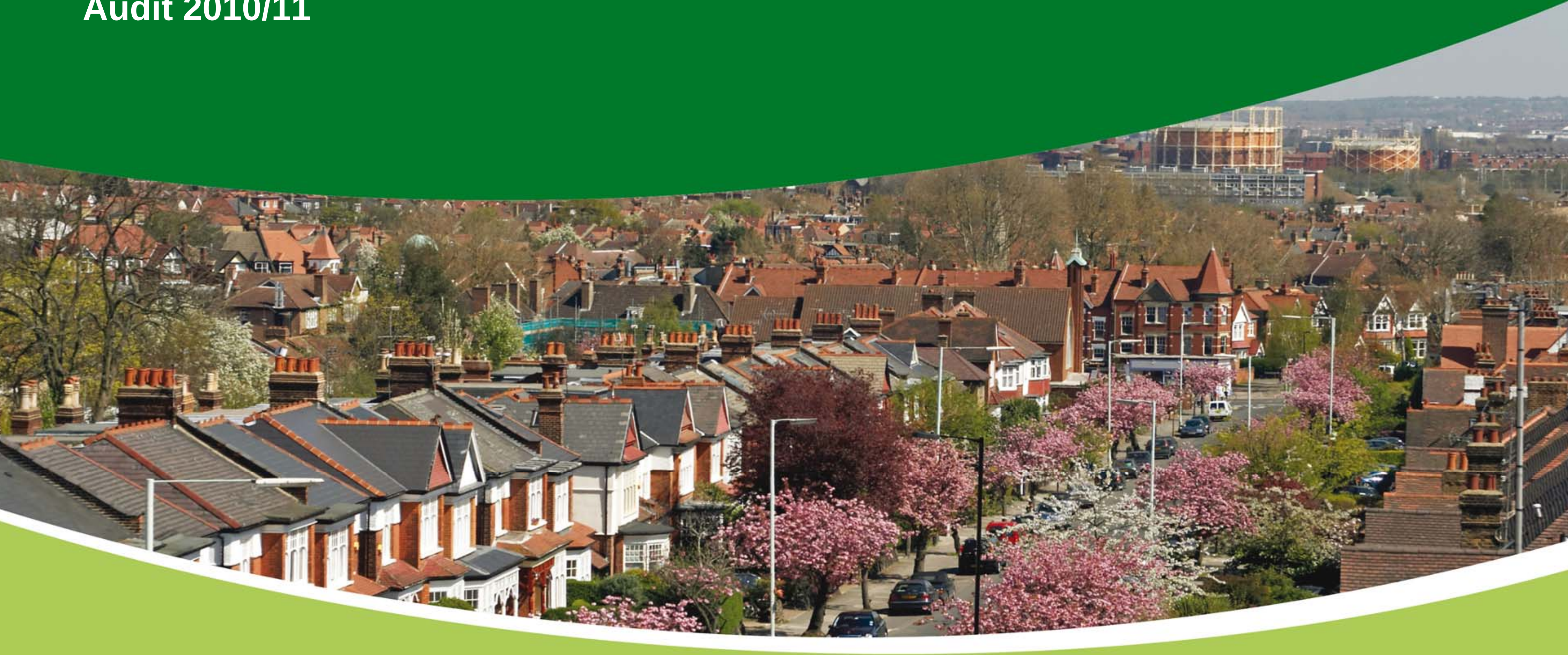
Annual Audit Letter

Norwich City Council

Audit 2010/11



audit commission

Contents

Key messages 3
- Audit opinion and financial statements 3
- Value for money 3

Current and future challenges 4

Financial statements and annual governance statement 7
- Overall conclusion from the audit 7
- Significant weaknesses in internal control 9
- Certification of claims and returns 10

Value for money 11

Closing remarks 14

Appendix 1 – Fees 15

Appendix 2 – Glossary 16

Appendix 3 – Action plan 18

Traffic light explanation

Red ■ Amber ◆ Green ●

Key messages

This report summarises the findings from my 2010/11 audit. My audit comprises two elements:

- **the audit of your financial statements; and**
- **my assessment of your arrangements to achieve value for money in your use of resources.**

I have included one significant recommendation in this report, which the Council has accepted.

