

AUDIT COMMITTEE

17 DECEMBER 2009

ANNUAL AUDIT LETTER 2008/2009

Report from: Mick Hayward, Chief Finance Officer

Author: Mick Hayward, Chief Finance Officer

Summary

This report and attachment presents the work carried out by PKF, our external auditors in respect of the 2008/2009 financial year. The report is presented to this committee to comply with governance requirements.

1. Budget and Policy Framework

- 1.1 In accordance with the terms of reference, receipt of the annual audit letter (the letter) is a matter for this committee.

2. Background

- 2.1 Independent external auditors are responsible for preparing an annual audit letter for all councils. This letter covers predominantly the financial year 2008/2009, but some references are made to progress in 2009 to give a more up to date picture given the time lag between end of the financial year and the publication of this letter.
- 2.2 The letter summarises the key issues arising from the work PKF have carried out during the year in respect of the Statement of Accounts and Use of Resources and the Value for Money conclusion and highlights some specific risk-based use of resources work.
- 2.3 The annual audit letter for 2008/2009, produced by PKF, is attached as Appendix 1 to this report.

3. Key Findings

- 3.1 PKF issued an unqualified opinion on the 2008/2009 Statement of Accounts on 30 September 2009. The accounts, which were considered by this committee on 24 September, had been adjusted to reflect an £82 million reduction in asset values following a revaluation completed after the draft accounts had been approved. This amendment to the accounts had no effect on the Council's overall financial position.

- 3.2 PKF have issued an unqualified value for money conclusion and confirmed that Medway 'performs well' in the use of resources. The Council has maintained its overall score of 3 out of 4 for the key themes of Managing Finances, Governing the Business and Managing Resources. This is against a background of significant change and a 'hardening' of the tests for the assessments compared to 2007/2008 and previous years.
- 3.3 The letter indicates that performance management within the Strategic Housing Service is improving following the introduction of the Covalent performance management system. Two out of seven Local Area Agreement (LAA) targets in respect of health equalities (adult participation in sport and child obesity) were not met in 2008/2009 and progress towards achieving these targets is being reviewed by PKF.
- 3.4 There were some instances where additional work was required by PKF in respect of government grant claims and returns. The Annual Audit Plan 2009/2010 report, considered, elsewhere on this agenda indicates additional financial resources required for the future audit of grant claims and returns.
- 3.5 The key findings from PKF's work are explained in more detail in the attached appendix.

4. Financial and Legal Implications

- 4.1 The financial implications are contained in the body of the report. By virtue of the Accounts and Audit Regulations 2003 a committee of the Council is required to consider the annual audit letter as soon as reasonably possible after receipt and thereafter the letter must be published. Consideration of the letter falls within this committee's terms of reference.

5. Risk Management

- 5.1 As the majority of the letter relates to activities of the Council during 2008/2009 no risks are identified. However, the Council must continually strive to demonstrate value for money in order to maintain the use of resources score, ensure improvements to the strategic housing service are maintained and the health LAA targets achieved.

6. Recommendation

- 6 That the Audit Committee accepts the annual audit letter for 2008/2009.

Background papers

The annual audit letter 2008/2009 (attached as Appendix 1)

Lead Officer Contact:

