

# Interim Annual Audit Letter

## Southwark London Borough Council

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<b>Date:</b>	September 2003



## Introduction

The purpose of this Letter

This is an Interim Annual Audit Letter which summarises for Members the more important matters arising from our audit work to date. The final Annual Letter for the year 2002/03 will be published in December and will take account of the comprehensive performance assessment (CPA) refresh work taking place over the autumn period. Consequently the purpose of this Interim Letter is to inform Members of the key messages arising from the audit work we have undertaken to date. It does not in any way precipitate the results/findings of work to be done in relation to the CPA process.

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

During the year we have produced separate reports on specific aspects of our work, which have been discussed in detail with officers. These reports are listed at the end of this Interim Annual Audit Letter for Members' information.

### Audit objectives

The audit this year has been developed to support the Council in securing the performance and service delivery improvements laid out in the CPA Improvement Plan. Our work has also included the Best Value Performance Indicator Audit and an assessment of the Council's performance across the Code of Audit Practice (the Code).

In addition we have 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 have met with chief officers and attended management meetings at key stages throughout the year to raise

awareness about audit requirements. We find this productive for sharing learning and development ideas and see such meetings as continuing to be an important part of our work to promote effective joint working arrangements.

### Context

This Interim Letter reflects positively on the overall direction of travel the Council is treading towards achieving improvement. We note a renewed vigour to seeking progress and recognise the commitment demonstrated by senior officers to delivering a change agenda.

Members should bear in mind that there will be a number of factors to take in to account when considering the CPA update in the autumn. In particular the results will be dependent on improvements in service quality, inspections undertaken in the year (which are not reported in this Interim Annual Audit Letter) and work carried out by external inspection agencies. The results of our work to date are not in any way an indicator of the potential outcome of the CPA update exercise.

The Letter also draws Members attention to areas where there is a need for urgent action – particularly in continuing to address issues of governance and to strengthen internal financial control.

Last year we noted that the Council had responded positively to the concerns we raised over its devolved management arrangements and the standards of internal audit. We are pleased to note the appointment of new Internal Auditors, PriceWaterhouseCoopers (PWC) and we have already begun to work constructively with them. We welcome the increased robustness they are providing in challenging areas of financial control.

The Council has also been making progress towards many of its key financial objectives such as the development of financial management arrangements and strategic financial planning, aligning the business planning and budget setting timetable and continuing programmes to reduce debt and restore financial balances.

## Audit findings

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### Accounts

The audit work was completed by mid-September and an unqualified opinion on the financial statements issued on the 25 September. This is over three months earlier than the previous year and a creditable achievement reflecting officers' commitment to make improvements. The step change has been achieved in both the timeliness and quality of the accounts submitted for audit.

We believe that the progress demonstrated this year can be attributed to a number of factors including:

- a detailed and jointly developed working protocol
- tighter co-ordination and 'unblocking' of problems/issues by the Central Team
- early joint meetings with the Central Team, individual department senior finance managers and our auditors
- weekly communication between the Central Team and our auditors during the accounts auditing period
- the 'Forward to sound financial management' programme.

We are pleased to have been given the opportunity to work more closely with officers and the department finance teams to help achieve this and will shortly be holding a series of follow-up meetings both with the departments and with the Central Team to ensure that learning can be taken on board to secure further improvements next year. The Council now needs to build on these improvements to ensure a smooth transition to the introduction of Whole of Government Accounting which will require it to produce draft accounts and the Audit Commission to review those accounts to an increasingly tighter timetable.

#### Opinion

A Final Accounts Memorandum Report will be issued shortly to officers which will detail all the

findings from our opinion audit work. However, the key area of concern during the course of our work related to schools' cash balances. Each of the Council's schools holds its own cash balance which is then incorporated in to the accounts to give an overall cash held figure. This cash figure should agree back to the schools' records. However, in most instances these reconciliations done by the schools were inadequate and not properly supported. A significant amount of work has been undertaken by the Chief Accountant and Education Senior Finance Manager to try and resolve the problems, resulting in a much clearer understanding of the true position. Members should ensure that the Council now takes steps to improve the quality of the information collated from schools as a matter of urgency. Until this situation is resolved the Council cannot be sure that there is not an underlying problem of mis-management or misconduct.

During the course of the audit we also experienced difficulties with the Pension Fund Statement. The Central Team had highlighted early that there were potential problems in this area however, it was disappointing that the quality of working papers and supporting information provided for audit was poor. Officers did respond immediately to our concerns and were able to provide more robust information within a short timescale.

