

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

**Accounts
for the year ended
31 October 2002**

FOREWORD TO THE ACCOUNTS

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

Statement of Account 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.

The functions of the Secretary of State in relation to the Audit Commission are exercised jointly by the Deputy Prime Minister, the Secretary of State for Wales or the Welsh Assembly Government (as appropriate) and the Secretary of State for Health. On 29 May 2002, the Audit Commission's sponsoring department changed from the Department for Transport, Local Government and the Regions, to the Office of the Deputy Prime Minister

Statutory Background

1. 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.
2. The Commission's responsibilities were further extended by the Local Government Act 1999. Under this 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 the Act.
3. Members of the Commission are usually appointed for a three year period (which may be extended for a further three year period) by the Secretary of State.
4. The appointment of Controller of Audit is approved by the Secretary of State.
5. Dame Helena Shovelton DBE was the Commission's chair until 30 November 2001; the end of her contract. From 1st December 2001 and throughout the financial year ended 31 October 2002, Adrienne Fresko (who formerly held the post of Deputy Chair) was the Commission's Acting Chair.

On 5 November 2002, James Strachan was appointed as the Audit Commission's Chairman, with Adrienne Fresko reverting to the Deputy Chair.

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Members

	Contract started	Contract ends
Mr R A Arthur	1/04/96	30/04/03
Ms J Baddeley	1/09/99	30/04/03
Mr J Bowen	1/09/01	31/10/04
Dr J Curson	1/10/98	30/06/04
Ms E Filkin	1/11/99	30/04/03
Mrs A Fresko	1/02/96	31/10/03
Sir Graham Hart	30/11/99	30/04/03
Mr R Hoyle	1/01/02	30/06/05
Dr P Lane	1/12/00	31/10/03
Mr G Lemos	1/12/00	31/10/03
Mr D Moss	1/04/01	30/06/04
Professor S Richards	1/11/97	31/10/03
Mr N Skellett	1/12/00	31/10/03
Mr C Swinson	1/12/00	31/10/03
Sir David Williams	1/11/97	31/10/03
Mr B Wolfe	1/09/99	30/04/03
Commissioners who left during the year		
Dame Helena Shovelton	1/2/95	30/11/01

Controller of Audit Sir Andrew Foster

The Commission's Duties

6. A summary of the main duties and powers laid upon the Commission under the Audit Commission Act 1998 (the 1998 Act) and the Local Government Act 1999 (the 1999 Act) are as set out below. For more detailed guidance, reference should be sought from the relevant section of the Acts.

	1998 Act	1999 Act
Duties	section	section
To appoint auditors	3	
To prepare and review the Code of Audit Practice and the Code of Practice for the audit of Best Value Performance Plans (BVPPs).	4	8
To set a scale or scales of fees for the audit of accounts, for the audit of BVPPs and for Best Value inspections.	7	8 and 12
On request of the body concerned, make arrangements for certifying claims in respect of grants, subsidies, or other such claims or returns received by an audited body.	28	
Undertake or promote comparative and other studies designed to enable it to make recommendations for improving economy, efficiency and effectiveness in the provision of services; and for improving financial and	33	

ACCOUNTS for the year ended 31 October 2002

other management.		
Undertake or promote studies on the impact of the operation of any statutory provision, or any direction or guidance given by a minister of the crown, on economy, efficiency or effectiveness on the provision of services, or on the financial management of audited bodies (other than health service bodies).	34	
To direct relevant bodies to publish information that will facilitate comparisons between different relevant bodies; and between different financial years.	44	
If directed by the Secretary of State, to carry out an inspection of a specified best value authority's compliance.		10

	1998 Act section	1999 Act section
Powers		
To carry out an inspection of a best value authority's compliance with the requirements of Part 1 of the Act		10
Direct an auditor to hold an extraordinary audit either if it appears to the Commission to be desirable; or, other than in a health service body, at the request of a local government elector.	25	
With the consent of the Secretary of State, and with the agreement of the body, undertake the audit of the accounts of a body which appears to the Secretary of State to be connected with local government or the National Health Service; and is not a body subject to audit.	29	
On request from any audited body, to promote or undertake studies designed to improve economy, efficiency and effectiveness in the management or operation of the audited body.	35	
On request from specified educational bodies, to promote or undertake studies designed to improve economy, efficiency and effectiveness in the management or operations of specified educational bodies.	36	
On request from the Secretary of State, to aid in any study designed to improve economy, efficiency, effectiveness and quality of performance in the discharge of social services functions by local authorities.	37	
On request from the Secretary of State, to aid in any study designed to improve economy, efficiency, effectiveness and quality of performance in the discharge by local authorities of functions relating to the administration of housing benefit and council tax benefit.	38	
The Housing Corporation and the Commission may agree programmes of comparative studies designed to enable the Commission to make recommendations for improving economy efficiency and effectiveness of registered social landlords.	40	
Require any audited body to provide specified information to the Commission required for the discharge of its functions.	48	

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Financial Results

7. The Commission is charged by the 1998 Act (paragraph 8 of Schedule 1) with the duty so to manage its affairs that its income from fees and otherwise will, taking one year with another, be not less than its expenditure properly chargeable to its income and expenditure account. This applies separately to the local government and NHS work within the Commission.
8. The Commission made a surplus in the period of £945,000, (£687,000 of which related to local Government) bringing its general reserves to £13,052,000, of which £8,616,000 related to Local Government. The surplus in the year relating to the Commission's work within the National Health Service was £258,000 bring those reserves to £4,436,000 at 31 October 2002. The Commission aims to produce sufficient surpluses to meet its own working capital requirements, and to provide reserves against possible litigation and other contingencies. The Commission has contingent liabilities as set out in note 25 to these accounts, in respect of its indemnity to appointed auditors for costs incurred by them in connection with Court proceedings arising through their exercise of special legal functions, and issues arising out of the VAT treatment of its Inspection activity. Any costs arising under the terms of the indemnity can be significant, although the timing can be unpredictable. The Commission's reserves are set out in note 18 of these accounts.

Principal Activities

9. The principal activities of the Commission remain the audit of local authorities and NHS bodies (74 per cent of income) and inspection activities (including working with other regulators) - 24 per cent of income. The Commission also has income streams from the sale of publications, and from seconding staff to other organisations.
10. The Commission revised its strategy in 2001 - *Delivering Improvement Together*. The strategy reflects a number of key changes in local government and the health service, in particular the work arising out of the Commission's role in helping to implement the White Paper *Strong Local Leadership, Quality Public Services* and the NHS Plan. A fuller report of the Commission's activities and its future developments are contained within its annual report.

During the year the Government announced the creation of the Commission for Health Audit and Inspection (CHAI). This new body will assume responsibility for the work currently undertaken by the Commission for Health Improvement, the private health care role of the National Care Standards Commission, and the national value-for-money work of the Audit Commission. The Audit Commission will continue its programme of work in readiness for transferring the appropriate functions to CHAI and the Commission for Social Care Inspection without any loss of continuity. Although CHAI is not expected to be fully operational until 2004 there will be a phased programme of joint activities leading up to that date.

