Notice of Meeting

Audit & Governance Committee

Date & time	Place	Contact	Chief Executive
Monday, 18 March 2013 at **10.00 am**	Ashcombe Suite, County Hall, Kingston upon Thames, Surrey KT1 2DN	Helen Rankin Room 122, County Hall Tel 020 85419 126 helen.rankin@surreycc.gov.uk	David McNulty

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This meeting will be held in public. If you would like to attend and you have any special requirements, please contact Helen Rankin on 020 85419 126.

Members

Mr Nick Harrison (Chairman), Mr W D Barker OBE (Vice-Chairman), Mr Stephen Cooksey, Mr Tony Elias, Mr Mel Few and Denis Fuller

Ex Officio:

Mr David Hodge (Leader of the Council), Mr Peter Martin (Deputy Leader), Mr David Munro (Vice Chairman of the County Council) and Mrs Lavinia Sealy (Chairman of the County Council)

AGENDA

1 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

2 MINUTES OF THE PREVIOUS MEETING [21 FEBRUARY 2013] (Pages 1 - 10)

To agree the minutes as a true record of the meeting.

3 DECLARATIONS OF INTEREST

To receive any declarations of disclosable pecuniary interests from Members in respect of any item to be considered at the meeting.

Notes:

- In line with the Relevant Authorities (Disclosable Pecuniary Interests) Regulations 2012, declarations may relate to the interest of the member, or the member's spouse or civil partner, or a person with whom the member is living as husband or wife, or a person with whom the member is living as if they were civil partners and the member is aware they have the interest.
- Members need only disclose interests not currently listed on the Register of Disclosable Pecuniary Interests.
- Members must notify the Monitoring Officer of any interests disclosed at the meeting so they may be added to the Register.
- Members are reminded that they must not participate in any item where they have a disclosable pecuniary interest.

4 QUESTIONS AND PETITIONS

To receive any questions or petitions.

Notes:

1. The deadline for Member's questions is 12.00pm four working days before the meeting
2. The deadline for public questions is seven days before the meeting
3. The deadline for petitions was 14 days before the meeting, and no petitions have been received.

5 RECOMMENDATIONS TRACKER (Pages 11 - 24)

To review the Committee's recommendations tracker.

6 EFFECTIVENESS REVIEW OF THE SYSTEM OF INTERNAL AUDIT (Pages 25 - 52)

This report sets out the findings and recommendations from the 2012/13 review of the effectiveness of the system of internal audit in Surrey County Council.

7 EXTERNAL AUDIT - AUDIT PLAN (Pages 53 - 86)

Please see attached 2 reports from the Council's external auditors, Grant Thornton:

a) This paper provides the Audit and Governance Committee with a report on progress in delivering our responsibilities as your external auditors. The paper also includes a summary of emerging national issues and developments that may be relevant to you as a County Council.

b) the external auditor’s annual audit plan for year ended 31 March 2013

David McNulty
Chief Executive
Published: 8 March 2013

MOBILE TECHNOLOGY – ACCEPTABLE USE

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MINUTES of the meeting of the **AUDIT & GOVERNANCE COMMITTEE** held at 10.00 am on 21 February 2013 at Ashcombe Suite, County Hall, Kingston upon Thames, Surrey KT1 2DN.

These minutes are subject to confirmation by the Committee at its meeting.

Elected Members:

Mr Nick Harrison (Chairman)
Mr W D Barker OBE (Vice-Chairman)
Mr Stephen Cooksey
Mr Tony Elias
Mr Mel Few
Denis Fuller

In Attendance
Cath Edwards, Risk & Governance Manager
Kevin Kilburn, Deputy Chief Finance Officer (Section 151 Representative)
Sue Lewry-Jones, Chief Internal Auditor
Helen Rankin, Committee Manager

6/13 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS [Item 1]

There were none.

7/13 MINUTES OF THE PREVIOUS MEETINGS - 6 DECEMBER 2012 AND 12 FEBRUARY 2013 [Item 2]

The minutes of the 6 December 2012 were agreed as a true and correct record.

The minutes of the 12 February 2013 were agreed as a true and correct record, subject to amendments circulated ahead of the meeting. The amendments drew attention to follow up action required by the Committee, following recommendations from the Council Overview & Scrutiny Committee on Business Planning for 2013/14.

The minute relating to Item 5 (Dispensation for Members to enable them to participate in the Council budget meeting) was also amended to clarify that the Council had decided to proceed with the recommendation as government advice had not specifically covered the issue of a Member being a freeholder or lease holder of a property in Surrey.

8/13 DECLARATIONS OF INTEREST [Item 3]

There were none.

9/13 QUESTIONS AND PETITIONS [Item 4]

There were none.

10/13 RECOMMENDATIONS TRACKER [Item 5]

Tony Elias joined the meeting.

Declarations of interest:
None.

Officers:
Cath Edwards, Risk & Governance Manager
Kevin Kilburn, Deputy Chief Finance Officer
Sue Lewry-Jones, Chief Internal Auditor
Helen Rankin, Regulatory Committee Manager

Key points raised during the discussion:

1. In relation to A14/12 (internal audit reports on the SNet), the Regulatory Committee Manager advised that all Internal Audit reports published in the period May 2012 – present had been uploaded into an intranet library. The Chief Internal Auditor would send out a link to all Members after the meeting.
2. In relation to A20/12 (damage to county property recovery rates), the Chairman advised that he would ask the Projects and Contracts Group Manager to attend the next meeting.
3. In relation to A38/12 (Creditor balance), the Deputy Chief Finance Officer provided an update. He reported that the action related to an uncorrected non-material error identified by the eternal auditor. The

Finance service had been investigating this since September 2012 and found that £1.7m (of the reported £9.3m balance) had subsequently been paid. The investigation had been broken down into vendor balances of over £50k, those worth £25k-50k, and under £25k. The higher balances had been the focus of the initial stages of the investigation, and good progress had been made so far. The problem had occurred because of a difference between amounts recorded on purchase orders and actual goods received. It was noted that there had also been cases where invoices had not been received or where use of an alternative payment method had not been advised to Accounts Payable. The Deputy Chief Finance Officer explained that the whole end-to-end purchasing-to-pay process was being reviewed. He clarified that no balances (which were favourable) had been written back yet, as the investigation was not complete and officers were keen to avoid writing back any balances that could be a proper liability. In terms of timescales, it was reported that some of the work, particularly on the smaller balances, was likely to continue after the end of this financial year. It was reported that when the total amount was confirmed, it would be written back centrally so that Cabinet could decide what to do with it. The Deputy Chief Finance Officer advised that he would speak to the external auditor about the next steps, but did not anticipate that reallocating the expenditure by expense category to services in the financial accounts would be a time consuming task.

4. Members expressed concern that items were being marked as goods receipted, without the Council ever receiving the goods. The Deputy Chief Finance Officer explained that necessary controls were in place through budget monitoring. The Chief Internal Auditor confirmed that audits of budgetary control, accounts payable and the General Ledger were currently underway
5. In relation to A45/12 (schools early closure of accounts), the Deputy Chief Finance Officer reported that major problems were not anticipated this year as Easter fell earlier than previous years. In addition, Babcock 4S were sending out additional information to schools, a new SAP module had been implemented for capital and quarterly closing was helping to ensure that there should not be any issues with early close because of schools. The Audit Manager (Grant Thornton) reported that the Finance Manager (Assets and Accounting) had been present at a recent Grant Thornton session on account closing where Oldham Council had shared information about successful accounts closing with relation to schools.
6. In relation to A53/12 (select committee review of Internal Audit reports), the Committee agreed the proposed wording of a recommendation to select committee chairmen setting out the process handling Internal Audit reports.
7. In relation to A58/12 (Environment and Infrastructure risk register), the Risk & Governance Manager advised that she had not yet received an updated version of the register. The Chairman agreed to write to the relevant Portfolio Holder again.
8. In relation to A59/12 (energy purchasing contract), the Chairman confirmed that a letter had been drafted, signed by the Leader and sent to the Leader of the local authority in question.
9. It was noted that A1/13 would be updated to reflect the amended minutes, agreed at Item 2.

10. Before concluding the item, Members agreed that it would be helpful to ensure that the recommendations tracker was fully up-to-date, ahead of the forthcoming elections, which could see a change in Committee membership.

Actions/Further information to be provided:
The recommendations tracker to be updated to reflect the discussion, as noted above.

RESOLVED:
The recommendations tracker was noted and the Committee agreed to remove pages 37 – 39 of the tracker, as the actions were completed.

Committee Next Steps:
The Chairman agreed to write to:

- The Portfolio Holder for Environment & Transport about the Environment & Infrastructure Strategic Risk Register
- Select Committee chairmen, with reference to the select committee process for handling Internal Audit reports
- The Highways Department, with regard to A20/12

11/13 EXTERNAL AUDIT - CERTIFICATION OF CLAIMS AND RETURNS [Item 6]

Declarations of interest:
None.

Officers:
Kevin Kilburn, Deputy Chief Finance Officer
Sue Lewry-Jones, Chief Internal Auditor
Andy Mack, Engagement Lead (Grant Thornton)
Kathryn Sharp, Audit Manager (Grant Thornton)

Key points raised during the discussion:

1. The Audit Manager (Grant Thornton) introduced the report, and advised that it summarised the work undertaken on 3 grants during 2011/12. 2 claims had been submitted on time, with the third slightly delayed due to further clarification being required. It had been noted that the processes had improved on previous years, and recommendations from the previous year's audit had been addressed, particularly around information relating to external payroll providers.
2. The Teacher's Pensions Return had been qualified due to identification by Internal Audit of payments coded as honorarium being made to teachers. The Deputy Chief Finance Officer explained that he was working on resolving this issue.
3. In the previous year, the external auditor had reported problems with obtaining information from external payroll providers, and it was noted that this issue had now been resolved. The Chairman thanked the Section 151 Officer and her team for addressing and resolving this problem.
4. It was noted that the total fee for certification of claims and returns for the previous year was £9,630 in total, against the budget of £11,858.

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5. The Audit Manager (Grant Thornton) clarified that the grant claim for Walton Bridge had been completed by the Audit Commission, before duties were transferred to Grant Thornton.
6. Members queried why the external auditor was intending on placing less reliance on Internal Audit. The Audit Manager (Grant Thornton) advised that this approach meant that Internal Audit were less bound by what the external auditor required of them, and therefore they had more freedom in their approach to auditing the key financial systems. The Chief Internal Auditor commented that different external auditors often took different approaches and that this approach would give her team more freedom with regards to their testing.
7. Members asked whether there was any further information on the coded as honorarium payments made to teachers. The Deputy Chief Finance Officer explained that he had been in touch with the Teacher's Pension Agency (TPA) and submitted all relevant information. At this stage officers were responding to queries from the TPA on the information submitted.
8. Members queried whether Internal Audit's involvement in the certification of grants and returns work in previous years had been resource intensive. The Chief Internal Auditor explained that when she presented her audit plan for 2013/14, at a future committee, Members would see that days set aside for grant work had reduced further, meaning there was more capacity within the plan for other audit work.

Actions/Further information to be provided:
None.

RESOLVED:
The Committee noted the report.

Committee Next Steps:
None.

12/13 EXTERNAL AUDIT PROGRESS REPORT [Item 7]

Declarations of interest:
None.

Officers:
Kevin Kilburn, Deputy Chief Finance Officer
Andy Mack, Engagement Lead (Grant Thornton)
Kathryn Sharp, Audit Manager (Grant Thornton)

Key points raised during the discussion:
1. The Engagement Lead (Grant Thornton) advised that initial planning for the year's audit had been completed, and the proposed audit plan would be presented at the Committee's next meeting. He reported that initial conversations with officers had been successful and time had been spent discussing the relationship between the Council and the external auditor moving forward.
2. The report also brought to the attention of Members national publications on the challenges that local government was facing.
3. Members queried whether the external auditor could audit balances at an earlier date than month-end, to help the Council bring its account

closing forward by a month. The Engagement Lead (Grant Thornton) explained that he was currently engaged in discussions with Finance about bringing timescales forward.

4. The Chairman confirmed that even though it was not a statutory duty, the Committee would be reviewing and signing off unaudited accounts on 24 June. The audited accounts would be presented to the Committee in early September 2013, but it was hoped that this could be brought forward by a month in future years. The Deputy Chief Finance Officer explained that a faster close was anticipated this year, with the target for draft account completions set for the end of May, although the external audit would not start until the end of June
5. Members asked the external auditor how reserves should be shown on the balance sheet. The Engagement Lead (Grant Thornton) explained that for long term planning decisions the holding of reserves was beneficial. He agreed to include consideration of this in the interim work undertaken by the external auditor before the final findings were reported. (**Recommendations tracker ref: A2/14)**
6. It was noted a report would be brought to the Committee at their next meeting with a self assessment of the Council against the recommendations made in Grant Thornton's 'Toward a Tipping Point' and the National Audit Office's 'Financial Sustainability of Local Authorities'.

Actions/Further Information to be provided:
The recommendations tracker to be updated to reflect the actions identified during the discussion.

RESOLVED:
The Committee noted the update.

Committee next steps:
None.

13/13 REVIEW OF THE PAMS SYSTEM [Item 8]

Declarations of interest:
None.

Officers:
Nigel Jones, Performance Manager
John Stebbings, Chief Property Officer

Key points raised during the discussion:

1. The Performance Manager introduced the report and explained that the Property Asset Management System (PAMS), was a joint procurement exercise between Surrey County Council (SCC) and Hampshire County Council (HCC). PAMS would enable the Council to have all its information relating to property assets in one system, including information at the point of purchase right through to disposal.
2. The first phase of the PAMS launch was scheduled for April 2013 and would include all maintenance projects. Rental accounting information was expected to be live in the system by the end of the first quarter of the 2013/14 financial year. There would then be an incremental implementation of the rest of the features of PAMS, through to November 2013.

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3. Members asked whether officers could guarantee that the system would include information on all buildings owned by the Council. The Chief Property Officer explained that PAMS would ensure a clearer and more transparent record.
4. The Committee asked what the overall cost of procuring the system would be and when the implementation was likely to be complete. The Performance Manager advised that it was aimed for the system to be fully functional by November 2013. It was noted that costs would be shared with HCC. The cost of implementation for SCC was £52,025 and thereafter a licence fee of £7,500 would be payable per annum.
5. The Chief Property Officer explained that once the system was up and running it would continue to be developed so that South East Seven authorities could invest in it.
6. Members noted that PAMS had been purchased through the 'Invest to Save' budget and queried what the actual savings had been. The Performance Manager explained a number of savings had been factored in, including looking at how money could be saved by having better information about properties and analysing assets. Further benefits of PAMS included increased levels of customer service and better transparency.
7. The Committee asked for assurance that the company providing the software was resilient in the current economic climate. The Performance Manager advised that the procurement process had included checks on the company. In addition, SCC would still have access to the system, even in the event of the provider no longer being active.
8. The Performance Manager explained that the system would require very little customisation. He went on to advise that expressions of interest had been received from 3 other local authorities about using PAMS.
9. The Chief Property Officer reported that his department had recently been through a restructure and around 15 roles were still being actively recruited too. However, he reassured the Committee that there was adequate cover available to keep the service running.
10. It was noted that the system would be hosted on an external server, and Members asked what assurance there was that data would be secure. The Performance Manager explained that he had been working closely with SCC and HCC's IMT departments to ensure that the system would be secure. Once implemented, the security of the system would continue to be reviewed.
11. Members asked whether consideration had been given to hosting the software at the Council's Data Centre. The Performance Manager explained that this had been considered, although at the time of procurement the SCC Data Centre was not live. HCC had also considered hosting the system, but had concluded that the work involved would significantly delay the project. However, moving the system across to a Council server was an option for the future.

Actions/further information to be provided:
None.

RESOLVED:
The Committee:

a) Noted the progress made against the implementation plan so far and recognised the achievements to date.

b) Agreed to receive further updates on progress against planned activities at future Committee meetings, as required.

Committee next steps:
The Committee to receive a further update and demonstration of the system once it is implemented. **(Recommendations tracker ref: A3/13)**

14/13 COMPLETED INTERNAL AUDIT REPORTS [Item 9]

Declarations of interest:
None.

Officers:
Sue Lewry-Jones, Chief Internal Auditor

Key points raised during the discussion:

1. The Chief Internal Auditor drew the Committee's attention to the Records Management audit report, which had attracted an 'Effective' audit opinion. However, it was noted that the Direct Payments follow up audit and the Corporate Purchasing Cards audit had received 'Major Improvement Needed' opinions. The review of Special Schools (funding of residential provision) was the only report to receive an 'unsatisfactory' audit opinion.
2. It was noted that the Direct Payments follow up audit had been discussed in detail at the Adult Social Care Select Committee in November 2012. Most of the other reports, including the Corporate Purchasing Cards report, had been discussed at the last meeting of the Council Overview & Scrutiny Committee (COSC).
3. Members were concerned that staff other than the designated card holder might be using purchasing cards. The Chief Internal Auditor explained that when issued with a card, the terms of issue stated that only the cardholder must use it. Discussions were taking place to ensure that adequate controls were in place to ensure that others were not able to use purchasing cards that had not been assigned to them. It was reported that managers were issued with guidance when a member of staff received the card; however, this guidance may not be passed on to any subsequent manager taking on that role. Therefore, it was important that awareness of guidance and rules continued to be promoted on an ongoing basis.
4. The Committee asked whether inappropriate expenditure had been recovered. The Chief Internal Auditor advised that appropriate action was taken on individual cases such as repayment of money and removing the card from an individual. Members felt that if the responsibility lay with the manager not making the required checks on a team's purchasing card use, the use of cards should be withdrawn from that department. It was agreed that the Committee would make this recommendation to the Head of Corporate Purchasing. **(Recommendations tracker ref: A3/13).**
5. The Chief Internal Auditor explained that as a result of the Corporate Purchasing Cards audit attracting an opinion of 'major improvement needed', a follow up audit would be planned. Members agreed that the Chief Internal Auditor should report on progress against actions at the next meeting, along with the Head of Corporate Purchasing. **(Recommendations tracker: A4/13).**

6. One Member of the Committee commented, during the debate, that the content of the Schools Basic Needs Programme audit report was being considered very closely by the Education Select Committee.
7. Members commended the work of the Superfast Broadband team and the work undertaken so far.
8. During the debate, one Member queried whether Internal Audit would be reviewing the end-to-end process for accounts receivables in Adult Social Care. The Chief Internal Auditor confirmed that an audit of financial assessments and benefits was underway.

Actions/Further Information to be provided:
The recommendations tracker to be updated to reflect the actions identified during the discussion.

RESOLVED:
The Committee noted the content of the report.

Committee next steps:
The Committee to receive a further update on the Corporate Purchasing Cards audit report at their next meeting.

15/13 PUBLIC SECTOR INTERNAL AUDIT STANDARDS [Item 10]

Declarations of interest:
None.

Officers:
Sue Lewry-Jones, Chief Internal Auditor

Key points raised during the discussion:
1. The Chief Internal Auditor introduced the item and explained that in recent years, Surrey County Council had adopted the CIPFA Code of Best Practice. The annual effectiveness review of the system of internal audit had been used to assess compliance with the Code in the past years. It was reported that the Institute of Internal Auditors and CIPFA had collaborated and produced the Public Sector Internal Audit Standards (PSIAS), which would come into effect in April 2013, replacing the CIPFA code.
2. The Chief Internal Auditor explained that if it were found that the Council's Internal Audit department did not comply with the PSIAS in any significant way, it should form part of the findings of the Annual Governance Statement.
3. It was noted that the terms of reference for this year's effectiveness review of the system of internal audit had included an assessment of the readiness of the Council to adopt the new standards.
4. It was agreed that the terms of reference for the Committee would need to be changed to reflect the adoption of the new standards **(recommendations tracker: A5/13)**.
5. The Chief Internal Auditor confirmed that there were no fundamental differences between the CIPFA Code of Best Practice and the PSIAS. There were some small changes which would be reflected in Internal Audit's work, such as the requirement to link the Internal Audit plan to level of resource within the team.

Actions/Further information to be provided:

The recommendations tracker to be updated to reflect the actions determined during the discussion.

RESOLVED:
The Committee agreed to adopt the Public Sector Internal Audit Standards as best practice for the delivery of a quality Internal Audit Service at Surrey County Council, for the benefit of both the Council as a whole and the residents of Surrey.

Committee next steps:
Terms of reference to be amended to reflect the changes identified in the report.

16/13 LEADERSHIP RISK REGISTER [Item 11]

Declarations of interest:
None.

Officers:
Cath Edwards, Risk & Governance Manager

Key points raised during the discussion:

1. The Risk & Governance Manager introduced the report and advised that there had been no changes to the register since the Committee last reviewed it. However, it was noted that proposed changes would be considered at the next meeting of the Corporate Board.
2. In relation to L1 (Medium Term Financial Plan), Members were concerned that in some departments underspend was being transferred to other departments. It was clarified that there was a virement process which needed to be followed if budgets were transferred between departments.
3. Members repeated concern about the Strategic Director risk register for Environment & Infrastructure, which had not recently been updated. It was noted that this would be followed up through the item on the recommendations tracker.

Actions/further information to be provided:
None.

RESOLVED:
The Leadership Risk Register was noted.

Committee next steps:
The Committee to review the updated risk register at their next meeting.

Before closing the Committee, it was noted that it was the Committee Manager's last meeting in her current role. Members thanked Helen for the support she had provided to the Committee over the last 2 years.

Meeting ended at: Time Not Specified

Chairman

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SURREY
COUNTY COUNCIL

Audit & Governance Committee
18 March 2013

RECOMMENDATIONS TRACKER

PURPOSE OF REPORT:

For Members to consider and comment on the Committee's recommendations tracker.

INTRODUCTION:

A recommendations tracker recording actions and recommendations from previous meetings is attached as **Item 5 Annex A**, and the Committee is asked to review progress on the items listed.

RECOMMENDATION:

The Committee is asked to monitor progress on the implementation of recommendations from previous meetings (Item 5 Annex A).

REPORT CONTACT: Helen Rankin, Regulatory Committee Manager
020 8541 9126
Helen.rankin@surreycc.gov.uk

Sources/background papers: None

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Audit & Governance Committee Recommendations Tracking

Recommendations (REFERRALS)

Number	Meeting Date	Item	Recommendation / Referral	To	Response
R3/11	05/10/11	(75/11)	That the audit report 'accounts receivable' be referred to the Adult Social Care Select Committee for scrutiny (with a particular focus on the finding that debts had arisen as a result of recipients of direct payments within ASC, using the money for purposes other than to meet their care needs and improvements in the dunning process).	Adult Social Care Select Committee	An audit of Social Care debt was included in the 'Completed Audit reports' item on the agenda (5 April 2012) and an audit of Direct Payments is included on the 'Completed Audit Reports Item' on the 21 May 2012 agenda. An update on Social Care Debt was considered by the Adult Social Care Select Committee at their meetings on 4 July and 30 November 2012. The Audit & Governance Committee will continue to be kept updated on the outcome of the Adult Social Care Committee's debate through the Bulletin.
R1/12	21/05/12	(36/12) Annual Governance Statement	That the Annual Governance Statement be COMMENDED to Cabinet for publication with the council's statement of accounts.	Cabinet	The Annual Governance Statement was presented to the Cabinet on 19 June 2012. The Cabinet approved the content and authorised the Leader and Chief Executive to sign for inclusion in the Statement of Accounts. The Committee will continue to monitor progress on the implementations of the actions required and report to Cabinet where appropriate.

Audit & Governance Committee Recommendations Tracking

Number	Meeting Date	Item	Recommendation / Referral	To	Response
R3/12	21/05/12	(38/12) Completed Internal Audit Reports	The Committee recommends that the Adult Social Care Select Committee: Review the Direct Payments audit report and monitor the situation until the policy commitment for annual reviews of the social care needs of the recipients of direct payments is met.	Adult Social Care Select Committee	An officer working group reported to the Adult Social Care Select Committee on 30 November 2012. The Assistant Director for Transformation reported to the Committee that the intention was that the review process would be embedded within the Locality Teams in the future, rather than responsibility of a dedicated team. There would be a review of the Direct Payment Review team in March 2013. A Member Reference Group of the Adult Social Care Select Committee has also been set up to review whether AIS meets the needs of the directorate. The outcome of this review is due to be reported in May 2013.

Audit & Governance Committee Recommendations Tracking

Recommendations (ACTIONS)

Number	Meeting Date	Item	Recommendation / Action	Action by whom	Action update
A17/12	07/04/12	Completed Internal Audit Reports (21/12)	Traffic Signal Management audit report: Data to be reported to the Committee regarding the level of collection rates.	Audit Performance Manager	An update was annexed to this tracker with the agenda papers for 21 May 2012. Members were concerned that recovery rates were still low and commented on the fact that action had only been taken on 50 cases out of the 71 recorded. It has subsequently been confirmed that the remaining 21 cases are those being actively pursued with companies, insurance companies and individuals.
A20/12	21/05/12	Recommenda tions tracker (31/12)	With regards to low recovery rates in cases of damage to county property, the Chairman to write to the Portfolio Holder and ask for his comments on the matter and seek assurance that relevant action was being taken to improve collection rates for damage to county property.	Chairman of the Committee	Following the response to action A17/12 (above), the Chairman determined that it was no longer necessary to write to the Portfolio holder on damage to traffic signals. However, the Chairman has requested further information about other damage to county property. At the meeting in February 2013, the Committee agreed to invite the accountable officer to the next meeting.
A33/12	25/06/12	Completed Internal Audit reports (51/12)	An update to be provided on the recommendations made in the Highways Contract audit report.	Projects & Contracts Group Manager (Surrey Highways)	A follow up audit will commence at the end of February, with an audit report circulated in April 2013.
A36/12	25/06/12	Future of External Audit (54/12)	When the new external auditors are in place, the Committee to challenge how the estimated 40% savings will and have been met.	Committee Members	The new external auditor's attended the meeting in December 2012. The new District Auditor was confident that the 40% savings could be met, based on the quality of the previous year's accounts.

Audit & Governance Committee Recommendations Tracking

Number	Meeting Date	Item	Recommendation / Action	Action by whom	Action update
A39/12	3/09/12	2011/12 Surrey County Council accounts and external audit annual governance report (63/12)	Recommended that Environment & Transport Select Committee should be considering the outcome of the MAXIMO internal audit report	Projects & Contracts Group Manager (Surrey Highways)	A six-month review of the May Gurney contract was considered by the Environment & Transport Select Committee in February 2013. Members were satisfied with the performance figures and supported proposals to improve the highways maintenance programme. A twelve-month review will be considered by the Select Committee in June 2013.

Audit & Governance Committee Recommendations Tracking

A45/12	03/10/12	Financial Management PVR Update (75/12)	Officers to consider whether early close of schools accounts would help overcome the barrier of schools not using SAP	Deputy Chief Finance Officer	At the meeting in December 2012, the Finance Manager (Assets & Accounting) advised that a mini project on schools accounts closing was underway. A further update was provided at the meeting in February. Detail of the response can be found in the minutes of the meeting on 21 February 2013.
A53/12	06/12/12	Recommendations tracker	Letter from Chairman to select committee chairmen about importance of internal audit reports	Chairman of the Committee.	The Chairman has discussed with the Chairman of the Council Overview & Scrutiny Committee. A draft paper on select committee review of audit reports has been circulated for Member comment before being shared with select committee chairmen. It was agreed at the meeting on 21 February 2013, that the Chairman would write to the select committee chairmen to advise them on the process of handling Internal Audit reports at select committees.
A54/12	06/12/12	Whistleblowing update (92/12)	Babcock 4S representative to attend the meeting when the next 6 monthly whistleblowing report is presented.	Deputy Head of HR&OD	This is scheduled for June 2013.
A55/12	06/12/12	Completed Internal Audit Reports (95/12)	Further update to be provided on the recommendation that finance staff continue to develop reports for budget holders to analyse all additional payroll costs.	Chief Internal Auditor	Implementation of the Finance Dashboard will enable these to be developed
A57/12	06/12/12	Risk Management Half year report (96/12)	The Assistant Chief Executive to attend a future meeting of the Committee to talk about risk management arrangements.	Risk & Governance Manager/Assistant Chief Executive	The Assistant Chief Executive will be invited to attend the meeting in June, when the Risk & Governance Manager presents her annual report.

Audit & Governance Committee Recommendations Tracking

A58/12	06/12/12	Risk Management Half year report (96/12)	The Chairman to write to the Cabinet Member for Environment & Transport to raise his concern about the outstanding Strategic Director risk register.	Chairman of the Committee	A response was received from the Cabinet Member which read: *Work has been underway since November to review and revise the 3 Service Risk Registers within the directorate. Once these are completed a revised Directorate Risk Register will be compiled. This is due to be agreed early this month. The new Directorate Risk Register will be reviewed at Directorate Management Team, Directorate Leadership Team and by myself (with DMT) on a quarterly basis.* At the meeting on 21 February 2013, the Risk & Governance Manager confirmed that she had not yet received the updated risk register. The Chairman agreed to write to the Portfolio Holder again.
A59/12	06/12/12	Energy Purchasing Contract (99/12)	The Committee to urge the Leader to write to the Council involved to offer support to amending the terms of reference of the governance panel.	Chairman of the Committee	A letter has been sent from the Leader of the Council to the Leader of the local authority in question, to make the recommendations.
A1/13	12/02/13	Business Planning 2013 – 2018 (4/13)	The recommendations from the 5 February Council Overview & Scrutiny Committee to the Cabinet include follow up action by the Committee (see Annex A)	Chairman of the Committee.	The details of these recommendations will be added to the Committee's forward work programme.

Audit & Governance Committee Recommendations Tracking

A2/13	21/02/13	External Audit Progress Report (12/13)	Members asked the external auditor how reserves should be shown on the balance sheet. The Engagement Lead (Grant Thornton) explained that for long term planning decisions the holding of reserves was beneficial. He agreed to include consideration of this in the interim work undertaken by the external auditor before the final findings were reported	Engagement Lead (Grant Thornton)	Updates to be provided through the external auditor's progress reports
A3/13	21/02/13	PAMS (13/13)	The Committee to receive a further update and demonstration of the system once it is implemented	Chief Property Officer/Performance Manager	Progress check in June 2013.
A4/13	21/02/13	Completed Internal Audit Reports (14/13)	Committee recommend to Head of Corporate Purchasing that where managers are failing to follow Purchasing Card guidelines, consideration be given to removing cards from use in that department.	Head of Procurement & Commissioning	The Procurement & Commissioning Manager has replied that new guidelines re clear that where there are repeated failures to follow guidelines, then the user's card is withdrawn. Monitoring is in place to ensure this happens.
A5/13	21/02/13	Public Sector Internal Audit Standards (15/13)	It was agreed that the terms of reference for the Committee would need to be changed to reflect the adoption of the new standards	Chairman	The Chairman to discuss with the Monitoring Officer.

Audit & Governance Committee Recommendations Tracking

Completed Recommendations/Referrals/Actions

Recommendations – to be deleted

A9/12	07/04/12	Recommendations tracker (17/12)	It was noted that Babcock 4S were known to have large cash balances, but taking out dividends was restricted by pension liability. It was agreed that options would be explored outside of the meeting	Section 151 Officer	Babcock 4S attended the Committee in December 2012. The Finance Director (Babcock 4S) provided the following update: Based on the quarter three company accounts, with a revised valuation of the pension fund deficit, there was a sufficient balance on the company's profit and loss account to make a dividend payment of £1,865,000. This has been approved by the company board and the council has received its 30% of this, which is £559,500 on 7 February 2013.
A14/12	07/04/12	Internal Audit Plan 2012/13 (19/12)	Consideration to be given to the wider distribution of internal audit reports.	Chief Internal Auditor/Chairman of the Committee	At the meeting on 21 May, most Members agreed with the recommendation that audit reports would be published on the S-Net for use by Members. Democratic Services have procured a new committee management system and all Internal Audit reports published since 21 May 2012 are now available on the S-Net. A link was included in the Chief Internal Auditor's regular email to all Members to notify them of reports considered at each Audit & Governance Committee.

Audit & Governance Committee Recommendations Tracking

A34/12	26/05/12	Completed Internal Audit reports (51/12)	The findings of the work being carried out by the Council Overview & Scrutiny Committee relating to mapping vacancies across the organisation be reported back to the Committee.	Committee Manager	The findings were presented to the Council Overview & Scrutiny Committee in December 2012. The Committee agreed that further consideration needed to be given to the wording of the recommendations arising from the review, and therefore resolved to receive a further at their next meeting. At their meeting in February 2013, the Committee agreed the following recommendations: **a. That a policy is formulated to define what constitutes a vacant position the organization structure.** **b. That criteria are established which vacant positions must meet in order to remain in the organization structure together with the operating budget allowance.** **c. That the definition and criteria be consistently applied in all services in the management of their business plans.**
A38/12	3/09/12	2011/12 Surrey County Council accounts and external audit annual governance report (63/12)	Updates throughout the year to be provided on the work being undertaken to identify the extent of overstatement identified in the external auditor's Annual Governance Report.	Deputy Chief Finance Officer	An update was provided at the meeting. Detail of the response can be found in the minutes of the meeting on 21 February 2013.
A42/12	03/10/12	Leadership Risk Register (73/12)	An update to be provided on whether the Waste Contract risk was still 'high'.	Section 151 Officer	At the meeting in December 2012 the Section 151 Officer advised that she had spoken to the Strategic Director for Environment & Transport and could confirm that the risk should remain 'high'. This was because of the significant implications should the contract fail in anyway – however, it was stressed that there was no indication that the contract would fail.

Audit & Governance Committee Recommendations Tracking

A43/12	03/10/12	Funding Strategy Update Report (74/12)	Update to be provided on the impact of the Strategic Director for Customers & Communities working part-time with Mole Valley District Council, on the rest of CLT.	Section 151 Officer	At the meeting in December 2012, the Section 151 Officer assured the Committee that she still had as much access to all of the strategic directors and that the Strategic Director for Customers & Communities had been present at all CLT meetings, since taking on the additional responsibilities at Mole Valley District Council.
A44/12	03/10/12	Funding Strategy Update Report (74/12)	Funding Strategy task group to report findings to the Committee in due course.	Chairman	A joint meeting of the task group and the Council Overview & Scrutiny Committee Finance Sub Group was held in December 2012. Audit & Governance Committee also joined Council Overview & Scrutiny Committee at their formal meeting on 1 February 2013, to consider the Treasury Management Strategy.
A46/12	03/10/12	Completed Internal Audit Reports (77/12)	An update to be provided on the actions coming out of the ICS audit report, to include: • The views of Children's Services in terms of how serious situationwas • Detail of how much information had been transferred incorrectly from the old SWIFT system to the new ICS System	Compliance Auditor	An update was circulated on 3 January 2013.
A47/12	03/10/12	Completed Internal Audit Reports (77/12)	Members to raise their concern about the Telecare audit at the next Council Overview & Scrutiny Committee	Chairman of the Council Overview & Scrutiny Committee	Members of the Committee who also sat on the Council Overview & Scrutiny Committee explained that the projected savings of the Telecare project had reduced from £1m to £200k – however, matters were progressing.

Audit & Governance Committee Recommendations Tracking

A48/12	03/10/12	Completed Internal Audit Reports (77/12)	Chief Internal Auditor to report back regarding the control and cost issues identified in the Waste Contract Management report	Chief Internal Auditor	An update was circulated by email on 13 December 2012. The auditor advised that: 1. The Environment & Infrastructure directorate was being re-structured in 2011/12 (Nov '10 - March '11) and a Finance Manager responsible for verifying recycling credits, was seconded to oversee this change. 2. Information on any items recycled by SITA as part of the contract is provided by SITA monthly. 3. The districts and boroughs (D&B) have their own waste collection contracts and recycling arrangements which is not part of the SITA contract. They provide the recycling credit figures to SCC who undertake a sample test to verify these before finally agreeing the recycling credits to be granted to D&Bs. It is this check which slipped in 2011/12 due to resource constraints but was put back on track in early 2012/13 after the new structure was in place and as part of finalising and completing year-end accounts.
A49/12	03/10/12	Completed Internal Audit Reports (77/12)	Chairman to write to the Leader of the Council to stress that select committee chairmen take audit reports more seriously when considering their work programmes	Chairman	The Chairman has raised concerns with the Leader of the Council. It has been agreed that where the Audit & Governance Committee feel matters need to be considered more seriously, they will make a direct recommendation to the relevant select committee.

Audit & Governance Committee Recommendations Tracking

A51/12	03/10/12	Fighting Fraud Locally (78/12)	Feedback to be provided following discussions with HR about changes to recruitment vetting procedures	Chief Internal Auditor	At the meeting in December 2012 the Chief Internal Auditor explained that here team were working closely with HR on vetting procedures. In addition, the Better Governance Forum had recently issued a publication on recruitment practices, which had been shared with HR, so that they could look at best practice related to fighting fraud locally.
A56/12	06/12/12	Risk Management Half year report (96/12)	Risk & Governance Manager to circulate one page summary of directorate risk registers	Risk & Governance Manager	The summary was circulated to Committee Members on 19 December 2012.

Item 6

AUDIT & GOVERNANCE COMMITTEE
18 March 2013

2012/13 Review of the Effectiveness of the System of Internal Audit

SUMMARY AND PURPOSE:

This report sets out the findings and recommendations from the 2012/13 review of the effectiveness of the system of internal audit in Surrey County Council.

RECOMMENDATIONS:

The Committee is asked to consider the findings of this report and request an update on progress in implementing the recommendations arising from the review be included in the Annual Internal Audit report to be presented to this Committee by the Chief Internal Auditor in June 2013.

BACKGROUND:

1 The Accounts and Audit Regulations require local authorities *"to conduct, at least once in each year, a review of the effectiveness of the system of internal audit."* The Audit and Governance Committee, as the Committee charged with responsibility for Internal Audit, considers that it is best placed to sponsor such a review on behalf of Surrey County Council.

2 As well as assessing the effectiveness of the current system of Internal Audit in Surrey County Council, this year's review considered whether any changes are required to ensure compliance with the new Public Sector Internal Audit Standards (PSIAS) which come into effect from 1 April 2013.

3 To ensure an appropriate level of objectivity this review was undertaken by a suitably qualified external assessor (appointed through CIPFA). This approach seems to be favoured by the PSIAS which suggests that *"External assessments must be conducted as least once every five years by a qualified independent assessor or assessment team from outside the organisation".*

4 The report produced by the external assessor concluded that internal audit in the Council is well led and is given a high priority by those charged with good governance who acknowledge that improvements have been made in the service over recent years. The report did however include a number of recommendations to ensure compliance with the PSIAS for 2013/14. The Chief Internal Auditor has agreed actions in response to those recommendations and these are detailed in the full copy of the assessor's report which is attached at Annex A.

IMPLICATIONS:

Financial
There are no direct financial implications arising from this report
Equalities
There are no direct equalities implications arising from this report

Risk management
An effective system of internal audit complements good risk management across the Council

WHAT HAPPENS NEXT:

The findings from this review will help inform the Council's 2012/13 Annual Governance Statement.

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Sources/background papers: Public Sector Internal Audit Standards

The Chartered Institute of Public Finance & Accountancy

External Review of the System of Internal Audit in Surrey County Council

6th March 2013

Contents

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Acknowledgements

Steve Mungavin, Elizabeth Humphrey and the team at CIPFA would like to thank elected members, the chief internal auditor, management and staff of Surrey County Council for their help and co-operation during this review.

1.0 Introduction

Background and terms of reference

1. A professional, independent and objective internal audit service is one of the key elements of good governance, as recognised throughout the public sector.