Key audit risk	Our findings
Unqualified audit opinion	●
Proper arrangements to secure value for money	●

Audit opinion and financial statements

The changes arising from introducing International Financial Reporting Standards (IFRS) significantly affected both the Council's preparation and my audit of the financial statements.

My audit highlighted a significant number of errors within the financial statements provided to me. The extent of issues identified during my audit resulted in significant changes to the Council's financial statements. This resulted in:

- a delay in issuing my audit report until April 2012, six months after the statutory deadline; and
- an additional audit fee charge to cover the additional audit costs as set out in appendix 1.

The delays in completing the financial statements audit also meant that I was not able to certify the Council's Whole of Government accounts submission by 30 September 2011. The Council provided me with a revised WGA pack on 18 June 2012, and this work is still in progress. I am therefore currently unable to issue my certificate concluding the audit for 2010/11.

Given these issues, I have included a recommendation in this letter regarding required improvements to financial reporting.

I also identified some weaknesses in your internal control arrangements and reported these to your Audit Committee in my Annual Governance Report. I have included a brief summary of these control issues in this letter.

Value for money

I issued an unqualified value for money conclusion stating the Council had proper arrangements to secure economy, efficiency and effectiveness in your use of resources.

Current and future challenges

Economic downturn and pressure on the public sector

The economic downturn is placing increasing pressure on the public sector as a whole. This is reflected in the:

- challenging Comprehensive Spending Review settlement;
- increasing demand for key services; and
- reduced ability of members of the public to pay for services;

In addition there are challenges arising from Housing Revenue Account self-financing, welfare reforms and increased pension costs arising from the triennial revaluation and changing assumptions regarding pensionable employees. Taken together, these challenges will put increasing pressure on the Council's finances.

So far the Council has responded well to financial challenges, but the pace of change will be challenging to the Council.

Joint arrangements and shared services

Central Government has identified joint arrangement and shared services as a key element in councils reducing their overall costs. The Council has a track record of partnership working with public, private and voluntary sector bodies. Recent examples show that this approach is being continued including entering an arrangement with Local Government Shared Services (LGSS) to provide IT and finance services in April 2012.

Housing Revenue Account self financing

Under the existing housing subsidy system councils with housing stock are required to prepare a notional Housing Revenue Account. This uses a set of predetermined factors for such items as maintenance costs and rental income to reflect the mix and age of the housing stock. In simple terms, if this notional account is in credit then the surplus is payable to central government and if in a deficit situation an equivalent payment is made to the council to support the housing landlord function.

The current year, 2011/12, is to be the last year of the existing system. Under a new financing system, councils will be responsible for financing of the Housing Revenue Account, and the existing system of grants and payments will end. To fund this Central Government made payments to certain local authorities and in the case of local authorities that currently contribute to the scheme, transferred a debt liability. The debt liability transfer for Norwich City Council of £148.9 million took place on 28 March 2012.

Localism Act

The Localism Act received Royal Assent in November 2011. This enables the Housing Revenue Account self-financing proposals discussed above to proceed. However, the Act has far reaching implications for councils including the following.

- Granting of a ‘general power of competence’, to provide councils with the legal power to do what is not specifically prohibited.
- New rights and powers for communities. These include:
  - ‘community right of challenge’ – this would allow voluntary and community groups to express an interest in taking over and running local authority services; and
  - ‘community right to buy’ – where local authorities hold a list of community value assets and if they wish to dispose of them, community groups must be allowed time to put together bids and finance.
- Planning system reforms including changes to the community infrastructure levy with a proportion going to neighbourhoods affected by the developments.

The full implementation of the provisions of the Act will impact on service provision and hence have budgetary implications for the Council.

Welfare reform

The Welfare Reform Act 2011 received Royal Assent in March 2012. The Act introduces significant changes to the welfare system. It provides for the introduction of a 'Universal Credit' to replace a range of existing means-tested benefits and tax credits for people of working age, starting from 2013. These include Housing Benefit and Council Tax Benefit, which are administered by councils. The Act follows the November 2010 White Paper, 'Universal Credit: welfare that works', which set out the Coalition Government’s proposals for reforming welfare to improve work incentives, simplify the benefits system and tackle administrative complexity.

