

Annual Audit Letter

Somerset County Council

Audit 2010/11



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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.

	Audit findings
Unqualified audit opinion	Yes
Adequate internal control	Yes
Financial statements free from material error	Yes
Proper arrangements to secure value for money	Yes

Value for money

The Council has adequate arrangements in place for securing economy, efficiency and effectiveness in the use of resources. I also issued an unqualified value for money conclusion on 29 September.

Audit opinion and financial statements

I issued an unqualified opinion on Somerset County Council's financial statements on 29 September 2011.

Current and future challenges

Organisational change

In May 2011 the Council approved the County Plan 2011-2013 setting out its priorities for the forthcoming year. There is in place strong and strategic leadership to deliver the plan. The Council through the Change Programme initiative is paving the way to redesign work flows and ultimately the management structure, while improving service delivery and making savings. Careful management and readiness for the pace and scale of change this is likely to present will be essential to its successful implementation.

The Council will need to continue to show strong leadership in meeting the challenges ahead and must not underestimate the capacity needed to manage significant organisational change.

Economic downturn and pressure on the public sector

The Council, like many others, faces some major challenges in the period ahead. The coalition government announced details of its spending plans for the next few years on 20 October 2010, requiring every council across the country to make substantial financial savings.

The Council follows a clearly defined financial planning process. Officers and members are fully engaged in the budget planning and setting process. Robust assumptions have been considered in forming the Medium Term Financial Plan and 2010/11 and 2011/12 budgets. These include the financial risks and savings needed to deliver the Plan.

Efficiency savings from the SouthWest One (SWO) partnership are taking longer to deliver than first envisaged. The Council is working with SWO through contract renegotiation to improve savings delivery.

Continued regular scrutiny of financial performance remains a top priority. In the current economic climate the Council continues to face difficult decisions on service provision and setting a deliverable budget.

Treasury management

Since the Icelandic banks went into administration, negotiations to recover invested funds have been ongoing between creditors and the administrators. Somerset County Council had £25 million invested. Over the last few years there has been continuing uncertainty over the repayment of these loans. As at 10 October 2011 the Council had received £6.5 million back from their original investments including £198,500 of interest. The recovery potential of the investment is being resolved through the legal process. The Council continues to monitor progress of their claim against the Icelandic Government.

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.

Overall conclusion from the audit

I issued an audit report including an unqualified opinion on the financial statements on 29 September 2011. The financial statements and working papers presented for audit were complete and prepared to a good standard. The transition to International Financial Reporting Standards (IFRS) was well managed and a high standard achieved in the presentation of the County Council accounts.

A number of issues were identified from my audit of the accounts.

- My audit of the financial statements identified incorrect coding of expenditure to payments in advance of £905,290, instead of to expenditure in 2010/11. The draft accounts were amended prior to completion of the audit.
- My audit of the Pension Fund accounts identified the investment system (ICON) had not been reconciled to the general ledger (SAP). This was achieved prior to issuing the audit opinion.
- Although the Pension Fund accounts are correctly stated, officers were unable to provide a detailed breakdown of pension fund lump sum payments and transfers to or received from other pension funds. Officers have agreed to maintain future records of lump sum payments and transfers to and received from other pension funds and reconcile these to the general ledger.

Formal audit powers

I have responded to an objection from a member of the public, regarding:

- cross-subsidy arising from alleged unequal allocation of SAP costs; and
- consistent public reporting of costs and savings arising from the SouthWest One procurement.

Under section 8 of the Audit Commission Act 1998, I have to consider whether there is any matter on which I should report. Taking all matters into account, I have decided not to issue a report in the public interest.

Icelandic banks

English local government authorities hold deposits in two of the three failed Icelandic banks (Glitnir and Landsbanki) or their UK subsidiaries (Heritable and KSF). 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 10 October 2011 the Council had received £6.5 million from Kaupthing, Singer and Friedlander bank including £198,500 of interest.

