Hart District Council

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Annual Audit Letter to Members

2002/03

BAKER TILLY

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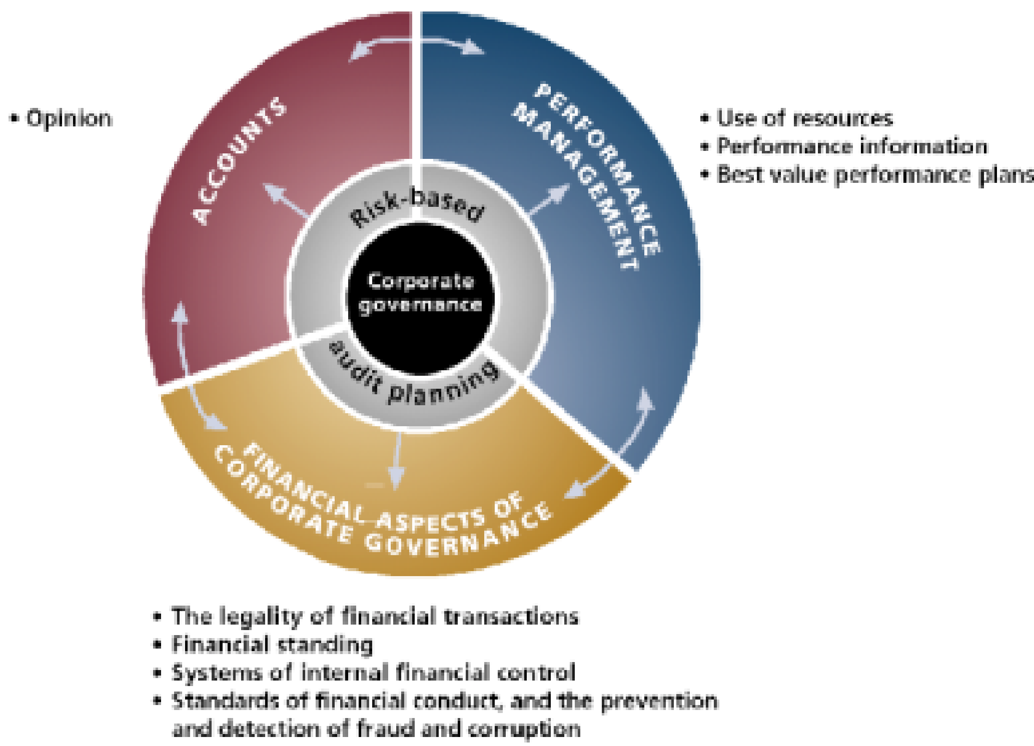
1. INTRODUCTION

The Audit Commission has recently aligned its audit year with audited bodies' financial years so that the year now starts in April rather than November as in the past. This meant that we have prepared one audit plan for the 17-month period from November 2002 to March 2004. This annual audit letter therefore summarises the work that we have carried out to date in respect of the 2002/03 element of that longer-term plan.

The audit was conducted in accordance with the Audit Commission's Code of Audit Practice ("the Code") and this year's audit plan, agreed by the Staff & General Purposes Committee on 29 May 2003. Our responsibilities and those of the Authority itself are described in more detail in the Audit Commission's document *"Statement of Responsibilities of Auditors and Audited Bodies"*, a copy of which has been sent to the Authority.

Broadly we carry out work in three main areas: auditing the accounts; reviewing the financial aspects of corporate governance; and reviewing aspects of performance management. This is illustrated in the facing diagram.

We have not carried out any work at the Authority which does not relate directly to the Code of Audit Practice.



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The detailed work that we undertake is based on an assessment of risk and is set out in the audit plan. A list of the audit outputs is set out at Appendix A. Our planned audit fee for the 17-month period was £140,000, to be billed over 20 instalments. A comparison with the actual fee to date analysed between the main audit areas is shown at Appendix B.

