

Item No:	Classification: Open	Date: 25^h February 2003	Meeting Name: Executive
Report title:	District Audit Annual Letter		
Wards or Groups affected:	All		
From:	Chief Executive Chief Finance Officer		

RECOMMENDATIONS

1. That Executive notes this report and asks Overview and Scrutiny Committee for their comments and views on its contents.

BACKGROUND

2. The District Auditor issues an annual audit letter which Members have to consider as part of their governance arrangements. The letter has to be published and made available to the public if they wish a copy.
3. This year the letter was not produced until early February 2003. In previous years it has usually been published by 31st December. However, its publication was delayed because the Audit Commission reports under the Comprehensive Performance Assessment (the CPA) took precedence.
4. The Council's District Auditor, Derek Elliott – who is also the Council's "Customer Relationship Manager" under the CPA – will be present at the meeting of the Executive to answer questions and make a brief presentation.

KEY ISSUES FOR CONSIDERATION

5. The District Auditor draws on the work he has done at the Council and states that:

"This letter reflects positively on the strong corporate focus the Council has to delivering service improvement. The letter also draws Members' attention to the need for urgent action to address issues of governance and strengthen internal control."

"A key element in any Council's ability to promote, manage and sustain change is its overall management capacity. As highlighted by the CPA process, management capacity will be critical in its efforts to progress complex and difficult issues"

"Whilst acknowledging the sound framework and arrangements that the Council has in place we have some concerns. To have confidence in the governance structure, standards need to be robust and consistently applied. As well as having a governance framework in place the Council needs to ensure that it has capacity and

capability to deliver it in practice through both behaviours and actions across the whole organisation. One of the particular challenges is the Council's ability to respond effectively to weaknesses identified through internal and external audit processes."

6. The Annual Audit Letter and the recent report under the finance element of the Comprehensive Performance Assessment have highlighted some inconsistencies in the effectiveness of financial administration across some of the Council's business units.
7. The letter covers a range of governance issues including those relating to financial management and associated matters. Officers initial responses to the elements included in the letter are set out in the schedule attached to this report. Where more fundamental matters need further review another report will be presented to the Executive.
8. An improvement programme to bring "sound financial management", under the umbrella of the "forward @ southwark" initiative, will be led by the Chief Finance Officer. The programme will focus on the three key themes to ensure:
 - Clear accountability – both professional and managerial
 - Effective resource management – assessing capacity, competency and training issues, and
 - Rigorous systems are in place
9. The Council already has the key ingredients in place to achieve this. They will be augmented by the new Internal Audit contract with PricewaterhouseCoopers and assistance from the District Auditor.
10. The CPA issues have already been reported to Members together with an improvement plan that the District Auditor has recognised as being among the best responses so far received. The challenge will now be to ensure that these changes and improvements are delivered. To address this and other weaknesses the Council will need to develop its capacity - particularly in terms of people and technology and bring about significant changes to the way the Council works.
11. In order to do this a range of activities have already been put in place which include
 - The restructuring of Strategic Services in order to enhance capacity and create more "challenge" and support from the centre.
 - The development of a comprehensive programme of modernising services - including the customer access and E – government programmes for which substantial additional investment has been planned for 2003/04.
 - A Council wide change and improvement programme "forward @ Southwark" aimed at improving management capacity and modernising the way the Council works.
 - The development of robust governance arrangements.

REASONS FOR LATENESS and URGENCY

12. The report has to be presented to the first available meeting of the Executive after its receipt by the Council.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
District Audit Annual Audit Letter	Financial Management Services	Dave Howes Head of Risk and Financial Control (020 7525 4314)
Audit Commission – Comprehensive Performance Assessment	Financial Management Services	Alan Layton, Head of Corporate & Strategic Finance (020 7525 4309)
	Financial Management Services	Alan Layton, Head of Corporate & Strategic Finance (020 7525 4309)

APPENDIX A

Audit Trail

Lead Officer	Bob Coomber , Chief Executive Keith Brown , Chief Finance Officer	
Report Author	Keith Brown	
Version	Final	
Version Date	20/02/03	
Key Decision	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / EXECUTIVE MEMBER		
Officer Title	Comments Sought	Comments Included
Borough Solicitor & Secretary	Yes	No
Executive Member	Yes	No
Date Final Report Sent to Constitutional Support Services		

Key Findings	Response
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Response to the District Auditor’s Annual Audit Letter

The District Auditor’s 2001/2002 Annual Audit Letter (AAL) raises concerns over several issues, which have been identified during the audit of the authority. Below is a summary of the action being taken by management to address the key findings.

