

Audit Panel

update

London Borough of Lewisham

Audit 2011/12

The Audit Commission is a public corporation set up in 1983 to protect the public purse.

The Commission appoints auditors to councils, NHS bodies (excluding NHS Foundation trusts), police authorities and other local public services in England, and oversees their work. The auditors we appoint are either Audit Commission employees (our in-house Audit Practice) or one of the private audit firms. Our Audit Practice also audits NHS foundation trusts under separate arrangements.

We also help public bodies manage the financial challenges they face by providing authoritative, unbiased, evidence-based analysis and advice.

Contents

Introduction	2
Progress report	3
2010/2011 Audit.....	3
2011/2012 Audit.....	3
Government response to consultation on the future of local public audit...6	
Update on the externalisation of the Audit Practice.....	8
Other matters of interest	9
2010/11 Accounts	9
Managing Workforce Costs	10
Joining up health and social care	11
CIPFA's Prudential Code for Capital Finance.....	11
2011/12 Accounts: CIPFA Guidance Notes for Practitioners.....	12
For information: Board Governance Essentials	12
Fire and Rescue National Framework	13
Local Government Finance Bill.....	13
Guide to HRA Self Financing.....	14
Contact details	15

Introduction

- 1 The purpose of this paper is to provide the Audit Panel with a report on progress in delivering our responsibilities as your external auditors. It includes an update on the externalisation of the Audit Practice.
- 2 This paper also seeks to highlight key emerging national issues and developments which may be of interest to members of the Audit Panel.
- 3 If you require any additional information regarding the issues included within this briefing, please feel free to contact me or your Audit Manager, Geoffrey Banister, using the contact details at the end of this update.
- 4 Finally, please also remember to visit our website (www.audit-commission.gov.uk) which now enables you to sign-up to be notified of any new content that is relevant to your type of organisation.

Susan M Exton

District Auditor

March 2012

Progress report

2010/2011 Audit

5 Following the late completion of the 2010/2011 audit my team held a highly constructive ‘lessons learned’ meeting with the finance team on 12 December 2011. We jointly identified a number of areas to improve the quality of the draft financial statements and make the audit process smoother. These included:

- Reviewing the scope to make more use of estimates in closing the accounts (finance). I have provided a paper on the use of estimates outlining the audit work I would carry out to assist with the preparation of working papers.
- Setting out more clearly on the audit exception reports the action required to resolve an issue (audit),
- Setting clear timescales for answering queries and agreeing action to be taken (all),
- Giving greater priority to resolving issues which may lead to a qualification of the financial statements or where exercise of judgement is required (audit),
- Identifying areas for early audit work such as review of private finance initiative (PFI) schemes and testing of the property, plant and equipment register (all),
- Developing plans to address known areas of weakness in 2010/2011 such as the pension fund accounts, preparation of the cash flow statement, property, plant and equipment and whole of government accounts (finance).

6 Following discussions with the Head of Business Management and Service Support I agreed a fee of £35,000 for the additional audit work on the 2010/2011 financial statements, made up of £3,000 for whole of government accounts, £5,000 for the pension fund accounts and £27,000 for the main statements. Successfully addressing the actions in paragraph 5 will reduce the risk of additional charges occurring in 2011/2012.

2011/2012 Audit

Financial statements

7 Our interim audit is underway. As part of this we are meeting with officers regularly to monitor progress against the final accounts closedown plan and to ensure that any potentially complex areas are discussed at an early stage. In the last month we have had discussions with officers on possible significant risks to inform our 2011/12 audit plan and assist with the financial statements preparation. This cover such areas as heritage assets, valuation of property, plant and equipment (PPE); investment property,

Implementation of new systems, classification of Schools, new PFI schemes.

8 We are updating our understanding of the Council's systems and control environment by carrying out walk through testing of all fundamental systems and updating our systems documentation as appropriate. Once this is completed we will decide whether or not to carry out detailed testing of controls, to determine whether we can place reliance on controls in these areas to reduce the amount of substantive work we perform on the financial statements later in the year. We are reviewing the work Internal Audit has performed on these systems during the year to minimise duplication of our work.