We are grateful for the co-operation and assistance provided to us during the audit by Authority's Members and staff.

We will send a copy of this letter, as required by the Code, to the Audit Commission.

Baker Tilly

Baker Tilly **19 November 2003**

Our reporting responsibilities

This report is addressed to the Authority's members and has been prepared for the sole use of the Authority. We take no responsibility to any member or officer acting in their individual capacity, or to third parties.

In our audit plan we confirmed that, in our view, that there were no conflicts of interest in our appointment as the Authority's external auditors. At the conclusion of the audit we still believe this to be the case. If however, members believe differently, then they should raise any issues with us.

2. SUMMARY

This section summarises matters arising from our work as well as highlighting issues for members' attention over the coming months.

Opinion

The draft accounts were produced by the agreed date of mid August 2003. Our detailed fieldwork was completed by the end of September 2003. However, we experienced delays in the receipt of both revised accounts from the Finance Department and also important supporting information from the Superannuation Fund Authority auditors. The delays meant that we were unable to table our report to those charged with governance at the expected Staff & General Purposes (S&GP) Committee meeting. Following the S&GP meeting on 11 December 2003 we expect to issue our unqualified opinion.

Financial aspects of corporate governance

We reviewed the financial aspects of the Authority's corporate governance arrangements, as they relate to:

- the legality of transactions that might have a significant financial consequence
- the Authority's financial standing
- systems of internal financial control
- standards of financial conduct, and the prevention and detection of fraud and corruption

We concluded that overall the arrangements were generally adequate during the year in all areas examined, although more work needs to be done to drive forward the risk management agenda and the Authority's financial standing is coming under increasing pressure.

In relation to the latter, the medium term financial strategy makes it clear that the Council is facing some difficult decisions in the light of its increasingly fragile finances.

Uncommitted reserves are at a minimal level, leaving Hart with very little room to manoeuvre should costs overrun or income fall short of forecasts. This reinforces the need for the Authority to be absolutely clear as to its service and spending priorities, particularly over the medium to longer term. Firm control over income and expenditure will also be necessary, including regular exception reporting to management, in order that the outturn is kept within agreed limits.

Performance management

We have qualified the BVPP on the basis that it has not been prepared and published in compliance with legislation and statutory guidance in respect of the BVPI performance information. This is the third year running that problems with BVPIs have led to an audit qualification. The development of a robust, comprehensive corporate plan also remains an issue for Hart. Although there has been a degree of activity on this matter over the last year, progress has been limited.

The Authority has recently been subject to a Comprehensive Performance Assessment (CPA) by the Audit Commission, informed, in part, by the Authority's self assessment of its own performance and also scored judgements from us, the external auditors. The provisional view of the Commission is awaited at the time of drafting this letter.

CPA will be a significant piece of work that has lasting impact well beyond this assessment phase. The implementation of any subsequent improvement plan could be time consuming and it will require input and commitment from both Members and senior management.

In order to drive forward the improvement agenda the Authority has accepted that widespread changes are required to the structure of the senior management team. The proposals are still under consideration but will involve replacing the business unit heads structure with a lesser number of corporate directors.

It will be vital that the new structures are finalised and implemented as soon as possible so that the strategic issues facing the Authority, particularly the implementation of the CPA improvement plan, can be progressed effectively.

Key actions for Members

- keep the Authority's performance against its financial strategy under regular review, especially important given the minimal level of "free" reserves
- drive forward the risk management agenda to ensure that the Authority's response accords with best practice
- following the forthcoming CPA implement agreed actions as soon as possible as part of a wider improvement plan
- agree on and implement the revised senior management structure as soon as possible
- ensure that the improvement opportunities identified from our work on the BVPP, in relation to corporate planning and also BV performance indicators are addressed

3. ACCOUNTS

Our responsibilities

We are required to audit the financial statements and to give an opinion:

- whether they present fairly the Authority's financial position and its income and expenditure
- whether they have been prepared properly in accordance with relevant legislation and accounting standards.