<p>Comprehensive Performance Assessment</p> <p>Under the comprehensive performance assessment (CPA), the Council has been assessed as weak in the way that it serves its local people however the CPA report published by the Audit Commission acknowledged the significant challenges the Council faces in responding to high levels of deprivation, crime and unemployment. It commented favourably on the Council’s ambitions for improving the quality of life for its local communities and noted considerable improvements in social care for adults and children as well as an improvement in education performance. There were also weaknesses identified such as benefits administration and housing and environment services which need to be addressed. The Council is now working hard on how it takes the improvement process forward.</p>	<p>An action plan to address the findings from the CPA report has now been agreed with the Audit Commission.</p> <p>As Members know they have already endorsed this proposal and activity is currently taking place as detailed in the main report. Major improvements in key areas are being made have already been such as the continuing improvements in the Revenues and Benefits service.</p>
<p>Accounts</p> <p>We gave an unqualified opinion on the financial statements on 23 Dec 2002 The Council needs to continue to improve the timeliness of its accounts process before the introduction of Whole of Government Accounting in two years time. Arrangements for the completion of grant claims also need to be strengthened.</p>	<p>The Council is developing an action plan to address the specific issues raised by the District Auditor during the 2001/02 accounts audit. The Council is working together with its Internal Auditors to review all its major systems and processes. Staffing recruitment problems are being addressed; but there has recently been an unsuccessful recruitment campaign to appoint</p>

Key Findings	Response
	<p>to a post created specifically to deal with project finance and management.</p> <p>Grant Claims</p> <p>A grants protocol has been agreed with DA, and all departments have been given a checklist of the working papers required to support claims and this will be implemented fully the 2002/03 submissions.</p>
<p>Systems of internal financial control</p> <p>The Council’s systems of internal control are generally adequate. This year it has entered into a new contract for the provision of internal audit services. The introduction of these new arrangements are welcomed and in the first year a locally tailored audit programme has been agreed which is comprehensive and risk focused. The successful delivery of this programme of work is critical to providing assurances on the adequacy of the Council’s system of internal control and needs the full endorsement and commitment of management in co-operating and responding promptly to the demands of the audit process.</p>	<p>Internal Audit arrangements</p> <p>The Chief Finance Officer has put in place arrangements to address the practical problems, which could hinder the successful delivery of the internal audit contractor’s programme of work. In particular, the potential difficulties identified by the DA will be addressed as follows:</p> <ul style="list-style-type: none"> • ensuring ownership of corporate reviews – a senior departmental manager will take the lead responsibilities in the area being reviewed and will take a “client” role in the individual audit. • the Chief Financial Officer has issued an Audit Protocol, agreed with the Internal Auditors, which details the access to information, escalation and arbitration arrangements. • Responsibility and accountability for the implementation of Internal Audit recommendations is to be allocated to a named officer with appropriate line responsibility, for implementation. The Internal Audit Client will be tasked with ensuring that the

Key Findings	Response
	<p>targets are met.</p> <p>Financial management of out-sourced LEA services</p> <p>The collation of key information from schools is managed by WS Atkins on behalf of the Council under the PPP education contract. Currently, all Southwark schools have payroll providers other than the Council, which has made the logistics of collecting data less easy compared to councils where the payroll service is provided centrally. One of the main issues is the variety of payroll contracts that schools have entered into after the delegation of payroll and personnel functions to schools a number of years ago, prior to the Atkins contract. Schools are self-managing under the Local Management in Schools scheme (LMS) and have discretion over the procurement of their management process, and the payroll and personnel contracts are with the schools and not the Council. In fact, in the case of Foundation and Voluntary Aided Schools (VA), a school's governing body is the employer compared to Community Schools.</p> <p>Overall, these factors have reduced the consistency and timeliness with which data can be produced by the schools in order to meet the Council requirements. However, Atkins, in partnership with the Council, is in the process of devising a strategy to satisfy the Council requirements for this information on an annual basis, through consultation with the schools.</p> <p>Risk Management</p> <p>A Risk Management strategy was agreed and adopted by the</p>

Key Findings	Response
	<p>Chief Officer Team in June 2002. Risk management workshops have been held with departmental SMT and senior finance managers, and a high-level risk register has been compiled. The Corporate Risk Management team will develop the risk register further by interviewing Business Unit managers to identify operational risks.</p> <p>A more detailed register, dealing with risks at a Business Unit level, will be developed during 2003 with the aim of having a complete register in place later this year.</p> <p>A report to the Executive in late March or early April will set this out in more detail.</p>
<p>Standards of financial conduct and the prevention of fraud and corruption</p> <p>The Council has met the requirements of the government's new 'ethical framework', establishing an independent Standards Committee, and adopting the Code of Conduct for members. Arrangements for dealing with fraud and corruption are generally adequate. The Council has proper procedures and contract standing orders for the tendering and awarding of contracts. However, our work has identified instances where these are not being complied with. This puts the Council at risk of potential allegations of bias or corruption or poor value for money.</p>	<p>The weaknesses in the tendering and award of contracts identified by the District Auditor are still being reviewed. Corporately. Generally the Council has a strong framework for the tendering, procurement and management of its contracts. This will be supported by a new commissioning strategy, contract standing orders and a commissioning code of practice which are being drafted.</p> <p>However, the DA has identified a limited number of areas where some problems have been identified. Following their report a comprehensive review has been started, conducted by Internal Audit, to test compliance with the Council procedures. This will be completed later in the year.</p> <p>A new corporate contract register is being created, which will facilitate better monitoring of the Council's contract</p>