VFM conclusion

9 I am required to reach a conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness. My conclusion on the Authority's arrangements is based on two criteria, specified by the Commission. These relate to the Authority's arrangements for:

- securing financial resilience – focusing on whether the Authority is managing its financial risks to secure a stable financial position for the foreseeable future; and
- challenging how the Authority secures economy, efficiency and effectiveness – focusing on whether the Authority is prioritising its resources within tighter budgets and improving productivity and efficiency.

10 I will be carrying out this work over the next few months building upon the strong results from previous years, knowledge of the Council, document review and interviews with officers.

Other areas of work

Grant claims

11 The Council receives funding from various grant paying departments which the Audit Commission review and certify. There are conditions attached to these grants by the paying departments. The Council must show that it has met these conditions. If the Council cannot evidence this, the funding can be at risk. It is therefore important the Council manages certification work properly and can demonstrate to us, as auditors, that the relevant conditions were met.

12 In 2010/11, my audit team certified eleven grant claims. Of these:

- six claims were provided to me after the Authority's deadline for preparation,
- I amended two claims for errors,
- For four claims I was unable to certify fully the claim and issued a qualification letter to the grant paying body.

13 The main qualification was in respect of the Housing and council tax Benefits scheme which is quite normal for a London Borough given the size and complexity of the grant claim. There will be less grants claims requiring certification in 2011/12 and consequently the amount of work that I am required to carry out and the fees charged will fall. The fees I charged for grant certification work in 2010/11 was £159,000 (2009/10 was £129,000).

14 My audit team made a recommendation, to consider appointing an officer to coordinate the grant claims. I am pleased to state that by reallocating duties within existing resources a grants coordinator was appointed at the Authority and there has been good liaison with my staff, although there is scope to improve the timeliness of grant claims preparation and working papers. In the spring of 2011 I ran a workshop for grants officers to present the significant findings from the 2009/10 grants report and also explain a list of the tests which I carry out on all grants and returns received. I will discuss the results of the 2010/11 grants certification process with the grants coordinator and the finalised report will be available to those charged with governance.

Management and Audit Panel representations required by ISA (UK&I) 240, 260 and 315

Under the ISA (UK&I) I am required to update my understanding annually of:

- management processes and arrangements; and
- how the Audit Panel as those charged with governance gains assurance over management.

In order to comply with the standards I need to obtain and consider information from management and the chair of the Audit Panel and I have thus written to both. The questions should be answered in respect of the Authority and the Pension Fund.

Government response to consultation on the future of local public audit

15 In August 2010, the government announced its intention to bring forward legislation to abolish the Audit Commission and put in place a new framework for local public audit. In March 2011, the government published a consultation paper and, in January 2012, announced its response to the consultation to which it received 453 responses, the majority from audited bodies.

16 The Audit Commission is currently in the process of the award of contracts for the work currently undertaken by the Audit Practice for the period 2012/13 to either 2014/15 or 2016/17 (see 'update on the externalisation of the Audit Practice' below). The government envisages the retention of the Audit Commission as a small residuary body until the end of those contracts, to oversee them and to make any necessary changes to individual audit appointments.

17 Thereafter, the government proposes that a new local public audit regime will apply. The key features of that regime are as follows.

- The National Audit Office will be responsible for developing and maintaining audit codes of practice and providing support to auditors.
- Mirroring the Companies Act provisions, auditors will be subject to the overall regulation of the Financial Reporting Council (the FRC). The FRC will authorise one or more Recognised Supervisory Bodies (in practice, the professional institutes) to register and supervise audit firms and engagement leads.
- directly-elected local government bodies will appoint their own auditor on the advice of an independent audit appointment panel with a majority of independent members. Such panels may be shared between audited bodies;
- Audited bodies must run a procurement exercise for their external audit appointment at least every five years, although there would be no bar on the reappointment of the incumbent audit firm (for a maximum of one further five-year term);
- Audited bodies will be able to remove their auditor, but only after due process, involving the independent audit appointment panel and culminating in a public statement of the reasons for the decision.
- The audit will continue to cover arrangements for securing economy, efficiency and effectiveness, but without imposing further burdens on audited bodies. There will be further consultation on the approach to value for money.
- The power to issue a public interest report will be retained.
- Audit firms will be able to provide non-audit services to audited bodies, subject to complying with ethical standards and gaining approval from the independent auditor appointment panel.
- The right to object would be retained, but the auditor will be given the power to reject vexatious, repeated or frivolous objections.

