

Annual Audit Letter

Somerset County Council

Audit 2009/10

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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Key messages

This report summarises my findings from the 2009/10 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 only significant recommendations in this report. The Council has accepted these recommendations.

Audit opinion and financial statements

1 The audit of Somerset County Council's (the Council) financial statements was completed in September 2010. The accounts presented for audit contained material misstatements. These were amended in the final version approved by the Audit Committee on 23 September 2010. I also identified significant weaknesses in the Council's internal control arrangements. Following completion of the audit I issued an unqualified opinion on the financial statements.

Value for money

2 I assessed the Council's arrangements to secure economy, efficiency and effectiveness in the use of its resources against criteria specified by the Audit Commission. I issued an unqualified conclusion stating the Council had adequate arrangements in place to secure value for money in the use of its resources.

Audit fees

3 The analysis in Appendix 1 shows our fees changed since agreeing the original Audit Plan for 2009/10, due to:

- Issues arising from my audit of the financial statements which resulted in additional audit work; and
- The Audit Commission reducing pension fund fee scales nationally part way through the audit.

Current and future challenges

4 The Council and SouthWest One (SWO) have clearly spent significant time and money to make a success of the arrangement but so far the benefits have not fully met those originally envisaged. Performance management arrangements of the contract have improved over the last year, however, realising future savings will become more difficult given the reductions in local government spend nationally. The financial success of the contract is dependent on SWO's performance in delivering procurement savings and the ability of the organisation to manage contractual performance.

5 The Council established good arrangements to manage the Building Schools for the Future (BSF) procurement. A Gateway Review in April 2010 concluded the project was 'well led and managed' and had 'strong stakeholder support'. The BSF programme team developed robust risk management arrangements for the procurement phase. The Council now need to set up a more robust risk management arrangement for the construction and operational phases of the project, to ensure the project is delivered on time and within budget.

6 The economic downturn has and will continue to have a very significant impact on public finances for the foreseeable future. The ability to fund service delivery and capital programmes will be significantly reduced. Yet the demand for core services such as social care continues to increase. These challenges will mean that difficult policy decisions will have to be made, especially where the pattern of demand is changing or where services need to be reduced.

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 2009/10 financial statements on 23 September 2010, before the statutory target date.

Overall conclusion from the audit

7 I issued an audit report including an unqualified opinion on the financial statements on 23 September 2010.

Errors in the financial statements

8 A number of errors were identified from my audit of the Accounts although none of these affected the net spending of the Authority or its revenue balances:

- Environmental Services income and expenditure for structural maintenance of highways and concessionary fares were overstated by £18.233 million and £2.690 million respectively.
- Children's Services and Education Services income and expenditure was overstated by £1.8 million.
- The audit identified inconsistencies between the fixed asset register kept by the accountants and the asset listing kept by valuers. Fixed asset values in the accounts were understated by about £5.2 million.
- My audit of the Pension Fund accounts identified that recurring pension payments reported in the Fund account were understated by £3.313 million.

9 The accounts were amended to reflect my findings above prior to re-approval by the Audit Committee on 23 September 2010.

Icelandic banks

10 English local government authorities hold deposits worth £953 million in two of the three failed Icelandic banks (Glitnir and Landsbanki) or their UK subsidiaries (Heritable and KSF). Of the 127 local authorities that are affected, councils have the largest exposure, with 105 holding deposits worth more than £793 million.

11 At the time of the collapse of the Icelandic banks in early October 2008, Somerset County Council had £25 million invested. Since the Icelandic banks went into administration, negotiations to recover invested funds have been ongoing between creditors and the administrators. As at July 2010 the Council had received £4.64 million from Kaupthing, Singer and Friedlander bank and another dividend of five pence in the pound (a minimum of £500,000) is due December 2010. There is an expectation of more to come.

12 The Council continues to monitor the progress of their claim against the Icelandic Government.

Significant weaknesses in internal control

13 Testing of the new financial system (SAP) showed the system controls had not worked effectively for part of 2009/10. As a result I was unable to rely on financial system controls for my audit assurance. Therefore I carried out a substantive audit testing approach.

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.

2009/10 use of resources assessments

14 At the end of May 2010, the Commission wrote to all chief executives to inform them that following the government's announcement, work on Comprehensive Area Assessment would cease with immediate effect and the Commission would no longer issue scores for its use of resources assessments.