Mick Hayward: Chief Finance Officer



Accountants &
business advisers

Medway Council

Annual Audit Letter 2008/09

Report to Members

November 2009

Contents

1	Executive summary	1
2	Introduction.....	3
3	Key findings.....	4

Appendices

Appendix 1: Reports issued in relation to the 2008/09 audit

Appendix 2: Achievement of LAA targets for reducing health inequalities

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

The Statement of Responsibilities of Auditors

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

1 Executive summary

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

Key findings

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

Area	Conclusion
Accounts	We issued an unqualified opinion on the financial statements.
Value for money conclusion	We issued an unqualified value for money conclusion.
Use of resources assessment	Our overall assessment is the Council 'performs well' in its use of resources (a score of '3 out of 4'). Our scored judgements were: <ul style="list-style-type: none"> '3 out of 4' for managing finances: performing well '2 out of 4' for governing the business: performing adequately '3 out of 4' for managing resources: performing well
Strategic Housing Service	The Council responded to an adverse inspection published by the Audit Commission by restructuring the Housing Service and preparing a comprehensive improvement plan. Improvement in the performance of the Strategic Housing Service is evident. Investment in Medway's housing stock means the Council expects to achieve the decent home standard by the Government's target date of 2010. The Council surpassed its target for delivering affordable housing units in 2008/09 and is working with developers to find ways of progressing housing development to achieve the 2009/10 target.
Health inequalities	The Council is working to reduce health inequalities through the Medway Local Strategic Partnership. In 2009, data is available to measure progress towards eight of nine targets set. Five targets were met and three targets were not met in the year. The targets not met in the year where the Council is responsible for delivery are 'adult participation in sport'; 'obesity among primary school age children in Year 6' and 'Social Care Clients Receiving Self Directed Support (Direct Payments and Individualised Budgets)'.
Emerging issues	Financial outlook As at the end of September 2009, the Council is reporting the 2009/10 net budget is likely to be achieved. Corporate action has taken to address additional expenditure incurred by service departments. The medium term financial strategy for the period 2010 to 2013 specifies the resources required to deliver Medway's priorities while ensuring the overall financial position remains soundly based. The financial outlook remains challenging and work is underway to ensure the 2010/11 budget is fully balanced. Treasury Management The Council has reviewed its lending criteria and strengthened its monitoring arrangements in the light of the collapse of the Icelandic banks.

Improvement opportunities

- 1.3 In order to improve performance further, the Council should focus on:
- delivering Medway's ambitious regeneration agenda while finding innovative ways of working with strategic partners in the challenging economic climate. In particular, achievement of the Council's target for affordable housing units will require careful management
 - implementing the new Performance Management System ('Covalent') to enable the more systematic use of data and information, thereby supporting the service planning and performance monitoring approach
 - delivering annual expenditure plans while balancing the overall financial position
 - ensuring the medium term financial strategy remains sustainable while planning for reduced growth in the annual budget
 - sustaining performance in those services where improvement is being reported (such as the Strategic Housing Service)
 - achieving the targets set in the local area agreement where the Council has a lead role in delivering outcomes and taking action where performance is behind target
 - keeping the 'Gateway' procurement process under review, thereby securing further improvement in arrangements for commissioning and procuring goods and services
 - implementing the value for money strategy, embedding the supporting delivery framework and securing efficiencies identified through the 'star chamber' process.

Acknowledgement

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

2 Introduction

About the Council

- 2.1 Medway is situated in the south east of England, about 35 miles from the centre of London. It comprises the five towns of Rochester, Strood, Chatham, Gillingham and Rainham. Designated by the Government as a Thames Gateway growth area, the Council and its partners are involved in a major investment programme to regenerate brownfield sites, improve infrastructure and provide wider access to jobs, education and training for local people. About £120 million of specific Government funding is expected to secure investment of about £5 billion in the area over the next 20 years. The Council and its partners are overseeing delivery of major regeneration projects and investment measures through the Medway Renaissance Partnership.
- 2.2 Just over 250,000 people live in the Medway area though the population is projected to grow to about 300,000 by the year 2028. The local strategic partnership has set an ambitious vision for the area to be a 'city of learning, culture, tourism and enterprise'. In turn, the Council is working to ensure all people benefit from the significant investment being made in the area.
- 2.3 The Council spends about £600 million annually on services such as education; children's and adult social care; community services; refuse collection and disposal; street cleaning; planning and economic development; environmental health and benefit payments. About £9 million of the total budget is spent on managing and maintaining the Council's stock of 3,000 dwellings. Some £60 million was spent on capital projects in 2008/09 with further investment of £155 million planned in 2009/10 and beyond.

The purpose of this Letter

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

Responsibilities of the auditors and the Council

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

The scope of our work

- 2.7 Our main responsibility as the appointed auditor is to plan and carry out an audit that meets the requirements of the Audit Commission's Code of Audit Practice (the Code). Under the Code, we are required to review and report on:
- the Council's financial statements
 - whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

3 Key findings

Accounts

- 3.1 We issued an unqualified opinion on the Council's financial statements on 30 September 2009. Our opinion confirms that the financial statements present fairly the financial position of the Council as at 31 March 2009 and its income and expenditure for the year then ended. Our audit of the 2008/09 financial statements resulted in a material amendment to the accounts which had no effect on the Council's overall financial position, as shown below.

Land and property – downward valuation

- 3.2 The unprecedented economic downturn in 2008/09 meant all local authorities reviewed the value of their assets to establish any impact on the carrying value ('price') as at 31 March 2009. Medway completed this work only after the draft accounts were produced and adjusted the value of land and property downwards by £82 million. Adjustments were made to the value of investment properties; other land and buildings and council dwellings.

