

Report to: **Audit and Best Value Scrutiny Committee**

Date: **10 November 2010**

By: **Chief Executive and Deputy Chief Executive and Director of Corporate Resources**

Title of report: **Annual Audit Letter 2009/10**

Purpose of report: **To inform the Committee of the content of the External Auditor's Annual Audit Letter for 2009/10**

RECOMMENDATION:

The Committee is recommended to note the Annual Audit Letter for 2009/10.

1. Financial Appraisal

1.1 There are no direct financial implications from this report. The Annual Audit Letter (AAL) is produced as part of the agreed external audit plan by PKF and is funded from within existing budgets.

2. Supporting Information

2.1 The AAL summarises the key issues arising from the work carried out by the Council's external auditors, PKF, during the year. This report contains no new findings or recommendations, but reflects the key issues already reported in the Annual Governance Report. The AAL will also be considered by Cabinet at its meeting on 16 November 2010.

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Background Documents
None



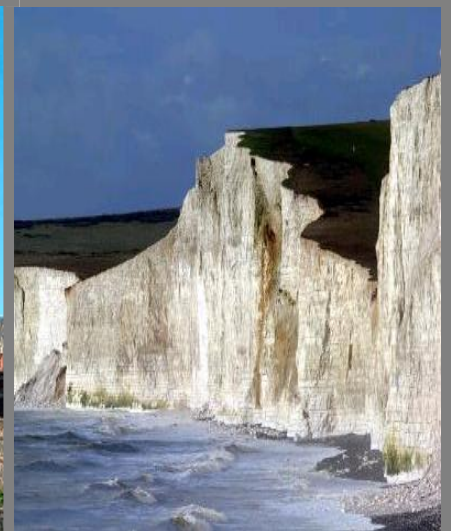
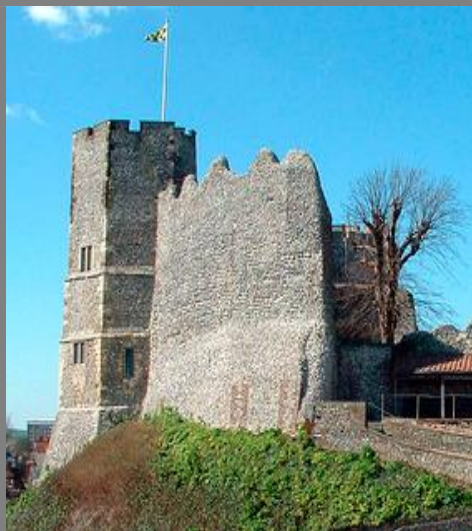
Accountants &
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East Sussex County Council

Annual Audit Letter 2009/10

Report to Members

October 2010



Local Public Services

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<http://www.pkf.co.uk/>

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

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

<http://www.audit-commission.gov.uk/localgov/audit/auditmethodology/Pages/codelocalgov.aspx>

<http://www.audit-commission.gov.uk/localgov/audit/auditmethodology/Pages/statementresponsibilities.aspx>

1 Executive summary

- 1.1 This Annual Audit Letter (Letter) summarises the key issues arising from the work that we carried out on East Sussex County Council and East Sussex Pension Fund during the year.
- 1.2 We have already reported the detailed findings from our audit work to those charged with governance in the reports documented in the Appendix to this letter. We have no additional recommendations for the Council at this time.
- 1.3 Along with other local authorities, the Council faces a period of considerable change over the next few years with expected funding reductions and increased responsibilities with regard to the planning, commissioning and provision of NHS and adults and children's social care services. However the Council is proactively planning to ensure that it is well prepared to deal with these changes.

Key findings

- 1.4 A summary of key conclusions is included in the table below.

Area	Conclusion
Financial statements	We issued unqualified opinions on the financial statements of East Sussex County Council and East Sussex Pension Fund
Value for money conclusion	We issued an unqualified value for money conclusion for East Sussex County Council

Acknowledgement

- 1.5 We would like to thank staff for their co-operation and assistance during the audit and throughout the period.

2 Introduction

About the Council and the Pension Fund

- 2.1 East Sussex County is located in the south east of England and covers an area of 1,792 square kilometres, with a considerable part of the County being the Sussex Downs Area of Outstanding Natural Beauty. The Council serves a population of 512,000, with many people living in the urban areas of Bexhill, Eastbourne, Hastings and Lewes.
- 2.2 The Council spends about £868 million annually, including £486 million on Education and Children's services, £232 million on Adult Social Care and £49 million on Highways. Much of the funding of this expenditure is through direct central government grant, such as Dedicated Schools Grant, Revenue Support Grant and the Area Based Grant, with the remainder being funded from Council Tax and National Non-domestic Rates.
- 2.3 The Council is the administering authority for East Sussex Pension Fund. The Pension Fund is a national pension scheme, which is open to all employees of the Council; District, Borough and Unitary Authorities in East Sussex; as well as Colleges of Further Education, Town and Parish Councils and a small number of charitable organisations who have applied to be treated as "admission bodies. Currently within the Pension Fund there are 59 participating employers.