15 However, I am still required by the Code of Audit Practice to issue a value for money conclusion. I have therefore used the results of the work completed on the use of resources assessment up to the end of May to inform my 2009/10 conclusion.

16 I report the significant findings from the work I have carried out to support the vfm conclusion.

VFM conclusion

17 I assessed your arrangements to achieve economy, efficiency and effectiveness in your use of money, time and people against criteria specified by the Audit Commission. The Audit Commission specifies, each year, which Key Lines of Enquiry (KLOE) are the relevant criteria for the VFM conclusion at each type of audited body.

18 This is a summary of my findings.

Criteria	Adequate arrangements?
Managing finances	
Planning for financial health	Yes
Understanding costs and achieving efficiencies	Yes
Financial Reporting	Yes
Governing the business	
Commissioning and procurement	Yes
Use of information	Yes
Good governance	Yes
Risk management and internal control	Yes
Managing resources	
Natural Resources	Yes
Strategic asset management	Yes
Workforce	Yes

19 I issued an unqualified conclusion stating that the Council had satisfactory arrangements to secure economy, efficiency and effectiveness in its use of resources.

Managing finances

20 The Council's costs and services continue to compare well with other counties. The Council has a good understanding of its costs and performance, which it uses well in its decision making and commissioning. A comprehensive range of cost benchmarking and performance information is used by the Council and effective performance management arrangements exist.

21 The Council has clear aims and objectives, linked to and supporting the needs of the public and its partners. It engages well with local communities and stakeholders in the financial planning process and invites feedback from the public through a number of different mediums. Shared priorities as set out in the Annual Plan and Sustainable Community Strategy continue to be delivered with partners. Whilst the national requirement to monitor the LAA has been removed, the Council and its partners will continue to measure and monitor those that are relevant to ensure the delivery and achievement of local priorities. Financial training is available to all staff and members, in support of their individual and collective responsibilities for financial management.

22 The Council has effective procedures to oversee and challenge efficiency targets but has been less effective in their delivery. The Council has identified some £45 million of new efficiencies but only realised 57 per cent of the £10.6 million efficiency savings identified in 2009/10. Given the reductions in local government spending nationally, to secure increased savings targets in the future will be more difficult to make.

23 The Council has clear and concise reports that support its strategic decision making. Robust monthly and quarterly dashboards and performance monitoring reports are produced. These allow the Council to monitor progress on the actions within the Annual Plan and measure the difference they are making in the community.

24 Budget and performance monitoring remain sound. Budget processes remained robust despite problems following implementation of the new financial system. Budgets continue to be monitored and reported to members on a directorate basis. Evidence obtained from audit work provides assurance as to the accuracy of these reports and confirms that significant variances are monitored. The accounts were approved by the deadline and detailed electronic working papers provided for audit to support the accounts.

Governing the business

25 The Council has a good understanding of the social, economic and environmental factors affecting Somerset. It has clear aims and objectives and engages well in the commissioning and procurement of services. Extensive use is made of joint procurement where this offers best value.

26 The Council adopts, promotes and displays the principles of good governance. Regular corporate reviews and action plans are in place. Ethical standards are good and governance arrangements and security issues reviewed and reported to councillors. The Council has an effective and approved constitution in place and it has approved a Code of Corporate Governance. Equality and diversity training is in place and reviews of the governance and management arrangements of the key partnerships undertaken. The Council ensures that sufficient resources are made available for anti-fraud and corruption work.

27 The Council improved risk management processes during 2009/10 and updated the Risk Management Strategy in November 2010 to reflect the new arrangements. Most internal controls remain effective but weaknesses have been found in the Council's financial controls following the implementation of SAP. Many of these have since been addressed.

Managing resources

28 The Council takes a strategic approach to asset management but has yet to complete its Asset Management Plan. Plans are in place at directorate level but the Council has yet to produce a corporate plan linking all the subsidiary plans. All Directorates have carried out a review of their assets to look at usage, condition and cost. This information has been used to prioritise project bids and feed the accommodation and wider property review.

29 The Council has good arrangements for management and monitoring of its workforce that supports its priorities. The Council acknowledges good performance and staff know what is expected of them. Managers recognise good performance and provide regular feedback. An employee assistance scheme is in place and there is comprehensive health and safety management. Under-represented groups are identified to deliver greater diversity. However, workforce and service planning is not yet comprehensive across the Council. The Council has proper policies and diversity practice to support good people management and comply with equalities legislation. Employment action plans are in place for race, disability and gender. It has four equality networks, runs an equalities conference and has extended mentoring and coaching schemes to address minority groups.

