

Annual Audit and Inspection Letter

South Kesteven District Council

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Reference:	KE011 Annual Audit & Inspection Letter
Date:	December 2004

Executive Summary

The purpose of this letter

This is our audit and inspection 'Annual Letter' for Members which incorporates the Annual Audit Letter for 2003/04, and is presented by the Council's Relationship Manager and District Auditor. The letter summarises the conclusions and significant issues arising from our recent audit and inspections of the Council.

We have issued separate reports during the year. These reports are listed at Appendix 1 for information.

Appendix 2 sets out the scope of audit and inspection.

Appendix 3 provides information about the fees charged.

Key messages

Council performance

Following CPA the Council has been quick to make initial progress in establishing a robust framework aimed at addressing shortcomings and building on strengths, and signal an increased focus on improvement.

A key first milestone has been met in establishing the change plan, and some initial improvements to corporate processes to deliver the Council's ambitious vision have been made but much more remains to be done. Following the strengthening of senior management and comprehensive reassessment of priorities the Council is now entering a crucial stage in ensuring changes result in sustainable improvements in service performance. The enthusiasm, commitment and momentum built up so far will be critical in ensuring this carries through.

A robust and embedded performance management framework will also be crucial and the Council needs to build on the work commenced in this area.

We gave an unqualified opinion on the Council's BVPP and PIs.

The Accounts

We have given your accounts an unqualified audit opinion. The final accounts closedown process is now increasingly more complex and will continue to be so. More demanding technical requirements such as pensions accounting requirements need to be met as well as increasingly early accounts closedown deadlines.

Financial position

The Council's financial position provides challenges for members. For the 2005/06 budget the Council will need to respond to the Gershon regime that will require 2.5 per cent efficiency savings. The Council will also need to ensure that its budget for 2005/06 is within the specified capping criteria to avoid being capped and incurring significant extra costs and having to make difficult decisions about service cuts at short notice.

The Council also needs to ensure that the housing options appraisal exercise is completed on time.

Other accounts and governance issues

Your overall internal control arrangements cover the major areas we would expect, but they are not as strong as they could be in some key areas and would benefit from strengthening.

Action needed by the Council

- Ensure the focus and momentum generated so far in compiling the change plan is sustained in delivering improvement priorities and projects contained within it.
- Implement a more robust performance management framework.
- Re-appraise the accounts closedown process to ensure that earlier deadlines are achieved.
- Secure a balanced budget for 2005/06 within council tax limitations, incorporating Gershon efficiency savings regime.

- Strengthen key internal control arrangements including embedding risk management and further member training and development.
- Ensure that the housing options appraisal exercise is completed by the July 2005 deadline.

Council performance

Following CPA the Council has been quick to make initial progress in establishing a robust framework aimed at addressing shortcomings and building on strengths, and signal an increased focus on improvement.

A key first milestone has been met in establishing the change plan, and some initial improvements to corporate processes to deliver the Council's ambitious vision have been made but much more remains to be done. Following the strengthening of senior management and comprehensive reassessment of priorities the Council is now entering a crucial stage in ensuring changes result in sustainable improvements in service performance. The enthusiasm, commitment and momentum built up so far will be critical in ensuring this carries through.

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CPA and improvement

In March 2004 the Audit Commission published the results of the Comprehensive Performance Assessment of South Kesteven District Council which had been carried out in November 2003.

The Council was assessed as a fair council which is self aware and has recognised the need to change and improve. The report also noted that the Council was in a state of rapid transformation, having strengthened its senior management team, with the new political and officer leadership driving change.

The main objective of CPA is to help council's achieve and sustain improvements in the services provided to local people, and key to this is the way the Council sets about addressing key shortcomings and building on strengths identified in the CPA report and in its own self assessment.

Whilst we have not completed a formal assessment of progress this year, in this section of the letter we comment on the progress the Council has made so far. The Council has sought external peer update of progress and this shows that despite good initial progress there is still much to do.

The Council recognised the need to respond swiftly to the issues in CPA and has established a framework within which this can be achieved, known locally as the change management action plan (the plan). This is a good platform from which improvement can be built, and is subject to dedicated monitoring both within the Council and externally via the Change Management Monitoring group. The plan prioritises 22 key projects where it intends to focus improvement over the forthcoming years. These cover the key issues in the CPA report.

Throughout the last year the Council has been active in implementing the plan. In particular it has consulted widely with the public and stakeholders on what the priorities and non priorities for the Council should be to try to ensure that these reflect community needs, and over the next four years ensure resources are re-aligned to match these.

The CPA report recognised that the corporate management team had recently been strengthened and the Council has been successful in accessing additional resources from the ODPM Capacity Building Fund to develop member and officer capacity.

However the path to improvement is long term by nature and it is essential that the full commitment of members and officers so far generated is maintained and that monitoring by the cabinet is both challenging and supportive.