Use of resources and the value for money conclusion

- 3.3 The Code requires us to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources. This is known as the value for money conclusion and draws on the results of specific risk based audit work as well as the results of our use of resources assessment.
- 3.4 Taking into account our work on use of resources, we have concluded that adequate arrangements are in place to secure value for money and have provided an unqualified value for money conclusion for the year ended 31 March 2009.

Use of resources assessment

- 3.5 We are required to assess how well local authorities manage and use their financial resources by providing scored judgements on the Council's arrangements in three specific areas. Our assessment forms part of the Audit Commission's new Comprehensive Area Assessment (CAA) for 2008/09 and is not comparable with 2007/08 or earlier years' scores.
- 3.6 Our overall assessment is Medway 'performs well' in the use of resources. The highest available score is 4 ('excellent performance') and the lowest available score is 1 ('inadequate performance'). Our scores for each key line of enquiry are shown in table 1 overleaf and our main conclusions are shown the paragraphs which follow.

Table 1: Use of resources assessment scores

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

Managing finances

- 3.7 The Council 'performs well' in managing its finances. It has established effective arrangements for setting a balanced budget and delivering its expenditure plans. A surplus of £3.5 million was achieved as at 31 March 2009. The 'star chamber' process, which involves service managers and portfolio holders in detailed service and financial planning each year, enabled the Council to publish a comprehensive and balanced budget for the year and establish a sustainable medium term financial platform.
- 3.8 Integrated financial planning is a strength. The Council manages its financial partnerships with other local authorities; local NHS organisations; the voluntary sector and private sector partners well and there is effective leadership on financial matters. The Council understands the financial risks it is facing in the short and medium term and manages these effectively. A detailed programme of efficiency reviews is prepared through the 'star chamber' process and savings targets set for the year. The Council's reported its target for savings for the 2008/09 year was surpassed, with savings of £6.7 million being achieved.
- 3.9 Recognising the approach to understanding costs could be more systematic, the Council has invested in additional functionality for the new Performance Management System known as 'Covalent'. The additional investment has improved the accuracy and timeliness of data available to inform the service planning and performance monitoring processes.

Governing the business

- 3.10 The Council performs adequately in governing the business. The 'star chamber' process provides a framework for securing value for money which supports service planning and the review of unit costs and performance. This has enabled the successful delivery of major projects such as 'Customer First'; the relocation of services to a new municipal building; the reconfiguration of the special needs services and services provided to people making the transition from children's to adult social care. All of these projects followed the 'Gateway'

procurement process and have secured better value for money for the Council. The Council is keeping the effectiveness of the Gateway process under review.

- 3.11 The Local Area Agreement (LAA) sets a clear strategic direction for the Medway area and the Council works successfully through the local strategic partnership (LSP) towards common objectives, it has responsibility for delivering 29 targets and tracks progress through its performance management arrangements, with outcomes reported in the Council's annual report. Increasingly, the Council is encouraging its key strategic partnerships to implement performance management systems based on its approach.
- 3.12 Medway published a revised Council Plan for the period 2009 to 2013 in the year. The plan supports delivery of Medway's community plan and the LAA. It is based on a comprehensive analysis of needs informed by the Joint Strategic Needs Assessment. A 'story of place' was published after extensive consultation with local people and strategic partners. The Council therefore has assurance its priorities are the right ones for the area.
- 3.13 The Council involves service users in preparing and publishing key strategies and in developing services. For instance, service users are represented on the physical and learning disability partnership board and contribute to the service development process. Some children's services are being designed with input from looked after children, ensuring services meet the needs and expectations of a vulnerable group of young people. The Carer's strategy was prepared in partnership with the local primary care trust and involved service users and their families throughout the development process. Voluntary sector organisations are provided with advice and support to assist them in tendering for Council contracts.
- 3.14 The Council works successfully in partnership with the local primary care trust to deliver services and projects through pooled budget arrangements. Governance arrangements are effective and have assisted in restoring financial balance to the learning disabilities pooled budget. An innovative pooled budget was established in the year to support achievement of Medway's LAA objectives through a programme of projects overseen by the LSP.
- 3.15 The Council provides clear leadership in establishing a common sense of purpose for Medway's LSP. The Council led the restructuring of the LSP in the year, ensuring a smooth transition to new thematic partnership boards. In particular, the Council ensured all partners understood the different cultures and strengths each brought to the LSP and the need for effective delivery of objectives through more focussed performance management arrangements.