The purpose of this Letter

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

Responsibilities of the auditors and the Council

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

The scope of our work

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

3 Key findings

Council financial statements

- 3.1 We issued an unqualified opinion on the Council's financial statements on 3 September 2010. Our opinion confirms that the financial statements gave a true and fair view of Council's financial affairs as at 31 March 2010 and of its income and expenditure for the year then ended.
- 3.2 We were satisfied that the Annual Governance Statement, which is included in the Statement of Accounts, was not inconsistent or misleading with other information we were aware of from our audit of the financial statements.
- 3.3 We did not identify any significant issues from our review of the Council's accounting and internal control systems and we are satisfied that appropriate action plans are in place to further strengthen controls in some areas.

Key issues arising from the audit

PFI schemes

- 3.4 The Council has Private Finance Initiative (PFI) schemes in place for its Waste Management Contract and Peacehaven Schools project. The 2009 Statement of Recognised Practice (SORP) applicable to local authorities in 2009/10 requires that PFI projects are now accounted for under International Financial Reporting Standards (IFRS) rather than the UK accounting standards previously applied. This means that these assets that were previously 'off Balance Sheet' are now required to be recognised in the Council's Balance Sheet, with a liability for the financing provided by the PFI operator.
- 3.5 For the schools PFI scheme, the Council recognised fixed assets of £21 million and a related finance lease liability of £16 million in its financial statements at 31 March 2010, with a prior period adjustment to restate the comparative figures as at 31 March 2009. We reviewed the integrity of the financial model applied in calculating the asset and liability values, including the relevant inputs and assumptions, and we were satisfied that the scheme was properly accounted for.
- 3.6 For the waste PFI scheme, the Council recognised fixed assets of £26 million, a finance lease liability of £20 million and a prepayment of £25 million in its financial statements at 31 March 2010, with a restatement of comparative figures as at 31 March 2009. We reviewed the integrity of the financial model that the Council had built jointly with its partner in the contract to derive these values. We noted that the model assumes that the split between the capital and the service charge element of the unitary charge is a constant ratio in each year, although there is an argument that a different ratio may be more appropriate for the early years of the contract. However we were satisfied that the effect on the Council's financial statements of using an alternative split in the early years would not be material.
- 3.7 A correction of £1 million was made to the restated 2008/09 comparative figures in the financial statements to remove the finance lease liability element of the service charge for both the waste and the schools PFI schemes from cost of services. This adjustment had no net impact on the County Fund Balance at 31 March 2009.

Council tax balances and accrued income

- 3.8 The 2009 SORP recognises that billing authorities act as agents of precepting authorities in collecting Council Tax. This introduced a change in accounting policy as it required that Council Tax income included in the financial statements of preceptors and billing authorities should be the accrued income for the year, and consequently appropriate shares of Council Tax debtor and creditor balances should be included in the preceptors' balance sheets. Our audit found that the Council had correctly accounted for the change in accounting policy.

Fixed asset impairments and reversal of impairments

- 3.9 The Council operates a policy of revaluing its properties on a rolling five year cycle, however in view of the impact of the recession on property values in recent years, the Council also commissioned an independent review of its fixed assets at 31 March 2009 and again at 31 March 2010.
- 3.10 The review at 31 March 2009 resulted in an impairment charge of £28 million to the Income and Expenditure Account in 2008/09. At 1 April 2009, the Council's five year rolling programme of revaluations resulted in upward revaluations in some properties and downward revaluations in other properties. The review as at 31 March 2010 concluded that no further impairment allowance was required against the portfolio in 2009/10.
- 3.11 The Council credited all upward revaluations at 1 April 2009 to the revaluation reserve as it did not believe that there were sufficient links between the impairment review at 31 March 2009 and the valuation at 1 April 2009 for any of the previous impairment to be reversed in the 2009/10 Income and Expenditure Account. However, it is our view that £806k revaluation gains should have been credited to the Income and Expenditure Account, rather than the revaluation reserve, as the two valuations are both based on the movement in property prices. We therefore reported an uncorrected misstatement in our Annual Governance Report to the Audit and Best Value Scrutiny Committee in September 2010. There is no impact on the closing County Fund balance.

