



**PUBLIC SECTOR**

# **Bridgend County Borough Council**

Audit for the year ended 31 March 2005

Annual Audit Letter

6 December 2005

**AUDIT**

# Contents

---

## **Introduction**

## **Executive Summary**

## **Financial statements**

- Financial reporting
- Agreed audit adjustments
- Audit differences & independence

## **Financial aspects of Corporate governance**

- Legality
- Financial standing
- Fraud and Corruption
- System and Control issues

## **Use of resources**

- Wales Programme for Improvement
- Budget Monitoring and links between Budget and Corporate Improvement Plan

## **Status of the audit**

The audit is complete subject to the following matters:

- Receipt and review of final set of financial statements
- Presentation to Audit Committee
- “Wanless” work – this is a national study covering local authorities and the NHS. We have completed our fieldwork at Bridgend County Borough Council, but are awaiting survey information and the national reporting templates from the Wales Audit Office.

# Introduction

We are required under the Audit Commission's Code of Audit Practice (the Code) to issue an Audit Letter to the Council on completion of our audit, demonstrating that the Code's objectives have been addressed and summarising all issues of significance arising from our work.

The Annual Audit Letter is presented to Members and officers to communicate the scope, nature and extent of our audit work for the year, and report on matters of substance.

This Letter reflects our responsibilities under the Code. This requires us to consider and assess the relevant significant operational and financial risks that apply to Bridgend County Borough Council and the arrangements it has put in place to manage these risks. We place significant emphasis on ensuring that our work is tailored to Bridgend's particular circumstances and to direct our audit effort to those areas of greatest risk.

The Code of Audit Practice also stresses that each part of the audit should be viewed in the context of the whole. No one part stands alone, and work in relation to one element of the audit informs work in relation to other elements.

This letter focuses on those operational and financial risks that we considered to be relevant to our responsibilities as updated and amended during the course of our audit.

In accordance with our statutory obligations, we have also made a Welsh language version of this document available to the Authority. Copies can be obtained from the Authority.

## **Respective responsibilities**

*This Annual Audit Letter is addressed to all the Members of the Council and has been prepared for the sole use of the Council. We take no responsibility for any officer or Member acting in their individual capacities, or to third parties.*

*The Audit Commission has issued a document entitled the "Statement of Responsibilities of Auditors and Audited Bodies". This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw the Authority's attention to this document, a copy of which is held by the Chief Executive of the Council.*

*External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.*

# Executive summary

In September this year we reported on the Council's preparation of its 2005-8 Corporate Improvement Plan. We were delighted to report that this had been drawn up for the first time on a three year basis, allowing the Authority to start to plan on a longer term basis. We observed, however, that there were serious issues with which the Authority needed to deal, the most significant being the action plan arising from the Corporate Culture Review and the implementation of the protocol for securing performance improvement in Children's Services. These issues are dealt with elsewhere within the Relationship Manager's Annual Letter.

## **Year end financial reporting**

We are pleased to report an improved performance in the timeliness of the preparation of the year end accounts and related working papers. We have also been impressed by the positive and pragmatic approach taken by Finance staff in dealing with a technical accounting issue related to certain borrowings (see pages 8 & 9).

## **Pressure on resources**

Bridgend's provisional budget settlement for 2006/7 is 5.5%, compared with an all-Wales average of 5.1% (after deducting 1% efficiency savings required by the Welsh Assembly Government). This national drive to efficiency is likely to continue in future years, with a continued downward pressure on income from the Welsh Assembly Government. The Council also faces upward pressure on costs. For example, the pension scheme actuary has asked for an additional £1m contributions in 2005/6 to start to fund the scheme deficit, with further increases of £1m in each of the following two years.

There are also longer term cost issues: increasing maintenance of the ageing leisure portfolio, concerns over the ongoing level of funding at schools and of highway maintenance. The Council has also been asked for additional funding to pay for the disposal of waste through the Materials Recycling Centre.