The plan should become one key means whereby the Council can measure and demonstrate its own success at responding to CPA. The Council needs to ensure it maintains focus and momentum on achieving the plan.

It is too early after nine months to assess the impact of the plan on service performance but the Council is well placed to ensure this happens in the longer term.

Performance Information

We gave an unqualified audit opinion on the Council's Best Value Performance Plan and the Best Value Performance Indicators.

One area where the CPA report was critical was in the way the Council used performance information and indicators as part of its performance management arrangements. It concluded that longer term and more stretching targets were needed.

The Council has already introduced a more focused means of reporting and monitoring key indicators using a traffic light system, and ensuring potential performance problems are being addressed.

The Council's BVPIs for 2003/04 show that overall service levels are reasonable but that there is scope for improvement.

The Council measures its performance using its top 50 PIs and a traffic lights system. The current position up to October 2004 is as follows.

TOP 50 PI COMPARISON - OCTOBER 2004

Number of PIs green – at or better than target performance	24
Number yellow or red – below target	26
Total number of top PIs	50

This shows the Council needs to improve its performance on around half its PIs. To achieve this it needs to build on the work already started as part of the plan and ensure a robust performance management framework is developed and where appropriate use lessons learned from BV reviews and CPA.

Accounts and Governance

We have given your accounts an unqualified audit opinion. The final accounts closedown process is now increasingly more complex and will continue to be so. More demanding technical requirements such as pensions accounting requirements need to be met as well as increasingly early accounts closedown deadlines.

Your overall internal control arrangements cover the major areas we would expect, but they are not as strong as they could be in some key areas and would benefit from strengthening.

Audit of 2003/04 accounts

We gave an unqualified opinion on the Council's accounts on the 29 November 2004.

Matters arising from the final accounts audit

The published accounts are an essential means by which the Council reports its stewardship of the public funds at its disposal and its financial performance in the use of those resources. Members approved the Council's annual accounts on 18 August 2004.

In last year's Annual Audit and Inspection Letter we emphasised that timeliness in producing the accounts will become increasingly important over the next few years as the deadline for completion of the accounts is brought forward to 31 July 2005, then 30 June 2006 in line with the Government's requirement. Whilst the accounts have been prepared to meet the requirements this year, the deadlines will become increasingly more difficult to achieve and will require early planning and thoughtful scheduling of key tasks and cooperation of service managers next year.

In June 2004 we held a workshop for the Council's accountancy staff and discussed a range of technical accounting issues and ways of streamlining the closedown process to ensure timeliness and accuracy in the accounts.

The Council needs to reappraise the accounts closedown process to ensure that earlier deadlines are achieved.

Report to those with responsibility for governance in the Council

We are required by professional standards to report to those charged with governance if there are concerns before we give an opinion on the financial statements. However this year, again there were no unadjusted amendments nor were there any significant matters of concern, so we issued a SAS 610 letter confirming that there were no matters that we wished to raise.

Financial standing

The Council's financial position provides challenges for members. For 2005/06 budget the Council will need to respond to the Gershon regime that requires 2.5 per cent efficiency savings. The Council will also need to ensure that its budget for 2005/06 is within the specified capping criteria to avoid significant extra costs and difficult decisions at short notice.

The Council also needs to ensure it completes the housing options appraisal exercise by the deadline.

General fund spending and balances

In 2003/04 the Council's net expenditure was £13.2 million which was £960,000 less than budget. The £960,000 was largely used to increase revenue reserves to £6.073 million.

Current forecasts show that 2004/05 spending is expected to be in line with budget which should leave around £2.5 million in revenue balances.

Gershon efficiency savings for 2005/06

For 2005/06 budget round the Council will need to respond to the Gershon efficiency regime. Key points include:

- Councils should aim for 2.5 per cent savings based on 2004/05 budget as a baseline (but excluding rent allowances and rebates).
- Half of these savings should be cashable – these are where resources can be redirected eg. lower costs for the same service level.
- Non cashable savings include improved performance or quality or outputs for the same levels of resources.
- Cashable savings can be reinvested in local services.

- Service cuts will not count as efficiency gains.
- Council's have discretion over how to deliver the savings i.e. how much from each service.
- The AES will be audited, and is likely to inform future CPA assessments.

Detailed guidance is expected in December 2004 and the Annual Efficiency Statement (AES) for 2005/06 submitted by April – June 2005. Progress will need to be closely monitored during the year to ensure the Council achieves its Gershon savings.

The change management plan will be an essential element in enabling the Council to meet Gershon targets over the longer run. Particularly ensuring the Council adopts a procurement strategy which allows potential sources of savings to be secured which do not affect the quality of service delivered.