Net worth of the Council

- 3.12 The County Fund Balance Sheet at 31 March 2010 shows that the Council had a negative net worth of £0.2 million. There was a positive net worth of £241 million at 31 March 2009. The change in net worth in 2009/10 is almost entirely to the increase in the Council's Local Government Pension Scheme liability as assessed under Financial Reporting Standard 17 from £263 million as at 31 March 2009 to £516 million as at 31 March 2010. The increase in the liability is largely driven by the change in the assumption made in calculating the liability of the annual rate of return on investment grade corporate bonds from 6.9% at 31 March 2009 to 5.5% at 31 March 2010 and in the assumed future inflation rate from 3.1% to 3.8%.
- 3.13 The fact that the Council has a negative net worth at 31 March 2010 does not affect the Council's ability to continue as a "going concern" because the pension fund liability is to be met over a long period. The Council has net current assets as at 31 March 2010 of £143 million.
- 3.14 The Government announced in June 2010 that the consumer price index will be the basis for future public sector pension increases, rather than the retail prices index that was previously used. It is expected that this change will reduce the value of the pension fund liability in future actuarial valuations.

East Sussex Pension Fund financial statements

- 3.15 We issued an unqualified opinion on the Pension Fund's financial statements on 3 September 2010. Our opinion confirms that the financial statements present a true and fair view of the financial transactions of the Pension Fund during the year ended 31 March 2010 and the amount and disposition of the Pension Fund's assets and liabilities as at 31 March 2010, other than liabilities to pay pensions and other benefits after the end of the scheme year.
- 3.16 Our review of the Pension Fund's accounting and internal control systems found that there is no documented audit trail for any checks done by the Council, as administering authority, on the accuracy of employee contributions from admitted and scheduled bodies into the Pension Fund. The Council is exploring options for carrying out periodic checks in this area going forward.

Use of resources

- 3.17 The Code requires us to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources. This is known as the “value for money conclusion” and draws on the results of specific risk based audit work.

Specific risk-based work

- 3.18 Our use of resources work included review of the following areas:

Health inequalities

- 3.19 Work done by the Audit Commission on the organisational assessment and the area assessment in 2009 concluded that there is a good understanding of how health differs across the county and improvements are being made in people's health and wellbeing although there are still large variations in life expectancies across the county.

Age Well PFI scheme

- 3.20 In June 2010 the Council decided to withdraw from the procurement process for the Age Well PFI project.

Value for money conclusion

- 3.21 We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources (value for money).
- 3.22 In June 2010 the Government announced the abolition of Comprehensive Area Assessment. As a result the Audit Commission announced changes to its use of resources approach, effective immediately, which included removal of the scored judgements for use of resources assessments in local government bodies. It was still necessary, however, for auditors to complete sufficient use of resources assessment work to support their statutory duty to give a value for money conclusion. In practice, much of the use of resources assessment had already been completed at the time of the announcement, in order to meet the prior deadline of submitting indicative scores to the Audit Commission by 21 April 2010.
- 3.23 Taking into account our work on use of resources, we have concluded that adequate arrangements are in place to secure value for money and have provided an unqualified value for money conclusion for the year ended 31 March 2010.
- 3.24 In response to the anticipated future funding pressures, a Council wide programme of value for money service reviews was commenced in 2009/10. This will comprehensively review cost and performance of all elements of services over the period 2009-2012, including benchmarking unit costs and performance measurements against those of similar authorities and including peer input where possible. The first reviews in two areas of Children's Services identified potential savings of £0.6 million per annum. A major review of highways maintenance, which was already underway, identified a new method of highways maintenance involving £8.5 million of capital investment to achieve both better service level performance and £1 million per annum relevant cost savings.
- 3.25 In respect of financial planning, the Council's 'Reconciling Policy and Resources' process was further improved in 2009/10 to specifically build in the outcomes of equalities impact assessments. New guidelines on consultation were introduced and these require feedback of the results of consultation to the public and those consulted.
- 3.26 We specifically reviewed whether the impact of the recession and likely reduced levels of future central government funding was reflected in medium term financial planning. This had been modelled in terms of 20 per cent real term reductions in formula funding, low council tax increases and higher bad debt charges.

- 3.27 One of the key themes underlying the KLOEs is the effectiveness of partnership working with other bodies. In this respect Internal Audit carried out a review within the year on the adequacy of partnership governance arrangements. This reported that whilst the principal partner bodies all had adequate governance arrangements, the documentation and checklists the Council has prepared to monitor and review this were not being completed as required. There are action plans in place to address this issue.
- 3.28 We reviewed the Council's workforce planning arrangements for a key line of enquiry that was considered for the first time in 2009/10 at upper tier authorities. We concluded in summary that the Council has very strong and comprehensive processes in this area, including a robust workforce plan which is monitored against identified actions. Proactive recruitment processes have a track record of delivering results.
- 3.29 We also carried out a number of spot checks on performance indicators during the year in order to gain assurance as to the adequacy of the Council's data quality arrangements. We concluded that the Council has robust and effective performance management arrangements in place and the indicators tested were found to be fairly stated.