The Action Plan for Children's Services and the implementation of the Council's "Flagship" improvement projects (Performance Management, Procurement and Human Resources) are likely to require additional investment, at least in the short term.

The Authority considered the priorities of the 2004 CIP while preparing the 2005/6 budget, but was unable to identify at that time enough efficiency or other savings to be able to recycle resources to the prioritised risk areas.

These issues combined mean there is real urgency in generating significant efficiencies or the Council may risk having to cut discretionary services in future. There are projects in place to help identify savings, such as the Efficiency Agenda and Procurement, and we recommend that they must continue to be given a very high profile.

We understand that there is a more robust budget process underway for 2006/7, with a drive to identify efficiencies and redirect resource to the areas of highest priority. We also understand that there are plans to engage with members at an earlier stage than last year to allow the optimum time for debating these significant financial and operational matters.

We have recommended some improvements to the quarterly reporting of financial information (see page 28). These have been accepted and will be implemented from December 2005. This should provide benefits in assessing cost pressures across the Authority.

## **Overall conclusion**

The Authority currently needs to deal with a number of serious issues. There are risks arising from both particular areas (eg Children's Services) and the number of issues on the change agenda. It is critical that the Authority maintains its focus and manages this major programme of work, as well as ensuring that it continues to deliver its normal "day to day" services. The next six months may prove critical for Bridgend to move forward its improvement agenda.

# Financial statements audit

We are required to audit the Authority's financial statements and to give an opinion on whether they present fairly the financial position of the Authority and its expenditure and income for the year, and have been properly prepared in accordance with relevant legislation and applicable accounting standards.

This section deals with:

- The year end financial reporting process
- The audit and other adjustments made to the year end accounts
- Our formal report confirming that there are no remaining unadjusted audit differences.

*The audit of the annual accounts for the year ended 31 March 2005 is nearing completion and we expect to issue a report to the Authority containing an unqualified opinion. We have agreed a number of adjustments to the accounts originally submitted to members (see page 7).*

*We are pleased to report an improved performance in the timeliness of the preparation of the year end accounts and related working papers. We have also been impressed by the positive and pragmatic approach taken by the Central Finance team in dealing with a technical accounting issue related to certain borrowings (see pages 8 & 9).*

# Financial reporting

## Accounts preparation process

2004/5 has seen a step forward for BCBC's preparation of its annual accounts. The accounts and supporting working papers were made available for audit on 20 June 2005, within three months of the end of the financial year. This has been an excellent improvement in performance,

During the audit, we identified a number of issues and have agreed certain audit adjustments with management. These are detailed on page 7.

We made a number of recommendations in our 2003/4 management letter which your Finance team implemented to help the process:

- A detailed "prepared by client list" of information required for the audit of the financial statements was prepared and discussed with the Central Finance team. This allowed the Audit and Central Finance teams to identify roles and responsibilities in the audit process and increase the efficiency and effectiveness of audit fieldwork
- The Central Finance team developed and implemented a detailed project plan to ensure that all key actions from last year were identified and dealt with successfully, and we saw much better co-ordination in the financial reporting process between the Central Finance team and the accounting staff at directorates.
- Key Council staff were available throughout the audit process.

- The Central Finance team has improved its process for carrying out control account reconciliations: reconciliations are prepared by responsible staff and reviewed by senior accounts staff before inclusion in the reconciliations file; all reconciliations are now signed to evidence review; reconciliation sheets generally contain an explanation of the purpose of the account, which helps staff to understand reconciling items. There were some occasions where narrative explanations of variances over 10% had not been completed, and we understand that additional training will be carried out to ensure that the process continues to improve.
- We have also seen evidence of the Finance team tidying up the ledger, which is an important housekeeping exercise and reduces effort in the longer term.

# Financial reporting - adjustments to draft accounts

The following table shows how the final income & expenditure account and net assets position changed from the original accounts presented to members in July.

## Adjustments recorded

A number of adjustments (net £16k) were made by the Central Finance team to ensure the correct disclosure of Council Tax and National Non Domestic Rates ("NNDR") year end balances.

