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# *Huntingdonshire District Council*

*Annual Audit Letter*

2012/13

Government and
Public Sector

October 2013

# Contents



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

*In April 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and of audited bodies'. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is to be expected of the audited body in certain areas. Our reports and management letters are prepared in the context of this Statement. Reports and letters prepared by appointed auditors and addressed to members or officers 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.*

*An audit is not designed to identify all matters that may be relevant to those charged with governance. Accordingly, the audit does not ordinarily identify all such matters.*

# Introduction

## The purpose of this letter

This letter summarises the results of our 2012/13 audit work for members of the Authority.

We have already reported the detailed findings from our audit work to the Corporate Governance Panel in the following reports:

- Audit opinion for the 2012/13 financial statements, incorporating opinion on the proper arrangements to secure economy, efficiency and effectiveness in its use of resources; and
- Report to those charged with Governance (ISA (UK&I) 260).

The matters reported here are the most significant for the Authority.

## Scope of Work

The Authority is responsible for preparing and publishing its Statement of Accounts, accompanied by the Annual Governance Statement. It is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Our 2012/13 audit work has been undertaken in accordance with the Audit Plan that we issued in March 2013 and is conducted in accordance with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission.

We met our responsibilities as follows:

| Audit Responsibility | Results |
|---|---|
| *Perform an audit of the accounts in accordance with the Auditing Practice Board's International Standards on Auditing (ISAs (UK&I)).* | We reported our findings to the Corporate Governance Panel on 26 September 2013 in our 2012/13 *Report to those charged with governance (ISA (UK&I) 260)*. A final version of our report, following the completion of all audit work, was issued on 27 September 2013. We issued an unmodified audit opinion on the same date. |
| *Report to the National Audit Office on the accuracy of the consolidation pack the Authority is required to prepare for the Whole of Government Accounts.* | We issued a short form assurance statement to the National Audit Office on 27 September 2013. |
| *Form a conclusion on the arrangements the Authority has made for securing economy, efficiency and effectiveness in its use of resources.* | On 27 September 2013 we issued an unmodified value for money conclusion. We have detailed our findings on pages 4-7. |
| *Consider the completeness of disclosures in the Authority's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work and consider whether it complies with CIPFA / SOLACE guidance.* | We reviewed the AGS to consider whether it complied with the CIPFA / SOLACE "Delivering Good Governance in Local Government" framework and whether it is misleading or inconsistent with other information known to us from our audit work. No matters were noted in this regard. |

| Audit Responsibility | Results |
| --- | --- |
| *Consider whether, in the public interest, we should make a report on any matter coming to our notice in the course of the audit.* | We did not deem it necessary to issue a report in the public interest. We have detailed our consideration of this on page 8. |
| *Determine whether any other action should be taken in relation to our responsibilities under the Audit Commission Act.* | There were no issues to report in this regard. |
| *Issue a certificate that we have completed the audit in accordance with the requirements of the Audit Commission Act 1998 and the Code of Practice issued by the Audit Commission.* | We issued our completion certificate on 27 September 2013. |

***We have identified three accounts related matters during the course of our audit that we wish to draw to your attention:***

1. ***Cut off treatment for housing and council tax benefit payments;***
2. ***Bank reconciliations; and***
3. ***Pension liability.***

# *Audit Findings*

## *Accounts*

We audited the Authority's accounts in line with approved Auditing Standards and issued an unqualified audit opinion on 27 September 2013.

The Authority had significant difficulties in producing its accounts for 2010/11 on a timely basis. In our reporting on the 2011/12 audit we noted that there had been good progress in preparing a version of the Annual Financial Report suitable for audit, but that we continued to encounter some lower level difficulties with obtaining adequate working papers which supported the figures included in the Annual Financial Report.

We are pleased to report to there has again been significant improvement in the quality of working papers received in the current financial year. We are aware that the finance team has made a significant effort during the year to ensure that the Annual Financial Report and working papers were prepared to a standard suitable for audit.

