

# Annual governance report

Brighton & Hove City Council

Audit 2011/12

39



# Contents

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Key messages .....	3
Before I give my opinion and VFM conclusion .....	5
Financial statements .....	6
Value for money .....	22
Fees .....	28
Appendix 1 – Draft independent auditor’s report .....	29
Appendix 2 – Uncorrected errors .....	33
Appendix 3 – Corrected errors .....	35
Appendix 4 – Draft letter of management representation .....	36
Appendix 5 – Glossary .....	39
Appendix 6 – Action plan .....	42

# Key messages

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**This report summarises the findings from my 2011/12 audit which is substantially complete. It includes the messages arising from my audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.**

## Financial statements

As at 25 September 2012 I expect to issue an unqualified audit opinion.

4 You continue to produce good quality draft financial statements in accordance with statutory deadlines and your internal timetable. The financial statements submitted for audit were complete, internally consistent and compliant with extant accounting and disclosure requirements. This is a result of effective closedown processes and arrangements to produce and quality review the draft financial statements prior to submission for audit. The financial statements were supported by good quality working papers and I have identified only a relatively small number of errors and other issues as part of my work.

Your internal financial control arrangements remain sound except for the control environment within your payroll system. I am satisfied risks caused by the weaker control environment in payroll are recognised by both management and the Audit & Standards Committee. There has been a clear focus throughout the year on improving the payroll control environment. However, some actions that could help improve internal control, for example reducing the relatively high level of complexity of the Council's payroll, cannot be quickly or easily achieved.

## Value for money (VFM)

My detailed work to inform my value for money conclusion is now complete. I intend to conclude that you have made proper arrangements to secure economy, efficiency and effectiveness in your use of resources.

You are a high spending Council compared to your nearest neighbours although your spending is reducing at a slightly quicker rate than average. Available data also suggests you have high unit costs relative to others. A number of your service areas with higher unit costs are where you spend a large proportion of your total budget. I am satisfied you have adequate arrangements to be able to understand, assess and improve the value for

money you deliver. Your systems thinking initiative in revenues and benefits administration provides a good of example of where you have sought to better evaluate the specification of services currently delivered and focus the process of service delivery primarily on what is needed and most valued by the service user. You should seek to apply this type of evaluation more widely to assess what changes need to be made to deliver services with greater economy, efficiency and effectiveness.

You have sound financial plans which properly reflect both your priorities and the significant financial challenges you face. You have a good track record of delivery against those plans and you have shown that you are able to set and deliver value for money improvement programmes as part of your annual budget. However, given the scale of the medium term financial challenges you face it is likely you will need to think more radically about your current methods and level of service provision if you are to continue to deliver the value for money improvement needed to maintain your financial resilience.

# Before I give my opinion and VFM conclusion

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**My report includes only matters of governance interest that have come to my attention in performing my audit. I have not designed my audit to identify all matters that might be relevant to you.**

## Independence

I can confirm that I have complied with the Auditing Practices Board's ethical standards for auditors, including ES 1 (revised) - Integrity, Objectivity and Independence.

I am aware of one threat to independence that I am required to report to you. The spouse of one of my team working on the audit of the financial statements is a Council employee working in the highways department. I took steps to ensure that the member of my team did no work relating to the highways department or payroll to reduce this threat to an acceptably low level.

The Audit Commission's Audit Practice has not undertaken any non-audit work for the Council during 2011/12.

## I ask the Audit & Standards Committee to:

- consider whether to adjust the errors in the financial statements I have identified that management has not amended, or set out the reasons for not amending the errors (appendix 2);
- take note of the adjustments to the financial statements included in this report (summarised at appendix 3);
- approve the letter of representation (appendix 4), on behalf of the Council before I issue my opinion and conclusion; and
- agree your response to the proposed action plan (appendix 6).

# Financial statements

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**Your financial statements and annual governance statement are important means by which the Council accounts for its stewardship of public funds. As elected Members you have final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements and the annual governance statement.**

## **Opinion on the financial statements**

Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements. Appendix 1 contains a copy of my draft audit report.

## **Errors in the financial statements**

I detected a number of errors during the course of audit that I wish to draw to your attention. Corrected errors are summarised in Appendix 3. Where errors were detected in relation to a specific and significant risk, or where errors have led to agreed recommendations, they are considered in more detail in the main body of the report. Details of errors that management has declined to correct are set out in full in Appendix 2.

## **Significant risks and my findings**

In planning my audit I identified significant and specific risks to my audit of your financial statements. I reported those risks to the Audit & Standards Committee in April 2012 within my 2011/12 Audit Plan. I report my findings against each of these risks in Table 1.

Table 1: Risks and findings

Significant risk	Finding
<p><b>Payroll</b></p> <p>Although controls within your Midland i-Trent payroll system are capable of giving material assurance, my work, and the work of internal audit, has highlighted significant weaknesses in the operation of controls. As in previous years I am therefore unable to rely on controls to gain assurance for my opinion on the financial statements.</p> <p>The weaknesses in the operation of controls within payroll create a risk of misstatement and fraud. This is recognised by both management and the Audit and Standards Committee, as those charged with governance. Action is being taken to address the control issues noted.</p> <p>As I was not able to rely on controls I tested payroll transactions to gain assurance for my audit opinion.</p> <p>Where I sought to test payroll transactions in 2010/11 difficulties in finding documentation and other evidence to support payments caused delays in my work. My team therefore worked with officers responsible for payroll to undertake as much of this testing as possible before the financial statements were produced.</p>	<p>My substantive testing of payroll expenditure identified errors in three of the 40 cases selected for detailed testing:</p> <ul style="list-style-type: none"> <li>in one case six hours worked that were supported by an authorised timesheet had not been paid to the employee; and</li> <li>in two cases enhanced payments to staff were calculated at an incorrect rate of pay. In both cases this resulted in small value underpayments.</li> </ul> <p>You have been unable to demonstrate that these errors were isolated. I have therefore extrapolated the errors to determine the likely impact on your financial statements. The value of the extrapolated error is £197,000. No amendments have been made to the financial statements to adjust for the extrapolated error.</p> <p>I also found weaknesses in supporting evidence to support payments made in a further four of the 40 cases selected for detailed testing:</p> <ul style="list-style-type: none"> <li>in one case overtime payments had been made on the basis of an unauthorised timesheet. You have subsequently provided evidence to support the payment made; and</li> <li>in three cases there was no documentary evidence to support the pay-point and level of allowances paid to staff working in schools. In all cases you have subsequently provided evidence to support the level of payments made.</li> </ul> <p>Although the work of my team was well supported by payroll staff there remained difficulties in locating records to evidence the expenditure tested. This was particularly true for Council staff working in schools where employees may have one substantive role, but also undertake additional duties at a different rate of pay.</p> <p>I have considered the totality of my findings in this area. Although I have concluded that there is no material impact on my opinion or evidence of fraud, my findings continue to show that the control environment within payroll remains weaker than for your other main financial systems. Given the high level of expenditure generated by the payroll</p>

## Significant risk

## Finding

system you need to continue to address this. I am satisfied that this is recognised by both management and the Audit & Standards Committee. There has been a clear focus throughout the last year on improving the control environment within the system, including extensive communication with your payroll system provider. However, some actions that could help improve internal control, for example reducing the relatively high level of complexity of the Council's payroll, cannot be quickly or easily achieved.