Financial statements

We assessed the Authority's general control environment and fundamental financial systems. We also tested material items in the accounts.

We received draft financial statements for audit and supporting evidence files in mid August as planned. In general, the supporting evidence files were complete although the draft accounts omitted the pension fund disclosures and cash flow statement. The Authority needs to address this matter for next year's audit.

Our detailed fieldwork was completed by the end of September 2003. However, we also experienced delays in the receipt of important supporting information from the Superannuation Fund Authority auditors in respect of the pension fund disclosures in the accounts.

The delays meant that we were unable to table our report to those charged with governance at the expected Staff & General Purposes (S&GP) Committee meeting. Following the S&GP meeting on 11 December 2003 we expect to issue our unqualified opinion.

Steps need to be taken to prevent a recurrence of this year's delays. This is particularly important given that the timetable for the closure and audit of local authority accounts is being accelerated nationally over the next couple of years.

Reports

We have not issued any reports in the public interest nor have we received any questions or objections in relation to items contained in the Authority's statement of accounts.

4. FINANCIAL ASPECTS OF CORPORATE GOVERNANCE

Our responsibilities

We are required to review the financial aspects of the Authority's corporate governance arrangements, as they relate to:

- the legality of transactions that might have a significant financial consequence
- the Authority's financial standing
- systems of internal financial control
- standards of financial conduct, and the prevention and detection of fraud and corruption

We presented a detailed report on these issues, other than financial standing, to the Staff & General Purposes Committee in May 2003.

We also reviewed and reported on your statement of internal financial control as part of our opinion work

Legality

We reviewed the Authority's arrangements to ensure the legality of transactions and were alert to potential issues in the course of the audit. We have reviewed Authority reports and minutes to identify any decisions or transactions that are of unusual or questionable legality. No issues arose during our work that we need to draw to Members' attention.

We also reviewed the Authority's progress in implementing the provisions of the Race Relations and Freedom of Information Acts respectively. Progress in respect of Freedom of Information was satisfactory although more needed to be done to implement fully the requirements of the Race Relations Act.

Overall we concluded that the Authority has in place adequate arrangements to ensure the legality of significant financial transactions.

Financial standing

2002/03 outturn

The General Fund was some £166,000 underspent compared to the expected outturn (generating a surplus of £77,000 compared to a budgeted deficit of £89,000). The underspend was due to a large number of variances, the most significant of which were increased investment income (+£102,000), and unforeseen one off items such as costs relating to the sale of the trade waste facility to an external contractor (+£116,000) and redundancy costs totalling £111,000. We are satisfied that the variances have been properly reported.

Balances at 31st March 2003

Non-earmarked balances available to HDC are shown below, with the prior year comparative.

	31 March 2002		**31 March 2003**	
	£m		**£m**	
Balance/Reserve	Revenue	Capital	Revenue	Capital
General Fund	1.4	-	1.4	-
Other reserves	2.3	-	2.6	-
Usable cap receipts	-	6.8	-	3.7
Total	**3.7**	**6.8**	**4.0**	**3.7**

Broadly revenue balances overall have remained at a similar level over the last two years, although usable capital receipts have declined due to the net effect of new receipts and in-year spending. As in previous years, the investment of balances (including cash backed reserved capital receipts) provides a significant interest receipt to subsidise the level of council tax. The Authority is facing increasing financial pressures and recognises that its ability to offset unexpected spending from contingency reserves still stands at a minimal level. This issue is explored in more detail in the following section.