Key Findings	Response
<p>Performance Management</p> <p>We have carried out reviews of specific areas of the Council's activities. We identified a range of good practices and made recommendations for improvement where appropriate. The Council's Best Value Performance Plan complied with legislative requirements in all significant respects. We issued an unqualified opinion on the Plan on 19th December 2002. The Council has strengthened its arrangements for central co-ordination of Best Value Performance indicators, but there is scope for further improvement in the preparation of indicators in some departments. Any slippage in performance could be damaging to the Council in terms of its future CPA assessment. Members play a valuable role in the Council's performance management system. It will be important to maintain their level of involvement over the coming year and give impetus to the Council's performance agenda.</p>	<p>arrangements, and aid in the programme of contract audit included in the Annual Internal Audit Plan.</p> <p>Performance indicators</p> <p>The Council has made significant improvements in producing reliable and accurate performance indicators. The DA's reservation on four BVPIs was mainly due to issues largely outside of its control, and OfSTED have acknowledged that significant efforts have been made to resolve the situation. Some of the problems surrounding the timeliness of some indicators, mentioned in the AAL, may have been the result of inadequate guidance from the Audit Commission and changes in deadlines.</p>
<p>Inspection visits</p> <p>The Inspection reports emphasised areas where the Council has good performance, for example, waste collection, housing repair times and high number of library visits. It also indicates where the Council has made improvements since earlier visits such as in the educational attainment of looked after children. However, the report goes on to identify significant areas of weakness with</p>	<p>The Benefits service has improved significantly since the last BFI inspection, meeting all of its Best Value Performance Plan targets. Recently published data suggests that the Council, over the last 2 months or so, has now reached London Standard performance in the 2 key indicators for new claims and change of</p>

Key Findings	Response
<p>development required across most service areas.</p> <p><i>In particular the 0* awarded to the benefits service will need significant management input to improve claim processing times and collection of monies.</i></p>	<p>circumstances. Its very possible that under the new contract arrangement with Liberata for the Council to reach top quartile performance levels within the next 12 months.</p>



Annual Letter

London Borough of Southwark

INSIDE THIS LETTER

PAGE 2 - 4

- Introduction
- Summary of key findings

PAGE 5 - 12

- Comprehensive Performance Assessment
- Accounts
- Financial aspects of corporate governance
- Performance management

PAGE 12 - 13

- Follow up
- Future audit work
- Conclusions
- Reports issued during the course of the audit

Reference:	Mil09SO01002 FINAL ANNUAL LETTER
Author:	Derek Elliott – District Auditor Alastair Rankine – Audit Manager
Date:	January 2003

Introduction

The purpose of this Letter

This Annual Audit Letter summarises for Members the more important matters arising from our audit and from the inspections carried out by the Audit Commission Inspection Service for 2001/02 and comments on other current issues.

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

We have produced separate reports during the year on completion of specific aspects of our work, which have been discussed in detail with officers. The reports are listed at the end of this Letter for Members' information.

We also summarise the Inspection work carried out by the Audit Commission.

Background

The white paper 'Strong Local Leadership, Quality Public Services' (December 2001) makes clear the government's commitment to ensure improvement in local Council services across the country.

At the forefront of this is the Comprehensive Performance Assessment (CPA), which the Audit Commission has been charged with implementing, and which will produce a judgement for every Council based on:

- how it is run (including corporate and managerial effectiveness and capacity to improve local services)
- the quality of its local services.

The judgement scores authorities on the scale excellent/good/fair/weak/poor.

Those councils which perform well in the CPA will receive additional freedoms and flexibilities.

Councils which perform poorly will need to draw up detailed action plans to secure improvement, and may be subject to increased levels of audit and inspection until those improvements have been delivered.

Audit objectives

Our audit this year has included a programme of work designed to help the Audit Commission deliver its CPA judgement. This includes the Best Value Performance Indicator Audit and an assessment of the Council's performance across the Code of Audit Practice.

In addition to our CPA work, we have also undertaken a full Code audit, incorporating accounts, financial aspects of corporate governance and performance management work. In line with Code requirements, the audit has been tailored to meet the operational and financial risks facing the Council.

To ensure that our audit is carried out as effectively as possible, we met with key officers and attended departmental management meetings at key stages throughout the year to raise awareness about audit requirements. We see this continuing to be an important part of our work to promote effective joint working arrangements.

Inspection objectives

Section 10 of the Local Government Act 1999 provides for the Audit Commission to carry out inspections for best value purposes and to produce inspection reports that will:

- enable the public to see whether best value is being delivered
- enable the Government to see how well its policies are working on the ground
- identify failing services where remedial action may be necessary
- identify and disseminate best practice.

Audit Commission inspectors look at the quality and costs of the service being provided and check whether Best Value Reviews (BVRs) comply with the requirements of best value. For services with recognised standards, inspectors check how far they are being achieved from the customer's viewpoint. Councils must demonstrate that they are striving for continuous improvement in the economy, efficiency and effectiveness of all services.

Context

This Letter reflects positively on the strong corporate focus the Council has to delivering service improvement. The Letter also draws Members attention to the need for urgent action to address issues of governance and strengthen internal financial control.

Performance and service delivery

The Council has faced a year of significant change with the election of a new administration. Although its six Community Strategy priorities remain central to the corporate agenda the new administration has brought fresh priorities which the Council is already beginning to address.

During the year the Council has been progressing many of its key objectives. The development of financial management arrangements and strategic financial planning has continued and in 2003/04, the business planning and budget setting timetable will be aligned. The Council is developing a strong performance culture and is responding well to the post CPA agenda.

