

Report to: **Cabinet**

Date: **26 January 2010**

By: **Chief Executive and Deputy Chief Executive and Director of Corporate Resources**

Title of report: **Annual Audit Letter 2008/09**

Purpose of report: **To seek Cabinet's approval of the Annual Audit Letter for 2008/09.**

RECOMMENDATIONS

The Cabinet is recommended to approve the Annual Audit Letter for 2008/09.

1. Financial Appraisal

1.1 There are no direct financial implications from this report. The Annual Audit Letter (AAL) is produced as part of the agreed external audit plan by PKF and is funded from within existing budgets.

2. Supporting Information

2.1 The AAL summarises the key issues arising from the work carried out by the Council's external auditors, PKF, during the year. This report contains no new findings or recommendations, but reflects the key issues already reported in the Annual Governance Report and the Comprehensive Area Assessment.

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East Sussex County Council

Annual Audit Letter 2008/09

Report to Members

December 2009



Local Public Services

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Code of Audit Practice and Statement of Responsibilities of Auditors and Audited Bodies

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission contains an explanation of the respective responsibilities of auditors and of the audited body. Reports and letters prepared by appointed auditors are addressed to members or officers. They are prepared for the sole use of the audited body and no responsibility is taken by auditors to any Member or officer in their individual capacity or to any third party

1 Executive summary

- 1.1 This Annual Audit Letter (Letter) summarises the key issues arising from the work we have carried out during the year and highlights the key findings that we consider should be addressed by the Council.
- 1.2 We have already reported the detailed findings from our audit work to those charged with governance in the reports documented in the Appendix to this report. We have no additional recommendations for the Council at this time.

Key findings

- 1.3 A summary of key conclusions is included in the table below:

Area	Conclusion
Accounts	We issued an unqualified opinion on the financial statements of the Council and of the Pension Fund.
Value for money conclusion	We issued an unqualified value for money conclusion.
Use of resources assessment	<p>Our scored judgements for the use of resources assessment were:</p> <ul style="list-style-type: none"> • 3 for managing finances: performing well • 3 for governing the business: performing well • 3 for managing resources: performing well <p>Our overall assessment is that the Council performs well in its use of resources (a score of 3 out of 4).</p>

Of the 150 single tier and County Council authorities in England, 3 were scored at level 4 (the highest level) overall for 2008/09, 77 at level 3, 69 at level 2 and 1 at level 1.

- 1.4 To improve further its use of resources the Council should continue to focus on:
- developing further the strong Reconciling Policy and Resources (RPR) process to include more formally diversity and equalities considerations, to link changes to fees and charges to policy considerations and to improve the linking of consultation outcomes to service changes
 - building on the value for money analysis already included in its RPR to identify specific measures to improve value for money and to develop further the systematic analysis of unit costs being achieved by the Council
 - building on the partnership reviews carried out to date to produce agreed action plans
 - building on its Carbon Management Policy to consider further non carbon aspects of natural resources and the impact of overall climate change on the Council's operations through an integrated environmental policy.

Acknowledgement

- 1.5 Our aim is to deliver a high standard of audit which makes a positive and practical contribution that supports the Council's own agenda. We recognise the value of your co-operation and support and would like to take this opportunity to express our appreciation for the assistance and co-operation provided during the course of the audit.

2 Introduction

About the Council

- 2.1 East Sussex County is located in the south east of England and covers an area of 1,792 square kilometres, with a considerable part of the County being the Sussex Downs Area of Outstanding Natural Beauty. The Council serves a population of 766,000, with many people living in the urban areas of Bexhill, Eastbourne, Hastings and Lewes.
- 2.2 The Council spends about £811 million annually, including £482 million on Education and Children's services, £316 million on Adult Social Care and £51 million on Highways. Much of the funding of this expenditure is through direct central government grant, such as Dedicated Schools Grant, Revenue Support Grant and the Area Based Grant, with the remainder being funded from Council Tax and National Non-domestic Rates.

The purpose of this Letter

- 2.3 The purpose of this Letter is to summarise the key issues arising from the work that we have carried out during the year. Although this Letter is addressed to Members, it is also intended to communicate the significant issues we have identified, in an accessible format, to key external stakeholders, including members of the public. The Letter will be published on the Audit Commission's website at www.audit-commission.gov.uk and also on the Council's website at www.eastsussex.gov.uk.

Responsibilities of the auditors and the Council

- 2.4 We have been appointed as the Council's independent external auditors by the Audit Commission, the body responsible for appointing auditors to local public bodies in England.
- 2.5 As the Council's external auditors, we have a broad remit covering financial and governance matters. We target our work on areas which involve significant amounts of public money and on the basis of our assessment of the key risks to the Council achieving its objectives. It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for. We have considered how the Council is fulfilling these responsibilities.