Financial outlook 2003/04 and beyond

The latest financial projections are outlined below:

	2003/04 budget	**2004/05 possible**	**2005/06 possible**
	£,000	£,000	£,000
Net cost of services	9,030	9,163	9,319
Less - interest & investment income	(550)	(475)	(500)
- other	(35)	(35)	(35)
Budget req't before balance draw down	**8,445**	**8,653**	**8,784**
Council tax and NNDR/RSG	(7,939)	8,098	8,234
Special exps – Fleet & Church Crookham	(536)	551	566
Sub total	**8,475**	**8,649**	**8,800**
Budget gap	**(30)**	**4**	**(16)**
Transfer to/(from) working balances	**30**	**-**	**-**
Targeted reductions /increases in spending	**-**	**(4)**	**16**

Hart's medium term financial strategy (2004 – 2007) is based on two central tenets - that council tax increases will be held at 2.5% and that no further transfers will be made from general reserves to support revenue expenditure. This inevitably increases the focus the need to generate "efficiencies" from reduced spending and/or increased income. Getting more for less is an admirable objective, but the Council needs to ensure that any net expenditure reductions are realistic, deliverable within the planned timescales and that services are still capable of being delivered to the desired level and quality. Harnessing the skills, experience and goodwill of staff will be crucial in this respect.

The medium term strategy makes it clear that the Council is facing some difficult decisions in the light of its increasingly fragile finances. The figures in the table on page 7 assume that Hart's Rate Support Grant is maintained at 2002/03 levels, which is some £400,000 above the minimum level. Until Government confirms the arrangement this income is effectively "at risk".

The Council's Head of Finance has suggested that the general fund working balance should, as a minimum stand at £1m, to provide a buffer against any unexpected expenditure pressures or safeguard against reductions in income, such as RSG. Taking into account the balance at March 2003 (£1.4m), adjusted for expected rates reductions (£250,000), the Head of Finance has calculated that non-earmarked working balances should total some £630,000.

However, much of this "free" reserve could be exhausted by the costs of restructuring the senior management team (see section 5 of this letter). Whilst the exact costs of redundancies/early retirements are not yet quantified they are likely to be considerable, running into many hundreds of thousands of pounds. This would leave Hart with very little room to manoeuvre should costs overrun or income fall short of forecasts.

The above reinforces the need for the Authority to be absolutely clear as to its service and spending priorities, particularly over the medium to longer term. Firm control over income and expenditure will also be necessary, including regular exception reporting to management, in order that the outturn is kept within agreed limits. We will continue to monitor the situation over the coming months.

Systems of internal financial control

The Authority has in place adequate arrangements to satisfy itself that systems of internal financial control are both adequate and effective in practice or to address weaknesses where identified.

Key financial systems

The internal financial controls for key financial systems were adequate and could be relied upon to support material balances generated in the ledger. We made a number of detailed recommendations to secure control improvements in our interim report but none of these warrant reporting to Members in this letter.

Risk management

The change agenda to improve corporate governance in local government has resulted in a number of publications by CIPFA, SOLACE and ALARM on developing effective risk management arrangements.

Furthermore, the revised Accounts and Audit Regulations 2003 requires all local authorities to have in place adequate risk management strategies for 2003/04 and to report on the effectiveness of these arrangements in the Statement of Internal Control in the statement of accounts for that year.

We have previously noted that the Authority's progress in developing adequate risk management arrangements has been slow, and our review earlier this year found that this was still the case. Whilst the Authority had begun the process of identifying key risk areas, little progress had been made in developing and promulgating robust risk management arrangements, including the following:

- assigning officer responsibility and accountability for risk management processes
- production of a methodology for categorising and managing risks
- use of the CIPFA/SOLACE framework to establish a locally adopted code of corporate governance
- existence of an overall framework/strategy that defines roles, responsibilities, and reporting on risk management issues

At the time of writing this letter, remedial action was in hand to address the above concerns and develop the Council's overarching risk management strategy. The Head of Support has been given overall responsibility for risk management in the Council and work has commenced on putting in place a risk management framework. In addition, full Council approved a locally adopted Code of Corporate Governance at the end of July 2003.

Risk management is a key agenda item for the Authority and we will revisit this area at the 2003/04 audit.