Although, CIPFA guidance suggests the Council should expect to receive the vast majority of the investment back, this is still being resolved through the legal process. The Council continues to monitor progress of their claim against the Icelandic Government.

Significant weaknesses in internal control

I did not identify any significant weaknesses in your internal control arrangements.

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 issued an unqualified value for money conclusion on 29 September.

My conclusion on each of the two areas is set out below.

Value for money criteria and key messages

Criterion	Key messages
<p>1. Financial resilience</p> <p>The organisation has proper arrangements in place to secure financial resilience.</p> <p>Focus for 2010/11:</p> <p>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.</p>	<p>Financial governance</p> <p>The Council has adopted, promotes and displays the principles of good governance, and the Chief Financial Officer leads on financial governance arrangements. The Cabinet receives comprehensive and useful finance and performance reports outlining key performance issues and risks to corporate performance, incorporating key performance measures.</p> <p>The Council has an objective, knowledgeable and effective Audit Committee. The Audit Committee regularly reviews the financial governance arrangements to ensure they are robust and work as intended.</p>

Financial planning

The Council prepares a Medium Term Financial Plan (MTFP), which includes the current budget with estimates for the following two years. It is the key document linking the County Plan, Business Plan and budget, reflecting the Council's strategic objectives and priorities for the year and the longer term.

The Council follows a clearly defined financial planning process including financial modelling, which provides the Council with a sound base from which to start. Impact assessments for each directorate document the effect on each service of any proposed service cuts, including a risk assessment of the possible consequences.

Officers and members are fully engaged in the budget planning and setting process. The outturn report for 2010/11 demonstrates control over the budget. The general reserves balance as at 31 March 2011 is £15.09 million, showing appropriate levels of reserves being maintained.

The corporate risk register identifies financial and operational risks and action being taken to mitigate the potential impact on achieving the corporate objectives.

Financial control

The Council has robust financial monitoring arrangements in place to ensure the budget is delivered. Budget monitoring reports are prepared quarterly and presented to Cabinet, providing predictive revenue and capital outturn positions for the financial year end. A monthly budget monitoring statement is also produced highlighting unfavourable variances and decisions are taken on how these are to be addressed.

Criterion

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.

Key messages

Prioritising resources

The Council has clear aims and objectives linked to and supporting the needs of the public and its partners. The County Plan sets out the Council's priorities for the forthcoming year. There is in place strong and strategic leadership to deliver the plan. The Change Programme initiative is paving the way to redesign work flows and ultimately the management structure, while improving service delivery and making savings.

The Council produces clear and concise reports to support strategic decision making. This allows the Council to monitor delivery of the County Plan, measure the difference they are making in the community against priorities and assess progress against national and local performance indicators.

Improving efficiency and productivity

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 and effective performance management arrangements are in place.

The Council has well established arrangements to evaluate options for making efficiencies in the short and longer term. Regular reporting to Cabinet using a traffic light system shows councillors progress against the County Plan.

Robust assumptions have been considered in forming the MTFP and 2010/11 and 2011/12 budgets. These include the financial risks and savings needed to be made, the contingency budget available to offset unplanned expenditure, and the level of reserves and balances. Efficiency savings to balance the budget have been identified and for the most part delivered in 2010/11. Efficiency savings from the SouthWest One (SWO) arrangements are taking longer to deliver than first envisaged and the Council is working with SWO through contract renegotiation to improve this aspect of savings delivery.

Criterion

Key messages

The Strategic Procurement Service is changing the way the Council conducts its procurement and ensure best value for money. Extensive use is made of joint procurement including purchasing through SWO and local procurement agencies where these offer best value. The Change Programme initiative will radically reshape and innovate the delivery of Council services for the future.

Follow up review of SouthWest One performance management and benefits realisation

I undertook a review of SouthWest One (SWO) performance management and benefits realisation in November 2010. I have followed up the Council's response to my action plan and conclude although progress is being made, delivery of savings continues to fall behind original forecasts.