I have raised a recommendation on the need to continue to focus attention on the improvement of the control environment in payroll. I also consider this in the section of my report where I comment on significant weaknesses in internal control.

### **See recommendation 1**

There were delays in the production of a year end data return of pensions contributions required by East Sussex Pension Fund (ESPF). This was caused by difficulties in extracting data accurately from the payroll system in the required format. These delays meant that ESPF was not able to operate some year end controls in a timely manner. The operation of these controls gives assurance over pensions data included in your financial statements. This in turn impacted adversely on the planned timetable for the auditor of ESPF to test the operation of these controls and provide me with assurance for my opinion on your financial statements. You recognise the need to improve the format, timeliness and accuracy of pensions data extracted from your payroll system and have been actively liaising with your payroll system supplier to address this.

### **See recommendation 2**



## Specific risks

### Local Delivery Vehicle – Seaside Community Homes Limited.

You plan to transfer 499 council dwellings to Seaside Community Homes Limited (Seaside), a charitable company limited by guarantee. The transfer of properties began in November 2011 and therefore impacts on my 2011/12 responsibilities. The properties will be transferred under a 99-year lease of land and buildings with a break point exercisable by you after 40 years. Seaside will provide accommodation to tenants, manage the transferred properties, collect rents and undertake capital works on the properties. Seaside will pay cash sums to you as properties are transferred that you intend to recognise as capital receipts in your financial statements.

There are two main issues arising from this arrangement that impact on my 2011/12 responsibilities in relation to the financial statements:

- There may be a group relationship between you and Seaside that would require you to produce group financial statements in 2011/12.
- Accounting for the arrangement involves the exercise of judgement by management. In particular, the classification of the lease of land and buildings as a finance or operating lease has an impact on how you recognise receipts from Seaside for the transferred properties in your accounts.

## Finding

Finance officers have liaised with my team over the course of the year and have shared proposals on how you intend to account for your relationship with Seaside in your 2011/12 financial statements. I have considered and challenged those proposals. This challenge has included detailed audit work on calculations, documentation and other supporting evidence.

Based on my work undertaken to consider the evidence supporting your proposals I am not minded to challenge your view that:

- there is no group relationship between the Council and Seaside. I have therefore accepted your conclusion that group accounts are not required in 2011/12;
- the lease of transferred buildings should be accounted for as a finance lease in your 2011/12 financial statements; and
- sums paid to the Council should be accounted for as capital receipts in your 2011/12 financial statements.

My team has also undertaken detailed audit work on a sample of properties transferred to Seaside to check that you have accounted for the transfer in accordance with your proposals. Specifically this work checked that the details of the transfer agree with the requirements of the over-arching agreement between the Council and Seaside and that the accounting adopted in practice accords with the accounting for finance leases required by the 2011/12 code of practice on local authority accounting (the Code). There are no issues arising from this work that I wish to bring to your attention and I am satisfied that the accounting treatment adopted in your 2011/12 financial statements is materially consistent with the requirements of the Code.

As part of my work I identified a risk that your relationship with Seaside should be accounted for as a service concession arrangement under the international standard IFRIC 12. If applicable, this would require you to account for the assets transferred under the arrangement with Seaside on your own balance sheet. Your view is the

## Specific risks

## Finding

arrangement is not a service concession for the purposes of IFRIC 12. I have considered your representations to me and available supporting evidence and I am not minded to challenge your view. This is because it is reasonable to conclude that the Council does not have control over the price charged by Seaside for services delivered. I am therefore satisfied that your relationship with Seaside should not be accounted for as a service concession arrangement in your 2011/12 financial statements.

I also consider your relationship with Seaside as part of my work to give a value for money conclusion later in this report.

### Falmer Academy

The new school for Brighton Aldridge Community Academy (BACA) was held on your 2010/11 balance sheet as an asset under construction.

The new school was completed and transferred to the possession of BACA in August 2011. It became operational as the main school premises in September 2011. The school land and buildings are subject to a long-term lease that will start on completion of the contract. The final legal execution of the lease will not now take place until the 2012/13 financial year. There is therefore some exercise of judgement required to determine how the asset and associated changes should be accounted for in your 2011/12 financial statements.

Finance officers liaised with my team over the course of the year and shared proposals on how you intended to account for BACA in your 2011/12 financial statements.

I am satisfied that you have accounted in accordance with your proposals and that the accounting treatment adopted complies with the requirements of the Code.

I identified one issue as part of my work this area which I wish to bring to your attention. Depreciation of approximately £294,000 was charged in the year on the new school. Your accounting policy is to not charge depreciation on a new asset until the year following acquisition or the year after the asset becomes operational. Depreciation charged on BACA in 2011/12 is therefore not in line with your stated accounting policy and is a non-trivial error in your financial statements. As this impacts on 2011/12 only you have decided not to correct this error in your financial statements – see Appendix 2. This finding only affects disclosures in your financial statement and has no overall impact on Council or Academy budgets.

The error arose because the main building expenditure was transferred from assets under construction into operational land and buildings in your asset register at the start of the financial year. This triggers an automatic depreciation calculation in the system. All other acquisitions and transfers from assets under construction were made at the end of the year to avoid a depreciation charge being triggered by the system.

You plan to complete Portslade Aldridge Community Academy (PACA) in 2012/13 and this will be accounted for in a similar way to BACA in your 2012/13 financial statements. It is therefore important that you avoid a similar error arising when PACA assets are

## Specific risks

## Finding

transferred from assets under construction into operational land and buildings on your asset register.

**See recommendation 3**

### **Waste management private finance initiative (PFI) – energy from waste facility**

The energy from waste facility at Newhaven is now operational. Although accounting arrangements for the joint waste management PFI are well established specific entries will be needed to bring the facility on to your 2011/12 balance sheet.

As in previous years, I engaged a technical specialist to review the accounting for the joint waste management PFI in your 2011/12 financial statements. This work included specific consideration of the accounting entries to bring the energy from waste facility on to your balance sheet.

I am satisfied that the joint waste management PFI, including the new energy from waste facility at Newhaven, is correctly accounted for in your financial statements. Recognition of the energy from waste recycling facility on your 2011/12 balance sheet added approximately £48.5 million to the carrying value of your property, plant and equipment.

As part of my work to review PFI related entries to your accounts I identified a non-trivial error in the classification of expenditure relating to contingent rents in your consolidated income and expenditure statement. I am satisfied this been corrected in your revised financial statements.