2. The Accounts and Audit Regulations 2006 introduced a requirement for local authorities *"to conduct, at least once in each year, a review of the effectiveness of its system of internal audit."*

3. The CIPFA Code of Practice for Internal Audit in Local Authorities in the United Kingdom is recognised as best practice and has been adopted by the County Council and previous effectiveness reviews have assessed the level of compliance against this standard.

4. A collaboration announced by CIPFA and the Chartered Institute of Internal Auditors (IIA) in May 2011 has led to the development of a new set of Internal Audit Standards – the Public Sector Internal Audit Standards (PSIAS) which will, in effect, replace the CIPFA Code of Practice and will provide a coherent and consistent internal audit framework for the whole of the public sector.

5. The draft standard will come into effect from 1 April 2013. In anticipation of this, the Chairman of Audit and Governance Committee of Surrey County Council (the Council) has asked that the effectiveness review for 2012/2013 assesses the Council's readiness for the PSIAS.

6. To ensure an appropriate level of objectivity it is proposed that this review is undertaken by a suitably qualified external assessor. This approach is favoured by the PSIAS which states that *"External assessments must be conducted as least once every five years by a qualified independent assessor or assessment team from outside the organisation"*.

7. The Council therefore commissioned CIPFA in December 2012 to undertake an external review of the system of internal audit. The review was benchmarked against the new PSIAS.

8. The aim of the review as set out in the terms of reference (Annex 3) is to review the effectiveness of the current system of Internal Audit in Surrey County Council and consider whether any changes are required to ensure compliance with the PSIAS from 1 April 2013.

Scope and methodology

9. In order to reach an opinion on the extent to which the internal audit function is complying with the PSIAS, CIPFA undertook:

    - A review of key audit documentation

    - Interviews with internal audit staff

- A review of feedback from key stakeholders through internal audit customer satisfaction questionnaires and interviews (refer to the list of participants in Annex 1)

10. It should be noted that the Council's internal audit service does not carry out any consultancy engagements. The standards relating to consultancy have not been included in this review.

2.0 Executive summary

11. CIPFA found that internal audit in the Council is well led and is given a high priority by those charged with good governance. The Council Leader, Audit Committee and chief executive are all strong advocates of internal audit and acknowledged that improvements have been made in the service over recent years.

12. We undertook an assessment of Surrey County Council's internal audit section's readiness against the Public Sector Internal Audit Standards (PSIAS), interviewing key stakeholders, reviewing working papers and other documents. The review found that most aspects of internal audit are satisfactory. Most of the necessary documents were compliant with the standards or needing only minor tweaks to make them compliant, interviewees were generally complimentary about the service provided by internal audit and audit planning and performance was broadly satisfactory.

13. There are, however, some areas for improvement, as follows:

- Although assurance was given that all the appropriate processes are followed by auditors in planning and carrying out their work and its supervision and review, there was limited documentation of these processes in the two audits selected for review and so we were unable to assess them

- In particular, although risks are identified in final audit reports, the links to risk were not made clear in the underlying supporting working papers or terms of reference reviewed by CIPFA

- Audit should be more explicit about many of the aspects of its work, particularly in relation to the charter, annual internal audit report and other similar documents. For example, the internal audit charter should explicitly state that internal audit activity must be free from interference in determining the scope of internal audits, performing work and communicating results

14. CIPFA has assessed the position against each of the standards as follows:

Standard		CIPFA opinion
1000	Purpose, authority and responsibility	Minor amendments needed to achieve full compliance
1100	Independence and objectivity	Minor amendments needed to achieve full compliance
1200	Proficiency and due professional care	Partially compliant
1300	Quality assurance and improvement programme	Minor amendments needed to achieve full compliance
2000	Managing the internal audit activity	Minor amendments needed to achieve

Standard		CIPFA opinion
		full compliance
2100	Nature of work	Partially compliant
2200	Engagement planning	Partially compliant
2300	Performing the engagement	Partially compliant
2400	Communicating the results	Partially compliant
2500	Monitoring progress	Fully compliant
2600	Communicating the acceptance of risks	Fully compliant

15. In order to address these, CIPFA has made a series of recommendations which are set out in section 3 of this report and which are consolidated in the schedule in Annex 2. However, the three most important recommendations to effect the necessary improvements to internal audit and enable compliance with PSIAS are as follows:

- Use risk as a thread throughout the audit, driving the audit work and acting as a focus for the results (standard 2100)

- Have a standardised approach to audit planning, including documenting discussions between the auditor and audit manager about the audit, related risks and controls and service objectives so that there is a clear link between expectations of the audit through the work carried out to the findings included in the report (standard 2200)

- Introduce standard review sheets (see Annex 5 for a suggested format) for all audits, raising and clearing concerns or identifying where there are no review points (standard 2300)

3.0 Internal audit review findings

16. At a strategic level, we found that internal audit in the Council is well led and is given a high priority by those charged with good governance who acknowledge that improvements have been made in the service over recent years. The Council has proactively sought to improve the internal audit function for example by regular internal reviews, by learning from visits to neighbouring councils and by commissioning this external review.

17. The Leader of the Council recognises the value of the internal audit service and takes a proactive interest in its work. For example, we were informed the Leader makes a point of reading all internal audit reports to help keep informed of risks and controls in the Council. We also found the Audit Committee to be well respected in the Council with a good mix of skills and an effective Chair and Vice-Chair.

18. The chief executive places a strong reliance on internal audit to help provide assurances to the Council and he respects the independence and integrity of the chief internal auditor. The chief executive meets with the chief internal auditor regularly on a one-to-one basis as well as part of the statutory officers' team (which also includes the section 151 officer and the monitoring officer).

19. Despite the financial pressures of the current environment, the Council recognises the need to maintain internal audit resources as an important part of its assurance framework. Overall, we found that users of internal audit believed the service is strong in its regulatory role, although it could make some improvements, and it could add even greater value by providing professional advice and guidance. This is the backcloth to our review of internal audit against best practice.

20. When reviewing internal audit, in order to reach an opinion on the overall level of compliance with PSIAS best practice, CIPFA benchmarked audit practice in the Council with the following standards:

Attribute Standards

- Purpose, authority and responsibility
- Independence and objectivity
- Proficiency and due professional care
- Quality assurance and improvement programme

Performance Standards

- Managing the internal audit activity
- Nature of work
- Engagement planning
- Performing the engagement
- Communicating results
- Monitoring progress
- Communicating the acceptance of risks

Standard 1000: Purpose, authority and responsibility

21. This standard states that the purpose, authority and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the *Definition of Internal Auditing,* the *Code of Ethics* and the *Standards.* The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.

22. This standard is designed to ensure clarity of the role and scope of internal audit and to provide a firm foundation for its powers and rights of access etc.

23. CIPFA found that internal audit has a draft charter (to be approved at the March 2013 Audit and Governance Committee) that reflects all the requirements of the standard although, in some cases, this was implicit rather than explicit. This charter will supersede the current terms of reference. Although the terms of reference are clear, it became evident that some auditees are unsure about audit's role and responsibilities.

24. To address these issues, CIPFA recommends that the chief internal auditor should amend the charter to:

    - Define the scope of internal audit more clearly, explicitly stating that it is able to cover all the operations of the Council

    - Refer to all the resources available to it (for example, hardware and software, access to information and training), rather than just to staff

25. We also suggest that the chief internal auditor produce a one-page summary of the charter, making internal audit's roles and responsibilities clear, to give to auditees at the start of each assignment and to help promote internal audit across the organisation.

Standard 1100: Independence and objectivity

26. This standard states that the internal audit activity must be independent and internal auditors must be objective in performing their work.

27. This is important because internal audit has to be able to carry out its work without being fettered or influenced in any way. If audit's independence is compromised, it is unable to deliver a valid opinion on the Council's operations.

28. CIPFA found that there were no significant problems with independence and objectivity but that some minor improvements would aid the perception of this independence and objectivity. The chief internal auditor's reporting lines do not follow best practice (CIPFA guidance on the role of the head of internal audit states that he or she should report directly to the chief executive or head of finance), something that is of concern to members of the Audit and Governance Committee. In practice, however, the chief internal auditor (CIA) has direct access to and regular contact with the chief executive and the senior management team and we believe that her independence is not, therefore, compromised.

29. The key areas for improvement are as follows:

- Include an explicit independence statement in the chief internal auditor's annual report and the audit plan report and the words "free and unfettered" or similar should be included in the charter

- Ensure internal audit staff receive annual documented reminders of the ethical standards of behaviour expected of them, especially around impartiality and being unbiased. One way to do this would be to discuss this review and the standards in a formal team meeting which would be minuted.

Standard 1200: Proficiency and due professional care

30. This standard states that audit engagements must be performed with proficiency and due professional care.

31. This is important because reliance is placed on audit's work to improve services and to reduce the risk of fraud and error. Poor quality work that includes errors is, at best, worthless and, at worst, could lead to reduced service quality, illegalities and other such problems.

32. CIPFA found that internal audit has a good mix of staff with different skills, knowledge and backgrounds and with access to the IT tools needed to carry out their work. Staff are kept up to date on emerging issues and undertake the training required of them although evidence of this at a corporate level is patchy with inconsistent use of the Galileo module to record training.

33. Our review of two audit files found no evidence of problems with the planning of audit assignments and we were told that the auditor and audit manager discuss approaches to the audit before work starts and as the work progresses. There was, however, no formal evidence of these audit planning discussions. Without these records, it may be difficult to demonstrate that an audit has been carried out as planned and staff may have limited information to refer to if they need reminding of the work required. Furthermore, in the absence of formal audit planning documentation, it may be difficult for audit managers to hold staff to account for their work.

34. Risk is considered as part of each audit assignment as evidenced by the references to risks in the final reports. However, there is no evidence that there is a link between risks and audit tests (formal audit planning

documentation would support this) nor is there any reference to the risks being considered in the audit terms of reference.

35. To address these issues, CIPFA recommends that the chief internal auditor should:

- Require use of the training module in Galileo
- Formalise planning of individual audits, perhaps through an issues and investigations matrix or similar (see Annex 4 for example)
- Consider ways to make the link to risk explicit by, at the very least, highlighting some of the key risks to be examined in the audit terms of reference

Standard 1300: Quality assurance and improvement programme

36. This standard states that the chief audit executive must develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit activity.

37. This is important because, without such a challenge to processes and systems, audit is unlikely to identify where it is not complying with best practice nor will it identify new areas of audit work and its value to the organisation is likely to diminish. On-going performance monitoring and regular reviews of audit effectiveness will identify where improvement is needed, show when that improvement has been made and demonstrate that audit is delivering as well as it can.

38. CIPFA found that there is an annual assessment of delivery against the plan and customer satisfaction reported in the annual report as well as references to performance at each Audit and Governance Committee meeting. These concentrate on quantitative not qualitative matters. In addition, the Audit and Governance Committee carries out an annual review of internal audit effectiveness, identifying areas for improvement. These reviews are reported separately from the annual internal audit report and no reference is made to them in that report although they clearly could contribute to the conclusions drawn therein. This review is the first external review of internal audit commissioned by the Council and it was set up in accordance with the standards. The Council is to be commended for taking this initiative.

39. To address these issues, CIPFA recommends that the chief internal auditor should:

- Summarise the outcome of the effectiveness reviews in the annual internal audit report.

Standard 2000: Managing the internal audit activity

40. This standard states that the chief audit executive must effectively manage the internal audit activity to ensure it adds value to the organisation.

41. This is important because, without a fully-thought-through risk-based plan, internal audit is highly unlikely to identify where best to concentrate its efforts to deliver a useful output that will support its annual opinion and add value to the Council.

42. CIPFA found that annual audit planning was thorough, consultative and risk-based so that it could support the chief internal auditor's annual opinion. Making the link to the Council's objectives would be ideal but is not practical for two reasons: the objectives are high level and do not lend themselves to audit plans and they are not developed in time for the audit plan. However, although the audit team does consult with senior management to draw up these plans and explain their role and purpose, some managers seemed unaware of this.

43. We also believe that the annual planning report could be more explicit in making the link to risk as the basis for providing the chief internal auditor's annual opinion.

44. To address these issues, CIPFA recommends that the chief internal auditor should include a specific reference in the annual planning report to:

- Risk-based (as opposed to risk priority) planning
- Supporting the chief internal auditor's opinion

45. The Council should consider ways to develop engagement with senior management and their staff. The one-page summary of the charter referred to above may help. In addition, being explicit about the nature of annual audit planning (and other) meetings, perhaps formalising them with agendas and minutes, could also be of benefit.

Standard 2100: Nature of work

46. This standard states that the internal audit activity must evaluate and contribute to the improvement of governance, risk management and control processes using a systematic and disciplined approach.

47. This is important because these are key areas for delivery of the Council's objectives and fundamental to delivering a comprehensive audit opinion.

48. CIPFA found that internal audit carries out an annual review of risk management, varying the focus each year to ensure broad coverage. These audits may be reduced as risk management is a low risk audit having been assessed as effective in the most recent review.

49. In addition, all audits consider areas of risk and risks are highlighted in reports. However, the wording does not comply with the Council's risk approach nor with best practice in that there is no clear description of underlying cause of the risk, the risk itself or the effect or impact of the risk should it occur. Improving this wording would help management understand the underlying concerns, make the link between risk and audit work clearer and make inclusion in the risk register, if necessary, simpler.

50. We found that controls and their related risks are explicitly documented in audit reports and we were told that auditors place considerable emphasis on controls in their work.

51. Internal audit's remit does not extend to auditing the governance process, other than in relation to information governance, although the chief internal auditor sits on the Governance Panel and contributes towards the Annual Governance Statement. Governance work is carried out by the Governance team in liaison with internal audit. We believe that this coverage of governance is generally sufficient and the CIA is likely to identify where there are areas of concern or where audit should be more closely involved.

52. To address these issues, CIPFA recommends that the chief internal auditor should consider:

    - Aligning risk wording in reports with the approach used in the risk register

    - Using risk as a thread throughout the audit, driving the audit work and acting as a focus for the results

53. The Council might want to consider occasional independent (external) reviews of its governance arrangements.

Standard 2200: Engagement planning

54. This standard states that internal auditors must develop and document a plan for each engagement, including the engagement's objectives, scope, timing and resource allocations.

55. This is important because such plans ensure that auditors, audit management and clients all have the same expectations of the audit and these are agreed in advance. The audit can then be checked against these plans and reviewed accordingly. Without such a plan, misunderstandings and confusion are possible resulting in wasted effort and possible conflict between auditor, auditee and management.

56. CIPFA found that terms of reference were issued for all audits and were accepted by clients before any audit work began. However, there was some evidence that managers did not understand what they were agreeing to as the purpose of the audit was not made completely clear nor is there a clear link to risk in the standard terms of reference. We were told that there was a risk assessment before every audit but, as this was not documented in the notes for the two audits that we reviewed in detail, we were unable to assess this. We were shown risk assessments for some of the more standard (mandatory) audits.

57. Neither of the audits that we reviewed included any audit planning documentation other than the terms of reference. It was, therefore, impossible to assess if the work had been carried out as planned and we did not know what guidance or support had been given to the auditor before carrying out

this work. There is some guidance on sources of information to inform an audit in the manual. This list did not include checking service business plans.

58. To address these issues, CIPFA recommends that the Council's internal audit service should:

- Be more explicit about the risks that are been tested for at the start of each audit, including them in the terms of reference
- Have a standardised approach to audit planning, including documenting discussions between the auditor and audit manager about the audit, related risks and controls and service objectives so that there is a clear link between expectations of the audit through the work carried out to the findings included in the report (the issues v investigation matrix referred to earlier is one possible approach)
- Include service business plans on the sources of information list

Standard 2300: Performing the engagement

59. This standard states that internal auditors must identify, analyse, evaluate and document sufficient information to achieve the engagement's objectives.

60. This is important because, without such information, it is impossible to demonstrate that the audit has been carried out properly and that its conclusions are valid. The chief internal auditor would be unable to form an opinion without this information.

61. CIPFA found that, with the exception of consistently demonstrating audit supervision, the requirements of this standard are met.

62. To address this issue, CIPFA recommends that the chief internal auditor should:

63. Introduce standard review sheets (see Annex 5 for a suggested format) for all audits, raising and clearing concerns or identifying where there are no review points

Standard 2400: Communicating the results

64. This standard states that internal auditors must communicate the results of engagements.

65. This is important because, if the results are not communicated clearly and promptly, risks, frauds or errors may materialise, necessary action will not be taken speedily and the audit opinion will be compromised. In addition, misunderstandings about results can lead to time being spent on clarification rather than on planned audit work.

66. CIPFA found that audit reports were generally clear (other than the risk wording mentioned above), balanced and, in the cases that we examined, issued in a timely manner. All draft reports are reviewed by the relevant audit

manager and by the chief internal auditor to ensure quality. Reports are written on an exception basis and some interviewees commented that on occasions there is, therefore, little recognition of good practice and audit reports can appear judgemental and disproportionate. There is clear guidance about report distribution which was followed in the cases that we reviewed. There was one instance of management concern about not being included in the distribution for a contentious report in a timely fashion, having missed the advanced copy they were sent.

67. Each report contains an overall opinion on a four-point scale and these opinions are defined in each report. We understand that there have been many discussions about these opinion definitions but our interviews revealed that there is some lingering confusion about the distinction between "some improvement needed" and "major improvement needed". In addition, there was concern about the judgement call required to distinguish between these two opinions.

68. To address these issues, CIPFA recommends that the chief internal auditor should:

- Make the basis on which the report is written clearer, perhaps with an opening statement along the following lines: "We have examined such-and-such service, looking at the following areas [list]. All areas other than those mentioned below were effective" or "This report is written on an exception basis and, as such, highlights only those areas where there are weaknesses. Any areas not mentioned below are deemed to be effective"

- Consider ways to improve report writing further, perhaps through a team meeting, discussion and guidance note to be included in the audit manual

- Consider ways to bring management's attention earlier to reports that are contentious so that they are not caught unawares

- Consider sharpening the definitions for the two opinions to make the distinction between them clearer. Alternatively, consider if different opinion titles or a numerical system might assist

Standard 2500: Monitoring progress

69. This standard states that the chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.

70. This is important because otherwise there is a risk that audit recommendations will not be implemented, negating the purpose of the audit and increasing the chance of fraud, error, inefficiencies, etc.

71. CIPFA found that the requirements of this standard were met.

Standard 2600: Communicating the acceptance of risks

72. When the chief audit executive concludes that management has accepted a level of risk that may be unacceptable to the organisation, the chief audit executive must discuss the matter with senior management. If the chief audit executive determines that the matter has not been resolved, the chief audit executive must communicate the matter to the board (i.e. the Audit and Governance Committee).

73. This is important because the organisation should not put itself in a position of taking ill-thought-through risks. CIPFA was told that this situation had never occurred at the Council.

Conclusion

74. Overall, our review found that most aspects of internal audit are satisfactory. Most of the necessary documents were compliant with the standards or needing only minor tweaks to make them compliant.

75. From the range of personnel interviewed, feedback was generally complimentary about the service provided by internal audit and we found that audit planning and performance was broadly satisfactory. There are, however, some areas for improvement which we have identified under each standard and in summary format in Annex 2.

Annex 1: Participants in the review

CIPFA would like to thank all those who contributed to this review.

Bill Barker	Audit and Governance Committee Vice Chair
Anne Butler	Assistant Director for Commissioning, A&SC Directorate
Paul Carey-Kent	Senior Finance Manager, A&SC Directorate
Ann Charlton	Head of Legal and Democratic Services
Cath Edwards	Risk and Governance Manager
Julie Fisher	Strategic Director Change and Efficiency
Denise Le Gal	Cabinet Member for Change and Efficiency
Nick Harrison	Audit and Governance Committee Chair
David Hodge	Leader of the Council
Sue Lewry-Jones	Chief Internal Auditor
Sheila Little	Chief Financial Officer & Deputy Director for Change & Efficiency
David McNulty	Chief Executive
Sarah Mitchell	Strategic Director, A&SC Directorate
Trevor Pugh	Strategic Director Environment and Infrastructure
John Woods	Assistant Director Transformation, A&SC Directorate
Members of the internal audit team	

Annex 2: Schedule of recommendations

Standard	Recommendation	Management Response	Further action
Std 1000	**Purpose, authority and responsibility**		
	Define the scope of internal audit more clearly, explicitly stating that it is able to cover all the operations of the Council	The Internal Audit Charter will be amended to reflect this requirement	
	Refer to all the resources available to it (for example, hardware and software, access to information and training), rather than just to staff	The Internal Audit Charter will be amended to reflect this requirement	
	Produce a one-page summary of the internal audit charter	Once the internal audit charter has been approved by Audit and Governance Committee the Chief Internal Auditor will produce a one-page summary for sharing with auditees at Service Liaison meetings and audit planning meetings	
Std 1100	**Independence and objectivity**		
	Include an explicit independence statement in the annual report and the audit plan report and the words "free and unfettered" or similar should be included in the charter	Agreed	
	Ensure internal audit staff receive annual documented reminders of the ethical standards of behaviour expected of them, especially around impartiality and being unbiased	There will be an annual reminder at an internal audit team meeting at the start of each year – with appropriate meeting minutes as evidence	

Standard	Recommendation	Management Response	Further action
Std 1200	**Proficiency and due professional care**		
	Require use of the training module in Galileo to record training and development	The Chief Internal Auditor will remind the team to keep training records updated in Galileo	
	Formalise planning of individual audits	Internal Audit Management will devise a standard approach to audit planning which clearly identifies risks. The approach for each audit will be formally documented and agreed between the auditor and the audit manager. Team briefing on this proposed approach will provided at the April 2013 team meeting with the Audit manual updated to reflect this.	
	Consider ways to make the link to risk explicit by, at the very least, highlighting some of the key risks to be examined in the audit terms of reference	From April 2013 when the PSIAS come into effect the Internal Audit team will ensure the Terms of Reference for each audit identify the key risks.	
Std 1300	**Quality assurance and improvement programme**		
	Summarise the outcome of the effectiveness reviews in the annual internal audit report	Agreed- this will be actioned by the Chief Internal Auditor	
Std 2000	**Managing the internal audit**		
	Include a specific reference in the annual planning report to risk-based (as opposed to risk priority) planning	Agreed- this will be actioned by the Chief Internal Auditor	

Standard	Recommendation	Management Response	Further action
	Include specific links to risk supporting the chief internal auditor's opinion in the annual planning report	The Chief Internal Auditor will make it clear when presenting the proposed annual audit plan to the Audit and Governance Committee, that the plan is risk based and that as such, delivery of the audit plan of work will enable the Chief Internal Auditor to form an opinion on the Council's control environment.	
	Consider ways to develop engagement with senior management and their staff	A summary (1 page) charter will be used to assist this.	
Std 2100	**Nature of work**		
	Align risk wording in reports with the approach used in the risk register	The Chief Internal Auditor will discuss this in more detail with the Risk and Governance Manager. One approach may be to amend the Internal Audit Manual to provide more information on drafting internal audit reports. This could include describing risks in terms of cause, risk and effect.	
	Use risk as a thread throughout the audit, driving the audit work and acting as a focus for the results	This will be actioned through formalising the audit planning process and including risks in each audit's terms of reference.	
Std 2200	**Engagement planning**		
	Be more explicit about the risks that are been tested for at the start of each audit, including them in the terms of reference	Agreed. From April 2013 when the PSIAS come into effect the Internal Audit team will ensure the Terms of Reference for each audit identify the key risks.	

Standard	Recommendation	Management Response	Further action
	Have a standardised approach to audit planning, including documenting discussions between the auditor and audit manager about the audit, related risks and controls and service objectives so that there is a clear link between expectations of the audit through the work carried out to the findings included in the report	Internal Audit Management will devise a standard approach to audit planning which clearly identifies risks. The approach for each audit will be formally documented and agreed between the auditor and the audit manager. Team briefing on this proposed approach will provided at the April 2013 team meeting with the Audit manual updated to reflect this.	
	Include service business plans on the sources of information list	Agreed – this will be included as part of a wider update of the Internal Audit Manual planned for Quarter 1 2013/14	
Std 2300	**Performing the engagement**		
	Introduce standard review sheets for all audits, raising and clearing concerns or identifying where there are no review points	The Galileo system already provides this facility although it is currently not consistently used. The team will be reminded at the April team meeting, of the need to mark working papers for review so audit management can raise review points at the earliest opportunity.	
Std 2400	**Communicating the results**		
	Make the basis on which the report is written clearer, perhaps with an opening statement along the following lines: "We have examined such-and-such service, looking at the following areas [list]. All areas other than those mentioned below were effective" or "This report is written on an exception basis and, as such,	Will consider this as part of a team meeting discussion on audit report writing with any agreed changes to guidance included in the Internal Audit Manual	

Standard	Recommendation	Management Response	Further action
	highlights only those areas where there are weaknesses. Any areas not mentioned below are deemed to be effective”		
	Consider ways to improve report writing further, perhaps through a team meeting, discussion and guidance note included in the audit manual	Agreed –this will be actioned during Quarter 1 2013/14.	
	Consider ways to bring management’s attention earlier to reports that are contentious so that they are not caught unawares	Agreed. This will be considered at an Audit Management Team meeting.	
	Consider sharpening the definitions for the two opinions to make the distinction between them clearer. Alternatively, consider if different opinion titles or a numerical system might assist	The Chief Internal Auditor will discuss this with the S151 Officer.	

Annex 3: Terms of reference

Effectiveness of the system of internal audit 2012/2013

Background

The Accounts and Audit Regulations 2006 introduced a requirement for local authorities "to conduct, at least once in each year, a review of the effectiveness of its system of internal audit."

The CIPFA Code of Practice for Internal Audit in Local Authorities in the United Kingdom is recognised as best practice and has been adopted by the County Council and previous effectiveness reviews have assessed the level of compliance against this standard.

A collaboration announced by CIPFA and the Institute of Internal Auditors (IIA) in May 2011 has led to the development of a new set of Internal Audit Standards – the Public Sector Internal Audit Standards (PSIAS) which will in effect replace the CIPFA Code of Practice and will provide a coherent and consistent internal audit framework for the whole of the public sector.

The draft standard has been out for consultation and the expectation is that the PSIAS will be published in December 2012 and come into effect from 1 April 2013. In anticipation of this, the Chairman of Audit and Governance Committee has asked that the effectiveness review for 2012/2013 assesses the Council's readiness for the PSIAS.

To ensure an appropriate level of objectivity it is proposed that this review is undertaken by a suitably qualified external assessor. This approach would seem to be favoured by the (draft) PSIAS which suggests that "External assessments must be conducted as least once every five years by a qualified independent assessor or assessment team from outside the organisation"

Therefore an Independent External Assessor will be appointed to complete a review in line with these Terms of Reference on behalf of the Audit and Governance Committee.

Purpose of the review

To review the effectiveness of the current system of Internal Audit in Surrey County Council and consider whether any changes are required to ensure compliance with the PSIAS from 1 April 2013.

Work to be undertaken

This review of current working practices against the PSIAS will involve the following:

- Review of key audit documentation
- Interviews with Internal Audit Staff

- Review of feedback from key stakeholders – this may involve review of Internal Audit Customer Satisfaction Questionnaires and interviews with key stakeholders such as:
    - Leader of the Council
    - Members of the Audit and Governance Committee
    - Cabinet Portfolio holder for Change and Efficiency
    - Chief Executive
    - Section 151 Officer
    - Monitoring Officer
    - Risk and Governance Manager
    - Selected auditees

Outcomes

The findings of this review will inform the report of Audit and Governance Committee on the Effectiveness of the System of Internal Audit 2012/2013 which will be presented at a meeting of the Committee in February 2013. It is anticipated that the Independent External Assessor will attend that meeting of the Committee to present their findings.

Reporting arrangements

Auditor:	Independent External Assessor – to be appointed
Reporting to:	Audit and Governance Committee
Audit Ref:	IR / 171

Annex 4: Issues and investigation matrix

Issue/Risk	Investigation	Approach	Possible findings/notes
Individual aspects (risks, concerns, issues) that the audit is trying to reach a conclusion on, ideally expressed so that if everything is as it should be the audit response will be "yes" (eg payment are made on time and to the correct payee)	Method for checking this: • Testing • Interview • Observation • Review of papers • Cumulative audit knowledge (CAKE) • Etc	• Details for the testing samples • Who should be interviewed • Where and when to carry out observations • Which papers to be reviewed • Etc	Use this column for any other comments, ideas, etc

Annex 5: Review sheet

Review point	Response	Cleared Date

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AUDIT & GOVERNANCE COMMITTEE
18 March 2013

EXTERNAL AUDIT REPORT

SUMMARY AND PURPOSE:

Please see attached 2 reports from the Council's external auditors, Grant Thornton:

a) This paper provides the Audit and Governance Committee with a report on progress in delivering our responsibilities as your external auditors. The paper also includes a summary of emerging national issues and developments that may be relevant to you as a County Council.
b) the external auditor's annual audit plan for year ended 31 March 2013

RECOMMENDATION:

The Committee is asked to consider the contents of the report and determine whether there are any matters that they wish to ask the external auditors.

IMPLICATIONS:

2 Financial
Audit Fees are set out on page 14 of the plan.

3 Equalities
There are no direct equality implications arising from this report.

4 Risk management
There are no risk management implications arising from this report.

CONTACT DETAILS: 020 85 419122 helen.rankin@surreycc.gov.uk

Sources/background papers: None

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Audit and Governance Committee Update for Surrey County Council

Year ended 31 March 2013

04 Mar 2013

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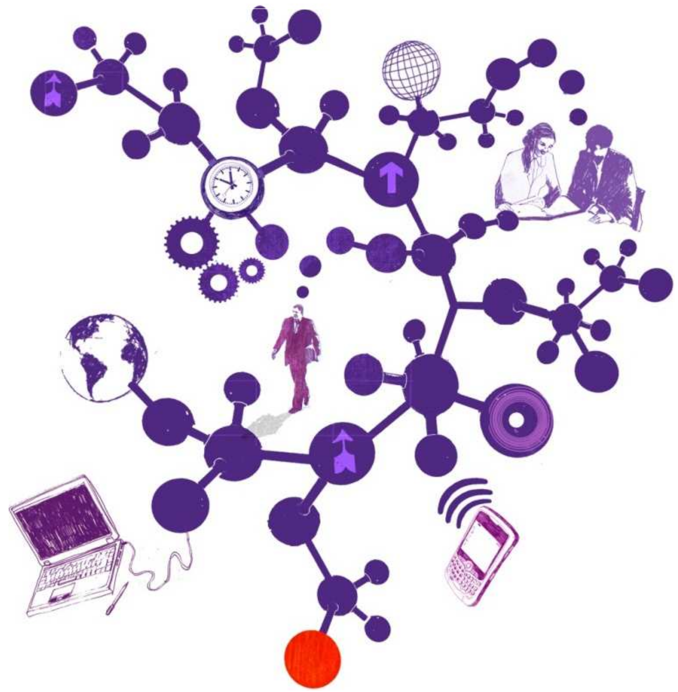

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Introduction

This paper provides the Audit and Governance Committee with a report on progress in delivering our responsibilities as your external auditors. The paper also includes a summary of emerging national issues and developments that may be relevant to you as a County Council.

Members of the Audit and Governance Committee can find further useful material on our website www.grant-thornton.co.uk, where we have a section dedicated to our work in the public sector. Here you can download copies of our publications - 'Local Government Governance Review 2012', 'The developing internal audit agenda', 'Preparing for the future', 'Surviving the storm: how resilient are local authorities?'

If you would like further information on any items in this briefing, or would like to register with Grant Thornton to receive regular email updates on issues that are of interest to you, please contact either your Engagement Lead or Audit Manager.

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Kathryn Sharp Client Manager T 01293 554086 M 07880 456150 Kathryn.E.Sharp@uk.gt.com

Progress at 4 March 2013

Work	Planned date	Complete?	Comments
2012-13 Accounts Audit Plan We are required to issue a detailed accounts audit plan to the Council setting out our proposed approach in order to give an opinion on the Council's 2012-13 financial statements.	18 March 2013	Yes	Our Audit Plan has been discussed and agreed with the Chief Finance Officer and Deputy Director for Change & Efficiency and is included on the agenda for today's meeting.
Interim accounts audit Our interim fieldwork visit is currently in progress and will cover the following: • review of the Council's control environment • walkthroughs of key financial systems • review of overall Internal Audit arrangements • early work on emerging accounting issues • early substantive testing on journals and the PFI schemes • review of progress in implementing the recommendation on accruals • review of the Council's arrangements for recording related party transactions • initial Value for Money assessments	Started 25 February 2013	No	
2012-13 final accounts audit Including: • audit of the 2012-13 financial statements • proposed opinion on the Council's accounts • proposed Value for Money conclusion.	17 June 2013	No	

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Progress at 4 March 2013

Work	Planned date	Complete?	Comments
Value for Money (VfM) conclusion The scope of our work to inform the 2012/13 VFM conclusion comprises: • reviewing the progress being made on the Council's Waste Management PFI project; • reviewing the Council's development of income generation plans; • assessing the achievement of the savings required by the Council's Medium Term Financial Plan (MTFP) and how future savings will be made; • reviewing the arrangements in place for budgeting, forecasting and reporting capital expenditure; • assessing progress in implementing the recommendations arising from Public Value Reviews (PVRs); • reviewing progress made in developing partnership working; and • assessing financial standing including adequacy of balances and reserves.	Started 25 February 2013	No	The results of our work will be reported to the Audit and Governance Committee in our Financial Resilience Report and in our Audit Findings (Annual Governance) Report.

Emerging issues and developments

Accounting and audit issues

Implications of the Local Government Finance Act 2012

The Local Government Finance Act 2012 has now been given Royal Assent. The Act has amendments in two areas of local government finance:

- Council tax support will now be localised and local authorities will be responsible for implementing their own council tax reduction schemes.
- 50% of the non domestic rates collected locally will be retained by the local authority. Billing authorities will pay over a share to central government and proportionate shares to their precepting bodies.

In December 2012, CIPFA issued a consultation on proposed amendments to the 2013/14 Code of Practice on Local Authority Accounting in the United Kingdom for the implications of business rates retention schemes. In summary, the changes are to account for business rates in a similar way to council tax. The Comprehensive Income and Expenditure Statement will need to show amounts collectible by each authority. Debtors/creditors will be recognised when these amounts do not match the actual amounts paid by each billing authority over to preceptors and government. The Collection Fund adjustment account will be used for accounting for the differences. Top-ups and tariffs and the safety net and levy will be recognised as grant income or expenditure. Individual authorities in a pool will need to account for their share of income and expenditure debtors/creditors as stipulated in any agreement made by individual authorities in the pool.

CIPFA consultation on Service Reporting Code of Practice 2014/15: Adult Social Care Service Expenditure Analysis (England only)

In January, CIPFA issued a consultation on the proposed changes to the Adult Social Care Service Expenditure Analysis. The proposed changes are for a complete revision to the mandatory lines and these have been based on work done by the Health and Social Care Information Centre.

Emerging issues and developments

Accounting and audit issues

Assets transferring to academy schools

There is on-going debate as to whether assets relating to schools that have been granted academy status should be:
- impaired to nil at the date of the granting of a transfer order on the basis that the assets will be disposed of for nil value; or
- not impaired as the assets are still being used and so should be shown at the balance sheet date at full existing use value.

Our view is that this is a matter for judgement and the financial statements should set out clearly:
- the policy followed by the Council
- details of material assets that are to be transferred out of local authority control.

Provisions

Under IAS 37 'Provisions, Contingent Liabilities and Contingent Assets', the criteria for recognising a provision is that there is:
- a current obligation as a result of a past event;
- a transfer of economic benefit is probable; and
- a reliable estimate of the liability can be made.

We wish to highlight the following matters to you for consideration where a provision may be required:

- Mutual Municipal Insurance – the Scheme of Arrangement was triggered in November 2012, therefore it is now virtually certain that there will be a transfer of economic benefit. If this liability has not been discharged by 31 March 2013, we would expect local authorities to recognise a creditor or, if the timing or amount of the payment is uncertain, a provision in their financial statements.

- Land restoration costs – where a local authority owns a closed landfill site and is responsible for aftercare costs, we would expect the authority to recognise a provision for total future costs. These landfill aftercare costs should also be capitalised and depreciated under IAS 16 'Property, Plant and Equipment' so there is no immediate impact on the General Fund.

Emerging issues and developments

Accounting and audit issues

- Equal pay - in October 2012 the supreme court ruled that more than 170 former Birmingham City Council employees can make equal pay claims. This effectively extends the time workers have to bring equal pay compensation claims from six months to six years. We would expect local authorities to consider whether they have received any additional claims and, where the criteria set out in IAS 37 have been met, recognise a provision.

- Redundancy costs –the recognition point for termination benefits fall under IAS 19 'Employee Benefits'. This is generally earlier than the IAS 37 recognition criteria for restructuring which requires that a valid expectation has been raised in those affected. The requirement in IAS 19 is that the entity is 'demonstrably committed'.

Emerging issues and developments

Grant Thornton

'Improving council governance: A slow burner'

Councils are facing continued, intense pressure to reduce spending and implement organisational change, while maintaining services and introducing alternative delivery models. There is also an increased public demand for greater transparency in decision-making and performance.

Our second annual review, published on 28 February 2013, is based on survey responses from over 60 senior council officers and members and a desk top review of over 150 UK councils' 2011/12 annual governance statements and explanatory forewords. It evaluates the soundness of existing systems for operating in the current challenging environment and also identifies trends in sector views around the effectiveness of underlying governance processes and the important factors of people, culture and behaviour.

'Towards a tipping point?: Summary findings from our second year of financial health checks of English local authorities '

In December 2012, Grant Thornton published 'Towards a tipping point?: Summary findings from our second year of financial health checks of English local authorities'. This financial health review considers key indicators of financial performance, financial governance, strategic financial planning and financial controls to provide a summary update on how the sector is coping with the service and financial challenges faced. The report provides a summary of the key issues, trends and good practice emerging from the review.

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Emerging issues and developments

Local government guidance

'Striking a balance: improving councils' decision making on reserves'

In December, the Audit Commission published 'Striking a balance: improving councils' decision making on reserves'. The report covers the findings from research undertaken by the Audit Commission on the level of reserves that councils hold and the decisions councils make on them.

The report encourages English councils to focus more attention on their reserves. It suggests that management should be providing more comprehensive information on reserves to elected members and councils should provide greater clarity on the reasons for holding reserves. The report includes questions for elected members that will help them in their decision making and scrutiny roles.

Broadband Initiative – Rural Broadband Fund

The Government has committed to delivering superfast broadband (24Mbps) accessibility to 90% of UK premises, and a minimum of 2 mbps to the remaining 10% of premises. The Department of Culture Media and Sport (DCMS) has entered into a Framework Agreement with two Suppliers, BT and Fujitsu, for the purposes of delivering this broadband infrastructure.

Local authorities are responsible for utilising the Framework Agreement to procure superfast broadband infrastructure for their areas. DCMS has grouped local authorities in England into circa 40 regions which are undertaking call-off procurements with BT and Fujitsu on a phased basis. Local authorities are therefore at different stages of the process (i.e. pre-procurement, in procurement, or at the award stage). The first local authorities to undertake the call-off process have recently awarded contracts to BT.

There are a number of important financial and commercial issues which local authorities will need to understand, investigate and take action in order to secure and demonstrate value for money. The main issues are:

- Procurement strategy
- Grant agreements
- Financial forecasts
- Milestone payments
- Phasing of roll-out
- Demonstrating value for money

Grant Thornton has significant experience of advising the public sector on broadband procurements of this nature. Please talk to your audit manager if you would like more information.

