

Annual Audit Letter

Durham County Council

Audit 2010/11



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Traffic light explanation

Red  Amber  Green 

Key messages

This report summarises the findings from my 2010/11 audit. My audit comprises two main elements:

- the audit of your financial statements; and
- my assessment of your arrangements to achieve value for money in your use of resources.

Key audit risk	Our findings
Unqualified audit opinion	●
Proper arrangements to secure value for money	●

Audit opinion and financial statements

The second year of the new Council has again been challenging. It faced several significant challenges, including:

- implementing new financial systems;
- dealing with the transition to International Financial Reporting Standards (IFRS), which many councils struggled with;
- continuing to address continuing issues following local government reorganisation; and
- responding to a challenging budget settlement following the comprehensive spending review.

All of these pressures had an adverse impact on the Council's capacity to produce good quality financial statements and working papers. Because of this my audit took longer than expected and the Council missed the 30 September deadline for publishing its audited financial statements.

My audit also identified significant weaknesses in the Council's financial systems, which officers are addressing as part of the migration to new systems in 2011/12.

The Council recognises there is much room for improvement and has developed an action plan to strengthen its arrangements for preparing its 2011/12 financial statements.

Value for money

I issued an unqualified conclusion on 31 October 2011 stating the Council had proper arrangements to secure economy, efficiency and effectiveness in its use of resources. This reflects an improvement in the Council's arrangements since my last audit when I issued a qualified VFM conclusion because of weakness in some areas.

The Council faces significant financial pressures because of the difficult economic climate and decreases in funding. This means resources will be constrained over the next few years. The Council recognised this at an early stage and has been proactive in identifying and delivering savings so far. The medium term financial plan (MTFP) recognises the need for more reductions and is underpinned by an efficiency improvement programme. This sets out how the Council will review services and deliver more savings in the future.

Audit certificate

The audit certificate serves to close my audit. I issued the 2010/11 certificate on 31 October 2011.

Current and future challenges

The Council is working in an increasingly demanding environment but it has high expectations of what it can achieve.

The Council has made significant progress since its creation but recognises the need to ensure continuous improvement remains at the heart of its agenda. It faces large financial challenges in the coming years, and it is likely that it will need to deliver more for less. The Council's plans already include initiatives to preserve its underlying financial health while delivering essential services. While the Council's finances remain comparatively healthy, it continues to recognise the need to ensure future financial risks are identified early and managed properly. These challenges include managing the impact of various central government initiatives.

Below I focus on some of the key challenges facing the Council going forward.

Challenges	Comments
<p>Economic downturn and pressure on the public sector <i>In his comprehensive spending review (CSR) announcement in October 2010, the Chancellor set out a significant financial challenge for the public sector.</i></p>	<p>The Council faces significant challenges arising from the impact of the economic downturn and decreases in funding. Its financial plans include significant savings targets (£123.5 million over the four years to 2014/15) to deliver its planned services within the reduced financial settlement from the government. Delivery of the planned savings will require close monitoring to minimise the risk of overspending budgets.</p> <p>My work on this year's VfM conclusion found the Council had taken prompt, effective action to achieve the savings required in 2010/11 arising from in-year decreases in funding. Other continuing decreases are included in the medium term financial plan (MTFP). This is underpinned by a continuing efficiency improvement programme that sets out how the Council will review services and deliver more savings in the future. The Council recognises the need to continue to monitor delivery of planned savings, taking forward planned reviews of services for other opportunities to reduce spending and increase income. These are monitored closely as part of budgetary control and in developing the MTFP for the next four years.</p> <p>I will update my conclusion on financial resilience as part of my 2011/12 audit.</p>

Challenges

Changes to the Housing Revenue Account (HRA) Funding Regime

The government proposes to reform the council housing finance system which will result in the existing Housing Revenue Account (HRA) subsidy being abolished and replaced with a one-off redistribution of debt. This will have a significant impact on the Council's treasury management activities.

Comments

The Council has identified and considered the implications of these changes. They will result in the end of current annual negative subsidy payments to central government. It will be replaced by a one-off repayment of debt and a move to a self-financing system where housing rents will be kept locally.

Officers are considering this as part of the MTFP review this year. Recent announcements show that rent proposals will require the Council to borrow around £55 million to finance a payment to government on 28 March 2012, significantly increasing Council borrowings. The government's review of the overall subsidy system is now overdue. The final debt settlement figure, now due the end of November, could be significantly higher than estimated due to various factors including the recent increase in RPI to 5.6 per cent.