The scope of our work

- 2.6 Our main responsibility as the appointed auditor is to plan and carry out an audit that meets the requirements of the Audit Commission's Code of Audit Practice (the Code). Under the Code, we are required to review and report on:
- the Council's financial statements
 - whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
- 2.7 We are also required to carry out an audit of the financial statements of the East Sussex Pension Fund, part of the Local Government Pension Scheme, of which the Council is the administering authority, and the accounts for which are included as a separate set of financial statements within the published audited financial statements of the Council.

3 Key findings

Accounts

- 3.1 We issued an unqualified opinion on the Council's financial statements on 4 September 2009. Our opinion confirms that the financial statements present fairly the financial position of the Council as at 31 March 2009 and its income and expenditure for the year then ended.
- 3.2 We did not identify any significant issues from our review of the Council's accounting and internal control systems.

Key points arising from the audit

- 3.3 The following significant points regarding the financial statements were reported in the Annual Governance Report.

Review of carrying value of land and property

- 3.4 The Council's policy is, as permitted by the relevant professional guidance contained in the Local Government Statement of Recommended Practice (SORP), to revalue its assets over a five year cycle. However, the SORP requires that, where there is a possibility that asset values have changed significantly between valuations, a review is carried out and estimated changes made between valuation dates.
- 3.5 In view of the potential impact of the recession on property values in 2008/09 the Council commissioned its external valuers to review the potential effect and to advise on adjustments which may be required to asset values. The valuers recommended changes to types of asset which ranged from 16% for residential property (of which the Council has very little) to 2% for libraries and other specialised assets which are valued on a depreciated replacement basis and therefore change in building costs is the relevant criterion. The Council made the resulting adjustments to all relevant assets and, in total, values were adjusted downward by £32m. We concurred with the action taken by the Council.

Voluntary aided schools

- 3.6 During the year the Council has changed its accounting policy in respect of voluntary aided (church) schools. This has been a trend amongst other councils to remove such assets from the balance sheet, on the grounds that the church authorities are the legal owners of the property and the substance of councils' interests in the assets, in terms of future economic benefits from the assets, is not sufficient, on balance, to override this.
- 3.7 SORP 2008 clarified the issue further for the first time and clarified that, to keep assets in councils' balance sheets, benefits would have to accrue directly to the council and, in discussion with officers, it was agreed that voluntary aided schools should be removed from the Council's financial statements as a change of policy and this has been effected, resulting in a reduction in the assets and net worth of the Council at 31 March 2008 of £39.7m.
- 3.8 The nature of the change is such that it impacts on a number of years of account, as the assets should now be treated as if they were never recorded in the Council's balance sheets. The SORP required restatement of the comparative balance sheet in the current year's financial statement and the opening balances on notes but permits the comparative Income and Expenditure Account not to be restated. One aspect of the restatement in the draft accounts were amended by agreement with the Council and the financial statements reflected the change in this manner.

Income in advance

- 3.9 The draft Balance Sheet included an amount reflecting "Income in Advance", recorded as a current liability. This primarily comprised capital contributions received in advance from government and other sources towards significant projects, such as the Building Schools for the Future (BSF) project in Bexhill.

- 3.10 Such contributions received in advance were not previously material to the Balance Sheet and the Council's policy was previously to record them as income in advance in the Balance Sheet until the project was completed and became operational, at which point the income was transferred to either the Government Grants Deferred or Capital Contributions account within the balance sheet (for capital projects) or the Income and Expenditure account (for revenue projects).
- 3.11 At 31 March 2009 amounts of government grants and other contributions received in advance which would not be utilised within one year had become material, this being primarily due to the significant advance funding (£21m) from government during 2008/09 for the BSF project in Bexhill. To reflect the nature of this now material type of balance, it was agreed that a new Balance Sheet disclosure category of Government Grants and Contributions Unapplied would be created and relevant amounts included here in the long term liabilities part of the Balance Sheet rather than as a current liability in Income in Advance, thus better reflecting the nature of these amounts.
- 3.12 When the associated asset comes into use, the appropriate balance will be transferred to the Government Grants and Contributions Deferred account and amortised over the life of the related asset in accordance with the Council's existing policy.

East Sussex Pension Fund

- 3.13 We issued an unqualified opinion on the Fund's financial statements on 4 September 2009. Our opinion confirms that the financial statements present fairly the financial transactions of the Fund during the year ended 31 March 2009 and the amount and disposition of the Fund's assets and liabilities as at 31 March 2009, other than liabilities to pay pensions and other benefits after the end of the scheme year.
- 3.14 We did not identify any significant issues from our review of the Fund's accounting and internal control systems.
- 3.15 One material error in the Fund's financial statements, caused by an error in the Fund's custodian's report, was identified by officers and corrected.