The Council Tax bad debt provision was originally calculated on the net debtor figure rather than the gross debtor, i.e. outstanding debt at 31 March 2005 less over-payments.

The Housing Revenue bad debt provision was reduced to bring it into line with the gross debtor balance.

The housing benefit subsidy in the unaudited accounts was based on estimates. There were two adjustments made:

- Following submission of the accounts, the Central Finance team noted that estimated subsidy did not include a reclaim from the Department for Work and Pensions for the final week of housing benefits payable to claimants. Central Services income has been increased by £473k to correct this, and then transferred to Corporate Service's earmarked reserves. There is no overall effect on the reported deficit, but net assets have increased.
- There was a correction to one of the subsidy percentages, which increased the amount receivable by £73k.

The Council is largely self-insured, and claims are managed by external insurance brokers. The brokers calculated the Council's exposure at the end of the financial year, and this was lower than the originally recorded estimate resulting in a release of provisions of £447k.

<b>Consolidated Revenue Account</b>	<b>£000</b>
(Deficit) for the year as originally reported	(621)
<b>Agreed adjustments</b>	
Reclassification of Council Tax and NNDR receipts	16
Under provision of Council Tax bad debts	(212)
Over provision of Housing Revenue Account bad debts	34
Correction to Housing Benefit subsidy estimate	73
Adjustments relating to LOBO loans (see page 8.)	
- interest	(412)
- premium	(48)
Over provision for future claims	447
(Deficit) in final accounts	(723)
<b>Consolidated Balance sheet</b>	
	<b>£000</b>
Total Assets less liabilities originally reported	100,049
<b>Agreed adjustments:</b>	
Items affecting deficit for the year (as above)	(102)
LOBO interest accrual transferred to earmarked reserve	412
Increased Housing Benefit subsidy entitlement	473
Other reserve adjustment	(34)
Net assets in final accounts	100,798

# Financial Reporting – LOBO adjustments

A LOBO is a form of borrowing, the initials standing for “lender’s option, borrower’s option”. The loans are taken out from banks at an agreed initial interest rate, but after a certain time the lender has the option to increase that rate. When this occurs, the borrower has the option to accept the increased rate, or to repay the loan without incurring a penalty.

There has been new, national accounting guidance issued for 2004/5, which has caused some controversy within local government. This section describes Bridgend’s LOBO loans, and how the Authority has approached the accounting aspects.

Towards the end of 2003/4, Bridgend converted £19m of its existing higher interest fixed loans into LOBOs. The new LOBOs had low interest rates in the early periods, rising to 4.65%. Bridgend also incurred £4.4m of penalties redeeming its old loans.

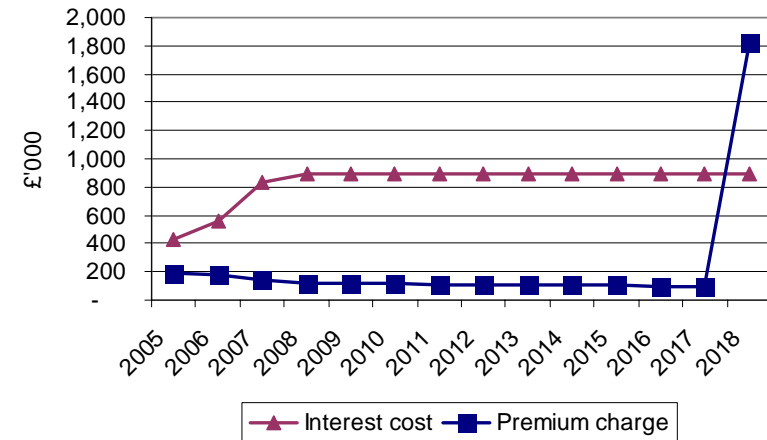
Following the accepted local government accounting practice of the time, Bridgend adopted the following accounting policies:

- The interest was to be charged to the consolidated revenue account in line with the amount calculated by the bank (ie low at the start, high later)
- The penalty for redeeming the original loan (“the premium”) was to be written off over the maximum possible future life of the new LOBOs (c50 years).