Internal audit

The most effective mechanism for ensuring that internal financial controls are adequate is the presence of an effective Internal Audit service. The Authority's key financial systems are subject to an annual review by Internal Audit and all other financial systems and operational sites are reviewed during a three-year period.

We have reviewed Internal Audit's work in areas such as adherence to professional standards, staffing levels, qualifications and skills, reporting arrangements, and planned and actual coverage of systems. We have also undertaken detailed file reviews for each key financial system and a review of all reports issued during the year. We concluded that the work was generally adequate and provided a satisfactory level of assurance to the Authority on the adequacy of internal financial controls.

Statement on internal financial control

2002/03 was the first year in which the Section 151 Officer was required to make a statement that he has reviewed the Authority's systems of internal financial control and confirmed that they meet certain minimum control standards set out by CIPFA.

We are required to review the statement and report on it, without being required to undertake any additional work.

Internal Audit undertook a detailed review of the statement: we have relied on its work in coming to our conclusions. We reported that the statement was not inconsistent with information of which we were aware from our audit work.

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

We are required to review the Authority's arrangements to maintain proper standards of financial conduct and prevent and detect fraud and corruption. It is not our function to prevent or detect breaches of proper standards of financial conduct or fraud and corruption; we are, however, alert to such possibilities.

We concluded that the specific arrangements in place to prevent and detect fraud and corruption remain sound and include the following:

- The Authority continues to maintain and promulgate an anti-fraud and corruption strategy;
- Internal Audit completes the CIPFA fraud and corruption checklists on key risk areas;
- The Authority continues to participate in the National Fraud Initiative data matching exercises (though in future the Authority will not submit payroll data as it feels that the costs of involvement are not outweighed by the benefits); and
- The Authority continues to maintain an in-house housing benefits fraud team.

In line with the recent work of Internal Audit we agree that whilst the Authority has formal policies and standards in place covering most aspects of financial governance, there needs to be a greater emphasis on reinforcing them via induction and formal training.

5. PERFORMANCE MANAGEMENT

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Our responsibilities

We are required to review and report upon the arrangements that the Authority has to secure economy, efficiency and effectiveness in the use of resources. Our work can include conducting reviews into specific services or functions based either on the requirements of the Audit Commission, or on our assessment of the audit risks.

This year, we have undertaken the following work:

- kept abreast of the Authority's preparations for dealing with corporate performance assessment (CPA) and the Audit Commission's subsequent conclusions from its review in late September 2003
- the audit of the Authority's best value performance plan (BVPP)
- kept abreast of the financial aspects of the Authority's proposed restructuring of the senior management team

Comprehensive performance assessment (CPA)

Introduction

Comprehensive performance assessment (CPA) is about allowing residents and others to better understand the role and performance of Hart District Council in enabling a better quality of life for local people. It is part of a wider improvement agenda set out in the Local Government White Paper *Strong Local Leadership – Quality Public Services*. Hart has recently been subject to the CPA, following a number of months of preparation, including a shadow review by Volanti and a more recent peer challenge (IdeA) review.

CPA framework

The Audit Commission developed the CPA framework and the main elements of the approach were as follows:

- a self-assessment by the Authority;
- a corporate assessment of the Authority by the Audit Commission informed by the organisation's self-assessment; appointed auditor assessments of performance on each of the main elements of the Code of Audit Practice; as well as performance indicators, inspection reports, user satisfaction data, and other knowledge.

Corporate assessments examine the following four questions and underlying themes:

What is the Authority trying to achieve?

1. Ambition
2. Prioritisation
3. Focus

How has the Authority set about delivering its priorities for improvement?

4. Capacity
5. Performance management

What improvements has the Authority achieved/not achieved to date?

6. Achievement in quality of service
7. Achievement of improvement
8. Investment

In light of what the Authority has learnt to date, what does it plan to do next?