Risk-based performance reviews

30 To support my review of the criteria I undertook the following studies.

- SouthWest One performance management and benefits realisation.
- Review of Somerset building schools for the future.

31 I have reported my detailed findings to the Council in separate reports.

SouthWest One performance management and benefits realisation

32 The first three years of the contract have been a difficult time for both the Council and SouthWest One (SWO), largely owing to the challenge of implementing SAP across the County Council and its partners. Both SWO and the Council have clearly spent significant time and money to make a success of the arrangement but so far the benefits have not fully met those originally envisaged.

33 Performance management arrangements of the contract have improved over the last year but more work is required. The Council has addressed data quality issues identified in 2009. Performance indicator definitions were re-assessed and an independent evaluation of the performance management arrangements undertaken. Monthly service performance reports are produced by SWO, however, more work is required to ensure the accuracy of the indicators. Some indicators are still to be agreed. Without them, key areas of the contract cannot be monitored. The Council should review key performance indicators (KPIs) ensuring that they are meaningful and provide an appropriate measure of performance.

34 Overall contract management arrangements are robust. Interdepartmental working groups meet weekly and aid the Client Services Team with the day-to-day management of the contract. Liaison with SWO has improved and parts of the contract re-negotiated to the benefit of the Council. However, SAP deficiencies have affected the ability to report on the arrangement. Problems obtaining accurate or complete information to support category management and significant system difficulties were overcome to produce the Council's 2009/10 accounts.

35 Financial reporting of the contract needs simplification. The use of differing price bases for costs and savings inhibits effective assessment of the contract. Savings can be less in real terms than forecast in 2007/08. The ability to drive out savings is likely to be significantly reduced because of the current economic climate and limits on available financial resources.

36 Potential savings of £45.5 million (£22 million implemented and £23.5 million awaiting implementation) have been identified and agreed. The Council is in the process of delivering these savings, with a further £40 million identified by SWO but not yet agreed by the Council for delivery (the 'pipeline'). However, actual savings are below those originally forecast and currently stand at £3.3 million 'cached' (part of the £22 million of benefits implemented). Savings to this value will flow as spend is incurred in future years. To realise the original savings profile will require a significant increase in the delivery of savings but this may be curtailed given the reductions in local government spend nationally. Managing the 'gain share' arrangement within the procurement project needs to be used to further incentivise the identification and delivery of savings.

37 In the current financial climate the Council has rightly questioned whether it could buy services at a reduced cost. Public sector contracts are being re-assessed across the country and many including those of the Council are being re-negotiated. It is also questioning whether some savings identified internally by the Council should be included within the procurement savings claimed by SWO. This is relevant as the claimed procurement figures approach the £75 million 'gain share' level. The Council has taken steps through the formal contractual processes to clarify this point.

38 IBM has provided much needed marketing skills and experience to aid economic development in Somerset. Their involvement in the Inward Investment Agency (Into Somerset) and the Somerset University Partnership Project have been appreciated. Similarly, access to specialist skills and experience has proved beneficial.

39 The financial benefits achieved through the SWO unitary charge continue to benefit the Council. These include a discounted price for the delivery of SWO services, continued uplift of the KPIs over the contract years, and the absorption by SWO of any price and volume increases related to the contracts novated to SWO by the Council. The move to a partially variable unitary charge has benefited the Council by reducing the initially contracted spend, across the term of the agreement.

Recommendations

- R1** Performance measures are a joint responsibility and should continue to be improved to ensure they are meaningful, relevant, and challenging to drive improvement in the delivery of services.
- R2** The expected savings the procurement project can produce needs to be urgently revised to accommodate the significant changes in local government finances.
- R3** As part of the recommended wider reassessment of expected savings, the 'gain share' arrangement where SWO receives a percentage of identified savings should be continually reviewed.
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Review of Somerset building schools for the future

40 The Council is taking part in the national Building Schools for the Future (BSF) programme. The Council chose three schools in Bridgwater to be rebuilt. The contract has been signed to rebuild Chilton Trinity, Elmwood and Robert Blake schools and work started on site in September.

41 My work found the Council established good arrangements to manage the BSF procurement. A Gateway Review in April 2010 concluded the project was 'well led and managed' and had 'strong stakeholder support'.