One of the Council's largest regeneration projects - Elephant and Castle - was delayed this year when it became clear that the commercial provider selected would not be a satisfactory partner. Since then the Council has taken the opportunity to revisit the project basis overall and has begun fresh work to consider local opinions and needs.

The Council received a setback to its stock transfer plans with the strong opposition voiced at the Aylesbury and Tabard Estates. It is still unclear what the next steps may be but in any event the Council faces a serious challenge if it is to meet the Government's 'decency standard' target for all social housing by 2010.

A key element in any Council's ability to promote, manage and sustain change is its overall management capacity. As highlighted by the CPA process, management capacity will be critical in its efforts to progress complex and difficult problems.

Standards of governance

Standards of governance and ethics, values and culture are the bedrock of a council's activities and play a vital role in ensuring honest and open

administration and public accountability. They are also essential if a council is to meet its external obligations to citizens, stakeholders, partners and government departments.

Whilst acknowledging the sound framework and arrangements that the Council has put in place, such as the award of the new internal audit contract, review of S151 responsibilities and the creation of two new Assistant Chief Executive posts, we have some concerns. To have confidence in the governance structure, standards need to be robust and consistently applied. As well as having a governance framework in place the Council needs to ensure that it has the capacity and capability to deliver it in practice through both behaviours and actions across the whole organisation.

One of the particular challenges is the Council's ability to respond effectively to weaknesses identified through internal and external audit processes.

Summary of key findings

Comprehensive Performance Assessment

Under the comprehensive performance assessment (CPA), the Council has been assessed as weak in the way that it serves its local people however the CPA report published by the Audit Commission acknowledged the significant challenges the Council faces in responding to high levels of deprivation, crime and unemployment. It commented favourably on the Council's ambitions for improving the quality of life for its local communities and noted considerable improvements in social care for adults and children as well as an improvement in education performance. There were also weaknesses identified such as benefits administration and housing and environment services which need to be addressed. The Council is now working hard on how it takes the improvement process forward.

Accounts

We gave an unqualified opinion on the financial statements on 23 Dec 2002. The Council needs to continue to improve the timeliness of its accounts process before the introduction of Whole of Government Accounting in two years time. Arrangements for the completion of grant claims also need to be strengthened.

Financial standing

The Council continues to face financial pressures in delivering front line services, particularly Social Services. The Medium Term Financial Strategy 2002-2006 will be critical to the financial success of the Council.

Legality of financial transactions

From our review of the Council's overall arrangements for ensuring the legality of its transactions, we are generally satisfied that appropriate arrangements are in place.

We have responded to a number of queries from local government electors and audit work is still continuing in a few cases. There are currently no issues to draw to your attention.

Systems of internal financial control

The Council's systems of internal control are generally adequate. This year it has entered into a new contract for the provision of internal audit services. The introduction of these arrangements are welcomed and in the first year a locally tailored audit programme has been agreed which is comprehensive and risk focused. The successful delivery of this programme of work is critical to providing assurances on the adequacy of the Council's system of internal control and needs the full endorsement and commitment of management in co-operating and responding promptly to the demands of the audit process.

Standards of financial conduct and the prevention of fraud and corruption

The Council has met the requirements of the government's new 'ethical framework', establishing an independent Standards Committee, and adopting the Code of Conduct for members.

Arrangements for dealing with fraud and corruption are generally adequate. The Council has proper procedures and contract standing orders for the tendering and awarding of contracts. However, our work has identified instances where these are not being complied with. This puts the Council at risk of potential allegations of bias or corruption or poor value for money.

Performance Management

We have carried out reviews of specific areas of the Council's activities. We identified a range of good practices and made recommendations for improvement where appropriate.

The Council's Best Value Performance Plan complied with legislative requirements in all significant respects. We issued an unqualified opinion on the Plan on 19th December 2002.

The Council has strengthened its arrangements for central co-ordination of Best Value Performance indicators, but there is scope for further improvement in the preparation of indicators in some departments. Any slippage in performance could be damaging to the Council in terms of its future CPA assessment.

Members play a valuable role in the Council's performance management system. It will be important to maintain their level of involvement over the coming year and give impetus to the Council's performance agenda.

Inspection visits

The Inspection reports emphasised areas where the Council has good performance, for example, waste collection, housing repair times and high number of library visits. It also indicates where the Council has made improvements since earlier visits such as in the educational attainment of looked after children. However, the report goes on to identify significant areas of weakness with development required across most service areas.

Comprehensive performance assessment

Under the comprehensive performance assessment (CPA), the Council has been assessed as weak in the way that it serves its local people however the CPA report published by the Audit Commission acknowledged the significant challenges the Council faces in responding to high levels of deprivation, crime and unemployment. It commented favourably on the Council's ambitions for improving the quality of life for its local communities and noted considerable improvements in social care for adults and children as well as an improvement in education performance. There were also weaknesses identified such as benefits administration and housing and environment services which need to be addressed. The Council is now working hard on how it takes the improvement process forward.

Background and overall score

Comprehensive Performance Assessment is an integrated performance framework designed to help authorities deliver better services for their communities.

The results of this year's Comprehensive Performance Assessment were published on 12 December 2002. There are two key judgements that go to make up the Council's overall score – how it is run and an assessment of main service performance. The findings are shown in the table below.

