



ANNUAL AUDIT LETTER 2009/10

SUMMARY

- 1.1 The Council's external auditor, Grant Thornton's main finds were that ...
- The Council performed well in producing a timely set of accounts against a tight timetable. This has continued this year.
 - The Council's processes over its key accounting systems and controls were generally sound with no material weaknesses.
 - The Council is on track in its progress in implementing the International Financial Reporting Standards.
 - The Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2010.
 - The Council's HR policies need to support the drive to achieve greater flexibility, efficiency and effectiveness of the Authority's workforce.

RECOMMENDATION

- 2.1 To approve the Annual Audit letter for 2009/10.

REASONS FOR RECOMMENDATION

- 3.1 To advise Cabinet on the findings of the Council's external auditor on their work programme.

SUPPORTING INFORMATION

- 4.1 The detailed report is attached at Appendix 2.
- 4.2 The letter covers the audit of 2009/10 year end accounts, the accuracy of grant claims and returns.
- 4.3 In addition, consideration was given to the use of resources, school balances and the Sinfon Waste Recycling facility.

OTHER OPTIONS CONSIDERED

5.1 None.

This report has been approved by the following officers:

Legal officer Financial officer Human Resources officer Service Director(s) Other(s)	Not required Julian Kearsley, Interim Strategic Director of Resources Not required Martyn Marples, Director of Finance and Procurement
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For more information contact: Background papers: List of appendices:	Julian Kearsley 01332 643552 e-mail julian.kearsley@derby.gov.uk None Appendix 1 – Implications Appendix 2 – Annual Audit Letter 2009/10
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IMPLICATIONS

Financial

1.1 As detailed in the report.

Legal

2.1 None directly arising.

Personnel

3.1 As detailed in the report.

Equalities Impact

4.1 None directly arising.

Health and Safety

5.1 None directly arising.

Carbon commitment

6.1 None directly arising.

Value for money

7.1 Referred to in the report.

Corporate objectives and priorities for change

8.1 Delivery excellent services, performance and value for money.



Derby City Council

Annual Audit Letter 2009/10

1 December 2010

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1 Introduction and Key Messages

Purpose of this Letter

- 1.1 This Annual Audit Letter (Letter) summarises the key issues arising from the work that we have carried out at Derby City Council (the Council) during our 2009/10 audit. The Letter is designed to communicate our key messages to the Council and 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.

Responsibilities of the external auditors and the Council

- 1.2 This Letter has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission (www.audit-commission.gov.uk).
- 1.3 We have been appointed as the Council's independent external auditor by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England. As external auditors, we have a broad remit covering finance and governance matters.
- 1.4 Our annual work programme is set in accordance with the Code of Audit Practice (the Code) issued by the Audit Commission and includes nationally prescribed and locally determined work. Our work considers the Council's key risks, when reaching our Code conclusions.
- 1.5 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.

What this Letter covers

- 1.6 This Letter covers our 2009/10 Code audit, including key messages and conclusions from our work on:
- auditing the 2009/10 year end accounts (Section 2);
 - the accuracy of grant claims and returns to various government departments and other agencies (Section 2); and
 - assessing the Council's arrangements for securing economy, efficiency and effectiveness in the use of its resources (Section 3).
- 1.7 A list of all the reports issued during the year is provided at Appendix A, whilst Appendix B sets out our actual and budgeted fees for 2009/10.

The Economy

- 1.8 In the current financial climate, the Government's most urgent priority is to reduce the deficit whilst ensuring the economic recovery continues. Savings of over £6 billion are planned from Government spending during this financial year, including some £1.1 billion in reduced grants to local government. At the same time, the Government aims to reduce top-down government and devolve power and greater financial autonomy to local authorities by a range of measures including:
- abolishing Comprehensive Area Assessment;
 - reducing ring-fenced central government grants; and
 - undertaking a full review of local government finance.
- 1.9 Council tax in England is also to be frozen for at least one year, with a possible freeze for a second year in partnership with local authorities.
- 1.10 Most recently, the Comprehensive Spending Review (CSR) announced annual cuts to the local authority budget of 7.1% over the next four years, along with cuts to other Central Government budgets that will impact significantly on the Council's finances, particularly in the latter years of the CSR. This comes at a time when Derby City Council has already had to devote considerable efforts to cost reduction and reorganisation.
- 1.11 This Letter has been written in the context of the significant change agenda in which the Council is operating, including the need to deliver savings of over £8 million to achieve a year end balanced financial position for 2010/11. As at Quarter 1 2010/11, £7.7m of the savings have either already been met or are forecast to be met by the end of the financial year 2010/11.

