 - the internal control systems including internal audit; in particular to appoint the internal auditors, approve their work plan and review their reports and the responses of management. The Committee receives the annual report from the internal auditor summarising the work done in the period, including a review of the ongoing work implementing audit recommendations;
 - the Commission's assessment and management of risk. It formally reviews the significant risks that have been identified twice a year;
 - the results of the external audit by the NAO including their management letter and the response by management;
 - on behalf of the Commission, to scrutinise any aspect of the work of the organisation and to report as appropriate; and
 - to oversee the quality review process for assessing the performance of auditors and inspection suppliers appointed by the Commission.

During the year the Commission Board added 'to scrutinise and review the implementation of recommendations from audit reports' to the Audit Committee responsibilities.

It also reports annually to the Board on its views of the governance of the Commission and its own effectiveness. It also regularly reviews the level of revenue reserves and makes recommendations to the Commission Board on an appropriate level of reserves for the Commission to hold.

The members of the Audit Committee for the period under review were:

Brian Pomeroy CBE (chair)	Whole year
Sheila Drew Smith OBE	From 1 July 2005
Roger Hoyle	to 30 June 2005
Cllr Peter Jones	to 7 March 2006
Professor Peter Smith	Whole year
Cllr Chris White	From 8 March 2006

As Accounting Officer, I attend all meetings of the Audit Committee.

d) **Internal audit**

An external firm of Chartered Accountants, Bentley Jennison, has been appointed as the Commission's internal auditors, with the relevant partner as Head of Internal Audit. He reports to the Audit Committee and Accounting Officer regularly to standards defined in the Government Internal Audit Standards. Those reports include the internal auditor's independent opinion on the adequacy and effectiveness of the Commission's system of internal control together with the recommendations for improvement. The Commission also encourages and endorses liaison between internal and external audit to achieve a more effective audit, based on a clear understanding of respective roles and requirements.

The Internal Auditors attend all Audit Committee meetings and the Head of Internal Audit has direct access to me.

e) **External audit**

The external auditor, the Comptroller and Auditor General is appointed by statute, and the National Audit Office regularly comments on governance.

The external auditor is invited to attend all Audit Committee meetings and has direct access to me.

4. The risk and control framework

- 4.1. The Commission subscribes to the seven principles of conduct underpinning public life as set out by Lord Nolan (Selflessness, Integrity, Objectivity, Accountability, Openness, Honesty, and Leadership).
- 4.2. There is a framework agreement in operation between the Commission and its principal sponsoring department, the Office of the Deputy Prime Minister. The Commission consults Ministers and others extensively when planning its activities, including on the risks associated with different courses of action. It also monitors progress against both the activities and the risks. The Commission Solicitor routinely attends Board meetings to advise on governance and legal risks.

- 4.3. Internally the Commission has produced, after both internal and external consultation, a comprehensive Corporate Governance Framework. This was subject to independent external scrutiny by Sir John Bourn, Sir Derek Higgs, and Mr Steve Freer. This clearly determines how the Board manages its affairs and which matters are delegated to the Chief Executive. It is reviewed annually.
- 4.4. Additionally the Commission has drawn up a Scheme of Delegation which reflects the Corporate Governance Framework. This Scheme covers all Directorates and enshrines a systematic and common approach to delegation within the organisation. This is backed by a comprehensive set of financial, IT and HR policies. This Scheme of Delegation is also reviewed annually.
- 4.5. The principal features and key high-level controls that have operated throughout the year are:
- a) an organisational structure that supports clear lines of communication and accountability;
 - b) business strategies that are approved by the Commission Board and are subject to consultation with Commission stakeholders;
 - c) key performance indicators that are regularly measured against the strategy and business plan; and
 - d) clear processes so that the risks identified fit into an overall structure.
- 4.6. The high-level controls enable the Commission to encourage innovative solutions that, whilst sometimes involving risk, can be implemented with an awareness and active management of the risks that they carry.
- 4.7. The Commission's risk processes have been designed to:
- a) establish a policy framework approved by the Commission Board and the Management Team, within which strategic risks are identified, managed and kept under review;
 - b) embed risk management and compliance by making it part of the day-to-day management processes. Although the Management Team collectively own the risks, each strategic risk is also allocated to an appropriate Management Team member. This ensures that risk management is an essential part of all directorate management arrangements. In addition, each risk is managed by a named manager, who actively reviews and reports on that risk;
 - c) adopt a consistent approach throughout the organisation. We have done this by appointing risk managers who take responsibility for risk identification in their directorates and by appointing a member of staff centrally, part of whose function is to ensure that all risk managers adopt a consistent approach. This appointment is included as a requirement within the Scheme of Delegation; and
 - d) encourage staff to identify and manage risk. We aim to provide all staff with appropriate tools and training. We have produced a handbook that is available to all staff that sets out the Commission processes.

- 4.8. Proper consideration of the mitigation of the risk is crucial to the effectiveness of the control. Risks are identified at an operational level and consolidated to identify themes arising across the organisation. The corporate level risks arising from this process are reviewed for completeness by the Management Team, the Audit Committee and the Commission Board. This formal process takes place twice a year. The Management Team considers the principal risks on a quarterly basis.
- 4.9. To maintain a proper profile within the organisation, the Audit Committee receives presentations from the responsible executives on emerging or changing risks each time it meets. These presentations detail the risk, how the risk is changing, and the steps being taken to limit or eliminate the risk. During the last two years these presentations have covered all major areas of activity within the Commission. The Committee also reviews the financial policies and the reserves policy.
- 4.10. At the financial period end the Commission had identified four generic risk areas which are increasing in both probability and impact and which it is actively managing:
- a) strategic risks;
 - b) risks to the Commission's reputation and credibility;
 - c) operational risks; and
 - d) risks associated with financial and regime stability.
- 4.11. The Commission has a well-developed, rigorous approach to reviewing the quality of the work of its appointed auditors. Our quality review process is similar to, but goes wider than, the system of external regulation of registered company auditors in the private sector.

Quality reviews are carried out by the Commission's head of audit regulation, the Director of Audit Policy and Appointments, who reports his findings to the Commission's Audit Committee.

5. Review of effectiveness

- 5.1. As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within the Commission who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Board and the Audit Committee. A plan to address weaknesses and ensure continuous improvement of the system is in place.
- 5.2. The process that the Commission has maintained to ensure internal control during the period includes both risk management and other sources of assurance, including internal audit. The Commission's internal audit function has regular access to myself and to the chairman of the Audit Committee, and attends every Audit Committee meeting.