Comparing the known interest rate of the LOBOs with the forecast rates for the market, suggests that the first likely date when the LOBO options would be exercised by the lender is in fifteen years.

Taking that first likely exercise date, the accounting policies would have created a profile of charges to the Consolidated Revenue Account as shown in the chart opposite.

Annual charge to Revenue account



There are two issues with this accounting treatment:

- The interest cost in the first three years does not reflect the fact that there will be higher costs in later periods; and
- When the option is exercised, the Council would need to charge a large sum – the “spike” in the graph – to the revenue account. There is a risk that when the bank exercises its option, the Council might choose not to redeem the loan because of the accounting effect on the revenue account, rather than potentially seeking the best value approach.

Both issues mean that the original accounting treatment is deferring problems to future years.

The following page shows how Bridgend has agreed to deal with these problems.



## Financial Reporting – LOBO adjustments (continued)

As described on the previous page, the commonly accepted accounting practice in 2003/4 for LOBO loans causes the recognition of costs to be deferred into future years. The new accounting guidance recognises the costs earlier.

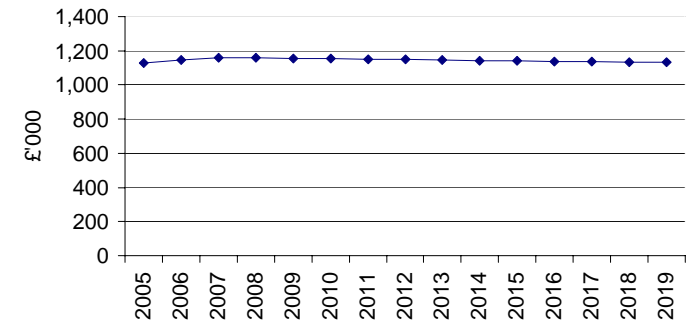
We are pleased to report that Bridgend has taken a pragmatic and positive approach to the issue, summarised as:

- Management has assessed the expected life of the LOBOs as fifteen years, based on forward predictions of interest rates
- Interest will be calculated over the expected life – so there will be interest costs will be evenly spread.
- The premiums incurred on redeeming the original loans will be written off on a straight line basis (“evenly”) over the next 15 years.

The effect is to create an even cost to the Revenue account over the expected life of the loan (15 years), as illustrated in the chart opposite.

The impact of the change in accounting practice to that adopted in the originally submitted accounts for 2004/5 is to increase costs by £460,000 (including interest of £412,000 and an additional premium charge of £48,000).

Annual charge to Revenue Account



# Audit differences and independence

Auditing Standards state that auditors should communicate relevant matters relating to the audit of the financial statements to those charged with governance of the entity. In particular the auditors should communicate all such unadjusted misstatements, other than those that they believe are clearly trifling.

For these purposes, we have identified the members of the Authority, the Chief Executive, s151 Officer and Corporate Directors as "those charged with governance".

Where those charged with governance propose not to make some or all of the adjustments, the auditors discuss with them the reasons for, and appropriateness of, not making those adjustments, having regard to qualitative as well as quantitative considerations, and consider the implications for their audit report of the effect of misstatements that remain unadjusted.

If those charged with governance do not make some or all of the adjustments the auditors have requested, a representation is obtained to reduce the possibility of misunderstandings concerning their reasons for not making the adjustments.

**We can report that there are no unadjusted mis-statements.**

The amendments and additional disclosures we identified during the course of our audit have been adjusted.

## **Statement on independence**

We are required under Auditing Standards to consider any issues that may impact on our independence and objectivity. In relation to the audit of the financial statements for Bridgend County Borough Council for the financial year ending 31 March 2005, we are able to confirm that our requirements in relation to independence and objectivity have been complied with and that we are not aware of any relationships that may bear on the independence and objectivity of the audit engagement partner and audit staff which are required to be disclosed.

