

# MEDWAY COUNCIL

Annual Audit Letter 2013/14

October 2014



# EXECUTIVE SUMMARY

## Background

This Annual Audit Letter summarises the key issues arising from the work that we have carried out during the year. It is addressed to the Council but is also intended to communicate the significant issues we have identified to key external stakeholders and members of the public.

## Responsibilities of auditors and the Council

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.

Our responsibility 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 Statement of Accounts
- whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We are also required to review and report on the Council's Annual Governance Statement, Whole of Government Accounts (WGA) submission, whether we have exercised our statutory powers under the Audit Commission Act 1998 in any matter, and our grant claims and returns certification work.

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 audit.

**BDO LLP**  
**31 October 2014**

## STATEMENT OF ACCOUNTS

The Chief Finance Officer certified the draft financial statements and submitted these to audit on 4 July 2014. The Government's deadline of 30 June 2014 was not met. We issued an unqualified true and fair opinion on the financial statements for the period ended 31 March 2014 on 30 September 2014. The deadline for publishing the audited financial statements was met. One material misstatement was identified by our audit and corrected by management. The error involved gross income and gross expenditure contained in the non-distributed costs (NDC) line of the Comprehensive Income and Expenditure Statement (CIES), which was overstated by £30.8 million. This issue also impacted on the prior year comparative figures and as a result management reduced gross income and expenditure by £24.3 million as at 31 March 2013. The corrections had no effect on the Net Cost of Services.

# 1

There were four unadjusted audit differences identified by our audit work which would have increased the draft deficit on the provision of services in the CIES by £2 million to £40.8 million before statutory adjustments (from £38.8 million). One of the unadjusted differences was an audit estimate (of £1.2 million). We noted a small number of areas where internal controls should be improved or where the control environment could be strengthened.

## USE OF RESOURCES

We were satisfied that, in all significant respects, the Council had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2014. The Council continues to manage its finances effectively. A small surplus was reported for the year ended 31 March 2014. However, a significant budget gap (£20 million) has been identified over the financial periods to 31 March 2017 and will continue to require careful attention. The Council is reporting progress in improving services in its priority areas, notably in Children's Social Care services. The Council should continue to ensure the investment necessary to sustain such improvement is maintained.

# 2

## OTHER MATTERS

We were satisfied that the Annual Governance Statement was not inconsistent or misleading with other information we were aware of from our audit of the financial statements and it complied with relevant guidance. Our audit of the Council's Whole of Government Accounts (WGA) return is due to be completed in October 2014. The deadline for submission of the audited return (3 October) was not met.

# 3

## GRANT CLAIMS AND RETURNS CERTIFICATION

Our audit of claims and returns in 2012/13 resulted in the benefits subsidy claim being qualified (from a total of four claims and returns audited). Our work on the benefits subsidy claim for 2013/14 is in progress.

# 4

# STATEMENT OF ACCOUNTS

## 1 OPINION

We issued an unqualified true and fair opinion on the financial statements on 30 September 2014.

### Financial performance as at 31 March 2014

The Council reported a General Fund surplus of £267,000 as at 31 March 2014. After adjusting for statutory items, the General Fund Balance was maintained at the level recommended by the Chief Finance Officer (£5 million) and total Earmarked General Fund Reserves (those held for specific purposes) increased from £20.9 million to £29.9 million. Other Earmarked Reserves reduced from £38.5 million to £30.7 million in accordance with the Council's plans.

In September 2013, the Council decided to transfer £2 million from the Housing Revenue Account (HRA) balance to General Fund Reserves. The Council's legal advice confirmed the transfer was allowed under existing regulations. As at 31 March 2014, the HRA reported a surplus for the year of £1.3 million against a budgeted surplus of £1 million.

### Financial statements

#### Preparation and publication of accounts

The Council did not meet the Government's deadline for the Chief Finance Officer to certify the financial statements by 30 June. The draft financial statements were provided to us on 4 July and further revisions were made before officers presented these to the Audit Committee for review on 17 July 2014. Working papers were generally made available to us at the start of the audit as requested, although there were some exceptions which we followed up over the course of the audit.