- 5.3. I believe that there are satisfactory processes in place to identify and manage the significant risks faced by the Commission.

A handwritten signature in black ink, appearing to read 'S. Bundred', written over a horizontal line that slopes downwards from left to right.

Accounting Officer Steve Bundred
Date 26 June 2006

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

THE CERTIFICATE AND REPORT OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSES OF PARLIAMENT

I certify that I have audited the financial statements of The Audit Commission for Local Authorities and the National Health Service in England and Wales (the Audit Commission) for the year ended 31 March 2006 under the Audit Commission Act 1998. These comprise the Income and Expenditure Account, the Balance Sheet, the Cashflow Statement and Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Audit Commission, Accounting Officer and auditor

The Audit Commission and Accounting Officer are responsible for preparing the Annual Report, the Remuneration Report and the financial statements in accordance with the Audit Commission Act 1998 and Treasury directions made thereunder and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Audit Commission Act 1998 and Treasury directions made thereunder. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I also report to you if, in my opinion, the Annual Report is not consistent with the financial statements, if the Audit Commission has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by relevant authorities regarding remuneration and other transactions is not disclosed.

I review whether the statement on pages 28 - 33 reflects the Audit Commission's compliance with HM Treasury's guidance on the Statement on Internal Control, and I report if it does not. I am not required to consider whether the Accounting Officer's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Audit Commission's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the 'Brief History and Statutory Background', 'Commissioners during the period under review', 'Members appointments and interests', 'Senior managers during the period under review', 'Auditor details', the unaudited part of the Remuneration Report and the Management Commentary. I consider the implications for my report if I become aware of any apparent

misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Audit Commission and Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Audit Commission's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

Opinions

In my opinion:

- the financial statements give a true and fair view, in accordance with the Audit Commission Act 1998 and directions made thereunder by HM Treasury, of the state of the Audit Commission for Local Authorities and the National Health Service in England and Wales' affairs as at 31 March 2006 and of its surplus for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Audit Commission Act 1998 and HM Treasury directions made thereunder; and
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.



John Bourn
Comptroller and Auditor General
Date 5 July 2006

National Audit Office
157-197 Buckingham Palace Road
Victoria, London SW1W 9SP

Audit Commission for local authorities and the national health service in England

Income and expenditure account for the year ended march 2006

		Year to 31 March 2006	Year to 31 March 2005		
	Note		Continued operations	Discontinued operations	Total
		£000	£000	£000	£000
Operating income					
Audit fee income		154,994	174,671	13,563	188,234
Inspection income	3	34,739	35,633	2,783	38,416
Other operating income	4	6,023	6,132	420	6,552
		195,756	216,436	16,766	233,202
Operating costs					
Staff and members' costs	5	122,834	124,000	9,973	133,973
Bought-in services	6	43,698	55,513	3,000	58,513
Other operating costs	7	33,210	39,434	2,165	41,599
Notional credits	1(x)	(1,423)	(2,492)	0	(2,492)
		198,319	216,455	15,138	231,593
Operating (deficit)/surplus including notional credits <i>Financing income</i>		(2,563)			1,609
Add back notional credits	1(x)	(1,423)			(2492)
Net interest receivable	8	2,713			2633
Net return on pension scheme assets	21(vii)	3,205			(716)
Surplus for period		1,932			1034

The notes that follow form part of these financial statements.

The movement on reserves is set out at note 17.

Statement of total recognised gains and losses for the year ended 31 March 2006

	Note	Year to 31 March 2006	Year to 31 March 2005
		£000	£000
<i>Surplus for period</i>		1,932	1,034
<i>Pension scheme</i>			
Actual return less expected return on assets	21	82,663	14,764
Experience gains and losses arising on liabilities	21	(1,977)	11,152
Changes in financial assumptions underlying the liabilities	21	(32,785)	(13,065)
<i>Total recognised gains in the period</i>		49,833	13,885

The entries relating to FRS 17 are explained in note 21. This statement analyses the difference between the long-term assumptions made by the actuary (showing the Scheme to be adequately funded) and the calculations required to be made under FRS 17 as at 31 March 2006.

There are three main elements reflected above.

Actual return less expected return on assets:

In the element charged to financing costs in the Income and Expenditure Account, an assumption is made at the beginning of the period about the expected investment returns to be achieved on the Scheme's assets in the accounting period. In practice, the actual investment returns will differ from those assumed. The difference between the expected returns and those actually achieved are reflected in this accounting statement.

Experience gains and losses arising on liabilities:

This item arises because the actual movement in the liabilities may not be in line with the assumptions made. For example, there may have been a different number of deaths or leavers, or salaries may not have grown as expected, which leads to a different period end assessment of liability from that expected. These differences are reflected above.

Changes in financial assumptions underlying the Scheme's liabilities:

These actuarial assumptions are partly financial and partly demographic. Changes in any of these assumptions over the period will result in a different period-end liability value being placed on members' entitlements under the scheme. Again the resulting differences are reflected in this accounting statement.

Balance sheet at 31 March 2006

	Note	31 March 2006 £000	31 March 2005 £000
<i>Fixed assets</i>	10	8,804	10,035
<i>Current assets</i>			
Fee debtors and work in progress	11	12,643	16,152
Other debtors	12	12,237	16,290
Short term investments	20	55,000	55,000
Cash at bank and in hand	20	3,104	862
		<u>82,984</u>	<u>88,304</u>
<i>Creditors: amounts falling due within one year</i>			
Creditors and accrued charges	14	15,060	18,362
Deferred income	15	52,713	56,449
		<u>67,773</u>	<u>74,811</u>
Net current assets		15,211	13,493
Provisions for liabilities and charges	16	1,354	1,605
Net assets employed excluding pension liability		<u>22,661</u>	<u>21,923</u>
Less pension liability	21(v)	38,407	87,502
<i>Total net liabilities</i>		<u>(15,746)</u>	<u>(65,579)</u>
<i>Financed by</i>			
Capital reserves		3,734	3,734
Revenue reserves		18,927	18,189
Pension reserve		(38,407)	(87,502)
Total financing	17	<u>(15,746)</u>	<u>(65,579)</u>

Audit Commission annual report and accounts

The notes that follow form part of these financial statements.

A handwritten signature in black ink, appearing to read 'S. Bundred', written over a horizontal line that extends to the left.