# Financial aspects of corporate governance

---

We are required to review the Financial Aspects of Corporate Governance of the Council, looking at:

- The Council's arrangements to ensure its continuing Financial Standing
- The Council's arrangements to ensure the Legality of transactions with a significant financial effect
- The Council's arrangements to prevent and detect fraud and corruption and to maintain standards of financial conduct
- The Council's arrangements to maintain appropriate systems of internal financial control

These matters are dealt with in the following sections.

# Financial standing

We are required to review the adequacy of the arrangements that Bridgend County Borough Council has in place to ensure that its financial standing is soundly based.

The following sections deal with specific issues:

- Assets and liabilities
- Revenue reserves
- Pension costs and liabilities
- The budget monitoring process and links between the budget and Corporate Improvement Plan were also reviewed see pages 28 and 29.

*Based upon the work we have undertaken, the Authority has in the year of our audit operated effective arrangements for maintaining its financial standing.*

*In 2003/4 we recommended that the Authority focus strongly on financial standing given the financial challenges that lay ahead. The actuarial valuation received in early 2004 confirms that the deficit on the pension scheme is a key financial risk. The Authority is now managing its budgets to meet the higher contribution levels.*

*There are plans in place to generate cost savings under the Efficiency Agenda – but these need to be given the very highest priority given the downward pressures on income, the upward pressure on costs, and the number of high profile issues facing the Authority (such as Children’s Services, Leisure and Waste Disposal).*

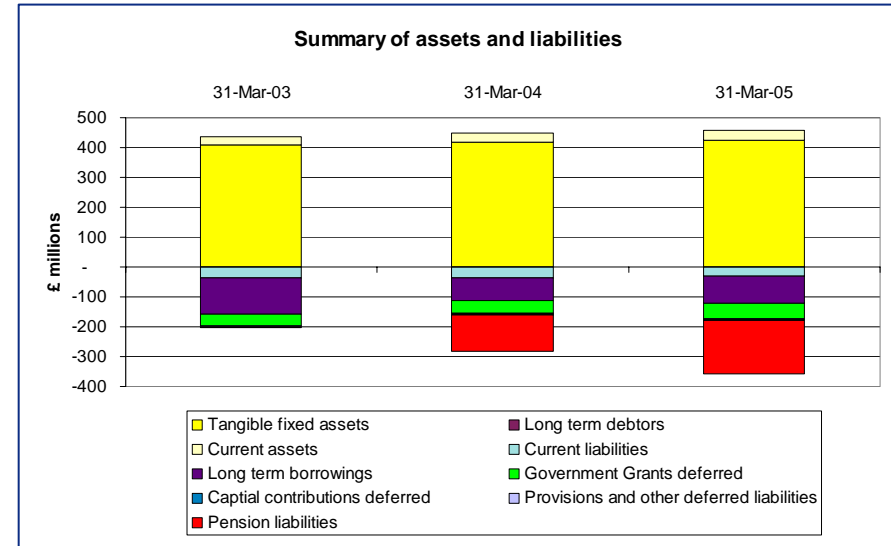
*The delays in collecting old Council Tax and NNDR balances that arose during 2004 have meant that the unpaid balances at 31 March 2005 were high. The Authority must continue to work hard at reducing the backlog during 2005/6 or there will be a higher bad debt charge in the 2006 annual accounts.*

# Financial standing – assets and liabilities

This chart shows the overall trend in the movement in the Council's assets and liabilities from March 2003 to 31 March 2005.

The key features are:

- The majority of the Council's assets are its fixed assets, and the greater part is in property.
- There were two significant movements between 2003 and 2004: the transfer out of the Housing stock, and the formal revaluation of the remaining property portfolio. The net position was broadly similar.
- There is a continuing opportunity for the Council to review its major assets and to consider whether the capital might be released – eg by sale of surplus property - and directed more appropriately.
- Long term borrowings fell in 2004 as a consequence of the housing stock transfer.
- As we described in last year's Annual Audit Letter, the Authority's share of the deficit on the pension scheme was brought into the Accounts in 2004. The impact was to record a significant liability of £121m.
- The major change in the 2005 balance sheet was the recognition of the worsening deficit in the pension scheme. This is discussed on page 16. Both the scale of the deficit, and the increase in 2005 are highly significant in the context of the rest of the Council's assets. The Authority needs actively to monitor the position.