GrantThornton

grant-thornton.co.uk

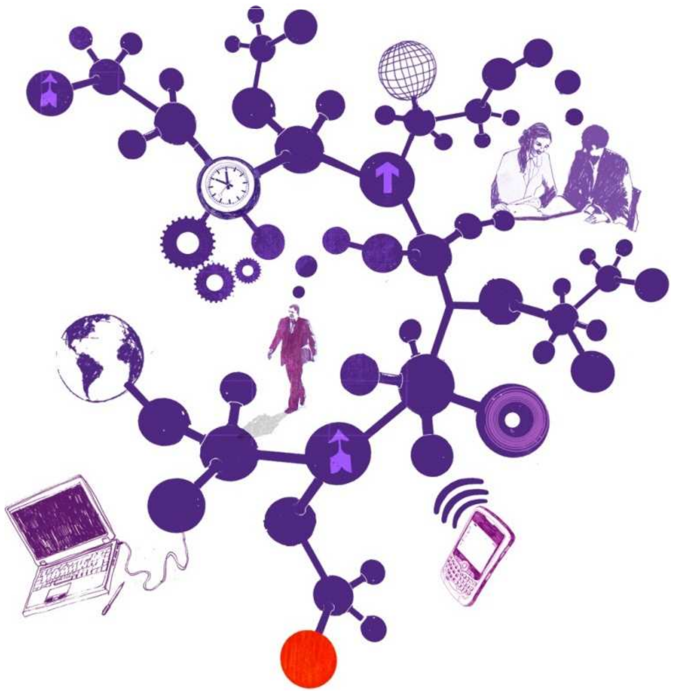
DRAFT

This version of the report is a draft. Its contents and subject matter remain under review and its contents may change and be expanded as part of the finalisation of the report.

Grant Thornton

The Audit Plan for Surrey County Council

Year ended 31 March 2013



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Contents

Understanding your business

In planning our audit we need to understand the challenges and opportunities the Council is facing. We set out a summary of our understanding below.

Challenges/opportunities

1. Financial pressures	2. Significant policy changes	3. Service developments	4. Public Health responsibilities
• Impact of current and future spending reviews • Reductions in the Council's main sources of funding • Increasing demands for services	• Government policy changes in relation to social care, welfare and funding • Increasing number of academy schools	• Delivery of key waste targets and waste infrastructure • Delivery of Surrey Highways Transformation Project	• The Council takes over responsibility for public health with effect from 1 April 2013

Our response

• We will review the Council's financial planning, monitoring and governance arrangements , focusing on preparation of and progress against its Medium Term Financial Plan Public Value Review (PVR) programme and income generation schemes. • We will report on financial resilience data, including benchmarking data for the sector	• We will review how changes, risks and opportunities have been incorporated into the Medium Term Financial Plan	• We will review the Council's progress on these areas, particularly the development of partnership working	• We will discuss how the Council is planning to deal with the impact of the changes through our meetings with senior management

Developments relevant to your business and the audit

In planning our audit we also consider the impact of key developments in the sector and take account of national audit requirements as set out in the Code of Audit Practice and associated guidance.

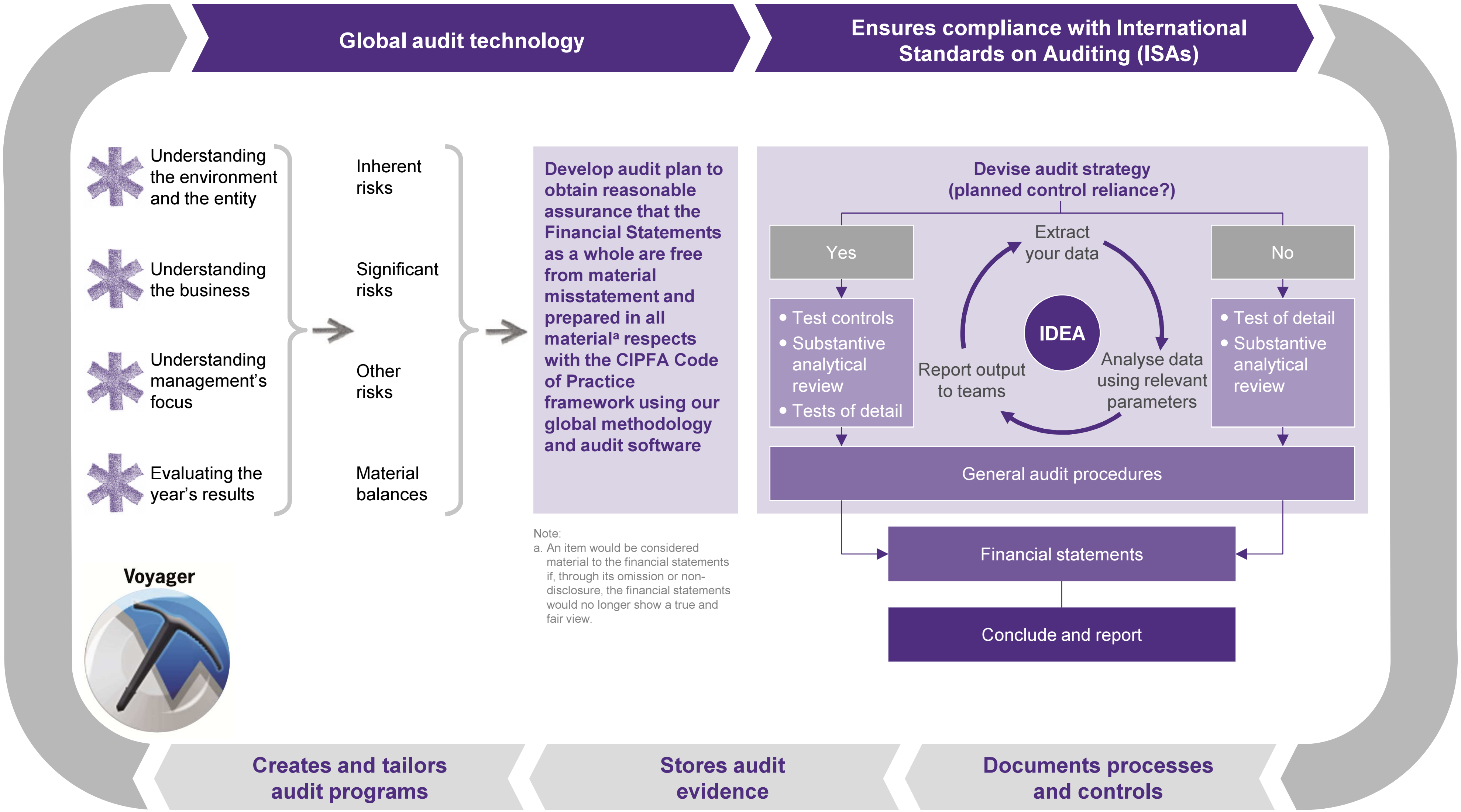
Developments and other requirements

1.Financial reporting	2. Legislation	3. Corporate governance	4. Pensions	5. Financial Pressures	6. Other requirements
• Changes to the CIPFA Code of Practice • Transfer of assets to Academies • Recognition of grant conditions and income	• Local Government Finance settlement 2012/13 • Welfare reform Act 2012	• Annual Governance Statement (AGS) • Explanatory foreword	• Planning for the impact of changes to the Local Government pension Scheme (LGPS) from April 2014.	• Managing service provision with less resource • Progress against savings plans	• The Council is required to submit a Whole of Government accounts pack on which we provide an audit opinion • The Council completes grant claims and returns on which audit certification is required

Our response

We will ensure that • the Council complies with the requirements of the CIPFA Code of Practice through our substantive testing • the Council's arrangements to ensure schools are accounted for correctly and in line with the latest guidance • grant income is recognised in line with the correct accounting standard	• We will discuss the impact of the legislative changes with the Council through our regular meetings with senior management and those charged with governance, providing a view where appropriate	• We will review the arrangements the Council has in place for the production of the AGS • We will review the AGS and the explanatory foreword to consider whether they are consistent with our knowledge	• We will discuss how the Council is planning to deal with the impact of the changes through our meetings with senior management	• We will review the Council's performance against its 2012/13 budget, including consideration of performance against the Medium Term Financial Plan • We will undertake a review of Financial Resilience as part of our VFM conclusion	• We will carry out work on the WGA pack in accordance with requirements • We will certify grant claims and returns in accordance with Audit Commission requirements

Our audit approach



Note:
a. An item would be considered material to the financial statements if, through its omission or non-disclosure, the financial statements would no longer show a true and fair view.

An audit focused on risks

We undertake a risk based audit whereby we focus audit effort on those areas where we have identified a risk of material misstatement in the accounts. The table below shows how our audit approach focuses on the risks we have identified through our planning and review of the national risks affecting the sector. Definitions of the level of risk and associated work are given below:

Significant – Significant risks are typically non-routine transactions, areas of material judgement or those areas where there is a high underlying (inherent) risk of misstatement. We will undertake an assessment of controls (if applicable) around the risks and carry out detailed substantive testing.

Other – Other risks of material misstatement are typically those transaction cycles and balances where there are high values, large numbers of transactions and risks arising from, for example, system changes and issues identified from previous years audits. We will assess controls and undertake substantive testing, the level of which will be reduced where we can rely on controls.

None – Our risk assessment has not identified a risk of misstatement. We will undertake substantive testing of material balances. Where an item in the accounts is not material we do not carry out detailed substantive testing.

Account	Material (or potentially material) balance?	Transaction Cycle	Inherent risk	Material misstatement risk?	Description of Risk	Substantive testing?
Cost of services - operating expenses	Yes	Operating expenses	Medium	Other	Operating expenses understated	✓
Cost of services – employee remuneration	Yes	Employee remuneration	Medium	Other	Remuneration expenses not correct	✓
Cost of services – other revenues (grants and fees & charges)	Yes	Other revenues	Low	None		✓
(Gains)/ Loss on disposal of non current assets	No	Property, Plant and Equipment	Low	None		×
Precepts and levies	Yes	Council Tax	Low	None		✓

An audit focused on risks (continued)

Account	Material (or potentially material) balance?	Transaction Cycle	Inherent risk	Material misstatement risk?	Description of Risk	Substantive testing?
Interest payable and similar charges	Yes	Borrowings	Low	None		✓
Pension Interest cost	Yes	Employee remuneration	Low	None		✓
Interest & investment income	Yes	Investments	Low	None		✓
Return on Pension assets	Yes	Employee remuneration	Low	None		✓
Income from council tax	Yes	Council Tax	Low	None		✓
NNDR distribution	Yes	NNDR	Low	None		✓
PFI, revenue support grant & other government grants	Yes	Grant Income	Low	None		✓
Capital grants & contributions (including those received in advance)	Yes	Property, Plant & Equipment	Low	None		✓

An audit focused on risks (continued)

Account	Material (or potentially material) balance?	Transaction Cycle	Inherent risk	Material misstatement risk?	Description of Risk	Substantive testing?
(Surplus)/ Deficit on revaluation of non current assets	Yes	Property, Plant & Equipment	Low	None		✓
Actuarial (gains)/ Losses on pension fund assets & liabilities	Yes	Employee remuneration	Low	None		✓
Property, Plant & Equipment	Yes	Property, Plant & Equipment	High	Significant	There is a risk that Property, Plant and Equipment may be materially misstated due to the incorrect inclusion or omission of schools on your balance sheet. Audit testing in 2011/12 identified errors in the disclosure of Assets under Construction in the notes to the accounts	✓
Property, Plant & Equipment	Yes	Property, Plant & Equipment	Medium	Other	Revaluation measurements not correct	✓
Heritage assets	No	Property, Plant & Equipment	Low	None		×
Intangible assets	No	Intangible assets	Low	None		×
Investments (long & short term)	Yes	Investments	Low	None		✓
Debtors (long & short term)	Yes	Revenue	Low	None		✓
Assets held for sale	No	Property, Plant & Equipment	Low	None		×

An audit focused on risks (continued)

Account	Material (or potentially material) balance?	Transaction Cycle	Inherent risk	Material misstatement risk?	Description of Risk	Substantive testing?
Inventories	No	Inventories	Low	None		×
Cash & cash Equivalents	Yes	Bank & Cash	Low	None		✓
Borrowing (long & short term)	Yes	Debt	Low	None		✓
Creditors (long & Short term)	Yes	Operating Expenses	Medium	Other	Creditors understated or not recorded in the correct period	✓
Provisions (long & short term)	No	Provision	Low	None		×
Pension liability	Yes	Employee remuneration	Low	None		✓
Reserves	Yes	Equity	Low	None		✓

Significant risks identified

'Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, either due to size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty' (ISA 315).

In this section we outline the significant risks of material misstatement which we have identified. There are two presumed significant risks which are applicable to all audits under auditing standards (International Standards on Auditing – ISAs) which are listed below. In addition, we have identified one further significant risk relating to Property, Plant and Equipment.

Significant risk	Description	Substantive audit procedures
The revenue cycle includes fraudulent transactions	Under ISA 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.	**Work planned:** • Review and testing of revenue recognition policies • Performance of attribute and / or substantive testing on material revenue streams
Management over-ride of controls	Under ISA 240 there is a presumed risk that the risk of management over-ride of controls is present in all entities.	**Work planned:** • Review of accounting estimates, judgments and decisions made by management • Testing of journal entries • Review of unusual significant transactions
Property, Plant and Equipment is materially misstated.	The Council manages schools through a variety of governance arrangements e.g. community schools, voluntary controlled schools, voluntary aided schools, foundation schools and academies. The differences in those arrangements have implications for the accounting treatment of each of these categories. There is a risk that Property, Plant and Equipment may be materially misstated due to the incorrect inclusion or omission of schools on your balance sheet. Audit testing in 2011/12 identified errors in the disclosure of Assets under Construction in the notes to the accounts.	**Work planned:** • Review the Council's consideration of schools, the proposed accounting treatment and the accounting policy • Testing the accounting treatment of schools • Review and testing of the reconciliations between the Fixed Asset Register and the General Ledger • Review and testing of movements during the year and of the year end balance

Other risks

The auditor should evaluate the design and determine the implementation of the entity's controls, including relevant control activities, over those risks for which, in the auditor's judgment, it is not possible or practicable to reduce the risks of material misstatement at the assertion level to an acceptably low level with audit evidence obtained only from substantive procedures (ISA 315).

Other reasonably possible risks	Description	Work planned
Operating expenses	Operating expenses understated Creditors understated or not recorded in the correct period	• Identification and walkthrough of controls • Testing of payments for completeness, classification and occurrence
Employee remuneration	Remuneration accruals understated	• Identification and walkthrough of controls • Attribute and / or substantive testing of payroll records
Property, Plant & Equipment	Revaluation measurement not correct	• Identification and walkthrough of controls • Substantive testing of revaluations in year

Planned interim audit work

Scope

As part of the interim audit work, which commenced on 25 February 2013, and in advance of our final accounts audit fieldwork, we will:

- consider the effectiveness of the internal audit function;
- review the results of internal audit's work on the Council's key financial systems;
- undertake walkthrough testing to confirm whether controls are implemented as per our understanding in areas where we have identified a risk of material misstatement; and
- carry out a review of Information Technology (IT) controls

	Work to be performed
Internal audit	We will review internal audit's overall arrangements against the CIPFA Code of Practice and the new Public Sector Internal Audit Standards (PSIAS) which come into effect on 1 April 2013. Our review will take into account CIPFA's recent review of internal audit at the Council. Where the arrangements are deemed to be adequate, we can gain assurance from the overall work undertaken by internal audit and can conclude that the service itself is contributing positively to the internal control environment and overall governance arrangements within the Council.
Walkthrough testing	Walkthrough tests will be completed in relation to the specific accounts assertion risks which we consider to present a risk of material misstatement to the financial statements.

Planned interim audit work (continued)

	Work to be performed
Review of information technology (IT) controls	Our information systems specialist will perform a high level review of the general IT control environment, as part of the overall review of the internal controls system. This work is scheduled for May 2013, after the SWAN network upgrade has been completed.
Journal entry controls	We will review the Council's journal entry policies and procedures as part of determining our journal entry testing strategy. We will undertake detailed testing on journal transactions recorded for the first ten months of the financial year, by extracting 'unusual' entries for further review.
PFI schemes	We will review the Council's 3 PFI accounting models to confirm they remain up to date, reasonable and provide materially correct entries to the financial statements.
Accruals	We will review the progress the Council has made in assessing the extent of the potential overstatement identified in 2012/13 and in improving its controls over this area.
Related party transactions	As Council elections will take place in May 2013, we will assess the Council's arrangements for ensuring that all declarations of interest and related party transactions are recorded before changes in elected members occur.

Value for Money

Introduction

The Code of Audit Practice requires us to issue a conclusion on whether the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the Value for Money (VfM) conclusion.

2012/13 VFM conclusion

Our Value for Money conclusion will be based on two reporting criteria specified by the Audit Commission.

We will tailor our VfM work to ensure that as well as addressing high risk areas it is, wherever possible, focused on the Council's priority areas and can be used as a source of assurance for members. Where we plan to undertake specific reviews to support our VfM conclusion, we will issue a Terms of Reference for each review outlining the scope, methodology and timing of the review. These will be agreed in advance and presented to Audit and Governance Committee.

The results of all our local VfM audit work and key messages will be reported in our Annual Governance (ISA 260) Report and in the Annual Audit Letter. We will agree any additional reporting to the Council on a review-by-review basis.

Code criteria

The Council has proper arrangements in place for:

- securing financial resilience
- challenging how it secures economy, efficiency and effectiveness in its use of resources

We will consider whether the Council is prioritising its resources with tighter budget

Work to be undertaken

Risk-based work focusing on arrangements relating to financial governance, strategic financial planning and financial control.

Specifically we will:

- Review the progress being made on the Council's Waste Management PFI project;
- Review the Council's development of income generation plans;
- Assess the achievement of the savings required by the Council's Medium Term Financial Plan (MTFP) and how future savings will be made;
- Review the arrangements in place for budgeting, forecasting and reporting capital expenditure.
- Assess progress in implementing the recommendations arising from Public Value Reviews (PVRs);
- Review progress made in developing partnership working; and
- Assess financial standing including adequacy of balances and reserves.

Logistics and our team

The audit cycle

Our team

Andy Mack **Client Relationship Lead** M 07880 456187 E andy.l.mack@uk.gt.com
Kathryn Sharp **Client Manager** M 07880 456150 E kathryn.sharp@uk.gt.com
Daniel Woodcock **Audit Executive** M 07921 659914 E daniel.woodcock@uk.gt.com

Date	Activity
17/01/2013	Planning meeting
25/02/2013	Interim site work
18/03/2013	The audit plan presented to Audit and Governance Committee
17/06/2013	Year-end fieldwork commences
Jul / Aug 2013	Audit findings clearance meetings
02/09/2013	Audit and Governance Committee meeting to report our findings
Sep 2013	Sign financial statements and VfM conclusion
Oct 2013	Issue Annual Audit Letter

Fees and independence

Fees

	£
Council audit	189,464
Grant certification	4,200
Total	**193,664**

Fees for other services

Service	Fees £
None	Nil

Our fee assumptions include:

- Our fees are exclusive of VAT
- Supporting schedules to all figures in the accounts are supplied by the agreed dates and in accordance with the agreed upon information request list
- The scope of the audit, and the Council and its activities have not changed significantly
- The Council will make available management and accounting staff to help us locate information and to provide explanations

Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

Full details of all fees charged for audit and non-audit services will be included in our Annual Governance (ISA 260) Report at the conclusion of the audit.

We confirm that we have implemented policies and procedures to meet the requirement of the Auditing Practices Board's Ethical Standards.

Communication of audit matters with those charged with governance

International Standards on Auditing (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table opposite.

This document, The Audit Plan, outlines our audit strategy and plan to deliver the audit, while the Annual Governance (ISA 260) Report will be issued prior to approval of the financial statements and will present key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

We will communicate any adverse or unexpected findings affecting the audit on a timely basis, either informally or via a report to the Council.

Respective responsibilities

This plan has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission (www.audit-commission.gov.uk).

We have been appointed as the Council's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England. As external auditors, we have a broad remit covering finance and governance matters.

Our annual work programme is set in accordance with the Code of Audit Practice ('the Code') issued by the Audit Commission and includes nationally prescribed and locally determined work. Our work considers the Council's key risks when reaching our conclusions under the Code.

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Council is fulfilling these responsibilities.

Our communication plan	Audit plan	Audit findings
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the entity's accounting and financial reporting practices, significant matters and issue arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence, relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence	✓	✓
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or others which results in material misstatement of the financial statements		✓
Non compliance with laws and regulations		✓
Expected modifications to the auditor's report, or emphasis of matter		✓
Uncorrected misstatements		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern		✓

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Item 8

SURREY
COUNTY COUNCIL

AUDIT & GOVERNANCE COMMITTEE
18 March 2013

PENSION FUND INVESTMENTS – DECEMBER QUARTER 2012

SUMMARY AND PURPOSE:

This report deals with the investment transactions of the pension fund during the December 2012 quarter and the position of the fund as at 31 December 2012, together with other matters considered by the Investment Advisors Group (IAG) at its quarterly meeting of 15 February 2013.

RECOMMENDATION:

It is recommended that the committee note the content of the pension fund report for the quarter to 31 December 2012.

BACKGROUND:

1. The Investment Advisors Group is responsible for monitoring the activities of the Surrey Pension Fund and reporting to the county council and other employing bodies. This is achieved through the presentation of a quarterly report to the Audit and Governance Committee.

PENSION FUND INVESTMENTS – DECEMBER QUARTER 2012:

Position Statement as at 31 December 2012

2. The market value of the fund increased during the quarter from £2,236.9 million at 30 September 2012 to £2,322.4 million at 31 December 2012, an increase of 3.8%. The value of the fund as at close of business on 13 February 2013 is estimated at £2,427.0 million.

3. The value of the major asset classes at 31 December 2012 compared with 30 September 2012 was as follows:

	31 December		30 September	
	£m	%	£m	%
Fixed Interest				
UK Government	172.2	7.4	109.3	4.9
UK Non-Government	178.5	7.7	180.1	8.1
Overseas	2.3	0.1	44.5	2.0
Index Linked	90.3	3.9	83.3	3.7
Equities				
UK	612.6	26.4	633.1	28.3
Overseas	791.0	34.0	749.0	33.5
Property Unit Trusts	123.7	5.3	121.3	5.4
Private Equity	87.8	3.8	84.5	3.8
Diversified Growth	205.9	8.9	157.7	7.0
Cash	53.2	2.3	67.3	3.0
Currency hedge*	4.9	0.2	6.8	0.3
Total Fund	**2,322.4**	**100.0**	**2,236.9**	**100.0**

* Net unrealised profit/loss

4. The following table shows the breakdown of the market valuation as at 31 December 2012 by asset class and compares the totals with the target asset allocation. The total excludes any private equity funds or cash held by SCC included in the table above.

	TOTAL FUND	Actual	Target	Last Quarter	
	£m	%	%	£m	%
Fixed Interest					
UK Government	172.2	7.8	8.0	109.3	5.1
UK Non-Government	178.5	8.0	8.0	180.1	8.5
Overseas	2.3	0.1	0.0	44.5	2.1
Index Linked	90.3	4.1	4.0	83.3	3.9
Equities					
UK	612.6	27.7	28.0	633.1	29.7
Overseas	791.0	35.8	35.0	749.0	35.2
Property Unit Trusts	123.7	5.6	7.0	121.3	5.7
Diversified growth	205.9	9.3	10.0	157.7	7.4
Cash	27.3	1.2	0.0	45.1	2.1
Currency hedge	4.9	0.2	0.0	6.8	0.3
TOTAL	**2,208.7**	**100.0**	**100.0**	**2,130.2**	**100.0**

5. The following table breaks down the above to show the value of assets held by individual managers at quarter end:

		Actual	TARGET	LAST QUARTER	
	£m	%	%	£m	%
Multi-Asset					
LGIM	731.5	33.1	32.0	743.1	34.9
Bonds/Property					
Western	270.9	12.3	11.0	266.6	12.5
CBRE	126.5	5.7	7.0	127.1	6.0
UK Equity					
Majedie	145.9	6.6	8.0	136.2	6.4
Mirabaud	88.9	4.0	4.0	85.9	4.0
UBS	181.5	8.2	8.0	170.0	8.0
Global Equity					
Marathon	294.0	13.3	12.0	280.7	13.2
Newton	162.7	7.4	8.0	161.9	7.6
Diversified Growth					
Baillie Gifford	77.8	3.5	4.0	31.1	1.5
Standard Life	128.1	5.8	6.0	126.6	5.9
Residual Cash	0.9	0.1	0.0	1.0	0.0
TOTAL	**2,208.7**	**100.0**	**100.0**	**2,130.2**	**100.0**

6. In July 2011 the Investment Advisors Group (IAG) started to review the investment strategy of the fund following the implementation of the 2010 actuarial valuation results. Changes to the investment strategy were approved by the IAG in March 2012 and began to be implemented in the June quarter.

7. During the December quarter, Baillie Gifford received funding of £45m to bring their total funding to £75m as agreed at the time of appointment based on their 4% target allocation.

8. At the IAG meeting in November 2012 the Group agreed that they wanted to use 50% of the gilts currently managed by Western to invest in a total return or absolute return bond strategy. The Group felt that it was the right time to decrease the allocation to gilts to realise the gains made in the last few years and to move to a product that would offer higher yields.

9. In December 2012 the Group held an extraordinary meeting to receive presentations from four fund managers, including Western, on potential investment options. The Group decided that the most attractive option was the Franklin Templeton Global Total Return Fund. This fund invests mainly in government and corporate bonds in developed and emerging markets.

10. On 11 February 2013 50% of the gilts managed by Western were redeemed into £67m of cash and invested into the pooled fund managed by Franklin Templeton.

11. As part of the strategy review, the Group had previously agreed to increase Majedie's benchmark allocation by 2% to 8% to fund a new investment into a global equities product Majedie were offering. Following the departure of key staff at Majedie, this investment will no longer be taking place. At the IAG meeting on the 15 February 2013, the Group discussed options reference the additional 2%. It was agreed the benchmark allocation to Majedie's UK Equity portfolio should increase by 1% to 7% and Legal & General Overseas Equities by 1% to 14%. This change will not require additional funding to be provided to either manager.

12. In the December quarter contributions from members exceeded the value of benefits paid and transfer values by £3.4m. Investment income (net of costs) totaled £8.9m. Market movements increased the value of the fund by £74.9m.

Investment Performance Results for the Period

13. The managed fund made a return of 3.3% over the quarter. This compares with a total fund customised benchmark return of 2.9% (+0.4%). The total fund return for the year to the end of December 2012 was 12.4% above the benchmark return of 10.7% (+1.7%).

14. For the quarter to 31 December 2012, performance returns for the individual fund managers, in absolute terms and relative to their benchmark target, were as follows:

Manager	**Asset Class**	**Market Value**	**Market Value**	**Return**	**Relative**
		30 September	**31 December**	**%**	**%**
Multi-Asset					
LGIM	Multi-Asset	743.1	731.5	+3.0	-0.2
Bonds/Property					
Western	Bonds	266.6	270.9	+1.6	+0.7
CBRE	Property	127.1	126.5	-0.3	-0.1
Equity					
Majedie	UK	136.2	145.9	+7.3	+3.5
Mirabaud	UK	85.9	88.9	+3.6	-0.2
UBS	UK	170.0	181.5	+6.8	+3.0
Marathon	Global	280.7	294.0	+4.8	+2.6
Newton	Global	161.9	162.7	+0.5	-1.7
Diversified Growth					
Standard Life	Diversified Growth	126.6	77.8	+1.2	+1.0
Baillie Gifford	Diversified Growth	31.1	128.1	+2.8	+2.7
Residual Cash		1.0	0.9		
TOTAL MANAGED FUND		**2,130.2**	**2,208.7**	**+3.3**	**+0.4**

15. In summary in the quarter to 31 December 2012:

- The total fund return of 3.3% was greater than the customised (hedged) benchmark return of 2.9% (+0.4%).
- In absolute terms, the best performing managers was Majedie with a return of +7.3%, compared to a benchmark return of 3.8% (+3.5%).
- In relative terms, the best performing manager was also Majedie (+3.5%). UBS also performed strongly with a return of 6.8% compared with a benchmark of 3.8% (+3.0%).
- Newton underperformed with a return of 0.5% compared to a benchmark of 2.2% (-1.7%). The reason for Newton's underperformance in the quarter was their underweight allocation to the financial sector which had performed well.

16. Under the fund's current strategy, short-term periods of underperformance (e.g. over individual quarters or years) should be expected. The overriding objective of the portfolio is to outperform the customised benchmark by 1% per annum over a rolling three-year period.

17. Each manager has a different target, depending on the type of mandate that they have. Having managers with different targets and different but complimentary styles means that short-term periods of underperformance are likely, with the expectation for the manager to perform over the longer term.

18. In the year to 31 December 2012 and in the period since inception (2004 for all managers, apart from Newton (December 2007) and Standard Life and Baillie Gifford (May 2012), performances for the individual managers were as follows:

Manager	Return for Year	Relative Performance to 31 Dec			Target Outperformance*
	%	year	3 years	since inception	
Multi-Asset		p.a.	p.a.	p.a.	
LGIM	+9.9	-0.1	+0.0	+0.0	n/a
Bonds/Property					
Western	+9.4	+1.7	-1.0	-0.8	0.75
CBRE	+0.9	+0.3	-1.0	-2.1	1.0
Equity					
Majedie	+16.2	+3.9	+2.5	+3.9	2.5
Mirabaud	+11.9	-0.4	+0.1	+1.8	2.5
UBS	+17.7	+5.4	+0.3	-0.8	2.0
Marathon	+18.8	+8.1	+5.6	+3.7	2.0
Newton	+14.5	+3.5	-0.9	-1.2	2.0
Diversified Growth					
Standard Life	n/a	n/a	n/a	1.5	5.0
Baillie Gifford	n/a	n/a	n/a	6.1	3.5
TOTAL MANAGED FUND	**+12.4**	**+1.7**	**+0.2**	**-0.2**	**1.5**

*Standard Life outperformance target is gross of fees, all others net

19. Over a rolling 3-year period:

- Marathon (+5.6%) achieved a return ahead of their performance target and Majedie (+2.5%) met their performance target.
- UBS (+0.3%) and Mirabaud (+0.1%) slightly outperformed compared to benchmark.
- Western (-1.0%), CBRE (-1.0%) and Newton (-0.9%) all underperformed compared with benchmark.

20. The overriding objective of the portfolio is to outperform the customised benchmark by 1% per annum over a rolling three-year period. Managers that underperform compared to benchmark over that period hamper the fund achieving its objective. The IAG continually monitors the performance of all managers and also monitors current developments to assess whether each manager has the ability to meet its target and help the fund achieve its objective.

IMPLICATIONS:

Financial:
There are no direct financial implications.

Equalities:
There are no direct equality implications.

Risk management and value for money:
Pension Fund risks are proactively monitored by officers and the Fund's Investment Advisors Group.

WHAT HAPPENS NEXT:

The February meeting was the last meeting of the IAG in its current form. Subject to a Council decision on 19 March 2013, the IAG will be transforming into a Pension Fund Board will full committee status. The first meeting of the newly formed Surrey Pension Fund Board will be on 31 May 2013.

REPORT AUTHOR:
Phil Triggs, Strategic Finance Manager, Pension Fund & Treasury

CONTACT DETAILS:
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Sources/background papers:
Investment Advisors Group meeting papers
Reports sourced from SAP, the Fund Custodian and Fund Managers.

Item 9

Audit & Governance Committee

18 March 2013

Surrey County Council self assessment on issues raised in:

- Financial sustainability of local authorities; and
- Towards a tipping point

Purpose of the report: This report summarises two recent publications on financial sustainability and good governance in local authorities. It analyses Surrey County Council's performance and highlights some areas for improvement.

Introduction:

1. This report summarises two recent national publications by the National Audit office (NAO) and our external auditors, Grant Thornton. Respectively they are:
   - Financial sustainability of local authorities (Annex 1); and
   - Towards a tipping point? (Annex 2)
2. The publications cover local authorities' performance in the current financial climate. This report assesses Surrey County Council's performance in relation to points raised in the publications.

Recommendations:

3. It is recommended that Audit & Governance Committee:
   a) notes the recent publications by NAO and Grant Thornton;
   b) considers the assessment of Surrey County Council's performance; and
   c) considers the impact of the suggested areas for improvement.

Financial sustainability of local authorities

Overview

4. National Audit Office (NAO) published *Financial sustainability of local authorities* (Annex 1) on 30 January 2013. It examines central government's approach to local authority funding, and reviews local authorities' financial sustainability in the current financial climate.

5. As part of its fiscal deficit reduction plan, the Government's 2010 spending review planned to reduce local authorities' real terms funding

by 26% (£7.6 billion) between April 2011 and March 2015 (excluding police, schools and fire). So far, local authorities have absorbed these funding decreases with some evidence of service reductions. NAO estimates local authorities still need to find about half their savings to be made before March 2015.

6. The Government is changing local government funding to increase local authorities' financial opportunities. However, this also increases their financial risks and uncertainty. Two of the biggest changes (partial retention of business rates and localisation of council tax support) take effect in April 2013.

7. The Department for Communities and Local Government (DCLG) has started to assess the combined impact of changes by different government departments on individual local authorities' financial risk profiles. The risk of financial failure will not spread evenly across local government; some authorities will be affected more than others. How DCLG and local authorities respond to possible multiple financial failures as financial difficulties intensify is untested.

8. NAO recommends DCLG and other government departments evaluate better the impact of decisions on local authority finances and services before and after implementation.

Changes to local authority funding

9. Since 2010 the Government has made several changes to local authority funding. The objectives underpinning them are localism and deficit reduction. These have driven the following changes:

   a) reduced central government grant funding;

   b) Council Tax Freeze Grant and the requirement to hold referendums for council tax increases above a set threshold;

   c) partial retention of local business rates; and

   d) local discretion over council tax support for working age people.

10. Central government's spending review plans to cut funding to local government by 26% between 2010/11 and 2014/15. Just over a third of this reduction was planned for the first year, 2011/12, with the remaining cuts spread evenly over the following three years. After taking account of local government's anticipated income from other sources, such as council tax, local government would see a 14% reduction over the spending review period to 2014/15.

11. Surrey's budgets and medium term financial plan (MTFP) for each year from 2010/11 to 2014/15 also show a 14% real terms funding reduction over the spending review period. This reduction takes account of

Surrey's actual council tax rises agreed for 2012/13 (2.99%) and 2013/14 (1.99%) and the 2.5% assumed increase built into its MTFP for 2014/15.

Council tax income

12. The Government introduced Council Tax Freeze Grant (CTFG) in late 2010 as a reward for authorities that did not increase council tax. The first CTFG offered a grant equivalent to a 2.5% rise in council tax payable in each of the four years 2011/12 to 2014/15. All authorities accepted the first CTFG. The second CTFG offered a grant equivalent to a 2.5% rise in council tax payable in 2012/13 only. 359 authorities accepted the second CTFG. The third CTFG offered a grant equivalent to a 1.0% rise in council tax payable in each of the years 2013/14 and 2014/15. As at 18 February 2013, 219 authorities had accepted the third CTFG, including 24 out of 27 county councils.

13. The Localism Act 2011 introduced the need for a referendum if a council wanted to raise its council tax above an excessiveness threshold determined annually by the Secretary of State for Communities and Local Government. For 2012/13, the Secretary of State set the threshold at 3.5%, for 2013/14 he set it at 2.0%.

14. Surrey accepted the first CTFG and receives £13.8m a year for it. Surrey declined the second and third CTFGs and raised council tax by 2.99% for 2012/13 and 1.99% for 2013/14. This means Surrey does not depend on variable short term grants and therefore has greater financial resilience.

Localisation of business rates

15. Partial local retention of business rates will incentivise local authorities to promote local business growth, as they will keep some of the increased business rate income. DCLG receives 50% of all local business rates collected (which it redistributes as revenue support grant). In two tier areas, districts and boroughs keep 80% of the remainder. As a county council with fire and rescue responsibilities, Surrey receives the other 20%. Because Surrey's share of the local business rates is less than our assessed spending need met from business rates, we also receive top up funding to bring us up to that business rates baseline level.

16. Surrey's business rates baseline for 2013/14 is £101m. Government estimates we will receive £44m funding from our share of business rates collected locally. Surrey's top up is £57m. The top up provides some protection from local volatility in business rates, due for example to rating revaluations as well as business growth and relocation. If business rates collected throughout Surrey rise by 5%, the county's business rates income rises by 5% too. If business rates collected throughout Surrey fall by 5%, the county council's business rates income falls by 5% too. However in both cases, this change only affects 44% of our assessed

spending need met from business rates. The top up element, being fixed, dampening the impact of volatility.

Localisation of council tax support

17. Changes to council tax support mean instead of paying benefits using the Department for Work and Pensions' (DWP) rules, local billing authorities (districts and boroughs) now set their own schemes to provide support as a discount on council tax. Nationally the government has provided local authorities 10% less money for this, but has partially mitigated it by introducing flexibilities around council tax premiums and discounts (for second homes and empty properties).

18. In Surrey, most districts and boroughs have broadly adopted a scheme in line with a county wide framework. The framework aims to minimise the impact on households least able to pay. The government's funding reduction means we receive a grant for council tax support of £38m in 2013/14 compared to £45m received in 2012/13 (as our 76% share of benefit subsidy paid into collection funds). Districts and boroughs estimate the use of new council tax flexibilities will reduce this £7m funding gap by around £5m.

19. As by far the biggest recipient of monies from collection funds, the county council bears three quarters of the risk of volatility introduced by these changes. The system itself is untried, which brings its own uncertainty, plus the economic outlook is still unsettled. So, the economic downturn reserve has been increased by £2.1m to help deal with the impact of potentially higher demand for council tax discounts arising from lower household incomes and lower collection rates from people who had previously paid little or no council tax, but now receive a bill.

Local authorities' savings requirements

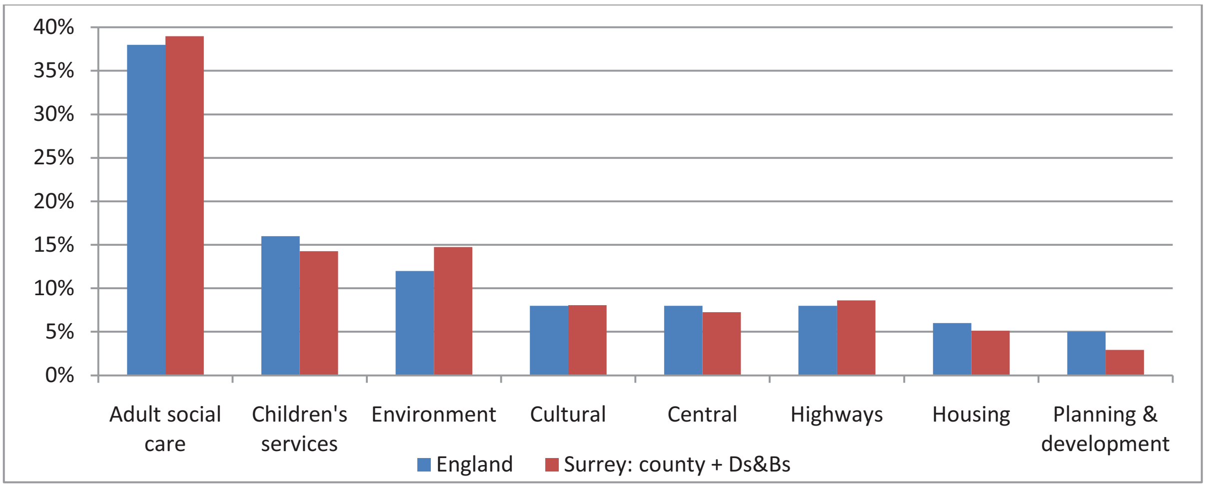
20. Local authorities have absorbed reductions in central government funding with some evidence that services have been reduced. Up to 2012/13 budgets, most local authorities had not drawn on financial reserves to make up for reduced income.

