

Annual Audit Letter

Dudley Metropolitan Borough Council

Audit 2010/11



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Traffic light explanation
Red  Amber  Green 

Key messages

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

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

I have included only significant recommendations in this report. The Council has accepted these recommendations.

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

Audit opinion and financial statements

I issued an audit report on 28 September 2011 which included an unqualified opinion on the financial statements. During the audit, management agreed to a number of adjustments to the financial statements. The only adjustment which affected usable reserves was in respect of accrued expenditure on termination benefits and this resulted in General Fund reserves increasing by £0.4m and schools reserves decreasing by £0.1m.

Value for money

My overall conclusion is that the Council has adequate arrangements to secure, economy, efficiency and effectiveness in its use of resources.

Current and future challenges

The Council continues to face a number of challenges and these are detailed in the table below.

Economic climate and pressure on the public sector	The Council faces significant challenges arising from the impact of the economic downturn and reductions in grant funding. As part of my assessment of your arrangements to secure economy, efficiency and effectiveness in your use of resources, I considered whether the Council has proper arrangements in place to secure financial resilience. I reviewed the Council's response to the Comprehensive Spending Review (CSR) and its impact on budget setting for 2011/12 and medium term financial planning and found that the Council has robust systems and processes in place to: ■ manage effectively the financial risks arising from the CSR; and ■ secure a stable financial position that enables it to continue to operate for the foreseeable future. I also assessed whether the Council has proper arrangements for challenging how it secures economy, efficiency and effectiveness. In performing this assessment I reviewed: ■ the adequacy of processes that the Council has in place to deliver cost savings and service efficiencies arising from the redesign of services for older people; and ■ the Council's arrangements for improving the range of cross directorate single coordinated services. I found that, for each of these areas, the Council is prioritising its resources within tighter budgets and is taking appropriate action to improve efficiency and productivity. Therefore, the Council is well placed to meet the financial challenges that it faces.

	As part of my 2011/12 audit I will review the Council's budget setting for 2012/13 and its impact on medium term financial planning.
Treasury management	The Government proposes to reform the council housing finance system which will result in the existing Housing Revenue Account (HRA) subsidy being abolished and replaced with a one-off redistribution of debt. This will have a significant impact on the Council's treasury management activities. The Treasurer reported to the Audit Committee on 22 September that the current proposals will require the Council to borrow approximately £335m to finance a payment to Government on 28 March 2012. This will significantly increase the Council's borrowings and alter the structure of its treasury portfolio considerably. The Treasurer and his officers are currently establishing a strategy for borrowing and accounting for new HRA debt. I will review the Council's accounting treatment for new HRA debt as part of my 2011/12 audit
Unequal pay	The Council has made provision for outstanding settlements with current and former employees in respect of actual or potential claims under equal pay legislation. The 2010/11 financial statements disclosed a total provision of £74.7m at 31 March 2011. The settlement process and litigation is ongoing which means that that the ultimate amounts involved and the payment timescale remain uncertain. I tested the Council's total provision as part of my audit of the 2010/11 financial statements and concluded that it was fairly stated. I will revisit this provision as part of my 2011/12 audit

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 on 28 September 2011 which included an unqualified opinion on the financial statements. During the audit, management agreed to a number of adjustments to the financial statements. Most of these adjustments were in respect of disclosures made in the notes to the statements and did not have any impact on the Council's usable reserves. The only adjustment which affected usable reserves was in respect of accrued expenditure on termination benefits and this resulted in General Fund reserves increasing by £0.4m and schools reserves decreasing by £0.1m. The other significant adjustments are detailed in the table below.

Table 1: Significant adjustments

Nature of adjustment	Reason for adjustment
The value of the Council's long term assets was reduced by £7.9m	■ The Council wrote off past expenditure of £5.5m on community assets where the Council's records do not show the nature of the expenditure and so the Council cannot demonstrate that benefit is still being received from the historic spend, eg expenditure on unidentified play areas and community leisure facilities. ■ There was a change in the basis of valuation for two of the Council's assets which resulted in their value decreasing by £2.4m. These two assets were the Savoy Centre and Dudley MBC Employees' Sports Club And Ground.

Nature of adjustment	Reason for adjustment
The value of the Council's current liabilities was reduced by £50.7m	■ Part of the unequal pay provision was re-classified from current liabilities to long term liabilities (£62.4m). ■ Part of the grants received in advance balance was re-classified from long term to current liabilities (minus £10.2m). ■ There was an adjustment in respect of accrued expenditure on termination benefits (£0.2m). ■ Part of the long term deferred liabilities balances was re-classified as short term deferred liabilities (minus £1.7m).
The value of the Council's long term liabilities was increased by £50.6m	This was due to the re-classifications in respect of the unequal pay provision (£62.4m), grants received in advance (minus £10.2m) and deferred liabilities (minus £1.7m) referred to above and an adjustment of £0.1m in respect of pension liabilities arising from adjustments to termination benefits referred to above.
The value of the Council's unusable reserves was reduced by £7.8m	This was due to the adjustments in respect of writing off of community assets (£5.5m), the change in basis of valuation of two assets (£2.4m) and pension liabilities (minus £0.1m) which are all referred to above.