We identified no material errors or adjustments to the accounts presented for audit. We have however identified three more minor matters during the course of our audit that we wish to draw to your attention:

1. Cut off treatment for housing and council tax benefit payments;
2. Bank reconciliations; and
3. Pension liability.

### *1. Cut off treatment for housing and council tax benefit*

Our cut off testing for payments pre and post year end identified that an adjustment is not made in relation to benefit payments which span the financial year end. This is on the basis that, for the accounts, the subsidy is calculated on what is paid in any given year, as opposed to the amounts payable in relation to the financial year. These figures are reconciled to the Annual Financial Report and form the figures in the income and expenditure account.

On the basis that: there is no clear guidance on treatment; a variety of options are being used by Authorities; the amount is below materiality; any impact on the general fund would be trivial; and the improvement of the information provided to the users of the accounts would be negligible, it has been deemed reasonable that the Authority continue to account on a paid basis. This was included as a critical accounting judgement in the Annual Financial Report and we recommended that management monitor the value year on year and consider whether adjustments should be made in future years.

### *2. Bank reconciliations*

In 2012/13 we experienced difficulties in the audit of the bank reconciliation, which reconciled in year movements for each bank account rather than at a point in time. We were subsequently provided with one reconciliation which successfully reconciled all bank account balances in total with the ledger balance as at 31 March 2013. However, reconciliations should be performed on an account by account basis. Management have identified that the brought forward figures for all bank accounts have been merged into a single figure since 1999. We should note that this is a discrepancy within the cluster of bank account ledger codes

*Value of money conclusion – there are four areas we wish to bring to your attention in concluding our audit work:*

1. ***Financial position;***
2. ***Project management;***
3. ***Procurement and contracting; and***
4. ***Culture of control and compliance.***

and the completion of the reconciliation across all accounts provides evidence that this is not a wider issue. We recommended that management disaggregate the ledger codes which will enable them to perform individual account reconciliations as described above.

### *3. Pensions liability*

The most significant estimate in the Annual Financial Report is in the valuation of net pension liabilities for employees in the Cambridgeshire County Council Local Government Pension Scheme (CCC LGPS). The net pension liability at 31 March 2013 was £58 million (2012 - £51 million).

We reviewed the reasonableness of the assumptions underlying the pension liability, and are comfortable that the assumptions are within an acceptable range. We also validated the data supplied to the actuary on which to base their calculations.

During the course of the audit it was identified that the Actuary in their calculation of the net pension liability for the total fund at 31 March 2013 had estimated total scheme assets as £1,967m. The results of the Cambridgeshire County Council Local Government Pension Scheme audit identified that the actual value of scheme assets at the balance sheet date for the fund was £1,904m, a difference of £63m.

A full valuation exercise is undertaken by actuaries every three years. As such the asset value in the intervening period is an estimate calculated by the actuary using a model, and any differences between the estimate and actual figures are adjusted at the next full valuation. In comparing the asset value per the actuary's report to the admitted body's share of the audited pension fund assets, we are therefore comparing two estimates. In effect we are using the estimated percentage share of the audited assets figure to assess the reasonableness of the actuary's estimate. In our view, a reasonable threshold would be +/- 5% of the asset value. As the difference between the actuary's estimate of the total value of the fund and the audited total value of the fund fell within the +/- 5% threshold (actual difference is c.3.2%) it was deemed to be reasonable. No adjustment was therefore required to the accounts.

## *Use of Resources*

We carried out sufficient, relevant work in line with the Audit Commission's guidance, so that we could conclude on whether you had in place, for 2012/13, proper arrangements to secure economy, efficiency and effectiveness in your use of the Authority's resources.

In line with Audit Commission requirements, our conclusion was based on two criteria:

- the organisation has proper arrangements in place for securing financial resilience; and
- the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

To reach our conclusion, we carried out a programme of work that was based on our risk assessment.

We issued an unqualified conclusion in respect of the two criteria above. However, as part of our work this year we identified four areas of note to report. These cover:

1. Financial position;
2. Project management;
3. Procurement and contracting; and
4. Culture of control and compliance.

A summary of the key findings have been set out below. More detailed information can be found in our Report to Those Charged with Governance (ISA (UK&I) 260).