21. Local authorities still need to find about half of their savings to be made in the spending review period in 2013/14 and 2014/15. Surrey expects to make £131m (52%) savings in 2011/12 and 2012/13, leaving £122m (48%) to be made in 2013/14 and 2014/15.

22. Local authorities face increasing demand for services such as adult social care and children's services, which account for over half of their non-schools spending. Councils' scope to absorb these cost pressures by reducing other services is falling as authorities have already reduced spending on these services which already cost less.

23. Figure 1 shows the spending distribution for Surrey compared to England. They are broadly similar, albeit that adult social care, environment and highways form a slightly higher proportion in Surrey and children's and central services a lower proportion.

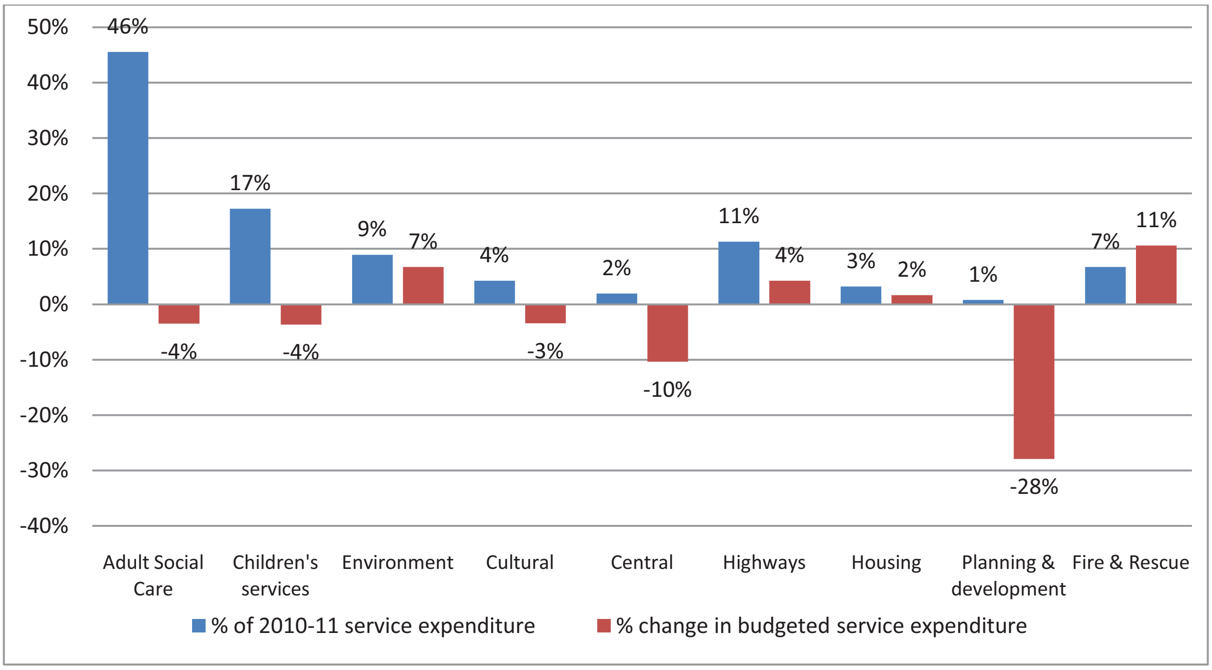
Figure 1 Comparative spending on local services in Surrey and in England 2010/11 (excludes schools and fire and rescue)



24. Nationally, local authority spending has reduced in real terms for all services. The largest reductions have been to lower spending services such as planning and development (36%), housing (22%) cultural (19%) and highways (14%). In contrast, adult social care, which forms the biggest part of councils' overall spending has reduced on average by 6% and children's services by 5%.

25. Figure 2 shows that since 2010/11, spending by Surrey County Council on adult social care and on children's services have each fallen by 4%, while planning and development services' spending has fallen by 28%. These are similar to the national trend. However, over the same period, Surrey's spending on environment and highways have both risen and Surrey's spending on fire and rescue grew by 11%.

Figure 2 Spending by Surrey County Council 2010/11 and planned changes for 2012/13 (excluding schools)



Use of reserves

26. Local authorities have a legal requirement to maintain adequate reserves to manage financial risks. The level of reserves is a matter for each local authority to decide. At 31 March 2012, local authorities held total reserves of £13.5 billion. Of this total, reserves earmarked for specific purposes amounted to £9.9 billion and unallocated general reserves £3.6 billion (4% of local authority spending). NAO analysed changes to local authorities' general reserves. NAO considers them particularly important for financial sustainability as they protect against unforeseen events.

27. In 2011/12 most local authorities (209) increased their general reserves and 93 reduced their general reserves. Surrey increased its level of general reserves to around £30m in anticipation of the continuation of volatility in future funding. Surrey also continued to provide a budget risk contingency of £8m to mitigate non delivery of service efficiencies.

Financial outlook

28. NAO found 12% of local authorities as at risk of not balancing future budgets. Of 52 local authority finance directors responding to a survey, most expected to make the largest savings through efficiency improvements. However, nearly all saw reducing the services their local authorities provided as contributing to meeting savings requirements.

29. Surrey's MTFP 2013-18 includes planned use of £23m of reserves in 2013/14 – in recognition of the strategy to smooth spending across financial years and follow the strategy of long term planning, rather than short term service reduction measures. A review of this during quarter 1

2013/14 will focus on specifying how further savings required will be delivered.

Towards a tipping point?

30. Grant Thornton succeeded the Audit Commission as Surrey County Council's external auditors in autumn 2012. *Towards a tipping point?* (Annex 2) summarises findings from Grant Thornton's second year of financial health checks of English local authorities. In 2012, Grant Thornton increased its local government audit portfolio by more than 100 clients. This will increase the breadth of data supporting its future financial health check reviews. Data from Surrey will therefore be reflected in the up-date of this review later this calendar year.

31. With financial austerity due to continue until at least 2017, *Towards a tipping point?* considers key indicators of financial performance, financial governance, strategic financial planning and financial controls across local government, to provide a summary update on how the sector is coping, drawing comparisons with the findings Grant Thornton published in December 2011 as *Surviving the storm: how resilient are local authorities?*.

32. *Towards a tipping point?* is based on reviews of 24 (7%) English local authorities undertaken between May and September 2012. This included a desk top review of key documents and interviews with key stakeholders to validate findings. The report focuses on the 2012/13 financial planning period and delivery of 2011/12 budgets.

33. The analysis followed the Audit Commission's broad approach to assessing value for money using themes and risk rating criteria. As Surrey received an unqualified value for money conclusion for 2011/12, our auditors rated us to be at high risk for no themes.

34. Grant Thornton also includes a best practice checklist under each theme. This report considers Surrey's performance against each theme's checklist and also highlights potential areas for improvement.

Is local government reaching a tipping point?

35. While authorities met their 2011/12 targets as they anticipated, their confidence in achieving medium-term targets has fallen in the last year. With many factors leading to an uncertain environment for setting financial plans, the report asks is a critical point coming where local authorities can no longer deliver?

36. *Surviving the storm: how resilient are local authorities?* identified confidence among local authorities about achieving 2011/12's savings. This was borne out as most authorities delivered their 2011/12 targets. However confidence waned over the medium term. *Towards a tipping point?* reinforces this. Strategic financial planning was the area where

risk rating increased between 2010/11 and 2011/12. The challenges and uncertainties facing the sector remain significant and confidence for the medium-term is generally weaker.

37. Grant Thornton lists factors that bring uncertainty in local government financial planning, including:

    a) the possibility of further funding reductions during the current spending review period, and a lack of certainty after 2015;

    b) the weakness of the economy which both depresses income sources and increases local government welfare related spending;

    c) the lateness of the 2013/14 Local Government Finance Settlement, providing a very limited lead in to the 2013/14 financial planning cycle;

    d) restrictions on local authorities' ability to raise additional council tax funding due to CTFG and council tax increase threshold;

    e) the opportunities and challenges from the partial localisation of business rates and the change to council tax support;

    f) the pressures of an ageing population with increasing complexity of need affecting social care delivery, a key spending pressure area; and

    g) limitations on the ability to finance capital projects.

38. Grant Thornton's analysis suggests a 'tipping point' is approaching, but what form this could take remains unclear. A tipping point has been described as the critical point in an evolving situation that leads to a new and irreversible development. The report identifies several tipping point scenarios related to individual local authorities, rather than local government as a whole:

    a) Statutory –a local authority can no longer meet its statutory responsibilities.

    b) Financial –the Section 151 Officer is unable to set a balanced budget.

    c) Industrial –industrial relations disputes lead to major service disruption.

    d) External –a major supplier fails.

    e) Incremental –small tipping points, accumulate to a critical mass.

    f) Decision paralysis –a council fails to make the difficult decisions needed to manage its financial and other challenges.

39. Grant Thornton will work with local authorities to explore the concept of a tipping point further. When it has better understanding, the firm will begin to analyse the actions needed to avoid and mitigate such tipping points.

Key indicators of financial performance

40. Overall, Grant Thornton found use of financial and other ratios improved from 2010/11 to 2011/12. Despite considerable improvement, managing the workforce remains a critical area, alongside liquidity where the trend for reducing working capital continues.

41. Surrey performs well against the best practice checklist. For example, we:

    a) operate within appropriate, locally determined levels of reserves and balances; and

    b) have a track record of spending to budget and managing overspends within year

42. Over the last 12 months, we have also made progress on absence management, including:

    a) monthly meetings between HR and Heads of Service to discuss absence cases;

    b) support for managers on conducting return to work discussions;

    c) improving data quality of sickness reporting; and

    d) a pilot for occupational health intervention on day one of any sickness absence.

Strategic financial planning

43. Grant Thornton found authorities typically started their 2012/13 planning cycles earlier to provide time to finalise savings programmes. Overall scenario planning remains weak. However, it is ever more critical given the uncertainty about Government spending plans and the volatility introduced by the partial retention of local business rates.

44. Surrey performs well against the best practice checklist. For example we:

    a) integrate financial and service plans well and follow the corporate and financial strategies over the longer term;

    b) use sensitivity analysis on our financial modelling; and

    c) regularly review the MTFP and the assumptions within it.

45. An area for improvement we are progressing is developing our approach to workforce planning. We have a new approach in place, which we are incorporating into preparation of the Corporate Plan. We are developing a toolkit to enable local workforce planning and structure analysis and Finance, Policy and HR are working to integrate the new approach into service and financial planning.

Financial governance

46. Grant Thornton found an increase in member and senior manager engagement on financial planning. Budget management has also improved. However, authorities' ability to manage volatile, demand led budgets remains a challenge.

47. Surrey performs well against the best practice checklist. For example we:

    a) report regularly to members on our financial position and our developing financial plans;

    b) respond promptly to internal and external audit recommendations; and

    c) address key areas of financial risk.

48. An area for improvement is to spread good understanding of unit costs and cost drivers. This is in place in parts, but not consistently throughout the Council. More widespread good understanding of unit costs would enhance understanding and analysis of financial implications of different options for management plans and actions.

Financial controls

49. Grant Thornton found in 2011/12 authorities' financial control had improved over that in 2010/11 and authorities had delivered in-year savings. However, Grant Thornton noted a key issue in 2011/12's reviews was a lack of transparency in how some authorities report performance against budgeted savings.

50. Many local authorities do not report effectively the savings they might or might not achieve. For example, a reduced budget incorporating savings agreed by Cabinet does not overspend at year end and is considered a success. However, the reality may be that other factors have led to the underspend, but are not apparent as reporting focuses on the savings target. So, management decisions to hold vacancies that were not part of the agreed savings plan may be absent from management information (and the consequent impact on service delivery may not be identified). Given the scale of savings local authorities are making and sensitivities about how they make them, it is vital key stakeholders understand whether managers have delivered agreed savings as planned.

51. Surrey performs well against the best practice checklist. For example:

    a) our budgets are robust and timely and the Council has a good track record of operating within its budget;

    b) budgets are monitored at officer, member and cabinet levels each month;

    c) the system of internal audit is effective;

d) the Annual Governance Statement represents the Council fairly; and

e) we were shortlisted in the LGC Awards Corporate Governance category.

52. An area for improvement is to increase the focus on income related budgets. Generating income will grow in significance as a source of funding for the Council over the coming years. As such, effective and reliable monitoring and forecasting of income streams will become even more important to our financial sustainability. The Funding Strategy with a focus covering 2012-17 will continue to drive this in 2014/15.

Conclusions:

53. NAO and Grant Thornton both found that so far, local authorities have generally absorbed central government funding reductions and are performing well overall in challenging circumstances. However, evidence is emerging of some service level reductions.

54. Overall funding continues to decline, while financial pressures and uncertainty rise. Consequently more local authorities are finding it hard to sustain their financial position and meet statutory responsibilities. Some local authorities will be more affected than others. DCLG and local authorities must identify this risk early so they can manage it effectively.

55. NAO considered a range of indicators, such as levels of local authority reserves and projections of service demand, to see what they showed about financial sustainability. NAO concluded financial sustainability depends on factors that go beyond the balance sheet, including strengths of financial management and governance arrangements. Coming to a view of the likely financial sustainability of a local authority using a single set of indicators is therefore problematic, and needs to consider local circumstances.

56. *Towards a tipping point?* Is based on analyses of local practices and circumstances. It suggests finance will remain an important factor for key stakeholders through the uncertain times ahead. As such, local authorities should aim to:

a) improve scenario planning, sensitivity analysis and fuller reporting of savings programmes; and

b) maintain the robustness of its financial governance arrangements.

57. Assessing Surrey's performance against the themes and best practices in the report helps reach a view about our financial sustainability. The findings bring some comfort, but no cause for complacency.

Financial and value for money implications

58. There are no specific additional financial implications from this report.

Equalities Implications

59. None.

Risk Management Implications

60. There are no specific additional risk management implications from this report.

Implications for the Council's Priorities or Community Strategy

61. None.

Next steps:

Grant Thornton will assess the Council's financial health as part of its audit of 2012/13 financial statements.

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Sources/background papers:

Annex 1 - Financial sustainability of local authorities, National Audit Office

Annex 2 - Towards a tipping point?, Grant Thornton

Surrey County Council Statement of Accounts 2010/11

Surrey County Council Medium Term Financial Plans: 2010-2014, 2011-2015 and 2012-2017.

CIPFA Statistics Revenue Outturn data 2010/11 and 2011/12

National Audit Office

REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

HC 888
SESSION 2012-13

30 JANUARY 2013

Department for Communities
and Local Government

Financial sustainability of local authorities

Our vision is to help the nation spend wisely.

We apply the unique perspective of public audit to help Parliament and government drive lasting improvement in public services.

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Amyas Morse, is an Officer of the House of Commons and leads the NAO, which employs some 860 staff. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively, and with economy. Our studies evaluate the value for money of public spending, nationally and locally. Our recommendations and reports on good practice help government improve public services, and our work led to audited savings of more than £1 billion in 2011.

National Audit Office

Department for Communities and Local Government

Financial sustainability of local authorities

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 28 January 2013

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act

Amyas Morse
Comptroller and Auditor General
National Audit Office

25 January 2013

HC 888 London: The Stationery Office £16.00

This report examines central government's approach to local authority funding, and reviews local authorities' financial sustainability against a background of changes to their funding.

Printed in the UK for the Stationery Office Limited on behalf of the Controller of Her Majesty's Stationery Office

2537545 01/13 PRCS

Contents

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This report can be found on the National Audit Office website at www.nao.org.uk/financial-sustainability-local-authorities-2013

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Key facts

£147bn	£103bn	£44bn
local government revenue income, 2010-11	central government grant funding to local government, 2010-11	other local government revenue income, 2010-11

353	local authorities in England
24 per cent	local government expenditure as proportion of total managed public spending in the UK in 2010-11
£7.6 billion	real-terms reduction in funding from central government to local authorities, 2010-11 to 2014-15, planned at 2010 spending review
14 per cent	real-terms reduction in local authority income, 2010-11 to 2014-15, estimated at 2010 spending review
0.2 per cent	increase in average band D council tax rates in cash terms, 2010-11 to 2012-13
£3.6 billion	total local authorities' unallocated general reserves, at 31 March 2012
4 per cent	total local authorities' unallocated general reserves as a proportion of total local authorities' revenue expenditure, at 31 March 2012
1,335	statutory duties on local authorities as at June 2011

Summary

1 There are 353 local authorities in England, providing a diverse range of services. Local government's revenue income was £147 billion in 2010-11, of which £103 billion was central government grants and £44 billion was other revenue income, including council tax of £22 billion. Local authority spending in England accounts for around a quarter of total public spending in the UK.

2 Local authority councillors are elected by, and accountable to, the people in their local authority. However, central government fundamentally influences the funding system for local authorities and is responsible for the statutory framework for the services they deliver. Local authorities are required to deliver 1,335 statutory responsibilities and, to be financially sustainable, must meet their service obligations within their available funding. A number of government departments are responsible for policy and funding for local authorities; the lead department is the Department for Communities and Local Government.

3 This report examines central government's approach to local authority funding, and reviews local authorities' financial sustainability against a background of changes to their funding. It has three parts:

- **Part One: Funding local authority services,** sets out the background to the current funding arrangements and the reduction in local authority funding from the government's 2010 spending review.
- **Part Two: Local authority budget management,** sets out how local authorities have responded to their reduced income.
- **Part Three: Maintaining financial sustainability,** covers the growing challenges to local authorities' financial sustainability; managing financial risks and opportunities; and the increasing need for central government to make informed decisions as financial and service pressures increase.

4 We have drawn in this report upon work done by the Audit Commission in its report *Tough Times 2012*. In line with our current statutory audit remit, we have not undertaken detailed fieldwork at individual local authority level, nor have we engaged directly with local auditors to assess the response of individual local authorities to the recent funding changes. We outline our audit approach and evidence base in Appendices One and Two.

5 The government is introducing a Local Audit Bill in 2013. This will provide for the abolition of the Audit Commission, clarify the NAO's powers to carry out value-for-money work on local authorities, and provide the NAO with statutory access to information held by local authorities in support of such work.

Key findings

6 As part of its fiscal deficit reduction plan, central government planned at the 2010 spending review to reduce funding of local authorities by 26 per cent (£7.6 billion) in real terms, between April 2011 and March 2015 (excluding police, school and fire). Including council tax, the overall reduction of local authority income was forecast to be 14 per cent in real terms. The effects on local authorities vary. In 2012-13, the overall reduction in spending power ranges from 1.1 per cent to 8.8 per cent in cash terms. Twelve local authorities experienced the highest reduction in spending power of 8.8 per cent in 2011-12 and 2012-13 (paragraphs 1.14 to 1.15).

7 By reducing ring-fencing of its grants, central government aims to give local authorities greater spending flexibility. In addition, from April 2013, local authorities will have a financial incentive to achieve growth in business rates and will be able to decide which council tax payers should benefit from council tax support. Central government has also introduced policies that reduce local authorities' flexibility, for example by requiring those that wish to raise council tax by more than a set percentage to hold a local referendum (paragraphs 1.10, 2.7, 3.12 to 3.19).

8 So far, local authorities have absorbed reductions in central government funding but there is some evidence that services have been reduced. Using data from the Audit Commission we estimate that local authorities are planning to make £4.6 billion of savings by April 2013. The majority of local authorities have so far not drawn on financial reserves to make up for reduced income. Although 93 used reserves in 2011-12, the remaining 260 either made no changes to their reserves or added to them. There is evidence that local authorities are reducing services, for example in adult social care and libraries (paragraphs 2.2, 2.10, 3.7 and 3.10).

9 Local authorities may find it harder over the rest of the spending review period to absorb funding reductions and maintain services. We estimate that local authorities still need to find about half of the savings to be made before March 2015 after considering the latest figures for inflation, council tax and government grants. At the same time, demand for high-cost services, such as adult social care and children's services, is increasing. The scope for absorbing cost pressures through reducing other, lower cost, services is reducing, as authorities have already reduced spending on these services. Nationally, the largest percentage reductions so far have been to services such as planning and development, where total spending by local authorities has reduced by 36 per cent. In contrast, adult social care has reduced by 6 per cent (paragraphs 2.3 to 2.4, 3.30).

10 The government is making changes that create financial opportunities for local authorities but also increase their financial risks and uncertainty. Two of the most important changes – the partial localisation of business rates and the arrangements for council tax benefit – come into effect in April 2013. The business rates change will incentivise local authorities to promote local business growth, as they will keep a share of increased business rate income. They will also be more exposed if income falls, although they will receive some protection from this. The changes to council tax support mean that instead of paying benefits according to rules that the Department for Work and Pensions sets, local authorities can have their own schemes but nationally they will have 10 per cent less money to do so. The opportunities and risks of both changes will be influenced by wider economic conditions, which are inherently uncertain (paragraphs 1.12, 3.11 to 3.20).

11 **Local authorities' ability to make savings while maintaining service levels depends on local circumstances.** Using information from local auditors, the Audit Commission identified 12 per cent of local authorities as at risk of not balancing future budgets. We surveyed local authority finance directors with most of the 52 that responded expected to make the largest savings through efficiency improvements. However, nearly all saw reducing the services their local authorities provided as contributing to their savings requirements (paragraphs 3.4 to 3.5, 3.34).

12 **While individual government departments assessed the impact of the changes being made, their approach was not comprehensive.** We looked at the information three departments provided for the 2010 spending review. One, the Department for Education, could not estimate the scope for savings across the entirety of their service area (children's services), but it did consider the pressures and scope for efficiencies in a number of major areas of spend, such as caring for 'looked after' children. In addition, all three departments did not identify regional or other variations in the demand for, or cost of, services (paragraphs 3.25 to 3.32).

13 **With a range of changes to local government funding being implemented over the spending review period, it becomes increasingly important to understand the cumulative effects of the changes as these may affect local authorities differently.** For example, local authorities that do not experience economic growth might, simultaneously, see a fall in their business rates and a rise in council tax benefit claimants. The Department for Communities and Local Government has recently started to provide the basis for such an analysis, by assessing the combined impacts of a range of changes on the financial risk profile of individual local authorities (paragraphs 3.20 to 3.21).

14 **The accountability framework for local government to address widespread financial failure is untested.** The framework, as described in the Department for Communities and Local Government's *Accountability System Statement*, relies heavily on the long-established safeguards and assurances within local authorities. The framework has not yet faced a case of widespread financial failure and where there have been 'one-off' failures requiring central government intervention, the failure regime has managed to resolve them. However, past failures in the local government sector have generally related to services or corporate governance, or both, and not financial failure. How the system responds in the case of multiple financial failures during possibly more challenging times for local authorities is therefore, at present, untested (paragraphs 3.35 to 3.42).

Conclusion

15 So far, local authorities have generally been able to absorb central government funding reductions. However, there is emerging evidence that some service levels are reducing. Funding reductions are continuing, along with changes to the resourcing mechanism of local authorities. These changes increase financial uncertainty and more local authorities are facing the challenge to avoid financial difficulties while meeting their statutory responsibilities. This risk will not manifest itself evenly across the sector, with some local authorities being more affected than others.

16 This risk must be identified early so it can be managed effectively. The Department for Communities and Local Government will need arrangements to detect where risks will emerge. Its response will need to be flexible and coordinated with local and sector-wide support mechanisms. Central government must also satisfy itself that it understands the cumulative impact of funding changes and can make informed decisions about the funding required for local authority services.

Recommendation

17 The Department for Communities and Local Government should build on previous work and, together with other government departments, better evaluate the impact of decisions on local authority finances and services – before and after implementation. With other departments, the Department has assessed the impact of funding reductions and other changes to the system of local authority financing, such as business rates. To develop its approach the Department should:

- work with other departments to understand the information needs to support decisions affecting local authority finances and services. This may not mean requiring more information, but understanding what is the right information for that purpose. For transparency, it should discuss and share the framework with local authorities;
- ensure that decisions on financing local authorities are made with an assessment of their service obligations including statutory responsibilities; and
- satisfy itself that the assurances provided by the accountability framework are robust enough for the more challenging financial and service delivery conditions facing local authorities. Informed decision-making requires a feedback loop so the Department can make adjustments in the light of performance; and identify evidence of potential difficulties early enough to intervene.

Part One

Funding local authority services

1.1 This part covers:

- the services local authorities provide and how central government has influenced their funding;
- local authority funding and spending at the beginning of the 2010 spending review;
- the main funding changes between April 2010 and March 2015; and
- funding reductions central government planned at the 2010 spending review and how these affect local authorities differently.

Local authorities and their services

1.2 Local authorities are democratically elected and provide a range of services to their communities in the broad areas of education, housing, social care, environmental services, and corporate functions such as collecting council tax.[1] They have 1,335 statutory duties, including child protection, provision of libraries, environmental health and trading standards – but within this framework have discretion to decide how they provide services according to local priorities.

1.3 Central government directly influences local authority funding for these services. Local authorities are required by law to balance their budgets. To remain financially sustainable, they must meet their service obligations with the available funding. Introducing the 'general power of competence' in the 2011 Localism Act increased local authorities' discretion over the range of services they provide.

The relationship between central and local government

1.4 The financial and statutory relationships between central and local government have a long and complex history, mostly concerning the degree of central government control. Central government policies are implemented through statutory service obligations on local authorities, which receive funding from different parts of government.

1 This report only covers councils, not other types of authorities such as police and fire authorities unless otherwise stated.

1.5 Before April 1990, local authorities retained locally raised taxes, in the form of rates levied on businesses (shops, offices, and factories) and households, and received central government funding in the form of the Rate Support Grant. Following funding changes in 1990 and up to April 2013, local authorities collect business rates, and pay them to central government, which redistributes them back through the grant system. Central government sets business rates, but local authorities have discretion to reduce individual bills by granting rate relief. Local authorities set, collect and retain council tax, using an administrative framework set by central government.

1.6 There have been periods when central government has sought to direct or influence increases in local tax levels through measures such as council tax capping. This is no longer in place but currently there is a requirement to hold a local referendum for increases above a certain level. There is also a Council Tax Freeze Grant which is distributed to those authorities that do not increase their council tax level (paragraph 2.7).

Local government funding at the beginning of the 2010 spending review

1.7 In 2010-11, total local government revenue income was £147 billion.[2] Of this, £103 billion was central government grant funding and £44 billion was other revenue income, principally income raised locally by local authorities through council tax (£22 billion) and sales, fees and charges (£12 billion).[3]

1.8 A large proportion of central government grants were not available for local authorities to spend directly on providing services as they choose and this report does not directly consider those:

- About thirty billion pounds of funding was the Dedicated Schools Grant, which local authorities pass directly to schools.
- A further £23 billion was passed directly by local authorities to third parties to administer (such as funding for adult and community learning) or to benefit recipients.

1.9 This report focuses on general revenue funding for local authorities, of which the largest elements are the Formula Grant (£29 billion in 2010-11) and council tax.[4] Local authorities can decide how to spend both funding streams in meeting their responsibilities. The last year of the Formula Grant is 2012-13. We describe the arrangements that replace it in paragraphs 3.12 to 3.17.

2 The figures in paragraphs 1.7 to 1.10 include income for all local authorities, including police and fire authorities. In addition to their revenue income, local authorities also receive capital income and rent income from social housing. This is not covered in this report.
3 The figures in paragraphs 1.7 to 1.10 may not add up due to rounding.
4 The Formula Grant consists of redistributed business rates (£21.5 billion in 2010-11), a central government 'top-up' added to business rates called the Revenue Support Grant (£3.1 billion), and the Police Grant paid directly to police authorities (£4.4 billion). Its allocation was the subject of a separate NAO report. Comptroller and Auditor General, *Formula funding of local public services*, Session 2010–2012, HC 1090, National Audit Office, July 2011.

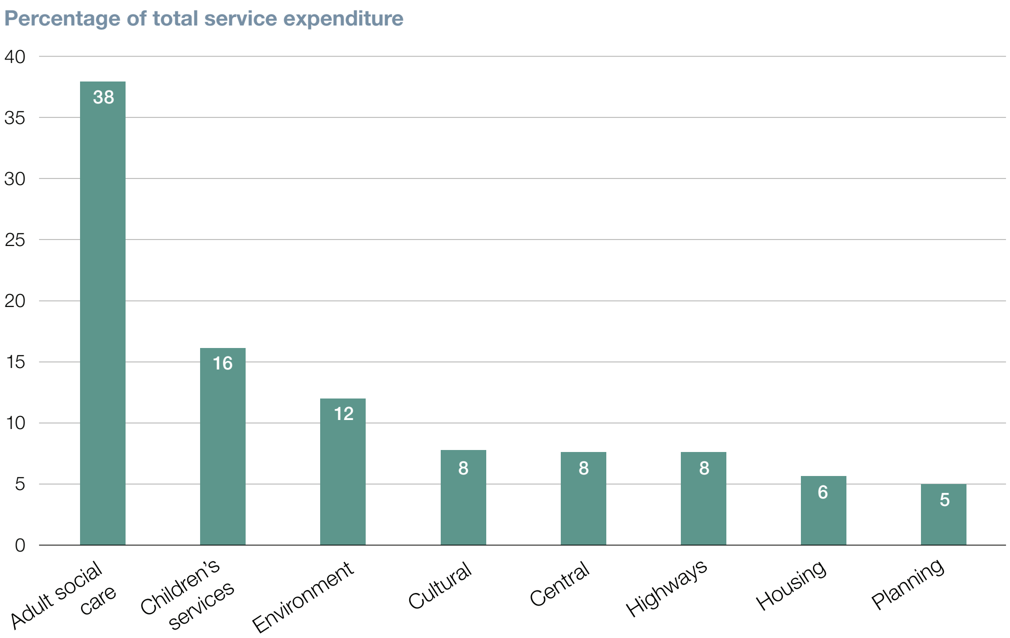
1.10 In 2010-11, central government also passed on £20 billion in grants for specific services, for example, for homelessness services. The extent to which local authorities had discretion in the use of such funding varied. Following the 2010 spending review, the Department for Communities and Local Government has merged several specific grants into the Formula Grant, while removing ring-fencing from most of those which remain, giving local authorities more spending flexibility.

Local authority spending on services

1.11 **Figure 1** shows how local authorities spent their income in 2010-11. Most money was spent on adult social care and children's services, with the least going to housing and planning services.

Figure 1
Spending on local services in 2010-11

In 2010-11, more than 50 per cent of local authority spending was on social care



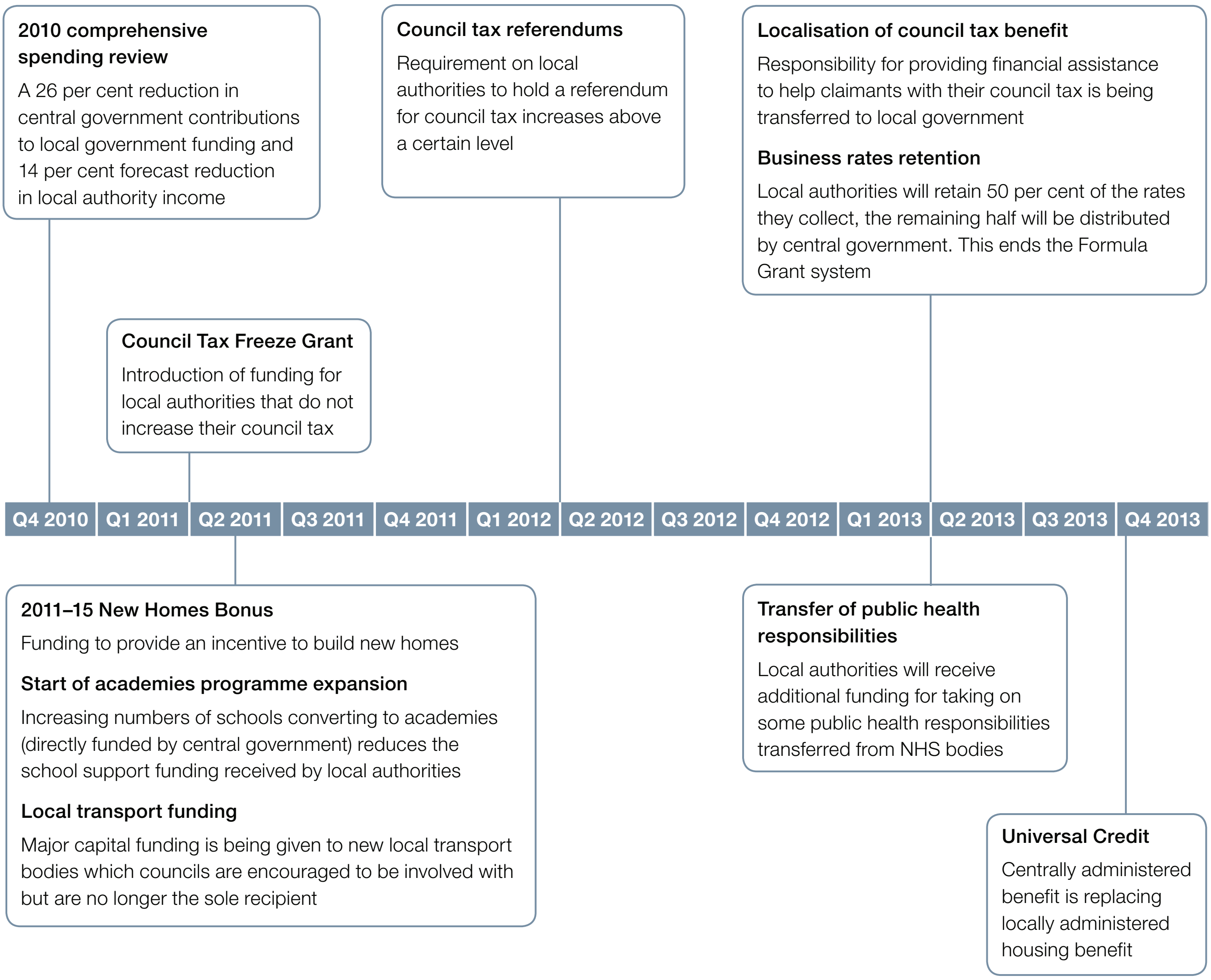
NOTE
1 Education spending is excluded.

Source: Audit Commission analysis of local authority revenue outturn data 2010-11, in 2012-13 prices

Changes to local authority funding

1.12 A number of changes taking place between April 2010 and March 2015 will affect local authorities' financial position as illustrated in **Figure 2**.

Figure 2
Timeline of major changes to local authority funding



Source: National Audit Office

1.13 Two key objectives underpin current government policy for local authority funding. One is localism, which means that local authorities have greater discretion over their decision-making. The other is deficit reduction through local economic growth and reducing spending. These objectives are driving a number of changes on which our report focuses:

- Reduced central government grant funding (paragraphs 1.14 to 1.15).
- Council Tax Freeze Grant and the requirement to hold a referendum for council tax increases above a certain level (paragraph 2.7).
- The way local authorities benefit from growth in business rates which is being introduced in April 2013 (paragraphs 3.12 to 3.17).
- Providing local authorities discretion over the levels of support working-age people receive with their council tax bill from April 2013 (paragraphs 3.18 to 3.19).

Funding reductions planned at the 2010 spending review

1.14 In its June 2010 Budget, the government set out a five-year plan to reduce the structural deficit over the course of this Parliament, specifying the greatest contribution would come from spending reductions. In *Spending Review 2010*, HM Treasury set out details of the government's plan to reduce local government funding for the four years 2011-12 to 2014-15.[5] Central government financial support for local authorities was planned to reduce over that period by 26 per cent in real terms,[6] from £29.7 billion to £22.1 billion. HM Treasury forecast that, after considering inflation and council tax, the effect would be a decrease in overall local authority income of 14 per cent in real terms (£51.8 billion to £44.8 billion).[7] **Figure 3** overleaf shows the greatest reductions were planned to occur in the first two years of the spending review.

1.15 The funding reductions do not have a uniform effect across local authorities. The Department for Communities and Local Government allocated a Transition Grant to all local authorities, totalling £116 million over 2011-12 and 2012-13, so that no local authority's annual reduction in spending power is more than 8.8 per cent in those years.[8] **Figure 4** on page 15 shows the distribution of spending power reductions across local authorities after the Transition Grant has been allocated in 2012-13. In 2012-13 the reduction in spending power ranges from 1.1 per cent to 8.8 per cent.[9] Twelve local authorities had reduced spending power of 8.8 per cent in both 2011-12 and 2012-13.

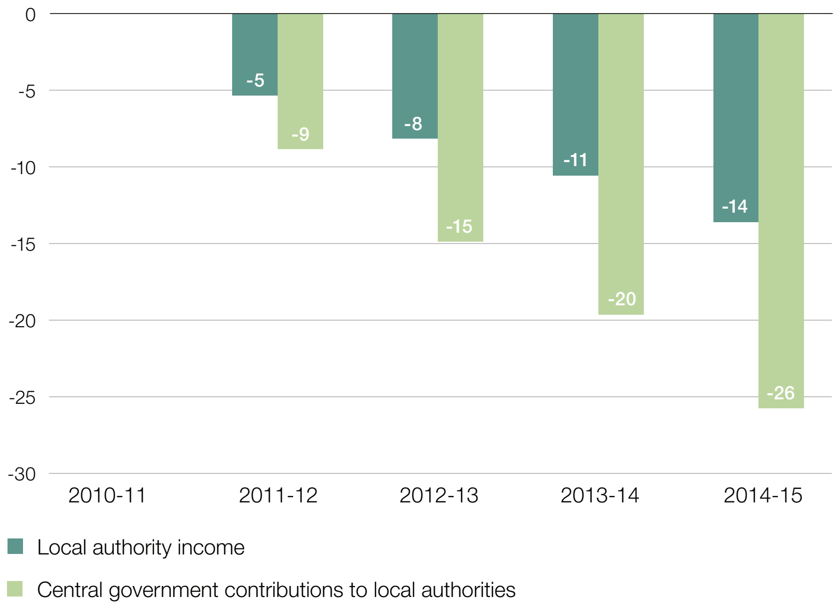
5 HM Treasury, *Spending Review 2010,* October 2010, available at: http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf
6 Figures in real terms are in 2010-11 prices, unless otherwise stated.
7 Local authority income refers to the line 'local government spending' in HM Treasury, *Spending Review 2010*, Table 1, p. 10, and includes central government contributions to local authorities and council tax.
8 Spending power is calculated by taking account of central government contributions to local authorities, council tax, and NHS social care funding.
9 These figures are in cash terms.

