

Table 3 Reporting to the Audit and Governance Committee
Matters reported to the Committee in October 2005

Areas to be reported	Summary of matters reported to Group
Mis-statements	A number of 'non-trifling' misstatements in the financial statements were identified which officers agreed to amend.
Expected modifications to the audit report	<p>Anticipated that standard report to be issued. However we cannot formally conclude the audit until the following matters are satisfactorily resolved:</p> <ul style="list-style-type: none"> • legality of and circumstances surrounding the inclusion of certain receipts and payments in the year, and in earlier years in respect of housing benefits; • on-going enquiries in respect of the disposal of certain pieces of land; and • internal audit review of leisure services.
Material weaknesses in accounting and internal control systems	We did not identify any material weaknesses in systems of accounting and financial control other than those that have already been reported by both internal and external audit.
Qualitative aspects of accounting practices and financial reporting	<p>Our audit identified a number of areas within the financial statements which were not compliant with the Code of Practice on Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice (SORP). In particular we identified:</p> <ul style="list-style-type: none"> • omission of some disclosure notes; • omission of relevant accounting policies; • the accounting policy for depreciation was inconsistent with the actual calculation by the asset accounting package; • inconsistencies of figures within different notes within the financial statements; and • balance sheet accounts not fully up-dated to reflect new requirements.

57 The 2004/05 accounts were prepared and submitted a month before the due date of 31 July 2005 and the Council are to be commended for achieving this earlier deadline. The principal reason for the delay in the issue of the audit opinion was due to lengthy discussions on a technical accounting adjustment following a change in the capital accounting regime.

- 58 For 2004/05 there was a continued improvement in the standard of working papers compared to the previous year. However, there remains scope for further improvement. In particular:
- working papers were incomplete at the commencement of the audit and were still subject to amendment;
 - the audit trail from the financial ledger to the financial statements was unclear and difficult to follow; and
 - amendments made following audit comment were not always undertaken correctly resulting in further amendments.
- 59 This area is a key component of the Audit Commission's use of resources assessment and it is important that the Council ensures that:
- there is a continued drive to improve the quality of working papers;
 - comprehensive and cross-referenced working papers are available at the commencement of the audit; and
 - financial statements and working papers are subject to senior officer review prior to passing to audit.
- 60 We will work with the Council to ensure that the improvements required are delivered as part of the 2005/06 closedown process.

Financial standing

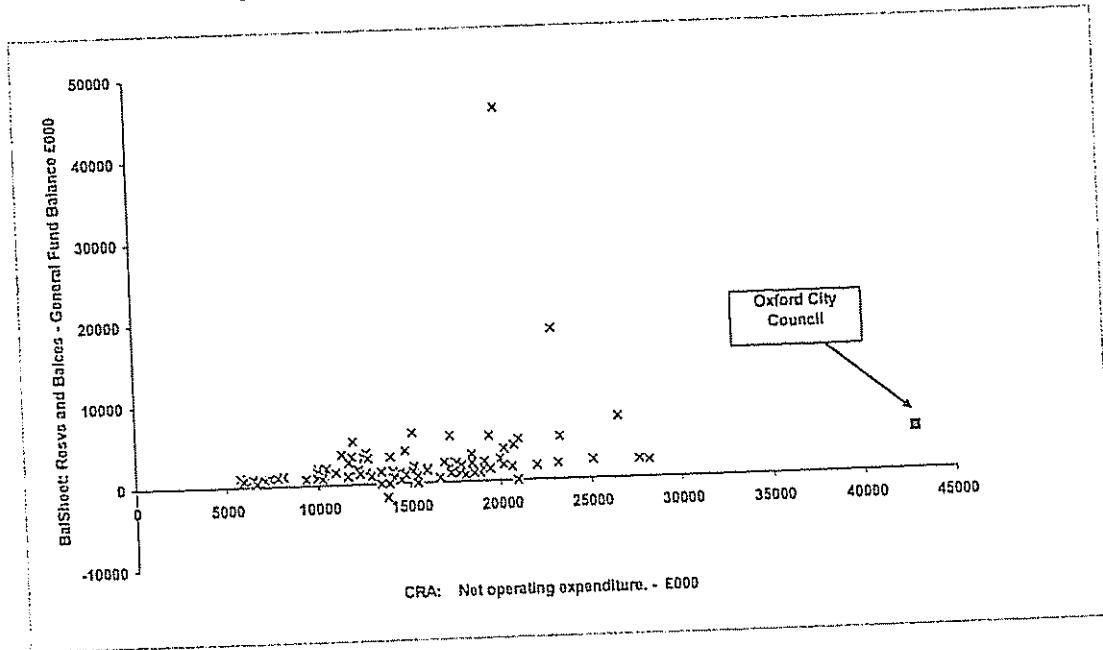
- 61 For 2004/05 the Council reported a surplus of £846,000 on its revenue account, increasing its General Fund balance to £5.1 million. Table 4 shows the level of balances and reserves at 31 March 2005.