*Financial position:*

In the past the Authority has generally had adequate reserves to support their continued operations. The Medium Term Financial Plan includes the use of reserves in balancing the budget with the acknowledgement that significant savings will be needed going forward. Despite this use of reserves, and comparing approved budgets to the final out-turn for the years 2009/10, 2010/11 and 2011/12, it has been demonstrated there that there has been a consistent pattern of under spending. Assessing the Authority's forward projections for reserves, the Authority is likely to hit their minimum reserves level by 2015/16.

There are a number of recommendations which we believe could be implemented to strengthen the budgetary control and financial planning process for the medium and longer term, based on the following key findings:

- A formal savings plan is not separately identified, agreed at the start of each financial period and monitored over the course of the year. Management have confirmed that savings are allocated to budgets and managers are expected to deliver them or to report that this will not be possible as part of the budgetary control process. Management's view is that the achievement of a saving in an alternative way is acceptable if it does not have an adverse impact on service delivery. Where this occurs it would be highlighted in the normal course of budget monitoring or when the MTP is reviewed.

  Our view is that, whilst the achievement of the budget helps to inform the overall financial position it does not necessarily enable the Authority to identify and take timely and appropriate actions where specific savings are not being realised. Furthermore the Authority may not be in a position to understand key drivers for costs and savings in departments, potentially lessening chances of utilising and sharing lessons learnt.

  We consider it would be good practice for the Authority to introduce formal procedures to initially record and subsequently monitor savings plans, with each plan having an assigned 'owner' who monitors the plan regularly and reports variances to Cabinet with budgetary information.

- We believe it is also best practice that zero based budgeting is performed and appropriate challenge is applied during the budget setting process to better identify and understand the Authority's cost base. We are not aware of this having occurred in recent years. Management have stated that they will record challenges to budgets and savings as part of the MTP process.

- The regularity of the current in year financial reporting should be considered. Cabinet receives financial monitoring reports quarterly and managers review their budgets monthly. It would normally be good practice that monthly monitoring of the overall financial position would be undertaken to identify any significant variances early on. Management have confirmed that a high level dashboard on the financial position is now produced monthly for all Members. A further monthly service highlight report is currently being considered.

- Given the significant historic variances against budget it should be ensured that budget holders are being held to account and justification sought where there are any significant under or over spends forecast. This process would help to avoid large variances at the year end. Management should ensure that full ownership is being taken by service managers and that appropriate challenge is applied by accountants to ensure effective review of budgets against actual and forecast spend. This point has been recognised by the Authority and has explicitly been included in the Annual Governance Statement.

Whilst we deem these matters significant enough to report, the Authority has demonstrated historical underspends against budget and there is evidence to support sufficient reserves in the medium term. As such we do not deem it appropriate to qualify the value for money conclusion on this basis. We note that budgetary control has been included as an area for improvement in the Annual Governance Statement.

*Project management:*

During the year the Authority contracted with Local Government Shared Service (LGSS) for the provision of HR and payroll services. Using risk based procedures we have performed a high level review of the contract this year as part of our review of significant contracts.

1. We understand that the Head of Legal and Democratic Services was not asked to be involved in the review of the contract until the very late stages of the negotiations. Management and the Head of Legal and Democratic Services subsequently confirmed that they believe the arrangement in place satisfied the criteria for not using EU tendering.

2. In reviewing the contract cost proposal it was noted that the overall cost of the service was calculated based on a number of assumptions, and covering several options. The estimated costs were then broken down into the contract cost with LGSS plus an element of costs that would still be incurred by the Authority through remaining staff in relation to payroll and HR.

   The initial costs drawn up by finance were £4,541k. This would have made the chosen option the most expensive. Following review of the accountancy assumptions by the former Managing Director of Resources, the overall estimated cost was reduced to £3,997k. The methodology and reasons behind this reduction were not documented at the time and are therefore unknown. This subsequently made the transition to LGSS, whilst retaining the current payroll package, the second lowest cost option.

   Following our findings the Assistant Director (Finance and Resources) reviewed the two versions in September 2013 and concluded that in his view the figure of £3,997k is reasonable as there were items in the original calculation that were confirmed as already included in the contract and some other items were significantly over-cautious. Whilst we have seen some evidence in relation to changes made in the services provided under the LGSS contract, there are some elements which have been based on management's current views of what assumptions may have been made at that time, that can now not be supported.