Use of resources

- 3.16 The Code requires us to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources. This is known as the value for money conclusion and draws on the results of specific risk based audit work as well as the results of our use of resources assessment as set out below.

Specific risk-based work

- 3.17 In accordance with our audit plan we reviewed the ongoing position with two key areas for the Council, based on our assessment of the key risks.

Age Well PFI scheme

- 3.18 We have reviewed the procurement process supporting the Age Well PFI scheme, which forms a key part of the Adult Social Care service plan, through attendance at progress meetings and review of supporting documentation, including the procurement plan which should ensure Value for Money is achieved.
- 3.19 Overall we consider that the Council is managing this process effectively. We are aware that financial completion of the project is due in early 2010, and we will need to consider the process further as part of the 2009/10 audit.

Waste disposal (PFI and LATS)

- 3.20 The Council has recognised that there is a limited future waste landfill capacity available to it and there is a PFI Project with Veolia seeking to deliver solutions that mitigate this and any potential financial effects of the Landfill Allowance Trading Scheme (LATS) which effectively penalises landfill. We have continued to review and monitor the actions being taken by the Council to reduce its LATS risk, including how this relates with progress on the key aspect of the PFI project.
- 3.21 The key aspect of the PFI project is the construction of an Energy from Waste Plant which will substantially reduce the Council's reliance on landfill through processing waste through an energy recovery process. There were delays to this project in its early years exacerbating the LATS risk. The delays mainly related to site acquisition, planning permission and dealing with issues raised by the contractor. The Council has taken action to resolve these matters and construction of the plant is now proceeding thus addressing the risk.

Use of resources assessment

- 3.22 We are required to assess how well local authorities manage and use their financial resources by providing scored judgements on the Council's arrangements in relation to Key Lines of Enquiry covering three specific themes. Our assessment forms part of the Audit Commission's new Comprehensive Area Assessment (CAA) for 2008/09 and is not comparable with 2007/08 or earlier years' scores.
- 3.23 Our scores for each Key Line of Enquiry are shown below:

Theme	2008/09
Managing Finances	
• Planning for financial health	3
• Understanding costs and achieving efficiencies	2
• Financial reporting	3
Theme score	3
Governing the business	
• Commissioning and procurement	3
• Use of information	3
• Good governance	3
• Risk management and internal control	3
Theme score	3
Managing resources	
• Natural resources	3
• Strategic asset management	3
• Workforce	n/a
Theme score	3
Overall score for Use of Resources	3

- 3.24 We concluded that the Council is performing well in respect of managing finances, governing the business and managing resources and consequently performing well overall in its use of resources. We set out a brief summary of our conclusions in each theme area below.

- 3.25 All local authorities in England have been scored using a scale of 1 to 4 where 1 is performing poorly, 2 is performing adequately, 3 performing well and 4 performing excellently. Of the 351 principal local authorities in England for 2008/09, 5 were scored at 4 overall. Of the 150 single tier and County Council authorities, the following scores were awarded:

Level	Score
Level 4	3
Level 3	77
Level 2	69
Level 1	1

None of those scored at level 4 were County Councils.

- 3.26 The use of resources score set out above is considered alongside a separate score given by the Audit Commission for managing performance by the Council and the use of resources and managing performance scores together give rise to an overall organisational assessment score which is given by the Audit Commission. The Council's score for managing performance was 3 and, therefore, given the score of 3 for use of resources, the overall organisational assessment score for the Council is 3 confirming it is performing well overall.

Managing finances

- 3.27 The Council has a very strong integrated policy, service and financial planning process called Reconciling Policy and Resources (RPR). RPR incorporates stakeholder engagement and input from scrutiny committees and drives both annual revenue and capital budgets and medium term financial planning. The process identifies substantial savings and priority areas for investment over a four year rolling cycle.
- 3.28 The Council understands its significant costs and income drivers and these are incorporated into RPR. Major service reviews have taken place in areas such as Passenger Transport and Directly Provided Services with good outcomes demonstrated. A business reengineering programme is in place within Adult Social Care and is improving services whilst reducing unit costs.
- 3.29 Monthly internal financial reporting integrates performance and financial information. Savings identified at budget stage are monitored each month for progress throughout the year. Key performance indicators are identified in advance each year and analysis of progress considered over the course of the year. The Council produces good quality annual accounts to an accelerated timetable and has a project in place to deal with the transition to International Financial Reporting Standards. The audit opinion on the 2008/09 financial statements was signed on 4 September, over three weeks before the deadline and the Council is to be commended on this.
- 3.30 The Council could further improve its performance by developing RPR to include diversity and equalities considerations more formally in the process, link changes to fees and charges to policy considerations, and demonstrate the link between consultation outcomes and service charges better.
- 3.31 It could also build on the value for money analysis already included in RPR to identify specific measures to improve value for money and to develop further the systematic analysis of unit costs being performed by the Council.
- 3.32 It could further expand on the key performance indicators reported by departments as part of the integrated financial / performance budget monitoring reports, either by inclusion of any additional relevant unit cost / activity indicators, or by inclusion of performance indicators relevant to the value for money equation for the service (possibly those highlighted in the VFM section of portfolio plans).