### **Housing Revenue Account (HRA) self-financing**

Under self-financing you will be required to take a calculated share of the national HRA debt onto your balance sheet. In return you will no longer pay negative subsidy to the Department for Communities and Local Government. Although the new system of HRA self-financing will not start until 2012/13, borrowing of around £18 million will be secured and will come on to your balance sheet at the end of March 2012. There is a risk that this is not accounted for correctly in your financial

I am satisfied that you have correctly accounted for and clearly disclosed the impacts of changes required in preparation for the start of self-financing of the HRA in your 2011/12 financial statements.

## Specific risks

statements.

## Finding

### Heritage assets

The 2011/12 code of practice on local authority accounting (the Code) adopts the requirements of FRS 30 Heritage Assets. As this is a new requirement, there is a risk that you may not be able to identify and account for all heritage assets within the time available.

A heritage asset is a tangible asset with historical, artistic, scientific, technological, geophysical or environmental qualities that you hold and maintain principally for its contribution to knowledge and culture.

This may include historical monuments, museum artefacts or works of art. You are now required to specifically identify and disclose such assets. You also may have to value and recognise assets meeting this definition on your 2011/12 balance sheet.

My work in this area included an evaluation of the management controls you have in place to identify and potentially value and recognise significant heritage assets. I also undertook testing to check that you have accounted for and disclosed heritage assets in accordance with FRS 30 and the Code.

You established sound processes and management controls for the identification and, where appropriate, valuation and recognition of heritage assets. I am satisfied that the heritage asset disclosures made in your financial statements are complete and comprehensive.

## Recommendation

**R1** Continue to improve the internal control environment within the Midland iTrent payroll system as a matter of priority. In particular, ensure that all controls are operated consistently and evidence is retained to show that controls have been operated.

**R2** Produce the year end data return of pensions contributions required by East Sussex Pension Fund in a timely manner.

**R3** Ensure transfers from assets under construction into operational land and buildings are made on your asset register so that no depreciation is charged in accordance with your accounting policy.

## Significant weaknesses in internal control

It is your responsibility to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. My responsibility as your auditor is to consider whether you have put adequate arrangements in place to satisfy yourselves that the systems of internal financial control are adequate and effective.

I have tested the controls of the Council only to the extent necessary for me to complete my audit. I am not expressing an opinion on the overall effectiveness of internal control. I have reviewed the Annual Governance Statement and can confirm that:

- it complies with the requirements of CIPFA/SOLACE Delivering Good Governance in Local Government Framework; and
- it is consistent with other information that I am aware of from my audit of the financial statements.

The following weaknesses in internal control are only those I have identified during the audit that are relevant to preparing the financial statements.

Table 2: Internal control issues and my findings

Description of weakness	Potential impact and management action
<p><b>Midland i-Trent payroll</b></p> <p>My work to document and walkthrough your Midland i-Trent payroll system confirmed that control weaknesses within the system have not yet been addressed. Although controls have been established that are capable of preventing and detecting material misstatement they are not operated consistently or insufficient evidence is retained to support the operation of the controls. I noted the following issues at the time of my review (January 2012):</p> <ul style="list-style-type: none"> <li>■ The signatory file of budget holders and staff who have authorisation to sign timesheets and expense claims was not up to date.</li> <li>■ Pre-vetting reports are run from the system before each payroll is finalised and paid. Checking of individual reports is delegated to a number of different staff with corrections to the payroll processed as necessary. There is, however, no consistent check to ensure that this process is completely and correctly undertaken.</li> <li>■ There was a continuing backlog in scanning records and supporting documentation.</li> </ul> <p>I have also considered the work of Internal Audit undertaken on the payroll system during the year. This has continued to identify significant weaknesses in the control environment within the payroll system.</p>	<p>The control weaknesses identified continue to create a risk that:</p> <ul style="list-style-type: none"> <li>■ Expenditure generated by the payroll system is not correctly classified on the general ledger.</li> <li>■ Expenditure generated by the payroll system is not accurately recorded on the general ledger.</li> <li>■ The payroll system transactions recorded on the system have not actually occurred or do not relate to the Council.</li> </ul> <p>I am satisfied these issues are recognised by the Council. There has been a clear focus during the year from both management and the Audit &amp; Standards Committee on improvement of the control environment within the system, including extensive communication with your payroll system provider. It is essential that this focus is maintained and improvements in internal control in this area are secured as a matter of priority.</p> <p><b>See recommendation 1.</b></p>
<p><b>Journals processed on the general ledger</b></p> <p>Manual adjustment journals processed on the general ledger are</p>	<p>Weaknesses in the internal control environment for journals create a risk that</p>

## Description of weakness

not always subject to formal checking and authorisation. For the majority of the year staff were able to raise and authorise all journals processed on the general ledger.

I raised similar weaknesses in journal controls as part of my 2009/10 and 2010/11 annual governance reports.

As part of my work in this area I also found that payroll recode journals of a gross value of approximately £19.6 million have been processed on your general ledger in the year. The journals affected more than 15,000 individual payments. I tested a number of these transactions as part of my general testing of journals processed on your general ledger. This testing identified no errors and I am satisfied that classification of payroll expenditure on the general ledger and in the financial statements is materially correct.

## Potential impact and management action

income and expenditure is misclassified on the general ledger and misreported in your financial statements.

You have considered the recommendation I raised in this area last year and have implemented a control with effect from the end of February 2012. You have introduced a scheme of on-screen authorisation for journals that are considered high risk or more complex. I have not tested the operation of this control as it did not operate through the whole financial year. I am, however, satisfied that it is properly focused on those areas of your accounts that are most susceptible to manipulation or error.

The number and value of recode journals processed increases the risk of misclassified expenditure in your accounts. The need to process this number of journals to correct the coding of expenditure also consumes a significant amount of officer time. I am satisfied some of these adjustments have been caused by restructuring of Council services. However, you should continue to review and improve processes for updating the general ledger with details of expenditure generated by the payroll system.

**See recommendation 4**

## Control accounts

As part of my work on payroll I reviewed your payroll control account balance at the end of the financial year. Although good progress had been made in reconciling the account approximately £160,000 of the account balance at year end could not be fully supported.

Unreconciled balances on control accounts create a risk that income and expenditure is not accurately recorded and classified on your general ledger. Much of the year end balance on the payroll control account relates to historical transactions that will not be easy to reconcile. You should consider whether these transactions should be written off to revenue.

**See recommendation 5**

## Recommendation

**R4** Improve processes to ensure payroll expenditure is correctly classified on the general ledger without the need for recoding.

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**R5** Review the outstanding unsupported balance on the payroll control account reconciliation and write off to revenue if necessary.

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## Other matters

I am required to communicate to you significant findings from the audit and other matters that are significant to your oversight of the Council's financial reporting process including the following:

- Qualitative aspects of your accounting practices.
- Matters specifically required by other auditing standards to be communicated to those charged with governance. For example, issues about fraud, compliance with laws and regulations, external confirmations and related party transactions.
- Other audit matters of governance interest.