The Council produced its 2010/11 financial statements in accordance with the CIPFA Code of Practice on Local Authority Accounting (the 'Code') which is based on International Financial Reporting Standards (IFRS). This was the first set of financial statements prepared under the new Code and a significant amount of work was needed by the Council's officers in order for this to be done. The most time consuming task was the restatement of the 2009/10 financial statements in accordance with the new Code. Officers had originally planned to complete this exercise by the end of January 2011 but it took longer than expected and was not completed until the end of June 2011. My review of the financial statements identified a number of material errors in the financial statements submitted for audit which arose from non-compliance with the requirements of the Code. These errors were corrected and have been reported to the Audit Committee in my Annual Governance Report. None of these errors affected the Council's level of usable reserves.

I have identified a number of ways in which the quality of your financial statements could be improved and have made recommendations to management as to how this could be done. These are set out in the table below.

Table 2: Improvements to the quality of your financial statements

Issue	Recommendation
The preparation of financial statements under the new Code has been a difficult and time consuming exercise for officers. The additional workload reduced the time available for checking the financial statements prior to submission for audit, leading to incorrect casting of figures, figures not being consistent between different areas of the financial statements and inconsistent use of brackets for debit and credit balances.	Management should ensure that the financial statements are checked for casting, cross referencing and consistent use of terminology before they are submitted for audit.
The new Code requires the Council to identify significant components of an asset that have a shorter life than the asset itself and to depreciate them separately. This is needed to ensure that the annual depreciation charge to CI&ES fully reflects the use of the asset. This requirement to componentise assets applies only to assets acquired, enhanced or revalued since 1 April 2010. Officers considered these assets and concluded that no componentisation was required as the effect on depreciation would not be material. I reviewed the Council's approach and was satisfied that the Council's decision not to componentise assets and depreciate them accordingly did not result in a material error in the 2010/11 financial statements. However, this issue will need to be revisited for the 2011/12 financial statements.	Management must revisit component accounting for the 2011/12 financial statements to ensure that their approach to componentisation does not result in a material misstatement.
Sample testing of grant income found that one grant had been miscoded on the ledger. An adjustment was made to the financial statements to correct this error but I was unable to conclude that this was an isolated error as it was caused by ledger miscoding which could have occurred elsewhere. The extrapolated effect of this error was £1.6m.	Management should continue to impress on staff the need for income and expenditure to be correctly coded on the ledger.

Recommendation

R1 Management should ensure that the financial statements are checked for casting, cross referencing and consistent use of terminology before they are submitted for audit.

R2 Management must revisit component accounting for the 2011/12 financial statements to ensure that their approach to componentisation does not result in a material misstatement.

R3 Management should continue to impress on staff the need for income and expenditure to be correctly coded on the ledger.

Significant weaknesses in internal control

I identified some significant weaknesses in internal control during the course of the audit in respect of housing benefits and payroll systems and property, plant and equipment. I have made recommendations to management as to how these weaknesses could be addressed and these are detailed in the table below.

Table 3: **Significant weaknesses in internal control**

Description of weakness	Potential effect	Recommendation
1. Housing Benefits The Quality Control Team check the accuracy of processing of housing benefit claims. Between 5/4/10 and 3/4/11 they found that errors had been made in the processing of 4.15% of all claims checked.	I am satisfied that this level of error could not lead to a material misstatement of the accounts. However, errors made in processing housing benefit claims could lead to incorrect levels of benefit being paid to claimants and reductions in the level of subsidy that the Council can claim from the Department of Works and Pensions.	Management should continue to check the accuracy of processing of housing benefit claims and to use the results to inform staff training and development.
2. Property, plant and equipment (except for-council dwellings) The Council does not have controls in place which require officers to confirm annually that all property, plant and equipment on the balance sheet are still owned and/or used by the Council.	There is a risk that assets are disposed of but continue to be recorded on the Council's balance sheet. Introducing this control would help to ensure that this risk is mitigated.	Management should require appropriate officers to confirm annually that all property, plant and equipment on the balance sheet is still owned and/or used by the Council.

Description of weakness	Potential effect	Recommendation
3. Property, plant and equipment (council dwellings) The Council maintains a register of all council dwellings which records the valuation for each council dwelling. This register is used to calculate the total value of council dwellings recorded on the balance sheet. The Council also has a HomeCheck inspection process which aims to inspect all council dwellings over a period of years. The Council could improve its internal controls by using the results of the HomeCheck inspection process to check that its register of council dwellings used for accounting purposes remains accurate.	There is a risk that council dwellings are disposed of but continue to be recorded on the Council's balance sheet. Introducing this control would help to ensure that this risk is mitigated.	Management should use the results of the HomeCheck inspection process to check that its register of council dwellings used for accounting purposes remains accurate.
4. Payroll system Internal audit testing found that there were weaknesses in the Council's controls for ensuring that changes to the payroll are appropriately authorised within some Directorates.	This prevented me from placing reliance on your controls in this area and I had to perform further testing as a result. This further testing did not identify any misstatements in respect of payroll expenditure. Management have informed me that HR First was established to help address issues such as the one identified by internal audit's testing and that they expect authorisation processes to be far more robust in future.	Management should continue to test whether changes to the payroll are appropriately authorised and take remedial action if any errors are found.