Table 4 Balances and reserves

Fund/reserve	31 March 2004 (£000s)	31 March 2005 (£000s)
General Fund	4,253	5,099
Housing Revenue Account	4,179	4,603
Collection Fund	511	2,681
Other reserves	11,482	8,720

- 62 The Council's general fund balance as a percentage of net operating expenditure amount to **11.9 per cent** and compares favourably with other district councils (Figure 2 below). General fund balances at 31 March 2005 are consistent with the Council's policy of maintaining a minimum level of balances of between **£4- 6 million**.

Figure 2 General fund as a percentage of net operating expenditure



Source: Audit Commission

- 63 For 2005/06, the Councils net spending requirement is £24.8 million representing an increase in Council Tax of 4.0 per cent.
- 64 Based on information at the end of March 2006, the Council is reporting underspends on both its General Fund (£0.33 million) and its Housing Revenue Account (£0.77 million).
- 65 Business Units overspent by £852,000 which were offset by underspends of £661,000. The net overspend of £191,000 amounted to 0.8 per cent of the Business Unit's net budget. The key areas of overspend within Business Units are summarised in Table 5 below.

Table 5 Key areas of overspend at March 2006

Business Unit	Overspend (£s)	Commentary
City Works	317,590	Additional cost of short term hire caused by delay in replacing old refuse vehicles and one-off costs for trade waste tipping.
Leisure and Cultural	247,000	Additional transport costs, leisure flex spend plus additional spend on parks.

Business Unit	Overspend (£s)	Commentary
Business systems	118,400	One-off consultant and recruitment costs.

- 66 Looking forward to 2006/07 the Council has received more than anticipated in government support and has continued with its policy of developing savings to help fund and improve services in priority areas.
- 67 In addition, it has established a review process of those Business Units assessed as high risk, to consider the robustness and deliverability of their plans.

Capital programme

- 68 Previous Letters have referred to the slippage in capital expenditure compared with budget. For 2004/05 the Council's original capital budget amounted to £23.6 million compared to actual spend of £18.8 million.
- 69 For 2005/06, the profile of capital expenditure has improved considerably in the latter part of the year resulting in an improved out-turn compared to budget.
- 70 Members and officers are reviewing the deliverability of the current capital programme and undertaking an assessment of the likely spend on individual capital schemes in the current and future years. In addition, officers are reviewing the increasing level of capital accruals.

Systems of internal financial control

- 71 Our work undertaken earlier in the year concluded that the Council was continuing to make progress in developing its corporate and financial governance arrangements. However, we made a number of recommendations designed to further strengthen the control environment. The key recommendations together with an assessment of the current position are shown in Table 6.

Table 6 Interim audit - key issues

The Council continues to make progress in developing its corporate and financial governance arrangements, it now needs to fully embed its arrangements

Issue originally reported	Current position/Action
Risk management was not fully embedded throughout the organisation during the year and as such risks have not been actively monitored.	The Council has established a Corporate risk register. Further work is required to fully embed a risk management system throughout the organisation including the identification of risks at business unit level.

Issue originally reported	Current position/Action
The Council has no processes in place that enables it to monitor the effectiveness of its internal control framework and provide the necessary assurance to support the Statement of Internal Control (SIC).	The Council needs to put in place a system of assurance that reports on the effectiveness of the internal control framework at each level of the organisation and supports the annual SIC.
The Council does not have a body or committee that fully fulfils the functions of an audit committee.	The Council has now established an Audit and Governance committee with a wider remit than its predecessor. In particular, it contributes to improved governance and helps raise the profile of the system of internal controls.
Only 64 per cent of the internal audit plan for 2004/05 had been delivered and coverage of the Council's key financial systems was neither comprehensive or complete.	Council has out sourced its internal audit function. For 2005/06 they are prioritising their coverage on key and high risk systems.