Key areas for Council action

- 1.12 We have set out below the key areas where action should be taken by the Council to further improve its arrangements during 2010/11:
- Whilst the Council's medium term financial plans and strategy are considered to be sound, the Council will need to continue to ensure that a flexible approach is taken in respect of future financial planning. With the on going requirement to make significant savings across the activities of the Council, the need to identify and deliver new ways of increasing productivity and improving efficiency will become even more critical;
 - The Council needs to ensure that its workforce plan is designed to improve efficiency, productivity and value for money outcomes against local priorities; and
 - The Council's IFRS project plan to restate the 2009/10 accounts by 31 December 2010 is on track. The Council needs to ensure that this remains so as the end of the year approaches. We will review the revised opening balances as part of our interim audit next year so that any issues can be identified and resolved prior to the 2010/11 year end accounts process.
 - The Council will need to consider carefully the results of the planning inquiry into the Sinfon waste recycling scheme and ensure that it responds to the findings. We

will issue a report on our observations regarding this issue, now that the Inquiry has completed.

- 1.13 The context for these key messages can be found in this Letter. Officers have agreed to the implementation of these recommendations.

2 Audit of Accounts

Introduction

- 2.1 We issued an unqualified opinion on the Council's 2009/10 accounts on 30 September 2010, ahead of the statutory certification deadline. Our opinion confirmed that the accounts gave a true and fair view of the Council's financial affairs at 31 March 2010 and of its income and expenditure for the year .
- 2.2 Prior to issuing our opinion on the accounts, we were required to report significant matters arising from the audit to those charged with governance (defined as the Audit and Accounts Committee at the Council). We presented our Annual Report to those Charged with Governance to the Audit and Accounts Committee on 23 September and summarise only the key messages in this Letter.

Audit of the accounts

- 2.3 The Council performed well in producing a timely set of accounts against a tight timetable. The Council produced its draft 2009/10 accounts in advance of the 30 June 2010 deadline and presented them to the Audit and Accounts Committee on 24th June 2010. The improvement in the overall quality of the Council's working papers presented for audit in 2008/09 continued in 2009/10.
- 2.4 It is pleasing to report that the improvements to the quality of the Council's accounts achieved last year, also continued into this year, although our audit still identified a number of adjustments. The adjusted misstatements resulted in the reported Income & Expenditure Account deficit decreasing by £2.6m to £27.3m but had no overall impact on the General Fund deficit which remained unaltered at £12.1m.
- 2.5 The most significant matters identified from our accounts audit are outlined below:

Fixed Asset Register (FAR)

Procedures to confirm the completeness and accuracy of the new FAR developed by the Resources Department (incorporating the asset register of the Estates Department), identified a number of matters, all of which are outlined in detail in our Annual Report to those Charged with Governance, presented to the Audit and Accounts Committee on 23 September.

The amendments made to the Statement of Accounts to address these issues resulted in a reduction in the carrying value of fixed assets of £3.6m, which was not considered to be material in the context of the Council's fixed asset balance of £1,175m.

Provision for Redundancy Costs

Over the past year the Council has restructured its senior officer posts. From this, as at 31 March 2010, a number of redundancy and retirement costs were expected to arise and a provision was therefore established to meet these anticipated costs.

However, our audit testing of the evidence provided to support the accounts indicated that plans were not sufficiently advanced to justify the inclusion of this provision.

An amendment was therefore made to the accounts to reduce provisions by £523k, with a corresponding adjustment to the Income and Expenditure account.