Managing resources

- 3.16 The Council 'performs well' in the management of its resources. It has a strategic approach to managing natural resources and reducing its environmental footprint. Good progress is being made towards targets. For instance, in 2006, the Council planned to reduce its carbon footprint by 10 per cent by 2011, and it is on track to achieve this. In addition, the Council advocated the inclusion of an LAA target to reduce CO₂ emissions by 13.9 per cent (before 2011) and has restated this target in the new Council Plan. An environment group, involving officers from all Council departments, monitors achievement of the Council's carbon management plan.
- 3.17 The Council undertakes energy audits to assess the impact of changes to its asset base and to inform decision-making. It uses 'invest to save' budgets to deliver projects designed to secure energy efficiencies. The procurement of new municipal buildings and associated energy contracts has assisted in reducing gas and electricity consumption. Progress is being made towards the Government's national indicator 185 (Percentage CO₂ reduction from local authority operations) with a six per cent reduction achieved in the year compared to the Council's baseline.
- 3.18 The Council has an effective, strategic approach to asset management which the whole organisation works towards through the property strategy and the Asset Management Plan.

The use of assets is reviewed annually through service and financial planning arrangements and the 'star chamber' process. The consolidation of staff and infrastructure from five sites across Medway into new municipal buildings on a single site involved a comprehensive review of asset usage and consultation with staff. Within services, the sharing and rationalisation of assets is undertaken after a thorough review of options. For instance, the Council decided to revise secondary education to improve pupil achievement by closing five schools and replacing these with three new Academies.

Specific risk-based use of resources work

Strategic Housing Service

- 3.19 We reviewed the Council's response to an inspection by the Audit Commission, published in July 2008, which concluded the Strategic Housing Service was 'poor' and had 'uncertain' prospects for improvement. The Council responded by restructuring the Housing Service and preparing a comprehensive improvement plan with Members of the Business Support scrutiny committee overseeing implementation. Improvement in the service is evident. The Council exceeded its target for new affordable homes in the year, providing 427 homes against a target of 177 homes. It also reduced the number of families in temporary accommodation from 307 families at the beginning of the year to 151 families as at 31 March 2009. The Council also expects all its housing stock to achieve the decent home standard by the Government's target date of 2010. The Council is also working with developers to find ways of progressing housing development and expects to achieve the target for affordable housing in 2009/10.
- 3.20 To improve the performance management culture in the Housing Service, the Council decided to pilot the new performance management system ('Covalent') within the service. There have been good outcomes, with a more transparent reporting of performance in Medway's annual report and action taken to improve performance being highlighted in the Council Plan.

Health Inequalities

- 3.21 We considered the Council's progress towards targets for narrowing health inequalities in the area as part of our use of resources assessment. The Council works through the Medway LSP and has responsibility for four targets with the local NHS primary care trust being responsible for a further five targets set.
- 3.22 In 2009, data is available to measure progress towards eight targets published in Medway's Local Area Agreement (LAA). Five targets were met and three targets were not met in the year. The targets not met in the year where the Council is responsible for delivery are 'adult participation in sport'; 'obesity among primary school age children in Year 6', and 'Social Care Clients Receiving Self Directed Support (Direct Payments and Individualised Budgets)' as shown at Appendix 2. The progress towards LAA targets is being kept under review and the Council is considering the further action needed to ensure delivery of all targets it is working towards.
- 3.23 We also reviewed the Council's progress in embedding new management structures in the year; improvement in financial management arrangements and procedures for investigating complaints about Member conduct in the light of the Government's new guidelines in completing our use of resources assessment.

Improvement opportunities

- 3.24 In order to improve further its use of resources, the Council should focus on:
- delivering Medway's ambitious regeneration agenda while finding innovative ways of working with strategic partners in the challenging economic climate. In particular, achievement of the Council's target for affordable housing units will require careful management
 - implementing the new Performance Management System ('Covalent') to enable the more systematic use of data and information; and thereby support the service planning and performance monitoring approach
 - delivering annual expenditure plans while balancing the overall financial position
 - ensuring the medium term financial strategy remains sustainable while planning for reduced growth in the annual budget
 - sustaining performance in those services where improvement is being reported (such as the Strategic Housing Service)
 - achieving the targets set in the local area agreement where the Council has a lead role in delivering outcomes and taking action where performance is behind target
 - keeping the 'Gateway' procurement process under review, thereby securing further improvement in arrangements for commissioning and procuring goods and services
 - implementing the value for money strategy, embedding the supporting delivery framework and securing efficiencies identified through the 'star chamber' process.
- 3.25 The results of our use of resources assessment have been shared with the Audit Commission as part of the integrated approach to developing CAA. The results of CAA will be reported separately by the Audit Commission.