SOUTHWARK'S CPA JUDGEMENT 2002 (1= LOWEST, 4 = HIGHEST)

Judgement	Score
How is Southwark run?	2
How do the main services perform?	2
Overall CPA Category	Weak

How the Council is run

The assessment of how the Council is run was undertaken in September 2002. The Corporate Assessment Team (CAT) concluded that the Council shares a vision of what it is trying to achieve with its partners, for example in social care and education. However, it needs to develop its performance management internally and learn from others if it is to deliver sustained improvement in services for local people. The assessment also highlighted the need to improve the capacity of the corporate centre to provide direction, co-ordination and consistent application of corporate standards across the Council as well as enhancing workforce planning to address capacity and skill gap issues.

Main service performance

Service scores were based on a range of data and other evidence, including performance indicators, Audit Commission inspections, and assessments by other government regulators such as OFSTED and the Social Services Inspectorate.

The results of the assessments are shown in the following table.

SOUTHWARK'S CPA SERVICE SCORES (1= LOWEST, 4 = HIGHEST)

Service	Score	Service	Score
Education	2	Housing	3
Social care - children	2	Libraries and leisure	3
Social care - adults	3	Benefits	2
Environment	2	Use of resources	3

Education and social care are given more importance in reaching the overall service score than other areas. The Council achieved an overall marking of 2.

Improvement planning

For 2003, the focus of CPA moves to improvement planning. The Council has produced a good response to the CPA process. This focuses on the priorities for improvement and action to address the issues raised. The inspection agencies have commented that it is a well focused and realistic starting point for the year ahead.

We and representatives of a number of other key agencies and inspectorates have already met with officers and the Leader of the Council to discuss how inspection and audit programmes can best be co-ordinated to support the Council in seeking continuous improvement. We will be taking these discussions forward in the coming months.

2

Accounts

We gave an unqualified opinion on the financial statements on 23 Dec 2002. The Council needs to continue to improve the timeliness of its accounts process before the introduction of Whole of Government Accounting in two years time. Arrangements for the completion of grant claims also need to be strengthened.

The draft accounts were completed by the end of July, a month earlier than in 2000/01 and we were able to begin our audit as planned. The majority of work was completed in July and August. However, problems were identified with capital accounting which delayed completion of the audit. The delay had an impact on the availability of both audit and finance staff resources to complete the work and clear matters arising.

We will continue working closely with the Council to improve working arrangements throughout the accounts audit.

A separate report on the Council's closedown and audit process will be issued shortly. Whilst acknowledging the improvements made this will focus on:

- the late closure of the capital accounts and its impact on the closure timetable

- timeliness of responses to queries and early warning notes
- quality of working papers
- progressing technical issues.

We have already agreed to work with the finance team in 2002/03 to facilitate the process for earlier accounts closure and improved communication during the course of the audit.

Opinion

The key areas of concern during the course of the accounts audit are shown in the following table.

OPINION ISSUES	
Area	Concern
Provisions for bad debts	Internal Audit have been commissioned to undertake a review of bad debt provision during the year. Their results will be used to inform the basis of the provision for 2002/03.
Fixed assets WIP	The Council has agreed to carry out a comprehensive review of the WIP balance included as part of fixed assets in the capital accounts. The purpose of the review is to ensure that capital expenditure is accurately recorded in the Council's accounts, relates to new capital projects or enhancements as disclosed in the accounts and is reconciled to the Council's asset register. Any necessary adjustments will be made in the 2002/03 accounts.
Deferred charges	Following discussion with finance officers and concerns over adherence to financial practice statements, the Council agreed to amend its amortisation period in line with audit recommendations and adjusting entries were made to the accounts. From 2002/03 new improvement grants will be written off in the year of payment.

Grant claims

During the year we review and certify a range of grant claims submitted to government departments. This year the Council has made notable progress in its submission of claims for certification before the due date. As a consequence we have been able to plan our own work better and in most cases claims submitted on time have also met the audit deadlines. Where this has not been possible the key reasons were:

- entries not reconciling to the general ledger, or the supporting systems
- lack of prime documentation to support the entries and poor working papers.

We have developed with the Council a grant claim working protocol, and a number of departments have set up grant claim co-ordinators. In particular this has worked effectively in Education and Social Services Departments. We will continue to work with the Council early in the year to improve the effectiveness of the protocol and quality of working papers submitted with claims to minimise time required for certification. This should result in reduced fees for the Council.

3

Financial aspects of corporate governance

Our audit of the financial aspects of corporate governance has covered the following areas:

- financial standing
- legality of financial transactions
- systems of internal financial control
- standards of financial conduct, and the prevention and detection of fraud and corruption.

Financial standing

The Council continues to face financial pressures in delivering front line services, particularly Social Services. The Medium Term Financial Strategy 2002-2006 will be critical to the financial success of the Council.

Review of 2001/02

The Council faced financial pressures across a range of services areas, including demand led overspends of £4m on Social Services which were acknowledged early in the year. Had action not been taken quickly by the new administration the overspend would have been greater.

In overall terms, the net General Fund expenditure for 2001/02 was above budget, resulting in a drawing on the General Fund reserve of nearly £4m and leaving a closing balance of £4m. This is below the Council's target of balance of £8m but it plans to restore this by the end of 2003/04.