Financial performance

- 2.6 In 2009/10, net spending on the Council's General Fund services was £197.115m creating a £1.168m net under-spend, which represented 0.59% of the Council's 2009/10 budget requirement. The overall year end variance target performance measure within the corporate plan was achieved. General fund reserves increased from £6.5m to £6.7m in year demonstrating that the Council continued to maintain a healthy level of reserves, at that time.
- 2.7 The current economic climate has placed significant pressure on the public sector and local government in particular, to generate efficiencies and operate within reduced resources.
- 2.8 In October 2010 the Chancellor announced the Government Comprehensive Spending Review (CSR), which reduced local government funding nationally by 7.1% per annum, over the next 4 years, as well as cuts to other Central Government budgets that will impact significantly on the Council's finances, particularly in the latter years of the CSR.
- 2.9 The main areas of revenue funding that will be impacted for the Council following the CSR relate to the Formula Grant, Area Based Grant (now within the Formula Grant) and the new Personal Social Services Grant.
- 2.10 Notably the estimated net reduction in the Formula Grant following the CSR could approach close to £30m. Including saving requirements to balance the existing medium term financial strategy and meet the challenges of further service pressures, the total savings required over the 4 year period, 2010/11 to 2014/15, are estimated to be in the region of £56m, when service inflation is taken into account.
- 2.11 The precise implications for the Council will become clearer shortly, when the revenue grant settlement for 2011/12 is announced. The Council will therefore need to carefully consider the implications of the Central Government funding reductions for Derby City Council, as they emerge, for its medium term revenue and capital spending plans.
- 2.12 The scale of the challenge faced has been recognised by Members, although, given the efforts to secure a stronger financial position already made, further savings may well be relatively difficult to realise. We will continue to keep the Council's financial position under review as part of our 2010/11 audit.

Review of Financial Reporting Controls

- 2.13 Our work in this area evaluates the design of the Council's controls, including relevant control activities, over risks that could lead to material misstatement in the financial statements, and determine whether they have been implemented. Emphasis is placed on identifying and obtaining an understanding of control activities that address the areas where we consider that material misstatements are more likely to occur.
- 2.14 In addition, for the areas identified as presenting a higher risk of material misstatement in the financial statements, we also evaluated the design of the Council's controls.
- 2.15 We found that the Council's processes over its key accounting systems and controls in these areas were generally sound with no material weaknesses.

Information Technology Control Environment

- 2.16 We also performed a high level review of the general IT control environment as part of the overall review of the internal control system and concluded that there were no material weaknesses within the IT arrangements that would adversely impact our audit of the accounts.

Employment Tax and VAT Compliance

- 2.17 We completed a high level review of the general employment tax control environment and the general VAT control environment as part of the overall review of the internal control system. This review was limited to the consideration of material employment tax obligations and material VAT obligations of the Council.
- 2.18 We concluded that there were no material weaknesses within the general employment tax systems nor within the VAT arrangements that could adversely impact on our audit of the accounts.

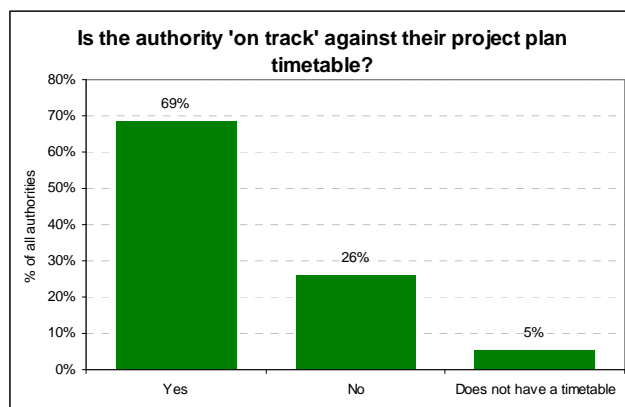
Annual Governance Statement

- 2.19 We have examined the Council's arrangements and processes for compiling the Annual Governance Statement (AGS). In addition, we read the AGS to consider whether the statement is in accordance with our knowledge of the Council.
- 2.20 We have concluded that the Council has good arrangements in place to compile the AGS and provide a strong audit trail for the Chief Executive and Leader to sign the statement.

International Financial Reporting Standards

- 2.21 The Council is required to prepare its accounts in accordance with International Financial Reporting Standards (IFRS) from 2010/11. The IFRS transition at the Council is being led by a dedicated project team and a clear project plan is in place.
- 2.22 A survey on IFRS progress was undertaken by the Audit Commission during July 2010. The survey indicated that whilst most authorities had made adequate progress against their project plans, nearly a third had not as can be seen in the following Exhibit.

Exhibit 1: IFRS Progress all authorities (source - Audit Commission)



- 2.23 Our work confirms that for Derby City Council, the overall project plan remains on track, with the project team receiving assurances that the key date of 31 December 2010 for the restated 2009/10 accounts and skeleton IFRS compliant statements will be achieved.
- 2.24 We will continue to work with the Council's finance team to ensure that arrangements are in place to support the effective transition to full IFRS for the 2010/11 Statement of Accounts. We will also continue to discuss with the Council the required accounting treatments under IFRS, where this will not compromise our independence, through sharing our experiences of IFRS transition from other public sector bodies and the commercial sector.