   The above highlights that there was no contemporaneous documentation of the adjustments, which represents a compliance failure in the process. There is a key need for an audit trail to be preserved on important financial decisions and a need to ensure that there is an effective structure to challenge senior staff, as finance staff did not challenge the understanding of how the revised costs had been derived.

   We should note that all options were more expensive than the existing arrangement, with a budget of £3,878k. At the point of approval by Council the option selected was the second cheapest option. We note that the report highlighted a number of non-financial advantages of the chosen option, and that cost is not the sole determinant of which option represent best value for money. We have not reviewed these other benefits in detail but understand that these were perceived to outweigh the additional cost.

4. Penalty clauses linked to key performance metrics were not built into the contract: as such there are no financial penalties for underperformance (although it is noted that in the event of non-compliance with the contract remedial action would be undertaken at LGSS' expense), and we understand there are no arrangements for the Authority to share in efficiencies through cost reductions under the current contract. The Authority is thus at risk of having locked in their future costs based

on an inefficient service, having lost the opportunity to get financial benefit through restructuring the service, and having less ability to ensure service quality is maintained. On this basis there is a real risk that this contract may prove to be poor value for money. Management stated that the Authority has some ability to share in the benefits of certain future efficiency proposals.

5. Performance monitoring reports are prepared by LGSS and reviewed at performance review meetings; however these are not subject to independent scrutiny and review for accuracy. Whilst discussion with management has identified that the reports are scrutinised and, where relevant, notes have been circulated, this process could be more formalised.

We understand that the Authority may be looking to undertake similar arrangements for other areas of the Authority. We therefore recommend that additional evidence in respect of the compliance, regularity and value for money of the LGSS contract is sought to ensure lessons are learnt before making any decisions.

*Procurement and Contracting:*

During the year, internal audit informed us that they had become aware of a potential breach in procurement rules for a contract for goods and services, which was reported to the Authority separately as part of the July 2013 Corporate Governance Panel meeting. We have therefore not included detailed information in this report due to the commercial and personnel implications. We do however note that the findings detailed serious non-compliance with the Authority's procedures.

At the time we completed our audit, the Authority was in the process of investigating potential differences in payments made under the contract. These were not material and hence did not prevent us from forming our audit opinion.

An internal audit report on improving internal controls was reported to the Corporate Governance Panel in September 2013, dealing with the proposed actions to minimise the chances of these issues recurring. Recommendations included:

1. Amending the Code of Procurement;
2. Increasing the influence of the Procurement Manager;
3. Improved reporting of procurement activity to the management team and the Corporate Governance Panel;
4. Enforcing the use of, and further developing the contracts register, so that it acts as an internal control mechanism;
5. Amending the Code of Financial Management;
6. Signing up to the Prompt Payment Code;
7. Rewriting and re-launching the Code of conduct as an employee handbook;
8. Introducing a code of ethics that will refer to the seven principles of public life;
9. Policies associated with the handbook to be made available in one location;
10. Formal 'sign up' to the handbook by all employees; and
11. All breaches of the handbook being treated in accordance with the disciplinary procedures.

*Culture of control and compliance*

Whilst we have not undertaken a detailed review of controls and compliance with controls across the Authority, in considering the issues related to project management, procurement and contracting we observed that there were some examples of poor compliance with mandated control procedures, inadequate identification of these breaches by more senior staff and weaknesses in the degree of financial challenge and rigour applied. Whilst this does not provide conclusive evidence it does raise concerns over the overall culture of compliance within the Authority, without which the established controls structure cannot operate effectively, even if adequately designed.

We would encourage the Authority to look closely at this issue, to establish the extent to which these are isolated issues or indicative of wider concerns across the Authority, encompassing all staff in critical control positions. To the extent there are broader compliance issues, the Authority will need to consider closely how it responds, through changes to procedures and training.

We note also that the Authority is heavily dependent on key individuals for its financial reporting, without whom the improvements made in the last two years could be lost.

### *Conclusion of value for money opinion:*

In determining whether to issue an unqualified or qualified opinion we carefully considered the items detailed above and concluded that it is appropriate to issue an unqualified value for money conclusion.

