

Annual Audit and Inspection Letter

January 2006



# **Annual Audit and Inspection Letter**

**Hampshire County Council**

**Audit 2004-2005**

External audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services.

Audit in the public sector is underpinned by three fundamental principles:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements but also value for money and the conduct of public business; and
- auditors may report aspects of their work widely to the public and other key stakeholders.

The duties and powers of auditors appointed by the Audit Commission are set out in the Audit Commission Act 1998 and the Local Government Act 1999 and the Commission's statutory Code of Audit Practice. Under the Code of Audit Practice, appointed auditors are also required to comply with the current professional standards issued by the independent Auditing Practices Board.

Appointed auditors act quite separately from the Commission and in meeting their statutory responsibilities are required to exercise their professional judgement independently of both the Commission and the audited body.

### **Status of our reports to the Council**

Our reports are prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission. Reports are prepared by appointed auditors and addressed to councillors or officers. They are prepared for the sole use of the audited body, and no responsibility is taken by auditors to any councillor or officer in their individual capacity, or to any third party.

### **Copies of this report**

If you require further copies of this report, or a copy in large print, in Braille, on tape, or in a language other than English, please call 0845 056 0566.

© Audit Commission 2006

For further information on the work of the Commission please contact:

Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ

Tel: 020 7828 1212 Fax: 020 7976 6187 Textphone (minicom): 020 7630 0421

[www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)

# Contents

<b>Introduction</b>	<b>5</b>
<b>Key messages</b>	<b>6</b>
Council performance	6
Value for money	6
Use of resources	6
The accounts	7
Governance	7
Action needed by the Council	7
<b>Performance</b>	<b>9</b>
CPA scorecard	9
Direction of Travel report	10
Value for money	12
Partnerships	13
Working with other inspectorates and regulators	13
<b>Accounts and governance</b>	<b>14</b>
Use of resources judgements	14
Audit of 2004/05 accounts	16
Report to those with responsibility for governance in the Council	16
Matters arising from the final accounts audit	17
Financial standing	18
Systems of internal financial control	19
Standards of financial conduct and the prevention and detection of fraud and corruption	20
Legality of transactions	21
<b>Other work</b>	<b>22</b>
Additional voluntary work	22
Grant claims	22
National Fraud Initiative	22

<b>Looking forwards</b>	<b>23</b>
Future audit and inspection work	23
Revision to the Code of Audit Practice	23
<b>Closing remarks</b>	<b>24</b>
Availability of this letter	24
<b>Appendix 1 – Background to this letter</b>	<b>25</b>
The purpose of this letter	25
Audit objectives	25
<b>Appendix 2 – Audit reports issued</b>	<b>27</b>
<b>Appendix 3 – Audit fee</b>	<b>28</b>

## Introduction

- 1 The Council has faced some significant challenges over the last 12 months. Its response to the Children Act 2004, which places new duties on local authorities, has led to significant change on the Corporate Management Team, bringing in new directors to two new posts, while two high profile and long-serving directors who have played a major part in gaining the Council its excellent rating, are moving on. The associated structural changes in directorates are having an impact on staff at all levels, as services are re-shaped to meet the new requirements.
- 2 In May, a new council was elected. Although this did not significantly alter the political shape of the administration, a number of experienced councillors did not stand for re-election and many new ones were elected.
- 3 Once again, adjustments to government grant allocations and pressures on spending have severely constrained the Council's budget. However, the Council's continuing efforts to improve efficiency in line with the Government's requirements on efficiency planning (the Gershon initiative), and to focus on priorities, have meant that the Council has been able to maintain its record of continuing to improve services while setting its lowest increase in council tax for 20 years.
- 4 Over the last three years, the Council has been working to deliver to very challenging targets a range of services under a Local Public Service Agreement (LPSA) with Central Government. Its success in improving performance is expected to attract over £9 million of performance reward grant. The Council has now been selected as lead authority to pilot a Local Area Agreement (LAA) with Government, which will involve working in partnership with other public and voluntary services across the county on key issues identified by Hampshire residents.
- 5 Our work this year, carried out within the statutory framework set out in Appendix 1, has been set against the background of these challenges. The results of that work are summarised below.

## Key messages

### Council performance

- 6 Under Comprehensive Performance Assessment (CPA) 2005 - The Harder Test, we have judged the Council to be improving well and performing at the 4 (out of 4) star level. This is based on its continued achievement of high performance across most services that matter to residents, the trend of improvement shown by 60 per cent of its key performance indicators over the last three years and the effective plans in place for future improvement.
- 7 There are a few service areas where particular attention is required. For example:
  - over 13 per cent of the Council's primary schools now have 25 per cent or more places unfilled, which is well above the 11.9 per cent average for other councils; and
  - household waste produced per head of population is in the worst 25 per cent of councils, and not improving.