Recommendations

R4 Management should continue to check the accuracy of processing of housing benefit claims and to use the results to inform staff training and development.

Recommendations

- R5** Management should require appropriate officers to confirm annually that all property, plant and equipment on the balance sheet is still owned and/or used by the Council.
 - R6** Management should use the results of the HomeCheck inspection process to check that its register of council dwellings used for accounting purposes remains accurate.
 - R7** Management should continue to test whether changes to the payroll are appropriately authorised and take remedial action if any errors are found.
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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.

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

Value for money criteria and key messages

Criterion	Key messages
1. Financial resilience The organisation has proper arrangements in place to secure financial resilience. Focus for 2010/11: The organisation has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.	I have assessed whether the Council has proper arrangements in place to secure financial resilience. In performing this assessment I reviewed the Council's response to the Comprehensive Spending Review (CSR) and its impact on budget setting for 2011/12 and medium term financial planning. I found that the Council has robust systems and processes to manage effectively the financial risks arising from the CSR, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.

Criterion	Key messages
2. Securing economy efficiency and effectiveness The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness. Focus for 2010/11: The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.	I have assessed whether the Council has proper arrangements for challenging how it secures economy, efficiency and effectiveness. In performing this assessment I reviewed: ■ the Council's response to the CSR and its impact on budget setting for 2011/12 and medium term financial planning; ■ the adequacy of processes that the Council has in place to deliver cost savings and service efficiencies arising from the redesign of services for older people; and ■ the Council's arrangements for improving the range of cross directorate single coordinated services. I found that, for each of these areas, the Council is prioritising its resources within tighter budgets and is taking appropriate action to improve efficiency and productivity.

Closing remarks

I have discussed and agreed this letter with the Chief Executive and the Treasurer. I will present this letter at the Audit Committee on 9 February 2012 and will provide copies to all 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 opinion plan	March 2010
Governance of regeneration partnerships	November 2010
Cost savings and service efficiencies arising from the redesign of services for older people (presentation)	January 2011
Improving the range of cross directorate single coordinated services (presentation)	January 2011
Annual governance report	September 2011
Auditor's report giving the opinion on the financial statements and the value for money conclusion	September 2011
Annual audit letter	November 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.

Tony Corcoran

District Auditor

November 2011

Appendix 1 - Fees

	Actual	Proposed	Variance
Fee	329,957	329,957	0
Non-audit work	0	0	0
Total			

The Audit Commission is paying a rebate of £33,527 to you.

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.

Appendix 3 Action Plan

Recommendations

Recommendation 1

Management should ensure that the financial statements are checked for casting, cross referencing and consistent use of terminology before they are submitted for audit.

Responsibility	Head of Accountancy
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Priority	High
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Date	31/12/2011
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Comments	We will review the process for producing the financial statements.
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Recommendation 2

Management must revisit component accounting for the 2011/12 financial statements to ensure that their approach to componentisation does not result in a material misstatement.

Responsibility	Head of Accountancy
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Priority	High
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Date	31/12/2011
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Comments	We will revisit our approach to component accounting.
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Recommendation 3

Management should continue to impress on staff the need for income and expenditure to be correctly coded on the ledger

Responsibility	Head of Accountancy
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Priority	Medium
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Date	31/12/2011
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Comments	Correct coding is essential and will be impressed on staff.
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Recommendation 4

Management should continue to check the accuracy of processing of housing benefit claims and to use the results to inform staff training and development

Responsibility	Head of Benefits Services
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Priority	High
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Date	31/12/2011
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Comments	The Quality Control Team continue with checking the accuracy of processing of housing benefit claims. The training team has conducted workshops and training for staff relating to errors identified from this checking and from subsidy work and will continue to do so as part of training and development.
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Recommendation 5

Management should require appropriate officers to confirm annually that all property, plant and equipment on the balance sheet is still owned and/or used by the Council

Responsibility	Head of Accountancy
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Priority	High
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Date	31/12/2011
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Comments	We will review the process for confirming the ownership and use of assets.
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Recommendation 6

Management should use the results of the HomeCheck inspection process to check that its register of council dwellings used for accounting purposes remains accurate

Responsibility	Housing Finance Manager
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Priority	High
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Date	31/12/2011
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Comments	Management have already incorporated a property type check in the Homecheck process, taking advantage of the move to mobile working practices to extend the areas covered. The process was in place for part of 2010-11 (trialled from Oct 2010, fully implemented from Feb 2011). However, management will use the results of the HomeCheck inspection process to check that its register of council dwellings used for accounting purposes remains accurate.
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Recommendation 7

Management should continue to test whether changes to the payroll are appropriately authorised and take remedial action if any errors are found.

Responsibility	Payroll Manager
Priority	High
Date	31/12/2011
Comments	Management will continue to test to ensure changes to payroll are properly authorised.

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November 2011