We issued an unqualified opinion on the financial statements and the audited financial statements were published on the Council's website (including our unqualified opinion) on 30 September 2014.

#### Material misstatements

One material misstatement was identified as a result of our audit testing. We found that gross income and gross expenditure contained in the non-distributed costs (NDC) line of the Comprehensive Income and Expenditure Statement (CIES) was overstated by £30.8 million. The misstatement arose because internal recharges had not been removed from the NDC service line after being allocated to other service lines as required by the CIPFA Service Reporting Code of Practice 2013/14 ('SeRCOP'). Management corrected this error by reducing both gross income and expenditure within the NDC line of the CIES by £30.8 million. This issue also impacted on the prior year comparative figures and as a result

management reduced gross income and expenditure within the 2012/13 NDC line on the face of the CIES by £24.3 million. These adjustments did not affect the net cost of services nor did they impact the surplus or deficit on the provision of services.

#### Unadjusted misstatements

There were four unadjusted differences identified by our audit work which would have increased the draft deficit on the provision of services in the CIES by £2 to £40.8 million (from £38.8 million, after taking account of adjusted audit differences). A summary is shown below.

#### Audit estimated differences

Our work found creditors had been recognised in respect of goods and services received after the end of the financial period (that is during 2014/15) and where payment had been made after 31 March 2014. These were not valid creditors at the year-end. However, the Council had also recognised prepayments against these amounts, meaning that both creditors and debtors were overstated by approximately £104,000. When extrapolated across the whole creditor population, we estimated both creditors and debtors were overstated by £1 million.

We also found two instances amounting to £181,000 where accruals had been underestimated. When extrapolated across the whole population, the estimated understatement of expenditure and creditor accruals was £1.2 million.

#### Factual differences

The following factual differences were found which management decided not to correct because these are not material:

- Capital grant income relating to schools devolved formula grant amounting to £509,000 had been included in the financial statements twice, thereby overstating income and capital grants received in advance (balance sheet)
- Internal transactions with Medway schools amounting to £400,000 had been included as income and debtor amounts in the financial statements. Internal transactions should be excluded from the financial statements and income and debtors were overstated.

# STATEMENT OF ACCOUNTS (continued)

1

OPINION

We issued an unqualified true and fair opinion on the financial statements on 30 September 2014.

## Internal controls

We did not find any significant deficiencies in internal controls but noted a number of areas where internal controls should be improved or where the control environment could be strengthened:

- Completeness of related party transaction disclosures
- Council tax and Non-Domestic Rates - 10% checking of exemptions, reliefs and discounts
- Completeness of payroll records
- Retention of HMRC returns
- Updating the payroll authorisation signatory list
- Timeliness of key control reconciliations (specifically housing benefit payment run, IWorld to Integra and treasury reconciliations).

Management has agreed to review and, where possible, strengthen these internal controls.

# USE OF RESOURCES

## 2

### CONCLUSION

We issued an unqualified value for money conclusion on 30 September 2014.

Our principal work in arriving at our value for money conclusion was comparing the Council's performance against the requirements specified by the Audit Commission in its guidance:

- the organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future
- the organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

Our work involved undertaking a risk assessment and ensuring our work was appropriately focussed on identified risks. We identified two significant risks involving the sustainability of the Council's medium term financial plan (MTFP) and the achievement of the improvement plan agreed following the inspection of certain children's services by OFSTED. We reviewed the MTFP to assess the reasonableness of assumptions and how well the Council is addressing financial pressures through the development and implementation of efficiencies arising from the its efficiency programme. We also reviewed the Council's arrangements to achieve the actions set out in the children's services improvement plan agreed with OFSTED and whether the Council had adequately assessed and planned for the financial consequences arising from the improvement plan. Other areas of focus for our work included the development of the work of the Health and Wellbeing Board and the establishment of a new Joint Venture company. We also reviewed the progress made towards Medway's priorities as published in the Council Plan.