Source: Audit Commission

- 72 Our detailed recommendations have been discussed with officers and an action plan agreed.

Leisure

- 73 During November 2005 we were contacted by a member of the public who advised us of a number of concerns in respect of the Council's Leisure services. At the same time we became aware of an investigation by the Council's then in-house internal auditors into these areas.
- 74 As previously mentioned following an unsuccessful attempt to recruit to the department, the Council out-sourced its internal audit function. As part of its initial plan the new auditors were required to review the work of the previous internal auditors, and assess the effectiveness of the internal controls within the Leisure department.
- 75 In view of the Internal Audit investigation and to avoid any duplication of effort we agreed with officers to await the outcome of the internal audit investigation before determining whether any further action was appropriate.
- 76 Their detailed report concluded '*that the systems reviewed have failed and there is a real and substantial risk that the systems will fail to meet their objectives*'. The report was considered by the Council's Audit and Governance Committee in February 2006 which recommended that a detailed management action plan to address the recommendations should be brought back to the Committee in March 2006.

- 77 We have reviewed internal audit's work in this area and are satisfied that they have considered all concerns expressed regarding the service where these are evidence based, and that all matters have been satisfactorily addressed in the report. We further understand that the Director of Corporate Services has now tasked internal audit with confirming that such weaknesses do not apply across other areas of council activity.

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

We did not identify any significant weaknesses in the Council's arrangements to prevent and detect fraud and corruption. However, we did identify scope to strengthen the Council's ethical governance arrangements, including:

- Members should receive training in their responsibilities under the Code of Conduct, which they sign up to on taking office;
- no formal monitoring arrangements are in place to ensure compliance with the Code of Conduct; and
- although Members are required to complete declaration of interests forms, no review is undertaken to ensure declarations are completed accurately.

Legality of transactions

- 78 Last year's Letter referred to weaknesses in the Council's arrangements for ensuring the legality of significant financial transactions. In particular we issued a recommendation under Section 11 of the Audit Commission Act 1998 designed to strengthen the Council's arrangements.
- 79 The Council has now appointed an experienced Monitoring Officer and has updated its Constitution to ensure that its decision making processes are clear and transparent. In addition, we have established regular meetings with the Monitoring Officer to discuss emerging legal issues on an ongoing basis.
- 80 Table 7 summarises provides an update on the issues identified in last year's Letter.

Table 7 Progress on legal issues

Progress is being made on out-standing legal issues

Issue	Conclusion
Kassam Stadium (see below)	
Garden Maintenance	
<p>The Council was not able to provide a statutory power relied upon to provide its free garden maintenance service.</p>	<p>The Council has now put a considered and reasonable argument on enabling powers, including that for funding the scheme from the HRA.</p> <p>While the Council did not consider 'vires' at the time, this doesn't, in our view, affect the lawfulness of the scheme itself. The powers existed at the time.</p>
Aristotle Skate Park	
<p>No evidence had been presented that the above skate park was subject to any risk assessment prior to it being built. This could have identified at the planning stage the noise problems which led to its closure.</p>	<p>As acknowledged by the Council, there is no evidence that the responsible officer carried out the instructions of the Council in terms of a re-examination of the site location and a prior risk assessment.</p> <p>Based on the information presented, there has been a loss caused to the Council due to a failure of corporate governance, and officer failure to do what was instructed by Members.</p>
Building control	
<p>Regulations state that the service should aim to break even over a three year period. We were awaiting an explanation from officers regarding an opinion obtained in 2002.</p>	<p>The Council took advice in May 2002 the context of which we agree, and the council now seems to be working to the spirit of the legislation and guidance.</p> <p>Based on the information presented, and the fact that the Council has appropriate arrangements in place moving forward, we do not propose to challenge actions in the early years.</p>

Source: Audit Commission

Sale of Land at Minchery Farm (Kassam Stadium)

- 81 Members will be aware that we have been considering for some time the circumstances surrounding the sale of the above piece of land, and in particular:
- whether the sale proceeds represented the best value that the Council could have reasonably obtained; and
 - any potential weaknesses in the Council's governance arrangements in reaching the decision that it did, particularly in light of weaknesses in governance arrangements identified in last year's Letter.
- 82 At this point in time we are not able to conclude this investigation, but action is in hand to conclude this work with a view to producing a separate report. Our aim, subject to receipt of additional information from the Council, is to update Members on progress on 29 June when this Letter is presented to the Audit Committee.