The matters I wish to report are set out in table 3.



Table 3: **Other matters**

Issue	Findings
<p>You are involved in a number of partnership arrangements under section 75 of the NHS Act 2006 for the commissioning and provision of services to adults, children and young people.</p> <p>The Children and Young People's Trust (CYPT) is a partnership between the Council, Brighton &amp; Hove City Primary Care Trust (BCHPCT) and Sussex Community Trust (SCT) to commission and provide education, health and social care services for people up to the age of 19 within your geographical boundaries. You are the host body, lead commissioner and lead provider for this arrangement.</p> <p>Adult social care services are commissioned and provided within your geographical boundaries in partnership with BHCPCT, SCT and Sussex Partnership Foundation Trust (SPFT). The partnership covers intermediate care, mental health, substance misuse, AIDS/HIV services and learning disabilities. You are lead commissioner and provider for learning disabilities services.</p>	<p>I found a number of issues relating to both the CYPT and adult social care partnership arrangements as part of my work which I wish to bring to your attention.</p> <p><b>Children and Young People's Trust</b></p> <p>The provider agreement with SCT is out of date and refers to South Downs Health NHS Trust which is SCT's predecessor body. The commissioner agreement with BHCPCT is out of date. It was drafted for the 2010/11 financial year and stipulates that it should be updated annually. It has not been updated for 2011/12 and you are therefore reliant on the default provisions of the agreement. The agreement identifies the Council as the host body for a pooled commissioning budget. In 2011/12 the Council hosted approximately £67 million or 98 per cent of the total funds spent under the pool. However, approximately £1.5 million of funds were spent directly with providers by BHCPCT and not pooled. The arrangement is not therefore operating as a true pooled budget or being accounted for as such in your 2011/12 financial statements. You account for any over or under spending in relation to the services you provide directly (£57 million expenditure in 2011/12) and BHCPCT accounts for over and under spending in relation to the services it directly commissions (£1.5 million expenditure in 2011/12). The split of over or under spending on services commissioned by the Council from SCT (£9.7 million expenditure in 2011/12) is agreed between both bodies each year.</p> <p>There were material errors in the disclosure of funding contributions and expenditure originally presented at Note 8 to the financial statements. The financial statements have been amended to correct this.</p> <p><b>Adult social care</b></p> <p>The commissioner agreement with BHCPCT dates from 2007 and is out of date. Although the commissioning agreement allows for funds to be pooled the arrangement is not currently operated as a pooled budget and is not being accounted for as such in your financial statements. There are no documented financial risk sharing arrangements in place apart from in the provider agreement with SPFT where you agree to share the</p>

## Issue

## Findings

impact of any over or under spending equally with the Trust. The split of over or under spending outside of the agreement with SPFT is agreed between the partner bodies each year.

There was a non-trivial error in the disclosure of provider spending for adult social care in the disclosure at Note 8 to the financial statements. You have corrected this in the revised financial statements.

There is a need to revisit, clarify and update your section 75 partnership arrangements for the commissioning and provision of services to adults, children and young people. You should also ensure that there is an effective process for checking the accuracy of the disclosure of commissioner and provider expenditure under these arrangements in the draft financial statements.

### **See recommendation 6.**

I note you have disclosed an ongoing action in your 2011/12 annual governance statement to review partnership and governance arrangements with health. In particular:

- supporting the implementation of the shadow Health and Wellbeing Board;
- preparing for the transfer of public health functions to local government; and
- to respond to structural change in the NHS which will affect existing section 75 agreements.

As part of my work to test capital expenditure I identified a situation where you had acted as both developer of one of your own capital assets and local planning authority. To meet planning conditions for development of the asset, the Council in its capacity as developer had sought to enter into an agreement under section 106 of the Town and Country Planning Act with the Council in its capacity as local planning authority. The commitment under the section 106 agreement of £82,000 has been capitalised in your 2011/12 financial statements as a cost

The accounting treatment in your 2011/12 financial statements is not correct. The Council is a single legal entity and therefore cannot enter into an enforceable agreement with itself under the Town and Country Planning Act. There has been no inflow or outflow of economic benefits to or from the Council. There is therefore no cost to capitalise or income received to appropriate to a reserve.

I am satisfied that this finding is isolated, its impact on the 2011/12 financial statements is trivial and therefore that it is appropriate not to amend the financial statements to correct this. I am bringing this issue to your attention as the Council is likely to act as both developer and local planning authority in the future. You therefore need to

Issue	Findings
<p>necessary to bring the asset into use. You have also accounted for the section 106 contribution in an earmarked reserve.</p>	<p>reconsider your arrangements and accounting in this area. <b>See recommendation 7.</b></p>
<p>My work on your 2010/11 Whole of Government Accounts (WGA) return identified non-trivial grossing-up of internal recharges in your 2010/11 comprehensive income and expenditure statement. This has the impact of over stating income and expenditure. You have revised your arrangements to reduce the possibility of this recurring in 2011/12.</p>	<p>As part of my testing of revenue grant income and contributions I detected that some capitalised salary costs had been revised from revenue by crediting income rather than expenditure in your consolidated income and expenditure account. This over stated income and expenditure by approximately £472,000. You should continue to review your internal process to minimise the possibility of double counting income and expenditure in the consolidated income and expenditure statement. <b>See recommendation 8.</b></p>
<p>I review and test your year end processes to reconcile your bank accounts and other cash balances reported in your financial statements. I am satisfied that your processes are sound overall, but I have identified a small number of issues.</p>	<p>I identified a difference of £60,000 between the bank balance on the general ledger and your reconciliation schedule relating to schools cash balances. This difference was originally caused by the merger of two schools during 2010/11. Although the reconciling item is below the triviality level for my audit, and I am satisfied it does not indicate any higher value discrepancies, it relates to cash and is more sensitive. You should continue to investigate the difference and take appropriate action to clear it as appropriate. <b>See recommendation 9.</b></p>
	<p>I identified an unmatched balance on the reconciliation of your payments accounts of approximately £80,000 which originates from the bank reconciliation module of your cash management system. Although the reconciling item is below the triviality level for my audit, and I am satisfied it does not indicate any higher value discrepancies, it relates to cash and is more sensitive. You should continue to investigate the difference and take appropriate action to clear it as appropriate. I have also identified a discrepancy in your processes for accounting for payments that straddle financial year end between payments initiated by financial systems which are</p>

## Issue

You participate in the local government pension scheme administered locally by East Sussex County Council. Each year you commission Hymans Robertson LLP, an independent firm of actuaries, to assess the value of your pension fund assets and liabilities. This work informs disclosures in your financial statements. As part of this process you are required to provide an estimate of annual employer contributions based on actual contribution expenditure data to the end of month 10.