- Grant certification will be subject to separate arrangements between grant paying bodies, audited bodies and reporting accountants (who could be the external auditors).
- The National Fraud Initiative will continue. Discussions on how this will be achieved are ongoing.

18 The government is holding further discussions with audited bodies and audit firms to develop its proposals. The Regional Improvement and Efficiency Partnerships are organising events in January and February 2012 to which audited bodies have been invited. The government intends to publish draft legislation for pre-legislative scrutiny in Spring 2012.

Update on the externalisation of the Audit Practice

19 The Audit Commission's Chief Executive, Eugene Sullivan, wrote to clients on 21 September 2011 summarising the Department for Communities and Local Government's plans for externalising the Audit Commission's work that is currently undertaken by the Audit Practice. An update on progress was provided in Eugene's subsequent letter of 10 November 2011.

20 The contract awards were announced on 5 March 2012, following a procurement process that began with a contract notice in September 2011. The Audit Commission announced the proposed award of the following contracts to:

- **Grant Thornton (UK) LLP**, a total notional value of £41.3 million a year covering four contract areas in the North West, West Midlands, **London (South) Surrey & Kent**, and South West
- **KPMG LLP** a total notional value of £23.1 million a year covering three contract areas in Humberside & Yorkshire, East Midlands, and London (North)
- **Ernst & Young LLP** a total notional value of £20 million a year covering two contract areas in Eastern, and South East
- **DA Partnership Ltd** a total notional value of £5 million a year covering one contract area in the North East & North Yorkshire

The contract notional value shown above is based on the proposed scale fees for 2012/13 and an estimated value for certifying grant claims and other financial returns. The contracts will contribute to up to a 40 per cent cut in the audit fees paid by local public bodies and will run for a period of at least five years.

21 The next steps in the process are

- For bodies currently audited by the Audit Practice, there will be an opportunity to attend an introductory event in each contract area with the Commission and the firm awarded the contract. The events will take place in May 2012.
- Appointments will start on 1 September 2012. As such, the Commission is extending the current audit appointment to allow any audit issues arising between 1 April 2012 and 31 August 2012 to be dealt with. The Commission's Director of Audit Policy and Regulation wrote to clients on 19 December 2011 setting out more details on this interim appointment.
- Audit Practice staff in each lot area will in the main transfer to the successful bidders on 31 October 2012.

22 Against this background, the Audit Practice's focus remains.

- Fulfilling our remaining responsibilities: delivering your 2011/12 audit to the high standards you expect and deserve.
- Managing a smooth transition from the Audit Practice to your new audit provider.

Other matters of interest

2010/11 Accounts

23 In December 2011 the Audit Commission published a report - Auditing the Accounts 2010/11 - which summarises its findings of the accounts audits in 2010/11.

24 The report covers the quality and timeliness of financial reporting by councils, police authorities, fire and rescue authorities and other local public bodies. In addition to auditors' work on the 2010/11 financial statements, the report also covers:

- the results of the first year of International Financial Reporting Standards (IFRS) implementation;
- auditors' work on the Whole of Government Accounts returns;
- auditors' local value for money work;
- public interest reports and statutory recommendations issued by auditors since December 2010; and
- the key challenges facing bodies for 2011/12.

25 Auditors were able to give opinions on the accounts by the target date of 30 September 2011 at most organisations and this performance compares well with the previous year.

26 However, the challenges presented by the transition to IFRS are demonstrated by an increase in the number of bodies, from seven last year to eighteen this year, where the auditor's opinion was still outstanding after 31 October. There was also a significant increase in the number of bodies needing to make material adjustments to their accounts following the audit.