Accounting Officer Steve Bundred
Date 26 June 2006

Cash flow statement for the 12-month period ended 31 March 2006

	<i>Note</i>	<i>Year to 31 March 2006 £000</i>	<i>Year to 31 March 2005 £000</i>
Net cash inflow from operating activities	<i>18</i>	137	8,442
Returns on investments and servicing of finance			
Interest received		2,713	2,633
Net cash inflow from returns on investments and servicing of finance		2,713	2,633
Capital expenditure and financial investment			
Payments to acquire tangible fixed assets		(608)	(3,012)
Acquisitions and disposals		0	(758)
Net cash outflow from investing activities		(608)	(3,770)
Management of liquid resources			
Receipts from short-term investments		55,000	60,000
Payments to acquire short-term investments		(55,000)	(70,000)
Short-term investments		0	(10,000)
Increase/(decrease) in cash	<i>19</i>	2,242	(2,695)

Note 1: accounting conventions and policies

- (i) The accounts are prepared under the historical cost convention, modified to account for the revaluation of fixed assets to their value to the business by reference to their current costs, in a form directed by the Secretary of State, with the approval of HM Treasury, under paragraph 11 (1) of Schedule 1 to the Act.
- (ii) The accounts meet the requirements of the Companies Acts 1985, without limiting the information given, and applicable accounting standards so far as those requirements are appropriate.
- (iii) Local Government and NHS expenditure has been directly attributed where possible to the relevant activity; where this has not been possible, common expenditure has been attributed to each activity on an hours worked or other appropriate basis.
- (iv) Operating lease rentals are charged on a straight line basis over the lease term.
- (v) Gross fee income and other operating income are recognised on the value of chargeable work exclusive of VAT.
- (vi) Operating Income, whether generated by direct government grant, fees to authorities or otherwise, is credited to the year of account in which the work is done. Debtors and Work in Progress are carried at their estimated realisable value.
- (vii) The net costs arising from litigation are not treated as part of the Commission's operating result, but shown separately on the Income and Expenditure Account.
- (viii) Depreciation is provided on all fixed assets calculated to write off the cost, less estimated residual value, of each asset in equal annual instalments over its expected useful life as follows:

Furniture and fittings	10 years
Computer equipment	3 years
Office equipment	5 years
- (ix) Under the Commission's capitalisation policy, individual computer equipment in excess of £5,000; other equipment in excess of £1,000 and office refurbishments, are capitalised.
- (ix) The Commission provides a defined benefit pension scheme for its employees, the costs of which are shown in these Accounts in accordance with FRS 17.
- (x) The Notional Cost of Capital calculation is based on net assets/liabilities at 3.5 per cent, (2004/05, 3.5%) and charged/credited to Operating Costs. This cost/credit is added back to the Operating Deficit and attributed to Local Government and NHS expenditure on the basis of reserves within each activity.
- (xi) Government grant received in respect of capital expenditure is accounted for through the Government Grant Reserve. It is released to the Income and Expenditure account to match the charge incurred when the underlying assets are depreciated.

(xii) The Commission provides for dilapidation costs under its property leases, discounted to current value.

(xiii) It is, and has been throughout the period under review, the Commission's policy that no trading in financial instruments shall be undertaken, and that all deposits will be made in Sterling.

The main risks arising from the Commission's financial instruments are interest rate and liquidity risks. The Commission reviews and agrees policies for managing each of these risks and they are summarised below:

- Interest rate risk – to maintain a mixture of fixed and variable rate deposits. Fixed rate deposits are maintained to maximise interest receivable; variable rate deposits for working capital requirements.
- Liquidity risk – to ensure that current working capital requirements are immediately available, and to limit fixed rate deposits to mature in no more than 12 months from the date of deposit. At the period end, the longest dated deposit matures in January 2007. Short-term flexibility is achieved by overdraft facilities.

(xiv) Debtors and Work in Progress are valued at estimated realisable value.

(xv) The Commission actively pursues all debt, and provides only for that element where recovery is in doubt. Any debt written off that is subsequently collected is netted against the additional provision made in the period.

Note 2: income and expenditure analysis

i) Analysis by sector

		<i>Year to 31 March 2006 £000</i>	<i>Year to 31 March 2005 £000</i>
Local Government, Community Safety and Housing			
Fee income (see ii)	Fee income	105,404	131,501
	Grant income	26,840	23,478
	Other income	9,127	6,977
		<u>141,371</u>	<u>161,956</u>
Expenditure	Direct and indirect costs	139,606	161,273
Net results		<u>1,765</u>	<u>683</u>

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Health

Income (see ii)	Fee income	57,490	71,671
	Other income	2,813	2,208
		<u>60,303</u>	<u>73,879</u>
Expenditure	Direct and indirect costs	60,136	73,528
Net results		<u>167</u>	<u>351</u>

ii) Analysis of Income: work undertaken by the Commission directly, and work outsourced

Local Government, Community Safety and Housing

	<i>Year to 31 March 2006 £000</i>	<i>Year to 31 March 2005 £000</i>
Undertaken by the Commission – fees	78,732	95,450
– grants	26,840	23,478
Audits undertaken by private accountancy firms	26,672	36,051
Other income	9,127	6,977
	<u>141,371</u>	<u>161,956</u>

Health

	<i>Year to 31 March 2006 £000</i>	<i>Year to 31 March 2005 £000</i>
Audits undertaken by the Commission	41,062	48,048
Audits undertaken by private accountancy firms	16,428	23,623
Other income	2,813	2,208
	<u>60,303</u>	<u>73,879</u>

iii) Analysis of disclosable activity

Section of the 1998 Audit Commission Act		<i>Year to 31 March 2006 £000</i>	<i>Year to 31 March 2005 £000</i>
Section 28: Certifying claims or returns made by an authority	Income	23,636	30,513
Section 29: Additional audits undertaken with the consent of the Secretary of State	Income	0	0
Section 35: Studies designed to improve economy, efficiency and effectiveness, undertaken at the request of the body concerned	Income	1,140	871
Section 36: Studies designed to improve economy, efficiency and effectiveness, undertaken at the request of specified educational bodies.	Income	0	0

These sections reflect the work for which the Commission is required to charge fees that will cover the full cost of providing the service.

Note 3: inspection income

Under the Local Government Act 1999 the Commission is responsible for the inspection of local authorities' compliance with the requirements of the Act.