#### SAS610

This year we have a new responsibility to report formally on the financial statements to those charged with governance. This SAS610 report does not have any material items to bring to Members attention. Our report will be formally presented at the next Council meeting.

#### Grant claims

Work on grant claims has also been able to begin earlier this year. We are noting improvements in the quality of working papers and will continue to work with officers to maximise the benefits of this so that detailed work can be undertaken in a more efficient manner and queries resolved more speedily. We will report formally on the grant claim work early in 2004 once the detailed testing is completed.

## 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

#### Review of 2002/03

This year whilst continuing to face financial pressures in delivering front line services, the Council has achieved a balanced budget outturn. This is particularly noteworthy because of the extreme pressures in Social Services experienced last year. It has also achieved a £2m increase in the General Fund balance as progress towards restoring an £8m balance by 2004. It is important that the Council maintains its ongoing budget strategy to ensure the £8m balance deemed appropriate to the Council is achieved.

The following table outlines the Council's current financial position.

	2002/03 £m	2001/02 £m	2000/01 £m
General Fund	6.8	4.1	8.0
HRA Reserve	25.1	9.2	20.1
Collection Fund	(3.1)	(6.9)	(8.6)

#### 2003/04 and longer term

For 2003/04 the Council has budgeted for net revenue expenditure of £379m and set a Band D council tax level of £1,034 (including the GLA precept).

Quarter one financial monitoring information for 2003/04 shows that the Council's projections for

service expenditure are largely in line with budget.

The Council is continuing to strengthen its budgetary and financial control. During our work we have noted improved monthly financial reporting for example, with explanations for significant variances. The 2004/05 budget setting process has also already begun. The use of 'challenge' panels using both officers and Members to 'test' the reality of departmental budgets is welcomed as another measure for increasing financial robustness.

#### Financial Management

This year we have reviewed financial management arrangements within the Social Services Department to assist the development of capacity to manage its finances more effectively in the future. Our findings are currently being reported separately but the key message is that to improve the efficiency of the delegated structure the Department needs to:

- improve the knowledge of and support to staff to whom functions are delegated
- improve communication with managers
- develop standards for decision making and support the monitoring of the decisions taken
- provide further financial training.

#### 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.

Last year we noted that the sharp fall in value of world stock markets, along with the relatively poor performance of the Council's external investment managers, had caused a significant deterioration in the overall value of the fund.

The fund has continued to fall over 2002/03 as shown in the following table.

**PENSION FUND NET ASSETS**

Net assets	2000/01 £m	2001/02 £m	2002/03 £m
Start of year	547	502	492
Movement	45	10	88
End of year	502	492	404

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 last actuarial valuation carried out in March 2001 revealed a deficit of £31.6m, a level of funding of 94%.

The Council will need to maintain robust arrangements for the monitoring of fund performance and will receive a full actuarial valuation in March 2004. This will provide key information which Members will need to consider in their future budget strategy as it is likely to lead to a necessary increase in contributions to the Pension Fund in the medium term.

**Legality of financial transactions**

Arrangements for ensuring the legality of the Council's financial transactions are adequate. The Council is statutorily obliged to provide a rigorous Monitoring Officer function and we have recently undertaken a brief review of this role. The role is documented in the Council's constitution and support to the Council's Monitoring Officer is provided by Legal Services.

The requirements of The Local Government Act 2000 place a number of duties upon the Monitoring Officer, with the aim of promoting high ethical standards within the Council. These include:

- providing advice to Members and chief officers on ethical issues
- disseminating good practice
- where appropriate, challenging the behaviour of Members and chief officers.

Recent changes to the structure of Legal Services have helped to improve the effectiveness in responding to department requests for advice which should assist in keeping the Council within the law. The challenge now is to develop a proactive approach to safeguarding the Council's interests by raising the profile of Legal Services and the

Monitoring Officer function with other Council departments and also with Members. This will help to ensure that potential legal and ethical issues are identified early and effective action taken in response.

We have received and responded to a number of queries from local government electors and in some cases, passed queries to the Council where we have deemed the issue to be outside our remit. There are currently no issues to draw to your attention.

**Public Interest Report**

Following a complaint from a local government elector, the Council asked us to carry out some detailed work on a specific planning issue. As a result of this work we will shortly be issuing a report in the public interest. A more detailed report on planning issues in general will also be provided in due course.