## Findings

integrated in your general ledger and payments initiated by financial systems external to your general ledger. Although this has not resulted in inconsistent treatment or any error in your financial statements in 2011/12 there is potential for it to do so in the future. You should therefore review your internal processes in this area to ensure accounting treatments are consistently applied.

**See recommendation 10.**

There was a difference of £525,000 between your estimate of employer contributions, which was considered by the actuary in its valuation of scheme assets and liabilities, and the actual value of employer contributions paid in the year. Although I am satisfied this has no material impact on disclosures in your financial statements you should seek to improve the accuracy of this accounting estimate. This will require better communication between your payroll and central accounting teams of the basis for the estimate.

**See recommendation 11.**

## Recommendation

**R6** Revisit, clarify and update partnership arrangements under section 75 of the NHS Act 2006 for the commissioning and provision of services to adults, children and young people. Ensure there is an effective process for checking the accuracy of the disclosure of commissioner and provider expenditure under these arrangements in the draft financial statements.

**R7** Review and reconsider your accounting arrangements in situations where the Council undertakes capital works on its own assets requiring planning consent and acts as both developer and local planning authority.

**R8** Continue to review your internal processes to minimise the possibility of double counting income and expenditure in the consolidated income and expenditure statement.

## Recommendation

**R9** Clear the difference of £60,000 between bank balances on the general ledger and your reconciliation schedule relating to schools cash balances.

**R10** Address the following in your year end bank reconciliation processes:

- clear the unmatched balance of approximately £80,000 on your year end payments account reconciliation which originates from the bank reconciliation module of your cash management system; and
- for payments that straddle year end, ensure that payments initiated by financial systems integrated in your general ledger are treated consistently with payments that are initiated by financial systems outside your general ledger.

**R11** Seek to improve the accuracy of your accounting estimate of employer pensions contributions that you provide to your actuary. This will require better communication between your payroll and central accounting teams of the basis for your estimate.

## Whole of Government Accounts

Alongside my work on the financial statements, I have also reviewed and reported to the National Audit Office on your WGA return. The extent of my review and the nature of my report were specified by the National Audit Office. My work in this area identified a relatively small number of errors in the WGA return. The WGA return has been amended to correct some of these errors. I have reported uncorrected errors to the National Audit Office.

# Value for money

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**I am required to conclude whether the Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is the value for money conclusion.**

## **Background and approach**

I assess your arrangements against the two criteria specified by the Commission which I reported to you in my 2011/12 Audit Plan.

The main risk that is relevant to my value for money conclusion continues to arise from funding reductions in the comprehensive spending review and the resulting need to continue to secure significant efficiencies to achieve your medium term financial plans. In light of this I have undertaken the following work to inform my 2011/12 value for money conclusion:

- I have used the Audit Commission's VFM profile database, and other available information on cost, to consider your costs relative to your statistical nearest neighbours;
- I have considered your arrangements to compare costs and outcomes against others to form a view on the level of understanding you have on the value for money delivered. In particular, I have considered your arrangements to ensure that commissioners have adequate information on costs and outcomes to make properly informed decisions; and
- I have considered how you use comparative information on costs and outcomes to inform budgeting and gain assurance that your pattern of spending matches your priorities.

## **Findings and conclusions**

I have set out below my findings relevant to the two criteria in table 4.

I intend to issue an unqualified conclusion stating that the Council has proper arrangements to secure economy, efficiency and effectiveness in the use of its resources. I include my draft conclusion in Appendix 1.

Table 4: Value for money conclusion criteria and my findings

Criteria	Findings
<p><b>Securing economy efficiency and effectiveness</b></p> <p>The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.</p> <p>Focus for 2011/12:</p> <p>The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.</p>	<p>Based on the Audit Commission’s VFM profile database, which uses 2010/11 spending data, the Council is high spending relative to its statistical nearest neighbours. This is true for both your overall spending and for your major service areas individually, where spending is generally in the top ten per cent. However, your overall spending is reducing, and reducing at a slightly quicker rate than at your nearest neighbours.</p> <p>The Council’s costs per unit of activity, your unit costs, also appear high relative to other local authorities. This is the case for the majority of your service areas based on available data. A number of the service areas with higher unit costs are where you spend a large proportion of your overall budget, for example children’s social care, older people and adult learning difficulties. However, these unit cost comparisons are based on information dating from 2009/10, and there are accepted difficulties in identifying reliable data to compare unit costs. You recognise this and have disclosed a risk in your 2011/12 annual governance statement of a more general reduction in the availability of reliable comparative data, and the impact this may have on your ability to benchmark your value for money in the future.</p> <p>High absolute levels of spending and high unit costs do not necessarily equal poor value for money. A range of variables drive your spending and costs. It is therefore essential that you are able to identify, monitor and compare these variables to arrive at an informed view of the value for money you deliver. For example:</p> <ul style="list-style-type: none"> <li>■ Relatively high levels of demand for a service can lead to high levels of spending absolutely, and high spending per head of population relative to others. You therefore need to be able to quantify and understand the drivers of demand for your services relative to others.</li> <li>■ Certain service costs are subject to significant local variation, for example regional variations in labour costs and the value of property. This can lead to relatively high levels of absolute spending and unit costs. You therefore need to be able to identify service costs that are genuinely subject to significant local</li> </ul>

## Criteria

## Findings

variation and the impact this has on your spending relative to others.

- A high service specification can lead to high levels of absolute spending and high unit costs compared to others. The specification of a service will in turn depend on a number of factors such as policy decisions on the level of service provided relative to the level of assessed need and your attitude to service delivery risk more generally.

Based on my review I am satisfied that you have adequate arrangements to be able to understand, assess and improve the value for money you deliver. For example, you have benchmarked children's services to evaluate your level of spending compared to the needs of service users. This found that the level of need was above average at just outside of the top third of the 124 local authorities included in the comparison. However your spend, which was in the top five per cent of local authorities included in the comparison, appeared disproportionately high relative to assessed need.

Your systems thinking initiative provides another good example of where you have sought to better evaluate the specification of services currently delivered and focus the process of service delivery primarily on what is needed and most valued by the service user. You intend to use this understanding to assess what changes need to be made to deliver services with greater economy, efficiency and effectiveness. Systems thinking is a term used to describe a process where a department, service or business area deconstructs and evaluates its processes to identify potential quality improvements, cost reductions, training needs and other barriers to efficiency. The aim is to reconfigure the service so that it offers better value for money. As part of my work I have considered the systems thinking review you have undertaken in revenues and benefits administration. You estimate that the review has resulted in recurrent savings of approximately £500,000 from an original budget of approximately £7 million. It has also identified a number of key principles which should be applied to improve value for money:

- A clear and up to date understanding of key customer requirements is essential to improve the value offered by a service. The service should be structured