The Corporate Director Resources and his team are developing a strategy for borrowing and accounting for this new debt. Officers are also considering the longer term implications of the new system.

I will review the Council's arrangements in this area as part of my 2011/12 audit.

Single Status and Equal Pay

The introduction of Single Status arrangements has been a massive challenge for all local authorities given the complexities involved. This has been even more of a challenge in Durham following Local Government Reorganisation. This was because each of the former councils in Durham had approached the implementation of the single status agreement in a different way and had different arrangements for remunerating their employees.

Since Local Government Reorganisation the Council has been progressing with harmonisation of pay and conditions. A new pay and grading structure has been developed and posts assigned to this through job evaluation. Negotiations have started with the trade unions on the results from job evaluation and proposed changes to pay and conditions.

So far claims up to 2008 have been settled and offers prepared for most claims for the period to December 2010. Existing claims are due to be settled by the end of the year. Amounts for employees who have not yet submitted a claim will be settled in early 2012. The Council has made provision for outstanding settlements with current and former employees for actual or potential claims under equal pay legislation. The settlement process is continuing which means the final amounts involved and the payment timescale remain uncertain.

I tested the Council's total provision as part of my audit of the 2010/11 financial statements and decided that it was fairly stated. I will revisit this in my 2011/12 audit.

Challenges

Treasury Management

All councils face challenges in how they manage debt and investments, including increasing long-term interest rates and decreases in central government support for capital expenditure. These are magnified by reduced revenue funding from central government and a decline in the availability of affordable long-term loans from the commercial market.

Comments

The Council has a sound track record on treasury management and is aware of the need to manage these challenges effectively. Treasury management activity is controlled by agreed performance indicators which help ensure that over the medium term, net borrowing is only for capital purposes. Members have recently set a new indicator to control overall borrowing.

The Council inherited £7 million of deposits from the former Derwentside District Council that were invested across the Icelandic banks:

- Glitnir (£4 million);
- Landsbanki (£2 million); and
- Kaupthing (£1 million).

All of these banks effectively collapsed in October 2008. The Council currently estimates an 82 per cent recovery for Kaupthing and following the recent Icelandic Supreme Court decision, 100 per cent recovery for Glitnir deposits and 98 per cent for Landsbanki.

Financial statements and annual governance statement

The Council's financial statements and annual governance statement are an important means by which the Council accounts for its stewardship of public funds.

Overall conclusion from the audit

I issued an unqualified opinion on the Council's financial statements on 31 October 2011.

Although my opinion was unqualified, my audit has again identified significant scope to improve:

- arrangements for producing the financial statements;
- the quality of the financial statements themselves; and
- supporting working papers.

In particular, the financial statements I received for audit were not of the expected standard as they omitted the group financial statements and some other disclosure notes. Detailed audit work subsequently identified many other errors and omissions, which needed to be corrected. In particular, there were many errors in accounting for property, plant and equipment. Working papers to support the financial statements were also not available when agreed and were not adequate in some areas.

Consequently, my audit took longer than anticipated and the Council missed the 30 September deadline for publishing its audited financial statements.

Although this year's financial statements were the first prepared under International Financial Reporting Standards (IFRS), which involved a significant amount of extra work for the Council, it is clear that there is significant room for improvement.

With this in mind we have agreed a detailed action plan with officers to ensure next year's arrangements for producing and auditing next year's financial statements are strengthened to ensure:

- the processes for producing the draft financial statements are strengthened;
- the number of, and value of, errors and omissions in the draft financial statements are reduced;
- working papers to support the figures in the financial statements are improved; and
- statutory deadlines are met.

Significant weaknesses in internal control

In my interim and annual governance reports to Members I noted that the large number of financial systems in continued use during 2010/11 continued to perpetuate control weaknesses. My work on these systems identified several weaknesses that could have led to errors in the financial statements.

I am pleased to report the Council made good progress in 2010/11 bringing the former districts off the old Agresso ledger onto the E Business Oracle system. This project represented a significant additional workload for the finance team. The organisation also had to implement International Financial Reporting Standards this year which alone was a major project and has caused many Local Authorities difficulties because of its scope and complexity.

During 2011/12 the Council has invested considerable effort in resolving this position. In particular, it has:

- accelerated its programme to switch off old systems and move to single systems eg general ledger; and
- introduce new systems for cash collection and revenues and benefits.

Value for money

I considered whether the Council is managing and using its money, time and people to deliver value for money. I assessed your performance against the criteria specified by the Audit Commission and have reported the outcome as the value for money (VFM) conclusion.