27 On 18 January 2012, the Audit Commission published 'Let's be clear: Making local authority IFRS accounts more accessible and understandable'.

28 This briefing supplements the report on the 2010/11 accounts referred to above and focuses on a long-running debate of how to make local government accounts easier to understand.

29 While the statutory accounts give comprehensive information on each local authority's financial position and performance, reflecting the range of activities which they cover, they are a poor way of communicating the key information to lay readers.

30 The briefing notes that:

- elected members and local people would benefit from having access to well-presented extracts from the accounts, which would provide the key information on each authority's financial position and performance;
- the accounting profession and the Audit Commission could do more to encourage auditors and preparers of accounts to reduce clutter in statutory accounts; and

- each authority could do more to ensure their accounts are shorter and more accessible. Those preparing accounts need to look critically at the previous year's accounts. They should identify how these accounts could be sharper and more focused before starting work on the next set.

31 The briefing concludes by identifying possible steps to make local authority accounts more accessible and easier to understand, and the implications of doing so.

32 The Audit Commission is seeking views on the issues raised within the briefing and has invited comments by 16 March 2012 - further information on this is available on the Audit Commission's website.

Managing Workforce Costs

33 The Audit Commission and Local Government Association have jointly launched 'Work in progress: Meeting local needs with lower workforce costs'.

34 The joint report - which can be found on the Audit Commission's website - is aimed at councils as employers and shows how local authorities across England are reducing their workforce costs, with some finding creative solutions.

35 As government funding for councils shrinks by over a quarter between 2011/12 and 2014/15, councils need to reduce their workforce costs substantially while still providing much needed services. Not all councils face the same financial challenges, but the message is that all must reassess what they do, how they do it, and what their priorities are. Those opting for major restructuring will take more time to realise savings.

36 Councils are finding ways to cut their pay bills without losing jobs, but the report says that redundancies are inevitable. Local government was already reducing posts before the cuts in government funding. In the past year an estimated 145,000 jobs have gone and this figure will increase in the future. So far many redundancies have been voluntary, but the report warns that compulsory ones are set to rise.

37 The report is supported by a number of resources including:

- an agency workers expenditure tool which shows councils how much they spend on agency workers, compared with groups of similar councils;
- a workforce expenditure tool which shows councils how much they spend on staff as a proportion of their net current expenditure, and how this has changed over time;
- five case studies which provide examples of the different approaches councils are taking to reduce the costs of employing people while protecting valuable services. The case studies show what the councils did and why - and the benefits achieved; and
- a practical guide on how to undertake effective pay benchmarking, providing a series of steps to follow when starting a pay benchmarking process and highlighting the main issues that should be considered.

38 The report is supplemented with a briefing for elected members that includes a number of questions designed to help members assess how well their council decides the size, shape and cost of its workforce and how these decisions will affect services and communities.

39 The questions are in two parts:

- the information that should be available to members about the workforce; and
- the savings strategies councils could follow in the light of that information.

Joining up health and social care

40 On 1 December 2011 the Audit Commission published the second in a series of briefings looking at adult social care.

41 'Joining Up Health and Social Care - Improving Value for Money Across the Interface' shows significant variations in indicators such as the levels of emergency admissions to hospital. This raises questions about how well services are being integrated to meet the preferences of older people. Despite the focus for many years on improving joint working across the NHS and social care, progress remains patchy.

42 At a time when the whole of the public sector must find significant savings, the report says that integrated working offers opportunities for efficiencies and improvements to services. Without it, there is a risk of duplication and 'cost-shunting' - where savings made by one organisation or sector simply create costs for others.

43 The briefing offers guidance to local partnerships, setting out a list of questions to consider and suggestions for interventions that might help. The briefing also includes a number of case studies which show how some areas have embraced partnership working and used local data and benchmarking to establish how and where to make improvements.

44 The Audit Commission has developed a tool to accompany the briefing that allows NHS and social care partnerships to benchmark their performance against others.