Figure 3

Planned decrease in central government funding and the overall effect on local authority income, April 2010 to March 2015

At the 2010 spending review, the government planned to reduce central government contributions to local authorities by 26 per cent over the spending review period, and forecast that overall local authority income will reduce by 14 per cent

Percentage of cumulative real reduction from 2010-11 baseline



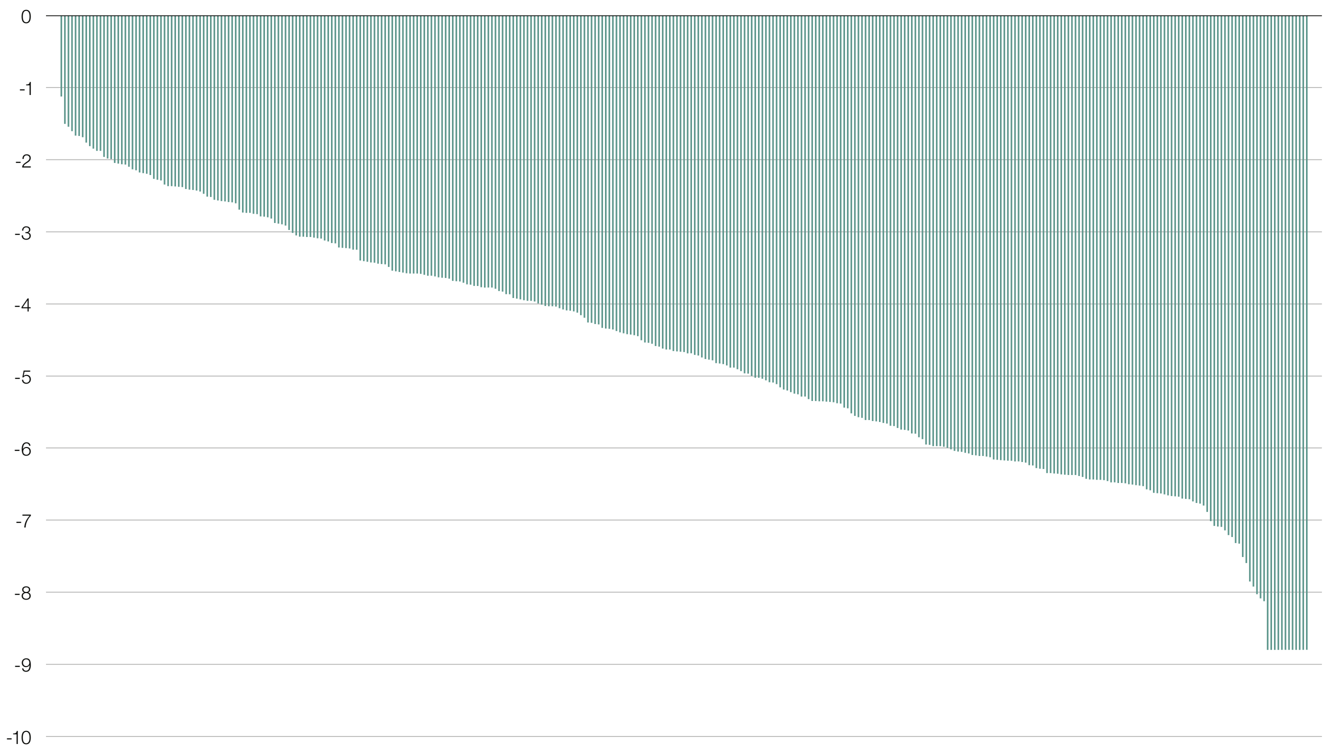
NOTES

1 Local authority income includes the Office for Budget Responsibility's council tax forecast at the time of the 2010 spending review.

2 The figures are in real terms and have been rounded to the nearest percentage point.

Source: HM Treasury, Spending Review 2010

Figure 4
Distribution of the annual reductions in spending power across local authorities, 2012-13



NOTES
1 The Isles of Scilly is excluded from this analysis due to lack of comparability with other councils.
2 Figures are in cash terms.

Source: National Audit Office analysis based on Department for Communities and Local Government spending power figures

Part Two

Local authority budget management

2.1 Part One describes the challenge local authorities face in this spending review, setting out major changes and reductions to local authority income. This part examines how local authorities have managed budgets over the first half of the 2010 spending review, looking at how they have:

- reduced spending;
- increased income;
- used reserves on a one-off basis; and
- performed against budget.

Reducing spending

2.2 Using Audit Commission data, we estimate that local authorities are planning to reduce spending by £4.6 billion in real terms by March 2013, after absorbing additional costs from increased demand for local authority services.[10]

2.3 Central government estimated at the 2010 spending review that the overall reduction in local authority income would be £7 billion (14 per cent) in real terms from April 2010 to March 2015 (paragraph 1.14). Since then, the government has announced further changes affecting local government, including a funding reduction of £445 million for 2014-15 in the 2012 *Autumn Statement*. Council tax income is also expected to be lower and inflation higher than forecast at the 2010 spending review. This creates difficulties in estimating precisely how much local authority income will reduce by March 2015, but we estimate that the £4.6 billion reduction of spending represents about half of the savings required by March 2015.

2.4 **Figure 5** shows where local authorities have made savings on individual services. The largest percentage reductions have been in areas with relatively low levels of spending. For example, total spending on planning and development represented 5 per cent of spending in 2010-11 and is planned to fall by 36 per cent between April 2010 and March 2013 in real terms. At the other extreme, adult social care represented 38 per cent of spending in 2010-11 and is planned to fall by 6 per cent in real terms between April 2010 and March 2013.[11]

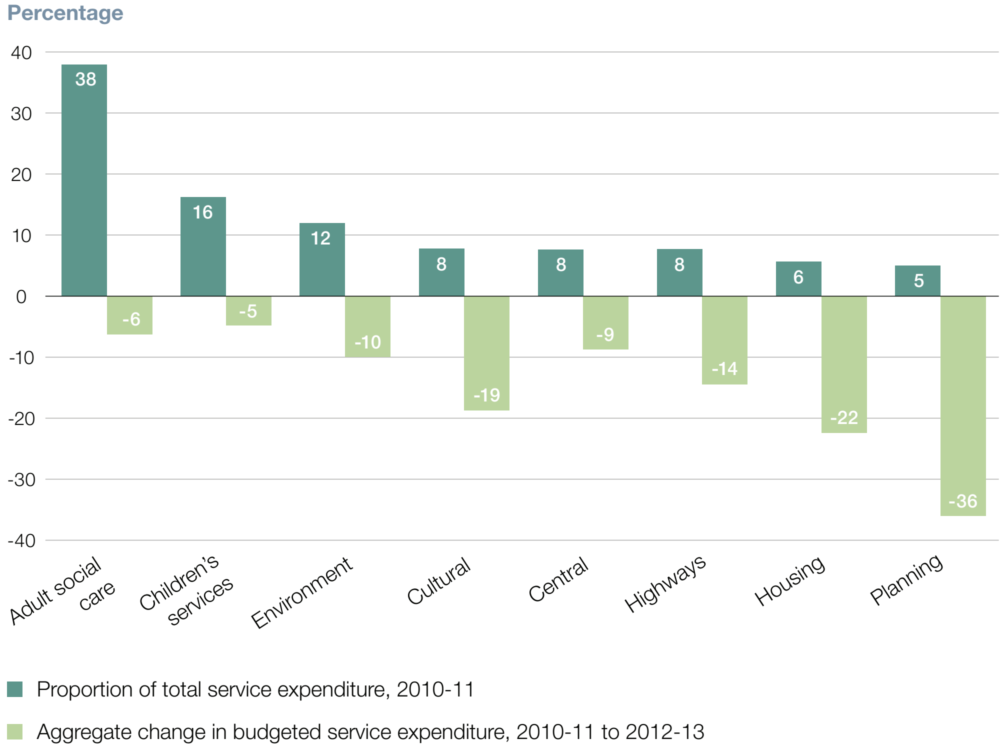
10 See Appendix Two for more details.
11 These real-terms figures are in 2012-13 prices.

2.5 If local authorities cannot reduce costs through making savings while maintaining services, they must consider managing demand or reducing services. There is evidence of increasing pressures on local authorities to do this (paragraphs 3.7 to 3.8).

Figure 5

Local authority planned real-term reductions in spending, April 2010 to March 2013

In the first two years of the 2010 spending review period local authorities focused their savings on planning and housing in relative terms



NOTES

1 In its *Tough Times 2012* report the Audit Commission reported service expenditure figures for 2011-12. This explains why the Audit Commission reported different figures on service expenditure proportions.

2 Education spending is excluded.

Source: Audit Commission analysis of local authority revenue outturn data 2010-11 and revenue account data 2010-11, 2011-12, 2012-13, in 2012-13 prices

Increasing income

2.6 Council tax is the main source of locally raised income. Council tax levels are set in eight bands, at rates local authorities decide. The bands themselves are determined by central government. The fourth (band D) is usually used for comparisons. In 2012-13, it ranges from £684 to £1,696, with the national average being £1,469. These arrangements have been in place with the current rate valuations since 1993. This shows that individual authorities are starting from different positions on council tax levels. A certain percentage increase will yield more in cash terms in a high-tax than in a low-tax authority.[12]

2.7 Between April 2010 and March 2013, the average total band D council tax level increase was 0.2 per cent in cash terms, compared with 5 per cent since the introduction of council tax. Two measures have influenced the comparatively low increase in the last two years:

- In 2010, central government introduced the Council Tax Freeze Grant. This grant rewards local authorities that do not increase council tax. In 2011-12, the grant was equivalent to a 2.5 per cent rise in council tax, and this level of grant is available for the full spending review period. In October 2011, the government announced it would provide a further year's Council Tax Freeze Grant in 2012-13 and this was equivalent to a 2.5 per cent increase in 2011-12 council tax. Then, in October 2012, it announced another Council Tax Freeze Grant, at a level equivalent to a 1 per cent rise in 2012-13 council tax, available in both 2013-14 and 2014-15. All local authorities received the 2011-12 grant; 316 (90 per cent) received the 2012-13 grant. These arrangements present an incentive for authorities not to increase the level of tax.
- The Localism Act 2011 requires local authorities wanting to raise council tax by more than a set percentage to hold a local referendum. The threshold for the current financial year was 3.5 per cent, and it will be 2 per cent next year.[13] Since the introduction of the act, no local authority has held a referendum.

Using reserves

2.8 In addition to the legal requirement to balance budgets, local authorities must maintain adequate reserves to manage financial risks. The level of reserves is a matter for individual local authorities to decide. As of 31 March 2012, local authorities held total reserves of £13.5 billion. They held earmarked reserves for specific purposes (£9.9 billion). These are held for a range of contingencies, for example to cover insurance liabilities or the costs of debt financing. They held unallocated general reserves of £3.6 billion (4 per cent of local authority spending). These provide a provision against general risk but are not allocated for specific purposes.

12 The relative size of the tax base also has a bearing on the cash increase.

13 The referendum thresholds for the financial year 2012-13 apply to all councils except the Greater London Authority. In December 2012, following the 2012 *Autumn Statement*, the government announced that district councils whose 2012-13 council tax was in the lowest quartile will be able to raise council tax by more than 2 per cent without a referendum provided the increase is not more than £5 in the average band D amount.

2.9 We focused our analysis on unallocated general reserves. These protect against unforeseen events, so are particularly important for financial sustainability. Local authorities can fund overspends by using these reserves. However, this is not a sustainable approach to balancing budgets in the longer term.

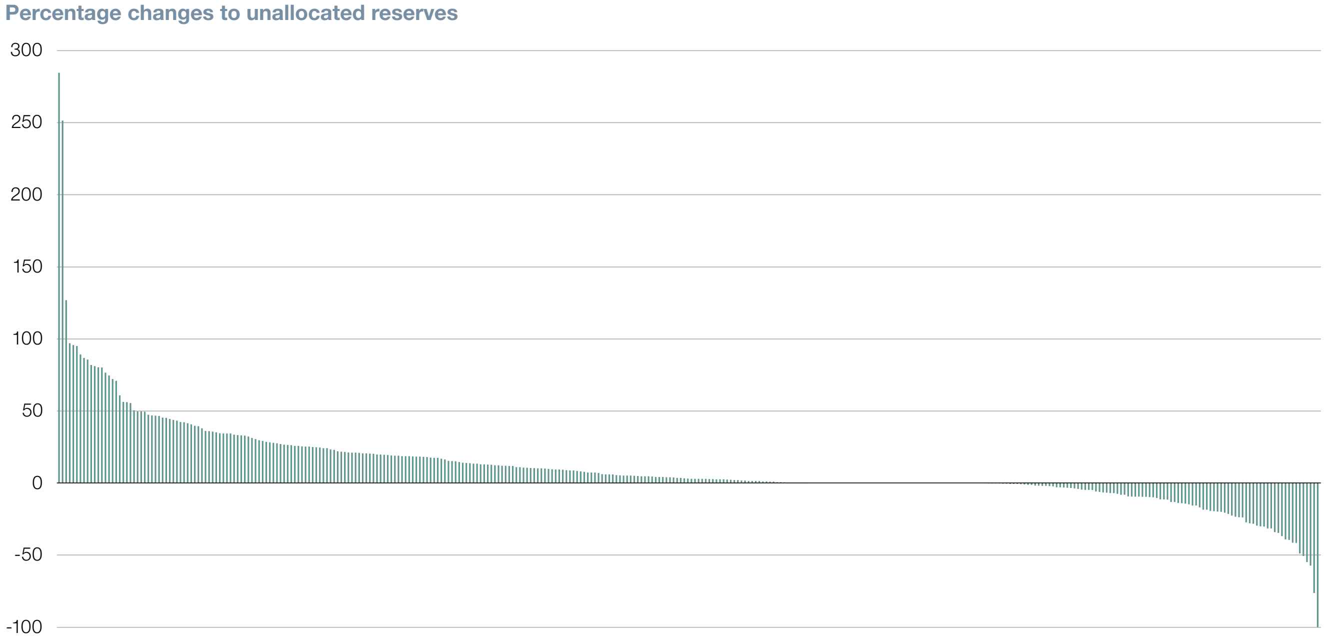
2.10 Local authorities have increased their unallocated general reserves over the last three years, adding £0.7 billion in 2011-12. **Figure 6** shows that the majority of local authorities (209) added to their general reserves in 2011-12. In 2011-12, 93 local authorities used reserves, with 32 (9 per cent) using reserves in both 2010-11 and 2011-12. Local authorities that have used their reserves may, however, not have used them to balance their budgets but to earmark them for specific purposes. This suggests that for most local authorities the primary method of balancing their budgets was reducing spending.[14]

2.11 We looked at whether local authorities using reserves were those with lower levels to begin with. There is no universally accepted level of reserves for a local authority, but we looked at those in the lowest quartile in terms of reserves as a proportion of revenue spending in 2009-10. Five of the 88 authorities in that quartile used reserves in 2010-11 and 2011-12.

Figure 6

Net change to unallocated general reserves as a proportion of total general reserves, 2011-12

Local authorities have increased their levels of unallocated general reserves, but there is considerable variation among local authorities



Source: Local authority revenue outturn data 2011-12

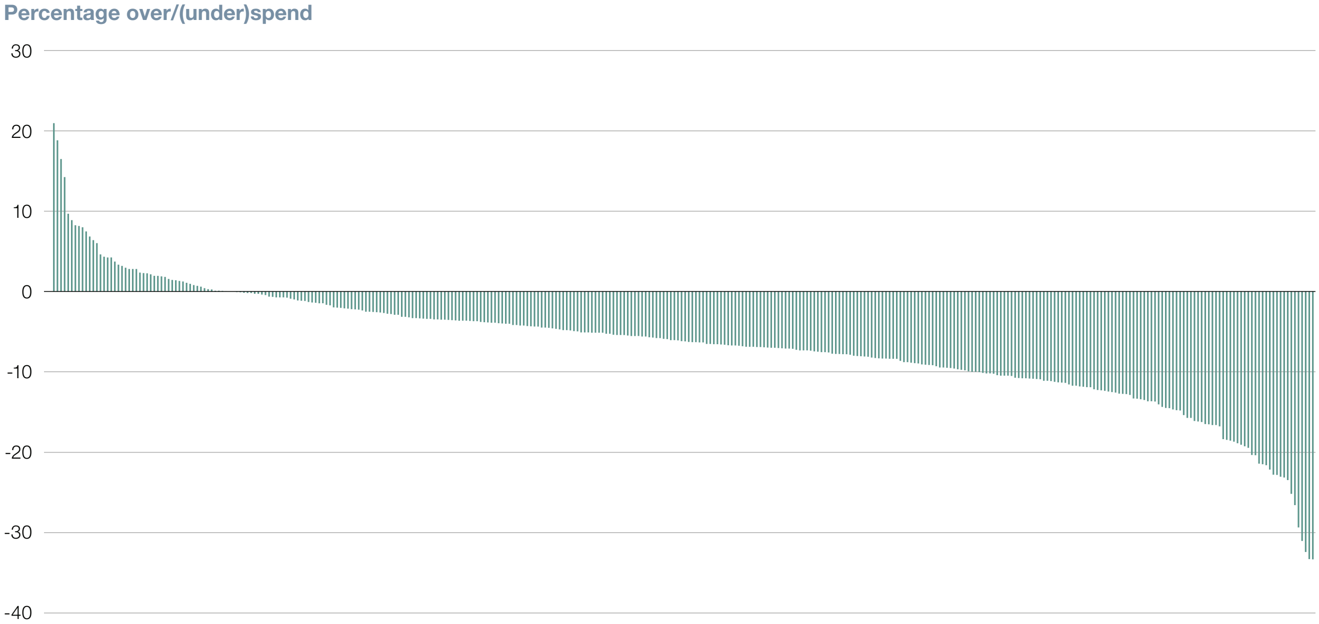
14 The figures in this paragraph are in cash terms.

Local authority performance against budget

2.12 Overspend against budget may show an authority is struggling to make planned reductions; this could, for example, reflect unexpected demand, or financial management difficulties. Local authorities in England underspent on average by 5.4 per cent against budget in 2011-12. **Figure 7** shows the distribution of over and underspends across local authorities. More than 300 local authorities underspent, but looking at performance over time provides a clearer indication of how well local authorities are managing. Some 24 overspent in both 2010-11 and 2011-12.

Figure 7
Local authorities' performance against budget, 2011-12

More than 300 local authorities underspent in 2011-12 against their budget



NOTE
1 One local authority has been excluded due to a data error.

Source: Local authority net revenue expenditure figures in revenue account and revenue outturn data, 2011-12

Part Three

Maintaining financial sustainability

3.1 This part sets out factors influencing medium-term local authorities' financial sustainability. As with the wider economy, local authorities face significant financial challenges, and these pressures are likely to increase. In the December 2012 *Autumn Statement*,[15] HM Treasury announced that public spending to 2017-18 will continue to be reduced at the same rate as over the 2010 spending review period. At the same time, demands for higher-cost local services – social care, for example – are increasing.

3.2 Local authority financial sustainability will depend increasingly on:

- Central government and local authorities managing the financial risks and opportunities.
- Central government making informed funding decisions, by understanding the financial and service delivery circumstances of local authorities, and responding in the light of performance.

Managing the financial risks and opportunities

3.3 This section of the report identifies factors that, depending on how well they are managed, could affect local authorities' financial sustainability. It focuses on:

- having to make savings while demand rises; and
- changes to the system of government funding for local authorities.

The need for savings in the face of rising demand

3.4 Local authorities are continuing to reduce spending to make the savings required in the spending review period to March 2015, and still have to make about half the savings required (paragraph 2.3). This is broadly consistent with information from our contacts with local authorities. Although not necessarily representative, 52 local authorities that responded to our survey estimated that 36 per cent of the total savings identified over the spending review period remain to be delivered, between April 2013 and March 2015. In addition, 34 had not identified how they were going to balance their budgets in 2014-15 with, where they were able to estimate it, the gap ranging from 1 per cent to 14 per cent.

15 HM Treasury, *Autumn Statement 2012*, December 2012, available at: http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf

3.5 Most local authorities expected to achieve the largest savings through efficiencies, though nearly all expected reductions to services to make at least some contribution to their savings targets. Our discussions with local authorities produced a number of examples of steps taken to make savings (**Figure 8** shows three of these).

3.6 The demand for local authority services is affected by factors such as population growth and economic circumstances. One of the ways to manage these pressures for a local authority is to change the eligibility criteria for a given service.

3.7 Local authorities can, for example, change adult social care provision from a service eligibility threshold of 'low' or 'moderate' to a higher threshold of 'substantial' or 'critical'. There has been an upward trend in the last eight years of local authorities raising these eligibility thresholds. By 2012-13, 85 per cent of local authorities had set eligibility at the highest two thresholds (**Figure 9**). This limits the scope for those authorities to find future savings by managing demand in this way.

Figure 8

Examples of local authority savings programmes gained from discussions with senior local authority officers

Norwich City Council

Between 2009-10 and 2012-13, Norwich City Council reported that its transformation programme made savings of £20 million (equivalent to more than a 33 per cent reduction in its general fund spend). Measures to make savings include renegotiating its IT contract, sharing back-office functions, reducing the number of council offices, and reducing non-core services such as grass verge cuttings.

Cambridgeshire and Northamptonshire County Councils: Local Government Shared Services

In 2010, Cambridgeshire and Northamptonshire County Councils (combined revenue expenditure £807 million in 2011-12) formed Local Government Shared Services, a venture designed to share services with each other and other local authorities. The councils forecast to have made cumulative savings of £9.5 million by the end of 2012-13, some 11.4 per cent of the venture's initial running costs. They are making savings by reducing staff, reducing the amount of leased office space, and re-tendering IT contracts. During 2012, Local Government Shared Services entered into partnership agreements with Norwich City Council to provide finance and IT services, and claimed to have secured immediate annual savings of £1.5 million.

London Borough of Brent

Brent's 'One Council' programme was reported to enable Brent to deliver £15.6 million in savings in 2010-11, representing 6 per cent of Brent's total general fund budget of £265.5 million. Brent is forecasting annual savings of £2.6 million by bringing all staff under one roof. It has also joined a group of six local authorities, which are making savings by jointly purchasing adult social care.

NOTE

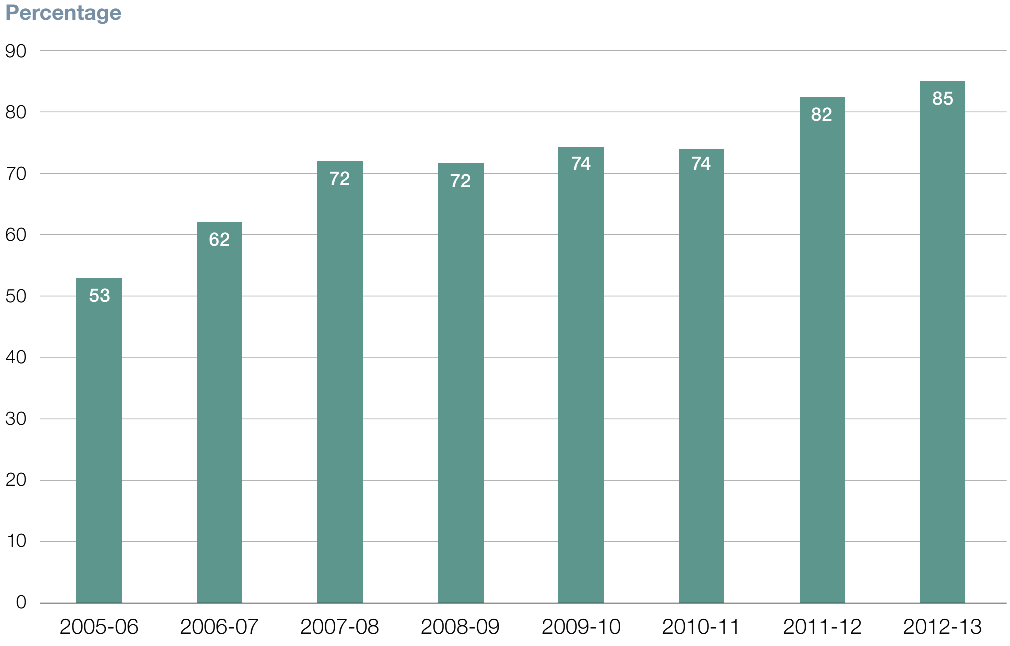
1 All figures are in cash terms.

Source: National Audit Office

Figure 9

Local authorities setting eligibility thresholds for adult social care of ‘substantial’ or ‘critical’, April 2005 to March 2013

An increasing number of local authorities since 2005-06 only offer social care to residents with ‘substantial’ or ‘critical’ needs



NOTE

1 This figure only applies to those 152 local authorities which deliver social care.

Source: National Audit Office analysis of Commission for Social Care Inspection, Care Quality Commission and Association of Directors of Adult Social Services data

3.8 When local authorities change their service levels, they must be able to show they are meeting their statutory obligations. As part of a wider package to save £300 million over four years, Birmingham City Council planned in 2011 to fund adult social care only for those whose needs were judged to be ‘critical’. A judicial review found the Council undertook inadequate analysis to understand the impact of this decision versus the alternatives for making savings elsewhere. It ruled that the decision-making and consultation processes failed to ask the right questions, and found the decision to be unlawful. This led to the Council reinstating its adult social care services for people with ‘substantial’ needs and looking for savings elsewhere.

3.9 Service level changes in one area can affect another. Recent research has demonstrated, for example, that greater spending on social care is related to lower delayed hospital discharge rates and emergency readmissions.

3.10 Library services are also coming under pressure. In a recent report, the House of Commons Culture, Media and Sport Committee drew attention to findings of a local authority survey carried out by the Chartered Institute of Library and Information Professionals.[16] This showed that across the 82 authorities which responded, in 2011-12, library budgets were reduced by £37.7 million (a 7.3 per cent drop in cash terms from the year before). Of those that responded, 84 per cent expected to reduce staff, with 14 per cent expecting to close libraries, in 2011-12. The Committee noted that a number of local authorities faced judicial reviews as a result of deciding to close libraries.

Changes to the system of funding local authority services

3.11 Paragraph 1.12 and Figure 2 show many changes that will alter the local government financial landscape. In the following paragraphs we focus on two major reforms planned for April 2013:

- Financially the most significant change is that, as a result of the local government resource review, the Department for Communities and Local Government (the Department) is ending the Formula Grant system and changing how it distributes business rates (£21.5 billion in 2010-11) to local government.
- Council tax support will be localised, replacing council tax benefit (£4 billion in 2010-11), and funding for it will 'roll into' the funding system replacing the Formula Grant.

Business rates

3.12 The objective of the local government resource review is to give local authorities greater power over their funding and reduce reliance on central government as the major provider of financial support. Business rates are one of the main sources of funding for local authorities. These are collected locally then pooled nationally, to be redistributed to local authorities through the Formula Grant. The Formula Grant is allocated according to a formula that considers local authorities' needs and ability to raise resources through council tax.

3.13 The Department is changing this system. From April 2013, local authorities will keep a share of any growth in business rates in their area as an incentive to promote local business growth. Local authorities as a whole[17] will retain approximately fifty per cent of business rate income (the 'local share'). They will pay the remaining amount into a central government pool (the 'central share') to be redistributed to local authorities through a grant called Revenue Support Grant.

16 HC Committee of Culture, Media, and Sport, *Library closures*, Third Report of Session 2012-13, HC 587, November 2012.
17 This includes fire authorities.

3.14 The Department is aiming to smooth the transition from the old system. It will ensure that each local authority's allocation for the first year (2013-14) is similar to what it would have received in that year, had the Formula Grant continued. For this the Department calculated for each individual local authority its Revenue Support Grant entitlement and, for the purpose of establishing a funding baseline for the new rates retention scheme, the amount of business rates that it should retain. Authorities expected to collect more business rates than their baseline will pay the difference to central government as a tariff, which will be used to pay for a top-up for authorities estimated not to raise enough business rates relative to their funding baseline. These tariffs and top-ups will be increased by inflation but otherwise are fixed until 2020.

3.15 As tariffs and top-ups are fixed under the new funding arrangements, local authorities that achieve business rate income above their baseline will benefit from the new arrangements. Those authorities that see a fall to below their baseline will have to absorb it. There will be a safety net mechanism so that no local authority's business rate income falls below a certain threshold. The Department is planning to set the threshold in 2013-14 at 7.5 per cent of authorities' baseline funding levels. This baseline figure will in future years be increased in line with inflation.

3.16 The Department modelled the effects of the business rates change to understand the impact of varying the split between the central and the local share, which local authorities would likely receive top-ups and which would pay a tariff, and the costs to central government of the safety net proposals. The main aims were to design the scheme so that there would be an optimum balance of tariff and top-up authorities,[18] and to assess how the safety net mechanism could be set to make it self-financing.

3.17 The new arrangements increase the incentives and opportunities for local authorities. There are also risks that local authorities will need to manage, and the Department will need to monitor. The Department intends to revisit the risks and terms of the new system in 2020:

- Under the current system the short-term risk associated with forecasting business rates rests with central government. From 2006-07 to 2010-11, the Office for Budget Responsibility has overestimated the net yield of business rates in four out of five years. In 2010-11, for example, aggregate business rates were £23.8 billion, £1.1 billion (4.5 per cent) lower than forecast. In 2011-12 receipts were again lower than forecast, though by a smaller amount (£0.4 billion or 1.7 per cent). From 2013-14, local authorities will share the risk associated with any overestimates in the national forecast of business rate.

18 In addition, the Department of Health undertook its own modelling at local authority level to understand the effect of the tariff and top-up system on individual local authorities' ability to provide adult social care.

- Under the current system costs from increased service needs are spread among all local authorities, with those local authorities judged to have higher needs receiving more funding. After the 2013-14 transitional year, allocations to local authorities from the central share will no longer be recalculated annually to include changes in relative need, including the ability to raise council tax. Local authorities with rising service needs and low or negative growth in their business rates will have to manage this within their individual budgets.
- Business rates income has been volatile across individual local authorities. Local authorities will soon have to manage the impact of volatility for half of its impact from business rates (the local share) up to the safety net. This increases the income uncertainty for local authorities and increases their planning challenge and financial risk which may impact on the level of reserves needed.

Localisation of council tax support

3.18 In 2010-11 the Department for Work and Pensions provided funding of £4 billion for council tax benefit. From April 2013, local authorities must implement their own council tax support schemes instead of paying benefits set by the government. In preparation, the Department for Communities and Local Government modelled, for individual local authorities, how much they could save if they reduced council tax discounts for non-pensioners. It also analysed the impact of reducing funding for council tax benefit by 10 per cent on local authorities' budgets.

3.19 Under the new arrangements the central government funding available nationally to local authorities will be 90 per cent of what it would have been in 2013-14. Rather than being paid as a demand-led grant as under the current system, this funding will be 'rolled into' the new revenue funding system replacing the Formula Grant system. This presents risks local authorities will need to manage:

- Council tax benefit claimant numbers have been on a rising trend, including a rise of 10 per cent from April 2009 to March 2011, which has levelled off in the last year. In future, local authorities will have to manage any changes in council tax benefit claimant numbers. The forecasts published by the Office for Budget Responsibility show a fall in council tax benefit claimant numbers, due to factors such as increased pension age and projected recovery from recession.
- Local authorities have flexibility about how much of the 10 per cent funding reductions they absorb themselves, and how much they pass on as benefit reductions to working age claimants. To the extent they maintain existing entitlements they will have to find corresponding savings elsewhere. Where they pass on some or the entire shortfall to claimants, they will face difficult decisions in how they design their schemes. One potential risk, highlighted to us in interviews with local authority finance directors, was that if they reduce the support they give unemployed claimants, this might lead to collecting small amounts of council tax from residents who were previously exempt. This would increase the cost of council tax collection.

Cumulative effect of changes

3.20 The cumulative effects of these changes will vary and depend on wider economic conditions. Local authorities with higher economic growth may experience a rise in business rate income and a fall in council tax support claimants. Conversely, if local authorities experience economic decline business rates income may fall, and the number of council tax support claimants may rise. It will therefore be increasingly important to evaluate and monitor the combined effects of changes that affect local authorities as a whole and individually.

3.21 The Department for Communities and Local Government has recently started to provide the basis for such an analysis, by assessing the combined impacts of a range of changes, such as the reform to the distribution of business rates and the localisation of council tax support, on the financial risk profile of individual local authorities. The Department should further build on this work to understand the impact of funding changes on local authorities' overall financial position.

Informed decision-making

3.22 Central government's decisions have a fundamental impact on the financial position of local authorities and the services they provide. The levels and methods of government funding, and restrictions on local authorities' flexibility to increase council tax without seeking the approval of the local electorate, directly influence the spending power of local authorities. In addition, central government policies are implemented through statutory service obligations on local authorities. Central government has sought to reduce the information burdens from central departments on local government, for example by abolishing the Comprehensive Area Assessment. It is therefore important that departments understand whether the information they collect is the right information they need to assess the potential and actual effects of their decisions.

3.23 Our work shows departments have worked to assess the potential effects of business rates reform and council tax support localisation (paragraphs 3.16 and 3.18). Departments were also engaged in the thinking that led to the funding reductions as a result of the 2010 spending review.

3.24 HM Treasury, the lead department for the spending review, asked departments to propose a range of savings options. The Department for Communities and Local Government coordinated the spending review input on local government funding. The Department liaised with other departments with policy responsibilities for the local services that central government funds – the Department of Health, the Department for Education, the Department for Environment, Food and Rural Affairs, and the Department for Transport.

Information used for the spending review

3.25 The Department for Communities and Local Government asked the other departments to estimate local authorities' funding pressures, and how they could reduce spending by 25 per cent and 40 per cent. Departments modelled pressures on costs, how much could be saved through efficiency measures, and how much local authorities could save if they reduced or changed services while meeting their statutory responsibilities. Understanding the scope for efficiency savings is important to assess the level of funding reductions that can be absorbed without affecting services.

3.26 We looked at the information that three of the five departments involved in this exercise used. We did not assess the detailed methods used; our focus was on the scope of their analysis.

3.27 Consistent with our report on *Managing budgeting in government*,[19] which looked at a larger sample of spending review submissions, not all these departments could give the full range of information (see **Figure 10**). For example, the Department for Education could not give an estimate of cost pressures and the scope for savings across the entirety of children's services. The Department for Education told us that while it monitors national and local spending on children's services, it considered that it was not appropriate to model cost pressures and potential savings for the spending review at an aggregate level, as local authorities have discretion in how they discharge many of their statutory duties.[20] It did, however, consider pressures and scope for efficiencies in a number of major areas of spend, such as services for 'looked after' children. In this case, therefore, the Department for Communities and Local Government assumed that the aggregate cost pressures for children's services would not be greater than inflation, and that local authorities could make savings at a flat rate of 15 per cent over the spending review period.

3.28 In addition, departments did not break down their analyses to identify regional or other variations. For example, they did not consider the demand for, or cost of, services and therefore how far individual local authorities could make the estimated savings.

3.29 The Department for Communities and Local Government assessed the scope for local efficiencies in setting the overall level of the Formula Grant. However, it was not based on explicitly assessing local authorities' statutory service obligations. This is a complex area. There is no direct link between statutory obligations and the cost of services, because local authorities mostly have freedom to decide how to provide services and the priority they give them.

19 Comptroller and Auditor General, *Managing budgeting in government*, Session 2012-13, HC 597, National Audit Office, October 2012, available at: www.nao.org.uk/publications/1213/managing_budgeting.aspx
20 Separate to the spending review, the Department for Education has worked with the Association of Directors of Children's Services to share good practice in reducing the costs of providing children's services.

Figure 10
Information used as part of the 2010 spending review

Departments provided a range of information to HM Treasury and Department for Communities and Local Government during the 2010 spending review process

	Department of Health	Department for Education	Department for Environment, Food and Rural Affairs
Estimated above-inflation spending pressures on local services	✔ (monetary)	✔ (non-monetary)	✔ (monetary)
Estimated efficiency savings or savings through reducing services offered, or both	✔ (monetary)	✔ (non-monetary)	✔ (monetary)
Estimated potential impacts of savings on local services	✔ (monetary)	✔ (non-monetary)	✔ (non-monetary)
Analysis broken down by region or types of local authorities	✗	✗	✗

✔ department provided a monetary or quantitative description

✔ department provided a non-monetary or qualitative description

✗ department did not provide this analysis

NOTE
1 While the Department for Education did not provide quantitative descriptions on an aggregate level for children's services, it undertook cost modelling for individual children's services, such as costs associated with services for 'looked after' children.

Source: National Audit Office analysis of departments' submissions to HM Treasury during the 2010 spending review

Deciding the priorities

3.30 An important part of the government's work in deciding the level of the Formula Grant, in total and for individual local authorities, was to decide policy priorities and the weight attached to individual service areas. The pressures on providing care for adults and children are increasing, along with increases in other areas such as households falling within the statutory definition of homeless (up 45 per cent from 2010). In July 2011, the Commission on Funding Care and Support projected that, without change to the current system of adult social care, the cost of this service would rise from £14.5 billion in 2010-11 to £19.0 billion by 2020-21. In addition, in the period 2007 to 2012, local authorities saw an 11.8 per cent increase in 'looked-after' children.[21]

21 'Looked after' refers to those children who are taken care of by the state.

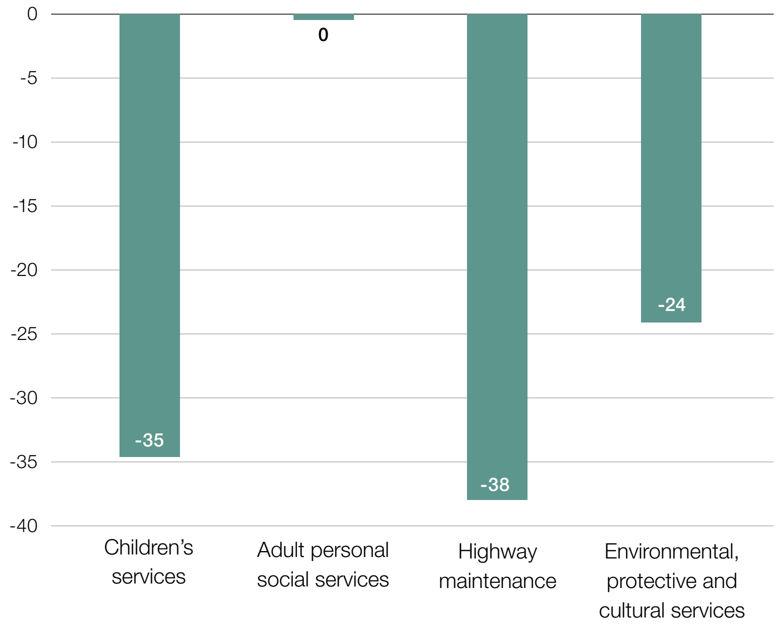
3.31 Figure 11 shows that the government attached the highest priority to adult social services in deciding on one of the key elements of the formula determining the distribution of the Formula Grant, the weight given to the various relative service needs.[22] In practice, local authorities decided to spend their income differently. For the three years ending in 2012-13, the lowest reduction in local authority spending is for children's services (Figure 5). Some local authorities we spoke to attributed this to increased demand for children's services and their concern to avoid the human and reputational risks attached to the failure of that service.

Figure 11

Changes to the weight given to the relative service needs in the Formula Grant formula, April 2010 to March 2013

The government decision to 'protect' the relative needs in adult social care in the calculation of the Formula Grant allocation led to larger reductions in the weight given to other relative service needs

Percentage change in the shares of relative service needs in the Formula Grant formula over the period April 2010 to March 2013



NOTE

1 Figures rounded to the nearest percentage point.

Source: National Audit Office calculation using Annex E from the annual local government finance reports for 2010-11 to 2012-13

22 The government allocates the Formula Grant to local authorities, among other factors, based on the relative needs of each local authority by service. Each service has its own relative needs formula, which takes into account the different factors affecting the cost of the delivery of the various local services. This relative needs formula allows each local authority's relative need share to be calculated. The percentage reduction in the shares of each local service do not equate to a specific grant reduction for these service areas, because the relative needs formulae are only one component of the elements that determine the Formula Grant a local authority receives. The final allocation of the Formula Grant depends also, for example, on the relative ability of the local authority to raise council tax, and on other grants being rolled into the Formula Grant.