42 The BSF programme team developed robust risk management arrangements for the procurement phase. The Gateway Review team commended the improvement in these arrangements between its reviews in October 2007 and February 2008.

43 The most recent Gateway Review highlighted some weaknesses in risk management arrangements for the period after financial close. The risk assessment set out in the Final Business Case does not provide enough information. The Council now need to set up a more robust risk management arrangement for the construction and operational phases of the project, to ensure the project is delivered on time and within budget.

44 In line with HM Treasury requirements, the Council verified the project represented value for money by comparing the estimated cost of the Private Finance Initiative (PFI) with the equivalent cost of a public sector project. The programme team worked with the Council's external advisers to confirm the project represented value for money when seeking government approval and revisited the case before financial close.

45 In the current financial climate, it is critical to confirm funding is available to meet long-term financial commitments. The Council used prudent estimates when planning the project, so the annual charge is lower than expected. Partnerships for Schools instructed the Department for Communities and Local Government to provide PFI credit funding for the scheme. The total PFI credit awarded represents more than 88 per cent of the total cost of this project. The Council will need to meet the balance from the overall and schools' budget.

46 The schools are expected to open in autumn 2012. Once open, the Council will start to pay the full unitary charge to the contractor. The Council is planning arrangements to ensure the contractor meets their contractual commitments. The Council must ensure that effective contract monitoring arrangements are in place.

Recommendations

R4 The Council should ensure that adequate risk management arrangements are in place for the operational phase of the BSF programme. These arrangements should include recording all information relevant to the risks identified and arrangements for reporting risks where appropriate.

R5 The Council should agree revised contributions to the BSF scheme with the schools to ensure that sufficient funding is available to cover the unitary charge once it falls due.

R6 The Council should specify the roles and responsibilities of the client monitoring team for the BSF project. This specification will enable the Council to identify the structural requirements for the client monitoring team.

Follow up of review of arrangements to transfer leisure services to a trust

47 The Council formed a charitable trust, Somerset Leisure Limited in November 2008. During 2009, the Council transferred the operation of twelve of its seventeen leisure facilities to Somerset Leisure Limited.

48 During 2010, I completed a follow up review of the Council's progress in responding to earlier audit recommendations and in implementing arrangements to manage the leisure trust. My review concludes that the Council has arrangements in place to address the issues raised in my original report.

Approach to local value for money work from 2010/11

49 Given the scale of pressures facing public bodies in the current economic climate, the Audit Commission has been reviewing its work programme for 2010/11 onwards. This review has included discussions with key stakeholders of possible options for a new approach to local value for money (VFM) audit work. The Commission aims to introduce a new, more targeted and better value approach to local VFM audit work.

50 My work will be based on a reduced number of reporting criteria, specified by the Commission, concentrating on:

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

51 I will determine a local programme of VFM audit work based on my audit risk assessment, informed by these criteria and my statutory responsibilities. I will no longer be required to provide an annual scored judgement relating to my local VFM audit work. Instead I will report the results of all my local VFM audit work and the key messages for the Council in my annual report to those charged with governance and in my annual audit letter.

Current and future challenges

Economic downturn and pressure on the public sector

52 The economic downturn has and will continue to have a very significant impact on public finances for the foreseeable future. Following the announcement of the Comprehensive Spending Review, councils up and down the country are updating budgets and medium term financial plans to address the shortfall in income. Reductions in government revenue grant over the next four years will have a fundamental impact on all councils.

53 The ability to fund service delivery and capital programmes will be significantly reduced. Yet the demand for core services such as social care continues to increase. These challenges will mean that difficult policy decisions will have to be made especially where the pattern of demand is changing or where services need to be reduced.

54 Although services are generally good, such standards are unlikely to be retained unless new delivery options are found. Thus the need to work well with its partners (public, private and voluntary) will become increasingly important. This is especially so where a number of these are being disbanded and services transferred to other bodies

55 Work continues to streamline Council services. The need to find increasing amounts of savings is central to the long term delivery of services. New procurement arrangements and transformation projects have the potential to fill such gaps but current delivery and savings are below expectations. The Council's Medium Term Financial Strategy and Improvement Plans are fundamental because the next few years will be a difficult time for the Council. The need for significant decreases in expenditure, at a time of increasing demand, will require careful planning and effective management if services are not to suffer.