Post Balance Sheet Events

11. The Commission's strategy *Delivering Improvement Together* identified the need for an organisational development review to determine the best possible structure and processes for its implementation. To improve internal cohesion the Commission brought together all parts of the organisation into a unified whole, and merged its current audit and inspection facilities into a new Operations Directorate. This was effective from 1 January 2003. Although the cost will be significant in undertaking this restructuring, it will allow the Commission to ensure a proper external focus to audited bodies. As part of the restructure, the Commission is now appointing Relationship Managers who will plan and co-ordinate the delivery and reporting of local services and will be the interface between the Commission and audited and inspected bodies. Additionally Sector Leads will be appointed for Local Government, NHS and Criminal Justice & Cross-cutting who will be externally-facing, responsible for shaping and commissioning national and local delivery. They will oversee the Commission's work in each sector and monitor quality and impact. The restructuring has not impacted on the statutory role of the District Auditor.

The Commission has been asked by the Government to build upon its current role in housing across local government and extend this to encompass the Registered Social Landlord sector. To do this effectively we will be working with the Housing Corporation to facilitate a smooth transfer of responsibilities. In addition we will create an effective ongoing relationship in which the Corporation retains its role as regulator and the Commission fulfils the role of independent inspector of services.

Payment Performance

12. The Commission policy is to pay all of its suppliers within a reasonable period of their invoice being received. In 2001/2, 83% of undisputed invoices were paid within 30 days (2000/1, 63%).

Equal Opportunities and Employee Involvement

13. The policy of the Commission is to ensure that both current employees and applicants for employment are not discriminated against on the grounds of sex, marital status, race, creed, colour, ethnic origin, age, sexual orientation, gender re-assignment or personal disability. Management negotiates pay and conditions within a Partnership Forum which has representatives from both management and staff. Consultations also take place regularly with staff networks, ENRG - the Black and minority ethnic staff group; DART (the disability awareness raising team) and the lesbian and gay network. Indicators on the Commission's performance against its targets for diversity are shown in its Annual Report.

The Commission's Role in Conservation of Resources

14. 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 reduce its impact on the environment. The Commission has two key roles to play in helping to implement the strategy:

To raise awareness and encourage local government and NHS bodies through its national reviews.

Through the management of its own activities and resources, for example:

- undertaking environmental performance assessment using the BREEAM Index for all new office buildings, and where possible moving towards the adoption of naturally ventilated building solutions;
- utilising office furniture produced from sustainable sources;
- undertaking environmental assessments of suppliers as part of our procurement procedures;
- printing all national reports on chlorine-free paper made from sustainable forestry, and using stationery from fully recycled sources;
- agreeing home working contracts for staff otherwise required to undertake excessive home to workplace travel;
- encouraging the use of video-conferencing to limit business travel where this is possible;
- encouraging staff to use public transport where appropriate;
- providing alternatives to the provision of a leased car for staff required to undertake significant business travel; and
- for staff eligible for the provision of a leased car:
 - providing incentives encouraging the selection of cars with a low environmental impact, currently taken up by 12 per cent of staff; and
 - limiting choice to cars of no more than an engine size of two litres producing less than 225gms/km of carbon dioxide.

Annual Report and Accounts

15. The Commission has not been designated by the Departmental Consolidation Group as a public body whose accounts are required to be consolidated into Central Government Accounts.

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16. Under paragraph 11(4) of Schedule 1 to the 1998 Act, and further provided by the National Assembly for Wales (Transfer of Functions) Order 1999, the Controller and Auditor General is required to lay these accounts together with his report thereon before Parliament and the Welsh Assembly Government.
17. In accordance with paragraph 14(2) of Schedule 1 to the 1998 Act and further provided by the National Assembly for Wales (Transfer of Functions) Order 1999, the Commission's annual report on the discharge of its functions is being submitted to the Deputy Prime Minister for laying before each House of Parliament and the Welsh Assembly Government. The report, laid after these accounts, incorporates a review of the past year and a preview of future developments.

Statement of Accounting Officer's Responsibilities

18. In accordance with paragraph 11(1) of Schedule 1 to the 1998 Act the Secretaries of State for Transport, Local Government and the Regions, Health and for Wales have 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 year end and of its income and expenditure and cash flows for the financial year.
19. 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.
20. The Controller of Audit 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.

..... *Chairman*
Mr James Strachan *March 2003*

..... *Accounting Officer and Controller of Audit*
Sir Andrew Foster *March 2003*

Statement on Internal Control

21. During the year ending 31 October 2002 the Commission continued to enhance its corporate governance and internal control arrangements. The following paragraphs comprise the Commission's Statement on Internal Control.
22. In signing this foreword to the Accounts, I acknowledge as Accounting Officer, that I have responsibility for maintaining a sound system of internal control that supports the achievement of the Audit Commission's statutory functions and its policies, aims and objectives; whilst safeguarding the public funds and Audit Commission assets for which I am personally responsible. This is in accordance with the responsibilities assigned to me in Government Accounting.
23. The system of internal control is based on an ongoing process that identifies the principal risks to the achievement of the Commission's functions, policies, aims and objectives, evaluates the nature and extent of those risks and manages them efficiently, effectively and economically. This process has been in place for the whole of the year ended 31 October 2002 and has been maintained up to the date of approval of the Annual Report and Accounts. The process accords with Treasury guidance.
24. As Accounting Officer, I also have responsibility for reviewing the effectiveness of the system of internal control. That system and the Commission's overall governance arrangements are as follows:
25. The Commission (at 31 October 2002 comprising the Acting Chair and 15 other non-executive members) exercises the statutory functions of the Commission and monitors the implementation of the Commission's policies, aims and objectives. The Commission met six times in the year to deal with the business of the Commission. A list of the Commissioners can be found at the beginning of the Foreword to the Accounts. At least twice a year, the Commission considers and reviews the Audit Commission's strategic direction.
26. In addition to the regular Commission meetings, Panels are established to consider specific items. All Panel remits and memberships are currently being reviewed by the Chairman, but those in place at 31 October 2002 were:

ACCOUNTS for the year ended 31 October 2002

Membership of the Panels at 31 October 2002

	Commission Advisory ¹	Audit	Purchasing and Quality Control	Analysis & Research	District Audit	Inspection
Mr R A Arthur		✓		✓		
Ms J Baddeley						✓
Mr J Bowen					✓	✓
Dr J Curson		✓		✓		
Ms E Filkin	✓		✓			
Mrs A Fresko	✓					✓
Sir Graham Hart	✓	✓				
Mr R Hoyle		✓			✓	
Dr P Lane					✓	✓
Mr G Lemos				✓		
Mr D Moss			✓			
Professor S Richards	✓			✓		
Mr N Skellett						✓
Mr C Swinson	✓				✓	
Sir David Williams				✓		✓
Mr B Wolfe		✓	✓			
Panel Chairs	Mrs A Fresko	Sir Graham Hart	Ms E Filkin	Professor S Richards	Mr C Swinson	Mrs A Fresko

Note 1: This acts as the Commission's Remuneration Panel

Commission Advisory Panel

27. The Commission Advisory Panel comprises the Commission's Chair and the Chairs of each of the other Panels. It considers the main issues in detail and reports those considerations to the full Commission. It also ensures the remuneration policies reflect the Commission's needs and the market in which it operates. As part of these responsibilities, the Panel approves the Controller's and Directors' remuneration and approves specific cases of early or ill health retirements and severance agreements. It met ten times during the year.