Grants are available to the Commission for Inspection work on best value authorities, and in the period a number of grants were received principally from the ODPM and the Welsh Assembly Government.

	<i>Year to 31 March 2006 £000</i>	<i>Year to 31 March 2005 £000</i>
Fee income	7,899	14,938
Grant income		
ODPM	20,907	17,048
ODPM – Fire	1,618	1,836
ODPM – Housing	4,213	2,968
Welsh Assembly Government	0	1,612
Other Departments	102	14
	<u>34,739</u>	<u>38,416</u>

Note 4: other operating income

	<i>Year to 31 March 2006 £000</i>	<i>Year to 31 March 2005 £000</i>
Legal costs reimbursed	1,127	963
Publications and conferences	16	205
Secondments	2,221	3,222
Sundry income	2,659	2,162
	<u>6,023</u>	<u>6,552</u>

Note 5: staff and commission members' costs

	<i>Year to 31 March 2006 £000</i>	<i>Year to 31 March 2005 £000</i>
Staff costs		
Staff salaries	84,101	90,882
Member remuneration	276	260
Social Security costs	8,270	8,204
Pension costs	14,862	16,256
	<u>107,509</u>	<u>115,602</u>
Lease cost of cars	5,725	6,819
Subscriptions and other benefits	841	753
	<u>114,075</u>	<u>123,174</u>
Audit and inspection contractors	8,759	10,799
	<u>122,834</u>	<u>133,973</u>
Included in pension costs is the additional cost resulting from the application of FRS17	2,011	2,193
Included in salaries are costs of staff seconded to other organisations	2,245	3,199

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The average number of staff employed during the period	<i>Year to 31 March 2006</i>	<i>Year to 31 March 2005</i>
Staff employed		
Operational		
– audit and inspection	1,125	1,184
– audit trainees	179	170
– support	173	165
ACiW	0	169
Central Directorates Commission Directorates	549	527
Secondees	37	52
	<u>2,063</u>	<u>2,267</u>
In post at period end	<u>2,023</u>	<u>2,307</u>
Contractors (average in period)	<u>155</u>	<u>178</u>
Contractors (in post at period end)	<u>200</u>	<u>229</u>

Note 6: bought-in services

	<i>Year to 31 March 2006</i>	<i>Year to 31 March 2005</i>
	<i>£000</i>	<i>£000</i>
Payments to private accounting firms	40,409	54,920
Research and other consultancy costs	3,289	3,593
	<u>43,698</u>	<u>58,513</u>

These costs relate to services bought in by the Audit Commission that directly relate to their audit, inspection or research functions.

Note 7: other operating costs

	<i>Year to 31 March 2006</i>	<i>Year to 31 March 2005</i>
	<i>£000</i>	<i>£000</i>
Accommodation		
– rent lease costs	3,814	4,559
– other costs	3,815	4,842
Supplies and services	11,705	13,585
Recruitment and transfers	1,166	2,186
Depreciation	1,839	1,969
Audit fee	76	79
Professional fees	1,152	2,088
Net costs arising from litigation	76	633
Publications	389	343
Support contractor costs	2,253	3,040
Travel and subsistence – staff	4,033	4,797
– members	35	38
Training	3,009	3,498
Debts provided for	(152)	(58)
	<hr/> 33,210	<hr/> 41,599

Note 8: net interest receivable

	<i>Year to 31 March 2006</i>	<i>Year to 31 March 2005</i>
	<i>£000</i>	<i>£000</i>
Interest receivable	2,713	2,633
Interest payable	0	0
	<hr/> 2,713	<hr/> 2,633

Note 9: taxation

The Commission is exempt from income tax and corporation tax by virtue of Section 519 of the Income and Corporation Taxes Act 1988, and from capital gains tax by virtue of Section 271 of the Taxation of Chargeable Gains Act 1992.

Note 10: fixed assets

	<i>Furniture and fittings £000</i>	<i>Computer equipment £000</i>	<i>Office equipment £000</i>	<i>Total £000</i>
Cost				
At 31 March 2005	11,814	3,167	1,403	16,384
Purchases	70	536	2	608
Disposals	(974)	(1,498)	(864)	(3,336)
At 31 March 2006	<u>10,910</u>	<u>2,205</u>	<u>541</u>	<u>13,656</u>
Depreciation				
At 31 March 2005	3,297	2,019	1,033	6,349
Provided in period	1,083	643	113	1,839
Disposals	(974)	(1,498)	(864)	(3,336)
At 31 March 2006	<u>3,406</u>	<u>1,164</u>	<u>282</u>	<u>4,852</u>
Net book value				
At 31 March 2006	7,504	1,041	259	8,804
At 31 March 2005	8,517	1,148	370	10,035

The net book value of assets using current value is not materially different from the net book value at historic cost.

All assets are owned and none subject to lease agreements.

Opening balances have been reduced to account for the transfer of assets to WAO on 1 April 2005.

Furniture and fittings has been reduced by £851,000, computer equipment by £ 52,000 and office equipment by £59,000. Accumulated depreciation on the assets transferred was £399,000 and the opening balances on depreciation have been reduced as follows: furniture and fittings £327,000, computer equipment £24,000 and office equipment £48,000,

Note 11: debtors and work in progress

	<i>31 March 2006 £000</i>	<i>31 March 2005 £000</i>
Fee debtors		
- Local Government	5,748	8,658
- National Health Service	3,260	2,617
Work in progress		
- Local Government	3,185	2,188
- National Health Service	450	2,689
	<u>12,643</u>	<u>16,152</u>

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Irrecoverable and doubtful debt provision (netted against appropriate debtor):

	<i>31 March 2006</i>	<i>31 March 2005</i>
	<i>£000</i>	<i>£000</i>
Opening provision	324	534
Debts previously provided for and written off in the period	(39)	(152)
Net provision made in the period	(152)	(58)
Closing provision	<u>133</u>	<u>324</u>

Note 12: other debtors

	<i>31 March 2006</i>	<i>31 March 2005</i>
	<i>£000</i>	<i>£000</i>
Other debtors and prepayments	5,935	5,841
Inspection grant due	6,000	9,978
Relocation advances	226	400
Employee advances	76	71
	<u>12,237</u>	<u>16,290</u>

Debts not due within one year included in the above figures:

	<i>31 March 2006</i>	<i>31 March 2005</i>
	<i>£000</i>	<i>£000</i>
Included in <i>relocation advances</i> :		
– housing relocation scheme: advances to staff	<u>0</u>	<u>19</u>

In accordance with the Whole of Government Accounts regulations the debtor balances in notes 11 and 12 can be analysed into the following categories:

	<i>31 March</i> 2006 £000	<i>31 March</i> 2005 £000
Central government bodies	12,319	14,638
Local government bodies	7,281	5,937
NHS trusts	1,823	3,175
Public corporations	200	253
Balances with bodies external to government	3,257	8,439
	<u>24,880</u>	<u>32,442</u>

Note 13: short-term investments

The Commission's financial instruments comprise borrowing facilities, some cash and liquid resources and various items, such as trade debtors, trade creditors and so on that arise directly from its operations.