Criteria	Findings
	<p>primarily to ensure compliance with legal requirements and focus on the key needs of the service user. Parts of the existing service specification and supporting processes that are no longer required to meet these key aims can be removed to reduce costs and improve efficiency and effectiveness.</p> <ul style="list-style-type: none"> <li>■ To improve value for money, systems and processes should primarily be designed to deal with the usual course of business. In the majority of cases they should not primarily be focused on managing a worst case scenario. To do this, services need to understand key business and reputational risks and make reasonable and proportionate allowances for them in the way the service is operated.</li> <li>■ Staff need to be well trained and understand the purpose of the processes they follow rather than simply operating them because they are required to.</li> </ul> <p>The next step is to seek to apply the lessons learned from this work to other areas of the Council's operations.</p>
<p><b>Financial resilience</b></p> <p>The organisation has proper arrangements in place to secure financial resilience.</p> <p>Focus for 2011/12:</p> <p>The organisation has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.</p>	<p>My work in this area considered:</p> <ul style="list-style-type: none"> <li>■ your track record of delivering to budget;</li> <li>■ your budget setting processes, including the system of star chambers to challenge budget proposals; and</li> <li>■ the robustness of your medium term financial plans and savings targets in the 2012/13 budget.</li> </ul> <p>Based on my work I am satisfied that you have adequate arrangements in place to secure financial resilience. Specifically:</p> <ul style="list-style-type: none"> <li>■ you have a good track record of delivering your budget;</li> <li>■ your financial plans properly reflect the significant financial challenges you face over the medium term;</li> <li>■ you have well established processes for identifying savings targets and setting budgets that fit with available funding; and</li> <li>■ you have effective processes for monitoring performance against budget and</li> </ul>

## Criteria

## Findings

instigating corrective action where necessary.

Your 2012/13 budget setting process was supported by a series of star chamber meetings of officers and members where services were required to justify and respond to challenge of their budget proposals. As part of my work I considered minutes of the meetings and detailed reports and other analysis produced in support of them. Although I noted some variation in quality I have concluded that overall they provided effective challenge and a mechanism to ensure that detailed budgets accord with your priorities. I note that the process followed deliberately allowed for some flexibility in the format of responses provided by services.

I have also considered the effectiveness of some of your specific actions to secure funding for urgently needed capital works on your housing stock. This work is needed to ensure compliance with the decent homes standard by your target timescale. The transfer of 499 council dwellings to Seaside Community Homes Limited is an innovative method of both securing improvements to the transferred properties and raising capital receipts to fund the capital works needed on other council dwellings. Although successful, its innovative nature, and other changes affecting the project that were not within your control, has made it a complex, resource intensive and time consuming scheme to progress. Your housing repairs and improvement contract with your external partner Mears has also been successful in improving value for money. It has secured both reduced repairs and maintenance costs and improved quality in terms of the consistency in standard of work delivered and the speed of response.

You have a good track record of setting and delivering value for money improvement programmes as part of your annual budget. However, it is becoming increasingly difficult to secure savings of the scale needed to meet the financial challenges you face. As part of my review of current performance against 2012/13 savings targets I noted that some of your planned savings in adult social care, for example savings generated by the planned implementation of the learning disabilities accommodation and support strategy, may not be achievable as at June 2012. This is a service where there is a mature market for the provision of services

**Criteria****Findings**

and you have already used your commissioning experience to outsource service provision where appropriate. Although mitigating savings have been identified for 2011/12 the rising demand for adult social care these means savings may be increasingly difficult to identify without a more fundamental review of how services are delivered.

Given the scale of the medium term financial challenges you face it is likely you will need to think more radically about your current methods and level of service provision if you are to deliver the value for money improvement needed to maintain your financial resilience. During 2012/13 you are experiencing significant changes in your senior management with the departure of the chief executive and three strategic directors. It is important that this level of organisational change does not result in a loss of focus on improving the value for money delivered by the Council's main services.

# Fees

## I reported my planned audit fee in the 2011/12 Audit Plan.

I will complete the audit within the planned fee.

Table 5: Fees

	Planned fee 2011/12 (£)	Expected fee 2011/12 (£)
Audit	£350,550	£350,550
Claims and returns <sup>i</sup>	£52,000	£52,000
Non-audit work	0	£0
<b>Total</b>	<b>£402,550</b>	<b>£402,550</b>

<sup>i</sup> The fee for certification of claims and returns for 2011/12 is an estimate based on work undertaken in 2010/11. The actual fee may be different to the estimate. The Audit Commission sets a schedule of hourly rates for different levels of staff and the final fee for this work is dependent on the work undertaken and the grades of staff used to deliver the work.

# Appendix 1 – Draft independent auditor’s report

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## INDEPENDENT AUDITOR’S REPORT TO THE MEMBERS OF BRIGHTON & HOVE CITY COUNCIL

### Opinion on the Authority financial statements

I have audited the financial statements of Brighton & Hove City Council for the year ended 31 March 2012 under the Audit Commission Act 1998. The financial statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement and Collection Fund and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

This report is made solely to the members of Brighton & Hove City Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010.

### Respective responsibilities of the Director of Finance and auditor

As explained more fully in the Statement of the Director Finance’s Responsibilities, the Director of Finance is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practices Board’s Ethical Standards for Auditors.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting

policies are appropriate to the Authority's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Director of Finance; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the explanatory foreword and the Summary of Accounts to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

### **Opinion on financial statements**

In my opinion the financial statements:

- give a true and fair view of the financial position of Brighton & Hove City Council as at 31 March 2012 and of its expenditure and income for the year then ended; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

### **Opinion on other matters**

In my opinion, the information given in the explanatory foreword and the Summary of Accounts for the financial year for which the financial statements are prepared is consistent with the financial statements.

### **Matters on which I report by exception**

I report to you if:

- in my opinion the annual governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007;
- I issue a report in the public interest under section 8 of the Audit Commission Act 1998;
- I designate under section 11 of the Audit Commission Act 1998 any recommendation as one that requires the Authority to consider it at a public meeting and to decide what action to take in response; or
- I exercise any other special powers of the auditor under the Audit Commission Act 1998.

I have nothing to report in these respects

### **Conclusion on Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources**

#### **Respective responsibilities of the Authority and the auditor**

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

I am required under Section 5 of the Audit Commission Act 1998 to satisfy myself that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires me to report to you my conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

I report if significant matters have come to my attention which prevent me from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. I am not required to consider, nor have I considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

### **Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources**

I have undertaken my audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2011, as to whether the Authority has proper arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

The Audit Commission has determined these two criteria as those necessary for me to consider under the Code of Audit Practice in satisfying myself whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2012.

I planned my work in accordance with the Code of Audit Practice. Based on my risk assessment, I undertook such work as I considered necessary to form a view on whether, in all significant respects, the Authority had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

### **Conclusion**

On the basis of my work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2011, I am satisfied that, in all significant respects, Brighton & Hove City Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2012.

### **Certificate**

I certify that I have completed the audit of the accounts of Brighton & Hove City Council in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.

Helen Thompson

District Auditor

Address: Audit Commission, Ground floor, Bicentennial Building, Southern Gate, Chichester, West Sussex PO19 8EZ.

