

# Annual Audit Letter

Somerset County Council

Audit 2008/09

November 2009



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## Status of our reports

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 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.
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# Key messages

This report summarises the findings from our 2008/09 audit. It includes messages arising from the audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.

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## Audit Opinion

- 1 We issued an unqualified opinion upon your financial statements on 24 September 2009.

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## Audit Certificate

- 2 As there is still an outstanding issue concerning the interpretation of Schedule 2 of the Controlled Waste Regulations 1992, I am not yet in a position to issue the audit certificate.

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## Financial Statements

- 3 No material errors have been identified from our audit of Somerset County Council's accounts, however, the Pension Fund accounts did require a number of adjustments.

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## Value for money

- 4 We issued an unqualified Value for Money conclusion on 24 September 2009.

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**Table 1**      **Audit fees**

	<b>Plan 2008/09</b>	<b>Actual 2008/09</b>	<b>Variance</b>
Financial statements and annual governance statement (including whole of government accounts)	£128,800	£128,800	Nil
Value for money	£90,500	£90,500	Nil
Inspection fee	£14,900	£14,900	Nil
Pension fund accounts	£48,000	£50,100	£2,100
<b>Total audit fees</b>	<b>£282,200</b>	<b>£284,300</b>	<b>Nil</b>

- 5 The analysis above shows that our fees have increased since agreeing the original Audit Plan for 2008/09 relating to issues arising during our audit of the financial statements of the Pension Fund.

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### Independence

- 6 I can confirm that the audit has been carried out in accordance with the Audit Commission's policies on integrity, objectivity and independence.

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### Action needed by the Council

- 7 Respond to the areas for further improvement to the Council's arrangements identified through the use of resources judgements, in particular:
- promote more effective joint working across Somerset to help achieve the potential improvement and efficiency savings identified through the Pioneer Somerset Programme;
  - consider and capture all risks as part of an integrated corporate risk management process; and
  - produce a corporate asset management plan linking subsidiary plans that meet the Council's corporate strategy.
- 8 Address the lessons learnt from the Icelandic banking crisis, by remaining vigilant and react to warning signals concerning all future financial investments.
- 9 Although the Council has responded positively to the economic downturn and banking crisis, cash efficiency savings are becoming more difficult to make. Work that started before the recession to streamline Council services remains a priority.
- 10 Continue to monitor Southwest One's delivery, to ensure that benefits realisation and the transformation of services is delivered on time and within budget. The implementation of new corporate systems (SAP) has been challenging and the Council must resolve the shortcomings being experienced as a priority.

# Financial statements and annual governance statement

**Somerset County Council's financial statements and annual governance statement are an important means by which the Council accounts for its stewardship of public funds.**

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## Significant issues arising from the audit

- 11** I issued an audit report including an unqualified opinion on the financial statements on 24 September 2009.
- 12** A number of errors have been identified from our audit of the Pension Fund Accounts:
- derivative assets and liabilities incorrectly included the value of transactions, which had already been completed. Derivative assets were overstated by £14.7 million and liabilities by the same amount;
  - there was an error of £275,000 in the analysis of contributions and benefits shown in Note 7 between employers' contributions deficit funding and normal funding; and
  - fixed interest investments were incorrectly valued using the 'dirty method' (that is inclusive of accrued interest) which is not compliant with accounting guidance. The amendment using the correct method' (that is exclusive of accrued interest) reduced the value of the investments by £2.81 million.
- 13** The accounts have been amended to reflect our findings in the paragraphs above.
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## Material weaknesses in internal control

- 14** No material weaknesses have been identified in the system of internal control operating at the Council for the year ended 31 March 2009.
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## Accounting Practice and financial reporting

- 15** I considered the qualitative aspects of your financial reporting.
- 16** A number of the fixed assets recorded in the accounts under vehicles and equipment are no longer in use or owned by the Council. The Council has no process in place for verifying that those assets recorded in the fixed asset register are still in use. Our audit found that vehicles and equipment are disposed of at the end of their useful life, without being written out of the fixed asset register. Although the balance sheet is materially correct, the gross book value and accumulated depreciation reported in the accounts should be reviewed.
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**17** The Council currently accounts for capital expenditure on highways and bridges on one asset code and depreciates this expenditure in accordance with their depreciation policy over 25 years. When an asset is upgraded or enhanced, any previous expenditure should be written-out of the fixed asset register and charged to the income and expenditure account, which is not currently taking place. As the system in place does not allocate expenditure to a specific asset, it is not possible to determine when new expenditure enhances or replaces parts of an existing asset. There are insufficient records to assess the scale of the adjustment and any impact that this may have on the accounts.