## Financial resilience

The Council continues to provide clear leadership on financial governance matters through the work of the Cabinet and the Senior Management Team. Financial responsibilities are clearly assigned and the Senior Management Team oversees the corporate response to expenditure pressures, other financial risks emerging in the year and the overall achievement of the annual budget. The Cabinet and Overview and Scrutiny Committees continue to challenge financial performance and the delivery of the Council's capital programme, effectively.

In 2013/14, the overall financial position was monitored closely throughout the year and the Council reported a General Fund surplus of £267,000 as at 31 March 2014. The General Fund Balance was maintained at the level recommended by the Chief Finance Officer (£5 million) and total Earmarked General Fund Reserves (those held for specific purposes) increased from £20.9 million to £29.9 million. Other Earmarked Reserves reduced from £37.7 million to £30.7 million in line with the Council's plans.

At the detailed level, the Council established a new Earmarked Reserve in the year (the Collection Fund Holding Account) and this amounts to £1.7 million. The reserve manages the variance between the statutory and actual call on the collection fund. Other Earmarked General Fund reserves increased as at 31 March 2014 in accordance with the Council's medium term financial plan and to meet Medway's priorities for investment. The Council therefore earmarked an additional revenue contribution (£2 million) to invest in capital schemes for the Children and Adult Services department and a further £1.9 million

has been earmarked to drive the improvement required in Children's Social Care services following the adverse Ofsted reports received in 2013. In addition, £1.9 million has been earmarked as a result of the underspent budget for Public Health services and is expected to meet expenditure planned in 2014/15.

In February 2014, the Council set a net budget requirement of £331.4 million for the period ending 31 March 2015. The level of Council Tax increased by 1.995%, which is below the limit (2%) set by the Government. As at 30 June 2014, the Council identified a potential overspend of £6.1 million across various services (excludes budgets devolved to schools funded by Dedicated Schools Grant). Management action is underway to reduce the overspend to about £4.2 million by 31 March 2015. Further management action plans are being formulated by directorate management teams and it is anticipated the overspend will reduce further as the year progresses and action plans are implemented.

In September 2013, the Council decided to transfer £2 million from the Housing Revenue Account (HRA) balance to General Fund Reserves. The Council's legal advice confirmed the transfer was allowed under existing regulations. We considered the basis of the Council's decision and wrote to the Chief Finance Officer highlighting our view that the statutory basis for the transfer was unclear. The Department for Communities and Local Government (DCLG) is aware a number of Councils completed transfers of resources in this way and further information was sought by the DCLG from the Council in March 2014 on this matter. The DCLG wrote to the Council again in September 2014 confirming it was still considering the matter and requesting that Medway continue to consider the appropriateness of using resources transferred from the Housing Revenue Account to the General Fund until its considerations are complete.

As at 31 March 2014, the HRA reported a surplus for the year of £1.3 million against a budgeted surplus of £1 million. A revenue contribution to capital expenditure of £1.7 million and the contribution of £2 million towards general reserves highlighted above meant that the balance on the account reduced to £2 million as at 31 March 2014. The balance remains in excess of the minimum level recommended by the Chief Finance officer (£450,000) and meets the requirements of 30 year HRA Business Plan.

The Medium Term Financial Plan (MTFP) covers a four year period and is updated annually. The MTFP for the period 2014 to 2017 provides a comprehensive analysis of the financial challenges the Council is facing. It also supports achievement of Medway's priorities and considers the impact of major changes planned to Council services, available resources and local need, including the impact of the Government's Academies programme, changes in resources retained from business rates, the introduction of the Council Tax support scheme and the views of local people and service users.

While the MTFP financial position is balanced in the period to 31 March 2015, significant resource gaps have been identified in 2015/16 (£12.2 million) and in 2016/17 (an additional £8.1 million).