3.32 As the Formula Grant paid to local authorities is 'un-hypothecated' (meaning they have complete discretion over how to spend it in meeting their responsibilities), local authorities do not have to spend it in line with central government priorities. Central government also does not expect local authorities to spend their resources in line with its priorities. It will be important, however, for the Department for Communities and Local Government to understand why local authority spending patterns are different from central government priorities to be able to adequately inform future funding decisions.

Maintaining financial sustainability and understanding financial failure

3.33 We considered a range of indicators, such as levels of local authority reserves and projections of service demand, to see what they showed about financial sustainability. Individually and collectively, however, they proved inconclusive. Moreover, financial sustainability depends on factors that go beyond the financial balance sheet. These include the strengths of financial management and governance arrangements. Coming to a view of the likely financial sustainability of a local authority using a single set of indicators is therefore problematic, and needs to consider local circumstances.

3.34 The Audit Commission surveyed local authority auditors and analysed budget outturns. It estimated that, in 2011-12, 9 per cent of local authorities experienced 'high financial stress' – meaning that they undertook unplanned in-year financial actions, for example using reserves, and were considered by their auditors as having had financial problems. Local auditors identified 12 per cent of local authorities were at an ongoing risk of being unable to balance their budgets in future financial years.[23]

3.35 In its *Accountability System Statement*, the Department for Communities and Local Government's (the Department's) Accounting Officer (the Permanent Secretary) sets out arrangements for giving accountability to Parliament for its spending on local government.[24] In addition, other departments that give grants to local authorities have also produced statements about local government which set out the accountability arrangements for the local services within their policy responsibility.

3.36 The Department's *Accountability System Statement* emphasises preventing failure through local government systems. Most important of all of these is the role of democratically elected members of local authorities acting in full council, cabinet or, in the case of a directly elected mayor, using their executive powers. To support this, there is the role of scrutiny committees, local authority audit committees, and systems of internal control captured in the council's standing orders and associated regulations.

23 See Audit Commission, *Tough Times 2012*, November 2012, p. 36, available at: www.audit-commission.gov.uk/nationalstudies/localgov/Pages/toughtimes2012.aspx

24 Department for Communities and Local Government, *Accounting Officer Accountability System Statement for Local Government*, March 2012, available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/6264/2110027.pdf

3.37 This structure is supported by the council's appointed officers. In particular, at the core of the council there are three corporate officers that each local authority must have by statute. These are the head of paid service (usually the chief executive), the monitoring officer (usually the chief legal officer), and the chief financial officer as determined by section 151 of the Local Government Act 1972 (usually the Director of Finance or Resources).

3.38 The section 151 officer is particularly important for financial sustainability. If a local authority does not set a balanced budget or spending materially exceeds the budget, the section 151 officer is obliged to make a report (called a section 114 report). The council is required to meet to discuss the report. This power has the effect of forcing the council to take action to bring the budget back to balance. Section 114 reports have rarely been made in recent years and are, generally, considered to be an action of last resort. The power has been in place for more than 20 years. That it has rarely been used may suggest that the mechanisms in place for managing financial pressure locally have been reasonably effective against the circumstances local authorities have faced so far.

3.39 Informed decision-making requires a feedback loop so that adjustments can be made in the light of performance, with evidence of potential difficulties being identified early enough to allow timely intervention. The Department has a range of information to help identify the impending financial failure of a local authority:

- In our 2012 report, *Central government's communication and engagement with local government*,[25] we found that local authorities viewed positively the Department's arrangements for around 70 'locality leads'. These senior officials spend between 5 and 10 per cent of their time familiarising themselves with authorities in a region, sharing information and good practice, and facilitating access including to other government departments. The informal contacts they make give them insight into the challenges, including financial challenges, local authorities are facing.
- The Local Government Association[26] coordinates support to local authorities, including peer challenges to help them improve performance. The Association has also developed an online tool, LGInform, which draws together comparative data across all local authorities. The tool is currently available to all local authorities but from summer 2013 will be available to the public and allow all users to compare performance and spend information. The Association meets with departmental officials to discuss matters of general concern to local government.
- Local auditors give an annual conclusion on arrangements to secure value for money and financial resilience which is published as part of the auditor's report on the accounts. The auditor will report to the council if there are any issues arising from their value-for-money work. The Department does not systematically review all audit reports but may consider them on an ad hoc basis if serious issues arise.

25 Comptroller and Auditor General, *Central government's communication and engagement with local government*, Session 2012-13, HC 187, National Audit Office, June 2012, available at: www.nao.org.uk/publications/1213/central_and_local_government.aspx

26 The Local Government Association is a voluntary membership organisation representing councils and councillors, funded by government grants and member subscriptions.

3.40 Under section 15 of the Local Government Act 1999, the Secretary of State has powers to intervene by directing an authority to take particular actions, and ultimately by directing another body to take over a council's specific functions. Such intervention is the last resort. The last time this happened was in the case of Doncaster Metropolitan Borough Council following a corporate governance investigation by the Audit Commission in 2010.

3.41 This, and other past cases of central government intervention, have generally related to failures in services or corporate governance, or both, rather than to councils being in financial difficulty. Within the past year evidence of councils at risk of becoming financially unviable has emerged, but it is too early to say whether this represents a trend of councils becoming financially unsustainable. The most widely reported examples so far are:

- West Somerset District Council, which is at risk of being unable to provide its statutory services to an acceptable minimum; and
- Birmingham City Council, which has indicated that a potential liability of over £750 million in equal pay claims against the Council would impact on its financial resilience and the resources available to provide services.

3.42 The interventions to date have largely dealt with individual local authorities. To date there has not been widespread financial failure in the sector. How the system responds in the case of multiple failures during possibly more challenging times for local authorities is therefore at present untested.

Appendix One

Our audit approach

1 This study gives an overview of the reductions and reforms to the funding of local authorities during the 2010 spending review period. Its focus is on the implications of these changes to funding on the financial sustainability of local authorities, which we define as meeting their financial and service obligations.

2 There were three main elements to our work:

- We analysed the key implications of these funding reductions and reforms on local authority income.
- We analysed how local authorities have managed their budgets in the first two years of the spending review.
- We reviewed what information government departments have to understand the impact of the reforms and local authorities financial sustainability.

3 Our audit approach is summarised in **Figure 12**. Our evidence base is summarised in Appendix Two.

Figure 12
Our audit approach

The objective of government

Central government's objective
Over this spending review period, the government intends to reduce funding of local government while giving local authorities more spending flexibility and incentives to promote local growth.

Local government's objective
Local authorities are subject to statutory requirements to provide a range of services while balancing budgets, and remaining accountable to their local electorate.

How this will be achieved

The government is reducing funding for local authorities while reforming business rates, and removing the ring-fencing for some grants.

Local authorities are pursuing a range of measures to reduce spending.

Our study

The study examined the implications of funding reductions and reforms on local government financial sustainability, and the information central government has on the impact of funding changes and about local government financial sustainability.

Purpose of our examination

To determine the implications for local authority finances.

To review how far departments understand the impacts of funding changes.

To analyse how local authorities are responding to funding changes.

Our evidence
(see Appendix Two for details)

We examined departmental documents, nationally available data sets on local authority finance and interviewed officials.

We interviewed officials and reviewed departmental documents.

We interviewed finance directors, treasurers' societies, and stakeholders; analysed local authority financial positions; and surveyed finance directors.

Our conclusions

So far, local authorities have generally been able to absorb central government funding reductions. However, there is emerging evidence that some service levels are reducing. Funding reductions are continuing, along with changes to the resourcing mechanism of local authorities. These changes increase financial uncertainty and more local authorities are facing the challenge to avoid financial difficulties while meeting their statutory responsibilities. This risk will not manifest itself evenly across the sector, with some local authorities being more affected than others.

This risk must be identified early so it can be managed effectively. The Department for Communities and Local Government will need arrangements to detect where risks will emerge. Its response will need to be flexible and coordinated with local and sector-wide support mechanisms. Central government must also satisfy itself that it understands the cumulative impact of funding changes and can make informed decisions about the funding required for local authority services.

Appendix Two

Our evidence base

1 Our independent conclusions arising from our report on financial sustainability of local authorities were reached following our analysis of evidence collected between June and December 2012.

2 We applied a range of quantitative and qualitative techniques in our examination. Our audit approach is outlined in Appendix One.

3 We analysed key national data sets for local authority finances, including the Department for Communities and Local Government *Local Government Finance Statistics England* and local authority revenue account and revenue outturn data which the Department for Communities and Local Government collects.[27] The *Local Government Finance Statistics England* contains the latest authoritative figures on local government grants. However, as the most recent publication (June 2012)[28] only covers 2010-11, we could only provide figures for that financial year in our overview of local government finances in Part One.

4 We estimated the proportion of 2010 spending review savings that local authorities achieved by comparing their planned reduction in their revenue expenditure between April 2010 and March 2013 with HM Treasury's forecast reduction in local government spending announced during the 2010 Spending Review. The Audit Commission provided us with local authorities' revenue spending figures, based on their analysis of local authorities' revenue account data. This showed that local authorities reduced their spending by £4.6 billion from April 2010 to March 2013. In their *Tough Times 2012* report the Audit Commission provides a figure of £5 billion for the equivalent period. This difference is due to the Audit Commission including 2010-11 in-year cuts and local authorities' planned use of reserves in their calculation, presenting the figures at 2012-13 prices, and excluding council tax.

27 For 2011-12, we used provisional revenue outturn data.
28 Department for Communities and Local Government, *Local Government Finance Statistics England*, Number 22, June 2012, available at: www.gov.uk/government/publications/local-government-financial-statistics-england-no-22-2012

5 We report the proportion of total expenditure for each local service area and the change in service expenditure by local authority service area based on analysis and data provided by the Audit Commission. In their *Tough Times 2012*, the Audit Commission used the same data to calculate change in service expenditure by local authority service area. However, the Audit Commission presented median changes in service area spend rather than aggregate changes across all local authorities. As a result the figures presented in *Tough Times 2012* differ slightly from the figures presented in our report.

6 We examined departmental documents setting out the details of a number of funding reductions and reforms:

- Reductions in overall central government funding to local government over the spending review period.
- Reforms to business rates.
- Localisation of council tax support.

7 We reviewed how government departments modelled and monitored the impacts of these funding reductions and reforms on local authority financial sustainability.

8 We conducted 27 semi-structured interviews with central government staff to understand:

- how far departments monitor local authorities' financial sustainability and statutory service delivery; and
- departmental accountability and assurance regimes.

9 We reviewed files of published and internal departmental documents to assess how departments considered local authorities' financial sustainability and statutory service delivery, including:

- accountability system statements;
- business planning papers and spreadsheets;
- consultation documents and impact assessments; and
- modelling of reforms to funding.

10 We conducted analysis on data of local authorities' eligibility thresholds for adult social care collected from Commission for Social Care Inspection, Care Quality Commission and Association of Directors of Adult Social Services. We are aware that Age UK has published data on eligibility thresholds for adult social care by local authority.[29] This data shows minor differences in some years when compared to the data we used. However, Age UK does not provide data for the years 2008-09, 2009-10 and 2012-13 which is why we have used different data sources. Please also note that in 2008-09, 2010-11 and 2011-12, the Care Quality Commission and the Association of Directors of Adult Social Services received a 98 per cent response rate, while in 2012-13, the Association of Directors of Adult Social Services received a 95 per cent response rate. We have also used research carried out by Jose-Luis Fernandez and J. Forder which demonstrates that greater spending on social care is related to lower delayed hospital discharge rates and emergency readmissions.[30]

11 We conducted eight semi-structured interviews with local authority financial directors (and one chief executive). The purpose of the visits was to understand each local authority's financial position and operating context, and how they responded to central government funding changes. We visited:

- Boston Borough Council (District);
- Brent Council (London Borough);
- Cheshire East Council (Unitary);
- Kirklees Council (Metropolitan);
- Norwich City Council (District);
- Nottinghamshire County Council (County);
- Wandsworth Borough Council (London Borough); and
- Westminster City Council (London Borough).

12 We conducted semi-structured interviews with representatives from the five societies of local authority treasurers to hear their views about central government funding changes:

- Society of District Council Treasurers
- Society of County Treasurers
- Society of London Treasurers
- Society of Municipal Treasurers
- Society of Unitary Treasurers

29 Age UK, Social care eligibility thresholds briefing, available at: www.ageuk.org.uk/Documents/EN-GB/For-professionals/Research/Eligibility_thresholds_briefing.pdf?dtrk=true.
30 Jose-Luis Fernandez and J. Forder, 'Consequences of local variations in social care on the performance of the acute health care sector', *Applied Economics*, vol. 40, Issue 12, 2008, pp. 1503–18.

13 We do not have the access right to local authorities. However, in an effort to capture the range of views across the local government sector we surveyed for the first time all local authority finance directors across England to understand existing and planned revenue expenditure and anticipated savings and budget gaps. We received 52 responses, a response rate of 15 per cent:

- London Councils: 15 responses;
- Unitary Councils: 10 responses;
- Shire County Councils: 10 responses;
- Shire District Councils: 8 responses; and
- Metropolitan District Councils: 9 responses.

14 We conducted semi-structured interviews with stakeholders with knowledge and expertise in local government finance to understand the implications of a range of funding reductions and reforms. We interviewed representatives from:

- the Local Government Association;
- the New Local Government Network;
- the Special Interest Group of Municipal Authorities;
- Grant Thornton;
- The Association of Chartered Certified Accountants;
- The Institute of Fiscal Studies;
- Local Government Futures; and
- London Councils.

15 Throughout the landscape review, we set up an expert panel that provided independent scrutiny and advice to the study team.

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ISBN 978-0-10-298126-1

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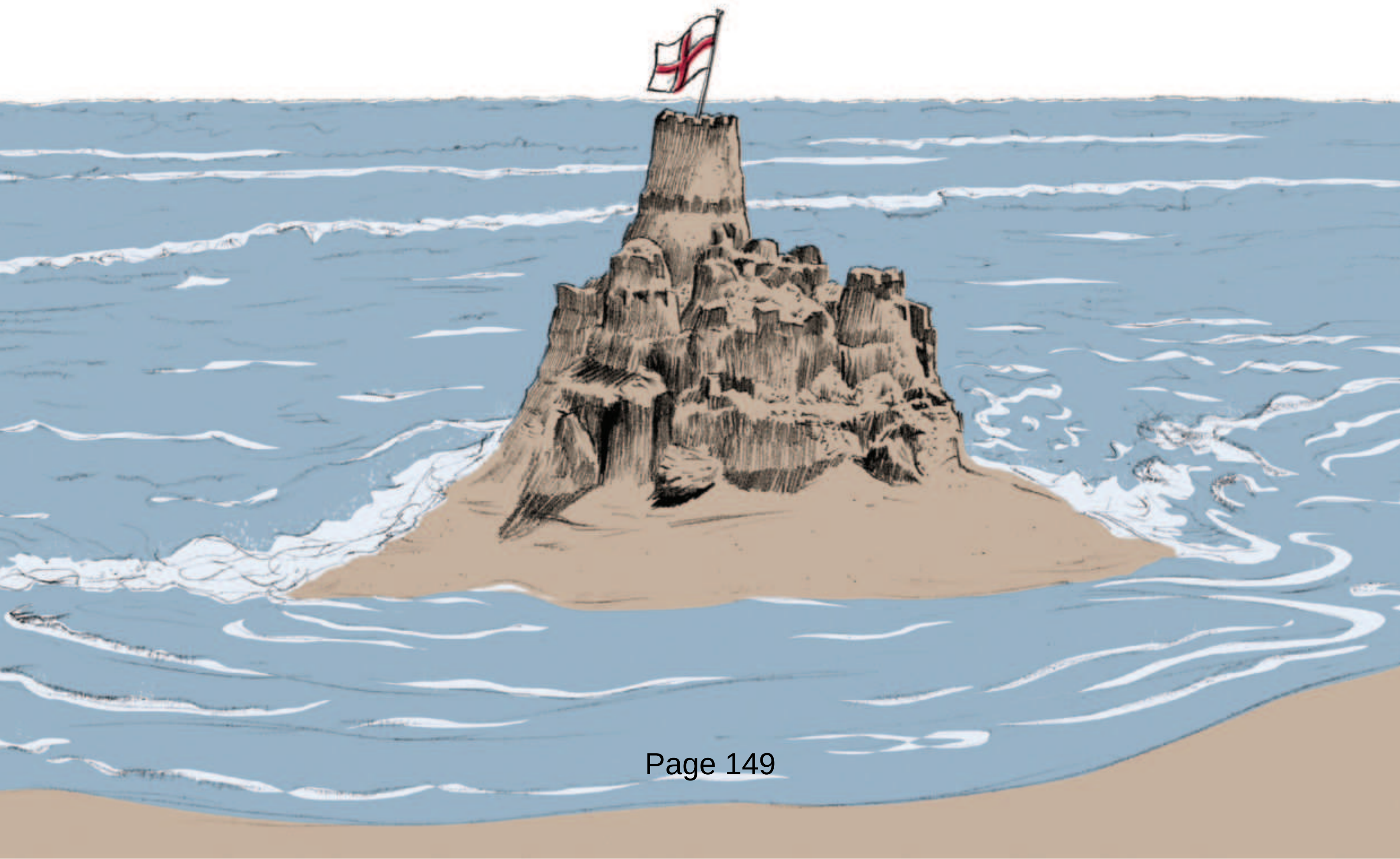
Towards a tipping point?

Summary findings from our second year of financial health checks of English local authorities
December 2012



Contents

Introduction

With financial austerity due to continue until at least 2017, our financial health review considers key indicators of financial performance, financial governance, strategic financial planning and financial controls, to provide a summary update on how the sector is coping, drawing comparisons with last year's findings.

Background

We published our report 'Surviving the storm: how resilient are local authorities?' in December 2011. The report examined the resilience of local government in responding to the financial, economic, demographic, policy and other challenges the sector was facing, and how prepared it was for the first year of the front-loaded 2010 Spending Review.

Our analysis was based on a national programme of financial health check reviews undertaken during 2011. We have repeated these reviews during 2012 and this report updates our findings and highlights the trends that are emerging in the sector.

Context

The Chancellor of the Exchequer announced the 2010 Spending Review (SR10) to Parliament on 20 October 2010. This formed a central part of the Coalition Government's response to reducing the national deficit, with the intention to bring public finances back into balance during 2014–15. The Chancellor has subsequently announced that public finances will not be brought back into balance during the lifetime of the current Parliament, and, in his Autumn Statement in November 2011, announced further public spending reductions of 0.9% in real terms in both 2015-16 and 2016-17. Financial austerity will therefore continue until at least 2017, and further funding reductions to local government funding may emerge within the SR10 period.

With or without further funding reductions, the four-year SR10 period (2011–12 to 2014–15) represents the largest reduction in public spending since the 1920s.

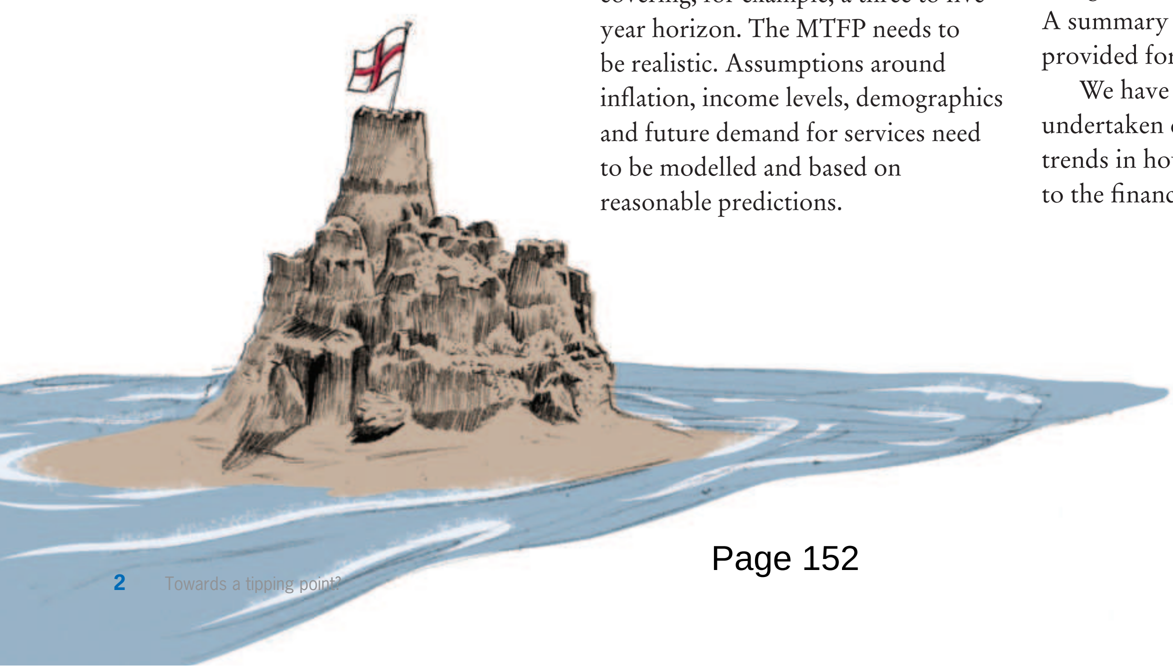
With or without further funding reductions, the four-year SR10 period (2011–12 to 2014–15) represents the largest reduction in public spending since the 1920s. Revenue funding to local government will reduce in real terms by 28% by 2014–15 (excluding schools, fire and police) with local government facing some of the largest funding reductions in the public sector. In addition, local government funding reductions were partially frontloaded, with 8% cash reductions in 2011–12. These reductions followed a period of sustained growth in local government spending, which increased by 45% during the period 1997 to 2007.

The funding reductions come at a time when demographic changes and recession-based economic pressures are increasing demands for services, for example rising demand for social care as well as debt, housing and benefits advice, while demand for some paid-for services is reducing, such as planning and car parking. At the same time, local authorities are managing the implications of the Government's policy agendas – such as those relating to localism and open public services – that could see a significant shift in the way that public services are provided.

Purpose of this report

To meet these significant challenges, local authorities must improve their efficiency and productivity, reduce their costs and have sustainable medium-term financial plans (MTFPs) to ensure their financial health remains robust.

This report provides a summary of the key issues, trends and good practice that have emerged from our second national programme of financial health reviews. The report provides local authorities with an up-to-date picture of how local authorities are coping with the service and financial challenges being faced by the sector. This report draws on benchmarking data provided by the Audit Commission and others, as well as the broad thematic approach adopted by the Audit Commission towards the assessment of the value for money arrangements in place in local authorities.



Our approach

Our analysis is based on reviews of 24 (7%) English local authorities undertaken between May and September 2012. This included a desk top review of key documents and interviews with key stakeholders to validate our findings. Our focus was on the 2012/13 financial planning period and the delivery of 2011/12 budgets and we analysed the following thematic areas:

- **Key indicators of financial performance**
  It is critical that local authorities maintain appropriate levels of reserve balances, regularly monitor their liquidity and long-term borrowing levels, deliver against planned budgets, and effectively manage unplanned staff absences.
- **Strategic financial planning**
  Local authorities need to be setting their budget in the context of a longer-term financial strategy and an MTFP covering, for example, a three to five year horizon. The MTFP needs to be realistic. Assumptions around inflation, income levels, demographics and future demand for services need to be modelled and based on reasonable predictions.
- **Financial governance**
  The quality of financial governance and leadership is critical in meeting the financial management challenges facing authorities, and for securing a sustainable financial position. Good basic systems, processes and controls are important, but it is the overall financial culture that makes the difference.
- **Financial controls**
  Local authorities need to manage within their budgets. They therefore need to have a robust way of challenging budget monitoring and reporting arrangements to ensure they are fit for purpose, and that they can respond to the ever greater need to demonstrate value for money and achieve efficiencies.

Within each of these themes advised by the Audit Commission, we identified a number of sub-categories (outlined in Table 1) and gave each a risk rating using the criteria provided in Table 2. A summary risk rating was also provided for each thematic area.

We have also drawn on our analysis undertaken during 2011 to identify trends in how the sector is responding to the financial challenges it faces.

Table 1 Themes and sub-categories for analysis

Theme	Sub-category
Key indicators of financial performance*	Liquidity Borrowing Workforce Performance against budget Reserve balances Schools balances (for single tier and county council authorities)
Strategic financial planning	Focus of the MTFP Adequacy of planning assumptions Scope of the MTFP and links to annual planning Review processes Responsiveness of the plan
Financial governance	Understanding the financial environment Executive and member engagement Performance management of budgets Accuracy of committee/cabinet reporting
Financial controls	Performance management of budgets Performance against savings plans Key financial accounting systems Finance department resourcing Internal audit arrangements External audit arrangements

Table 2 Risk-rating criteria

Green	**Arrangements meet or exceed adequate standards** Adequate arrangements identified and key characteristics of good practice appear to be in place.
Amber	**Potential risks and/or weaknesses** Adequate arrangements and characteristics are in place in some respects, but not all. Evidence that the authority is taking forward areas where arrangements need to be strengthened.
Red	**High risk** The authority's arrangements are generally inadequate or may have a high risk of not succeeding.

***Note on indicators used**

While undertaking this year's programme of health checks we have had a considerable amount of debate on what are the most appropriate KPIs for local authorities' financial performance, both in terms of the type of ratio, and the industry standard of the ratios being applied. We will continue to use the ratios we have used during our first two national programmes of health checks but will ensure that, where alternative ratios are being applied by authorities, they will be identified and discussed in our 2013 report.

Towards a tipping point?

While authorities met their 2011–12 targets as they anticipated, the confidence in achieving targets in the medium-term has fallen since last year. With many factors leading to an uncertain environment in which to set financial plans, is a critical point coming where local authorities can no longer deliver?

Our 2011 review identified a somewhat surprising level of confidence in the sector that savings targets would be achieved during 2011–12, given the context that this was the first year of SR10. Was this confidence accurate or misplaced? Our 2012 programme of reviews indicates that the sector was right to be confident as most local authorities in our sample have been able to deliver against their 2011–12 budgets, indicating the continued effective leadership of senior management and elected members.

Our 2011 review also identified that this confidence diminished when discussing the medium-term. Has this position for the medium-term improved, or are the storm clouds growing ever darker? The one area where the trend between 2010–11 and 2011–12 has seen a reduction relates to the increasing level of risk associated with strategic financial planning. The challenges facing the sector remain significant and the confidence for the medium-term is, understandably, generally weaker. Tough decisions have again been made when setting the 2012–13 budget, but managing the on-going implementation of these decisions and their impact on service users and staff will not be easy.

Historically, as a sector, local government has typically delivered whatever central government of all parties has asked of it over the past 30 years, such as the localisation of housing benefits, introduction of the Community Charge and then the Council Tax, Local Government Reorganisation (many times), and annual Gershon efficiency targets.

Our analysis of 2011–12, the first year of SR10, indicates the sector continues to deliver. However, local government's resilience over the medium-term remains far less certain. At the time of writing, we are half-way through the term of the current, fixed Parliament, but only 25% of the Government's fiscal consolidation plans have been implemented, with the majority still to be delivered over the next two and a half years.

Factors leading to uncertainty in local government financial planning include:

- the delivery of on-going SR10 funding reductions, with possible further funding reductions during this spending review period, and a lack of certainty of the funding landscape post 2015
- the weakness of the economy which both depresses income sources and increases local government welfare related spending
- the timing of the 2013–14 Local Government Finance Settlement, which at the time of writing is due to be late December 2012, providing a very limited lead in period to feed into the 2013–14 financial planning cycle
- restrictions on local authorities to generate additional funding by increasing Council Tax during 2013–14 due to the Government's effective freezing of the tax for a further year
- the opportunities and challenges that arise from the localisation of business rates, the reduction to Council Tax benefit funding, and the introduction of the universal credit
- the consequences of implementing the Government's policies, such as academies, health and wellbeing boards, Local Enterprise Partnerships and the Localism Act
- the pressures of an ageing population with an increasing complexity of need impacting on social care delivery, a key spending pressure area
- limitations on the ability to finance capital projects.

Will delivering services in this context be any different to the recent past? Our analysis and discussions with the sector indicate that a 'tipping point' is on the horizon, but what form this could take remains unclear. A tipping point has been described as the critical point in an evolving situation that leads to a new and irreversible development.

We have identified a number of scenarios for such a tipping point. These relate to an individual local authority, rather than the local government system as a whole:

- **Statutory** – where a local authority can no longer meet its statutory responsibilities to deliver a broad range of services within the funding available, leading to legal challenges and protests from impacted stakeholders.
- **Financial** – where the Section 151 Officer is unable to set a balanced budget, leading in the first instance to an unbalanced budget report to members in line with Section 114 of the Local Government Finance Act 1988 (England and Wales); or where the increased uncertainty leads to budget overspends of a level which reduces reserves to unacceptably low levels; or where an authority demonstrates characteristics of an insolvent organisation, such as a failure to pay creditors.
- **Industrial** – as a consequence of pay restraint, changes to terms and conditions, and job losses, employees and trade unions enact prolonged strike action, leading to major service disruption and long-term industrial relations disputes.
- **External** – failure of a major supplier, leading to significant service disruption and reputational damage to the authority.
- **Incremental** – multiple, smaller tipping points relating to individual service areas, developing over a period of time, leading to an eventual critical mass of tipping points.
- **Decision paralysis** – failure to make the challenging but necessary decision required to manage financial and other challenges.

We do not believe that all authorities share the same level or types of risk. We do not therefore suggest that all authorities could experience a tipping point. We will continue to engage with the sector to explore the concept of a tipping point, to identify if any of these scenarios above (or others) could be possible for an individual authority, and what the consequences would be for stakeholders, in particular service users. Once there is greater understanding of such scenarios, we will begin to analyse what actions need to be taken to mitigate or avoid such tipping points.

During 2012 we have had many discussions across the sector on the findings set out in 'Surviving the storm', our 2011 report. The overwhelming feedback has been that our findings, based on a significant, but relatively small, sample, were echoed across the sector. We hope that the findings in this report resonate in the same way.

We will be undertaking a third year of financial health reviews of local authorities during 2013, in relation to the 2013–14 financial planning cycle and the delivery of budgets and savings plans during the 2012–13 financial year. We will publish the summary results of this work during Autumn 2013. Our audit client base has increased to 40% of local authorities in England, so our next report will be based on a significantly increased programme of local authority financial health checks.

The summary findings from our 2012 reviews, and the trends between our 2011 and 2012 reviews, are set out in the following sections.

> **"Our discussions with the sector indicate that a 'tipping point' is on the horizon, but what form this could take remains unclear. A tipping point has been described as the critical point in an evolving situation that leads to a new and irreversible development."**

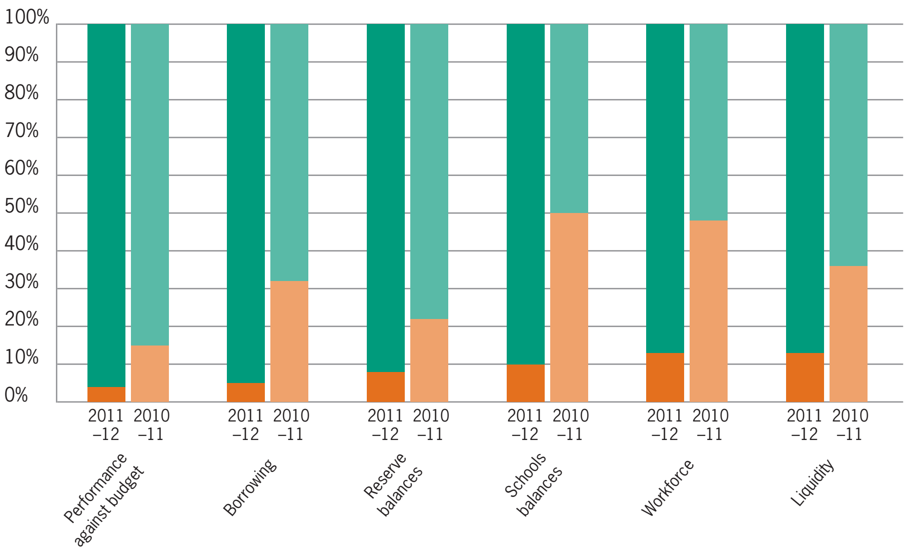
Key indicators of financial performance

Analysis of financial and other ratios for benchmarking indicates strength in performance against budget remain strong, while the gearing of long-term borrowing and reserve balances have improved on last year. Despite considerable improvement, managing the workforce remains a critical area, alongside liquidity where the trend for reducing working capital continues.

Our 2011 report noted that, while local government accountants have an understanding of the use of financial ratios to interpret financial statements, this skill has traditionally only been applied to procurement exercises. Our review last year represented one of the first times that financial ratios have been applied to local authority financial statements for the purpose of inter-authority benchmarking.

Figure 1 provides a summary of our ratings for selected key indicators of financial performance for our most recent reviews, and the results of our same review for the previous year. For each authority we benchmarked key indicators against their nearest neighbour group.

Figure 1 Key indicators of financial performance



Performance against budget

The track record of local authorities in our sample in managing revenue budgets during 2010–11, which included in-year government funding reductions, and in previous years was generally good, with 86% being rated green. The trend for 2011–12 was an improving one, with 96% rated green. Given that 2011–12 was the first year of SR10 funding reductions, and these reductions were front-loaded to 2011–12, this represents a significant achievement for the sector.

However, the challenges facing authorities are only increasing and the key question of how long the sector can continue to deliver against reduced funding has been discussed in more detail in the previous section (pages 4–5).

Borrowing

We reviewed long-term borrowing as a proportion of long-term assets and as a share of tax revenue. The majority (69%) of authorities in our sample in 2010–11 had an appropriate ratio of long-term borrowing to long-term assets, and long-term borrowing as a share of tax, indicating that the level of borrowing was effectively geared. The trend across our sample has improved for 2011–12 with 95% of authorities rated green, with long-term borrowing ratios reducing. A key factor has been strategies for reducing high interest-bearing, long-term borrowing and moving to internal and short-term external borrowing to take advantage of improved lower level borrowing rates, alongside a greater degree of caution with long-term borrowing following the experience of investment in Icelandic banks.

Reserve balances

We noted in our 2011 report that authorities had generally acted prudently over a long period, but that we were starting to see General Fund Reserves being used to fund General Fund revenue expenditure. Of our sample, 79% were rated green in 2010–11 which has increased to 92% in 2011–12. The overall trend has been an increase in the level of reserves, which is supported by 2011–12 Revenue Outturn (RO) return data. This reflects the better than expected performance in delivering 2011–12 revenue budgets. Nonetheless, it will be critical that reserve levels, both general and earmarked, are carefully monitored to ensure the financial resilience of authorities during SR10 is maintained.

Schools balances

For single tier and county council (STCC) authorities with responsibility for education, we analysed the ratio of schools balances as a proportion of dedicated schools grant. There is a trend of increasing schools balances, indicated by an increase in green ratings from 50% in 2010–11 to 90% in 2011–12. A key factor in this trend is that schools appear to be adopting a cautious approach to financial management due to concerns over future funding levels, in many cases leading to underspends. In addition, the financial risks associated with schools transferring to academies are leaving deficits which authorities will need to fund.

Workforce

The focus for this indicator was the level of sickness absence. Costs that accrue from sickness absence relate to the hiring of agency staff to cover staff gaps, or from holding a larger workforce complement than is desirable. Absence also damages service levels either through staff shortage or lack of continuity. Reducing absenteeism saves money, improves productivity and can have a positive customer benefit. It is clear that most authorities continue to proactively manage absenteeism, with a reduction from 57% receiving amber scores for 2010–11 to 12% receiving amber scores for 2011–12. Absence management will continue to be a challenge for authorities during SR10, particularly given the context of significant pressures on staff to deliver ‘more for less’.

Liquidity

This indicator looks at the working capital ratio, indicating if an authority has enough current assets to cover its short-term liabilities. Of our sample, 35% scored amber in 2010–11 and 65% scored green. This has improved for 2011–12 with 12% scoring amber and 88% green.

The overall trend noted for 2010–11 was of reducing working capital. This trend has continued for 2011–12. The improvement in the risk rating scores is a result of a further analysis undertaken during our second year of reviews to better understand the context of falling liquidity. In particular, we identified local authorities’ treasury management strategies to reduce long-term borrowing resulting in a planned reduction in liquidity. The level of borrowing room available to authorities should they wish to draw down to meet liquidity issues was also a factor in this year’s ratings. Nonetheless, local authorities will need to carefully monitor their liquidity levels during SR10 to ensure financial resilience is maintained.

Best practice

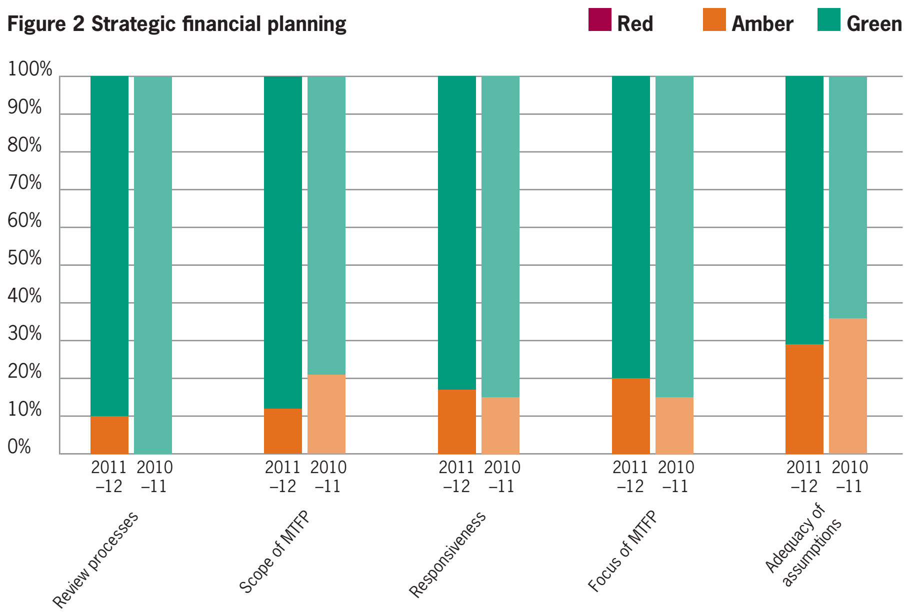
- The authority operates within a locally determined appropriate level of reserves and balances.
- The General Fund balance is maintained at or above the locally agreed minimum level.
- Working capital is at, or above, a ratio set by the Section 151 officer.
- Manageable levels of long-term borrowing within prudential borrowing limits.
- Targets have been set for future periods in respect of key indicators, such as reserve balances and prudential indicators.
- The authority has a track record of spending to budget and proactively managing forecast overspends in-year.
- A robust organisational approach and focus on absence management to improve productivity, reduce costs and enhance customer service.

Strategic financial planning

Having learnt from the previous year, 2012–13 planning cycles were typically started earlier to ensure adequate time to finalise their savings programme and a few authorities have chosen to focus on setting the 2012–13 budget, over updating 2011–12 plans. Scenario planning remains generally weak, but is even more critical given uncertainty about the Government's spending plans.

Strategic financial planning had the best overall rating across our sample for 2010–11, but this is the only thematic area that has seen a reduction in its overall rating for 2011–12. Figure 2 provides a summary of our ratings for selected key indicators of strategic financial planning and the key findings are set out below.

Figure 2 Strategic financial planning



Review processes

Of our sample, 100% was rated green for this category for 2010–11. This decreased to 91% for 2011–12. This indicates that the majority of authorities still have effective processes for the regular review of the MTFP and the associated assumptions, including appropriate scrutiny from elected members, including the Audit Committee. The increase in amber ratings to 9% is a result of a minority of authorities in our sample who have not updated their plans, focusing instead on setting the 2012–13 budget.