Grant Claims and Returns

- 2.25 We are required, acting as agents of the Audit Commission, to certify the Council's grant claims and returns.
- 2.26 We have already completed the certification of a number of the Council's claims for 2009/10 and have met all government department deadlines set under these arrangements. Our certification work is expected to be completed by the end of December 2010 after which we will prepare a separate grants report, summarising issues from the 2009/10 work, to facilitate continuous improvement. At this stage, we consider that the key areas for officers' attention, arising from our claims certification work, are likely to relate to Housing and Council Tax Benefits and Derby's New Deal for Communities, both of which have been subject to qualification in prior years.

3 Use of Resources

Introduction

- 3.1 We issued our annual Value for Money (VfM) conclusion on 30 September 2010, at the same time as our accounts opinion, in line with the required deadline. We concluded that, for 2009/10, the Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2010.
- 3.2 Prior to giving our VfM conclusion, we set out the basis of this conclusion and the results of our assessment against the use of resources framework, in our report presented to the Audit and Accounts Committee on 23 September. In this Letter we summarise the key messages from this work alongside relevant findings.

2009/10 VfM conclusion and UoR assessment

- 3.3 The Audit Commission's Code of Audit Practice requires us to assess whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. In discharging this responsibility, we are required to review and, where appropriate, examine evidence that is relevant to the Council's corporate performance management and financial management arrangements.
- 3.4 Our 2010 VfM conclusion has been informed by work carried out on Use of Resources (UoR) up until the abolition of Comprehensive Area Assessment, other local risk based work carried out in accordance with our 2009/10 Audit Plan and the results of our ongoing investigation into the Council's decision making regarding a new waste recycling facility.
- 3.5 The key developments in the Council's arrangements include:
- Improvement in understanding of costs and performance: The 'One Derby, One Council' transformational change programme report identified 14 areas across the Council where significant cost savings could be achieved through re-engineering processes and realigning services. In particular with regard to support functions; and
 - Improvements in achieving efficiencies: The Council has continued to seek and evaluate new ways of delivering services to achieve efficiencies, for example using business process re-engineering techniques to improve processes and structures through its Transforming Derby programme (e.g. Customer Service Improvement Programme).
- 3.6 The key areas for further development in the Council's arrangements include:
- Improving the effectiveness of asset management arrangements: We agreed to undertake a review of asset management arrangements as part of our 2009/10 and 2010/11 audit programmes. This project is currently in progress. Its focus is on refreshing the Council's existing asset management plan with a view to having a clearer understanding of the asset stock and identifying rationalisation opportunities.

- Improving the effectiveness of workforce planning arrangements: The Council needs to ensure that its workforce plan is designed to improve efficiency, productivity and VfM outcomes against local priorities.

3.7 Whilst the Council's medium term financial plans and strategy are considered to be sound, it will need to continue to ensure that a flexible approach is taken in respect of future financial planning. With the on-going requirement to make significant savings across the activities of the Council, the need to identify and deliver new ways of increasing productivity and improving efficiency will become ever more critical.

Use of Resources reviews

3.8 To support our assessment of the Council's use of resources, we have undertaken three specific pieces of work:

- Improving the effectiveness of asset management arrangements;
- School balances; and
- Sinfen waste recycling facility.

Improving the effectiveness of asset management arrangements

3.9 We agreed to undertake a review of asset management arrangements as part of our 2009/10 and 2010/11 audit programmes. This project is currently in progress. Its focus is on refreshing the Council's existing asset management plan with a view to having a clearer understanding of the asset stock and identifying rationalisation opportunities.

3.10 A full report will be issued separately to the Council in 2011 along with agreed action plans to progress recommendations.

School Balances

3.11 Our review of school balances was prompted by the concern of the Department for Children, Schools and Families (DCSF) that school balances in England are unacceptably high. Although 2008/09 saw a reduction in overall balances for the first time since the Audit Commission began publishing school balances data, the DCSF has warned that if balances do not reduce further, it intends to regulate in this area.

3.12 We compared the level of schools' balances in Derby to other local authorities using a benchmarking tool provided by the Audit Commission. This showed that the Council's surplus balances are relatively low in each of the benchmarking groups, with balances falling nationally in 2008/09. However the Council recognises that this issue must remain a priority as these funds are not providing benefit for children currently attending schools, as intended by the Council, but are being carried forward, with the intention of being used on projects which will realise benefit in the future.