2002/03 and longer term

For 2002/03 the Council budgeted for net revenue expenditure of £345m and set a Band D council tax level of £949.98 (including a precept of £173.88 for the GLA).

The latest financial projections for 2002/03 (Quarter 2 data) show that the Council's projections for service expenditure were largely in line with budget. Housing, education, environment and leisure were anticipating a total overspend of £1m.

The Council recognises the need for robust service and financial plans, and over recent months a number of measures have been taken to strengthen budgetary and financial control. These include:

- more robust arrangements for financial monitoring and control, including monthly meetings between heads of service and corporate finance
- re-alignment of service planning and budgeting.

Action to tackle the high level of debt that has plagued the Council for so long is also beginning to impact positively on collection performance in the case of rent, business rates and Council tax arrears. Internal Audit will be undertaking a review of debt management progress and we will continue to monitor the position as part of our ongoing audit.

Financial Management

We have previously agreed a programme of coverage of the Council's financial management arrangements to assist the development of capacity to manage its finances more effectively in the future. This year we have reviewed:

- corporate arrangements for monitoring devolved budgets
- financial management in the Housing Department
- management of the Social Services budget.

Our key findings are summarised in the following table.

FINANCIAL MANAGEMENT REVIEWS	
Review	Key findings
Corporate arrangements for monitoring devolved budgets:	The Council has improved its arrangements for monitoring devolved budgets including reducing the time taken to produce monthly reports. The Council now needs to focus more attention on the quality of commentary on variances highlighted between budgets and projects outturns.
Financial management in the Housing Department:	Our review of budget setting and monitoring in the Housing Department did not raise any significant audit issues. It was pleasing to note that there is consistency across the neighbourhoods in how budgets are set and monitored. This improves the usefulness of information provided to managers to aid decision making.
Management of the Social Service Budget:	We agreed to facilitate two workshops with service managers and budget holders. The first workshop held in November 2002 considered the strategic issues around financial management. We have started planning the content of a second workshop for a wider group of staff in February/March 2003. The aim of the work is to develop the financial management processes in the division and support the role of delegated budget holders in making stronger financial decisions

Pension Fund

The Council's Pension Fund is invested world wide with the majority (70%) in equities and the remainder in gilts and property. Over the ten years of this strategy up to March 2000 returns for the fund were within the top third of all local Council funds.

More recently, the sharp fall in the value of world stock markets, along with the relatively poor performance of the Council's external investment managers, has caused a significant deterioration in the overall value of the fund. This is set out in the table below.

PENSION FUND NET ASSETS		
Net assets	2000/01 £m	2001/02 £m
Start of year	547	502
Movement	45	10
End of year	502	492

In line with current stock market trends, the value of the fund has continued to fall in 2002/03 despite the improved performance of fund managers. The Council will need to maintain robust arrangements for the monitoring of fund performance and will receive an interim actuarial valuation in March which it should consider, taking action as necessary.

Legality of financial transactions

From our review of the Council's overall arrangements for ensuring the legality of its transactions, we are generally satisfied that appropriate arrangements are in place.

We have responded to a number of queries from local government electors and audit work is still continuing in a few cases. There are currently no issues to draw your attention.

At the request of the Borough Solicitor and Secretary we are currently reviewing the Council's complaints process. Should there be any matters arising from this review requiring members' attention, we will report back separately.

Systems of internal financial control

The Council's systems of internal control are generally adequate. This year it has entered into a new contract for the provision of internal audit services. The introduction of these new arrangements are welcomed and in the first year a locally tailored audit programme has been agreed which is comprehensive and risk focused. The successful delivery of this programme of work is critical to providing assurances on the adequacy of the Council's system of internal control and needs the full endorsement and commitment of management in co-operating and responding promptly to the demands of the audit process.

Internal Audit Arrangements

Last year the Council responded to our concerns regarding internal audit arrangements by awarding a new Council-wide Internal Audit contract with direct reporting lines to the

Council's newly appointed S151 officer. This should strengthen the Council's control environment.

Under our audit approach, we seek to rely as far as possible on the work performed by internal audit and the evidence provided by them to confirm that adequate internal controls are in place and operating as intended. Although we are satisfied that the Council has adequate overall arrangements we have been unable to place full reliance on work undertaken by internal audit. This has been due to concerns about the consistent application of those arrangements within individual departments.

We have liaised closely with the Internal Audit providers during the initiation of the contract. They have followed a rigorous risk based planning process and agreed a strategic and annual audit plan which address key risks and areas of concern within the Council. They also propose a rigorous review and assessment of the Council's core financial systems, from both a departmental and corporate focus. At the date of this Letter this work is still in progress.

We are satisfied that the Council's senior management are committed to supporting the new internal audit arrangements. However early experiences have identified some practical difficulties that, if not addressed could impede the effectiveness of the internal audit function. These include:

- ensuring ownership of corporate reviews
- timeliness in arranging meeting with officers
- providing accessibility to records and information to enable scheduled work to be completed on time
- responsibility and accountability for the implementation of Internal Audit recommendations.

Senior management are aware of these potential tensions and steps are being taken through the development of protocols and the introduction of forums for discussion.