The scope of MTFP and links to annual planning

Of our sample, 78% was rated green for this category for 2010–11. This had increased to 88% for 2011–12. The 2012–13 planning cycles typically started earlier than the previous year, reflecting a key lesson learnt from 2011–12 planning cycle: given the scale of the savings requirement, many authorities had not allowed enough time during their financial planning cycle to ensure adequate finalisation of their savings programme.

Good practice authorities demonstrate effective integration of the service and financial planning processes. However, individual services often undertake modelling of demand to understand the impact on future spending levels, but this information is often not consolidated within the plan, limiting the potential of members to understand in detail all the demand led financial challenges an authority faces.

Responsiveness of the plan

Of our sample, 86% was rated green for this category for 2010–11. This has reduced to 83% for 2011–12. Many authorities commenced the 2012–13 financial planning cycle early in the first quarter of 2011–12, having learnt from the previous financial planning period. There is a general recognition that assumptions may change during the lifetime of the plan, that the plan must evolve and be responsive to the external environment.

The focus of MTFP

Of our sample, 86% received a green rating for 2010–11. This had reduced to 79% for 2011–12. While many MTFPs have been refreshed for 2011–12 and typically receive greater challenge and scrutiny than in prior years due to the scale of savings required, many authorities have struggled to develop certainty on key factors affecting the financial position beyond 2012–13, such as the localisation of business rates and the reduction in Council Tax benefit funding, resulting in a return to a more annualised approach to financial planning for some authorities.

Developing budgets and savings plans on a departmental basis, and then reviewing them centrally by senior management and cabinet, remains the typical approach in the sector. The use of zero based budgeting (ZBB) also remains limited across our entire sample. Local authorities should consider adopting, in an appropriate and controlled way, aspects of ZBB to improve the strategic prioritisation during the financial planning cycle.

Some authorities, when updating their plans, noted that their key focus should be the maximisation of financial resilience rather than service improvement, with the aim being to ensure that the plans in place are affordable and sustainable in the light of resources that can reasonably expect to be available. This suggests that the savings are targeted where they have the least impact on priorities to ensure that there are no unplanned service reductions.

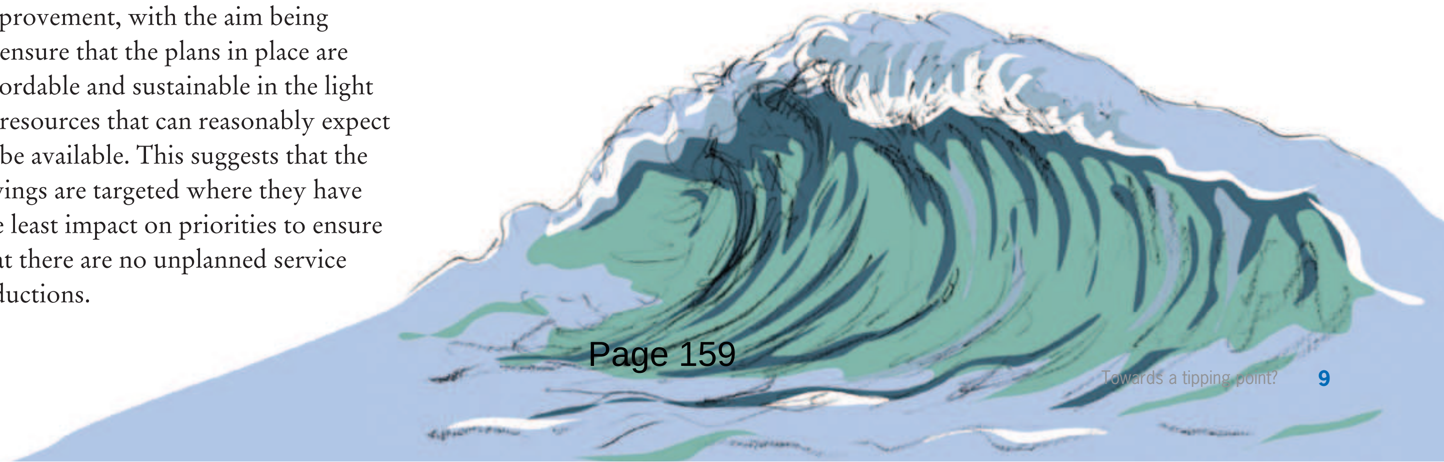
Adequacy of planning assumptions

This was the weakest category in relation to financial planning for 2010–11, with 36% of the sample receiving an amber rating. It was again the weakest category for 2011–12, with 29% receiving an amber rating.

While many plans had been updated, a number of authorities had not revisited funding assumptions for 2013–14 due to continuing uncertainties relating to the Government's spending plans. Scenario planning remains generally weak and sensitivity analysis patchy across the sample group. However, the lack of certainty should increase, not reduce, the need for effective scenario planning in relation to funding and other factors such as demographics. Local authorities will need to ensure they have the skills and capacity to develop and maintain an effective financial model that underpins their MTFP.

Best practice

- Focus on achievement of corporate priorities is evident through the financial planning process. The MTFP focuses resources on priorities.
- Service and financial planning processes are integrated.
- The MTFP includes outcome measures, scenario planning, benchmarking, resource planning and details on partnership working.
- Annual financial plans follow the longer-term financial strategy of the authority.
- There is regular review of the MTFP and the assumptions made within it. The authority responds to changing circumstances and manages its financial risks.
- The authority has performed sensitivity analysis on its financial model using a range of economic assumptions, including the impact of SR10.
- The MTFP is linked to and is consistent with other key strategies, including workforce.
- KPIs can be derived for future periods from the information included within the MTFP.
- Zero Based Budgeting is used to improve strategic prioritisation during the financial planning cycle.
- Effective treasury management arrangements are in place.

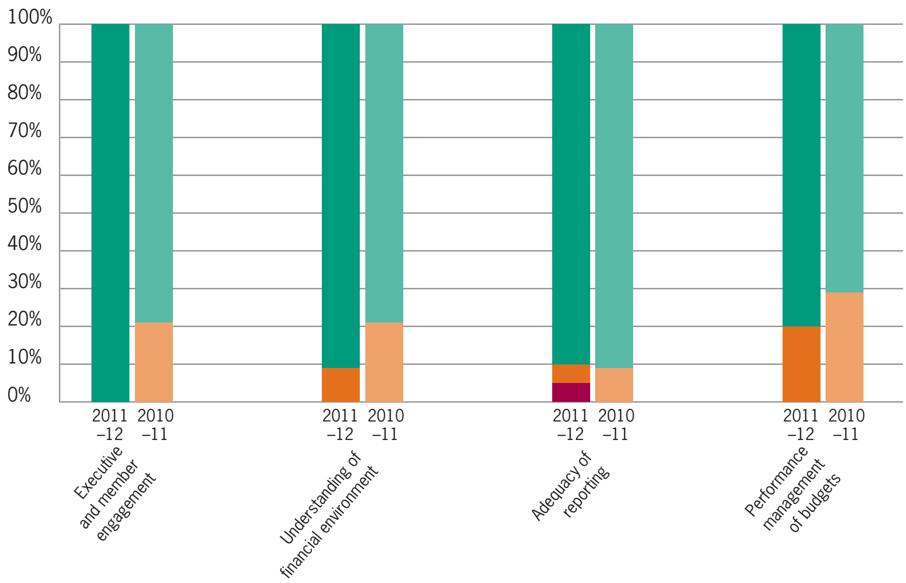


Financial governance

This year has seen a deeper engagement of senior management and members in relation to planning. While the performance management of budgets had increased, and forecast overspends are being managed corporately, rather than in departmental silos, the ability to manage volatile, demand-led budgets remains a challenge.

Figure 3 provides a summary of our ratings for selected key indicators of financial governance.

Figure 3 Financial governance



Executive and member engagement

Our 2010–11 review rated 79% of our sample as green. This increased to 100% for 2011–12. This indicates that the level of senior management and member engagement in relation to financial planning, reporting and management is appropriate in the sector.

We will continue to monitor the engagement of audit committees within local government, as the role of this committee becomes more prominent, and the demands increase on members.

Our 2011–12 reviews considered controls over key cost categories which formed part of executive and member engagement for our 2010–11 reviews. This category saw 82% of our sample rated green. Features of those receiving amber ratings included an unclear scheme of delegation, and lack of consistency in the application of unit cost data.

Understanding of the financial environment

Of our sample, 79% was rated green for 2010–11. This increased to 92% for 2011–12. Senior leadership continue to recognise the importance of communicating the impact of SR10 to all staff and elected members.

Many also recognise the need for greater consultation with their local communities on spending and saving priorities. With a focus on protecting front-line services, back office functions such as finance have seen significant reductions in staff numbers during 2011–12. As noted in our 2011 report, a key trend across many authorities in response to these reductions is greater financial management responsibilities being placed on service managers and budget holders, with job descriptions and competencies being enhanced to reflect this change. In parallel to this, the finance function is providing higher level and more targeted support to services. Our follow up reviews indicate that the implementation of these changes by both finance and service staff has been mixed. Clearly these cultural and process changes will take time to embed, and it will be essential that authorities monitor such changes, given the significant risks to effective financial management that failure to embed these changes could create.

Adequacy of reporting

We continue to find comprehensive levels of timely financial reporting to senior management and members, with a growing trend to consider financial monitoring reports alongside performance and workforce data, which is good practice. 93% of our sample was rated green for 2010–11; this had reduced slightly to 92% for 2011–12. The overall position has not changed, with most authorities continuing to utilise risk based exception reports allowing decisions to be made on corrective action and to allocate responsibilities for these actions. In most cases, year-end forecasts are effective in providing no surprises; however, a minority of authorities do not fully apply commitment accounting, which poses a risk to the provision of accurate outturn forecasts.

It is worth noting that this category included the only red rating (5%) in this year's programme. Factors leading to this rating included the timing and the period against which performance was reported during 2011–12 was not consistent and differed between bodies receiving reports, limited frequency of reporting, lack of reporting on savings, failure to use graphics and propensity to use lengthy narrative, and Cabinet reports only including forecast year-end outturn position, and not the actual position against a profiled budget.

Performance management of budgets

Of our sample, 71% were rated green for 2010–11. This increased to 79% for 2011–12. This was the lowest score for a category in Financial Governance for 2010–11, and it was the joint lowest category score for 2011–12, although it reflects a reasonable position overall. Local authorities continue to face challenges managing volatile, demand led, budgets. Our sample indicates a growing maturity amongst authorities in managing forecast overspends corporately, rather than within departmental silos, which is good practice. However, the challenges of setting appropriate budgets and then spending within them (or generating forecast levels of income) continues to be one of the key risks and challenges.

Best practice

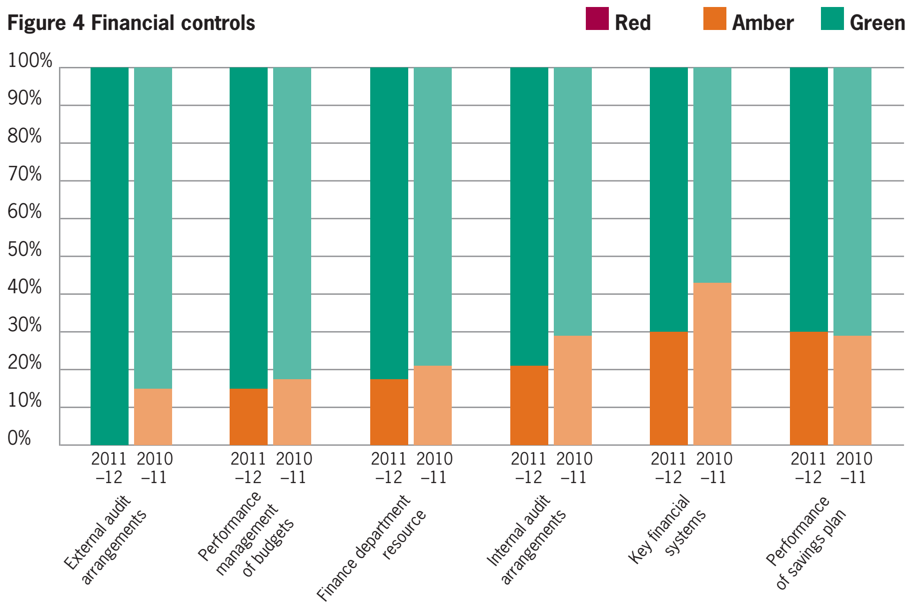
- Regular reporting to members. Reports include detail of action planning and variance analysis.
- Actions have been taken to address key risk areas.
- The CFO is a key member of the leadership team.
- Officers and managers across the authority understand the financial implications of current and alternative policies, programmes and activities.
- The leadership ensure appropriate financial skills are in place across all levels of the organisation, for example a good understanding of unit costs and cost drivers.
- The leadership foster an open environment of open challenge to financial assumptions and performance.
- There is an effective scheme of delegation, ensuring clarity of financial responsibilities and accountabilities.
- There is engagement with stakeholders, including budget consultations.
- There are comprehensive policies and procedures in place for members, officers and budget holders which clearly outline responsibilities.
- Internal and external audit recommendations are not overdue for implementation.
- Committees and cabinet regularly review.

Financial controls

The use of financial controls had improved on the prior year. Impressively, in-year savings are being delivered, although there is a lack of transparency in reporting performance against budgeted savings and demonstrating that the savings agreed have been delivered as planned.

Figure 4 provides a summary of our ratings for selected key indicators of financial controls.

Figure 4 Financial controls



External audit arrangements

We rated 86% of our sample green for 2010–11. This increased to 100% for 2011–12, the highest level for this, or any, theme. This indicates that IFRS accounting and associated budget and chart of account restructurings have been effectively embedded, and external audit had not identified serious issues in relation to the accounts or in relation to the value for money conclusion.

Performance management of budgets

The financial controls in place to ensure effective performance management of budgets were generally good for 2010–11, with 83% of our sample rated green. This has improved slightly for 2011–12 with 86% rated green. Those authorities who scored amber typically still need to improve the accuracy of financial reporting, for example by having accurate budget profiles, an improved understanding of cost drivers, and better use of benchmarking, trend analysis and unit costs. A more effective approach to presenting financial information is also required.

Finance department resource

Of our sample, 78% was rated green for 2010–11. This has increased to 83% for 2011–12. This indicates that the majority of authorities have been able to manage the impact of funding reductions to this part of the back office. Our 2012 reviews were undertaken prior to the finalisation of 2011–12 accounts, so we have not reviewed the effectiveness of reduced finance resources for a complete annual financial cycle. This is something we will focus on during our 2013 reviews. The ability of finance teams to withstand planned and unplanned absences in providing support to services remains a key risk for authorities, given widespread reductions in staff numbers and the context of the delivery of major savings at a time when services are taking on enhanced financial management responsibilities.

Internal audit arrangements

The majority of authorities in our sample (71%) were rated green for 2010–11. This has increased to 79% for 2011–12. Most authorities continue to apply a risk based approach to audit planning and involve services in this process, have a robust process for preparing and reporting the Annual

Governance Statement, and an engaged audit committee. Those authorities who were rated amber had weaknesses such as audit plans that are traditional, process driven and not based on risk prioritisation, for example audit plans that do not vary year on year.

Key financial systems

Of our sample 57% was rated green for 2010–11, which was the lowest level for Financial Controls. This rating has increased to 71% for 2011–12 which is the joint lowest green rating for Financial Controls.

Local authorities typically have well established systems and procedures for producing reliable financial monitoring and forecasting information, which is used alongside related performance information to support decisions. We noted in our 2011 report that many authorities are considering enhancing the functionality of their key financial systems to ensure the burden of producing work around financial information does not fall to non-financial managers, given the reduction in finance staff, previously discussed. While progress is being made, such changes take time to specify, procure and implement. The risks associated with such work around solutions, in the context of reducing finance resource and increasing financial management responsibilities within services, will require careful monitoring by authorities in this position.

Performance of savings plan

Local authorities have a good track record of delivering efficiencies. Most authorities were able to effectively manage the 2010–11 in-year funding reductions with 71% of our sample rated green. For 2011–12 the position remained at 71% receiving a green rating. Given the context of front-loaded year one SR10 savings this indicates a considerable achievement.

A key factor to emerge from this year's reviews is that there is a lack of transparency in the way some authorities report performance against budgeted savings. While there have been undoubted improvements in the way local authorities manage and monitor their savings plans, the sector does not effectively report countervailing (alternative) savings that may be being achieved. Therefore, so long as a reduced budget, which incorporates agreed savings, does not overspend at year end, it can be considered a success. The reality, however, may be that other factors have led to the break-even position or underspend. For example, management decisions to hold vacancies that did not form part of the original savings plan may be hidden from management information (and the consequent impact on service delivery may not be identified). This approach is not unique to local government; indeed it is common across the public sector. But given the level of savings being delivered, and that are still to be delivered, it is critical that key stakeholders understand if the savings agreed have been delivered as planned.

Best practice

- Budgets are robust and prepared in a timely fashion and the authority has a good track record of operating within its budget.
- Budgets are monitored at an officer, member and cabinet level and officers are held accountable for budgetary performance.
- Financial forecasting is well-developed and forecasts are subject to regular review, including trend analysis, benchmarking of unit costs, risk and sensitivity analysis.
- Budget profiles are accurate and regularly monitored.
- There is particular focus on monitoring income-related budgets.
- Savings programme reporting includes effective management information on countervailing savings.
- The capacity and capability of the finance department and service departments are fit for purpose for effective financial planning and financial management.
- Key financial systems have received satisfactory reports from internal and external audit.
- Financial systems are adequate for future needs, for example commitment accounting functionality is available.
- There is an effective internal audit which has the proper profile within the organisation and agreed internal audit recommendations are routinely implemented in a timely manner.
- There is an assurance framework in place which is used effectively by the authority and is how business risks are managed and controlled.
- The Annual Governance Statement gives a true reflection of the organisation.

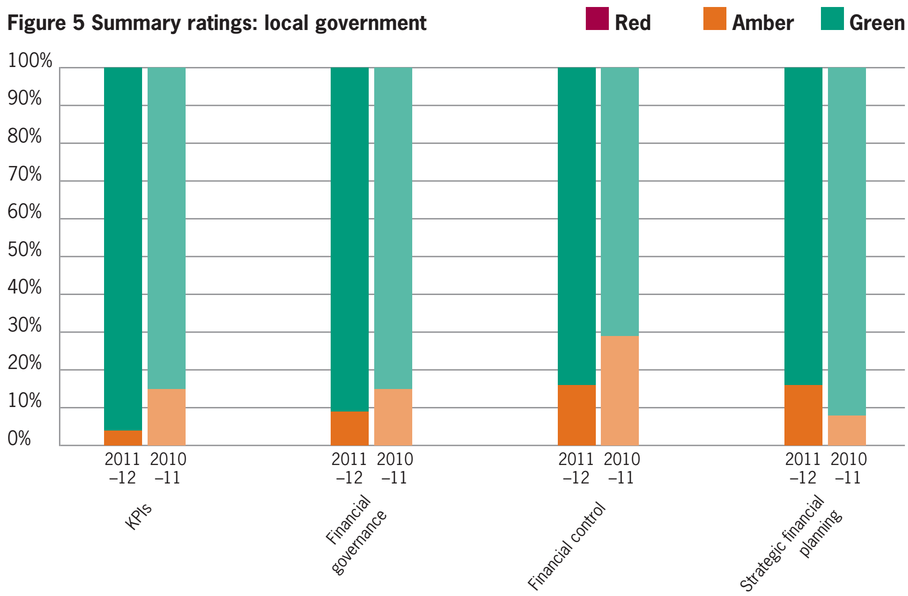
Summary and conclusions

Overall, local authorities have continued to manage in the current environment, but improving scenario planning, sensitivity analysis and reporting of savings programmes as well as ensuring financial governance arrangements remain robust will help finance management to influence key stakeholders in the uncertain times ahead.

The overall trend for many of the categories we have rated is a slightly improving position between 2010–11 and 2011–12. This is replicated in three of the four themes in Figure 5. Overall, local authorities have coped very well with delivering the first year of SR10. A summary for each theme follows.

86% of authorities were rated green for **key indicators of financial performance** for 2010–11, and this has increased to 96% for 2011–12. For each category in this thematic area the trend has been an increasing level of green ratings and reducing levels of amber ratings, with liquidity receiving the lowest overall rating (87%). While for many authorities their Treasury Management Strategy is leading to a planned reduction in liquidity, and borrowing headroom provides a degree of confidence for the medium-term, authorities will need to ensure that their liquidity is carefully monitored, for example in the collection of council taxes and business rates during challenging economic times. The overall position indicates that local authorities are both treating the financial challenges being faced seriously, and delivering against their financial plans. It was pleasing to see during our 2012 reviews that a number of authorities reflected some of our 2010–11 KPI recommendations in their updated MTFPs.

Figure 5 Summary ratings: local government



Local authorities demonstrated good **financial governance** during our 2010–11 reviews, with 86% receiving green ratings. This has increased to 92% for 2011–12. Local authorities will need to continue to ensure financial governance arrangements remain robust. Given the generationally significant financial challenges facing authorities, it will be particularly important that the chief financial officer is a key member of the authority's leadership team. This theme has the first sub category to receive a red rating (Adequacy of Reporting) and it will be critical that financial information is reported accurately, at the right frequency, and in a format that ensures effective monitoring and decision making. This includes where services are not delivered in-house, which will be an increasing trend for the sector.

Our 2010–11 reviews indicated that the weakest thematic area was **financial controls**, with 71% of authorities receiving a green rating. Our 2011–12 reviews indicate an improvement, with 83% of our sample receiving a green rating. However, this is the joint lowest overall rating, along with strategic financial planning. A key risk to be managed in this area continues to be embedding the changes resulting from reductions in finance staff and

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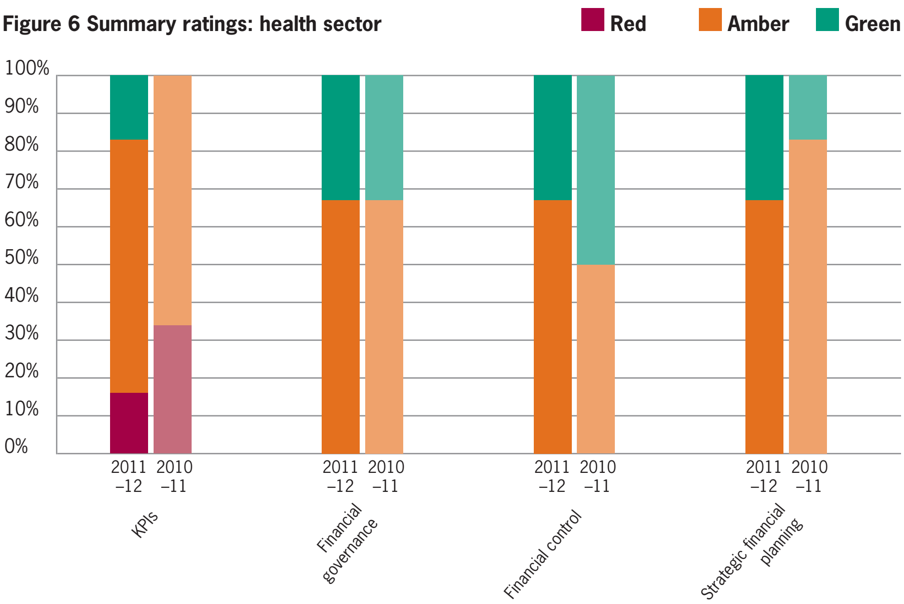
the associated increase in financial responsibilities of service managers and budget holders. Local authorities also need to improve the management information relating to the reporting of savings programmes, in particular with the inclusion of greater detail on the use of countervailing savings, so that key stakeholders can better understand the impact on service delivery and policy decisions, where such alternative savings are being applied to pre-agreed targets.

Local authorities demonstrated strong **strategic financial planning**, during our 2010–11 review, with 93% in our sample receiving a green rating. This declined to 83% for 2011–12, the only thematic area that saw a fall in the overall green rating. While this remains at a high level overall, the reduction highlights the increasing difficulty local authorities face in planning for the medium-term in what remains a greatly challenging and uncertain period. It remains critical that authorities improve their scenario planning and the use of sensitivity analysis on key assumptions in their financial models. As we noted in our 2011 report, we believe authorities can learn directly from the financial modelling analysis required by Foundation Trust applicants in the NHS.

Key findings from health sector reviews

- Liquidity problems for more bodies, manifested by the need for working capital loans to be taken out during 2010–11 or 2011–12 or expected in 2012–13.
- Cost improvement programmes (CIPs) increasing, in some cases to unprecedented levels, with some 2012–13 programmes lacking headroom, or with schemes not being fully identified, or lacking effective detail.
- Failure to achieve CIP savings during 2011–12 for some bodies, leading to doubt over the planned achievements for 2012–13.
- A continued environment of extreme uncertainty, leading to merger proposals in several cases for trusts that have not yet achieved foundation trust status.
- Weak performance against the Public Sector Payments Policy targets.

Figure 6 Summary ratings: health sector



Comparison to the health sector

We undertook similar reviews of a sample of NHS trusts and primary care trusts (PCTs) for both 2010–11 and 2011–12.

The methodology used for our reviews of health bodies was the same as that used for local authorities, and the summary results for our sample of health bodies are set out in Figure 6. Our 2011 report observed that, despite NHS funding levels being maintained by the Government, health bodies received lower ratings than local authorities for 2010–11, with significantly lower levels of green ratings across themes, and with no green ratings for key indicators of financial performance. There has been some improvement for 2011–12. For example, and unlike local authorities, strategic financial planning for health bodies has improved. Health bodies have also seen an improvement for KPIs and the overall position for financial governance has stabilised. However, the overall ratings remain significantly lower than the overall local authority ratings.

As we noted in our 2011 report, the underlying causes of these findings predate SR10, and relate to long-term structural issues, particularly within the acute sector. Like local government, performance is varied, but the higher performing trusts are often very good at scenario planning and sensitivity analysis as a response to volatile demand-led costs and income, although the sector as a whole has difficulty in delivering to these budgets.

About us

Grant Thornton UK LLP is a leading business and financial adviser with client-facing offices in 24 locations nationwide. While we understand regional differences and can respond to needs of local authorities, our clients can also have confidence that our team of local government specialists is part of a firm led by 200 partners and employing nearly 4,000 professionals, providing personalised audit, tax and specialist advisory services to over 40,000 clients.

Grant Thornton has a well-established market in the public sector, and has been working with local authorities for over 30 years. Our national team of experienced local government specialists, including those who have held senior positions within the sector, providing the growing range of assurance, tax and advisory services that our clients require.

We are the leading firm in the local government audit market, as the largest supplier of audit and related services to the Audit Commission with 40% of local authorities in England as external audit clients. We also audit local authorities in Wales and Scotland via framework contracts with Audit Scotland and the Wales Audit Office. We have over 180 local government and related body audit clients in the UK and over 75 local authority advisory clients. This includes London boroughs, county councils, district councils, city councils, unitaries and metropolitan authorities, as well as fire and police authorities. This depth of experience ensures that our solutions are grounded in reality and draw on best practice. Through proactive, client-focused relationships, our teams deliver solutions in a distinctive and personal way, not pre-packaged products and services.

Our approach combines a deep knowledge of local government, supported by an understanding of wider public sector issues, drawn from working with associated delivery bodies, relevant central government departments and with private-sector organisations working in the sector. We take an active role in influencing and interpreting policy developments affecting local government and responding to Government consultation documents and their agencies. We regularly produce sector-related thought leadership reports, typically based on national studies, and client briefings on key issues. We also run seminars and events to share our thinking on local government and, more importantly, understand the challenges and issues facing our clients.

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SURREY
COUNTY COUNCIL

AUDIT & GOVERNANCE COMMITTEE
18 March 2013

Internal Audit Plan 2013/14

SUMMARY AND PURPOSE:

1. The purpose of this report is to present the Annual Internal Audit Plan for 2013/14 to the Committee.

2. Under-pinning the work of the Internal Audit team in delivering the Annual Internal Audit Plan are the key principles and objectives as set out in the Internal Audit Charter and Strategy. These are presented alongside the Annual Internal Audit Plan for 2013/14 as good practice dictates that these are updated and reviewed on an annual basis.

3. Also included in this report is the updated Internal Audit Reporting and Escalation Policy.

RECOMMENDATIONS:

4. Members are asked to consider the contents of this report and annexes, and to approve the following:

   (i) Internal Audit Charter (Annex A)
   (ii) The Internal Audit Strategy (Annex B)
   (iii) The Internal Audit Reporting and Escalation Policy (Annex C)
   (iv) 2013/14 Internal Audit Plan (Annex D)

BACKGROUND:

5. The statutory basis for Internal Audit in local government is provided in the Accounts and Audit Regulations 2011 - which require a local authority to "*undertake an adequate and effective internal audit of its accounting records and of its system of internal control".*

6. The Accounts and Audit Regulations contain the expectation that Internal Audit will operate within acknowledged professional standards. The Audit and Governance Committee has adopted the Public Sector Internal Audit Standards (PSIAS), which come into effect on 1 April 2013, as the basis for Internal Audit in Surrey County Council.

7. **Internal Audit Charter (Annex A)**
   The PSIAS require Internal Audit to have a Charter that has been formally approved and is regularly reviewed. The Charter attached at Annex A has been developed in line with the PSIAS and replaces the Internal Audit Terms of Reference previously approved by this Committee. In response to the recommendations contained within the 2012/13 Review of the Effectiveness of the System of Internal Audit the Charter includes the following:

   (i) An explicit statement explaining that the scope of Internal Audit activity includes all the operations of the Council

(ii) Reference to the resources available to Internal Audit (including access to hardware, software, information and training)
(iii) An explicit statement confirming the requirement that Internal Audit activity is free from interference in determining the scope of activity, performing work and communicating results

8. **Internal Audit Strategy (Annex B)**
Under the PSIAS there is no longer a requirement to produce an Internal Audit Strategy. However the Chief Internal Auditor is of the opinion that this is a useful document that links the work of Internal Audit to the council's vision to be the most effective council in England by 2017. Through approving the Internal Audit Strategy for 2013-2017 alongside the Internal Audit Plan for 2013/14, the link between the work of Internal Audit and the high level strategic vision of the council is apparent.

There have been no substantial changes to the Strategy previously approved by this Committee in April 2012.

9. **Internal Audit Reporting and Escalation Policy (Annex C)**
The Internal Audit Reporting and Escalation Policy has been updated to reflect the following:
(i) the ability to view all Internal Audit reports on the council's intranet
(ii) the intention to alert the Head of Communications to Internal Audit reports attracting an “Unsatisfactory” or “Major Improvement Needed” audit opinion

10. **2013/14 Internal Audit Plan (Annex D)**
The Internal Audit Plan for 2013/14, which is a risk based programme of work, is set out at Annex D. There are a number of core elements to the Internal Audit Plan which are likely to feature each year. Certain audit activities are mandatory eg

(i) Reviewing corporate governance arrangements to inform the Annual Governance Statement
(ii) Grant Certification
(iii) Irregularity contingency
(iv) Participation in the National Fraud Initiative (NFI) as coordinated by the Audit Commission

In addition to these mandatory elements, Internal Audit also carries out testing on an annual basis, of all the Council's key financial systems. Previously this work had included specific audit testing defined by the External Auditor. Under the new external audit arrangements there is no requirement for Internal Audit to conduct such tests as the External Auditor does not place reliance on the work of Internal Audit. The S151 Officer has however confirmed that, due to the significance of these systems – which essentially underpin most of the council's transactions – theY should continue to be reviewed on an annual basis by Internal Audit unless specifically agreed otherwise.

Once these core elements of the Plan and follow up reviews are accounted for, the remaining audits shown in the proposed Plan have been included based on a risk priority which has been assessed following:

(i) Consultation with:
  a. Heads of Service and other senior management
  b. Members of the Cabinet including the Leader of the Council
  c. Members of the Audit and Governance Committee
  d. Head of Policy and Performance

e. S151 Officer
f. The Risk and Governance Manager
g. External Auditor

(ii) Consideration of risk registers
(iii) Areas of concern emerging from liaison with other Local Authority Internal Audit Sections

The draft Plan was also presented at a meeting of the Quality Board on 25 February 2013.

Members will note that the Plan includes a number of days to support the council's work on Innovation (included in the Cabinet forward plan for 26 March 2013). It will also be noted that the number of days set aside for Irregularity and Special Investigation including Fraud Prevention has increased to 345 days from 301 days in 2012/13. This reflects the intention to develop a programme of data matching and interrogation which will form a key part of our counter fraud work as well inform the audit work for a number of specific audits included in the Plan.

The Chief Internal Auditor is confident that the draft Internal Audit Plan at Annex D provides comprehensive coverage across the council's activities and addresses key areas of risk. The Internal Audit team is sufficiently resourced to deliver this programme of work which will enable the Chief Internal Auditor to provide an opinion on the adequacy of the Council's system of internal control for 2013/14.

WHAT HAPPENS NEXT:

11. The Internal Audit team will deliver the 2013/14 Internal Audit Plan and Internal Audit reports will be produced and distributed in line with the Reporting and Escalation Policy.

12. Completed audit reports will continue to be presented to the Committee throughout the year and an update on performance against the 2013/13 Plan will be reported to the Committee in December 2013.

REPORT AUTHOR: **Sue Lewry-Jones, Chief Internal Auditor**

CONTACT DETAILS: telephone: 020 8541 9190 e-mail sue.lewry-jones@surreycc.gov.uk,

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ANNEX A

SURREY COUNTY COUNCIL INTERNAL AUDIT CHARTER

1. Purpose

The Internal Audit Charter describes the purpose, authority and responsibilities of Surrey County Council's Internal Audit service. The Charter shall be reviewed annually and approved by the Audit and Governance Committee. The Chief Internal Auditor is responsible for applying this Charter and keeping it up to date.

2. Statutory Requirement

Within local government the requirement for an Internal Audit function is statutory. The Accounts and Audit Regulations (2011) requires every local authority to maintain an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control.

In addition, the Council's Chief Financial Officer has a statutory duty under Section 151 of the Local Government Act 1972 to establish a clear framework for the proper administration of the authority's financial affairs. To perform that duty the Section 151 Officer relies, amongst other things, upon the work of Internal Audit in reviewing the operation of systems of internal control and financial management.

3. Standards and best practice

The work of Internal Audit will be performed with due professional care and in accordance with the UK Public Sector Internal Audit Standards (PSIAS), the Accounts and Audit Regulations (2011) and with any other relevant statutory obligations and regulations.

4. Responsibilities and Objectives

The PSIAS define internal auditing as "an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

Internal Audit is not responsible for control systems. Responsibility for effective internal control rests with the management of the council.

5. Independence

Internal Audit is independent of all activities that it audits to enable auditors to perform their duties in a way that allows them to make impartial and effective professional judgements and recommendations without giving rise to conflicts of interest. Internal Auditors shall have no direct operational responsibility or authority over any of the activities they review. Accordingly, they shall not develop or install systems or procedures, prepare records, or engage in any other activity which would normally be audited.

Internal Audit activity must be free from interference in determining the scope of activity, performing work and communicating results.

6. Reporting Lines

Internal Audit is part of the Policy and Performance Service within the Chief Executive's Office Directorate.

There are a number of reporting lines in place to enable Internal Audit to be independent of the management of the organisation. There are seven specific lines of accountability for the Chief Internal Auditor:

(i) To the Head of Policy and Performance – who reports to the Assistant Chief Executive - in respect of achievement of the priorities as set out in the Policy and Performance Service Plan; and, the inter-relationship with the wider performance improvement agenda;

(ii) To the Head of Finance in respect of her statutory Section 151 responsibilities, including the investigation of irregularities;

(iii) To the Chief Executive as required in respect of investigation of matters requiring referral to them;

(iv) To the Cabinet Portfolio Holder as required in respect of matters falling within their remit;

(v) To the Audit and Governance Committee ('the Board' as defined in PSIAS) in discharging the corporate responsibility for Internal Audit under the Accounts and Audit Regulations (2011);

(vi) To the Chairmen of Overview and Scrutiny Committees in conjunction with the Audit and Governance Committee on matters relating to their specific service areas; and/or

(vii) To the Leader of the Council, as appropriate.

Specifically, the Chief Internal Auditor must have free and unfettered access to the Chief Executive and Chairman of the Audit and Governance Committee.

7. Scope

Internal Audit may review any aspect of the council's activities and the Chief Internal Auditor is required to give an annual opinion on the effectiveness of the whole of its internal control system, and the extent to which the council can rely on it.

In support of this, Internal Audit undertake risk-based reviews and evaluations of the control environment (including, where appropriate, those of external bodies and partnerships). The work of Internal Audit is set out in the Annual Internal Audit Plan. This Plan is designed to support the Annual Internal Audit Opinion and the council's Annual Governance Statement.

Internal Audit may undertake work for new clients by extending its work to third parties including schools and Parish councils. All engagements will be performed in accordance with this Charter to an agreed schedule of audit days.

8. Reporting

The responsibility for how audits will be reported rests with the Chief Internal Auditor. On the completion of each audit the findings and draft recommendations will be discussed with the responsible officer(s). In accordance with the Internal Audit Reporting and Escalation Policy a draft report summarising the work done, conclusions and recommendations will be issued to the responsible officer(s) for them to confirm its factual accuracy. A final report is circulated along with an agreed management action plan.

There are normally standard timeframes for the individual stages above to occur and these are agreed with services as a part of liaison arrangements.

All final audit reports – with the exception of irregularity reports – and their completed management action plans are made available to the appropriate Cabinet Portfolio Holder and all members of the Audit and Governance Committee. In addition, after each meeting of the Audit and Governance Committee, a list of completed audits is compiled for distribution to all elected Members of the Council informing them of audit work completed.

The Chief Internal Auditor will seek to co-ordinate Internal Audit plans and activities with managers, external audit, inspection bodies and other review agencies to ensure the most effective audit coverage is achieved and duplication of effort is minimised.

The Chief Internal Auditor will bring to the attention of the Audit and Governance Committee all issues relating to the control environment of the authority and the mechanisms by which Internal Audit provides assurance.

9. Right of Access and Authority to Obtain Information

In order for Internal Audit to discharge its responsibilities, it is granted full, free and unrestricted access to all council records, assets, personnel and premises as considered necessary for the purposes of the audit from any Member, officer, agent or contractor of the County Council. This is set down in the Council's Financial Regulations and is outlined on individual identity cards held by every auditor.

This access should be granted on demand and is not subject to prior notice, and extends to partner bodies and external contractors working on behalf of the council. Documents and information given to Internal Audit during a review will be handled in the same prudent and/or confidential manner as by those employees normally accountable for them.

10. Annual Governance Statement

Annually the Chief Internal Auditor provides to the Audit and Governance Committee an overall opinion on the County Council's internal control environment, risk management arrangements and governance framework to support the Annual Governance Statement.

11. Fraud & Corruption

Managing the risk of fraud and corruption is the responsibility of management. Internal Audit procedures alone, even when performed with due professional care, cannot guarantee that fraud or corruption will be detected. Internal Audit does not have responsibility for the detection or prevention of fraud and corruption but does undertake periodic activities to promote an anti-fraud and anti-corruption culture.

Investigations into potential financial irregularities are undertaken by Internal Audit whether reported directly to Internal Audit, through the Council's whistle blowing policy, or through Expolink, the Council's external whistle-blowing hotline. Such investigations are as far as possible conducted sensitively and confidentially, but the scope and manner of the investigation is dependent on the nature of the allegations.