Besides introducing Universal Credit and related measures, the Act makes other significant changes to the benefits system. The changes that specifically affect councils include:

- restriction of Housing Benefit entitlement for social housing tenants whose accommodation is larger than they need;
- up-rating of Local Housing Allowance rates by the Consumer Price Index; and

- capping of the total amount of benefit that can be paid.

The Act will have significant operational and resource implications for the Council.

Localising council tax support is a further area under review. Proposals are that council tax support will not form part of Universal Credit, remaining a local authority responsibility. The proposals give local authorities the flexibility to design schemes which reflect local priorities. This should give them greater financial stake in the economic future of their area and enabling them to deliver a saving of 10 per cent on the current council tax benefit expenditure bill.

Members and senior management are alert to the financial risks that these welfare reforms pose to the Council.

Financial statements and annual governance statement

The Council's financial statements and annual governance statement are an important means by which the Council accounts for its stewardship of public funds. I gave an unqualified opinion on the Council's 2010/11 financial statements on 4 April 2012. This was six months after the statutory target date of 30 September 2011 and was because of many errors in the financial statements presented for audit.

Overall conclusion from the audit

Norwich City Council, along with all local authorities and police authorities, were required to prepare their financial statements in line with International Financial Reporting Standards (IFRS) for the first time in 2010/11. This was a significant exercise because the new standards (which covered areas such as leases and the recognition of grant income and balances) had to be adopted retrospectively. This required finance officers to reconsider their lease agreements for example, and, where necessary, retrospectively restate accounting entries from the beginning of these agreements. IFRS implementation also created significant pressure on resources for councils due to the need for additional disclosures in the financial statements.

The Accounts and Audit (England) Regulations 2011 require the responsible financial officer to sign and date the financial statements and certify that it presents a true and fair view by 30 June. The Council failed to meet this deadline. The Head of Finance signed the financial statements on 28 July and submitted them to me for audit. The delay in preparing an auditable set of financial statements has clearly been affected by the requirement to apply IFRS, and the need to present restated comparatives. However, given the Council has not met the statutory deadline for audited financial statements in recent years, I have wider concerns about capacity and capability.

The financial statements presented for audit on 28 July required significant revision in terms of both accounting entries and financial statements disclosures. The issues resulted in the need for further versions of the financial statements and a protracted audit process which was not concluded until April 2012. Because of these issues I had to charge the Council additional audit fees as set out in appendix 1.

The financial statements included six individually material errors and a large number of errors that were not individually material but totalled to £16 million gross. Four of these had a net impact of £470,000 on the Council's general fund. Additionally, officers continued to make their own amendments to the financial statements after the Head of Finance had signed them and presented them for audit (gross total .of £10 million).

The individually material errors included:

- an increase required to the depreciation charge for IT assets acquired under the Private Finance Initiative (PFI) arrangement;
- reclassifying long term assets held for sale to short term in the restated 1 April 2009 balance sheet;
- reclassifying investment property to current assets held for sale in the restated 1 April 2009 balance sheet;
- reclassifying current assets held for sale to property, plant and equipment in the restated 31 March 2010 balance sheet;
- removing pension fund 'past service' costs from the Housing Revenue Account (HRA), as these can only be allocated to the HRA where there is a 'reliable' basis of apportionment. The error affected the face of the HRA and the Movement in Reserves Statement; and
- reclassification of various grants in the Consolidated Income and Expenditure Statement (CIES) as the classification of grant income had been incorrectly presented under IFRS.

I also detected material errors in the Council's cash flow statement, which underwent a number of iterations.

Officers adjusted for most of the errors I found, but chose not to adjust for 14 errors. These errors were not so significant to distort the overall financial position shown in the Council's financial statements. I reported these to the Council's Audit Committee. The Chair of the Committee agreed with officers' decision not to amend the financial statements for these errors, and the Council provided me with their explanation for this.