Audit Panel

28. The Audit Panel met four times in the year. Its key tasks are to:

- review and monitor the Commission's systems and controls and the Commission's financial performance;
- review the appointment of the internal auditor, to agree the internal audit programme for the forthcoming year and receive their reports. It also monitors the performance of the internal auditors and the implementation of the audit recommendations;

ACCOUNTS for the year ended 31 October 2002

- receive the external auditor's management letter, and reports from Commission staff on the progress in implementing any major National Audit Office recommendation for change. Both internal and external auditors have direct access to the Chair of the Audit Panel;
- consider issues of risk management and report on these to the Commission as appropriate; and
- consider and report on the adequacy and accuracy of management accounts, information and controls.

Other Panels

29. The main objectives of the other four Panels are:

The Purchasing and Quality Control Panel recommends audit appointments, and advises the Commission on matters relating to the procurement of audit and inspection services. The Panel oversees the production of technical advice provided to auditors and ensures that the quality of their work meets the standards laid down by the Commission.

The District Audit (DA) Panel oversees the work of the in-house audit provider of the Commission, operating with a degree of autonomy within a regulatory framework. The District Audit Panel supervises and advises on the strategy and performance of DA and ensures that, where necessary, the full Commission considers relevant DA issues. As such its key tasks are to:

- act as the strategic governing board for District Audit;
- advise the Commission on District Audit corporate strategy and business plans, and to monitor the Service's performance against these; and
- provide District Audit with advice and guidance on the Commission's purposes, objectives and strategies in so far as these affect or place requirements on District Audit.

The Inspection Panel co-ordinates the oversight of the Commission's inspection programme, including housing inspections, and reports to the full Commission as necessary. It monitors emerging trends and makes recommendations on changes to processes and procedures as required.

The Analysis and Research Panel develops the Commission's value for money (vfm) strategy and monitors the vfm processes from study selection to local delivery. The panel also oversees the Commission's work in the development of comparative databases.

Internal Control and Risk Management

30. The system of internal control is designed to manage, rather than eliminate, the risk of the Commission failing to achieve its functions, policies, aims and objectives. It can therefore only provide a reasonable and not absolute assurance of effectiveness.
31. I chair the Commission's Management Board which comprises the head of each of the Commission's directorates and meets not less than once in each month to review the Commission's performance, to inform the exercise by the Audit Commission of its functions and to oversee the achievement of its policies, aims and objectives.
32. Through the Commission's Management Board and Panel structure, the Commission manages progress with current initiatives and compliance with external requirements.
33. The Chair of the Commission's Audit Panel reports periodically to the Commission concerning internal control and the management of risk.
34. Internal Audit reports regularly to standards defined in the Government Internal Audit Standards, and 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 clearer understanding of respective roles and requirements.
35. The Commission's Management Board and, in turn, the Audit Panel receive regular reports from managers on the steps they are taking to manage risks in their areas of responsibility, including progress reports on key projects.
36. The Commission's corporate planning and budgeting process incorporates a robust prioritisation methodology based on risk ranking and cost-benefit analysis.
37. The Commission has integrated risk assessment and management into its routine business management processes through:
 - a programme of risk awareness training and facilitated workshops within the Commission's directorates and business units to identify and keep an up to date record of the risks facing the organisation;
 - the maintenance of an organisation wide risk register; and
 - monthly review of these arrangements and of significant risks and occurrences through a meeting of senior staff (the Resources Board).

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Each directorate and business division of the Commission is monitored against key performance and risk indicators.

38. During the period to which this Statement on Internal Control applies, the following events occurred relevant to the Commission's internal controls:
- The Commission has continued discussions with Her Majesty's Customs and Excise as to the appropriate VAT treatment for inspection fees charged by the Commission and recovery of VAT on related expenditure. The Commission has made no financial provision to allow for the potential outcome of those discussions, but has agreed an appropriate invoicing treatment for the time being pending the final outcome (see Note 25).
 - During the period to which this statement relates, the Commission has carried out a comprehensive performance assessment (CPA) of all single-tier local authorities and County Councils in England. The results of that assessment were announced on 12 December 2002 (after the period to which this Statement relates) and at that point two local authorities commenced judicial review proceedings against the Audit Commission. The Commission is contesting those proceedings, and the litigation is ongoing. Recognising that CPA might give rise to challenges from local authorities, the Commission applied a detailed quality assurance process throughout. Legal advice to the Commission is that it is in a strong general position in relation to CPA.
 - The Commission operates a stand-alone defined benefit pension scheme with similar terms and conditions to Civil Service and local government schemes. The Fund is 100 per cent invested in equities with a market value at 31 March 2002 of £284 million. At that date it showed a small actuarial surplus. A number of factors may adversely impact on the Scheme. In the short term, declining stock market value of assets combined with increasing liabilities due to low discount factors (related to the value of gilts) may result in a deficit on the Fund over the next couple of years, and in the longer term, changes in demographic assumptions (mainly life expectancy) are increasing the liability costs.
39. 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's directorates and business divisions 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.

.....
Sir Andrew Foster

*Accounting Officer and Controller of Audit
March 2003*

The Certificate and Report of the Comptroller and Auditor General to the House of Parliament and the Members of the National Assembly for Wales

I have audited the financial statements on pages 16 to 37 under the Audit Commission Act 1998 as extended by the National Assembly for Wales (Transfer of Functions) Order 1999. These financial statements have been prepared under the historical cost convention as modified by the revaluation of certain fixed assets and the accounting policies set out on page 19.

Respective responsibilities of the Audit Commission, Controller of Audit and Auditor

As described on pages 2 to 8 of the Foreword to the accounts, the Audit Commission and the Controller of Audit are responsible for the preparation of the financial statements in accordance with the Audit Commission Act 1998 and for ensuring the regularity of financial transactions. The Audit Commission and the Controller of Audit are also responsible for the preparation of the Foreword. My responsibilities, as independent auditor, are established by statute and guided by the Auditing Practices Board and the auditing profession's ethical guidance.