9. Learning
10. Future plans

Each of the ten themes is given a score between 1 (weak) and 4 (strong).

The themes are weighted differently, with 53% of the weight allocated to themes 6 to 8 above and the remaining 47% allocated equally across the other themes.

An overall judgement is reached by combining the scores from each theme, weighted as above. The maximum score an assessment could generate would be 60: minimum 15. The overall scores are rated according to the following scale:

15 – 29: Poor
30 – 35: Weak
36 – 41: Fair
42 – 47: Good
48 – 60: Excellent

Assessment

Judgement of each of the themes is informed by work undertaken both off and on site by an Audit Commission corporate assessment team. This work included: document review, interviews and focus groups with internal and external stakeholders, review of relevant performance and user satisfaction information, web-searches, observation of meetings, and similar methods.

Themes are also informed by assessments by us, the appointed auditors on each of the main elements of the Code of Audit Practice, except for performance management (commonly known as auditor scored judgments (ASJs)).

The way forward

At the time of writing this letter the assessment results were awaited, being due for release in late November 2003.

CPA is a significant piece of work that goes well beyond the Commission's corporate assessment phase. The implementation of any subsequent improvement plan will be time consuming and it will require continued input and commitment from both senior executives and Members if it is to deliver the improvements required.

Best value

BVPP 2003/04

Our work focused on the Authority's compliance with best value requirements. Our approach involved discussion with officers in April 2003, to clarify the matters that needed to be included in the BVPP in order for it to comply with the legislatory requirements. We also provided a checklist of the Performance Indicator information to be included in the 2003/04 BVPP.

We issued our statutory report and opinion that is qualified on 7 November 2003. The qualification was in respect of incorrect and missing performance and target information.

Disappointingly we identified a significant number of problems in relation to the statutory performance information included in the BVPP. In relation to the 68 BVPIs for which the Authority has had to prepare performance information, we found that:

Problem identified	No.
2002/03 performance omitted	4
Indicators in respect of which there was uncertainty about the data or systems used to prepare the performance information	11
2003/04 targets omitted	16
Total	**31**

This represents a high error rate and this was the third year running that problems with BVPIs have led to an audit qualification.

Performance management framework

The BVPP contains a summary of the Authority's key objectives as set out in its current Corporate Plan. In this regard, the BVPP complies with the statutory guidance.

However, it is vital that the Authority reviews its Corporate Plan and in particular:

- sets out more clearly how its high level corporate priorities translate into agreed objectives and targets;
- demonstrates clearly how the corporate objectives have resulted from consultation with stakeholders, including the wider community.

The current Corporate Plan, prepared in January 2003, is weak on both counts and, until the higher levels of the Authority's planning framework are strengthened, the BVPP will always reflect this position.

We have discussed with senior management the structure and content of well-prepared corporate plans. Whilst we recognise that preparations for the recent comprehensive performance assessment exercise have been time intensive and the Authority is resource constrained, the lack of progress in producing a well-founded and constructed corporate plan is disappointing. This issue has been around for too long and other consultees to the plan also echo our views. In short we are perplexed as to why such a routine process should be causing so much difficulty to the Authority.

On a more positive note the Authority's Best Value Review work is described clearly in the BVPP. The BVPP also has links to improvement plans. However, Hart's improvement plans mainly cover only the 2003/04 year, which is reflected in the BVPP and renders them less effective as tools to aid long term strategic planning.

In addition, the BVPP requires a greater focus on performance improvement. It will be important that the Authority addresses this issue next year: the BVPP will play a key role in the CPA cycle as the principal means by which the Authority will be expected to report its priorities, improvement plans and achievements following the CPA. It will also provide the means by which the Authority will track future improvements. The focus of next year's BVPP will need to be sharpened considerably if it is to achieve these aims.

In our detailed report on performance management and the 2002/03 BVPP (dated December 2002) we identified a few issues where improvements could be made. We are happy to report that subject to the one area noted below all such improvements have been actioned.