I also reported some weaknesses in the Council's accounting practices, policies, estimates and financial statements disclosures to the Audit Committee in my Annual Governance Report. These included:

- concerns about the overall quality of the financial statements presented for audit, including accounting policy disclosures;
- weaknesses in accounting for PFI transactions and associated disclosures;
- weaknesses in the Council's Capital Financing Requirement calculation which is required under the Prudential Code;
- the need for improvements in the Council's accounting practices for components of property, plant and equipment, and the related derecognition of components of assets that it replaces; and
- the Council's processes for capturing related party transactions.

Before giving my opinion I reported the issues arising from the 2010/11 audit to the Audit Committee in my Annual Governance Report (AGR) and in later updates. The AGR includes a comprehensive action plan which officers have responded to.

Because of the delay in issuing my opinion on the financial statements, the audit deadline of 30 September 2012 for the Whole of Government Accounts (WGA) consolidation pack was also not met. The Council provided me with a revised pack for audit on 18 June 2012, and my work is still in progress. Until that is complete I am not able to issue my certificate concluding the audit for 2010/11.

It is critical the Council improves its financial reporting capacity and capability so it can deliver a good set of 2011/12 financial statements for audit by 30 June 2012, with appropriate audit working papers. My letter includes a formal recommendation on this.

On 12 April 2012 the Council entered an arrangement with Local Government Shared Services (LGSS) for IT and finance services, including Internal Audit. This included the delegation of the responsible financial officer (Section 151 officer) role to an officer of Cambridgeshire County Council on behalf of LGSS. The Council will need to oversee these new arrangements to ensure they deliver improved outcomes, including the necessary improvements in financial reporting.

Significant weaknesses in internal control

I reported some weaknesses in internal control to the Audit Committee in my Annual Governance Report for 2010/11. The Council needs to continue to improve and strengthen internal controls. This year's recommendations covered weaknesses relating to:

- capturing information on leases;
- the valuation processes for valuing property, plant and equipment and investment property;
- the fixed asset register;
- delays in completing the Accounts Payable control account reconciliation;
- IT passwords and controls over spreadsheets;
- Internal Audit; and
- financial reporting to Council members at the year-end.

Recommendation

R1 The Council should put in place robust arrangements for the production of the 2011/12 financial statements, which meet statutory requirements and international financial reporting standards. In order to achieve this the Council should:

- ensure sufficient resources are available to support the financial statements production;
- develop a comprehensive project plan which ensures:
  - statutory deadlines for approval of the financial statements are met;
  - recommendations made in my Annual Governance Report are considered in sufficient depth and addressed before the financial statements are approved;
  - the entries in the financial statements are supported by good quality working papers which are available at the start of the audit;
  - the financial statements and working papers have been subject to robust quality assurance prior to approval by the Section 151 officer. This should include, but not be limited to, internal consistency checks;
  - the financial statements presented for audit are complete and are not subject to further change, subject to any amendments resulting from the audit process;
- provide additional training, where necessary, to ensure all staff involved in the accounts production process have the necessary skills and information; and
- monitor the production of the financial statements through regular reporting to the Corporate Executive Team and the Audit Committee.

Certification of claims and returns

As the Council's auditor I am required to certify the Council's claims and returns. I issued my 2010/11 Certification of Claims and Returns Annual Report in February 2012. This commented that the Council continues to improve its preparation of grant claims, but that claims production remains variable and the Council should make further improvement. Of the six claims I certified, five were subject to amendment, although some of these changes were presentational and did not impact on the amount claimed. I issued qualification letters on two of the claims certified, including the Housing and Council Tax Benefits claim, which is the Council’s largest grant claim.

The Council should continue to drive improvements in preparing its claims and returns to reduce the certification work and associated cost.

Value for money

I considered whether the Council is managing and using its money, time and people to deliver value for money. I assessed your performance against the criteria specified by the Audit Commission and have reported the outcome as the value for money (VFM) conclusion.

I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against two criteria specified by the Audit Commission. My overall conclusion is that the Council has adequate arrangements to secure, economy, efficiency and effectiveness in its use of resources.

I set out my conclusion on each of the two areas below.