**Systems of internal financial control**

We see the appointment of the new Internal Auditors, PWC, as a positive step in seeking improvement to systems of internal financial control. Whilst the Council's systems of internal control are generally adequate Internal Audit have highlighted a number of areas where improvements need to be made.

We have developed a good working relationship with PWC and meet regularly to share our respective audit progress and issues arising. Due to the timing of the first year's internal audit programme our reliance on their work has been limited but we are confident that in 2003/04 we will be able to place more reliance on work undertaken over the previous year.

Internal Audit's programme is risk based and the approach taken thorough in terms of agreeing terms of reference and working with project sponsors for the Council. They have been able to complete the majority of their timetabled work for the year. Audit staff have sometimes been frustrated at the delays that occur in getting projects set up and in progressing detailed work. The Council must continue to address this issue if Internal Audit is to have maximum effect in improving internal financial standards.

Whilst management has given a commitment to respond promptly to the demands of the audit process, it is still developing a system for

ensuring the Council deals robustly with audit findings, recommendations and follow through. Both our own work and that of Internal Audit has produced a number of reports with detailed recommendations which the Council must address. The development of the Chief Officer Team Audit Sub Group is a positive step but it is in an early stage of development and its remit and effectiveness have not yet become apparent.

### **Risk management**

Late last year the Council commissioned us to undertake an overview of risk management. Since then it has been working towards the development of a formal risk management strategy, implementation plan and monitoring arrangements. Progress includes:

- all business units contributing towards developing a corporate risk register
- individual business unit risk registers being prepared
- the appointment of risk champions in each department.

The Council is currently considering the purchase of risk management software which it believes will help to keep risk management a live issue at a local level. It should also consider how the risk information collated can be taken account of as part of the budget setting process for the coming year.

It is important that the Council determines how risk management is to be embedded into its day to day operations and understands how the framework it has developed will be evaluated. Following their recent training session on risk management, Members should ensure that the momentum gained over the last nine months is not lost and that risk management becomes a key part of the decision making process.

### **Charter School**

Following Members expressing concerns to the Chief Finance Officer regarding the substantial increase in budgeted costs for major capital works carried out at The Charter School, the Audit Commission was requested to undertake an independent high level review of specific areas of the project. Atkins Faithful Gould also undertook their own investigation and have reported separately to Members. We concurred

with all their findings but in addition noted the following key messages:

- the preparation of initial estimates for the work were not realistic
- there was no clear framework for collating and reporting relevant, accurate and timely information to Members to keep them fully briefed of costs and progress
- the levels of responsibility and accountability were not clear for those involved in the management of the project
- there was an inadequate level of expertise for the project management of such a large and complex undertaking
- there were no formal arrangements in place to monitor the external consultants' performance.

Our full report has been presented to Members separately.

### **Management of Education services**

This year has been a difficult one for the Council with regards to the outsourced contract with Atkins resulting in the termination of the contact from 1 August 2003. Since then a new provider has been appointed on a one year interim basis.

From a financial management perspective, there have been a number of lessons to learn from the failure of the first contract and we will be undertaking a piece of work in the autumn to consider the robustness of the contract monitoring arrangements with the new provider, CEA.

### **Agency staffing**

We have also carried out a specific review on the Council's use of agency staff. The aim of this review was to investigate the Council's procedures and practices when using temporary staff. It focused on the two departments with the highest use of agency staff – Housing and Social Services. We have reported separately on our work but the main messages are:

- The Council has a preferred supplier agreement with Hayes SRA. However, there is little evidence that systematic pre-employment checks are carried out by staff to assure the Council that the monitoring required under the terms of the Service Level agreement with Hayes is being done. This finding was also noted under our work on



fidelity insurance as it puts the Council at risk of invalidating its insurance policy.

- There is confusion between the usage of general ledger codes for "Consultancy, Agency, and Interim Management". This means that management can not produce accurate financial monitoring data for the use of agency staff.
- Within Social Services the approved list has not been formally reviewed since 1995. It is accepted practice that managers can approach agencies other than the preferred supplier without documenting any justification for such a decision.

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

Although arrangements for dealing with fraud and corruption are generally satisfactory, the Council has a history of problems in this area. As noted in previous years our work considering compliance with standing orders and financial governance standards continues to demonstrate serious lapses in standards. Members should note that there is still much to be done in this area if the Council is to ensure a rigourousness of control which minimises the opportunities for mis-management and mis-conduct.