I report my opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Audit Commission Act 1998 and Treasury directions made thereunder, and 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 if, in my opinion, the Foreword is not consistent with the financial statements, if the Commission has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I review whether the statement on pages 9 to 13 reflects the Commission's compliance with Treasury's guidance 'Corporate governance: statement on internal control'. I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements.

The maintenance and integrity of the Audit Commission's web site is the responsibility of the Accounting Officer; the work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

Basis of audit opinion

I conducted my audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Audit Commission and the Controller of Audit in the preparation of the financial statements, and of whether the accounting

ACCOUNTS for the year ended 31 October 2002

policies are appropriate to the 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 are free from material misstatement, whether caused by error, or by fraud or other irregularity 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 have also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In my opinion:

- the financial statements give a true and fair view of the state of affairs of the Audit Commission as at 31 October 2002 and of the surplus and cash flows for the year then ended and have been properly prepared in accordance with the Audit Commission Act 1998 and directions made thereunder by the Deputy Prime Minister and the Secretary of State for Wales; 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

March 2003

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ACCOUNTS for the year ended 31 October 2002

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

**INCOME AND EXPENDITURE ACCOUNT
FOR THE YEAR ENDED 31 OCTOBER 2002**

	<i>Note</i>	<i>2002</i> £000	<i>2001</i> £000
<i>Operating income</i>			
Audit fee income		158,888	135,033
Inspection income	3	50,990	40,761
Other operating income	4	4,039	2,730
	2	213,917	178,524
<i>Operating costs</i>			
Staff and members' costs	5	116,014	97,578
Bought-in services	6	61,916	49,232
Other operating costs	7	35,765	31,309
Notional costs	1(x)	791	820
		214,486	178,939
<i>Operating deficit including notional costs</i>		(569)	(415)
Add back notional costs	1(x)	791	820
Net Interest receivable	8	1,060	828
Net costs arising from litigation	9	(337)	(636)
<i>Surplus for year</i>		945	597

*The notes that follow form part of these financial statements.
The movement on reserves is set out at note 18.*

There were no recognised gains or losses other than the result for the year.

All of the results above are derived from continuing operations.

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BALANCE SHEET AT 31 OCTOBER 2002

	<i>Note</i>	<i>2002</i> £000	<i>2001</i> £000
<i>Fixed assets</i>	<i>11</i>	<u>5,602</u>	<u>6,246</u>
<i>Current assets</i>			
Fee debtors and work in progress	<i>12</i>	17,213	22,096
Other debtors	<i>13</i>	19,168	8,016
Short term investments	<i>14+21</i>	15,000	9,000
Cash at bank and in hand	<i>21</i>	1,131	5,767
		<u>52,512</u>	<u>44,879</u>
<i>Creditors: amounts falling due within one year</i>			
Creditors and accrued charges	<i>15</i>	21,642	19,579
Deferred income	<i>16</i>	21,422	18,799
		<u>43,064</u>	<u>38,378</u>
Net current assets		9,448	6,501
Provisions for liabilities and charges	<i>17</i>	1,438	-
Total net assets employed		<u>13,612</u>	<u>12,747</u>
<i>Financed by</i>			
Government grant reserve	<i>18</i>	560	640
General reserves	<i>18</i>	13,052	12,107
Total financing		<u>13,612</u>	<u>12,747</u>

The notes that follow form part of these financial statements.

.....
Mr J Strachan *Chairman*
2002

.....
Sir Andrew Foster *Accounting Officer and Controller of Audit*
2002

ACCOUNTS for the year ended 31 October 2002

**CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 OCTOBER 2002**

	<i>Note</i>	<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
Net cash inflow from operating activities	<i>19</i>	<u>1,647</u>	<u>8,005</u>
Returns on investments and servicing of finance			
Interest received		<u>1,060</u>	<u>829</u>
Net cash inflow from returns on investments and servicing of finance		<u>1,060</u>	<u>829</u>
Capital expenditure and financial investment			
Payments to acquire tangible fixed assets		(1,343)	(2,243)
Interest payable		-	(1)
Net cash outflow from investing activities		<u>(1,343)</u>	<u>(2,244)</u>
Management of liquid resources			
Receipts from short-term investments		41,000	-
Payments to acquire short-term investments		<u>(47,000)</u>	<u>(9,000)</u>
Short-term investments		<u>(6,000)</u>	<u>(9,000)</u>
Decrease in cash	<i>20</i>	<u>(4,636)</u>	<u>(2,410)</u>

ACCOUNTS for the year ended 31 October 2002

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 based 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 deficit, 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) The Commission provides a defined benefit pension scheme for its employees, the costs of which are charged to the Income and Expenditure Account.
- (x) The Notional Cost of Capital calculation is based on net assets at 6 per cent, and charged to Operating Costs. This cost 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.

ACCOUNTS for the year ended 31 October 2002

NOTE 2: INCOME AND EXPENDITURE ANALYSIS

i) Analysis by sector:

		<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
Local Government, Police and Probation			
Fee income (see ii)	Fee income	124,765	108,977
	Grant income	27,245	21,431
	Other income	2,747	2,248
		<u>154,757</u>	<u>132,656</u>
Expenditure	Direct and indirect costs	154,070	132,381
Net results		<u>687</u>	<u>275</u>
Health			
Income (see ii)	Fee income	57,868	45,386
	Other income	1,292	482
		<u>59,160</u>	<u>45,868</u>
Expenditure	Direct and indirect costs	58,902	45,546
Net results		<u>258</u>	<u>322</u>

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

Local Government, Police and Probation

	<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
District Audit – fees	74,048	65,387
Inspection income – fees	23,745	19,330
Inspection income – grants	27,245	21,431
Audits undertaken by private accountancy firms	26,972	24,260
Other income	2,747	2,248
	<u>154,757</u>	<u>132,656</u>

ACCOUNTS for the year ended 31 October 2002

National Health Service:

	<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
Audits undertaken by District Audit	38,836	30,349
Audits undertaken by private accountancy firms	19,032	15,037
Other income	1,292	482
	<u>59,160</u>	<u>45,868</u>

iii) Analysis of Audit and Inspection Type

Section of the 1998 Audit Commission Act		<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
Section 28: Certifying claims or returns made by an authority	Income	25,579	18,841
	Surplus	<u>114</u>	<u>63</u>
Section 29: Additional audits undertaken with the consent of the Secretary of State	Income	0	0
	Surplus	<u>0</u>	<u>0</u>
Section 35: Studies designed to improve economy efficiency and effectiveness, undertaken at the request of the body concerned	Income	1,222	14,944
	Surplus	<u>5</u>	<u>50</u>
Section 36: Studies designed to improve economy efficiency and effectiveness, undertaken at the request of specified educational bodies.	Income	0	2
	Surplus	<u>0</u>	<u>0</u>

These sections reflect the work where the Commission is required to charge fees that will cover the full cost of providing the service:

iv) Income generated in Wales

	<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
From local authorities		
Audit	8,390	7,884
Inspection fees	1,619	1,284
Inspection grant from the Welsh Assembly Government	1,964	1,713
From National Health Service Bodies	2,458	2,719
	<u>14,431</u>	<u>13,600</u>

NOTE 3: INSPECTION INCOME

Under the Local Government Act 1999 Commission is responsible for the audit of local authorities' Best Value Performance Plans (BVPPs) and for inspecting authorities' compliance with the requirements of the Act.