### Pension Fund Accounts

**18** A complete set of accounts was not provided at the commencement of the audit and working papers presented for audit fell short of the standard expected. A number of revised versions were presented during the audit, as a result of errors that we had identified during the course of our work.

**19** Cash and bank figures in the accounts are not reconciled to those shown on the ICON investment system. This is mainly due to investment debtors and creditors. However, we have agreed the cash and bank figures in the accounts to the general ledger. Once the Pension Fund has its own bank account, the task of reconciling the general ledger and the investment accounting system should be achievable.

**20** We made a number of recommendations in our Annual Governance Report about these issues, which the Council agreed to implement.

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### Icelandic banks

**21** One hundred and twenty-seven English local authorities including Somerset County Council are among the many UK public sector institutions that have funds in one or more of the Icelandic banks. Between them, they have deposits totalling more than £954 million. While this money is not necessarily lost, it is too early to say how much will be recovered, or when and on what terms it will be repaid. Deposits made by the local authorities are not covered by any central government guarantee scheme.

**22** At the time of the collapse of the Icelandic banks in early October 2008, Somerset County Council had £25 million invested. This money was invested in £5 million deposits with Glitner, Landsbanski and Kaupthing, Singer and Friedlander banks, and due to mature between January and September 2009.

**23** Since the Icelandic banks went into administration, negotiations to recover invested funds have been ongoing between creditors and the administrators. The latest information available suggests that the Council can realistically expect to recover approximately seventy per cent of their investment over the next three years. As at October 2009 the Council has received around £2 million plus some interest. A provision of £8.3 million was included in the 2008/09 Accounts as an 'extraordinary expense', to reflect potential future losses.

## Financial statements and annual governance statement

- 24** The Audit Commission carried out a review nationally of a number of councils, including Somerset County Council, who had invested money with Icelandic banks. The review and our local work confirmed that the Council's investments had been made in accordance with the treasury management policy and procedures in place at the time, and concluded them to be generally sound. The national findings from this study are published in the report Risk and Return on the Audit Commission's website.
- 25** Following the collapse of the Icelandic banks the Council made a number of immediate changes to treasury management practices, in order to avoid any future losses. The lessons and recommendations of the Audit Commission report are not just applicable at times of turbulence. The Council must remain vigilant and react to warning signals concerning all future financial investments.

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### Waste collection charges

- 26** Following a complaint from a local resident, an audit review of waste collection charging arrangements has been completed. The Council's former external auditors, Grant Thornton, submitted a report to the Audit Committee in September 2009.
- 27** Most of the concerns raised originally by the complainant have been resolved. There is, however, one significant issue that remains unresolved and stems from a difference of view over the interpretation of one particular section of the legal provisions.
- 28** Under the Environmental Protection Act 1990, 'household' waste must be collected free of charge. However, in certain cases specified by Schedule 2 of the Controlled Waste Regulations 1992, local authorities can charge for collection but not for disposal.
- 29** The ongoing area of disagreement relates to the treatment of waste from universities, schools, hospitals and nursing homes. The Council's view is that the legislation, which defines household waste relates only to the residential premises in such establishments. However, in my view and as set out in DEFRA's guidance, the waste arising from all the buildings within these establishments should be collected as 'household waste' and therefore subject to the Schedule 2 arrangements.
- 30** Ways of resolving this issue are currently being explored. Ultimately, it may be that a definitive interpretation can only be provided through legal action in the courts.

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# Value for money and use of resources

I considered how well Somerset County Council is managing and using its resources to deliver value for money and better and sustainable outcomes for local people, and gave a scored use of resources judgement.

I also assessed whether the Somerset County Council put in place adequate corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money (VFM) conclusion.

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## VFM Conclusion

- 31** I assessed your arrangements to secure economy, efficiency and effectiveness in your use of resources against criteria specified by the Audit Commission. From 2008/09, the Audit Commission will specify each year, which of the use of resources criteria are the relevant criteria for the VFM conclusion at each type of audited body.
- 32** I issued an unqualified conclusion stating that Somerset County Council had adequate arrangements to secure economy, efficiency and effectiveness in its use of resources.