3.13 Our approach examined the current policy and procedures in place to control balances. We found that these mechanisms are time-consuming to administer and have not previously resulted in many clawbacks of unspent funds, although a process of automatic clawbacks has now been introduced for 2009/10. It was, however, pleasing to find that the Council has a blend of activities which support the reduction of balances and the prevention of balances building up in the first place. This has included the adoption of a common accounting system, the support provided to schools in respect of financial management and using publicity to highlight individual schools' performance.

- 3.14 A full report has been issued separately to the Council along with agreed action plans to progress recommendations made within the reports.

Sinfin Waste Recycling Facility

- 3.15 During the course of the audit we were requested by two councillors, under their public rights as electors, to investigate the Council's decision to contribute to the funding of the appeal into the Council's own planning committee's rejection of the application to build a waste recycling facility at Sinfin, Derby. The project was being procured in partnership by the City Council and Derbyshire County Council and is at the heart of both councils' waste strategies for the future.
- 3.16 The request to investigate focused on whether, having rejected the original planning application, Derby City Council should be spending significant sums of public money in challenging what had, in effect, been its own decision.
- 3.17 However we also examined the background to the initial rejection of planning permission, in order to be fully apprised of this complex and sensitive issue.
- 3.18 Following a detailed investigation, which involved us obtaining independent legal advice, we concluded that the decision to support the appeal was not unreasonable and that we would therefore not seek to challenge it under our formal audit powers. We did, however, identify a number of procedural improvements that could have been made regarding that decision.
- 3.19 We also decided to await reporting of the outcome of the planning inquiry before concluding on the audit issues surrounding the original planning committee's decision. Now that the Inquiry has concluded in favour of the Council's original decision, we will report our detailed findings as part of the 2010/11 audit.
- 3.20 On the basis of all of the reviews undertaken with regard to UoR, including, but not limited to the specific reviews noted above, we issued an unqualified VfM conclusion.

Follow-up of Previous Reports

- 3.21 As part of our planned programme of work for 2009/10, we followed up progress made by the Council in implementing outstanding recommendations from current and previous years' reports issued. This work was completed during our interim audit and the outcome was presented to the Audit and Accounts Committee on 24 June 2010 in our Interim Audit Report.
- 3.22 At that time it was noted that good progress had been made with 35 of the 42 recommendations having been fully implemented. Six recommendations were still being actioned at the time of our interim audit and were expected to be fully implemented by July 2010.
- 3.23 The follow up procedures undertaken during our final accounts audit confirmed that action to address all recommendations had been duly completed.
- 3.24 In addition, we commend the Council's Audit and Accounts Committee for having in place a detailed and robust approach to monitoring the implementation of external audit recommendations

Approach to local VfM audit work from 2010/11

- 3.25 The Audit Commission has reviewed its work programme for 2010/11 onwards given the scale of the pressures facing public bodies in the current economic climate. As part of this

exercise, the Commission has been discussing possible options for a new approach to local VfM audit work with key national stakeholders.

- 3.26 From 2010/11 we will apply a new, more targeted approach to our local VfM audit work. This will be based on a reduced number of reporting criteria specified by the Audit Commission, concentrating on:

- securing financial resilience; and
- prioritising resources within tighter budgets.

- 3.27 We will determine a local programme of VfM audit work based on our audit risk assessment, informed by these criteria and our statutory responsibilities. We will no longer make annual scored judgements relating to our local VfM audit work. Instead we will report the results of all the local VfM audit work and the key messages for the audited body in our annual report to those charged with governance and in the Annual Audit Letter.

4 Closing Remarks

- 4.1 This Letter was discussed and agreed with the Chief Executive and Strategic Director of Resources and presented to the Audit and Accounts Committee on 02 December 2010.
- 4.2 We would like to take this opportunity to express our appreciation for the assistance and co-operation provided during the course of the audit.

Grant Thornton UK LLP
1 December 2010

- | Reports to be issued | |
|----------------------|--------------------------|
| 6 | School Balances |
| 7 | Grants Report |
| 8 | Waste Recycling Facility |
| 9 | Asset Management |

B Audit and Other Fees

Audit Area	Budget 2009/10 £	Actual 2009/10 £
Financial statements	215,000	215,000
VFM conclusion / Use of resources	105,000	105,000
Total Code of Practice fee	320,000	320,000
Certification of grant claims and returns	92,447*	TBC**
	412,447	TBC**

* Budget for certification work based on actual bills in 2008/09 less charges for EUR01 and EUR02 grant claims as there is no certification of these claims in 2009/10.

** To be confirmed as work is still ongoing on grant certification.



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