Cornmarket Street reconstruction

- 83 The detail of this jointly funded project is well documented.
- 84 Both the city and county councils took the decision to investigate their management of this contract through a public and independently chaired scrutiny process which published its findings in February 2005.
- 85 The scrutiny report was rightly critical of the processes of both councils, and has highlighted significant failings. Both councils have recognised these failings and have made a commitment to learn the lessons from these mistakes when managing similar contracts.
- 86 However, there were two areas which the review was not in a position to effectively address. This is not in any way a criticism of the review, but simply that the panel was not able to consider these areas.
- The process around mediation with affected parties, which the scrutiny panel was prevented from reviewing as a result of a confidentiality clause. This agreement has been reviewed, to consider whether a reasonable outcome was secured for the public in light of the evidence presented.
 - The role of members in terms of the original motivation for the scheme, and whether members were presented with all the information they required to enable them to make a lawful decision to proceed.
- 87 We have reviewed these areas in detail, and the conclusions insofar as they relate to the City Council are set out below.
- The independent scrutiny review has identified all of the issues which needed to be brought to the attention of the public, and an appropriate commitment has been made by each council to address the weaknesses identified.
 - No evidence has been identified to indicate that weaknesses in Council processes led to an unlawful decision.

Use of resources judgements

- 88 The use of resources assessment is a new assessment which focuses on financial management but links to the strategic management of the Authority. It looks at how the financial management is integrated with strategy and corporate management, supports council priorities and delivers value for money. It will be carried out annually, as part of each council's external audit. We anticipate in future the Use of Resources judgements will form part of the CPA framework.
- 89 We have assessed the council's arrangements in five areas.

Table 8 Councils arrangements

Element	Assessment
Financial reporting	1 out of 4
Financial management	2 out of 4
Financial standing	2 out of 4
Internal control	1 out of 4
Value for money	1 out of 4
Overall	1 out of 4

(Note: 1 = lowest, 4 = highest)

- 90 In reaching these judgements we have drawn on the above work and supplemented this with a review against specified Key Lines of Enquiry.
- 91 The most significant areas where further development is needed are as follows.

Financial reporting

- 92 The Council prepared its accounts in accordance with statutory timetables. However, although the quality of working papers produced to support the accounts has improved in recent years there is still much to do. Key areas for improvement are the need to:
- continue to develop Members role in reviewing the accounts and ensure they are subject to robust scrutiny through the new Audit and Governance Committee;
 - ensure a continued drive to improve the quality of working papers;
 - ensure accounts presented for audit are subject to supervisory review, and are fully SORP compliant; and
 - ensure consultation with a range of stakeholders in respect of their requirements for summarised accounts and develop its reporting of primary financial statements including publication of an annual report.

Financial management

- 93 The Council has continued to develop its systems for reporting both financial and non-financial information. It has implemented a comprehensive reporting process for both financial and performance management information with good commentary on both performance and budget variances. Key areas for improvement are to ensure that:
- the revenue consequences of capital schemes are fully considered;
 - the Council has undertaken a risk assessment of material items of revenue and capital expenditure including lessons learned from previous years;
 - that the Council's budget monitoring is informed by risk assessment; and
 - the Council's asset base is appropriately managed including allocating member responsibility to the fixed asset portfolio, developing performance measure.

Financial standing

- 94 The Council's financial position has improved, General fund balances have increased and improved budgetary control is starting to take effect.
- 95 Further action is required to strengthen the arrangements including the need to:
- establish targets for income collection and recovery of arrears;
 - ensure spending is within budget (both capital and revenue); and
 - ensure monitoring information is available that demonstrate the effectiveness of recovery actions and associated costs.

Internal control

- 96 During 2004/05 and the early part of 2005/06 the Council's internal audit function had significant resourcing shortages. Despite undertaking a regrading exercise it was unsuccessful in recruiting suitable staff to the department. As a consequence it subsequently out-sourced the internal audit function. It has now agreed an operational plan that gives priority to coverage of key financial systems.
- 97 However, further work is necessary to ensure that the Council has in place a fully embedded and effective system of internal control. In particular the Council needs to:
- develop further its risk management system and ensure that it is fully embedded across the organisation;
 - ensure that systems to support the Statement of Internal Control and particularly details of the assurance to support the SIC are reviewed by members; and
 - promote an antifraud and corruption culture throughout the organisation.
- 98 During 2005/06 the Council has strengthened its arrangements further and is working towards a fully embedded and effective system of internal control.