26 September 2012

70



# Appendix 2 – Uncorrected errors

I identified the following errors during the audit which management has not addressed in the revised financial statements.

Item of account	Description of error
Comprehensive income and expenditure statement	<p>My substantive testing of payroll expenditure identified errors in three of the 40 cases selected for detailed testing:</p> <ul style="list-style-type: none"> <li>• in one case six hours worked that were supported by an authorised timesheet had not been paid to the employee; and</li> <li>• in two cases enhanced payments to staff were calculated at an incorrect rate of pay. In both cases this resulted in small value underpayments.</li> </ul> <p>You have been unable to demonstrate that these errors were isolated. I have therefore extrapolated the errors to determine the likely impact on your financial statements.</p> <p>Based on my extrapolation expenditure in the comprehensive income and expenditure statement is understated by £197,000.</p>
Note 16 – Property, plant and equipment Comprehensive income and expenditure statement Balance sheet	<p>Depreciation of approximately £294,000 was charged in the year on the new school at Brighton Aldridge Community Academy (BACA). Your accounting policy is to not charge depreciation on a new asset until the year following acquisition or the year after the asset becomes operational. Depreciation charged on BACA in 2011/12 is therefore not in line with your stated accounting policy and is a non trivial error in your financial statements.</p> <p>Depreciation shown at Note 16 is overstated by £294,000 and the closing value of assets in the balance sheet is understated by £294,000.</p>

Item of account	Description of error
	Depreciation charged to and reversed from the consolidated income and expenditure statement is overstated by £294,000.
<p>Note 14 – Capital grants and contributions with conditions attached</p> <p>Balance sheet</p>	<p>You have a number of grants dealt with on a claim basis where monies are spent in advance of the grant being received. Approximately £1.7 million of these grants are included in the table of capital grants and contributions with conditions attached disclosed at Note 14 and netted off capital grants received in advance.</p> <p>Although this approach is disclosed at Note 14, it is not correct. A debtor should be raised against the expenditure to reflect grant funding due.</p> <p>Receipts in advance (creditors) in the balance sheet are understated by approximately £1.7 million. Debtors in the balance sheet are understated by approximately £1.7 million.</p>

# Appendix 3 – Corrected errors

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I identified a relatively small number of errors during the audit which management has corrected in the revised financial statements:

- The gross value of corrected errors impacting on the comprehensive income and expenditure statement was £3,068,000. Correction of these errors had no impact on the Council's financial performance reported in the draft financial statements.
- There were no corrected errors impacting on the balance sheet.
- There were a relatively small number of internal consistency, disclosure and numeric errors in the explanatory foreword and notes to the financial statements.

Where errors were detected in relation to a specific and significant risk, or where errors have led to agreed recommendations, they are considered in more detail in the main body of the report.

# Appendix 4 – Draft letter of management representation

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## **Brighton & Hove City Council - Audit for the year ended 31 March 2012**

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other directors of Brighton & Hove City Council, the following representations given to you in connection with your audit of the Authority's financial statements for the year ended 31 March 2012.

### **Compliance with the statutory authorities**

I have fulfilled my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom which give a true and fair view of the financial position and financial performance of the Authority, for the completeness of the information provided to you, and for making accurate representations to you.

### **Uncorrected misstatements**

The effects of uncorrected financial statements misstatements summarised in the attached schedule are not material to the financial statements, either individually or in aggregate.

These misstatements have been discussed with those charged with governance within the Audit & Standards Committee and the reasons for not correcting these items are as follows.

- **reason needs to be given for not correcting the unadjusted errors shown at Appendix 2.**

### **Supporting records**

I have made available all relevant information and access to persons within the Authority for the purpose of your audit. I have properly reflected and recorded in the financial statements all the transactions undertaken by the Authority.

## **Internal control**

I have communicated to you all deficiencies in internal control of which I am aware.

## **Irregularities**

I acknowledge my responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud or error.

I also confirm that I have disclosed:

- my knowledge of fraud, or suspected fraud, involving either management, employees who have significant roles in internal control or others where fraud could have a material effect on the financial statements;
- my knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others; and
- the results of our assessment of the risk the financial statements may be materially misstated as a result of fraud.

## **Law, regulations, contractual arrangements and codes of practice**

I have disclosed to you all known instances of non-compliance, or suspected non-compliance with laws, regulations and codes of practice, whose effects should be considered when preparing financial statements.

Transactions and events have been carried out in accordance with law, regulation or other authority. The Authority has complied with all aspects of contractual arrangements that could have a material effect on the financial statements in the event of non-compliance.

All known actual or possible litigation and claims, whose effects should be considered when preparing the financial statements, have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

**Accounting estimates including fair values**

I confirm the reasonableness of the significant assumptions used in making the accounting estimates, including those measured at fair value.

**Related party transactions**

I confirm that I have disclosed the identity of the Authority's related parties and all the related party relationships and transactions of which I am aware. I have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the Code.

**Subsequent events**

I have adjusted for or disclosed in the financial statements all relevant events subsequent to the date of the financial statements.

Signed on behalf of Brighton & Hove City Council

I confirm that the this letter has been discussed and agreed by the Audit and Standards Committee on 25 September 2012

Name: Nigel Manvell

Position: Acting Director of Finance

Date: 25 September 2012

# Appendix 5 – Glossary

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## **Annual Audit Letter**

Letter issued by the auditor to the Authority after the completion of the audit that summarises the audit work carried out in the period and significant issues arising from auditors' work.

## **Annual Governance Report**

The auditor's report on matters arising from the audit of the financial statements presented to those charged with governance before the auditor issues their opinion and value for money conclusion.

## **Annual Governance Statement**

The annual report on the Authority's systems of internal control that supports the achievement of the Authority's policies aims and objectives.

## **Audit of the accounts**

The audit of the accounts of an audited body comprises all work carried out by an auditor under the Code to meet their statutory responsibilities under the Audit Commission Act 1998.

## **Audited body**

A body to which the Audit Commission is responsible for appointing the external auditor.

## **Auditing Practices Board (APB)**

The body responsible in the UK for issuing auditing standards, ethical standards and associated guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

## **Auditing standards**

Pronouncements of the APB that contain basic principles and essential procedures with which auditors must comply, except where otherwise stated in the auditing standard concerned.

### **Auditor(s)**

Auditors appointed by the Audit Commission.

### **Code (the)**

The Code of Audit Practice for local government bodies issued by the Audit Commission and approved by Parliament.

### **Commission (the)**

The Audit Commission for Local Authorities and the National Health Service in England.

### **Ethical Standards**

Pronouncements of the APB that contain basic principles relating to independence, integrity and objectivity that apply to the conduct of audits and with which auditors must comply, except where otherwise stated in the standard concerned.

### **Financial statements**

The annual statement of accounts that the Authority is required to prepare, which report the financial performance and financial position of the Authority in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom.