Irregularity investigations often require the work to be undertaken without prior notice being given to local management and may also require referral to the police or other enforcement agencies.

In certain cases Internal Audit may delegate the investigation of specific allegations to the service itself following an assessment of risk and financial impact.

On completion, findings are reported to an appropriate level of management, who will then be responsible for determining the action to be taken.

12. Consultancy Work

Due to its detailed knowledge of County systems and processes Internal Audit is well placed to provide advice and support to services on issues of value for money and process re-engineering.

The Chief Internal Auditor shall seek the approval of the Audit and Governance Committee for any significant additional consultancy services not already included in the Annual Audit Plan prior to accepting the engagement.

In order to help services to develop greater understanding of audit work and have a point of contact in relation to any support they may need, Internal Audit has put in place a set of service liaison arrangements that provides a specific named contact for each service and regular liaison meetings. The arrangements also enable Internal Audit to keep in touch with key developments within services that may impact on its work.

13. Resources

The work of Internal Audit is driven by the annual Internal Audit Plan, which is approved each year by the Audit and Governance Committee.

The Annual Plan is derived from a risk-weighting of the known ‘audit universe’, prioritising potential audits in terms of their significance in risk terms. The methodology for determining risk takes account of both financial and non-financial factors, and is in line with good practice.

Activities identified within a given year in the annual Internal Audit Plan are audited using a variety of standard methodologies and the key financial systems are audited using a systems-based approach. Separate contingency time is allowed in the Annual Plan for irregularity-related activities, grant claim audit, audit management time, consultancy work, follow-up audits and other duties.

Against this list of audits is matched a determination of the available resource (in terms of productive days available across the team) and a ‘cut-off’ point is reached where the risk-ranked list of audits can be resourced by the available days.

In addition to appropriate staffing, Internal Audit must have access to appropriate IT hardware and software (including audit management software and data interrogation tools) to enable delivery of the audit plan.

If the Chief Internal Auditor has concerns regarding the level of resources, these will be raised with the Section 151 Officer at the earliest opportunity. Inadequate resourcing of the Internal Audit activity may result in the Chief Internal Auditor being unable to provide an annual opinion on the council’s internal control environment.

14. Training

Internal Audit will be appropriately staffed in terms of numbers, professional qualifications and experience, having regard to its objective and standards. The staffing of Internal Audit will be kept under review by the Chief Internal Auditor and the Audit and Governance Committee. Internal Audit staff will be properly trained to fulfil their responsibilities and will maintain their professional competence through an appropriate ongoing development programme.

15. Due Professional Care

Internal Audit will conform to the PSIAS Code of Ethics: (i) Integrity; (ii) Objectivity; (iii) Confidentiality; and, (iv) Competency.

If individual auditors have membership of another professional body then he or she must also comply with the relevant requirements of that organisation

In carrying out their work, Internal Auditors must exercise due professional care by considering:

(i) The extent of work needed to achieve the required objectives;

(ii) The relative complexity, materiality or significance of matters to which assurance procedures should be applied; and

(iii) The adequacy and effectiveness of governance, risk management and control processes;

(iv) The probability of significant errors, fraud or non-compliance; and

(v) The cost of assurance in proportion to the potential benefits.

Internal Auditors will also have due regard to the Seven Principles of Public Life – Selflessness; Integrity, Objectivity; Accountability; Openness; Honesty; and Leadership.

16. Quality Assurance

The Chief Internal Auditor will control the work of Internal Audit at each level of operation to ensure that a continuously effective level of performance – compliant with the PSIAS is maintained.

Annually, an independent assessor will review the effectiveness of Internal Audit against the prescribed standards. Instances of non-conformance with the PSIAS, including the impact of any such non-conformance, must be disclosed to the Audit and Governance Committee. Any significant deviations must be considered for inclusion in the council's Annual Governance Statement.

17. Internal Audit Strategy

The Chief Internal Auditor will develop and maintain a Strategy for delivering the Internal Audit service, including how the service will be provided. The Strategy will state how the assurance for the Annual Internal Audit Opinion will be demonstrated. This will include how the Chief Internal Auditor will review the Council's corporate governance arrangements, risk management processes and key internal control systems.

The annual Internal Audit Plan is designed to implement the Strategy, and both are approved by the Audit and Governance Committee on behalf of the council. Any difference between the Plan and the resources available will be identified and reported separately.

APRIL 2013

ANNEX B

Internal Audit Strategy 2013-2017

1. Mission Statement:

"Internal Audit exists to support the vision of Surrey County Council to be the most effective council in England by 2017. Specifically it will promote and champion sound governance and help drive improvement through the provision of an effective and timely assurance function which ensures that key business controls and risks are addressed, stakeholder needs are met, and value for money is achieved."

2. Purpose of the Strategy:

The purpose of this Strategy is to put in place a framework that will enable Internal Audit to be managed in such a way that will facilitate:

- The provision to the Audit and Governance Committee of an **overall opinion each year** on the County Council's internal control environment, risk management arrangements and governance framework to support the Council's Annual Governance Statement, in line with the Committee's Terms of Reference.

- **Risk-based audits** of the control, risk management, and governance systems through the annual Audit Plan in a way that affords priority of coverage with regard to the County Council's strategic and business objectives and provides evidence to form the opinion on the control environment.

- The **identification of resources** required to deliver an Internal Audit service that meets the required professional and ethical standards.

- Provision to the Council's management of **recommendations and advice** arising from Internal Audit work.

- Provision of **assurance and consultancy services** by Internal Audit, addressing significant local and national issues as they arise through appropriate allocation of resources in the annual Audit Plan.

- **Effective co-operation** with both the **External Auditor** and, through the Head of Policy and Performance, **other regulators**.

For every audit undertaken, Internal Audit will strive to provide assurance on the governance arrangements in place, identify areas of weakness where these exist and recommend improvements that will lead to better outcomes for residents and better value for money.

3. Features of the strategic approach:

The Strategy has the following features:

- It is **functionally driven –** the audit 'universe' consists of all areas of operational activity (or, where appropriate, sub-areas of activity).

- **Operational activities are audited on a periodic basis** determined by a risk assessment undertaken within Internal Audit in accordance with best practice. The annual Audit Plan is prepared on the basis of risk-assessed audit need, and is then matched to the available resources.

- Internal Audit takes a **systems-based audit approach** to most service area reviews but more **in-depth checking of compliance** with statutory requirements and internal procedures and policies may also be undertaken where appropriate. This combination of systems-based and compliance auditing is aimed at providing an overall assurance to the Council on the adequacy of its control environment. Should the status of the Council's functions and/or control environment change so that in the Chief Internal Auditor's opinion it is no longer possible to maintain such a service within the resources available then she reserves the right to report that fact to the Chief Executive and the Audit and Governance Committee.

- Separate contingency time is allowed in the Annual Plan for fraud-related activities, audit management time, consultancy work, follow-up audits and other duties.

- **Work is not outsourced to third party audit suppliers**: the strategy determines an in-house service provision to be the most effective way to provide the required assurances. Where Internal Audit have particular expertise precedent exists for selling limited services to neighbouring local authorities to supplement their audit resource, providing there is no detrimental effect on the Council's own audit coverage.

Internal Audit
Policy and Performance
April 2013

Internal Audit Reporting and Escalation Policy

Internal Audit
Policy and Performance
Chief Executive's Office
April 2013
Version 1.12

CONTENTS

INTRODUCTION:

1. Timely and appropriate management responses to Internal Audit reports enable the Council to demonstrate that it maintains high standards of internal control and governance in line with corporate objectives.

2. The Audit and Governance Committee have approved this policy in order to ensure that issues are remedied in an appropriate and timely manner.

REPORTING:

3. With the exception of investigations into alleged irregularities (which are subject to separate arrangements not covered in this policy), the following reporting and escalation arrangements apply to all audit reviews undertaken by Internal Audit.

Draft Report

4. Following completion of an audit review the auditor will produce a draft report, which is issued to the responsible manager, (the auditee). The auditee will be asked to comment on the factual accuracy of the report and attend an exit meeting with the auditor within 5 working days. In this context 'factually accurate' means that the auditor's report and recommendations are based on a correct interpretation of the systems or circumstances pertaining to the review.

Exit meeting

5. The exit meeting is held with the auditee and other officers as appropriate. It is during this meeting that key points arising from the audit, factual amendments and recommendations for improvement are discussed. Where possible service actions addressing audit recommendations should be captured for inclusion in a draft management action plan (MAP).

Management Action Plan production

6. Following the exit meeting a draft MAP and revised draft report will be produced for distribution to the auditee, Head of Service and other key officers involved in the audit. Auditees must obtain agreement from their Head of Service as to the proposed actions to be included in the MAP. The relevant Head of Service will be recorded in the MAP as the Responsible Officer. Where actions rest with one or more service, the Head of Service responsible for the business activity reviewed will be deemed the Responsible Officer.

7. The service then has 10 working days to return a populated MAP and any further comments on factual accuracy to the auditor. As part of this process the service is responsible for ensuring that named officers with responsibility for individual actions within the MAP are sufficiently briefed and accepting of such responsibility before the MAP is returned to Internal Audit.

Ownership of the Management Action Plan

8. Whilst individual actions within the MAP may rest with one or more officers, the Head of Service has overall accountability for timely completion of the actions in the MAP, and is required to inform Internal Audit if timescales are likely to be missed. In assigning their name to the MAP, Heads of Service are confirming that they accept responsibility for completion of the actions therein.

9. Where MAPs involve recommendations for more than one service, each relevant Head of Service must provide confirmation that they accept responsibility for those actions related to their service area.

10. In either case, the auditor will assume that the auditee has consulted with those officers listed as responsible for individual actions in the MAP, prior to said officers being assigned responsibility for those actions.

Final Report and agreed MAP

12. Upon receipt of the populated MAP the auditor will consider if the actions therein are appropriate. If the auditor is satisfied that all factual points have been addressed; that the service has no outstanding concerns with the report, and that the MAP sufficiently addresses all the findings raised in the audit report, then the final report and MAP can be issued.

13. **Final reports should be issued together with the populated MAP, both of which must be in PDF format. See paragraph 25 below.**

MAP Escalation Procedure

14. If the MAP is not returned to deadline, or in the auditor's opinion does not adequately address the issues raised, the Chief Internal Auditor or Audit Performance Managers will discuss their concerns with the Head of Service. If that discussion does not result in a MAP acceptable to Internal Audit the issue will be referred to the relevant Strategic Director for a decision.

15. The Strategic Director's decision will be either to agree an acceptable MAP on behalf of the Head of Service, which must then be implemented within the agreed timescale, or to accept the position and acknowledge that the Strategic Director accepts the risk. Risks tolerated in this manner should be entered into the service risk register.

16. If in the opinion of the Chief Internal Auditor the Strategic Director's decision exposes the Council to an unacceptable level of risk, the matter will be referred first to the Chief Executive and then to the Audit and Governance Committee.

17. Depending upon the time taken in escalating MAP completion, the Chief Internal Auditor reserves the right to issue the final report without the agreed MAP.

Distribution list

18. The front cover of the agreed final audit report should list the officers for whom the report has been prepared. This includes the auditee, the Head of Service and other key officers as set out in the agreed Terms of Reference.

19. The inside cover to the report should include a table showing who else the report has been circulated to. If any people in this list are included on the front cover of the report it will not be necessary to include them in the circulation list. **The following distribution list may not apply should the Chief Internal Auditor deem the report to be of a particularly sensitive nature.**

- The External Auditor (through the Lotus Notes group email address)
- Responsible manager's level 4 report;
- Relevant Head of Service;
- Service Finance Manager;
- Risk and Governance Manager;

- Section 151 Officer;
- Relevant Strategic Director(s);
- All members of the Audit and Governance Committee;
- Relevant Cabinet Portfolio Holder;
- Chairman of the relevant select committee; and
- Procurement (if applicable - see 22)

20. There may also be a requirement to circulate the final report to other officers not included in the above list e.g. where that officer is required to action one of the audit recommendations. Where this individual is known at the time of issuing the final report their details should be included in the circulation table.

21. In all cases the Head of Policy and Performance and the Chief Internal Auditor should be included in the email circulation of the final audit report - this is for information purposes only, so they do not need to be included in the report distribution table referred to above. The Head of Policy and Performance will also ensure that where appropriate to do so final audit reports will be forwarded onto the relevant Performance Lead managers.

22. All audit reports for **Procurement,** or reports that have recommendations for Procurement, should be copied to Derek Lancaster.

23. If an audit report has an audit opinion of “Unsatisfactory” or “Major Improvement Needed” the Chief Internal Auditor will draw this to the attention of the Head of Communications.

Structure and contents

24. The standard reporting template is found on the Internal Audit shared drive, under: G:\CS Audit Team\Documentation\Galileo Templates.

25. In order to aid the reader’s understanding of the report, a glossary of acronyms should be included as a table on the inside of the front cover under the distribution list.

26. Final audit reports and MAPs should be saved as a PDF document using the format below. Where practical the two documents should be joined as one PDF document.

    Audit name-year-Final Report
    For example: IFRS-09-10-Fin Rep

Protective marking

27. Both draft and final reports should be marked in accordance with the County Council’s Protective Marking Policy, a copy of which is on the ‘News’ section of Galileo.

28. The Chief Internal Auditor has determined that of the three levels of marking applicable to local government the third category – Restricted – is likely not to be relevant to audit reports. Consequently reports will generally either be marked as ‘Protect’ or not marked at all, in accordance with the extract from the Policy below:

    “Information created or held by the council must be classified as either:

    - <u>NOT PROTECTIVELY MARKED or UNMARKED:</u> The document may have no markings on it or may be positively marked as NOT PROTECTIVELY MARKED. Anyone is permitted to see the documents internally or externally; the documents may be published on the web or in paper form.

- PROTECT: Only available to a limited number of staff. Documents should be clearly marked as PROTECT. The information should be handled with care following the guidance laid out in Appendix B of the Policy.

29. If an auditor is in doubt whether a report should be marked “Protect” or otherwise they should seek guidance from the Chief Internal Auditor or an Audit Performance Managers.

30. Where the Protect marking is used, the following paragraph must be added to the front cover of the draft and final report above the date of issue, and should also be included in the email containing the report:

    Please note that this report has been prepared by the County Council's Internal Audit team for the use of management in connection with the discharge of the Council's business and has been marked as PROTECT due to the sensitive nature of its content. A copy is being provided to you on the express understanding that it enables you to carry out your role as an officer or Member of the Council. It is not to be copied or in any way shared with any other person outside the Council.

Summary of completed audits for Members

31. The Chief Internal Auditor will report on all audits completed since the previous meeting to the Audit and Governance Committee, summarising the reason for the audit, the key findings, the risks resulting from those findings and the recommendations for improvement. The Audit and Governance Committee then considers whether there are any reports that it would like to review in more detail at a future meeting. A list of completed audit reports for the period (together with a link to full copies of those reports) is circulated to all members following the meeting of Audit and Governance Committee.

32. Should the Audit and Governance Committee require an update on completion of actions for a particular audit, the relevant Head of Service is responsible for informing the Chief Internal Auditor of what actions have been completed or providing an explanation for any delay in, or change to, the action being taken.

ESCALATION:

Follow up reviews

33. A formal follow-up review of the progress made in implementing recommendations agreed within the MAP may be programmed into the annual Internal Audit Plan at a time the Chief Internal Auditor considers appropriate.

34. Upon completion of the follow-up review the auditor will report to the Responsible Officer drawing attention to any actions that have not been completed by the agreed date. A copy of the follow-up report will be sent to the full distribution list set out above.

34. In addition, the Chief Internal Auditor will provide a report, at least bi-annually, to the Audit and Governance Committee on progress in implementing MAPs agreed for audits completed.

Audit and Governance Committee

35. The Head of Service may be required to attend the Audit and Governance Committee to answer questions on the reasons for the non-completion of agreed action or delay in implementation, and the remedial action to be taken.

36. The Audit and Governance Committee having considered the report and the evidence provided by the Head of Service will either agree the remedial actions proposed or, if they

consider the position unsatisfactory, will refer the matter to the relevant select committee or to the Cabinet as necessary.

Council Overview and Scrutiny Committee

37. The Chief Internal Auditor provides a report for each meeting of the Council Overview and Scrutiny Committee listing all audits completed in the period. For those audits attracting an audit opinion of "Major Improvement Needed" or "Unsatisfactory" a summary of the key findings and recommendations for these audits is also provided. The Council Overview and Scrutiny Committee may require officers to attend to provide updates on progress on implementing audit recommendations and/or may refer the matter to the relevant Select Committee or Cabinet member.

<u>VERSION CONTROL:</u>

1.0	Approved by Audit and Governance Committee 19/11/08	Effective from 01/12/2008
1.1	Amended to include Strategic Director in circulation	Effective from 24/02/2009
1.2	Amended to reflect comments made at Audit and Governance Committee 19/03/09	Effective from 01/04/2009
1.3	Amended to reflect Directorate/ Service Restructure	Effective from 11/01/2010
1.4	Amended to reflect Protect designation, revised timescales for draft and final reporting times, additional distribution requirements, and incorporation of additional guidance on Galileo in this one document	Draft 01/03/10
1.5	As agreed at Audit and Governance Committee 29/03/2010	Effective from 01/04/2010
1.6	Updated following CLT request for MAP ownership to be at Head of Service (or above) level.	Effective from 04/05/2010
1.7	Updated to highlight the requirement to issue the Final Report and MAP together, plus reflect changes to the audit manual.	Effective from 09/07/2010
1.8	Updated to reflect the responsibility of the Head of Service to inform Internal Audit if timescales in the MAP are likely to be missed.	Effective from 20/08/2010
1.9	Revised following Internal Audit team comments.	Effective from 23/09/2010
1.10	Amended to reflect new Service Name	Effective from 01/04/2011
1.11	Amendments as reported to A&G committee on 05/04/2012	Effective from 05/04/2012
1.12	Amendments as reported to A&G committee on 18/03/2012	Effective from 18/03/2012

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Draft Internal Audit Plan 2013/14

Audit Days 2012/13			Risk Score*	Audit Days 2013/14
40	**Corporate Governance Arrangements**			40
		AGS - Internal Audit Opinion	MAN	
		Corporate Governance - CRSA	MAN	
		Risk Management Arrangements audit review	MAN	
		Corporate Governance support	MAN	
200	**Key financial and Non-financial Systems**			200
		Financial Assessments and Benefits	101	
		SAP Application controls - policy, roles and access	99	
		Accounts Payable	99	
		Capital expenditure monitoring	97	
		Payroll	97	
		Accounts Receivable	96	
		Revenue budget control	94	
		Treasury Management	94	
		General Ledger	93	
		Pension Administration	85	
		Pension Fund Investments	84	
30	**Grants**			20
		EU Grants	MAN	
		Government Grants	MAN	
110	**Contract Reviews**			120
		UNICORN (Public Service Network)	86	
		Supply of ASC Equipment	83	
		Central contract management	79	
		Youth Service Commissions	79	
		Library Service global transport van service	76	
		Walton Bridge contract	76	
	Service Reviews			
150	**ASC**	Domiciliary care external providers	85	135
		Supported Accommodation & Independent Living Service(SAILS)	85	
		Serious Case Review - recommendation tracking	83	
		AIS assessment process	82	
		ASC Safeguarding Assurance Process	80	
		ASC Commissioning Framework	79	
295	**CSF**	Schools compliance	88	230
		ICS Phase 2 - Payments to providers	86	
		Free school meals	82	
		Schools SFVS process	82	
		Community Homes	81	
		SIMS	81	
		Short Stay Schools	78	
		Homes for Children with Disabilities	78	

*MAN = Mandatory

Draft Internal Audit Plan 2013/14

Audit Days 2012/13			Risk Score*	Audit Days 2013/14
50	**C&C**	Adult and Community Learning	84	75
		Customer Services	79	
		Surrey Arts	78	
		Music Tuition	77	
		Blue Badges	77	
315	**C&E**	Property Asset Management system (PAMS)	91	298
		Social Care Debt	85	
		SFRS Capital Project Management	83	
		Surrey Local Assistance Scheme	83	
		Finance Dashboard	80	
		Insurance	79	
		Management of CITRIX systems	79	
		Data Centre	79	
		Imprest Accounts	79	
		Smallholdings	78	
		Shared Service Partnership arrangements	78	
		Officer Interests	78	
		Appraisal and PDP	78	
		Energy Management	78	
		Employee Expenses	78	
		People Strategy	76	
		Trust Funds	76	
65	**CEO**	Information Governance	82	75
		Communications	81	
		Support of Cabinet and Member Scrutiny	78	
		Community Budgets	78	
		Community Improvement Fund	77	
105	**E&I**	Carbon Reduction Scheme	MAN	130
		Waste Charges	87	
		Waste Data System	84	
		Local Sustainable Transport Fund	80	
		Asset Management (Highways)	79	
		Highway Property Information	79	
		European office	77	
10	**PH**	Public Health	84	30
50	**Follow-up Audits including**			50
		Direct Payments		
		Residential Care Homes		
		Children in care dental and health checks		
		Special Schools – in-house residential		
		Purchase Cards		

*MAN = Mandatory

Draft Internal Audit Plan 2013/14

Audit Days 2012/13		Risk Score*	Audit Days 2013/14
136	**Client support and Service liaison**		136
50	Innovation support/follow-up		50
301	**Irregularity and Special Investigation including Fraud Prevention**		345
	NFI - support to other LAs		
	NFI Data Matching Exercise		
	Audit Web Page		
	Anti fraud and data interrogation		
	Irregularity contingency		
294	**Internal Management, Corporate Support and Organisational Learning**		294
	Audit Planning and Management		
	Audit Manual and Effectiveness Review Action Plan		
	Corporate Support		
	Audit Management System Upgrade		
	Audit and Governance Committee Support		
	Member Support and Training		
2201	**Total Audit Days**		**2228**

*MAN = Mandatory

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Item 11

AUDIT & GOVERNANCE COMMITTEE
18 March 2013

Completed Internal Audit Reports

SUMMARY AND PURPOSE:

The purpose of this report is to inform Members of the Internal Audit reports that have been completed since the last meeting of this Committee in February 2013 - as attached at Annex A.

Although it is not the Committee's policy to review all Internal Audit reports in detail during the meeting, full copies of the reports summarised have been provided to Members of the Committee.

RECOMMENDATIONS:

The Committee is asked to consider whether there are any audit reports or management action plans that it would like to review further and whether there are any matters they wish to refer to the relevant Select Committee.

BACKGROUND:

1 At the conclusion of each audit review a report is issued to the responsible manager who is asked to complete an action plan responding to the recommendations.

2 The return of a management action plan (MAP), which in the auditor's opinion adequately addresses the report findings and recommendations, signals the end of the audit process. Any follow up work required forms part of future audit plans at the appropriate time.

3 There have been 4 audit reports issued since the last report to this Committee in February 2013. The table below lists those audits and shows the audit opinion and number of high priority recommendations included in the Management Action Plan.

	Audit	Opinion	Number of recommendations rated as High Priority
1	Members' Disclosures and Declarations	Effective	0
2	Corporate Governance Policies	Some Improvement Needed	0
3	Financial Assessments and Charging	Some Improvement Needed	1
4	Network Controls	Effective	0

4 Annex A contains more details of the audits listed above and shows for each the:

- title of the audit
- background to the review
- key findings
- overall audit opinion
- key recommendations for improvement

5 The Committee will be aware that in order to respond to general Member interest in Internal Audit reports it has previously been agreed that a list of completed reports will be circulated to all Members of the County Council on a periodic basis.

6 In order to fully discharge its duties in relation to governance the Committee is asked to review the attached list of recently completed Internal Audit reports and determine whether there are any matters that it would like to review further or if it would like to suggest another Select Committee does so.

SELECT COMMITTEE REVIEW:

7 A completed audit reports item, featuring the above audits was presented to Council Overview and Scrutiny Committee on 13 March 2013.

IMPLICATIONS:

8 Financial
Equalities
Risk management and value for money

9 There are no direct implications (relating to finance, equalities, risk management or value for money) arising from this report. Any such matters highlighted as part of the audit work referred to in this report, would be progressed through the agreed Internal Audit Reporting and Escalation Policy

WHAT HAPPENS NEXT:

10 See recommendations above.

REPORT AUTHOR: Sue Lewry-Jones, Chief Internal Auditor, Policy and Performance

CONTACT DETAILS: telephone: 020 8541 9190 e-mail sue.lewry-jones@surreycc.gov.uk,

Sources/background papers: Final audit reports and agreed management action plans

Completed Audit Reports (January 2013 – March 2013)

Annex A

Audit	**Background to review**	**Key findings**	**Audit opinion** (1)	**Recommendations for improvement (Priority)** (2)
Members' Disclosures and Declarations	The External Audit Annual Governance Statement for 2011/12 was presented to A&G Committee on 3rd September 2012. This included the following recommendation: • ensure all members' and officers' annual declarations are assessed for reasonableness and completeness against officers' expectations The Chief Finance Officer requested that Internal Audit undertake a follow-up audit of the members' registration of interests	Surrey County Council members are required to publically disclose information under two systems. One is under legislation pertaining to "The Relevant Authorities (Disclosable Pecuniary Interests) Regulation 2012". The second system is under International Accounting Standard (IAS 24), which the council is required to comply with. Members complete a paper form of any related-party disclosures on an annual basis. Both systems rely on members providing relevant, accurate and up to date information. The internal process managed by the officers provided assurances there was a process for the members to complete their disclosures and declarations, although there were no formal checks made to validate member's declarations.	Effective	Introduce a method of sampling members related party disclosure submissions for accuracy and completeness. **(M)**
Network Controls	This review looked at the project and specification model for the new Wide Area Network to be provided through British Telecom from 1 April 2013	The project demonstrates significant alignment with central government's strategic plan for increasing partnership working for the procurement of information infrastructure.	Effective	None

Audit	Background to review	Key findings	Audit opinion (1)	Recommendations for improvement (Priority) (2)
Financial Assessments and Charging	Adults Social Care (ASC) is currently transferring financial assessments from the ABACUS system to the SWIFT system. There are approximately 5,000 clients billed through SAP every month for annual contributions to their social care of £38.5m. The majority of service users are billed in relation to a residential service.	The migration to assessment in SWIFT has been slower than initially hoped. Over 90% of residential service users now have a current assessment on SWIFT but there has been a delay in transferring the service users with non-residential care. The target for the completion of the migration to SWIFT is 31 March 2013, although it is likely this will overrun. There is a programme to transfer the remaining service users in tranches but it relies on the capacity of the ASC teams. A key area of the migration has been to ensure data quality in terms of correct assessments, and so frequent comparisons were made to compare the before and after migration effect on charges raised to ensure all were billed correctly, thus offsetting the delay in the ability to record the check in SWIFT. The audit found that one area team has not been completing the required 5% management check of all financial assessments.	Some Improvement Needed	It is recommended that the resourcing of the migration programme is reviewed to ensure it meets management requirements. **(M)** Management should ensure the 5% sample checks are undertaken for all assessments in line with agreed procedures. **(H)**

Audit	Background to review	Key findings	Audit opinion (1)	Recommendations for improvement (Priority) (2)
Corporate Governance Policies – Control Risk Self Assessment	SCC's Code of Corporate Governance describes the methodology for the annual review of governance. The Code refers to a list of 31 policies that are of key importance to ensuring good governance. Using a cyclical programme of Control Risk Self Assessment Questionnaires (CRSA), the extent to which SCC management are aware of the contents of specific policies is assessed each year. This year the CRSA exercise covered the following policies: • Disciplinary Policy • Grievance Policy • Ending bullying and harassment • Whistle blowing • Change Management • Scheme of Delegation	Some elements of the disciplinary policy and particularly the details of the appeals process do not appear to be fully understood by a significant number of managers. There are low numbers of formal cases of bullying and harassment, but other measures of the issue (surveys etc), indicate a wider potential concern. Some behaviours are not universally accepted as being examples of bullying and harassment, which may lead to poor behaviour in the workplace. Some services may be holding vacant posts as a means of protecting the workforce from the potential risk of redundancy in the future.	Some Improvement Needed	The next review of the Disciplinary Policy should consider the specific points raised by the Auditor that may benefit from further clarification, and also respondents' desire to see a policy that is easier to read, supported by case studies, training and FAQs. **(M)** HR should raise the level of management understanding of the Disciplinary Policy in specific areas **(M)** The next review of the Bullying Harassment and Discrimination policy and guidance to provide clearer illustrative guidelines to staff on unacceptable behaviour, supported by innovative and concise ways to explain unacceptable behaviours to staff e.g. posters, video clips on SNET. **(M)** Strengthen SCC's Whistle Blowing Policy to reflect the British Standards Institute provisions. **(M)** HR to clarify in the next update of the Change Management policy, the best way to treat vacant posts to minimise redundancies, particularly where there is no immediate plan to recruit to these posts. **(M)**

[1] **Audit Opinions**

Effective	Controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.
Some Improvement Needed	A few specific control weaknesses were noted; generally however, controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.
Major Improvement Needed	Numerous specific control weaknesses were noted. Controls evaluated are unlikely to provide reasonable assurance that risks are being managed and objectives should be met.
Unsatisfactory	Controls evaluated are not adequate, appropriate, or effective to provide reasonable assurance that risks are being managed and objectives should be met.

[2] **Audit Recommendations**

Priority High (H) - major control weakness requiring immediate implementation of recommendation
Priority Medium (M) - existing procedures have a negative impact on internal control or the efficient use of resources
Priority Low (L) - recommendation represents good practice but its implementation is not fundamental to internal control

SURREY
COUNTY COUNCIL

AUDIT & GOVERNANCE COMMITTEE
18 March 2013

LEADERSHIP RISK REGISTER

SUMMARY AND PURPOSE:

The purpose of this report is to present the latest Leadership risk register and update the committee on any changes made since the last meeting.

RECOMMENDATION:

Review the Leadership risk register (**Annex A**) and determine whether there are any matters that they wish to draw to the attention of the Chief Executive, Cabinet, specific Cabinet Member or relevant Select Committee.

LEADERSHIP RISK REGISTER:

1 The Leadership risk register (Annex A) is owned by the Chief Executive and shows the council's key strategic risks. The register is reviewed by the Risk and Resilience Steering Group (chaired by the Assistant Chief Executive) and then by the Corporate Board as part of their performance, finance and risk monitoring. Annex B shows the movement of the risks since they were added to the register.

2 To assist the committee in gaining assurance on the monitoring and review of risks on the Leadership risk register, the register also identifies when specific areas have been included on Select Committee agendas and also dates of future Select Committee reviews, where known.

IMPLICATIONS:

Financial

3 Ineffective risk controls or lack of timely action may impact on reputation, costs or service delivery.

Equalities

4 There are no direct equalities implications of this report.

Risk management

5 Effective risk arrangements will lead to improved governance, value for money and delivery of objectives.

WHAT HAPPENS NEXT:

The Leadership risk register will be regularly presented to the Committee.

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Leadership risk register as at 26 February 2013 **Owner: David McNulty** **Annex A**

Ref	Directorate register ref	Description of the risk	Inherent risk level (no controls)	Existing controls	Risk owner – Officer	Risk owner – Member	Residual risk level (after existing controls)	Committee review
L1	ASC2 CAC1,8,15 CAE9 CSF2 EAI6,7	**Medium Term Financial Plan** - Failure to achieve savings in the Medium Term Financial Plan (2012-2017) and additional service demand leads to increased pressure on service provision and damage to reputation.	**High**	- Monthly reporting to Corporate Board and Cabinet on the forecast outturn position to enable prompt management action - Generation of alternative savings and income - Adequate provision through the risk contingency	Corporate Leadership Team / Sheila Little	David Hodge	**High**	Council Overview & Scrutiny Committee - on each agenda Adult Social Care: - 14 February 2013 (Budget monitoring) Children & Families: - 30 January 2013 (Budget monitoring) Education: - 28 January 2013 (Budget Monitoring)
L14	ASC5 CAE17 CSF22	**Future Funding** - Gradual erosion of the council's main sources of funding (council tax and the proposed new method of calculating formula grant) upon which the council is highly dependent and reductions in other funding (for example in relation to academy schools) leads to financial loss, damage to reputation and failure to deliver services.	**High**	- Continued proactive modelling and horizon scanning of the financial implications of local government funding changes and subsequent review of Medium Term Financial Plan (2012-2017) assumptions as relevant - Close working with district and borough colleagues to shape the direction of council tax localisation and business rate retention policies as well as active responses to government consultations - Development of longer-term funding strategy to develop alternative sources of funding - Not withstanding actions above, there is a high risk of central government policy changes impacting on the council's financial position.	Corporate Leadership Team / Sheila Little	David Hodge	**High**	Audit and Governance Committee: - 18 March 2013 (Finance update)

Leadership risk register as at 26 February 2013

Owner: David McNulty **Annex A**

Ref	Directorate register ref	Description of the risk	Inherent risk level (no controls)	Existing controls	Risk owner – Officer	Risk owner – Member	Residual risk level (after existing controls)	Committee review
L7	CAE12 EAI1,2	**Waste** - Failure to deliver key waste targets (including key waste infrastructure) could lead to negative impact	**High**	- This is a priority issue for the service manager with strong resourcing and project planning in place that is monitored at board level. - Further work with the Districts and Boroughs continue, to review waste plans to achieve the targeted increase in recycling. - Notwithstanding the controls above, there is still a risk that delivery could be delayed by external challenge and levels of recycling are strongly influenced by district and borough collection arrangements which are not within SCC's direct control. Although the council continues to work in partnership to achieve the desired outcome.	Trevor Pugh	John Furey	**High**	Environment & Transport SC: - 1 March 2012 (Waste Partnership)
L15	NEW	**Welfare Reform** Multiple central government welfare reform changes impact adversely on Surrey residents and put additional pressure on Surrey County Council services.	**High**	- Effective horizon scanning to ensure thorough understanding of intended changes - Implementation of a welfare reform programme including districts and boroughs covering: • Advice and information • Financial resilience • Emergency assistance • Localisation of council tax support • Housing and homelessness • Employment training and support - Taking opportunities to influence central government e.g. via the LGA.	Corporate Leadership Team	David Hodge	**High**	Council Overview & Scrutiny Committee – reviewed on a quarterly basis as part of business reporting Adult Social Care Select Committee - date tbc Children & Families SC - 20 March 2013

Leadership risk register as at 26 February 2013 — Owner: David McNulty — Annex A

Ref	Directorate register ref	Description of the risk	Inherent risk level (no controls)	Existing controls	Risk owner – Officer	Risk owner – Member	Residual risk level (after existing controls)	Committee review
L11	ASC12 CEO7 CSF18	**Information Governance** - Failure to effectively act upon and embed standards and procedures by the council leads to financial penalties, reputational damage and loss of public trust as a result of enforcement action taken by the Information Commissioner.	**High**	- Secure environment through the Egress encrypted email system - Internal Audit Management Action Plans in place that are monitored by Audit & Governance Committee and Select Committees - Ongoing communications campaign and training - Monitoring of compliance by Quality Board and Governance Panel - Despite the actions above, there is a continued risk of human error that is out of the council's control.	Corporate Leadership Team	Denise Le Gal	**High**	Council Overview & Scrutiny Committee: - Monitored through internal audit reports
L3	CAC2,5,12 CAE3 CEO3	**Business Continuity, Emergency Planning and the event of industrial action** - Failure to plan, prepare and effectively respond to a known event or major incident results in an inability to deliver key services	**High**	- The Risk and Resilience Steering Group meets regularly to coordinate and lead on strategic resilience planning. - The Council Risk and Resilience Forum reviews, moderates, implements and tests operational plans. -Services have adequate and up to date business continuity plans. - Continued consultation with Unions and regular communication to staff.	Corporate Leadership Team	Kay Hammond	**Medium**	Council Overview & Scrutiny Committee: - 17 April 2013 (Business Continuity)
L2	ASC4,9 CAE1,2,16 CAC13 CSF4 EAI4,8	**Major change programmes** - Failure to deliver major change programmes and work in partnership leads to the organisation not being fit for purpose, an inability to meet efficiency targets, improve performance and drive culture change	**High**	- Delivery of change is tracked at both directorate and Corporate Board level with key indicators included in the Quarterly Business Report to the Cabinet. - Communications, engagement and the STARS programme are designed to respond to identified issues and gaps. - Work to strengthen the Council's approach to innovation is developing tools and providing support to assist services to redesign services.	Corporate Leadership Team	Cabinet	**Medium**	Council Overview & Scrutiny Committee: - monitored through quarterly business report

Leadership risk register as at 26 February 2013 **Owner: David McNulty** **Annex A**

Ref	Directorate register ref	Description of the risk	Inherent risk level (no controls)	Existing controls	Risk owner – Officer	Risk owner – Member	Residual risk level (after existing controls)	Committee review
L9	ASC11 CAE13 CSF8	**NHS Reorganisation** - The Health and Well Being Board does not provide the necessary whole system leadership to implement the Health and Social Care Act.	**High**	- SCC identified as a National Leader in implementing the Health and Social Care Act. - Transition to new system is being managed well with strong joint leadership arrangements in place	Sarah Mitchell	Michael Gosling	**Medium**	Health Scrutiny Committee: - 15 November 2012 (NHS Surrey)
L4	CAE5,7	**IT systems** - major breakdown and disruption of systems leads to an inability to deliver key services	**High**	- Additional resilience has been brought about by the go-live of the Primary and Secondary Data Centres. - Design and implementation of a new 64 bit Citrix farm is in progress that will bring resilience and performance enhancements. - Work in progress to increase the performance of login/logout times. - UNICORN Network is fully on track for completion by the end of March 2013.	Julie Fisher	Denise Le Gal	**Medium**	Council Overview & Scrutiny Committee: - 1 February 2013 (IMT service review)
L5	ASC7,16 CSF6,16	**Safeguarding** - avoidable failure in Children's and/or Adults care leads to serious harm or death	**High**	- Appropriate and timely interventions by well recruited, trained, supervised and managed professionals, with robust quality assurance and prompt action to address any identified failings.	Sarah Mitchell / Caroline Budden	Michael Gosling/ Mary Angell	**Medium**	Children & Families Select Committee and Adult Social Care Committee: - on each agenda

Key to references:

ASC = Adult Social Care
CAC = Customers and Communities
CAE = Change and Efficiency
CEO = Chief Executive's Office
CSF = Children, Schools and Families
EAI = Environment and Infrastructure

Movement of risks

Ref	Risk	Date added	Residual risk level when added	Movement		Current residual risk level
L1	Medium Term Financial Plan	Aug 12	High	-	-	High
L2	Major change programmes	May 10	High	Jan 12	⇩	Medium
L3	Business Continuity and Emergency Management	May 10	Medium	Aug 12	⇩	Medium
L4	IT systems	May 10	Medium	-	-	Medium
L5	Safeguarding	May 10	Medium	-	-	Medium
L6	*Resource Allocation System in adults personalisation*	*May 10*	-	*Aug 12*	*	-
L7	Waste	May 10	High	-	-	High
L8	*Integrated Childrens System*	*May 10*	-	*Feb 11*	*	-
L9	NHS reorganisation	Sep 10	High	Jan 12	⇩	Medium
L10	*2012 project management*	*Sep 10*	-	*Aug 12*	*	-
L11	Information governance	Dec 10	High	-	-	High
L12	*LLDD budget transfer*	*May 11*	-	*Mar 12*	*	-
L13	*2012 command, control, coordination and communication*	*Dec 11*	-	*Sep 12*	*	-
L14	Future funding	Aug 12	High	-	-	High
L15	Welfare reform	Feb 13	High	-	-	High

* Removed from the risk register

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