### Value for money

- 8 We have concluded that the Council achieves good value for money. Costs compare well with others and are commensurate with policy decisions and with the strong performance and outcomes the Council achieves in the majority of its services. Nevertheless, there are a few relatively high-cost areas where the Council needs a better understanding of the relationship between costs and performance, such as aspects of social services and the planning function.
- 9 There is scope to integrate better the processes for monitoring costs and service performance and to seek greater consistency across services in reviewing value for money, including the benchmarking of service costs.

### Use of resources

- 10 Our assessment, as part of the 2005 CPA process, showed that the Council has in place a robust governance and performance management framework that meets at least minimum requirements across all areas. We have suggested further enhancement in some areas, including:
  - making greater use of performance indicators to support monitoring of spending and financial health;
  - ensuring the asset register is maintained up-to-date and that there are plans to tackle the building maintenance backlog;

- fully integrating partnership arrangements into the corporate planning and governance frameworks; and
- considering a higher profile approach to promoting an anti-fraud culture.

## The accounts

- 11 We have issued unqualified audit opinions on the Council's and the Pension Fund's accounts.
- 12 The Council's balance sheet includes property assets at a value of about £36 million that have not been re-valued within the last five years. This is contrary to proper accounting practices, and the Council needs to ensure that, by the end of 2005/06, all fixed assets have a valuation that is no more than five years old.
- 13 The Pension Fund actuarial report of March 2004 showed a shortfall of £911 million between the current value and the future liabilities of the Fund. The employers' contributions for scheduled bodies are to increase from 215 per cent to 295 per cent in three annual steps, in order to bring the fund into balance over a 25-year period. However, for admitted bodies the recovery period is to remain at 40 years and will need to be kept under review.

## Governance

- 14 The Council's overall corporate governance arrangements are satisfactory in most key areas.
- 15 There are a number of control and holding accounts operated as part of the Council's accounting systems, which provide assurance on the integrity of information transferred between accounts. At present, there is inconsistency in the way these accounts are managed and this has led to some misstatements in financial reports.
- 16 The role of the Governance Committee could be further enhanced through taking a proactive lead on governance issues for the Council, including audit and risk management, and having greater independence from the executive.

## Action needed by the Council

- 17 The main issues raised in this letter that require the Council's attention are as follows.
  - Seeking to understand high-cost areas through better integrated cost and performance information and a more consistent approach to reviewing value for money.
  - Making greater use of activity indicators that are linked to spend, to support the budget monitoring process.

## 8 Annual Audit and Inspection Letter | Key messages

- Completing the implementation of the new asset register and ensuring it is maintained up-to-date thereafter.
- Adopting a formal plan to deal with the backlog of building maintenance.
- Ensuring that all property assets have been re-valued within the preceding five years, by the end of 2005/06.
- Considering enhancing the role and independence of the Governance Committee.
- Integrating partnership arrangements into the corporate planning and governance frameworks.
- Ensuring that processes for managing control and holding accounts are tightened.
- Considering a higher profile approach to promoting an anti-fraud culture.
- Keeping under review the appropriateness of the 40-year Pension Fund recovery period for admitted bodies.

## Performance

The Council has continued to achieve, or strive for, high performance and value for money in all of its services. It has a very good record of improvement in its priority areas and in services that matter to residents and has effective plans for future improvement and is developing its ability to deliver these.

We have identified a small number of areas where there is scope to further enhance arrangements, including improving cost and performance information for reviewing value for money, tackling surplus primary school places and developing strategies to tackle traffic congestion.

### CPA scorecard

- 18 The CPA judgements this year are based on the revised methodology *CPA - the harder test*. As the title implies, CPA is now a more stringent test with more emphasis on outcomes for local people and value for money. There is also a new dimension, a scored Direction of Travel judgement that measures how well the Council is improving. The Council's scores under the new framework are set out in Table 1.

**Table 1 CPA scorecard**

Element	Assessment
<b>Direction of Travel</b>	Improving well (Level 3 of 4)
<b>Current performance overall</b>	Four star
<b>Current performance by service</b>	
Children and young people	3 (out of 4)
Social care (adults)	3
Use of resources	3
Environment	3
Culture	4
<b>Corporate assessment/capacity to improve</b> (not reassessed in 2005)	4 out of 4

(Note: 1=lowest, 4= highest)

## Direction of Travel report

### Overall conclusion

- 19 The Council is improving well. It has a strong track record of improvement in its priority services and in improving outcomes for its residents and communities. Where comparisons can be made, the Council continues to improve relative to other councils. Although securing substantial improvement to its already good or excellent services is becoming more challenging, it continues to achieve, or strive for, best 25 per cent performance across all key services. Around 60 per cent of the Council's best value performance indicators (BVPIs) show improvement over the last three years and 75 per cent of its 2004/05 indicators show above average performance.