Value for money

- 99 The Council's costs compares unfavourably with other Councils on a range of vfm indicators. Costs are high across a range of services, in some cases exceptionally so, for average outcomes. There are pockets of stronger performance – and areas of improvement, but the overall pattern is of significant weakness in vfm. Nonetheless, the Council's direction of travel is positive and momentum is being developed through a much firmer financial and business planning focus, from a very low base, and through other investments in future service improvement. This supports the development of a clearer corporate focus on local needs and priorities.
- 100 The Council has only recently begun a specific focus on vfm. As a result its management of it is underdeveloped and represents a number of significant challenges. This includes that the council's culture is not yet clearly attuned to vfm. This is important, as success will depend on drawing together the skills and energies of staff and councillors in a shared and systematic vfm focus.

Other work

Grant claims

- 101 In accordance with Strategic Regulation, the Audit Commission has continued with a more risk-based approach to the certification of grant claims. We have reduced our audit of these claims but our ability to reduce further depends on the adequacy of the Council's control environment.
- 102 The Council's arrangements for managing and quality assuring grant claims submitted for audit has improved in recent years.
- 103 Our work on the housing benefit claim is now substantially complete. We anticipate issuing an un-qualified opinion subject to the resolution of some out-standing issues relating to reconciliations. The Department of Work and Pensions is still in the process of making its decisions about the issues outstanding from prior years.

National Fraud Initiative

- 104 In 2004/05, the local authority took part in the Audit Commission's National Fraud Initiative. The NFI, which is undertaken every two years, aims to help identify and reduce fraud by bringing together data from NHS bodies, local authorities and government departments and other agencies, to detect a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud, tenancy fraud and payroll fraud as well as, new for 2004/05, right to buy scheme fraud and providing new contact details for former tenants with arrears in excess of £1,000.
- 105 The Council has been proactive in reviewing the results of the data matching exercise and has identified around £27,000 in respect of the overpayment of benefits.

Looking forwards

Future audit and inspection work

- 106 We have an agreed plan for 2005/06 and we have reported in this letter those aspects that have already been completed. The remaining elements of that plan, including our audit of the 2005/06 accounts, will be reported in next year's Annual Letter.
- 107 We have sought to ensure, wherever possible, that our work relates to the improvement priorities of the Council. We will continue with this approach when planning our programme of work for 2006/07. We will seek to reconsider, with you, your improvement priorities and develop an agreed programme by 31 March 2006.

Revision to the Code of Audit Practice

- 108 The statutory requirements governing our audit work, are contained in:
- the Audit Commission Act 1998; and
 - the Code of Audit Practice (the Code).
- 109 The Code has been revised with effect from 1 April 2005. Further details are included in our Audit Plan, the key changes include:
- the requirement to draw a positive conclusion regarding the Council's arrangements for ensuring value for money in its use of resources; and
 - a clearer focus on overall financial and performance management arrangements.

A new CPA framework

- 110 The Audit Commission is currently considering the results of the consultation on the proposals for revising the CPA framework for District Councils. The revised framework will be published in the early part of 2006 with implementation from April 2006.

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Closing remarks

- 111 This letter has been discussed and agreed with the Chief Executive and the Strategic Director, Finance and Corporate Services. A copy of the letter will be presented at the Council's audit and governance committee on 29 June 2006.
- 112 The Council has taken a positive and constructive approach to our audit and inspection I would like to take this opportunity to express my appreciation for the council's assistance and co-operation.

Availability of this letter

- 113 This letter will be published on the Audit Commission's website at www.audit-commission.gov.uk and also on the Council's website.