Financial management of out-sourced LEA services

Major changes occurred during the year to the Council's arrangements for managing education finance following the externalisation of LEA services. In order to assist the Council and the new education provider manage these changes we carried out work at an early stage during the

year directed at promoting a shared understanding of requirements in respect of:

- grants and statutory returns (including BVPIs)
- financial management and performance
- reliance on internal audit coverage.

As an outcome of this work we adapted the Council wide grant claims protocol and agreed a comprehensive quality review process involving the Council and the new education provider. These were included in a detailed report that was agreed with officers.

In general responses to our recommendations have been positive and officers have been working on a collaborative basis to resolve issues as they have arisen during the year. However, the Council has had less success in managing the information requirements from schools and this caused difficulties during the year, particularly in relation to the preparing of performance indicators and some grant claims.

Arrangements should be established to ensure that schools provide the required information in a timely manner.

Risk management

The Society of Local Council Chief Executives (SOLACE) states that "risk management is about making the right decisions, and about achieving objectives once those decisions are made". Risk management should therefore be integral to a council's corporate management arrangements.

The Council has identified the lack of a formal risk management strategy as a weakness and taken steps during the year to address this. It is anticipated that a risk management strategy and monitoring arrangements will be in place by March 2003. A key proposal is to incorporate risk assessment in to the budget setting process.

We are currently working with officers to assist the Council understand how effectively it responds to business risks. Our work will probe into two specific service areas – education and community safety. We will report on this work in due course.

Standards of financial conduct and the prevention of fraud and corruption

The Council has met the requirements of the government's new 'ethical framework', establishing an independent Standards Committee, and adopting the Code of Conduct for members.

Arrangements for dealing with fraud and corruption are generally adequate. The Council has proper procedures and contract standing orders for the tendering and awarding of contracts. However, our work has identified instances where these are not being complied with. This puts the Council at risk of potential allegations of bias or corruption or poor value for money.

Standards of financial conduct

In line with the requirements of the new 'ethical framework', as set out in the Local Government Act 2000, the Council has established a Standards Committee. Following the issue of final guidance by the DTLR, the Code of Conduct for members was adopted by full Council in April 2002.

Training in the new arrangements has been provided for members as part of an extensive programme.

Prevention of fraud and corruption

The Council continues to have sound arrangements in place for the prevention and detection of fraud and corruption including:

- an anti-fraud and corruption policy
- a whistleblowing strategy which has been in place for over two years, and has been publicised to all staff
- trained staff employed through an external provider to investigate allegations of fraud and corruption
- NFI data matching undertaken by internal audit.

4

Performance management

We have carried out a number of reviews of specific areas of the Council's activities. We identified a range of good practice and made recommendations for improvement where appropriate.

The Best Value Performance Plan is a well designed document which complied with legislative requirements in all significant respects. We issued an unqualified opinion on the Plan on 19th December 2002.

The Council has strengthened its arrangements for central co-ordination of Best Value Performance indicators, but there is scope for further improvement in the preparation of indicators in some departments. Any slippage in performance could be damaging to the Council in terms of its future CPA assessment.

Members play a valuable role in the Council's performance management system. It will be important to maintain their level of involvement over the coming year and give impetus to the Council's performance agenda.

This year's performance management audit has covered:

- use of resources – audit studies
- Best Value Performance Plan and performance indicators
- work carried out by the Audit Commission and other inspection services.

Use of resources – audit studies

Our use of resources programme this year included:

- arrangements for asylum seekers (work has just been completed and the report is being discussed with the relevant officers)
- monitoring educational services
- environmental services contract strategy
- trade waste arrangements
- review of strategic regeneration.

The following table summarises the audit conclusions from our performance work.

PERFORMANCE WORK

Review	Key findings
Arrangements for asylum seekers	<p>The audit identified some strengths in relation to the management of asylum seekers, e.g. the provision of appropriate interpretation and translation services, the approach to relations with the media, engaging in relevant partnerships and a sound accounting and anti-fraud framework.</p> <p>Currently no overarching corporate strategy relating to the Council's approach to asylum seekers. Assessment of individuals is carried out at a micro level but no formal mechanisms for practitioners to collate or share their knowledge at the broader strategic level.</p> <p>The Council generates a wealth of information but does not use this in the best way to inform decision making.</p> <p>The asylum seeker team is held in high regard by other parts of the Council and has a high degree of specialist knowledge. This has been used effectively in training and awareness raising where it has been provided but training has been patchy and ad hoc.</p> <p>A number of significant weaknesses were identified in respect of control of payments, particularly with regards to authorisation by an appropriate officer.</p> <p>Accommodation providers for unaccompanied minors do not have contracts with the Council stipulating their requirements and responsibilities.</p> <p>Case reviews are currently carried out six monthly whereas ideally these should be done on a 2-3 month basis.</p>
Monitoring educational services	<p>To help ensure that the Council knows the contract is being delivered it should consider identifying exceptions within the basket of key performance indicators and focusing on them to take a strategic view of the contract.</p> <p>Agree a 3-5 year vision of what the LEA wants to achieve. Cover a broader range of issues than just those in the EDP.</p> <p>In the process of defining the role of the CEO, consult schools to improve the quality of information.</p> <p>Explore whether data collection can be included in the schools' audit framework to ensure that the contractor meets requirements in terms of its wider role within the Council, amplify requirements and develop a methodology for measuring this.</p>