### Improving outcomes

- 20 The Council is improving its performance in most of its corporate priorities, particularly in 'maximising life opportunities'. In each of the last three years it has achieved a three-star rating from Ofsted, and performance of pupils in both primary and secondary sectors is good and continuing to improve. However, there is no room for complacency, as the Council's rate of improvement in educational attainment is lower than the national average and there are some schools with relatively poor achievement that are not improving. The Council has successfully reduced unauthorised absences in two targeted schools, and the number of permanent exclusions is falling. However, its management of unfilled primary school places has not been so successful, with an increase to 13.4 per cent in the number of schools with 25 per cent or more unfilled places. This is well above the 11.9 per cent average for other councils, although the Council has achieved its internal target to reduce surplus places by 10 per cent across all primary schools in 2005.
- 21 Performance in social care is improving in key areas and the Council has provided 300 additional nursing care beds in the past year. This year's Ofsted and CSCI Annual Performance Assessment concluded that the Council's children's social care and education services consistently deliver above minimum requirements and that these services are likely to improve. The Council's response to the Children Act has been well focussed and has resulted in a much improved service for children looked after. However, the unit cost of residential and nursing care remains relatively high.
- 22 The Council's BVPIs for cultural services show strong performance, with six out of seven in the best 25 per cent of authorities. Library facilities are being improved and modernised through the successful Discovery Centre project, and library user numbers are now increasing.

- 23 The Council is effective in addressing its 'stewardship of the environment' priority, particularly through its close involvement in Project Integra, the county-wide project for waste management. This has resulted in a significant reduction in the amount of waste going to landfill. In addition, the Council significantly improved its performance on recycling in 2004/05, meeting its target to recycle or compost 30 per cent of household waste. It is now focused on meeting a demanding aspirational target of 40 per cent in 2006.
- 24 Performance on the Council's transport priority is mixed and 82 per cent of residents feel that traffic congestion is getting worse. The Council has delivered improvements to some urban bus routes and to the condition of its non-principal roads and footpaths, but its future plans and targets for reducing traffic congestion are dependent upon Government funding and infrastructure decisions.
- 25 The Council has made significant contributions to wider community outcomes. 'Building strong and safe communities' is a priority in the corporate plan and the community strategy, and the Council's contribution to community safety is improving. Fear of crime is relatively low, but remains a key concern for residents. Crime is also relatively low and is decreasing in four of the six comparator categories. The Council has set up a successful scheme of accredited community safety officers, providing 34 officers who deal with issues such as low-level anti-social behaviour across the county. However, the future role, funding and sustainability of this service, alongside police authority proposals for community support officers and the existing district council community safety wardens, has not yet been addressed by the Council and its partners. The Council has not carried out a mainstreaming audit and as a result the extent of the mainstreaming of community safety<sup>1</sup> across the Council's services is not clear.
- 26 The Council is improving access to services for its citizens, and has an appropriate and improving focus on those who are 'harder to reach', including designing its extensive consultation and market research process to ensure such groups are included. It has improved access to its buildings for disabled people and is on target to fully enable electronic transactions by the end of the year.

### **Sustaining future improvement**

- 27 The Council has robust plans for future improvement, which are integrated into each of the priority areas in its corporate strategy, and the 'golden thread' from this, through service plans to individual performance plans, is being strengthened. Service, workforce and budget planning are now integrated and include an emphasis on value for money. The Council's improvement planning process places it in a strong position to sustain future improvement.

---

<sup>1</sup> Community safety and crime and disorder reduction is a responsibility for all councils. Section 17 of the Crime and Disorder Act 1998 requires that the Council exercise its functions with regard to community safety and does all it reasonably can to prevent crime and disorder - this has become known as mainstreaming.

- 28** Improvement planning is effectively managed and monitored in most areas and the Council has a good track-record in delivering improvement. For 2004/05, it met most of its key objectives and milestones, achieved two-thirds of its own improvement targets and improved in most other areas. However, the approach to target-setting is still not consistent across all areas of the corporate strategy, and as a result the Council cannot readily assess progress against its plans in some priority areas.
- 29** The Council has the capacity to continue delivering improvement. Council tax levels remain in the lowest 25 per cent and its performance in delivering value for money and efficiency savings is above minimum requirements, although the monitoring and review of value for money is not yet consistent across all services. The Council is developing its longer term plans and vision and is improving staff and councillor capacity, including the democratic framework, in order to deliver them. Although there are still staff recruitment problems in some areas, these are consistent with the regional and national picture. The Council is also reducing the number of staff days it loses to sickness and is developing its pay and reward framework. We have concluded that the Council is progressing well and has built up a strong momentum of development. We are confident that, once the current improvements are embedded, they will enable the Council to maintain its long-term trend of continuous improvement.