Grant claims and other Government Returns

- 3.26 The Council receives significant amounts each year from the Government through direct grant payments. In 2008/09 the dedicated schools grant amounted to £163 million and direct grant for expenditure incurred on housing and council tax benefit was £87 million. Grants from the Learning Skills Council amounted to £21 million. The Council is also required to submit an annual return stating the amount of non-domestic rate collected on behalf of the Government (£69 million in 2008/09).
- 3.27 External auditors must certify such claims and returns have been prepared in accordance with the terms and conditions set by individual Government departments. In 2008/09, the Council's arrangements for preparing grant claims and other returns to the Government were variable. Some minor amendments were required to individual claims and we confirmed expenditure was incurred for the purpose intended by the Government's grant paying departments. However, other claims such as the pooled capital receipts return; the housing subsidy base data return and the disabled facilities grant claim required additional work to resolve queries raised by auditors. We will be preparing a separate summary report on all of our grant claim work, which will be issued early in 2010.

Emerging issues

Financial outlook

- 3.28 As at the end of September 2009, the Council expects the overall 2009/10 budget to be achieved. Within departments, an overspend of £2.1 million is being reported against the budget of £51 million for Regeneration, Community and Culture services, mainly because of reduced income streams. Management is confident the corporate action it has taken will turn the situation around by 31 March 2010.
- 3.29 The worldwide recession and the impact on future funding streams from the Government and the expected increase in demand for Council services have been considered in publishing the Council medium term financial strategy for the period 2010 to 2013. Through comprehensive analysis and scenario planning, the Council has identified the resources it will need to deliver its priorities. The new value for money strategy and the implementation of the 'Covalent' performance management system will need to underpin the corporate approach to securing efficiencies and redesigning of services.

Treasury management

- 3.30 Following the collapse of the Icelandic banks in October 2008 the Audit Commission conducted a study to examine treasury management arrangements in local authorities. The resulting report *Risk and Return* was published in March 2009 and in this report the Audit Commission committed to asking auditors to follow up the lessons from the report as part of their use of resources work.
- 3.31 We concluded from this work that Medway's treasury management arrangements are satisfactory and the Council has taken action to strengthen its arrangements in light of the collapse of the Icelandic banks. Specifically, the Audit Committee has received reports on the enhanced procedures and criteria the Council put in place for assessing the risks involved in lending money to institutions. The Council also undertook close, daily, monitoring of the risks involved in the investments made.

Appendix 1: Reports issued in relation to the 2008/09 audit

Report	Date Issued
Annual audit plan	April 2008
Use of resources assessment	September 2009
Annual governance report	September 2009

Appendix 2: Achievement of LAA targets for reducing health inequalities

LAA Theme – Health and Adult Social Care	Baseline	Target 2008/09	Actual 2008/09
Targets the Council responsible for delivering (National Indicator reference)			
Adult participation in sport (NI 8)	18.4%	19.4%	14.07% Target Not Met
Obesity among primary school age children in Year 6 (NI 56)	19.13%	18.19%	20.4% Target Not Met
Social Care Clients Receiving Self Directed Support (Direct Payments and Individualised Budgets) (BV201)	-	162 clients	151 clients achieved Target not met New target (NI130) 7% for 2009/10 compared to baseline 3.2%. Target 30% for 2010/11
% of vulnerable people achieving independent living (NI 141)	62%	63%	Target Achieved (85.2%)
Targets the Council is working with partners to deliver			
Alcohol harm related hospital admission per 100,000 population (NI 39)	1,346	1,529	Target Achieved (1,435)
Number of drug users in effective treatment (NI 40)	600	630	Target Achieved (693)
Mortality rate from all circulatory diseases at ages under 75 (NI 121)	-	79.2	Target Achieved (78.7)
16+ current smoking rate prevalence (NI 123)	566	569	Target Achieved (839 stopping smoking)
People with a long-term condition supported to be independent and in control of their condition (NI 124)	57%	59%	Data not available – survey due 2010