Review	Key findings
Environmental services contract strategy	<p>Satisfied that existing proposals and procedures for the renewal of environment management service contracts are well in hand and progressed in line with the original aims and reference to national policies.</p> <p>Timescales are tight; work needs to be done to ensure procurement process moves smoothly, time and training are needed for staff in tender evaluation and creation of the client-side role.</p>
Trade waste arrangements	<p>A new management team, including a Client Enforcement Manager, has been established and issues are being tackled.</p> <p>Changes to administrative support enable front line staff to have greater direct contact with potential customers.</p> <p>Joint working between marketing and enforcement is needed to reduce time front line officers are spending on routine administration.</p> <p>A significant minority of traders are understating the true level of waste generated – a more systematic and co-ordinated approach is needed.</p> <p>Fundamental problems remain with the speed and regularity of payment of 40% of customers.</p>
Review of strategic regeneration	<p>Involving staff, stakeholders and local community in development of strategies and plans is good practice however level of involvement is currently unstructured and inconsistent across projects.</p> <p>There is a perceived lack of effective communications across department and council, projects isolated from the knowledge and expertise of other projects. There is also no consistent approach to business planning.</p> <p>There are ongoing problems with the initiatives at Elephant & Castle and Aylesbury Estate.</p> <p>Every regeneration project should relate to the aims, objectives and priorities of the council, there should be clear systems for monitoring project progress and outcomes against corporate targets.</p>

Best Value Performance Plan

Southwark's Best Value Performance Plan is a well designed document that clearly communicates the Council's main messages and achievements over the year, and contains a number of areas of good practice. The sections relating to community and partnership working and to the outcome of Best Value reviews were

particularly helpful. We issued an unqualified opinion on the Plan on 19th December 2002.

Performance indicators

Local authorities are required to publish annually their performance across a range of indicators in the Best Value Performance Plan. For the year 2001/02, the plan had to be produced by 30 June 2002.

The Council has made a step change since last year in the quality of information provided on its Best Value Performance Indicators (BVPIs). This year we expressed reservation on four of them.

Our overall conclusion is that the Council has made a good attempt to produce reliable and accurate performance indicators, which are supported by underlying systems. We were particularly impressed with the central co-ordination by the Corporate Strategy Division, which ensured a high level of awareness of audit requirements amongst departments.

In recent years, the Council has strengthened its reporting arrangements, and there is evidence that performance indicators are beginning to become 'part of the day job' and an effective tool for decision making.

Despite the above, there remain a number of areas where improvements need to be made in future years, particularly around the timeliness in the preparation of some indicators and the supporting working papers. We have agreed with the Council the key actions needed for 2002/03 and will review progress during the course of the year.

Work carried out by the Audit Commission and other inspection services

The Inspection reports emphasised areas where the Council has good performance, for example, waste collection, housing repair times and high number of library visits. It also indicates where the Council has made improvements since earlier visits such as in the educational attainment of looked after children. However, the report goes on to identify significant areas of weakness with development areas required across most service areas.

The following table summarises the results of the programme of inspections and re-inspections carried out during the year.

PROGRAMME OF INSPECTIONS

Inspection	Service	Inspection Scores
OFSTED	Education	Continued weaknesses with some improvement in service performance and educational attainment
SSI	Social Services	2 star with promising prospects for improvement
Repairs and maintenance	Housing	1 star with promising prospects for improvement
Development control and building control	Environment	1 star with uncertain prospects for improvement
Library service	Education and culture	2 star with promising prospects for improvement
Revenue and benefits	Benefits	0 star with promising prospects for improvement

In particular the 0* awarded to the benefits service will need significant management input to improve claim processing times and collection of monies.

Follow up

During the course of our regular audit work we follow up previous audit recommendations to ensure their successful implementation. The Council has sound arrangements to track the implementation of previous years' audit recommendations. Progress by officers in implementing agreed audit recommendations is regularly reviewed by the 'Heads of Service BV, Value for Money, Sub-Group' which we attend on a regular basis.

Future audit work

Our audit programme for 2002/03 will take account of the key operational and financial risks currently facing the Council. Our proposals have been discussed with officers and work will begin immediately.

Reports issued during the audit

Report	Issue date
Debt Management	April 2002
Grant Claims Outturn Report	April 2002
Grant Claims Protocol	April 2002
Discussion Draft on Financial Standing	April 2002
Final Accounts Memorandum	May 2002
Final Accounts Protocol	May 2002
Financial Management -Education Department	June 2002
Monitoring for Education Success	July 2002
Leaseholder Arrangements	August 2002
Comprehensive Performance Assessment – Code of Audit Practice Assessment May 2002	September 2002
Contract Standing Orders	September 2002
Asylum Seekers – Local Authority Arrangements	October 2002
Review of Strategic Regeneration	December 2002
Trade Refuse	December 2002

In conclusion...

I should like to take this opportunity to express my appreciation for the assistance received from officers during the course of our work. Our aim is to provide a high standard of audit service which makes a practical and positive contribution to the work of the Council. We recognise the value of your co-operation and support.



Derek Elliott
District Auditor
31 January 2003

Status of our Annual Letter to the Council

Our Annual Letter is prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission. Annual letters are prepared by appointed auditors and 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 director or officer in their individual capacity, or to any third party.