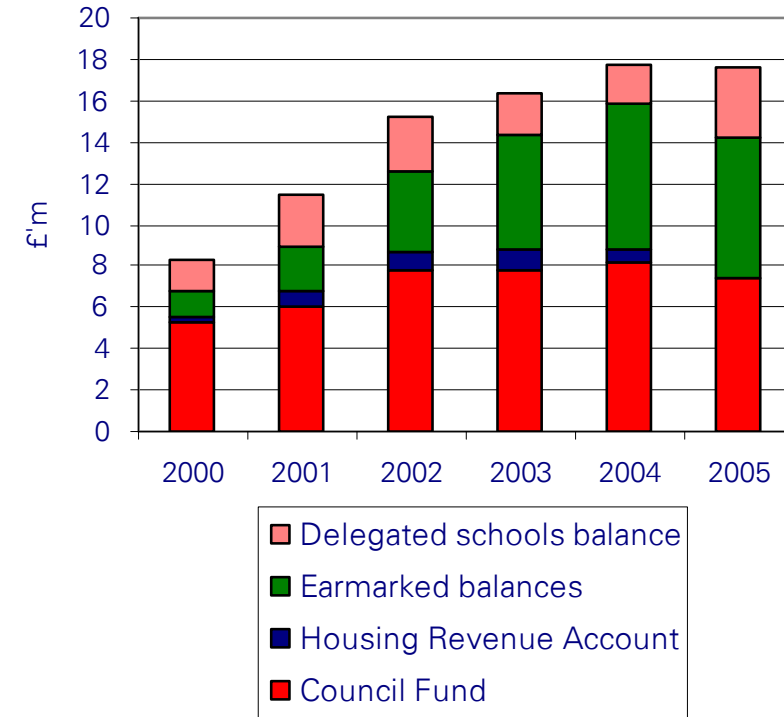


# Financial standing – Revenue Reserves

Overall the Council's reserves have decreased slightly in the year, with some fluctuations between reserve types. The five year trend is a growth in reserves, mainly those that are earmarked as set out below.

- Schools are obliged to comply with the national agreement for workforce remodelling. Teachers are to be given time to prepare lessons and have been freed from non-teaching related tasks. As a result, schools have been allocated funding in 2004/5 to carry forward in 2005/06.
- Earmarked balances have fallen by £0.2m. The main reductions relate to two directorate overspends (Chief Executive's and Environment & Planning) and the use of specific earmarked balances in the year. Offsetting the reductions are new reserves in the year, include the Materials Recycling Centre (£300k) and provision for Maesteg School PFI development (£600k).
- The Housing Revenue Account closed in 2004/5 following the stock transfer in 2003. The balance on the reserve was transferred to the Council Fund.
- The Statement of Accounts includes commentaries on the performance of the Council against budget, and explains the movement on the Council Fund