Approach to local value for money audit work from 2010/11

- 3.30 Given the scale of the pressures facing public bodies in the current economic climate, the Commission has reviewed its work programme for 2010/11 onwards. As part of this exercise, the Commission has been discussing possible options for a new approach to local value for money audit work with key national stakeholders. From 2010/11 we will therefore apply a new, more targeted and better value approach to our local VFM audit work. This will be based on a reduced number of reporting criteria specified by the Commission, concentrating on:
- securing financial resilience
 - prioritising resources within tighter budgets.
- 3.31 We will determine a local programme of value for money audit work based on our audit risk assessment, informed by these criteria and our statutory responsibilities. We will report the results of all the local value for money audit work in our annual governance report to those charged with governance and in our annual audit letter.

Grants

- 3.32 Based on our audit of grants claims for 2009/10 carried out to date, we are satisfied that there are no significant weaknesses in the Council's grant arrangements.

Emerging issues

Current economic climate

- 3.33 In light of the changing national and local circumstances, Cabinet has reviewed the Council's Promise and Policy Steers for 2011/12 to ensure that it reflects the Council's emerging local priorities, both in terms of what it delivers and how it intends to work in the future.
- 3.34 The Council's medium term financial plans include broad planning assumptions which will be confirmed or refined after the Comprehensive Spending Review announcement on 20 October 2010 or when there is further clarity on the Council's grant settlement for 2011/12.
- 3.35 Other impacts of the current economic climate include delays to the Department for Transport's decision on the Bexhill to Hastings link road while it carries out a spending review and reforms the way in which transport projects are prioritised and funded.

Government White Paper: Equity and Excellence: Liberating the NHS

- 3.36 The new Government's White Paper entitled '*Equity and Excellence: Liberating the NHS*' sets out the Government's plans for major reform of the NHS. It is part of a much broader programme of change being proposed by the Government and there will be further white papers concerning Public Health, Adult Social Care and Decentralisation and Localism later in the year.
- 3.37 Local authorities will have changed accountability with regard to the planning, commissioning and provision of NHS and adults and children's social care services. Primary Care Trusts will cease to exist from April 2013 and there will be a devolution of commissioning budgets to general practitioners. Within the new system local authorities will have greater responsibility in three areas:
- public health, including leading joint strategic needs assessments to ensure coherent and co-ordinated commissioning strategies
 - supporting local people's voices and the exercise of patient choice
 - promoting the joined up commissioning of local NHS services, children and adults social care and public health improvement and prevention.
- 3.38 The Council has acknowledged that the potential withdrawal of the Government from involvement in the day-to-day decision making and operation of the health service leaves significant opportunities for the Council to increase its democratic influence over how the NHS conducts its business locally. It also provides some very significant new risks that will need to be managed.
- 3.39 Whilst the new arrangements will only be required from 2013, work is already underway by the Council and the East Sussex PCTs to develop joint proposals to support the transitional period and the aim is to have shadow arrangements in place from 2011.

South Downs National Park Authority

- 3.40 From 1 April 2011 the South Downs National Park Authority (NPA) will become the planning authority for the national park area and the Revenue Support Grant paid to local authorities will be reduced in recognition of the fact that this work will transfer to the NPA.
- 3.41 The actual reduction will not be known until the Council receives its funding settlement for 2011/12 later in the year. However, under a proposed scheme of delegation, the NPA will itself consider only those applications that are of significance to the national park. It will delegate consideration of the remainder back to the current local planning authorities and pay them the current cost of processing applications delegated to them. The Council is in the process of negotiating a service level agreement with the NPA.

International Financial Reporting Standards

- 3.42 IFRS will be adopted in local government from 2010/11 and will require transitional arrangements to be put in place by officers to restate the 2009/10 comparatives.
- 3.43 We are satisfied that the Council is taking appropriate steps to implement IFRS, although we rated the Council as 'amber' in the Audit Commission's Local Government IFRS preparedness survey carried out in June 2010, as work remains in progress in areas such as fixed asset componentisation and review of leases, to calculate the resultant effect on the financial statements.

Appendix: Reports issued in relation to the 2009/10 audit

Report	Date Issued
Audit Plan	March 2010
Annual Governance Report, including use of resources	September 2010
Annual Audit Letter	November 2010