Note 14: creditors and accrued charges

	<i>31 March</i> 2006 £000	<i>31 March</i> 2005 £000
Trade creditors	2,684	2,409
Taxation and Social Security	516	364
Accrual for holiday entitlement not yet taken	2,361	2,545
Accruals	9,499	13,044
	<u>15,060</u>	<u>18,362</u>

Note 15: deferred income

	<i>31 March</i> 2006 £000	<i>31 March</i> 2005 £000
Deferred Income	52,713	56,449
	<u>52,713</u>	<u>56,449</u>

The deferred income represents the monies received in advance for audit and inspection work.

In accordance with the Whole of Government Accounts regulations the creditor balances in notes 14 and 15 can be analysed into the following categories:

	<i>31 March 2006 £000</i>	<i>31 March 2005 £000</i>
Central government bodies	9,807	14,536
Local government bodies	34,645	33,812
NHS trusts	7,725	8,264
Public Corporations	0	18
Balances with bodies external to government	15,596	18,181
	<hr/> <u>67,773</u>	<hr/> <u>74,811</u>

Note 16: provisions

These provisions apply to future accommodation costs.

	<i>31 March 2006 £000</i>	<i>31 March 2005 £000</i>
Opening balance	1,605	1,494
Provision in period	(251)	111
Closing balance	<hr/> <u>1,354</u>	<hr/> <u>1,605</u>

These provisions are released at the cessation of the lease.

Note 17: reserves

Capital and Revenue Reserves

Capital reserves reflect funding provided to the Commission to fund working capital. The Local Government reserve of £1.6m was received in year ending March 1984 at the inception of the Commission, and the £2.2m was received in year ending March 1991 when the Commission's remit was extended to include audit of Health authorities.

Revenue reserves show the net deficit or surplus for the period together with the cumulative amount brought forward from prior accounting periods. £1.3m has been set off against opening balances of revenue reserves. This represents assets transferred to WAO during April 2005 as approved by Statutory Instrument number 550 (SI 550).

Pension reserves shows the additional surplus or deficit experienced during the year resulting from the application of Financial Reporting Standard 17 together with the balance brought forward from prior accounting periods.

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		<i>31March</i> 2006 £000	<i>31March</i> 2005 £000
Capital reserve	Local Government	1,580	1,580
	Health	2,154	2,154
	Total capital reserves	<u>3,734</u>	<u>3,734</u>
Revenue reserves	Local Government		
	Brought forward	14,998	12,424
	Surplus for period	1,765	683
	Net movement to the pension scheme reserve	(836)	1,891
	Local Government reserves	<u>15,927</u>	<u>14,998</u>
	Health		
	Brought forward	3,191	1,822
	Surplus /(Deficit) for period	167	351
	Net movement to the pension scheme reserve	(358)	1,018
	Health reserves	<u>3,000</u>	<u>3,191</u>
	Total revenue reserves	<u>18,927</u>	<u>18,189</u>
Pension reserves	Brought forward	(87,502)	(97,444)
	Movement in the period from Income and Expenditure	(11,657)	(16,972)
	Cash payments to the scheme	12,851	14,063
	Movement in the period from the Statement of Recognised Gains and Losses	47,901	12,851
	Total pension reserves	<u>(38,407)</u>	<u>(87,502)</u>
Total reserves		<u>(15,746)</u>	<u>(65,579)</u>

Note 18: reconciliation of operating surplus for period to net inflow from operating activities

	<i>Year to 31 March 2006 £000</i>	<i>Year to 31 March 2005 £000</i>
Operating (loss)/surplus	(2,563)	1,609
Notional credits	(1,423)	(2,492)
Net pension credit	2,011	2,193
Net depreciation	1,839	1,969
Loss on disposal of fixed assets	0	9
Reduction in debtors and work in progress	7,562	180
(Reduction)/Increase in creditors and provisions	(7,289)	4,974
Net cash inflow from operating activities	<u>137</u>	<u>8,442</u>

Note 19: reconciliation of net cash outflow to movement in net funds

	<i>Year to 31 March 2006 £000</i>	<i>Year to 31 March 2005 £000</i>
Increase/(Decrease) in cash	2,242	(2,695)
Cash used to increase short term investments	0	10,000
Change in net funds	<u>2,242</u>	<u>7,305</u>
Net funds at 1 April 2005 (2004)	<u>55,862</u>	<u>48,557</u>
Net funds at 31 March 2006 (2005)	<u>58,104</u>	<u>55,862</u>

Opening cash balances have been adjusted by £758,000 paid to WAO in April 2005 in accordance with SI550.

Note 20: analysis of changes in net funds

	<i>At 1 April 2005 £000</i>	<i>Cash Flows £000</i>	<i>At 31 March 2006 £000</i>
Short-term investments and cash at bank and in hand	55,862	2,242	58,104

Opening cash balances have been adjusted by £758,000 paid to WAO in April 2005 in accordance with SI550.

Note 21: pension scheme

The valuation provided by the Scheme's actuary as at 31 March 2005 showed a surplus of £5m under the Projected Unit Credit basis of valuation. This compares with an FRS 17 valuation at 31 March 2006 of £38.4m deficit (£87.5m deficit at 31 March 2005).

Under the accounting standard FRS 17, the net effect on the Income and Expenditure Account increased the Commission's surplus by £1.2m (surplus reduced by £2.9m for the year to 31 March 2005).

(i) Contribution rates

The Commission has a self-administered occupational pension scheme open to all permanent employees and employees who are on a fixed-term contract of two years or more. It is a defined benefit scheme partly funded by contributions from members based on 6 per cent of pensionable salaries. The Commission contributes the balance of the cost which for the 12-month period amounted to £12.9m (year to 2005 – £14.1m).