## Value for money

- 30** As part of our review of the Council's use of resources for CPA, we have assessed whether it achieves, manages and improves value for money. We have concluded that the Council's performance is consistently above the minimum requirements specified for the assessment, and it achieves good value for money. Costs compare well with others and are consistent with policy decisions and with the strong performance and outcomes the Council achieves in the majority of its services. The cost of waste disposal is in the highest 25 per cent when compared to similar councils, but the Council is satisfied that this is due to the phasing of spending. There are other service areas where the links between spending and value are less clear, such as aspects of social services spending that are in the fourth of five performance bands and the planning function that is relatively high cost.
- 31** Although processes for monitoring costs and service performance are in place, they are not yet fully integrated and the reviewing of value for money is not yet consistent across all services. As regards major spending decisions, the Council takes account of the full long-term costs and is continuing to develop its approach to the management of procurement.

- 32 The main areas where there is scope for the Council to further enhance its arrangements are
- developing approaches to the benchmarking of service costs;
  - improving the integration of performance and cost information; and
  - ensuring there is consistency across all services in establishing links between quality, cost and value for money and in setting targets for value for money improvements.

## Partnerships

- 33 The Council has invested significantly in partnership working in order to facilitate progress on key objectives and address wider community priorities. The Hampshire Strategic Partnership (HSP) is now playing an important part in co-ordinating public and voluntary service action across the county, and the HSP's community strategy is a major driver of the Council's corporate strategy. The current development of a Local Area Agreement (LAA) with Central Government, following on from the successful Local Public Service Agreement (LPSA), is being co-ordinated by the HSP through the LAA Executive.
- 34 We carried out a review of how the Council is managing its partnership arrangements, focusing particularly on the Supporting People initiative, and we reported the results in June this year. We concluded that the Council's partnership arrangements have many strengths, while stressing the importance of ensuring clarity about how partnership objectives link to the achievement of the Council's priorities, and having key performance indicators in place so that partnership achievements can be measured.

## Working with other inspectorates and regulators

- 35 An important aspect of the role of the Relationship Manager is to work with other inspectorates and regulators who also review and report on the Council's performance. These include:
- Office for Standards in Education (OFSTED);
  - Commission for Social Care Inspection (CSCI);
  - Department for Education and Skills (DfES); and
  - the Government Office for the South East (GoSE).
- 36 We share information with these agencies and seek to provide 'joined-up' regulation to the Council. During the last year, the Council has received assessments from CSCI, who have rated the Council's social care services for children and adults as serving most people well. CSCI and OFSTED also completed an annual performance assessment of the Council's education and social care services for children, which reported 'good' performance for four areas and 'satisfactory' for the fifth.

## Accounts and governance

The Council successfully brought forward closure of its accounts as required by the Accounts and Audit Regulations 2003, and we issued unqualified audit opinions on the Council's 2004/05 accounts on 31 October 2005 and on the Pension Fund accounts on 26 October 2005.

The Council's overall corporate governance arrangements are satisfactory in most key areas. However, there is a need to tighten management of control accounts and to consider strengthening the role and independence of the Governance Committee. We completed our first use of resources judgements under the new CPA framework for 2005 and concluded that the Council is performing well and consistently above minimum requirements.

### Use of resources judgements

- 37 The 'use of resources' assessment is a new part of the CPA framework that looks at how the Council's financial management is integrated with strategy and corporate management, supports council priorities and delivers value for money. We will make an assessment each year as part of our annual audit. The results of our assessment for 2005 are shown in Table 2.

**Table 2 Use of resources assessment 2005**

Element	Assessment
Financial reporting	3 out of 4
Financial management	2
Financial standing	3
Internal control	2
Value for money	3
<b>Overall</b>	<b>3 out of 4</b>

*(Note: 1=lowest, 4=highest)*

- 38 In reaching these judgements, we have drawn on work carried out to discharge our responsibilities under the Code of Audit Practice, supplemented by specific reviews to fill gaps in our understanding and enable us to judge the Council's arrangements against the assessment criteria. The headlines from our work are highlighted below, with more detail on many of the key findings reported under the relevant headings elsewhere in this letter.

## Financial reporting

- 39 The Council has sound arrangements for producing its accounts and has successfully modified them to meet the earlier statutory deadlines for their adoption by Council. We have suggested that the Council:
- makes further refinements to supporting documentation, and
  - obtains stakeholders' views on the form of published summary accounts they would find most helpful.