Closing remarks

56 I have discussed and agreed this letter with the Corporate Director - Resources. This Letter is presented to the Audit Committee and electronic copies provided for circulation to committee members.

57 Full detailed findings, conclusions and recommendations in the areas covered by my audit were included in the reports I issued to the Council during the year.

Report	Date issued
Audit Plan for Somerset County Council	March 2009
Audit Plan for Somerset County Council Pension Fund	March 2009 updated June 2010
Audit opinion plan	June 2010
Audit of financial systems	June 2010
Annual Governance Reports	September 2010
Auditor's opinion and value for money conclusion	September 2010
Final accounts memorandum	October 2010
Review of Somerset building schools for the future	October 2010
SouthWest One performance management and benefits realisation	November 2010
Annual Audit Letter	November 2010

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

Brian Bethell
District Auditor

November 2010

Appendix 1 Audit fees

	Actual	Original agreed fee	Variance
Financial statements and annual governance statement	£151,500	£136,300	+£15,200
Value for money	£96,300	£96,300	nil
Total audit fees	£247,800	£232,600	+£15,200
Pension Fund	£38,600	£48,600	-£10,000
Total	£286,400	£281,200	+£5,200

Note: The fee notified for the certification of claims and returns for 2009/10 was £23,700. The audit of claims and returns is dependent on the number submitted for audit. I am currently auditing the claims and will notify you of the audit fee on completion.

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 accounts, auditors must give their 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;
- whether they have been prepared properly, following the relevant accounting rules; and
- for local probation boards and trusts, on the regularity of their spending and income.

Financial statements

The annual accounts and accompanying notes.

Qualified

The auditor has some reservations or concerns.

Unqualified

The auditor does not have any reservations.

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 money, people and time.

Appendix 3 Action Plan

Recommendations

Recommendation 1

Performance measures are a joint responsibility and should continue to be improved to ensure they are meaningful, relevant, and challenging to drive improvement in the delivery of services.

Responsibility	Oliver Woodhams, Group Manager - Business Operations
Priority	High
Date	Ongoing
Comments	<p>Since contract commencement, working together with colleagues from Taunton Deane Borough Council, officers from Somerset County Council's Client Services team have been engaged negotiating a number of improvements to the original price-performance mechanism.</p> <p>These negotiations have been challenging commercially. All have involved transferring additional risks to the supplier after the contract has been signed. Furthermore, measuring the complexity and range of the services delivered under the contract in an objective manner is intrinsically difficult.</p> <p>The Council acknowledge further improvements are required and will continue to negotiate changes to performance measures throughout the life of the contract. The next phase will commence with a planned revision to output specifications, however, this will be a long and complex process.</p>

Recommendation 2

The expected savings the procurement project can produce needs to be urgently revised to accommodate the significant changes in local government finances.

Responsibility	Steve Murphy, Finance Manager Client Services and Ian Conner, Chief Procurement Officer SWO
Priority	High
Date	March 2011
Comments	The Council will ensure the addressable spend is calibrated by changes in local government finance through appropriate targets and expectations.

Recommendations

Recommendation 4

As part of the recommended wider reassessment of expected savings, the 'gain share' arrangement where SWO receives a percentage of identified savings should be continually reviewed.

Responsibility	Matt Jones, Head of Client Services
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Priority	High
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Date	March 2011
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Comments

Recommendation 5

The Council should ensure that adequate risk management arrangements are in place for the operational phase of the BSF programme. These arrangements should include recording all information relevant to the risks identified and arrangements for reporting risks where appropriate.

Responsibility	Julia Ridge, Somerset BSF Programme Director
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Priority	High
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Date	December 2010
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Comments

Recommendation 6

The Council should agree revised contributions to the BSF scheme with the schools to ensure that sufficient funding is available to cover the unitary charge once it falls due.

Responsibility	Julia Ridge, Somerset BSF Programme Director
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Priority	High
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Date	June 2011
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Comments	Somerset BSF is a town-wide proposal and schools' contributions will be the same across the town. Therefore the Council need to be aware of the position of the remaining three schools.
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Recommendation 7

The Council should specify the roles and responsibilities of the client monitoring team for the BSF project. This specification will enable the Council to identify the structural requirements for the client monitoring team.

Responsibility	Julia Ridge, Somerset BSF Programme Director
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Priority	High
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Date	December 2010
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Comments

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