Council Tax increases and Capping

Members will recall that six councils had their 2004/05 proposed budgets capped. The criteria for capping in 2004/05 were:

- more than 2 per cent increase in net expenditure;
- more than £137 average band D council tax; and
- more than 8.5 per cent increase in council tax.

Expectations are that the 2005/06 criteria will be much tighter with lower increases and the government expectation is that average council tax increases nationally will be at 5 per cent. The level of provisional grant settlement will impact on levels of budget reductions and council tax increases needed.

The provisional settlement for 2005/06 was 5 per cent which was better than expected. One other major cost pressure is the level of employer's superannuation contributions. The Council has prudently included slightly higher base budget assumptions for this in anticipation of the expected increase.

The consequences of capping typically include having to identify additional service cuts at short notice, and incurring significant extra costs for re-billing.

Housing Revenue Account

At 31 March 2004 the Housing Revenue Account balance was £4.464 million largely due to the transfer of £3.5 million from housing reserves. The Council also has a major repairs reserve of £9.6 million available to meet the significant investment that decent homes standards will require.

Options appraisal & decent homes

The Council is currently carrying out a comprehensive options appraisal exercise to meet the governments July 2005 deadline. This is a complex task and involves the following:

- Establishing various groups to ensure that members, tenants, and staff and GOEM have input.
- Project managing the options appraisal exercise to meet tight timescales.
- Consultation with tenants and their representatives and advisers, including tenant surveys.
- Stock condition assessment including external validation.
- Compiling a 30 year business plan reflecting tenants aspirations including detailed costing and financial projections.
- Assessing the capability of delivery for various options such as retention or stock transfer.

The Council's corporate director of regulatory services is managing the options appraisal project and it is currently on course for completion by May 2005. Members will need to ensure this deadline is met.

Systems of internal financial control

The Council, like most councils, disclosed key weaknesses in the overall control framework in the Statement of Internal Control.

This year we also reviewed the Council's response to Prudential Code requirements and suggested improvements.

Statement of Internal Control (SIC)

The Accounts and Audit Regulations 2003 require councils to publish a SIC with the Financial Statements and carry out a review at least once a year. This embodies the statutory responsibility to ensure that financial management is adequate and effective, and that there is in place a sound system of internal control including arrangements for risk management. Though the requirement applied from April 2003, the guidance was finalised late and most councils disclosed key weaknesses in an action plan.

For 2003/04, the Council's SIC disclosed key internal control issues that needed attention including:

- embedding risk management throughout the organisation;
- developing awareness of internal control and corporate governance through training;
- further developing the scrutiny function; and
- training & development of elected members to enable them to fulfil their roles more effectively.

The Council will need to address these issues as soon as possible.

Prudential Code

The Prudential Code provides a new and comprehensive framework for self regulation of councils' borrowing and capital investment plans and the financing and other revenue costs.

The Council has made a useful start in implementing the requirements of the Prudential Code. Progress to date includes reports to members, establishing prudential indicators, staff attending training courses, and various relevant strategies in place eg. asset management plan, capital strategy and medium term financial strategy.

The principal strategic challenge for the Council under its current policies is to develop a 3–5 year capital programme for general fund services (similar to the HRA capital programme). This will enable the Council to make a rounded assessment whether or not it needs any new borrowing, or restructure or redeem existing loans.

Our report suggests ways that the Council can improve.

- Strengthen the framework for linking Council main aims and the projects included in the Capital Programme.
- Consider ways of building market capacity to meet expected levels of investment in housing capital works post 2010.
- Develop an affordability model.
- Provide Training for members to help them better understand Prudential Code implications.

Officers are currently considering these recommendations.

Standards of financial conduct and the prevention and detection of fraud and corruption

We have not identified any significant weaknesses in your arrangements to prevent and detect fraud and corruption. The Council has in place policies and procedures at officer and member level designed to prevent and detect significant fraud. We continue to send Fraud Warning Bulletins to the Council's Director of Finance for him to forward to internal audit for appropriate preventative action.

Legality of transactions

We have not identified any significant weaknesses in the Council's framework for ensuring the legality of its significant financial transactions.

Other work

Grant Claims

Over recent years the number of claims requiring audit certification has grown and audit fees have risen in line with this growth. In accordance with Strategic Regulation, the Audit Commission has adopted a more risk-based approach to the certification of grant claims. With effect from 2003/04 the smaller claims have not been subject to audit or have received a lighter touch audit. The approach to larger

claims has been determined by risk and the adequacy of the Council's control environment.

The Council's arrangements for managing and quality assuring grant claims submitted for audit are generally satisfactory. For next year we have agreed with the director of finance that we will rely on internal audit (IA) work for the Housing Benefits claim. We will shortly be arranging detailed discussions with IA to meet audit commission requirements. This initiative should reduce the fee for this work.