## Financial management

- 40 The Council has a robust framework of corporate strategies, budgets and capital programmes, and budget monitoring arrangements are sound. However, the Council's asset register is not currently capable of being maintained up-to-date and is updated only at the year-end. We have suggested that the Council should:
- integrate joint plans agreed with partners into the corporate planning framework;
  - improve understanding of spending trends, through greater use of appropriate activity indicators that are linked to spend;
  - prepare more detailed action plans for savings and efficiency gains, and report to senior management on progress against plans;
  - ensure there are effective arrangements for maintaining the asset register up-to-date, once the new computer module is fully implemented;
  - prepare a formal plan to address backlog building maintenance; and
  - develop performance measures for asset use that link to corporate objectives.

## Financial standing

- 41 The Council is effective at managing its spending within available resources. Reserves and balances are well-controlled and kept to a relatively low level. We have suggested that the Council should:
- identify and set targets for a set of key financial health indicators and monitor them regularly; and
  - assess whether arrangements for monitoring performance on debt collection are effective, in the absence of the facility to produce analysis of debts by age.

## Internal control

- 42 The Council's arrangements for maintaining internal control are sound, but could be further strengthened. We have suggested the Council should:
- increase the Governance Committee's role and independence;
  - ensure that all regulatory governance documents make reference to partnership working and that formal agreements are in place and regularly reviewed for all partnerships;
  - consider whether a higher profile approach to promoting an anti-fraud culture is appropriate; and
  - further develop approaches to risk management so that it becomes embedded in the Council's processes.

## Value for money

- 43 The Council's overall performance in delivering value for money is consistently above minimum requirements. Costs compare well with others and are consistent with policy decisions and with policies and performance. We suggest that the Council should:
- ensure processes for monitoring performance and cost are fully integrated and consistent across services.

## Audit of 2004/05 accounts

- 44 We issued unqualified audit opinions on the Council's and the Pension Fund's accounts.
- 45 Local authorities were required to approve their 2004/05 financial statements by the end of July 2005. The Council achieved this and is now working to ensure it can meet the requirement to approve its 2005/06 accounts by the end of June 2006. It is also exploring the costs and benefits of options for fully accrued half-year financial monitoring reports, including appropriate revenue account and balance sheet items, which should help to ensure the accuracy and integrity of in-year reporting and to reduce the burden of year-end accounting procedures.

## Report to those with responsibility for governance in the Council

- 46 We are required by professional standards to report to those charged with governance (in this case the Governance Committee) certain matters before we give an opinion on the financial statements. In our letter, dated 28 October, to the Chair of the Governance Committee, we reported two main issues arising from our audit of the accounts.

- 47 Assets included in the Council's balance sheet as 'other land and buildings' and 'non-operational buildings' are currently disclosed at values of £26.6 million and £9.6 million respectively, but have not been re-valued in the last five years. Proper accounting practice requires that all assets are re-valued at least every five years. We do not know the current value of these assets, although officers have stated that their nature is such that they are unlikely to have changed significantly in value. Nevertheless, it is essential that priority is given to revaluing these assets in order to ensure that the Council's 2005/06 accounts are soundly based.
- 48 As mentioned last year, reconciliation of the 'net-pay' control account with the general ledger had identified unexplained differences totalling £0.5 million net. Included within this figure is a balance on the Inland Revenue holding account. These differences arise because of unallocated payroll charges. Work to reconcile the differences and to ensure these are allocated to originating cost centres where appropriate, is continuing.

## **Matters arising from the final accounts audit**

- 49 There are two aspects of our final accounts audit work that we have reported on in previous years and should update councillors on this year.
- 50 In the past, we have pointed to the variable quality of documentation provided by officers to support the disclosures in the financial statements. This year, we are pleased to report a significant improvement in that documentation. However, there remains scope for further improvement by ensuring coverage is comprehensive, files are fully indexed and there is a detailed analytical review, supported by evidence, of figures in the primary financial statements. The importance of this has increased with the shorter time frame for completing both the accounts and audit processes.
- 51 In order to comply with auditing standards, we need to document and understand the accounting controls in place in the Council's material financial systems. We reported last year that the Council could not provide information on the design and operation of the SAP accounting system, as the information was fragmented across different departments. We therefore had to carry out a high-level review. We are pleased to report that Internal Audit has now collated this information and made it available to us, and we have been able to make use of this for our 2004/05 audit.
- 52 We tested some of the controls documented, in order to determine whether they are operating satisfactorily. This identified some problems, largely associated with the reconciliation of control accounts, but we were able to confirm the reported figures through additional testing as part of our final accounts work.