ACCOUNTS for the year ended 31 October 2002

Grants are available to the Commission for Inspection work on best value authorities, and in the period a number of grants were received from the Office of the Deputy Prime Minister, Department for Transport, Local Government and the Regions (DTLR), and the Welsh Assembly Government.

	<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
Fee income	23,745	19,330
Grant income		
ODPM / DTLR	23,757	18,065
Department of Health	1,524	1,653
Welsh Assembly Government	1,964	1,713
	<u>50,990</u>	<u>40,761</u>

Prior to June 2001, the grants provided by DTLR were provided by the Department of the Environment, Transport and the Regions; and after May 2002, by the Office of the Deputy Prime Minister

NOTE 4: OTHER OPERATING INCOME

	<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
Legal costs reimbursed	459	606
Publications and conferences	917	517
National fraud initiative	298	303
Secondments and sundry income	2,365	1,304
	<u>4,039</u>	<u>2,730</u>

NOTE 5: STAFF AND COMMISSION MEMBERS' COSTS

	<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
(i) Staff costs		
Staff salaries	84,383	70,629
Member salaries	145	157
Cost of early retirements and other pension costs	265	663
Social Security costs	6,859	5,939
Other pension costs	11,749	9,575
Lease cost of cars	6,585	5,640
Staff travel and subsistence costs	6,012	4,952
Member travel and subsistence costs	16	23
	<u>116,014</u>	<u>97,578</u>

ACCOUNTS for the year ended 31 October 2002

(ii) Chief Executive and senior manager appointments.

Details of fixed term contracts

	Term of office	Contract Ends
Sir Andrew Foster, Controller of Audit		Permanent contract
Colin Douglas, Director of Communications	5 years	31/03/2007
Martin Evans, Director of Audit Policy and Appointments		Permanent contract
Trish Longdon, Director of People Development		Permanent contract
Alan Meekings, Director of Operations	3 years	4/03/2004
David Prince, Director of Strategy and Resources	4 years	30/09/2006
Peter Wilkinson, Director of Health		Permanent contract

In addition, two directors resigned during the year:

Joanne Shaw, Director of Performance Development	4/1/2002
Paul Kirby, Director of Inspection	30/10/2002

During the year the Commission's management board was restructured and a number of changes made. Posts filled during the year are reflected in the table above.

(ii) Chief Executive and senior manager remuneration details

	2002		2002 total		2002	2001 total
	Salary	PRP	Other Benefits	(excluding pension contribution)	Pension Contribution	(excluding pension contribution)
	£	£	£	£	£	£
Directors in place at 31 October 2002.						
Sir Andrew Foster	163,413	35,814	5,837	205,064	12,924	198,607
Colin Douglas ¹	52,500	5,671	2,377	60,548	7,673	-
Martin Evans	84,744	14,413	4,739	103,896	12,452	103,473
Trish Longdon	88,735	14,413	454	103,602	13,173	102,813
Alan Meekings ²	113,106	20,934	5,409	139,449	12,924	80,092
David Prince	128,033	21,442	3,757	153,232	12,924	151,227
Peter Wilkinson	100,809	16,396	7,278	124,483	12,924	119,388
Directors who left during the year.						
Paul Kirby ³	90,923	16,596	4,878	112,397	12,924	-
Joanne Shaw ⁴	13,514	1,311	981	15,806	1,383	62,865

All Commission staff are eligible to receive performance related pay (PRP). This is assessed bi-annually against predetermined targets, and paid in arrears. 'Other Benefits' primarily include the provision of a car leased by the Audit Commission.

Notes

1. The 2002 figures relate to the period 1 April to 31 October 2002
2. The 2001 figure relates to the period 11 March to 31 October 2001
3. The 2002 figures relate to the period 1 November 2001 to 30 October 2002
4. The 2002 figures relate to the period 1 November 2001 to 4 January 2002

ACCOUNTS for the year ended 31 October 2002

(iii) Chief Executive and senior manager pension entitlement details

	Age at 31 October 2002	Real increase in pension at 60 £	Total accrued pension at 31 October 2002 £	Total accrued pension at 31 October 2001 £
Directors in place at 31 October 2002.				
Sir Andrew Foster	57	3,390	70,178	65,672
Colin Douglas ¹	39	660	660	-
Martin Evans	46	1,823	22,056	19,895
Trish Longdon	50	2,197	32,682	29,975
Alan Meekings ²	52	1,217	53,540	787
David Prince	54	2,343	54,662	51,444
Peter Wilkinson	49	1,241	15,126	13,653
Directors who left during the year.				
Paul Kirby ³	38	4,125	21,212	
Joanne Shaw ⁴	39	320	4,115	3,784

These staff are members of the Commission's defined benefit pension scheme and accrued benefits during the year in that scheme. The total accrued pension is that which would be paid annually on retirement at 60, based on their service to 31 October 2002.

Notes

1. The Real Increase in Pension refers to the period 1 April to 31 October 2002
2. At 31 October 2001, Alan Meekings had decided to transfer in his entitlement from another scheme, but the transfer value had not been received by the Audit Commission Pension Scheme.
3. The Real Increase in Pension figure relates to the period 1 November 2001 to 30 October 2002
4. The Real Increase in Pension figure relates to the period 1 November 2001 to 4 January 2002

(v) Commissioner remuneration details

	2002 £	2001 £
Commissioners in place at 31 October 2002.		
Mr R A Arthur	7,328	7,128
Ms J Baddeley	7,328	7,128
Mr J Bowen	7,328	1,203
Dr J Curson	7,328	7,128
Ms E Filkin	7,328	7,128
Mrs A Fresko	33,814	15,057
Sir Graham Hart	7,328	7,128
Mr R Hoyle	6,125	0
Dr P Lane	7,328	6,545
Mr G Lemos	7,328	6,545
Mr D Moss	7,328	4,212
Professor S Richards	7,328	7,128
Mr N Skellett	7,328	6,545
Mr C Swinson	7,328	6,545
Sir David Williams	7,328	7,128
Mr B Wolfe	7,328	7,128
Commissioners who left prior to 31 October 2002		
Mr J R Foster	0	7,128

ACCOUNTS for the year ended 31 October 2002

Ms R Lowe	0	4,722
Dame Helena Shovelton	2,907	34,455
Sir Ron Watson	0	7,128

Commissioners receive a salary based on their time commitment, expressed in terms of days per month. The usual time commitments are:

	Days per month
Dame Helena Shovelton while Chair: and Adrienne Fresko as Acting Chair	6
Adrienne Fresko as Deputy Chair	4
Commissioner	2

No Commissioner receives performance related pay, nor are they members of the Audit Commission Pension Scheme.