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## Use of resources judgements

- 33** In forming my scored use of resources judgements, I have used the methodology set out in the use of resources framework. I have also taken into account, where appropriate, findings from previous value for money conclusion assessments and any other relevant work.
- 34** I assessed the Council's arrangements in three areas: managing finances, governing the business and managing resources; applying the following scoring methodology:
- Level 1 Inadequate and below minimum standards;
  - Level 2 Adequate;
  - Level 3 Performing well; and
  - Level 4 Performing excellently.
- 35** The Council's use of resources Key Lines of Enquiry (KLOEs) and theme scores are shown in Table 2.

**Table 2 Use of resources scores**

Use of resources themes and key lines of enquiry	Scored judgement
<b>Managing finances theme</b>	3
• KLOE 1.1 Planning for financial health	3
• KLOE 1.2 Understanding costs and achieving efficiencies	3
• KLOE 1.3 Financial reporting	3
<b>Governing the business theme</b>	3
• KLOE 2.1 Commissioning and procurement	3
• KLOE 2.2 Use of information	3
• KLOE 2.3 Good governance	3
• KLOE 2.4 Risk management and internal control	2
<b>Managing resources theme</b>	3
• KLOE 3.1 Natural resources	3
• KLOE 3.2 Strategic asset management	2

**36** The Council has achieved Level 3 for each of the three Use of Resources themes. It also scored Level 3 for all except two of the Key Lines of Enquiry (KLOEs) supporting these themes. The Council is to be commended for achieving such a strong set of scores for the first year of the new methodology. The score for the themes equates to a Level 3 overall, as reported in the Council's Organisational Assessment.

### Managing finances

**37** The Council's priorities and wider ambitions for the community of Somerset are based on a strong understanding of its needs. The Council engages with stakeholders in the financial planning process. The Medium Term Financial Plan (MTFP) is reviewed annually and adjustments made where priorities and requirements have changed. This provides a stable and responsive environment for service planning and delivery. Budget pressures and savings targets are revisited to confirm their continued relevance and achievability.

**38** Robust performance management arrangements are in place allowing the Council to effectively monitor progress on the actions within the Annual Plan, measure the impact they are making in the community against each of their priorities and assess progress against national and local performance indicators.

- 39** The Council's costs and services compare well with other counties. The Council receives a lower than average funding and has a lower than average council tax, yet has provided services which are judged generally good or excellent. The Council monitors performance against efficiency savings and identified cost pressures within the budget, providing reliable financial information regularly to officers and councillors. The Council did not achieve its efficiency target for 2008/09 of £10.25 million but achieved £5.87 million (57 per cent).
- 40** Areas for further improvement:
- delivery of benefits arising from the SWOne initiative and implementation of the new corporate systems (SAP);
  - linkages between financial and non-financial information following the migration to SAP;
  - there is a need to assess information requirements and reporting alongside the development of SAP;
  - partnership arrangements and reporting to ensure that cross agency work is better linked;
  - further strengthen partnership finance and governance;
  - achievement of the efficiency target for 2009/10 - only 57 per cent met in 2008/09; and
  - demonstrate innovative practices to continually challenge and improve service delivery and communicate these effectively internally and externally.

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### Governing the business

- 41** The Council has a clear understanding of the social, economic and environmental factors affecting the area. The Council's priorities and ambitions for Somerset are based on a strong understanding of its needs. The Council engages with stakeholders in the commissioning and procurement of services to gain a clear understanding of the needs of local citizens. Innovative approaches to procurement are being made, which include cost savings (£1.6 million in 2008/09) and improved efficiency in the delivery of services through its partnership arrangements with Southwest One.
- 42** Progress on developing the potential for more effective joint working between Somerset councils has been mixed. Plans to provide greater managerial capacity have been amended in the past few months. As a result, individual councils now have more responsibility to achieve efficiency gains. The type of efficiencies achieved and the involvement of particular councils is likely to be more flexible. Consequently, strong leadership will be needed to deliver the potential improvement and efficiency savings from closer joint working.