In relation to the contracting and procurement matters identified above, and the culture of compliance in the Authority, actions are being taken by the Authority to address the matters identified and our discussions with the new Managing Director identified that these are high priority issues for the coming year. Both the procurement and project management matters feature in the Annual Governance Statement.

## *Reports in the public interest*

As part of our audit, we have a legal duty to consider:

- Whether anything coming to our attention is sufficiently important that we should issue a separate report on the matter for consideration by the Authority's members or so that the matter can be brought to public attention; and
- Whether the public interest in the matter is such that we need to issue a report immediately rather than at the end of the audit.

Having carefully considered the issues identified in relation to contracting and procurement above, we determined that a report in the public interest was not required. We believe we can most effectively discharge our reporting responsibilities in a timely matter through referring to these issues in this letter.

## *Annual Governance Statement*

Local authorities are required to produce an Annual Governance Statement (AGS) that is consistent with guidance issued by CIPFA/SOLACE.  The AGS accompanies the Statement of Accounts.

We reviewed the AGS to consider whether it complied with the CIPFA/SOLACE guidance and whether it might be misleading or inconsistent with other information known to us from our audit work. We found no areas of concern to report in this context, and would complement the Authority on the efforts made to produce an AGS that clearly set out for readers the key matters, in a format which is easy to read and understand. In this context we saw the AGs as representing good practice. We note that significant matters we have been made aware of during the course of the audit have been included.

## *Whole of Government Accounts*

We undertook our work on the Whole of Government Accounts consolidation pack as prescribed by the Audit Commission. We noted two inconsistencies between the Annual Financial Report and the WGA schedules of £3.680m. These related to the brought forward figures for the pension asset and pension liability provided by the DCLG being incorrect; however the overall net position remained consistent. We reported this matter within the short form assurance statement issued on 27 September 2013.

## *Certification of Claims and Returns*

We presented our most recent Annual Certification Report for 2011/12 to those charged with governance in March 2013. We certified two claims worth £96 million. In one case a qualification letter was required to set out the issues arising from the certification of the claim. We will issue the Annual Certification Report for 2012/13 in February 2014.

*We are required to report to you any significant deficiencies in internal control.*

# Summary of Recommendations

## Accounting systems and systems of internal control

Management are responsible for developing and implementing systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. As auditors, we review these arrangements for the purposes of our audit of the Annual Financial Report and our review of the annual governance statement.

We have to report to you any significant deficiencies in internal control that we found during the audit which we believe should be brought to your attention. Other than the matters identified in the main body of this report we have no further issues to report.

We report those internal control issues that are less significant separately to management, with action plans being agreed with officers. Consistent with prior years, our Internal Control Report will be issued in due course, however we have discussed all matters identified during the course of the audit with management.

# Final Fees

## Final Fees for 2012/13

We reported our fee proposals in our audit plan.

We are currently in the process of agreeing the fee over and above the scale element with management. This will then need to be subsequently agreed with the Audit Commission. We will report the final position in due course.

Our fees charged were therefore:

| | 2012/13 outturn | 2012/13 fee proposal | 2011/12 final outturn |
|---|---|---|---|
| Audit work performed under the Code of Audit Practice | | | |
| - Statement of Accounts | £58,081* | £58,081 | £104,302 |
| - Conclusion on the ability of the organisation to secure proper arrangements for the economy, efficiency and effectiveness in its use of resources | £10,000* | £10,000 | £16,666 |
| - Whole of Government Accounts | £2,000 | £2,000 | £3,333 |
| Certification of Claims and Returns | £21,950** | £21,950 | £35,000 |
| Non Audit Work | £0 | £0 | £0 |
| **TOTAL** | **£92,031*** | **£92,031** | **£159,301** |

* Areas where we are seeking fees over and above the scale element.

** Our fee for certification of claims and returns is yet to be finalised for 2012/13 and will be reported to those charged with governance in February 2014 within the 2012/13 Annual Certification Report. At the time of writing this report we have identified a systematic issue which will require additional certification procedures. Once we are able to determine the final cost of this additional work we will agree the amount with management. Similarly we will then need to subsequently agree the additional fee with the Audit Commission. We will report the final position in due course.

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