(vi) The average monthly number of staff employed during the period

	<i>2002</i>	<i>2001</i>
District Audit - audit staff	1,181	1,083
- audit trainees	180	146
- support staff	182	182
Inspection Service - inspection staff	332	262
- support staff	106	62
Commission Directorates	380	345
Secondees	20	11
	<u>2,381</u>	<u>2,091</u>
In post at 31 October	<u>2,437</u>	<u>2,271</u>

NOTE 6: BOUGHT-IN SERVICES

	<i>2002</i>	<i>2001</i>
	<i>£000</i>	<i>£000</i>
Audit fees to private accounting firms	41,918	35,818
District Audit	7,767	6,191
Inspection Services	9,323	5,508
Commission Directorates	2,908	1,715
	<u>61,916</u>	<u>49,232</u>

These costs relate to services bought in by the Audit Commission that directly relate to their audit, inspection or research functions. The Inspection costs include the peer reviews held under the Corporate Performance Assessment process.

ACCOUNTS for the year ended 31 October 2002

NOTE 7: OTHER OPERATING COSTS

	<i>2002</i>	<i>2001</i>
	<i>£000</i>	<i>£000</i>
Accommodation		
- rent lease costs	4,794	3,171
- other costs	3,136	2,639
Supplies and services	15,192	11,642
Recruitment and transfers	1,966	3,762
Training	3,607	2,767
Depreciation (note i)	1,606	1,242
Audit fee	80	87
Professional fees	1,309	2,237
Publications	984	837
Other operating costs	2,913	2,645
Debts written off	5	74
Debts provided for	173	206
	<u>35,765</u>	<u>31,309</u>

Note i

	<i>2002</i>	<i>2001</i>
	<i>£000</i>	<i>£000</i>
Included within depreciation is:		
Write back of government grant	<u>80</u>	<u>80</u>

NOTE 8: NET INTEREST RECEIVABLE

	<i>2002</i>	<i>2001</i>
	<i>£000</i>	<i>£000</i>
Interest receivable	1,060	829
Interest payable	<u>0</u>	<u>(1)</u>
	<u>1,060</u>	<u>828</u>

NOTE 9: NET COSTS ARISING FROM LITIGATION

	<i>2002</i>	<i>2001</i>
	<i>£000</i>	<i>£000</i>
Litigation services	<u>337</u>	<u>636</u>

The majority of these costs relate to legal costs incurred by the auditor in the appeal against his determination of the Westminster Designated Sales Objections. The case was determined by the Divisional Court in December 1997, and by the Court of Appeal in May 1999. The Divisional Court's judgement included an award of costs against the auditor which have been paid. Certain aspects of the Court of Appeal judgement were subject to further appeal to the House of Lords. The House of Lords in December 2001 unanimously allowed the auditor's appeal. Their lordships awarded costs in the

ACCOUNTS for the year ended 31 October 2002

House of Lords proceedings in favour of the auditor and have reversed the earlier decision on costs against the auditor by the court of appeal. The quantification of costs pursuant to their lordships' decisions has not, as at February 2003, concluded.

Some further costs may be borne by the Commission in concluding the quantification of the costs awarded in these proceedings although some sums may subsequently be recovered. There is not a sufficient basis on which a reasonable estimate can currently be made. See Note 25.

NOTE 10: 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 11: FIXED ASSETS

	<i>Furniture and Fittings £000</i>	<i>Computer Equipment £000</i>	<i>Office Equipment £000</i>	<i>Total £000</i>
Cost				
At 1 November 2001	6,830	2,561	1,381	10,772
Purchases	696	616	31	1,343
Disposals	(787)	(431)	(169)	(1,387)
At 31 October 2002	<u>6,739</u>	<u>2,746</u>	<u>1,243</u>	<u>10,728</u>
Depreciation				
At 1 November 2001	2,155	1,526	845	4,526
Provided in period	851	644	191	1,686
Disposals	(535)	(419)	(132)	(1,086)
At 31 October 2002	<u>2,471</u>	<u>1,751</u>	<u>904</u>	<u>5,126</u>
Net book value				
At 31 October 2002	4,268	995	339	5,602
At 31 October 2001	<u>4,675</u>	<u>1,035</u>	<u>536</u>	<u>6,246</u>

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

ACCOUNTS for the year ended 31 October 2002

NOTE 12: DEBTORS AND WORK IN PROGRESS

	2002 £000	2001 £000
Fee debtors		
- Local Government	8,636	10,501
- National Health Service	2,782	3,247
Work in progress		
- Local Government	4,601	5,427
- National Health Service	1,194	2,921
	<u>17,213</u>	<u>22,096</u>

(i) Debts and work in progress are valued at estimated realisable value

(ii) Bad and doubtful debt provision (netted against appropriate debtor above):

	2002 £000	2001 £000
Opening provision	514	329
Bad debts previously provided for and written off in the year	(176)	(21)
Net provision made in the year	173	206
Closing provision	<u>511</u>	<u>514</u>

The Commission actively chases 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 year.

NOTE 13: OTHER DEBTORS

	2002 £000	2001 £000
Prepaid pension costs	369	993
Other debtors and prepayments	4,569	4,688
Owed by sponsoring government departments	13,991	2,108
Loans to employees	239	227
	<u>19,168</u>	<u>8,016</u>

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

	2002 £000	2001 £000
Included in <i>Loans to employees</i> :		
- housing relocation scheme : advances to staff	<u>24</u>	<u>10</u>

NOTE 14: 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 etc, that arise directly from its operations. 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.

ACCOUNTS for the year ended 31 October 2002

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; and
- 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 year end, the longest dated deposit matures April 2003. Short-term flexibility is achieved by overdraft facilities.

NOTE 15: CREDITORS AND ACCRUED CHARGES

	<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
Trade creditors	4,594	2,471
Taxation and Social Security	1,766	1,872
Holiday pay	2,056	2,016
Accruals	13,226	13,220
	<u>21,642</u>	<u>19,579</u>

The accrual for holiday pay represents the liability for holiday entitlement carried over at the year-end.

NOTE 16: DEFERRED INCOME

	<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
Deferred Audit Income	16,483	13,269
Deferred Inspection Income	4,939	5,530
	<u>21,422</u>	<u>18,799</u>

NOTE 17 : PROVISIONS

Provision for Lease Dilapidations	<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
At 31 October 2001	0	-
Provision in year	1,438	-
At 31 October 2002	<u>1,438</u>	<u>-</u>

For the first time, the Commission has provided for the cost of property lease dilapidations. The cost charged to the Income and Expenditure account in the year of £1,438,000 represents the liability at 31 October 2002, and includes both in-year and previous year costs.