Benefits realisation

As part of the SWO partnership, procurement activity is undergoing transformation, to deliver around £192 million of savings over the ten year term of the contract.

By the end of July 2011 potential savings for Somerset County Council of £57.4 million (£48.5 million implemented and £8.9 million awaiting implementation) have been identified and agreed. The Council is in the process of delivering these savings, with a further £76.6 million identified by SWO but not yet agreed by the Council for delivery (the 'pipeline'). Although, benefits realisation has improved, actual savings are below those originally forecast and currently stand at £7.6 million 'cached', part of the £48.5 million of benefits implemented.

Recent changes to local government finances

Due to significant budget restrictions and following a number of internal/external reviews, the Council is currently renegotiating the SWO contract to improve savings, simplify the contract, change the governance and bring some services/functions back in-house. The Chief Executive and Service Director - Client Services have been tasked by members to address this through renegotiation of the contract with SWO. These changes are expected to be concluded by March 2012.

Performance measures

Monthly performance reports produced by SWO are presented to the Council ten working days after the month end. There are 34 key performance indicators and 82 service performance indicators. Although ongoing refinement of key performance indicators takes place, these are also formally reviewed annually. Evidence shows this is being done.

Spot checks on reported performance

The Council's performance officer reviews the monthly performance report and investigates missed targets. Where this leads to penalties these are invoked. Internal audit is to carry out a review of SWO contract performance data back to baseline data. This will provide assurance for the Council, particularly where missed targets have resulted in penalties for SWO.

Follow up of review of Somerset building schools for the future

I have carried out a review of actions taken on my review of Somerset Building Schools for the Future (BSF) carried out in October 2010 and conclude good progress has been made. The Council must continue to manage the contract in the face of increasing budgetary pressures.

In September 2010, the Council signed a PFI contract with BAM PPP to build three PFI schools in Bridgwater under the BSF programme. I found the Council has robust arrangements in place for managing the contract during construction and plans are in place to review these arrangements once the contractor has completed construction work.

The Council needs to define contract monitoring arrangements for the operational phase before construction is complete. Retention of knowledgeable staff during construction through to the opening of the schools will help to ensure contractor standards are maintained and value for money obtained. As part of the operational phase, to avoid duplication and improve efficiency, the Council should develop arrangements for the future ongoing maintenance of the schools to the required standard.

During the procurement, officers confirmed the unitary payments for the scheme were affordable. The business case for the project showed payments would be met using PFI credits, contributions from the schools and the Council. The Council based its affordability projections on an inflation rate of 2.5 per cent, however, inflation has been higher than forecast. As the PFI credit from the government is not index-linked, the Council and schools will meet a higher share of the unitary payment in future. The Council will therefore need to budget sufficiently to meet the higher costs.

Closing remarks

I have discussed and agreed this letter with the Service Director – Finance and Property. This Letter is presented to the Audit Committee and electronic copies provided for circulation to committee 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	March 2010
Audit opinion plan	June 2011
Annual governance reports	September 2011
Auditor's opinion and value for money conclusion	September 2011
Final accounts memorandum	October 2011
Annual audit letter	October 2011

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

Brian Bethell
District Auditor
October 2011

Appendix 1 - Fees

	Actual	Original agreed fee	Variance
Somerset County Council fee	£246,600	£246,600	-
Pension Fund fee	£38,600	£38,600	-
Challenge work (Objection from a member of the public)	£4,225		£4,225
Total	£289,425	£285,200	£4,225

In recognition of the financial pressures public bodies face in the current economic climate, the Commission subsidised the 'one-off' element of the cost of transition to International Financial Reporting Standards (IFRS) for local authorities in 2010/11. To avoid any confusion with the annual audit fee, the Commission refunded £14,151 of the fee (£246,600) directly to the Council in April 2010.

As the Commission deferred the setting of the 2010/11 fee scales for pension fund audits, it agreed to absorb the extra audit costs arising from the transition to IFRS within the published fee envelope. Therefore, no subsidy was payable in respect of pension fund accounts.

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.

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.

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.

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