## Financial standing

- 53 The Council's financial position is satisfactory, with an adequate level of balances and strong processes for budgetary control. However, the Pension Fund has moved further into deficit and a stepped increase in employers' contributions has been agreed in response.

### General fund spending and balances

- 54 In 2004/05, despite a £0.5 million overspend on social services, the Council spent marginally less overall on services than it had budgeted for. Other changes in the year, such as increased interest on balances and a reduced call upon contingency reserves, led to a surplus for the year of £5 million.
- 55 The General Fund Balance at 31 March 2005 was £17.6 million. This is planned to reduce through 2005/06 to £8.7 million and through 2006/07 to about £6.7 million, close to the level of 0.6 per cent of net expenditure regarded by the County Treasurer as prudent. Earmarked balances were £75.7 million, including £30.8 million of schools' reserves representing their net under-spending on budgets.
- 56 For 2005/06, the Council increased council tax by 3.5 per cent, its lowest increase for 20 years. This was achieved by applying cash efficiency savings and revenue balances totalling £8.4 million to meet new pressures on spending. Delivery of the 2005/06 budget is dependent upon the achievement of efficiency improvements worth over £16 million. The risks associated with this, alongside substantial additional spending pressures, will demand continued vigilance by the Council.
- 57 At the half-year point in 2005/06, spending on services is progressing broadly in line with the budget. However, there are £2.8 million of unbudgeted spending pressures on the adult social care budgets and £1.6 million on the children's budget. Management action is being taken to address these.

### Pension fund deficit

- 58 The latest Actuary's Report at 31 March 2004 states that, at current values, the Pension Fund is sufficient to cover only 69 per cent of all current and future fund liabilities, equivalent to a shortfall of £911 million. We have expressed our concern previously, when the funding ratio was 88 per cent and the deficit £271 million, about the strategy to bring the fund into balance over a 40-year period, relying on a continuation of the market upturn to recover the deficit. The deteriorating position of the fund, largely because of low interest rates and poor returns earned by the Fund's investments over the period, suggests it would not be prudent to maintain this policy, and we are pleased to see that the recovery period for the scheduled bodies has been reduced to 25 years. The Council's contributions are to rise from 215 per cent to 295 per cent in three annual steps in order to bring the fund into balance over the agreed period. The recovery period for admitted bodies has remained at 40 years and will need to be kept under review.

## Systems of internal financial control

- 59 The Council produced a Statement on Internal Control (SIC) for inclusion in the 2004/05 financial statements. This was compliant with CIPFA requirements in all significant respects and was supported by a well-designed process for the annual effectiveness review.
- 60 While the Council's arrangements for maintaining internal control are sound, they could be further improved by a more disciplined approach to the use of control accounts and by strengthening the Governance Committee's role and independence.

### Control accounts

- 61 The Council's accounting system makes use of control and holding accounts in order to provide a check on the accuracy of entries in individual accounts and identify errors in the completion and posting of detailed records. For purposes of ensuring the integrity of the Council's financial reports and accounts, it is important that responsibility for regularly reviewing and reconciling each control account is assigned to an individual officer, and that there is high-level monitoring to ensure that reviews are carried out, errors corrected and reconciliations signed-off.
- 62 At present, the Council's arrangements are incomplete. In some cases responsibility for reviews has not been assigned and, where it has been, there is an inconsistent approach to ensuring that reviews are carried out. Problems have occurred in the Council's accounts recently through failure to review the control accounts for Goods Received Notes and Payroll Deductions, and it is important that action is taken to strengthen arrangements so that the risk of future such problems is reduced.

### Governance

- 63 The Governance Committee was established in 2004 to be responsible for all aspects of corporate governance, and has performed a valuable role in raising the status of audit and helping to ensure that action is taken on areas of control weakness. However, the guidance on Audit Committees recently issued by CIPFA, on which the CPA Use of Resources criteria are based, indicates how the role of the Committee could be further enhanced. This would involve the committee being independent of executive and scrutiny functions, with the ability to challenge the executive if necessary, and providing assurance to councillors and the public that arrangements for audit, risk management, internal control and governance are adequate and effective.

- 64 We suggest therefore that the Council should consider the benefits of adopting CIPFA's recommended approach and revising the terms of reference of the Governance Committee, so that it:
- has increased independence of the executive and scrutiny functions and reports directly to the Council rather than to the Cabinet;
  - takes a proactive lead on governance issues for the Council, with a programme of work that covers risk management, audit, financial management and reporting, and counter fraud and corruption arrangements; and
  - receives regular training to ensure its members have the knowledge and understanding of governance matters to carry out their roles effectively.