Since issuing our unqualified opinion in September 2014 the Council has updated its MTFP for the period 2014 to 2018 and reported potential deficits for 2015/2016 to 2017/2018 of £12.2 million, £20.4 million and £27.3 million respectively.

The Cabinet is developing various options to address the resource gap, including further reducing expenditure, opportunities for joint working with other local authorities, securing further procurement efficiencies and increasing income streams. However, further pressure is being placed on the Council's general and earmarked reserves and there remains little room for manoeuvre in the event that demand-led expenditure pressures emerge over the remainder of the financial year.



## Challenging economy - efficiency - effectiveness

### Arrangements for the protection of children and for looked after children

The Council is taking action to address the adverse judgements reported by OFSTED following its inspection of arrangements for protecting children (February 2013) and for looked after children services (August 2013). Both judgements concluded the Council's arrangements were inadequate. The OFSTED review of arrangements for the protection of children concluded that in all four focus areas the Council's arrangements were inadequate (the areas reviewed were overall effectiveness of the service; the effectiveness of the help and protection provided to children, young people, families and carers; the quality of practice; and leadership and governance). The inspection of looked after children's services concluded that in four of the five judgement areas (overall effectiveness of the service; outcomes for looked after children and young people; quality of provision and leadership and management) arrangements were inadequate. The inspectors concluded that the capacity of the service to improve was adequate.

Since the inspections, the Council has identified additional resources of £1.9 million per annum to invest in its children's services and has made progress to establish structures and processes to address the weaknesses identified by inspectors. The Medway Safeguarding Children's Board, which is led by an independent chair, receives reports from the External Improvement Board on the delivery of the improvement plan agreed with the Department for Education. There is clear evidence of progress in implementing all of the actions agreed and there have been positive outcomes following the Council's investment in a new workforce strategy and the implementation of an effective performance and quality assurance framework. For instance, a detailed independent audit of cases where a child protection plan is in place found many examples of good practice. Other reviews have found better practice towards looked after children and the more consistent implementation of care plans.

The involvement of Partners in the strategic approach to children's social care services is increasing and this is improving access to services for those children who need it (such as Child and Adolescent Mental Health Services). The Council recognises much remains to be done to achieve its objectives for safeguarding children's services and has identified the investment, and is providing the leadership necessary to achieve this.

### Partnership working (Health and Wellbeing Board)

The Health and Well Being Board continues to oversee the joint approach to the assessment of need for the Medway area and has led the development of the joint

approach to the Government's Better Care Fund and other pooled budgets. A major review of health inequalities and the future investment required for the Medway area was published by a task group led by the Chairman of the Health and Adult Care Overview and Scrutiny Committee in the year. The Group consulted with the Council's key strategic partners and published its findings in May 2014. The work of the Health and Wellbeing Board is now being developed further to improve access to primary care (through partnership working with Medway Clinical Commissioning Group); overcome barriers to engagement and outreach services; identify the scope for undertaking health equity audits may be of assistance in identifying and addressing health inequalities

The Health and Wellbeing Board is also working on specific projects designed to support achievement of the Children's Services improvement plan and has integrated such actions with its regular performance management arrangements.

### Medway Norse Joint Venture Company

The Medway Norse Joint Venture Company was established on 1 April 2013. The Council initially agreed that contracts for facilities management services such as cleaning, buildings maintenance and catering should be transferred to the joint venture with the transfer of 158 council employees under TUPE arrangements. The initial value of services transferred was £6.7 million with an anticipated profit share of £316,000 (100%) to be returned to the Council as at 31 March 2014. In the event, the Council received all of the company profits amounting to £282,000 as at 31 March 2014 (which was above the revised target of £263,000).

The Council published its review of the first trading year in July 2014 and noted that governance arrangements were working well and that the Operational Liaison Board (which includes nine senior council managers) had overseen the transfer of contracts and human resources effectively. The Council has evaluated other services for inclusion in the joint venture and decided that with effect from 1 April 2014, grounds maintenance contracts (value £3 million and involving 76 employees under TUPE) and aspects of special education needs transport services should be transferred. The joint venture now employs about 400 people, with over 95% living in the Medway area. The company has set a target to incur 40% of its expenditure with local companies in Medway by 2018. As at 31 March 2014, expenditure of £1.4 million is delivered in this way and represents 26% of total expenditure.