(ii) Actuarial information

Full actuarial valuations are conducted annually and the last one finalised was carried out using the projected unit method as at 31 March 2005.

The market value of the net assets of the scheme at 31 March 2005 was £351.8m which on the actuarially assessed value provided cover of 101 per cent of the benefits that had accrued to members after allowing for expected future increases in earnings. The principal financial assumptions used by the actuary and quoted in real terms relative to price inflation were:

	2005	2004
Rate of interest	% pa 3.5	% pa 3.3
Rate of salary escalation	1.7	1.5

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Under the accounting standard FRS 17: Retirement Benefits, the principal financial assumptions used by the actuary will be:

	2006	2005	2004
	% pa	% pa	% pa
Rate of inflation	3.0	2.9	2.9
Rate of salary escalation	4.5	4.4	4.4
Discount rate for liabilities	5.1	5.4	5.5
Rate of increase of pensions in payment	3.0	2.9	2.9
Rate of increase of deferred pensions	3.0	2.9	2.9

(iii) Market value information

	Long-term expected rate of return at 31 March 2006	Fair value at 31 March 2006	Long-term expected rate of return at 31 March 2005	Fair value at 31 March 2005	Long-term expected rate of return at 31 March 2004	Fair value at 31 March 2004
	% pa	£000	% pa	£000	% pa	£000
Equities	7.40	442,737	7.70	351,285	6.75	293,914
Property	7.40	21,159	N/A	0	N/A	0
Cash	4.50	482	4.75	493	4.00	2,631
Market value of the net assets of the scheme at the year end		464,378		351,778		296,545

(iv) Net pension asset

	31 March 2006	31 March 2005
	£'000	£'000
Fair values of scheme assets (see iii above)	464,378	351,778
Present value of scheme liability	(502,785)	(439,280)
Net pension liability	<u>(38,407)</u>	<u>(87,502)</u>

(v) Reconciliation of scheme surplus

	<i>Year to 31 March 2006</i>	<i>Year to 31 March 2005</i>
	£'000	£'000
Surplus in scheme at beginning of the year	(87,502)	(97,444)
Movement in year:		
Current service cost	(15,741)	(15,602)
Contributions	12,851	14,063
Past service costs	(582)	(1,171)
Gains on settlements	1,461	0
Gains on bulk transfers in	0	517
Other finance income	3,205	(716)
Actuarial gain	47,901	12,851
Closing surplus in scheme	<u>(38,407)</u>	<u>(87,502)</u>

(vi) Analysis of amount charged to operating profit

	<i>Year to 31 March 2006</i>	<i>Year to 31 March 2005</i>
	£'000	£'000
Current service cost	15,741	15,602
Past service cost	582	1,171
Gains on settlements	(1,461)	0
Gains on bulk transfers in	0	(517)
Total operating charge	<u>14,862</u>	<u>16,256</u>

(vii) Analysis of amount credited to other finance income

	<i>Year to 31 March 2006</i>	<i>Year to 31 March 2005</i>
	£'000	£'000
Expected return on pension scheme assets	27,177	20,599
Interest cost	(23,972)	(21,315)
Net return	3,205	(716)

(viii) Analysis of amount recognised in statement of total recognised gains and losses

	<i>Year to 31 March 2006</i>	<i>Year to 31 March 2005</i>
	£'000	£'000
Actual return less expected return on pensions scheme assets	82,663	14,764
Experience gains and losses arising on the scheme liabilities	(1,977)	11,152
Changes in financial assumptions underlying the scheme liabilities	(32,785)	(13,065)
Actuarial gain recognised in STRGL	47,901	12,851

(ix) History of experience gains and losses

	<i>Year to 31 March 2006</i>	<i>Year to 31 March 2005</i>	<i>17 month period to 31 March 2004</i>
Difference between the expected and actual return on scheme assets:			
Amount (£'000)	82,663	14,764	29,124
Percentage of the present value of the scheme assets	18%	4%	10%
Experience gains and losses on scheme liabilities:			
Amount (£'000)	(1,977)	11,152	(24,062)
Percentage of the present value of the scheme liabilities	0%	3%	-6%
Total amount recognised in statement of total recognised gains and losses:			
Amount (£'000)	47,901	12,851	(54,624)
Percentage of the present value of the scheme liabilities	10%	3%	-14%

Note 22: operating results for the last five periods

<i>Total</i>	<i>Year to 31 March 2006 £000</i>	<i>Year to 31 March 2005 £000</i>	<i>17 months to 31 March 2004 £000</i>	<i>Year to 31 October 2002 £000</i>	<i>Year to 31 October 2001 £000</i>
<i>Operating income</i>	195,756	233,202	331,291	213,917	178,524
<i>Operating costs</i>	199,742	234,085	328,246	215,275	178,755
<i>Notional credits/costs</i>	(1,423)	(2,492)	(1,896)	(523)	820
	(2,563)	1,609	4,941	(835)	(1,051)
<i>Add back:</i>					
<i>Notional credits</i>	(1,423)	(2,492)	(1,896)	(523)	820
<i>Net interest receivable</i>	2,713	2,633	1,735	1,060	828
<i>Return on Pension Scheme Assets</i>	3,205	(716)	2,457	3,758	0
<i>Surplus</i>	1,932	1,034	7,237	3,460	597

The operating results for prior years have not been adjusted to reflect the transfer of the Audit Commission's responsibilities in Wales to a new body called the Wales Audit Office (WAO) from 1 April 2005.

Note 23: financial commitments

There are revenue commitments at 31 March 2006 in respect of non-cancellable car leases which expire:

	<i>31 March 2006 £000</i>	<i>31 March 2005 £000</i>
Within one year	416	463
Within one to five years	2,753	2,967
	<u>3,169</u>	<u>3,430</u>

There were annual commitments as at 31 March 2006 to pay rentals under lease agreements which expire:

	<i>2006 £000</i>	<i>2006 Number of Properties</i>	<i>2005 £000</i>	<i>2005 Number of Properties</i>
Within one year	237	12	294	12
From one to five years	594	13	778	24
Over five years	2,979	28	3,221	24
	<u>3,810</u>	<u>53</u>	<u>4,293</u>	<u>60</u>

All building leases are taken out in the name of the Audit Commission. Office accommodation with spare capacity is sub-let, with the majority of building leases subject to rent reviews.