ACCOUNTS for the year ended 31 October 2002

NOTE 18: RESERVES

(i) Government Grant Reserve

	<i>2002</i>	<i>2001</i>
	<i>£000</i>	<i>£000</i>
At 31 October 2001	640	720
Movement in year	(80)	(80)
At 31 October 2002	<u>560</u>	<u>640</u>

The Commission received £800,000 for the provision of office accommodation as a capital grant received from the Department for Transport, Local Government and the Regions to undertake inspection work. This is released on a straight line basis over a period of ten years to the income and Expenditure Account as a reduction to the depreciation charge. (note 1(xi))

(ii) Capital and Revenue Reserves

		<i>2002</i>	<i>2001</i>
		<i>£000</i>	<i>£000</i>
Capital reserve	Local Government	1,580	1,580
	Health	<u>2,154</u>	<u>2,154</u>
	Total	<u>3,734</u>	<u>3,734</u>
Revenue reserves	Local Government		
	Brought forward	6,349	6,074
	Surplus for year	<u>687</u>	<u>275</u>
	Local Government reserves	<u>7,036</u>	<u>6,349</u>
	Health		
	Brought forward	2,024	1,702
	Surplus /(Deficit) for year	<u>258</u>	<u>322</u>
	Health reserves	<u>2,282</u>	<u>2,024</u>
	Total revenue reserves	<u>9,318</u>	<u>8,373</u>
Capital and revenue reserves		<u>13,052</u>	<u>12,107</u>

NOTE 19: RECONCILIATION OF OPERATING DEFICIT FOR YEAR TO NET INFLOW FROM OPERATING ACTIVITIES

	<i>2002</i>	<i>2001</i>
	<i>£000</i>	<i>£000</i>
Operating deficit	(569)	(415)
Notional costs	791	820
Net costs of litigation	(337)	(636)
Net depreciation	1,606	1,207
Loss on disposal of fixed assets	301	94
(Increase)/ Reduction in debtors and work in progress	(6,269)	2,897
Increase in creditors and provisions	6,124	4,038
	<u>1,647</u>	<u>8,005</u>

ACCOUNTS for the year ended 31 October 2002

NOTE 20: RECONCILIATION OF NET CASH OUTFLOW TO MOVEMENT IN NET FUNDS

	<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
Decrease in cash	(4,636)	(2,410)
Cash used to increase short term investments	<u>6,000</u>	<u>9,000</u>
Change in net funds	1,364	6,590
Net funds at 1 November 2001	<u>14,767</u>	<u>8,177</u>
Net funds at 31 October 2002	<u>16,131</u>	<u>14,767</u>

NOTE 21: ANALYSIS OF CHANGES IN NET FUNDS

	<i>At 1 November</i> <i>2001</i> <i>£000</i>	<i>Cash</i> <i>Flows</i> <i>£000</i>	<i>At 31 October</i> <i>2002</i> <i>£000</i>
Cash at bank and in hand	<u>14,767</u>	1,364	<u>16,131</u>

NOTE 22: PENSION SCHEME

(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 2002 amounted to £11,749,000. (2001 - £9,575,000). This contribution rate of 13.4 per cent of pensionable salaries has been agreed for the period until 31 October 2003.

(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 2001. The March 2002 valuation is awaiting completion.

The market value of the net assets of the scheme at 31 March 2001 was £268 million which on the actuarially assessed value provided cover of 96 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:

	2001
	%
rate of interest	3.33
rate of salary escalation	1.67
rate of dividend yield	3.40

ACCOUNTS for the year ended 31 October 2002

Under the new accounting standard Financial Reporting Standard (FRS) 17: Retirement Benefits, the principal financial assumptions used by the actuary will be:

	2002 %	2001 %
Rate of inflation	2.3	2.1
Rate of salary escalation	3.8	3.6
Discount rate for liabilities	5.7	5.5
Rate of increase of pensions in payment	2.3	2.1
Rate of increase of deferred pensions	2.3	2.1

(iii) Market value information (FRS 17 disclosure)

	Fair value at 31 October 2002 £000	Fair value at 31 October 2001 £000
Equities	226,060	249,421
Market value of the net assets of the scheme at the year end	<u>226,060</u>	<u>249,421</u>
Long-term expected rate of return	<u>7.5%</u>	<u>6.5%</u>

(iv) Reconciliation of scheme surplus (FRS 17 disclosure)

	31 October 2002 £000	31 October 2001 £000
Fair value of scheme assets (see iii above)	226,060	249,421
Present value of scheme liabilities	<u>(269,868)</u>	<u>(228,134)</u>
Net pension (liability)/ asset	<u>(43,808)</u>	<u>21,287</u>

(v) Reconciliation of scheme surplus (FRS17 disclosure)

	31 October 2002 £000
Surplus in scheme at beginning of the year	21,287
Movement in year:	
Current service cost	(11,525)
Contributions	11,749
Past service costs	(1,467)
Other finance income	3,758
Actuarial gain	(67,610)
Closing deficit in scheme	<u>(43,808)</u>

ACCOUNTS for the year ended 31 October 2002

(vi) Analysis of amount charged to operating profit (FRS17 disclosure)

	31 October 2002 £000
Current service cost	11,525
Past service cost	1,467
Total operating charge	<u>12,992</u>

(vii) Analysis of amount credited to other finance income (FRS17 disclosure)

	31 October 2002 £000
Expected return on pension scheme assets	16,775
Interest cost	(13,017)
Net return	<u>3,758</u>

(viii) Analysis of amount recognised in statement of total recognised gains and losses (STRGL) (FRS17 disclosure)

	31 October 2002 £000
Actual return less expected return on pension scheme assets	(57,448)
Experience gains and losses arising on the scheme liabilities	(9,926)
Changes in financial assumptions underlying the scheme liabilities	(236)
Actuarial loss recognised in STRGL	<u>(67,610)</u>

(ix) History of experience gains and losses (FRS17 disclosure)

	31 October 2002 £000
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Difference between the expected and actual return on scheme assets:

amount	(57,448)
percentage of the present value of the scheme liabilities	-21%

Experience gains and losses on scheme liabilities:

amount	(9,926)
percentage of the present value of the scheme liabilities	-4%

ACCOUNTS for the year ended 31 October 2002

Total amount recognised in statement of total recognised gains and losses:

amount	(67,610)
percentage of the present value of the scheme liabilities	-25%

Additional information (a) Additional funding into the Scheme for the Commission's audit activities was made over the period 1990 to 1996. This occurred when the Commission granted full service credits to certain staff who transferred in 1984-85 (mainly from the Department of the Environment) and October 1990 (from the Department of Health). This funding was kept separately identified within the Scheme, and in 2000 the surplus that had arisen on this funding was crystallised at £6.4 million. Under SSAP24, this surplus was being written back to the Commission's accounts over the actuarially assessed lifetime of the relevant staff, but after the recent adverse stock market performance the Commission, with the agreement of its actuaries, has not written back any part of this surplus for the current period of account. Last year (2001) £1.1 million surplus was written back, reducing the Commission's pension expenditure for that year.