A strategic aim of the company is that it should win contracts for the provision of services to other public and private sector organisations. There has been only limited

success in securing such additional work though the Council believes this is understandable in the first year of operation as the company established itself and prepared for the transfer and future delivery of additional services on behalf of Medway. The Council has not proposed the transfer of any of its services without completing a full financial evaluation of the costs, benefits and risks involved. A key challenge for the company will be to secure further growth in the scope and extent of services it provides to other organisations. Through the work of the Board of Directors, the Council has established arrangements to monitor such outcomes through the work of the Operational Liaison Board in place to oversee the operation of Medway contracts.

#### **Council efficiency programme**

The MTFP considers the progress and expected outcomes from the 'better for less' ('BfL') efficiency programme. The programme is transforming Council services and the way they are delivered including the new Category Management approach to procurement. Services now being delivered through a joint venture company (known as 'Medway Norse') include facilities management, grounds maintenance and aspects of Special Education Needs Transport (see above).

The four phases of the category management of procurement programme completed to date are designed to deliver savings of approximately £4.5 million per annum by 2016/17, with the Council reporting that 82% of these savings have been secured and service budgets reduced accordingly. A further £2.6 million has been profiled to reduce budgets in 2014/15 and 2015/16. The programme has the stated potential to deliver up to £10 million of savings through the more effective commissioning and procurement of services over the MTFP period. New contracts for Homecare Services were introduced at the end of 2012/13 and this resulted in reduced contract costs of £1.9 million per annum. Further savings for Facilities Management, Agency Staff and High Cost Placements are anticipated to yield an additional £2.2 million of reduced costs in 2014/15 and there is a programme of work planned to secure further savings

#### **Cost/benefit analysis and options appraisal in decision making**

The Council continues to use data and analysis effectively to inform its procurement decisions. The 'Gateway' procurement process ensures the Cabinet considers relevant procurement decisions based on analysis of costs, benefits and risks undertaken by service managers. Examples of successful procurements progressed using the Gateway approach in 2013/14 include:

- the purchase of retail units for the Rochester Riverside development
- agreement of a procurement process involving an alternative delivery model for the management of the Medway Control Centre service (including the CCTV Partnership, out-of-hours and associated personal safety services such as telehealthcare)
- agreement of contracts with a local charity for the delivery of Medway's Local Welfare Provision.

#### **Achievement of targets and priorities set for 2013/14 and 2014/15**

The Council's performance management arrangements remain effective. The Council Plan is the published business plan, setting out the Council's commitment to achieving agreed outcomes. The Plan is reviewed and adjusted each year to take account of financial performance and service developments and links Council priorities to available resources. It also sets out key performance measures and actual performance (using agreed performance indicators measured over time as well as customer satisfaction indicators). Progress is reported quarterly to the Cabinet and scrutiny committees using the embedded performance management system. The Council Plan 2013 to 2015 is a key part of the budget and policy framework which is developed alongside annual capital and revenue budget proposals. Based on consultation with local people and strategic partners, the Plan was updated in the year and the number of key performance indicators was reduced from 102 to 62. As at the end of March 2014, in terms of Medway's key measures of success, the Council reported:

- 50% of indicators achieved target compared with 56% in 2012/13
- 31% of indicators were significantly under-performing compared with 28% in 2012/13.

At the beginning of September 2014 progress against the Council's Key Measures of Success for the period to 30 June 2014 (Quarter One) as set out in The Council Plan 2013 to 2015 was reported. The report included progress on performance against 51 Key Measures of Success and 24 Key projects. Whilst noting that data was not available to report on all measures in quarter one, the Council had achieved target on 18 out of 36 indicators (50%). Achievement of targets is in line with the quarter one position reported in 2013/14.