National Fraud Initiative

The Council took part in the Audit Commission's national fraud initiative (NFI) 2002/03. The NFI, which is undertaken every two years, brings together data from local authorities, NHS bodies, government departments and other agencies, to detect a wide range of frauds against the public sector. Total savings from the 2002/03 exercise exceeded £83 million of which £6,500 savings were identified at South Kesteven.

The Commission are repeating the exercise this year and will again collect payroll, pensions, housing benefits, student loan and housing rents data from Authorities. Alongside the core exercise a number of pilot initiatives are being undertaken at selected sites. These are focused on risk areas that were highlighted by Authorities and include abuse of blue badge parking permits, serial insurance claimants and duplicate payments to suppliers. These pilot areas, if they prove effective, will be incorporated into future NFI exercises.

Looking Forwards

Future audit and inspection work

We have an agreed plan for 2004/05 and we have reported in this letter those aspects that have already been completed. The remaining elements of that plan, including the planned inspection of housing strategy, and our audit of the 2004/05 accounts, will be reported in next year's Annual Letter.

We will seek to ensure, wherever possible, that our work relates to the improvement priorities of the Council when planning our programme of work for 2005/06. We will seek to reconsider, with you, your improvement priorities in the light of the CPA assessment and your own analysis, and develop an agreed programme by 31 March 2005.

Revision to the Code of Audit Practice

The Audit Commission has consulted on a revised Code of Audit Practice for application to the audit of the 2005/06 accounts. The new Code, which will be laid before Parliament in January 2005, is designed to secure:

- a more streamlined audit, which is proportionate to risk and targeted on areas where auditors have most to contribute to improvement;
- a stronger emphasis on value for money, focussing on corporate performance and financial management arrangements (rather than individual services and functions); and
- better and clearer reporting of the results of audits.

Further details will be provided in the Audit and Inspection Plan 2005/06.

Closing remarks

This letter has been discussed and agreed with the chief executive and director of finance. A copy of the letter will be presented at the cabinet on 24 January 2005.

The Council has taken a positive and constructive approach to our audit and inspection I would like to take this opportunity to express my appreciation for the Council's assistance and co-operation.

Availability of this letter

This letter will be published on the Audit Commission's website at www.audit-commission.gov.uk, and also on the Council's website.



N G Bellamy
District Auditor and Relationship Manager
December 2004

Status of our reports to the Council

Our annual audit and inspection letter is prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission. Annual audit and inspection letters are prepared by relationship managers and appointed auditors and addressed to members and officers. They are prepared for the sole use of the audited and inspected body, and no responsibility is taken by the Audit Commission or its appointed auditors to any member or officer in their individual capacity, or to any third party.

Audit & Inspection reports issued

Reports	Date
Audit plan	March 2004
Final accounts workshop	June 2004
Mid year progress report	August 2004
Prudential Code report	November 2004
Final accounts memorandum	December 2004

Scope of audit and inspection

Audit

Our main objective as your appointed auditor is to plan and carry out an audit that meets the requirements of the Code of Audit Practice. We adopt a risk-based approach to planning our audit, and our audit work has focused on your significant financial and operational risks that are relevant to our audit responsibilities.

Central to our audit are your corporate governance arrangements. Our audit is then structured around the three elements of our responsibilities as set out in the Code and shown in Exhibit 1.

The three main elements of our audit objectives



Accounts

- Opinion.

Financial aspects of corporate governance

- Financial standing.
- Systems of internal financial control.
- Standards of financial conduct & the prevention and detection of fraud and corruption.
- Legality of transactions.

Performance management

- Use of resources.
- Performance information.
- Best Value Performance Plan.

Inspection

Inspection work is based around section 10 of the Local Government Act 1999, which requires us to carry out inspections and deliver reports that will:

- enable the Council and the public to judge whether best value is being delivered;
- enable the Council to assess how well it is doing;
- enable the Government to assess how well its policies are being implemented; and
- identify failing services where remedial action may be necessary.

The Audit Commission has circulated to all audited bodies a statement that summarises the key responsibilities of auditors. Our audit has been conducted in accordance with the principles set out in that statement. What we say about the results of our audit should be viewed in the context of that more formal background.

Audit and Inspection fee

Audit fee update

Audit area	Plan 2003/04	Actual 2003/04
Accounts	24,000	24,000
Financial aspects of corporate governance	15,000	15,000
Performance	47,900	47,900
TOTAL CODE OF AUDIT PRACTICE FEE	86,900	86,900
Grant Claim certification	20,000	20,000
Additional Voluntary work (under Section 35)		

Inspection fee update

The full year inspection fee for 2003/04 was £15,800. The work reported in this audit and inspection letter has been funded by an element of the fee covering 2003/04 and by an element of the fee covering 2004/05. In both years the actual fee will be in line with that planned.