## **Standards of financial conduct and the prevention and detection of fraud and corruption**

- 65 We have not identified any significant weaknesses in the Council's arrangements to prevent and detect fraud and corruption, but we have suggested a number of ways in which they might be enhanced.
- 66 Although the Council has promulgated policies on fraud and whistle-blowing, it does little to promote an anti-fraud culture, on the grounds that fraud has not been a major problem. However, it is important to ensure that staff and contractors are alert to the possibility of fraud and are diligent in maintaining controls that are aimed at preventing fraud. Our anti-fraud and corruption work and our assessment of the Council for CPA use of resources has suggested that the Council could strengthen arrangements by:
- raising the profile of the Council's stance on fraud and corruption; and
  - establishing a formal, proactive audit programme of counter-fraud work.
- 67 We have also carried out a review of the Council's compliance with ethical standards. Our main conclusion is that the arrangements are sound and that councillors and officers have effective mechanisms for ensuring the maintenance of high standards. However, there are some areas for potential improvement, notably:
- ensuring the Standards Committee meets regularly;
  - responding to the Graham Committee's recommendations on investigating alleged breaches of the Code of Conduct and enhancing the number and role of independent members of the Standards Committee; and
  - ensuring that councillors and officers are aware of the Council's ethical governance arrangements.
- 68 Our draft report is with officers and we will be discussing it with them and agreeing an action plan shortly.

## **Legality of transactions**

- 69 We have not identified any significant weaknesses in the framework established by the Council for ensuring the legality of its significant financial transactions.

## Other work

### Additional voluntary work

- 70 The Council invited us to undertake work to facilitate improved partnership working for children's services and to support the implementation of Children Act requirements. This work, which is in progress, includes consideration of:
- shared understanding of priorities, direction and outcomes for children;
  - partners' roles, relationships and capacities;
  - partnership decision-making and accountabilities; and
  - performance management frameworks for children's services and processes for joint working.
- 71 We will also be carrying out facilitated workshops with partners to help develop a local shared vision for children's services in Hampshire. We will use our findings to assess the viability of current arrangements and set out options for maximising their effectiveness, which we will present to the Hampshire Children's Board.

### Grant claims

- 72 In accordance with strategic regulation, we have continued with a more risk-based approach to the certification of grant claims. This has enabled us to reduce our claims audit work, but our ability to reduce further depends on the adequacy of the Council's control environment.
- 73 The Council's arrangements for managing and quality assuring grant claims submitted for audit have improved in recent years, and we are working together to promote further improvement so that:
- claims are submitted to us promptly;
  - there are controls to ensure that claims are correctly completed, in accordance with grant conditions and consistent with accounting records; and
  - supporting documentation is comprehensive.
- 74 This should lead to a more efficient audit process and, potentially, to further reductions in the associated audit fees.

### National Fraud Initiative

- 75 In 2004/05 the Council took part in the Audit Commission's National Fraud Initiative. The NFI, which is undertaken every two years, aims to help identify and reduce fraud by bringing together data from NHS bodies, local authorities and government departments and other agencies, to detect a wide range of frauds against the public sector.

## Looking forwards

### Future audit and inspection work

- 76 We have an agreed plan for 2005/06 and have reported in this letter those aspects that have already been completed. The remaining elements, including our audit of the 2005/06 accounts, will be reported in next year's Annual Letter. Our planned work, together with that of other inspectorates, is included on both the Audit Commission and LSIF (Local Services Inspectorates Forum) websites.
- 77 We have sought to ensure, wherever possible, that our work relates to the improvement priorities of the Council. We will continue with this approach when planning our programme of work for 2006/07. We will seek to reconsider, with you, your improvement priorities in the light of the latest CPA assessment and your own analysis, and develop an agreed programme by 31 March 2006. We will continue to work with other inspectorates and regulators to develop a coordinated approach to regulation.

### Revision to the Code of Audit Practice

- 78 The statutory requirements governing our audit work, are contained in:
- the Audit Commission Act 1998; and
  - the Code of Audit Practice (the Code).
- 79 The Code has been revised with effect from 1 April 2005. Further details are included in our Audit Plan which was agreed with your Chief Executive and County Treasurer in March 2005. The key changes include:
- the requirement to draw a positive conclusion regarding the Council's arrangements for ensuring value for money in its use of resources; and
  - a clearer focus on overall financial and performance management arrangements.

## Closing remarks

- 80 The draft of this letter was discussed and agreed with the Chief Executive and County Treasurer and presented to the Cabinet on 23 January 2006.
- 81 The Council has taken a positive and constructive approach to our audit and inspection, and I would like to take this opportunity to express my appreciation for the assistance and co-operation we have had from officers and councillors.

## Availability of this letter

- 82 This letter will be published on the Audit Commission's website at [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk) and also on the Council's website.