In particular, last year we raised concerns about the robustness of compliance with the Council's proper procedures and contract standing orders for the tendering and awarding of contracts. Although our work this year has identified areas of good practice, notably in Social Services, it is disappointing to note that progress has not been made more widely across other departments.

This year as well as considering general arrangements, our fraud work has looked in particular at:

- Public Interest Disclosure Act (PIDA)
- Fidelity insurance and agency staffing risks.

In addition we have worked with the Council to use a self-assessment checklist to test IT users' perceptions and knowledge of IT fraud and abuse. The checklist covers general good practice on IT security and specific hazards such as fraud, sabotage and theft. It also covers the potential risks posed to information and systems by viruses, misuse of IT facilities and links with the Internet.

Each of these pieces of work have been reported on separately but the main messages are shown in the table below.

Review	Key findings
PIDA	<p>There are no arrangements in place to notify new starters of the Council's whistleblowing policy.</p> <p>The named appointed officer indicated on the website has left the Council.</p> <p>There are no arrangements in place to report disclosures and the general status of disclosure under the act to Members.</p>
Fidelity Insurance	<p>There is a risk that the Council's fidelity insurance cover will be invalid and losses occur if it does not comply with the terms and conditions of the policy. In particular:</p> <p>There is insufficient detail of the fidelity guarantee cover in the description in the Business Managers' Handbook (BMH) for staff to understand the requirements of the policy.</p> <p>When agency staff are taken on by the Council reliance is placed on the Agency to check the references of contractors. However, there is no written confirmation that this has been done.</p> <p>The level of checks undertaken for new staff are the same regardless of the level of financial responsibility. The Council should consider carrying out staged checks including police checks, for those staff with significant financial responsibilities such as handling cash.</p>



IT self assessment	<p>Staff perception is that:</p> <ul style="list-style-type: none"> <li>the procedures for recovering from a virus infection have not been well documented</li> <li>network security and management arrangements need more clearly defining</li> <li>arrangements for backing up the Council's systems require improvement</li> <li>the IT implications of relevant legislation have not been properly assessed.</li> </ul>
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During the year officers identified contract corruption in part of the Council's DSO undertaking which has contributed significantly to the losses of the DSO operation in 2002/03. As part of the subsequent investigation officers have been reviewing governance arrangements to consider where proper and improved controls need to be introduced. Members should ensure that this investigation is completed promptly and action taken where appropriate to improve governance arrangements.

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## Performance management

### Best value performance plan 2003/04

The Council's Best Value Performance Plan complied with legislative requirements in all significant respects and we will be issuing an unqualified opinion on the Plan shortly.

Overall, the quality of the BVPP was a significant improvement on last year's Plan, reflecting recent improvements to the Council's corporate planning processes.

### Best value performance indicators (BVPIs)

The Council has continued to make progress in the quality of information provided on its Best Value Performance Indicators. The use of a detailed working protocol developed with the BVPI Team has provided an important framework for both parties and the co-ordination role played by the Central Team has allowed the audit to be completed earlier and in a more efficient way. The central co-ordination by the

Corporate Strategy Division worked well and helped ensure good quality working papers were produced for audit in a timely way.

As last year we expressed reservation on four of the indicators all of which were around education information which had not been properly collated by schools. The Council has an action plan to try and address this for the future.

## Future audit work

Our audit programme for 2003/04 is already underway. Besides the core audit work there is a strong emphasis on supporting the Council's improvement agenda working alongside chief officers as they continue to develop the required changes. We will continue to liaise regularly with the chief officers as well as meeting with the Chief Executive and Leader on a regular basis.

## Reports issued during the audit

Report	Issue date
Audit Plan	Jan 2003
Risk Management	Feb 2003
Final Accounts Protocol	April 2003
BVPI protocol	May 2003
Handling of Complaints	June 2003
Use of Agency Staffing	June 2003
Grant claim protocol	June 2003
Interim Audit Report	July 2003
Management of Contracts follow-up	July 2003

## In conclusion...

I should like to take the opportunity to express my thanks for the assistance given to the audit team during the course of our work.

**Derek Elliott**

**District Auditor, September 2003**

### Status of our Interim Annual Audit Letter to the Council

*Our Interim Annual Audit Letter is prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission. Annual audit 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.*