(b) From the Commission's newly formed inspection activity, a liability has been established caused by the large number of staff joining the organisation from other public sector schemes in this set up period. As with the initial actuarial deficit on its audit activity, and having consulted the actuary, the Commission intends to make additional funding to meet this liability and these accounts include a charge of £1.5m (2001, £2.62 million) in respect of additional cash payments made to the Pension Scheme. The Commission considers this now completes its initial set-up phase, and any future liabilities will be funded through the ongoing pension contribution rate.

NOTE 23: OPERATING RESULTS FOR THE LAST FIVE YEARS

<i>Total</i>	<i>12 months to 31 October 2002 £000</i>	<i>12 months to 31 October 2001 £000</i>	<i>12 months to 31 October 2000 £000</i>	<i>12 months to 31 October 1999 £000</i>	<i>12 months to 31 October 1998 £000</i>
<i>Operating income</i>	213,917	178,524	144,345	111,596	105,156
<i>Operating costs</i>	213,695	178,119	143,940	110,561	104,850
<i>Notional costs</i>	791	820	673	645	625
	(569)	(415)	(268)	390	(319)
<i>Add back:</i>					
<i>Notional Costs</i>	791	820	673	645	625
<i>Net interest receivable</i>	1,060	828	298	539	720
<i>(Net costs) recoveries arising from litigation</i>	(337)	(636)	(205)	(1,059)	(853)
<i>Surplus/(deficit)</i>	945	597	498	515	173

ACCOUNTS for the year ended 31 October 2002

NOTE 24: FINANCIAL COMMITMENTS

There are revenue commitments at 31 October 2002 in respect of non-cancellable car leases which expire:

	<i>2002</i> <i>£000</i>	<i>2001</i> <i>£000</i>
within one year	679	355
within one to five years	3,552	3,723
	<hr/> 4,231 <hr/>	<hr/> 4,078 <hr/>
District Audit	3,088	2,926
Commission Directorates	297	326
Inspection Service	846	826

There were annual commitments as at 31 October 2002 to pay rentals under lease agreements which expire:

	<i>2002</i> <i>£000</i>	<i>2002</i> <i>Number of</i> <i>Properties</i>	<i>2001</i> <i>£000</i>	<i>2001</i> <i>Number of</i> <i>Properties</i>
within one year	414	33	355	31
from one to five years	127	8	89	6
over five years	3,002	32	2,817	32
	<hr/> 3,543 <hr/>	<hr/> 73 <hr/>	<hr/> 3,261 <hr/>	<hr/> 69 <hr/>

All building leases are taken out in the name of the Audit Commission. Some are occupied exclusively by either District Audit or the Inspections Service, and where appropriate some are jointly occupied. The majority of building leases are subject to rent reviews.

NOTE 25: 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 Her Majesty's Customs and Excise that its best value inspections are not business activities for VAT purposes. The Commission is in discussion with Her Majesty's Customs and Excise to establish with them the correct accounting treatment for this function and continue to charge and recover VAT on this activity.

NOTE 26: RELATED PARTY TRANSACTIONS

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

The Commission is an executive non-departmental public body sponsored by the ODPM. It has had a number of material transactions with its sponsoring department, the Department for Transport, Local Government and the Regions, the Department of Health, the Welsh Assembly Government and the Home Office.

ACCOUNTS for the year ended 31 October 2002

A number of Commissioners also hold senior positions in authorities where the Commission acts as auditor. In their role as a Commissioner, they would have some influence in the setting of audit fee rates for their authorities. The Commissioners also holding positions in authorities and other public bodies are:

Commissioners in place at 31 October 2002.

Mr R A Arthur	Councillor of the London Borough of Camden. Vice-chair of the ALG, Deputy Chair of Public Private Partnership Programme. Member of the boards of the Housing Corporation and Accord plc and of the Management Executive of the LGA. Mr Arthur also undertook some limited consultancy for the Commission during the year.
Ms J Baddeley	Director of the DWP Pensions Group
Mr J Bowen	A wide range of non-executive interests, including Finance Wales Investments Ltd (a subsidiary of the Welsh Development Agency). He is also Chairman of The Employment Tribunals.
Dr J Curson	Assistant Medical Director Frimley Park Hospital and Associate Dean Wessex (Medical Workforce Review Team).
Ms E Filkin	No position currently held in relevant authorities
Mrs A Fresko	Senior Fellow of Office for Public Management, Director Accountancy Foundation (as Audit Commission nominee)
Sir Graham Hart	No position currently held in relevant authorities
Mr R Hoyle	CEO of Liverpool Health Authority
Dr P Lane	Deputy leader of Trafford Metropolitan Borough Council. Member of the Local Government Association Scrutiny Review Panel, Chair of the Old Trafford SRB Partnership Board and co-opted member of the North-West Regional Assembly. Non-executive Director of English Partnerships and Board Member of the North West Regional Assembly
Mr G Lemos	No position currently held in relevant authorities
Mr D Moss	Chief Executive of Southampton University Hospitals NHS Trust
Professor S Richards	Member of the Modernising Government Project Board
Mr N Skellett	Leader of Surrey County Council and a governor of Oxted County School. He is Chairman of the County Councils Network and Chairman of the South East Regional Assembly
Mr C Swinson	No position currently held in relevant authorities
Sir David Williams	Councillor of the London Borough of Richmond upon Thames, a board member of the Improvement and Development Agency, and Chairman of Petersham Common Conservators.
Mr B Wolfe	No position currently held in relevant authorities

ACCOUNTS for the year ended 31 October 2002

In addition the following members of our staff worked as in non-executive positions during the year

Catherine Staite	Nottinghamshire Healthcare NHS Trust
Nicholas Ville	North East London Strategic Health Authority
Kashif Khan	Walthamstow, Leyton & Leytonstone PCT
Susan Mew	Standards Committee of the Exmoor National Park Authority
Paul Najsarek	London Borough of Islington Standards Committee
Nick Mapstone	United Lincolnshire Hospitals NHS Trust
Asari St Hill	Walthamstow, Leyton & Leytonstone PCT
Elizabeth Hale	Hampshire and IOW Health Authority
Gillian Connolly	Calderdale PCT
Anthony Tweh	Greater Manchester Probation Service
Colin Douglas	London Ambulance Service NHS Trust
Alan Lovett	Wendens Ambo Parish Council
Clive Billeness	Tockwith and Wilstrop Parish Council
Gordon Brown	Chairman of Leybourne Parish Council