Stephen Taylor  
District Auditor  
Relationship Manager

January 2006

# Appendix 1 – Background to this letter

## The purpose of this letter

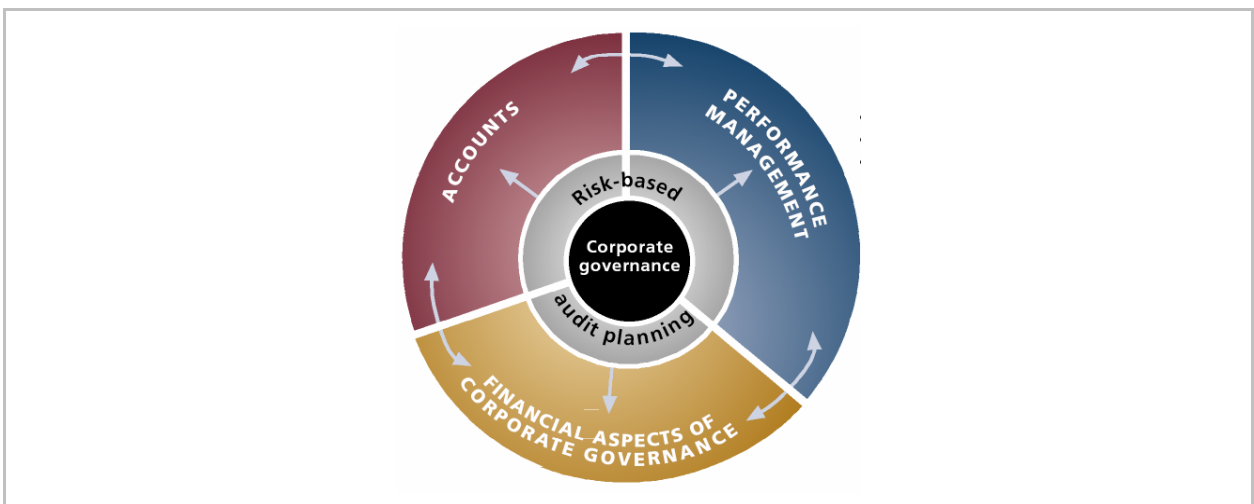
- 1 This is our Annual Audit and Inspection Letter for councillors which is presented by the Council's Relationship Manager and District Auditor. The letter summarises the conclusions and significant issues arising from our recent audit and inspections of the Council.
- 2 We have issued separate reports during the year setting out the findings and conclusions from the specific elements of our programme. These reports are listed at Appendix 2 for information.
- 3 The Audit Commission has circulated to all audited bodies a statement that summarises the key responsibilities of auditors. Our audit has been conducted in accordance with the principles set out in that statement. What we say about the results of our audit should be viewed in the context of that more formal background.
- 4 Appendix 3 provides information about the fee charged for our audit and inspections.

## Audit objectives

- 5 Our main objective as your appointed auditor is to plan and carry out an audit that meets the requirements of the Code of Audit Practice. We adopt a risk-based approach to planning our audit, and our audit work has focused on your significant financial and operational risks that are relevant to our audit responsibilities.
- 6 Central to our audit are your corporate governance arrangements. Our audit is then structured around the three elements of our responsibilities as set out in the Code and shown in Figure 1.

**Figure 1 Code of Audit Practice**

Code of practice responsibilities



- 7 Central to our audit are your corporate governance arrangements. Our audit is then structured around the three elements of our responsibilities as shown below.

### **Accounts**

- Opinion.

### **Financial aspects of corporate governance**

- Financial standing.
- Systems of internal financial control.
- Standards of financial conduct and the prevention and detection of fraud and corruption.
- Legality of transactions.

### **Performance management**

- Use of resources.
- Performance information.
- Best value performance plan.

## Appendix 2 – Audit reports issued

**Table 3      Audit reports issued in 2005**

<b>Report title</b>	<b>Date issued</b>
Audit Plan	March 2005
Partnerships	June 2005
Interim Audit Report	September 2005
Report to Those Charged with Governance on the Financial Statements 2004/05 (SAS610)	October 2005
Ethical Governance	November 2005
CPA Use of Resources Findings and Conclusions	November 2005
Matters Arising from the Review of the Financial Statements	November 2005
Annual Audit Letter	November 2005
Best Value Performance Plan Report	December 2005

## Appendix 3 – Audit fee

**Table 4      Audit fee update**

<b>Audit area</b>	<b>Plan 2004/05</b>	<b>Actual 2004/05</b>
Accounts	£111,000	£111,000
Financial aspects of corporate governance	£106,000	£106,000
Performance	£ 58,000	£ 58,000
<b>Total Code of Audit Practice fee</b>	<b>£275,000</b>	<b>£275,000</b>