Governing the business

- 3.33 The Council has a significant commissioning and procurement agenda which is based on an informed assessment of need and supported by a Procurement Strategy and Sustainable Community Strategy. There are a number of joint commissioning strategies in place with partners, including the Primary Care Trusts, for improving health inequalities, and the Council proactively seeks opportunities for efficiencies through joint procurement arrangements. The introduction of procurement peer reviews and the development of the analysis of unit costs represents an opportunity to impact on value for money improvement.
- 3.34 The Council has robust processes for the production, review and challenge of accurate data to support decision making, both internally and with partners. There is a strong focus on maintaining high levels of awareness on the importance of good data quality. We carried out detailed spot checks on four pieces of data and concluded all were fairly stated.
- 3.35 The Council recognises that good governance is essential to an effective community leadership role and there is a well established governance framework in place, including processes to ensure that a strong ethics culture is maintained. Annual partnership reviews are carried out, although arrangements could be enhanced by producing action plans from these reviews to ensure continued improvements in governance arrangements.
- 3.36 Risk management is well embedded in all areas of the Council, including major projects and partnership working. There are sound systems of internal control and a strong commitment to maintaining a counter fraud and corruption culture.

Managing resources

- 3.37 The Council has a strong understanding of its use of natural resources and the factors influencing them. Specific plans and targets to reduce environmental impact have been in place for several years and the Council has achieved significant reductions in its carbon footprint. The Council could build on its strong Carbon Management Policy to consider further non carbon aspects of natural resources and the impact of overall climate change on the Council's operations as part of an integrated environmental policy.
- 3.38 The Council has effective processes for ensuring that it achieves value for money from its assets. Asset management plans link to corporate priorities and local service needs. The Council's corporate approach to maintenance has resulted in decreases in maintenance costs and increases in the number of properties in good or satisfactory condition. Annual suitability assessments are carried out and improvements have been made in office accommodation as a result of a drive to rationalise the estate.

Value for money conclusion

- 3.39 On the basis of our review of specific Use of Resources rules and the Use of Resources Key Lines of Enquiry, we have concluded that adequate arrangements are in place to secure value for money and have provided an unqualified value for money conclusion for the year ended 31 March 2009.

Emerging issues

Current economic climate

- 3.40 In response to the continued economic downturn, the Council has undertaken a review of the impact on all aspects of its operation. This identified a number of areas for the Council to consider in addition to the review of land and buildings for impairment commented on above.

Treasury management

- 3.41 Following the collapse of the Icelandic banks in October 2008 the Audit Commission conducted a study to examine treasury management arrangements in local authorities. The resulting report *Risk and Return* was published in March 2009 and, in this report, the Audit Commission committed to asking auditors to follow up the lessons from the report as part of their use of resources work.
- 3.42 We concluded from this work that the Council's treasury management arrangements are satisfactory and the Council has taken action to strengthen its arrangements in light of the collapse of the Icelandic banks. The Council did not have any investments in Icelandic Banks and has had a prudent approach to treasury management.

Members' allowances

- 3.43 The Local Authorities (Members' Allowances) (England) Regulations 2003 (members' allowances regulations) include a requirement for councils to publish annually amounts paid to each member for different types of allowances. As in previous years, and in accordance with the SORP, the Council included, in a note to the financial statements, the total amounts paid to members during 2008/09 and published more detailed disclosures by member on its website.
- 3.44 It is not a requirement of the members' allowances regulations to disclose amounts paid to each member within the financial statements, however, in light of the recent publicity surrounding MPs' expenses, the Council may wish to make such disclosures even more transparent and consider including them in the financial statements in future.

International Financial Reporting Standards

- 3.45 International Financial Reporting Standards (IFRS) will be adopted in local government from 2010/11 and require transitional arrangements to be put in place by the Council. The Audit Commission is undertaking a national study on the implementation of IFRS in local government to assess the progress being made by authorities towards preparing IFRS based financial statements. As part of this study, and of our use of resources work, we have reviewed the Council's progress in this area. We are satisfied that the Council is taking appropriate steps to implement IFRS. Work remains in progress to identify all areas of the accounts that require restatement and to calculate the resultant effect on the financial statements.

Appendix: Reports issued in relation to the 2008/09 audit

Report	Date Issued
Annual audit plan	May2008
Use of resources report	December 2009
Annual governance report	August 2009