# OTHER MATTERS

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REPORT BY EXCEPTION

We have no other matters to report.

## Annual Governance Statement

We are satisfied that the Annual Governance Statement is not inconsistent or misleading with other information we were aware of from our audit of the financial statements and complies with '*Delivering Good Governance in Local Government*' (guidance published by CIPFA / SOLACE).

## Whole of Government Accounts (WGA)

Our audit of the Council's WGA return is due to be completed in October 2014. The Government's deadline for submitting the audited return (3 October 2014) was not met.

# GRANT CLAIMS AND RETURNS CERTIFICATION

## 4

### CERTIFICATION WORK

Our audit of claims and returns in 2012/13 resulted in one claim being qualified (from a total of four audited).

#### Certification findings 2012/13

We presented our most recent Grant claims and returns certification report in February 2014, which included the results of the audited returns for 2012/13.

We certified four returns amounting to over £220 million. The Housing Pooled Capital Receipts return and Teachers Pensions' return were certified without amendment or qualification. The National non-domestic rates return was amended to increase contribution to the national pool by £50,000.

Our audit of the Housing and Council Tax Benefits subsidy claim was qualified because our audit found a number of errors in expenditure type classification, classification of overpayments and modified local scheme benefit underpayments. The DWP wrote to the Council on 28 January 2014 to confirm the amount payable to the Council was £123,273,628 as a result of the qualification issues noted above. This was an increase in subsidy of £41,097.

#### Work in progress for 2013/14

In 2013/14, only two grant claims remain within the scope of the Audit Commission's grant certification regime. Our audit of the Government's pooling of capital receipts return was completed in September 2014 and no issues arose from our audit.

The audit of the 2013/14 housing benefits subsidy claim is currently in progress and will be completed in November 2014.

The Teachers' Pensions Return has been removed from the Audit Commission regime from 2013/14. We are still required to certify the Teachers' Pensions Return and we are currently liaising with Teachers' Pensions, which administers the scheme on behalf of the Department for Education, to agree an appropriate work programme. We will agree a separate engagement letter and fee for this work in due course.

# APPENDIX 1

## Reports issued

We issued the following reports in respect over the last 12 months.

REPORT	DATE
Planning letter	April 2013
Grant Claims and Returns Certification Report (2012/13 year)	February 2014
Audit Plan	March 2014
Audit Report and Supplementary Letter	September 2014
Annual Audit Letter	October 2014

## Fees update

A summary of fees for audit for the period from 1 April 2013 to date is set out below:

AUDIT AREA	FEES
Scale fee	188,460
Certification work <sup>(1)</sup>	16,341
Total fees for audit services	204,801

<sup>(1)</sup> Certification work fees have reduced from £23,950 in 2012/13 to £16,341 in 2013/14 to reflect the removal of the council tax subsidy element of the Housing Benefits Subsidy Grant Claim, removal of the requirement to audit the National non domestic rates (NNDR) return and the Teachers' Pensions Return which has been removed from the Audit Commission regime from 2013/14. We are still required to certify the Teachers' Pensions Return and we are currently liaising with Teachers' Pensions, which administers the scheme on behalf of the Department for Education, to agree an appropriate work programme. We will agree a separate engagement letter and fee for this work in due course.

In previous years, we were able to take assurances of amounts included in the financial statements for council tax benefits (now local council tax reduction scheme) from the audit of the subsidy claim and NDR net yield from the NNDR return audit but this assurance is no longer available as the audits are no longer carried out. As a result, we have had to undertake additional testing on the financial statements this year and we are currently discussing with the Audit Commission a small increase in the scale fee. We will report the final fee outturn once this has been agreed with management and the Audit Commission.

The matters raised in our report prepared in connection with the audit are those we believe should be brought to your attention. They do not purport to be a complete record of all matters arising. This report is prepared solely for the use of the council and may not be quoted nor copied without our prior written consent. No responsibility to any third party is accepted.

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