Note 24: contingent liabilities

The Commission indemnifies appointed auditors against costs incurred by them in connection with Court proceedings arising through their exercise of special legal functions. In addition, costs may be awarded against auditors in such proceedings which fall to be borne by the Commission under the terms of the indemnity. Amounts incurred in any one year, as a result of this indemnity, depend upon the progress of individual cases and cannot, therefore, be predicted nor quantified until they crystallise.

The Commission has received an initial ruling from HM Customs and Excise that its best value inspections are not business activities for VAT purposes. The Commission is in discussion with HM Revenue and Customs to establish with them the correct treatment for this function and continues to charge and recover VAT on this activity.

Note 25: related party transactions

During the period, no Commissioners, members of the key management staff or their related parties have undertaken any material transaction with the Commission.

The Commission is a public corporation sponsored in the year by the ODPM. It has had a number of material transactions with its principal sponsoring department

The following disclosure relates to staff who are in a position of influence resulting from being elected to, receiving remuneration from, or being appointed to any organisation:

- where the Commission appoints the auditor or inspects the body;
- where there are specific statutory responsibilities to cooperate, for example, the Healthcare Commission;
- that is a central government department; and
- that is a provider or receiver of significant services to or from the Commission.

The disclosure in relation to Commission members is shown on page 9.

Staff member

John Barber

Position held in year ending March 2006

Non Executive Board Member on

- Norfolk Courts Board Committee – Her Majesty's Court Service; and
- Risk and Audit Committee – Her Majesty's Court Service.

Mike Barnes

Immediate past President of CIPFA and trustee of the charity. As President in the year to 16 June 2005 he was also a Director of the Consultative Committee of Accountancy Bodies Ltd.

George Clark	Regional Representative sitting on the CIPFA Council trustee of the charity.
Barbara Deacon	Company Director and Trustee of Richmond Fellowship Employment Training Charity. Trustee of the Richmond Fellowship Mental Health charity. Undertaken sessional work for the Department of Work and Pensions as a tribunal member. Magistrate for the East Sussex eastern bench.
Chris Hurford	CIPFA Council member and Trustee of the charity. Honorary Treasurer of CIPFA and a Director of IPF, CIPFA's commercial arm.
Nick Mapstone	Non Executive Director at United Lincolnshire Hospitals NHS Trust.
Kathleen Turner	Bayston Hill Parish Councillor.
Richard Walsh	Board member of Bourne Housing Society Ltd.

Note 26: discontinued operations

From 1 April 2005, the Audit Commission's audit and inspection functions in Wales were transferred to the Auditor General for Wales. One hundred and sixty nine of the Commission's staff were transferred to the new body called the Wales Audit Office (WAO) together with the offices and equipment. The transfer was implemented by the Public Audit (Wales) Act 2004.

Assets of £1.3m were transferred to WAO and set off against Reserves. Comparative figures in the Income and Expenditure Account include WAO figures as all of the income and expenditure for this period was due to the Audit Commission. The comparative Balance Sheet reflects assets post transfer, even though the fixed assets were not transferred until 1 April 2006 and the cash balance was not transferred until 6 April. This treatment has been adopted in accordance with accounting standards.

Statutory Instrument 2005 number 550 came into force on 1 April 2005. This order transfers the Property, Rights and Liabilities from the Audit Commission to WAO who now exercise the functions carried out in Wales by the Audit Commission up to March 2005. It also outlines the terms for staff and asset transfer including £758,000 cash and identifies that a corresponding transfer of the Audit Commission's reserves will be made to match assets transferred to the WAO.

Note 27: losses and special payments

There were no cases of losses or special payments made in the year.

Appendix 1

THE AUDIT COMMISSION FOR LOCAL AUTHORITIES AND THE NATIONAL HEALTH SERVICE IN ENGLAND AND WALES

Accounts direction given by the First Secretary of State, the Secretary of State for Health and the National Assembly for Wales, with the consent of the Treasury, in accordance with paragraph 11(1) of Schedule 1 to the Audit Commission Act 1998.

1. The annual accounts of the Audit Commission for Local Authorities and the National Health Service in England and Wales (hereafter in this accounts direction referred to as “the Commission”) shall give a true and fair view of the income and expenditure and cash flows for the financial year and the state of affairs at the year end. Subject to this requirement, the annual accounts shall be prepared in accordance with:-

- (a) the accounting and disclosure requirements of the Companies Act 1985;
- (b) generally accepted accounting practice in the United Kingdom;
- (c) any guidance that the Treasury may issue from time to time in respect of the annual accounts of public corporations;
- (d) any other specific disclosure requirements of the Secretaries of State;

insofar as these requirements are appropriate to the Commission and are in force for the year for which the accounts are prepared, and except where agreed otherwise with the Secretaries of State or the Treasury in which case the exception shall be described in the notes to the accounts.

2. Schedule 1 to this direction gives clarification of the application of the accounting and disclosure requirements of the Companies Act and accounting standards and also gives any exceptions to standard Treasury requirements. Additional disclosure requirements of the Secretaries of State and further explanations of Treasury requirements are set out in Schedule 2.

3. This direction shall be reproduced as an appendix to the annual accounts.

4. This direction replaces that dated 24/10/01

Signed by authority of the First Secretary of State

Sarah Sturrock

***An officer in the Office of the Deputy
Prime Minister
Date 29/3/06***

Signed by authority of the Secretary of State for Health

Peter Kendall

***An officer in the Department of Health
Date 29/3/06***

Schedule 1

1. The annual accounts shall contain the information required to be disclosed in directors' reports as specified in Schedule 7 to the Companies Act 1985, save that the Commission shall prepare an Operating and Financial Review (in place of a Business Review) in line with the recommendations of Reporting Statement Operating and Financial Review, to the extent that such requirements are appropriate to the Commission and for which purpose Commission members shall be taken to be directors.

*2. The annual accounts shall contain a Remuneration Report in line with the requirements of section 234B and Schedule 7A of the Companies Act 1985 and for which purpose the Commission's chairman, chief executive and all members of the management board shall be taken to be directors.

3. The Commission's income and expenditure account shall be in format 1 as set out in Schedule 4 to the Companies Act 1985, adapted where necessary to suit the special nature of the Commission's business. The balance sheet shall be in format 1. In the balance sheet, totals shall be struck at "Total assets less total liabilities".