Last year we recommended that the 2003/04 BVPP should make an explicit link between the information about the Authority's medium term financial strategy and its key Priority Objectives.

The 2003/04 BVPP does not fully address this. This will be a more important issue post CPA, when improvement activity will need to be prioritised and clarity needed about how it will be resourced.

Restructuring of the senior management team

In order to drive forward the improvement agenda the Authority has accepted that widespread changes are required to the structure of the senior management team. For a number of years the Chief Executive's post has been supported by a number of business unit heads (BUHs), whose responsibilities have mainly been focused on dealing with departmental concerns - basically a "silo" approach to management. Whilst such an approach has its merits – as it enables specialist expertise to be brought to bear – the downside can often be a lack of corporatism or joined up management.

It is currently proposed that 3 corporate director (CD) posts replace the five existing BUH posts, with further structural changes beneath this level. The CDs will be expected to take a much broader view of the Authority and also deliver corporate projects outwith their immediate field of expertise. They will be pivotal in helping shape and implement the strategic direction of the Authority.
The restructuring process is presently in hand. It is important that Hart is able to demonstrate that not only has it followed its own established policies and procedures but that such policies/procedures are legal and that they accord with best practice.

We have reviewed the processes to date in considering an alternative structure and any related costs (redundancies, revised pay packages etc) that might arise and have offered advice on how to ensure that it accords with the best practices advocated by the Audit Commission. We would however stress that it is not our responsibility to "sign off" the financial aspects of the proposals.

The final proposed costs of the restructuring were not available at the time of writing this letter, but we understand that they may be sizeable, depending on whether existing BUHs are appointed to the new CD posts, redeployed elsewhere in the Authority or released from the Authority's employ.

Presently it is not expected that in itself the restructuring will lead to ongoing revenue savings, as more expensive salary packages are likely to be required for the CDs. The Authority believes that the real benefits will accrue from a more corporate approach to management, with a different skill set being brought to bear on the Authority's strategic agenda. We will continue to keep abreast of developments over the next few months.

Follow up of prior year studies

At the time of writing this letter there were no outstanding agreed actions from past performance management reports.

6. THE 2003/04 AUDIT

We will shortly be revisiting the audit plan, prepared for the 17-month period to March 2004, to determine if the planning assumptions, assessment of risks and work programme originally suggested remain valid.

Key elements of our ongoing work will focus on agreed actions arising from CPA, the development of corporate planning, the Authority's overall financial health, the senior management restructuring and the development of risk management arrangements. We will also take into account the latest advice from the Audit Commission concerning national risks and any related audit work required.

APPENDIX A – Audit outputs

AUDIT REPORTS ISSUED	DATE ISSUED
Audit Plan	February 2003
Key Financial Systems and Financial Aspects of Corporate Governance	May 2003
Matters Arising from the Audit of the Authority's 2002/03 financial statements	November 2003
Audit Opinion on the Authority's 2002/03 Authority accounts	December 2003
BVPP Compliance Review 2003	October 2003
BVPP Opinion	November 2003
Annual Audit Letter	November 2003

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APPENDIX B - Audit Fees

The planned fees for the audit period November 2002 to March 2004 are shown below, split by Code of Audit Practice area. For comparative purposes the 2001/02 fee is also shown.

Code Area	**2001-02 £**	**2002/03 £**	**2003/04 £**
Opinion	35,532	37,000	38,000
Financial aspects of corporate governance	18,800	20,000	21,000
Performance management	21,620	23,325	(Note 1)
Contribution to the Audit Commission	4,848	4,675	3,025
Total	80,800	85,000	55,000

Note

1 – the Performance Management is scheduled for June 2003 to November 2003 and will be in respect of the 2002-03 period. Fees for Performance Management work relating to the 2003-04 period will be included in the 2004-05 audit plan

The 2002/03 outturn was in line with the plan www.bakertilly.co.uk