CIPFA's Prudential Code for Capital Finance

45 CIPFA has recently updated its Prudential Code for Capital Finance in Local Authorities. This new version reflects the introduction of IFRS which required:

- PFI schemes to be included on organisations' balance sheets; and
- The accounting treatment of leases to be reviewed – with many more likely to be considered as finance leases and thus also included on the relevant balance sheets.

46 The code also includes guidance on the treasury management implications of the housing self-financing reforms.

47 Although local authorities determine their own capital programmes, they are required to have regard to CIPFA's Prudential Code (the Code) in order to ensure that these capital investment plans are affordable, prudent and sustainable.

48 To demonstrate that these objectives have been met, the Code sets out the indicators that must be used and the factors that must be taken into account.

49 The Code does not include suggested indicative limits or ratios and these are for the local authority to set itself, subject to some overriding controls.

50 The prudential indicators required by the Code should be considered alongside its Treasury Management performance indicators. These indicators are both are designed to support and record local decision making and are not designed to be comparative performance indicators.

2011/12 Accounts: CIPFA Guidance Notes for Practitioners

51 CIPFA has recently published a set of guidance notes to provide support in preparing the 2011/12 year-end accounts. These offer constructive advice on all aspects of the requirements for 2011/12 and provide detailed guidance on the key changes, including accounting for:

- heritage assets;
- business rate supplements;
- community infrastructure levies;
- related party disclosures;
- exit packages;
- trust funds;
- financial instruments; and
- interests in joint ventures.

52 The key changes to your financial statements in 2011/12 will also be covered by our final accounts workshops.

For information: Board Governance Essentials

53 The Public Chairs' Forum and CIPFA have recently published a joint 'how to' guide for Chairs and Boards of public bodies.

54 'Board Governance Essentials: A Guide for Chairs and Boards of Public Bodies' offers advice across four key areas.

- Good corporate governance.
- Roles, responsibilities and relationships.
- Standards of behaviour in public life.
- Effective financial management and transparency.

55 This guide may provide interesting reading for all members.

Fire and Rescue National Framework

56 In December 2011 the government launched a consultation exercise seeking views on freeing fire and rescue authorities to tailor their services to meet local needs whilst meeting the wider needs of national resilience.

57 The priorities in the draft National Framework are for fire and rescue authorities to:

- identify and assess the full range of fire and rescue related risks their area faces, make provision for prevention and protection activities and to respond to incidents appropriately;
- work in partnership with their communities and a wide range of partners locally and nationally to deliver their service; and
- be accountable to communities for the service they provide.

58 The consultation exercise ends on 19 March 2012 and further information can be found on the DCLG website.

Local Government Finance Bill

59 In December 2011 the government introduced proposals to devolve greater financial powers and freedoms to councils. The Local Government Finance Bill sets out the legislative foundations to implement the changes from April 2013. The most significant proposals relate to non-domestic rates, which are currently pooled and redistributed nationally.

60 The Bill provides for councils to:

- retain a portion of their business rate growth;
- borrow against future income from business rates to pay for roads and transport projects alongside other local priorities;
- ensure a stable starting point for all authorities. No authority will be worse off as a result of their business rates base at the start of the scheme;
- establish a national baseline alongside a system of top ups and tariffs. Councils with business rates in excess of a set baseline would pay a tariff to government whilst those below would get an individually assessed top up from government; and
- create a levy to take back a share of growth from those councils that gain disproportionately from the changes. This money would be used to fund a safety net providing financial help to those authorities which experience significant drops in business rates, for example caused by the closure or relocation of a major business.

61 The Bill provides for much of the detail of the arrangements, including the sharing of business rate growth between billing and precepting authorities, to be left to secondary legislation.

Guide to HRA Self Financing

62 The introduction of self-financing to the housing revenue account (HRA) in April 2012 will fundamentally change the way that local authority housing is funded.

63 CIPFA has therefore recently produced a publication which brings together the latest guidance to assist those working in the sector to understand the changes and help with their implementation.

Contact details

64 If you would like further information on any items in this briefing, please feel free to contact either your District Auditor or Audit Manager.

65 Alternatively, all Audit Commission reports - and a wealth of other material - can be found on our website: www.audit-commission.gov.uk.

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