I assessed your arrangements to secure economy, efficiency and effectiveness in your use of resources against two criteria specified by the Audit Commission. I issued an unqualified conclusion on 31 October 2011 stating that the Council had proper arrangements to secure economy, efficiency and effectiveness in its use of resources. This outcome reflects an improvement in the Council's arrangements since my last audit when I issued a qualified VFM conclusion due to weakness in several areas. My conclusion on each of the two areas is set out below.

Value for money criteria and key messages

Criterion	Key messages
<p>1. Financial resilience</p> <p>The organisation has proper arrangements in place to secure financial resilience.</p> <p>Focus for 2010/11:</p> <p>The organisation has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.</p>	<p>My focus was on whether the Council is managing its financial risks to secure a stable financial position for the foreseeable future. I considered the Council's financial planning, financial governance and financial control arrangements.</p> <p>I concluded the Council's arrangements has robust arrangements in place to secure financial resilience and these were operating effectively.</p> <p>The Council understands the financial challenges and risks it faces. Senior officers and members provide constructive scrutiny on financial matters. It has effective arrangements to establish its strategic financial position and to develop its budgets. It has also updated its medium term financial plan (MTFP) to reflect the savings required over the next four years.</p> <p>In relation to the delivery of the 2010/11 budget I was satisfied the Council had achieved its plans, including delivering the planned savings for the year.</p>

Criterion

2. Securing economy efficiency and effectiveness

The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

Focus for 2010/11:

The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

Key messages

My work in this area involved an assessment of how the Council manages its funds. This included consideration of how resources are prioritised and arrangements to ensure resources are used to their maximum benefit.

I concluded the Council has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

A balanced four-year medium term financial plan for the four-year period 2011/12 to 2014/15 was agreed in February 2011. The main objective of the programme is to achieve budget savings of up to £123.5 million by 2014/15 while maintaining focus on its vision and priorities for the county which were developed with partners following local government reorganisation. An updated four-year MTFP has been developed and discussed with members for the period 2012/13 to 2015/16.

Whilst the financial position is challenging, the creation of the new single unitary means the Council has significant opportunities for economies of scale and efficiencies in service delivery. This will help it to deliver the required savings.

The Council recognises the need to ensure sufficient capacity is provided to deliver the programme effectively. Many projects to be delivered in 2011/12 are now in the implementation phase. Accurately monitoring savings from these projects will continue to be important if budget savings are to be achieved as planned.

Closing remarks

I have discussed and agreed this letter with the Leader, Chief Executive, Assistant Chief Executive and the Corporate Director Resources. I will present the letter at the Audit Committee on 5 January 2012 and will provide copies to all Council Members.

Further detailed findings, conclusions and recommendations in the areas covered by my audit are included in the reports issued to the Council during the year.

Report	Date issued
Audit progress reports (update report to meetings of the Audit Committee)	Selected Audit Committee meetings during year
Audit fee letter	March 2010
Audit plan	January 2011
Interim governance report	April 2011
Annual governance report	October 2011
Audit report, including audit opinion on the financial statements for the year ended 31 March 2011, value for money conclusion and audit certificate	October 2011
Whole of Government Accounts assurance statement	November 2011
Annual audit letter	November 2011

The Council has continued to take a positive and constructive approach to our audit. I wish to thank members and officers for their support and cooperation during the audit.

Cameron Waddell
District Auditor
November 2011

Appendix 1 – Fees

	Actual	Proposed	Variance
Scale fee ⁱ	637,000	617,000	20,000
Non-audit work	15,000	15,000	0
Total	652,000	632,000	20,000

The actual fee charged was £20,000 higher than that originally proposed. This is because of the extra time required to complete the audit of the financial statements.

ⁱ The final amount paid to the Audit Commission was £580,303. This was because the Council received a 6 per cent rebate for the additional work required for IFRS implementation (£32,115) and further 3.5 per cent rebate to reflect changes in the approach to value for money work (£24,582).

Appendix 2 – Glossary

Annual governance statement

Governance is about how authorities ensure that they are doing the right things, in the right way, for the right people, in a timely, inclusive, open, honest and accountable manner.

It comprises the systems and processes, cultures and values, by which bodies are directed and controlled and through which they account to, engage with and where appropriate, lead their communities.

The annual governance statement is a public report by the Authority on the extent to which it complies with its own local governance code. This includes how it has monitored the effectiveness of its governance arrangements in the year and any planned changes in the coming period.

Audit opinion

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

Opinion

If I agree the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm the statements give a true and fair view.

Value for money conclusion

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

If I find the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

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