Value for money criteria and key messages

Criterion	Key messages
1. Financial resilience **The organisation has proper arrangements in place to secure financial resilience.** Focus for 2010/11: The organisation has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.	The Council has a savings and efficiency plan in place. It is delivering efficiency targets and making budget reductions to ensure the Council's financial position is sufficiently robust. While the focus is on longer term financial solutions rather than short term financial fixes, the Council has had to modify its approach because of the late announcement of reduced grant settlements which outstripped the Council's estimates. The Council planned to fund £1 million of revenue expenditure from reserves in 2011/12, as well as saving £0.85 million from not filling vacancies and by deferring expenditure. Its budget setting paper acknowledged that these were temporary measures to help balance the budget and to prevent cuts to frontline services.

Criterion	Key messages
	The use of reserves to their prudent level to avoid cost savings increases the risk that the Council may be less able to deal with an unexpected hit on its finances. It has clearly acknowledged this risk in its corporate risk register. The focus is now on further development of a programme to reshape the Council and achieve the four years savings programme. The Council has a good record of achieving budget savings in recent years. It acknowledges that, in the current financial environment, these are going to become harder to achieve. However, unaudited figures suggest an underspend position will be achieved for 2011/12. The Council has a significant asset base which impacts financial planning. Additional management resource, expertise and training has been brought in to support the delivery of the Asset Management plan and to start to address the service development and improvement issues raised by Internal Audit in 2009. The Council adopted a Corporate Asset Management Strategy in July 2011, and this is a welcome development. There are potentially some significant ‘wins’ to be made from a more focused approach to asset management. This is necessary given an identified need for over £6 million of urgent repairs and refurbishments to be carried out. Financial governance arrangements are more mixed. A strong internal control environment is a key to supporting the Council’s financial planning and overall governance arrangements. As noted earlier in my letter, I continue to find weaknesses in the design and application of some controls, including the effectiveness of the Internal Audit function. I determined that these weaknesses were not significant enough to detract from the strong arrangements the Council has put in place to ensure that cost savings are made and that long term financial planning is robust. However, the Council should recognise and address these underlying weaknesses.

Criterion	Key messages
2. Securing economy efficiency and effectiveness **The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.** Focus for 2010/11: The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.	Members and senior management provide strong leadership to prioritise resources, with clear focus on the necessary spending reductions. Strategic priorities and ongoing activities are effectively challenged using a variety of techniques. The Council is prepared to investigate longer term options to secure reductions. This has resulted in areas of business process redesign and some sharing of services. Examples include shared legal services with Norfolk County Council, and, from April 2012, a shared service arrangement with LGSS to deliver financial services and IT arrangements. The Council has consulted with staff and external stakeholders when appropriate to inform these processes and the ultimate prioritisation of resources. Arrangements to prevent the unintended impact of savings on activities or spending of other departments are in place. Business cases include an integrated impact assessment which considers the impact on other areas of the Council as well as other factors such as social and environmental impacts. The Council benchmarks its costs to inform its spending challenges, although this could be extended and made more visible across the Council. It works well to understand the resources that partners have. An example is the work it has done with the Homes and Communities Agency to facilitate capital developments. Further, it considers other organisations' good practice and learns from others.

Closing remarks

I have discussed and agreed this letter with the Chief Executive and the Chief Finance Officer. I will present this letter at the Audit Committee on 10 July 2012 and will provide copies to all board members.

Further detailed findings, conclusions and recommendations in the areas covered by our audit are included in the reports issued to the Council during the year.

Report	Date issued
Audit Fee Letter	April 2010
Audit Opinion plan	August 2011
Annual Governance Report	December 2011
Certification of claims and returns – annual report	February 2012
Auditor's report giving the opinion on the financial statements and value for money conclusion	April 2012

The Council has taken a positive and constructive approach to our audit. I wish to thank the Council staff for their support and cooperation during the audit.

Rob Murray

District Auditor

June 2012

Appendix 1 – Fees

	Actual £	Proposed £	Variance £
Audit fee	311,000	185,355	125,645
Grants fee	106,366	67,585	38,781
Total	**417,366**	**252,940**	**164,426**

Audit Fee

The proposed audit fee for 2011/12 was £185,355. I set this fee on the basis that the general level of risk reduced as the Council resolved issues that led to material financial statements amendments in previous years. This risk reduction was not achieved and I raised a significant number of issues in my Annual Governance report, which have been summarised in this letter. This included the extent of issues around the transition to IFRS, the quality of the first set of financial statements presented for audit and weaknesses in internal control.