A P Burns
District Auditor and Relationship Manager
May 2006

Appendix 1 – Background to this letter

The purpose of this letter

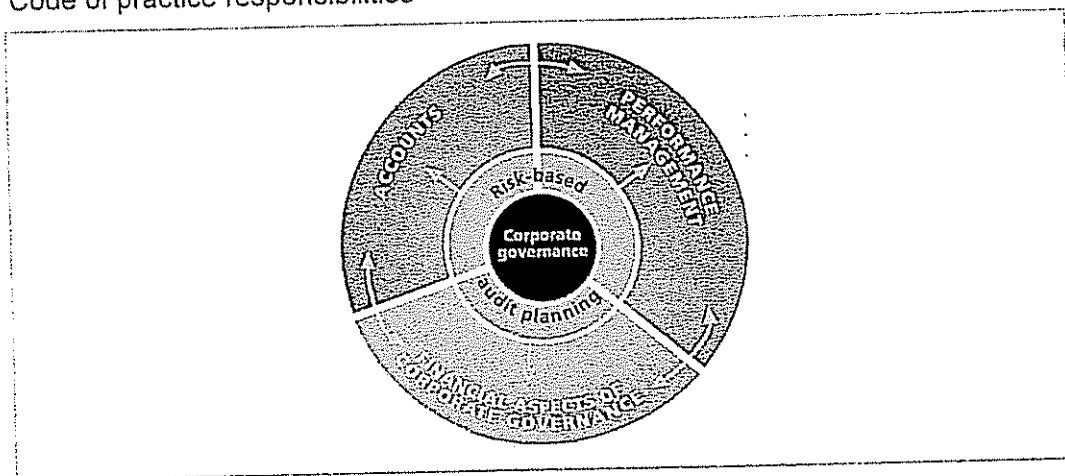
- 1 This is our audit and inspection 'Annual Letter' for members which incorporates the Annual Audit Letter for 2004/05, which is presented by the Council's Relationship Manager and District Auditor. The letter summarises the conclusions and significant issues arising from our recent audit and inspections of the Council.
- 2 We have issued separate reports during the year setting out the findings and conclusions from the specific elements of our programme. These reports are listed at Appendix 2 for information.
- 3 The Audit Commission has circulated to all audited bodies a statement that summarises the key responsibilities of auditors. Our audit has been conducted in accordance with the principles set out in that statement. What we say about the results of our audit should be viewed in the context of that more formal background.
- 4 Appendix 3 provides information about the fee charged for our audit and inspections.

Audit objectives

- 5 Our main objective as your appointed auditor is to plan and carry out an audit that meets the requirements of the Code of Audit Practice. We adopt a risk-based approach to planning our audit, and our audit work has focused on your significant financial and operational risks that are relevant to our audit responsibilities.
- 6 Central to our audit are your corporate governance arrangements. Our audit is then structured around the three elements of our responsibilities as set out in the Code and shown in Figure 3.

Figure 3 Code of Audit Practice

Code of practice responsibilities



Accounts

- Opinion.

Financial aspects of corporate governance

- 7 Reviewing how effectively the Council ensures:
- financial standing;
 - systems of internal financial control;
 - standards of financial conduct and the prevention and detection of fraud and corruption; and
 - legality of transactions with significant financial consequences.

Performance management

- Use of resources.
- Performance information.
- Best Value Performance Plan.

Inspection objectives

- 8 Inspection work is based around section 10 of the Local Government Act 1999, which requires us to carry out inspections and deliver reports that will:
- enable the Council and the public to judge whether best value is being delivered;
 - enable the Council to assess how well it is doing;
 - enable the Government to assess how well its policies are being implemented; and
 - identify failing services where remedial action may be necessary.

Appendix 2 – Audit and inspection reports issued

Report title	Date issued
Audit Plan	March 2005
Follow Up: Review of Rent Arrears	March 2005
CPA Progress Assessment	May 2005
Interim report	July 2005
Report on the 2004/05 financial statements to those charged with governance (SAS 610)	October 2005
Issues arising from the audit of the financial statements	Report not yet released
Landlord Services Inspection	November 2005
Review of Performance Indicators	November 2005
Follow Up: Human Resources Policies	December 2005
Auditor's Report on the Best Value Performance Plan	December 2005
Annual Audit and Inspection Letter	March 2006

Appendix 3 – Audit and inspection fee

Table 9 Audit fee update

Audit area	Plan 2004/05	Actual 2004/05
Accounts	75,900	85,900
Financial aspects of corporate governance	45,000	45,000
Performance	82,500	82,500
Total Code of Audit Practice fee	203,400	213,400
Additional voluntary work (under section 35)		
Total	203,400	213,400

Inspection fee update

The full year inspection fee is £12,400 net of ODPM grant. The work reported in this audit and inspection letter has been funded by an element of the fee covering 2004/05 and by an element of the fee covering 2005/06. In both years the actual fee will be in line with that planned.