### **Group accounts**

Consolidated financial statements of an Authority and its subsidiaries, associates and jointly controlled entities.

### **Internal control**

The whole system of controls, financial and otherwise, that the Authority establishes to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

### **Materiality**

The APB defines this concept as 'an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor's report; likewise a misstatement is material if it would have a similar influence. Materiality may also be considered in the context of any individual primary statement



within the financial statements or of individual items included in them. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

### **Significance**

The concept of ‘significance’ applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit of the financial statements. Significance has both qualitative and quantitative aspects.

### **Those charged with governance**

Those entrusted with the supervision, control and direction of the Authority. This term includes the members of the Authority and its Audit Committee.

### **Whole of Government Accounts**

A project leading to a set of consolidated accounts for the entire UK public sector on commercial accounting principles. The Authority must submit a consolidation pack to the department for Communities and Local Government which is based on, but separate from, its financial statements.

# Appendix 6 – Action plan

## Recommendations

### Recommendation 1

Continue to improve the internal control environment within the Midland iTrent payroll system as a matter of priority. In particular, ensure that all controls are operated consistently and evidence is retained to show that controls have been operated.

<b>Responsibility</b>	Head of People Centre
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<b>Priority</b>	High
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<b>Date</b>	Ongoing
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<b>Comments</b>	Agreed. We are continuing to work with Internal Audit as a high priority to improve the internal control environment. This is evidenced in the draft findings from their recent follow up on recommendations arising from the 2011/12 audit.
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### Recommendation 2

Produce the year end data return of pensions contributions required by East Sussex Pension Fund in a timely manner.

<b>Responsibility</b>	Head of People Centre
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<b>Priority</b>	Medium
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<b>Date</b>	Ongoing
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<b>Comments</b>	Agreed. We are working with our software provider to improve the system reporting on pensions to enable the end of year return to be provided to the administering authority as soon as the year-end has balanced. This will be particularly important for the next return as the fund will be valued as at 31 March 2013.
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### Recommendation 3

Ensure transfers from assets under construction into operational land and buildings are made on your asset register so that no depreciation is charged in accordance with your accounting policy.

<b>Responsibility</b>	Principal Accountant, Central Accounting
<b>Priority</b>	Low
<b>Date</b>	For 2012/13 financial statements
<b>Comments</b>	Agreed. The Central Accounting team will liaise with the asset register software providers to request that the system program provides a facility for transfers of assets under construction to meet the policy properly. The way the asset register system treats assets under construction will be reviewed to enable future transfers to be recorded with a transfer date whereby the system is programmed in such a way that depreciation is not charged until the following year.

### Recommendation 4

Improve processes to ensure payroll expenditure is correctly classified on the general ledger without the need for recoding.

<b>Responsibility</b>	Acting Director of Finance
<b>Priority</b>	Medium
<b>Date</b>	Ongoing
<b>Comments</b>	Agreed. The People Centre and Finance will work together on implementing establishment management and Finance will continue to work to improve the accuracy of coding.

### Recommendation 5

Review the outstanding unsupported balance on the payroll control account reconciliation and write off to revenue if necessary..

<b>Responsibility</b>	Principal Accountant, Central Accounting
<b>Priority</b>	Medium
<b>Date</b>	31 March 2013
<b>Comments</b>	Agreed. The process for the payroll account reconciliation is currently under review, this review will assist in improving the completeness and accuracy of the reconciliation in 2012/13 at which time any unsupported balance will be considered for write off to revenue where necessary.

## Recommendation 6

Revisit, clarify and update partnership arrangements under section 75 of the NHS Act 2006 for the commissioning and provision of services to adults, children and young people. Ensure there is an effective process for checking the accuracy of the disclosure of commissioner and provider expenditure under these arrangements in the draft financial statements.

<b>Responsibility</b>	Acting Director of Finance
<b>Priority</b>	Medium
<b>Date</b>	Ongoing
<b>Comments</b>	<p>Agreed.</p> <p>Commissioning agreements will be reviewed when greater legal clarity about the status of clinical commissioning groups is available and obtained. This does not present significant risks because, in general terms, the statutory powers and functions of primary care trusts will fall to a successor health body and therefore extant section 75 agreements would remain in force with the identified successor body.</p> <p>While the disclosures for section 75 agreements are not mandatory, their accuracy should be assured where they are provided. The Council will ensure greater oversight and review of information provided by partners and will formalise this in its closedown timetable.</p>

## Recommendation 7

Review and reconsider your accounting arrangements in situations where the Council undertakes capital works on its own assets requiring planning consent and acts as both developer and local planning authority.

<b>Responsibility</b>	Head of Finance – Integrated Financial Management and Planning
<b>Priority</b>	Medium
<b>Date</b>	With immediate effect
<b>Comments</b>	Agreed. Accounting arrangements will be amended where the Council is required to make section 106 or community infrastructure levy payments when acting as both developer and planning authority.

### Recommendation 8

Continue to review your internal processes to minimise the possibility of double counting income and expenditure in the consolidated income and expenditure statement.

<b>Responsibility</b>	Head of Financial Services
<b>Priority</b>	Medium
<b>Date</b>	For 2012/13 WGA return.
<b>Comments</b>	Agreed. Whole of Government Accounts are complex and all public sector organisations are improving their knowledge and understanding of best practice completion of WGA statements to eliminate double-counting not only between transacting public sector organisations but also internally within each organisation. Having identified this issue, the Council will modify its procedures accordingly.

### Recommendation 9

Clear the difference of £60,000 between bank balances on the general ledger and your reconciliation schedule relating to schools cash balances.

<b>Responsibility</b>	Principal Accountant, FC / CYPT & Environment
<b>Priority</b>	Medium
<b>Date</b>	By 31/3/2012
<b>Comments</b>	Agreed. The school accounts are reconciled on a quarterly basis. This imbalance will be investigated and cleared appropriately by the end of 2012/13.

## Recommendation 10

Address the following in your year end bank reconciliation processes:

- clear the unmatched balance of approximately £80,000 on your year end payments account reconciliation which originates from the bank reconciliation module of your cash management system; and
- for payments that straddle year end, ensure that payments initiated by financial systems integrated in your general ledger are treated consistently with payments that are initiated by financial systems outside your general ledger.

<b>Responsibility</b>	Principal Accountant, Income & VAT
<b>Priority</b>	Medium
<b>Date</b>	Ongoing
<b>Comments</b>	The Council is working with its software provider to resolve the unmatched balance on the payments account reconciliation.

## Recommendation 11

Seek to improve the accuracy of your accounting estimate of employer pensions contributions that you provide to your actuary. This will require better communication between your payroll and central accounting teams of the basis for your estimate.

<b>Responsibility</b>	Head of People Centre
<b>Priority</b>	Medium
<b>Date</b>	For 2012/13 financial statements
<b>Comments</b>	Agreed. The People Centre will coordinate with Finance on the provision of data to the scheme administrators.

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