## Value for money and use of resources

- 43** The use of a VFM index to monitor costs and performance of services shows the Council is achieving good value for money from its services and has been adopted by the Society of County Treasurers as good practice. The Council's arrangements to provide effective governance and monitoring of information are being extended. Partnership information quality and has been improved through joint arrangements. Robust performance management arrangements including a performance dashboard provide effective assessment and monitoring of the Council's key aims and objectives and the difference they are making to the community.
- 44** The Council adopts, promotes and demonstrates the principles of good governance as confirmed by the annual governance review. The Council promotes good governance by regular corporate reviews and through challenge by councillors. Internal control arrangements remain strong but the Council does not capture nor consider all risks as an integrated corporate process. In particular corporate directors do not receive timely information on the progress of risk management or the risks relating to the meeting of the Council's corporate objectives.
- 45** The Council's fraud and corruption policy clearly sets out the approach to prevention and detection of fraud and corruption. The policy emphasises the responsibility of staff to prevent and report instances in their daily activities. Performance of anti-fraud and corruption measures is reported regularly to councillors.
- 46** Areas for further improvement:
- enhancement of procurement arrangements as part of SWOne, which have not yet been fully realised;
  - strong leadership is required to deliver the potential improvement and efficiency savings identified through joint working;
  - sustainability not embedded and market analysis still embryonic;
  - management arrangements and gaps found in directorate information collection;
  - partnership arrangements being enhanced but need to be embedded;
  - continue to strengthen and improve governance and financial arrangements with partners; and
  - develop risk management processes to capture and consider all risks as an integrated process, ensuring that they meet corporate objectives.

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## Managing resources

- 47** The Council's performance in relation to the natural environment continues to be strong and improving. A Climate Change Strategy was adopted in February 2008 and a successful climate change conference held in November 2008. The Council has well developed initiatives to reduce carbon emissions and promote the use of green energy. These include initiatives to reduce travel and energy consumption, and increase the use of sustainable energy. The Council plans to reduce emissions by 4 per cent each year. To help towards this target a new £1.63 million investment programme is expected to reduce consumption and costs by between 5 and 15 per cent and CO2 emissions by 2.4 per cent.
- 48** The Council takes a strategic approach to asset management but it does not demonstrate a corporate approach. It has a large number of plans in place at directorate level but has not produced a corporate plan linking all subsidiary plans to show how they are linked, in order to meet the Council's corporate objectives. As a result it is difficult to assess the successful outcomes of the management of its assets.
- 49** Areas for further improvement:
- enhance arrangements so that it is easy to identify and record improvements in the use of natural resources;
  - improve cross Council working in the management of natural resources;
  - expand work on sustainable procurement;
  - produce a corporate asset management plan that meets corporate objectives; and
  - cross agency working and shared resources is good with NHS Somerset but could be further enhanced.

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## Economic downturn and pressure on the public sector

- 50** The economic downturn and banking crisis is having a very significant impact on public finances and the bodies that manage them but there are wider and more fundamental impacts on the ability of public sector bodies to fund service delivery and capital programmes, including pressures on income streams. There are further challenges for policy priorities where patterns of demand for services are changing. These impact on the audit and as part of my responsibility, I have reflected on the wider environment, specific issues and risks and the Council's response to the down turn in the economy.
- 51** Growing Somerset's economy is a challenge for the Council and other organisations. Wages are low and house prices high. Much of the County is fairly affluent but some areas within it are among the poorest in Britain. To address this, the Council and its district partners have moved forward with plans to provide more homes, shops, and better job prospects. The Council is helping businesses cope with the recession by advising them on recovery plans and creating more business premises.

## Value for money and use of resources

- 52** The Council also responded quickly and well to the recession. It works with its partners helping small businesses write recovery plans and with their implementation. Although the effects of the recession have not yet been as extreme as in other counties, the County's reliance upon the public sector may mean that it takes longer for the recovery to take effect. The most badly affected areas are manufacturing and construction, especially housing. Some regeneration projects have stalled due to the lack of capital and small to medium enterprises have also been affected by the lack of working capital. However, while unemployment has risen during the recession, it is still lower than the national average.
- 53** The County Council convened a recession task force in December 2008, which included district councils, NHS Somerset, and private and voluntary sectors. A common action plan was produced. Support for wellbeing of residents and in particular those seen as vulnerable residents were seen as central to the action plan. The initial action plan has been costed at around £5 million, which includes some virement of budgets within the Council and use of funding streams from Business Link, rural regeneration funds, district council contributions and REIP.
- 54** Work commenced before the recession to streamline Council services, as cash efficiency savings have become more difficult to realise. The Council is working with IBM on procurement and its transformation agenda to release savings that can be diverted into mainstream services.