These issues resulted in significant additional audit work being undertaken to gain sufficient audit assurance for opinion purposes and therefore the fee for the audit was significantly higher than that proposed in my audit fee letter. The additional fees were discussed and agreed with the Head of Finance and have been notified to the Audit Committee Chair.

Grants Fee

My fee letter commented that £67,585 was an estimate and that the fees would be based on the rates prevailing when the work was carried out. My letter highlighted a degree of risk based on the 2009/10 certification work which was being completed at that time. The fee charged of £106,366 compares with £124,612 in 2009/10.

Appendix 2 – Glossary

Annual governance statement

Governance is about how local government bodies ensure that they are doing the right things, in the right way, for the right people, in a timely, inclusive, open, honest and accountable manner.

It comprises the systems and processes, cultures and values, by which local government bodies are directed and controlled and through which they account to, engage with and where appropriate, lead their communities.

The annual governance statement is a public report by the Council on the extent to which it complies with its own local governance code, including how it has monitored the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period.

Audit opinion

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

International Financial Reporting Standards

Guidelines and rules set by the International Accounting Standards Board that companies and organisations follow when compiling financial statements.

Opinion

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

Private Finance Initiative (PFI)

The use of private finance in capital projects, particularly in relation to the design, construction and operation of buildings and support services.

Value for money conclusion

The auditor’s conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

Appendix 3 – Action plan

Recommendations
Recommendation 1

The Council should put in place robust arrangements for the production of the 2011/12 financial statements, which meet statutory requirements and international financial reporting standards. In order to achieve this the Council should:

- ensure sufficient resources are available to support the financial statements production;
- develop a comprehensive project plan which ensures:
  - statutory deadlines for approval of the financial statements are met;
  - recommendations made in my Annual Governance Report are considered in sufficient depth and addressed before the financial statements are approved;
  - the entries in the financial statements are supported by good quality working papers which are available at the start of the audit;
  - the financial statements and working papers have been subject to robust quality assurance prior to approval by the Section 151 officer. This should include, but not be limited to, internal consistency checks;
  - the financial statements presented for audit are complete and are not subject to further change, subject to any amendments resulting from the audit process;
- provide additional training, where necessary, to ensure all staff involved in the accounts production process have the necessary skills and information and
- monitor the production of the financial statements through regular reporting to the Corporate Executive Team and the Audit Committee.

Recommendations	
Responsibility	Chief Financial Officer
Priority	High
Date	June 2012
Comments	As requested we set out below the actions already taken to address the points in the recommendation. Following the production and audit of the Council's Statement of Accounts for year ended 31 March 2011, considerable changes have been made to ensure that the process for 2011/12 enables the timely production of financial statements which meet statutory requirements and International Financial Reporting Standards. Firstly, partnership arrangements with LGSS are now in place. The finance team on site in Norwich is now part of a larger LGSS team and can call on technical support from colleagues if issues arise. A project plan, supported by detailed work programmes, has been put in place. This includes tasks to address the few AGR issues that remain. Adherence to the project plan should ensure that there is time available to produce good quality, reviewed and approved working papers and financial statements. Progress against work plans is being reviewed fortnightly by the Chief Accountant and Finance Control Manager, with an overview by the Chief Finance Officer. Progress is currently to plan, with the exception of the revised HRA asset valuation, as already discussed with the external audit team so that it can be factored into the planning of the forthcoming audit. Progress is being reported to CLT monthly, with the option of more frequent exception reporting if required. Written updates are being provided to the Chair of the Audit Committee on the same basis. No additional training needs have been identified. Significant training was undertaken last year, and this has been updated through attendance at the Audit Commission workshop in January. Further training and support will be provided if required, through LGSS or externally as appropriate.

If you require a copy of this document in an alternative format or in a language other than English, please call:
0844 798 7070

Design and production by the Audit Commission Publishing Team.

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

www.audit-commission.gov.uk

June 2012