4. Except where the Treasury has agreed otherwise, freehold land and non-leased buildings held as fixed assets shall be stated at existing use value or, for property of a specialised nature, at depreciated replacement cost. Other non-leased fixed assets shall be stated at net current replacement cost. All valuation bases as defined by the Royal Institution of Chartered Surveyors.

5. Stocks and work in progress shall be included in the balance sheet at the lower of estimated replacement cost and estimated net realisable value.

6. Central government grants used to pay for fixed assets, stocks or work in progress shall be credited to a grant reserve. This is different from the requirement in accounting standards that such grants should be credited to deferred income.

7. Revaluation gains on fixed assets, stocks or work in progress, to the extent that the assets were financed by central government grants, shall be taken to the grant reserve in the balance sheet, without passing through the income and expenditure account. To the extent that the assets were financed by funds from other sources, revaluation gains shall be taken to the revaluation reserve in the balance sheet. This is different to the requirement of the Companies Act that all revaluation gains should be taken to one separate reserve.

8. On the disposal of fixed assets, stock or work in progress, any amount in the grant reserve relating to the assets shall be transferred directly to the general reserve in the balance sheet, without passing through the income and expenditure account.

9. On the disposal of a fixed asset financed wholly by central government grants, the profit or loss on disposal shall be offset in the income and expenditure account by an equal and opposite amount transferred to or from the general reserve. Where central government grants were only used to finance a part of the cost of the asset, the amount of the transfer to or from the general reserve shall be reduced in proportion.

10. Expenditure in the income and expenditure account shall include a notional cost of capital, at 3.5% of the average net assets during the year. This amount shall be reversed after the line showing the surplus or deficit for the year.

11. The foreword and balance sheet shall be signed and dated on behalf of the Commission members and by the accounting officer.

Schedule 2

Additional disclosure requirements

The following information shall be disclosed in the annual accounts, as a minimum, and in addition to the information required to be disclosed by paragraphs 1 and 2 of this direction.

1. The income and expenditure account or the notes thereto

(a) The following income -

- (i) fees
- (ii) grants from the Office of the Deputy Prime Minister
- (iii) grants from Department of Health

(b) The following expenditure -

- (i) audit fees to private firms
- (ii) contract audit assistance for District Audit
- (iii) other amounts payable to private accountancy firms
- (iv) debts written off and movements in provisions for bad and doubtful debts.

2. The notes to the annual accounts

(a) For each of the following categories of business, an analysis of income between that generated from work carried out by District Audit and that generated from work carried out by private accountancy firms:

- (a) local government audits,
- (b) local government Best Value inspections,
- (c) National Health Service audits and
- (d) National Health Service Best Value inspections.

(b) For work carried out under each of the following sections in the Audit Commission Act 1998, a statement showing the income and expenditure for the year:

- section 28 (certification of claims, returns etc.),
- section 29 (agreed audit of accounts),
- section 35 (studies at request of bodies subject to audit) and
- section 36 (studies at request of educational bodies).

(c) For each of the following categories of business, a statement showing the opening income and expenditure reserve, income and expenditure for the year and the closing income and expenditure reserve.

- (i) Local Government authorities
- (ii) Health Service authorities.

(d) Details of employees, other than Commission members, showing:-

- (i) the average number of persons employed during the year, including part-time employees and secondees, analysed between appropriate categories
- (ii) the total amount of loans to employees
- (iii) employee costs during the year, showing separately:-
 - (1) wages and salaries
 - (2) early retirement costs
 - (3) social security costs
 - (4) contributions to pension schemes
 - (5) payments for unfunded pensions
 - (6) other pension costs.

(e) An analysis of liquid resources, as defined by accounting standard FRS1 (revised).

(f) In the note on debtors, prepayments and payments on account shall each be identified separately.

*(g) particulars, as required by the accounting standard on related party disclosures, of material transactions during the year and outstanding balances at the year end (other than those arising from a contract of service or of employment with the Commission), between the Commission and a party that, at any time during the year, was a related party. For this purpose, notwithstanding anything in the accounting standard, the following assumptions shall be made:

- (i) transactions and balances of £5,000 and below are not material
- (ii) parties related to board members and key managers are as notified to the Commission by each individual board member or key manager
- (iii) the following are related parties:
 - (1) subsidiary and associate companies of the Commission
 - (2) pensions funds for the benefit of employees of the Commission or its subsidiary companies (although there is no requirement to disclose details of contributions to such funds)
 - (3) board members and key managers of the Commission
 - (4) members of the close family of board members and key managers
 - (5) companies in which a board member or a key manager is a director
 - (6) partnerships and joint ventures in which a board member or a key manager is a partner or venturer
 - (7) trusts, friendly societies and industrial and provident societies in which a board member or a key manager is a trustee or committee member
 - (8) companies, and subsidiaries of companies, in which a board member or a key manager has a controlling interest
 - (9) settlements in which a board member or a key manager is a settlor or beneficiary
 - (10) companies, and subsidiaries of companies, in which a member of the close family of a board member or of a key manager has a controlling interest

(11) partnerships and joint ventures in which a member of the close family of a board member or of a key manager is a partner or venturer

(12) settlements in which a member of the close family of a board member or of a key manager is a settlor or beneficiary

(13) the Office of the Deputy Prime Minister, as the sponsor department for the Commission.

For the purposes of this sub-paragraph:

(i) A key manager means a member of the Commission's management board.

(ii) The close family of an individual is the individual's spouse, the individual's relatives and their spouses, and relatives of the individual's spouse. For the purposes of this definition, "spouse" includes personal partners, and "relatives" means brothers, sisters, ancestors, lineal descendants and adopted children.

(iii) A controlling shareholder of a company is an individual (or an individual acting jointly with other persons by agreement) who is entitled to exercise (or control the exercise of) 30% or more of the rights to vote at general meetings of the company, or who is able to control the appointment of directors who are then able to exercise a majority of votes at board meetings of the company.

(h) A statement of losses and special payments during the year, being transactions of a type which Parliament cannot be supposed to have contemplated. Disclosure shall be made of the total of losses and special payments if this exceeds £250,000, with separate disclosure and particulars of any individual amounts in excess of £250,000. Disclosure shall also be made of any loss or special payment of £250,000 and below if it is considered material in the context of the Commission's operations.

* Note to paragraph 2 of Schedule 1 and paragraph 2(g) of Schedule 2: under the Data Protection Act 1998, individuals need to give their consent for some of the information in these sub-paragraphs to be disclosed. If consent is withheld, this should be stated next to the name of the individual.

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