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## Specific risk based work

### Review of arrangements of transfer of leisure services to a trust

- 55** In 2006 an independent consultant was commissioned by the Council to provide an assessment of all the service delivery options for leisure management. The Council carried out further research and a report was presented to the Executive Board on 5 November 2007, recommending that they should approve the development of a new leisure trust to operate the existing in-house managed leisure services.
- 56** There followed a period of extensive consultation and preparation during 2008. During this time we met with key officers to undertake a review of the arrangements. Our review and the resulting report are based on the original plan of achieving a transfer by 1 April 2009. In the event the transfer of the business and all the in-house leisure staff to Somerset Leisure Ltd a charitable trust, was achieved on 1 August 2009.
- 57** Financial considerations are an important factor behind the decision to transfer leisure services. However, the transfer was not undertaken for financial reasons alone. The transfer was intended to secure services and develop new services to attract further income streams. The financial consequences of the transfer have been estimated, but still need to be assessed in detail. Following the transfer, responsibility for service delivery has been passed to the Trust, however, the Council has retained the obligation to fund service provision and maintenance of facilities.

- 58** Our main concern at the time of our review (March 2009) was the volume of work still to be completed, given the limited time available. Although the Council made progress in establishing the Trust and its operational arrangements, at the time of our review it was apparent that the Council was less well prepared to transfer services. Our discussions with officers and our review of the draft documents, which govern the relationship with the Trust, indicated that the Council's arrangements for managing the service after the transfer were similarly less well advanced. At the time it was critical that the Council established sufficient and appropriate arrangements in advance of the transfer.
- 59** The key issues the Council had to address were in respect of asset management and arrangements for the provision of support services. The Council is leasing its leisure facilities to the Trust. The Council needed to ensure that the implications for maintenance and joint use were fully established prior to the transfer.
- 60** The Council previously signed an agreement with Southwest One for the provision of support services. This agreement affects the provision of support services to the Trust. It may also have cost implications for the Trust if they decide to change support services provider at a future date. Any such cost incurred by the Trust is likely to have implications on the contribution required from the Council.
- 61** The Council has responded positively to our findings and presented an update on our action plan included in the report to the Audit Committee in September 2009.

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### Follow up of review of Southwest One

- 62** We have followed up progress on issues raised in our review of Southwest One reported to the Council September 2008.
- 63** Somerset County Council, Taunton Deane Borough Council and the Avon and Somerset Police Authority were the lead bodies in a procurement process, which asked the private sector to provide a number of back office services. The chosen solution was for the establishment of a joint arrangement with IBM called Southwest One (SWOne).
- 64** The affordability of the contract with SWOne is dependent upon procurement savings and they are committed to identifying these savings over the life of the contract. The savings are reliant upon council staff and SWOne working in partnership to ensure that lower cost suppliers are used. For 2008/09 the estimated savings were in the region of £4.5 million, with a further £30 million identified. However, the savings achieved are currently behind schedule and the Council will need to carefully monitor the achievement of these savings.
- 65** The transfer of services to SAP used by SWOne to provide and support council services and facilitate financial reporting has encountered a number of challenges. The main issue has been caused by SAP not accepting certain information transferred from the public sector systems and the ability of some staff to access the system. There has also been a delay in the payment of invoices and coding to the proper accounts. Consequently this has affected the management of cashflow and the Council's ability to monitor its budgetary position.

## Value for money and use of resources

- 66 As a result the Council has expended extra effort on monitoring the implementation of SAP, which has been tracked and will form the basis of further discussion with SWOne.
- 67 The Council needs to ensure that councillors continue to be kept fully informed of any contract issues and that appropriate action is taken to address any shortcomings. Contract monitoring and management, and benefits realisation continue to remain a priority. We will continue to review developments as part of the 2009/10 audit.

# Closing remarks

- 68** I have discussed and agreed this letter with the Acting Chief Executive and the Corporate Director - Resources. This Letter is presented to the Audit Committee and electronic copies provided for circulation to committee members.
- 69** Further detailed findings, conclusions and recommendations in the areas covered by our audit are included in the reports issued to Somerset County Council during the year.

**Table 3**

Report	Date issued
Audit Plan for Somerset County Council	May 2008
Audit Plan for Somerset County Council Pension Fund	September 2008
Review of arrangements for transfer of leisure services to a trust	September 2009
Supplementary opinion plans	July 2009
Annual Governance Reports	September 2009
Auditor's opinion and value for money conclusion	September 2009
Final accounts memorandum	October 2009
Annual Audit Letter	December 2009
Use of Resources results presentation	December 2009
Southwest One follow-up presentation	December 2009

- 70** Somerset County Council has taken a positive and constructive approach to our audit. I wish to thank the Somerset County Council staff for their support and co-operation during the audit.

Brian Bethell  
District Auditor  
November 2009

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# The Audit Commission

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

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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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