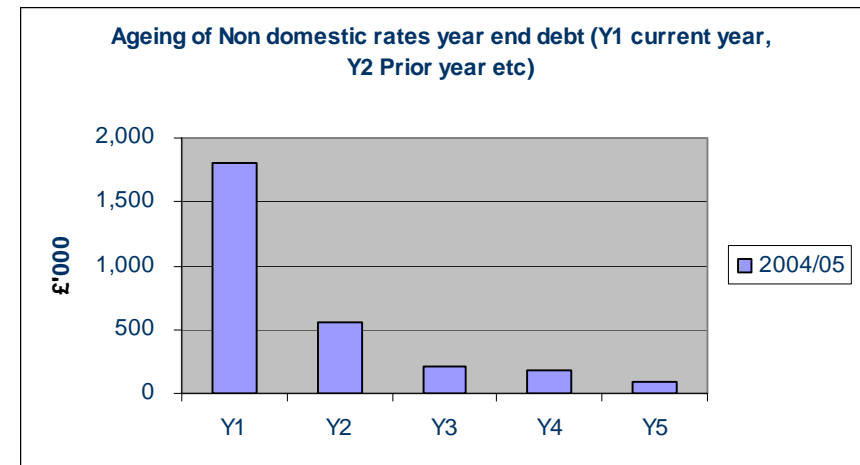
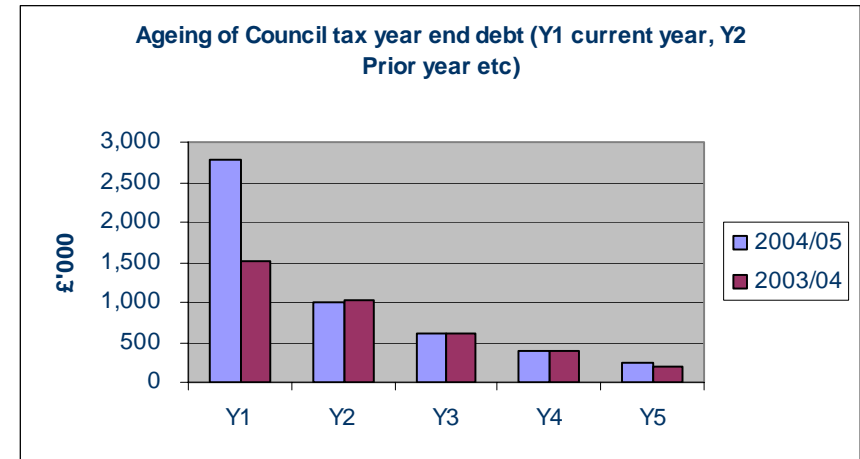
**Trend in reserves**



# Financial standing - Cash collections

## Council Tax and NNDR collections

The Council introduced a new Council tax and NNDR accounting and collections system during 2004. As we reported last year, significant staff time was devoted to the implementation, which resulted in less time being available for credit procedures to be run. As a result, higher levels of debt had built up by 31 March 2005. This backlog is now being addressed by the council tax recovery team. We have recommended that the council put sufficient resources into this exercise, as debt generally becomes harder to collect as it gets older. There is also a potential risk to the 2005/6 accounts, as the older debt will start to attract higher rates of bad debt provision.



NNDR comparative figures for 2003/04 were unavailable

# Financial standing - Pension Costs and liabilities

A large number of Bridgend Council employees belong to the Rhondda Cynon Taf Pension Scheme, in common with other Authorities covered by the former Mid-Glamorgan area.

The scheme is on a defined benefit basis, where the pension paid to retiring staff is linked to their length of service and their salaries. This form of scheme requires that the employer bears the risk of any adverse fluctuations in the value of the assets in the scheme. Every three years, the Pension Scheme commissions an actuary to look at the liabilities that the scheme has incurred to its members (including current employees, former employees and people already retired). This liability is then compared with the value of the assets owned by the scheme.

If the liability exceeds the assets (as here), the scheme is in deficit and the actuary makes recommendations to the employer for removing the deficit – normally by increasing the employer contributions over time.

In the case of the RCT scheme, the actuary is able to split both the assets and liabilities between the partner authorities, so the figures in Bridgend's Accounts and this document refer to Bridgend Council's share.

The actuary also calculates how the costs of the scheme are recorded in the financial statements. The objective is to ensure that each financial year bears a fair cost for the work carried out by the employees.

## Cash contributions

The level of cash contribution is assessed by the actuary during the three-yearly actuarial valuation.

The last actuarial valuation was carried out as at 31 March 2004 and showed a funding deficit.

The actuaries certified that Bridgend's employer's contributions for the period to 2008 would need to be increased. These are detailed below. The actuary has allowed a gradual phasing in of the necessary increase to allow partner authorities to manage the additional burden.

As discussed elsewhere in this report, the Authority will need to identify efficiency measures in order to meet these commitments:

- 2005/06 – 346% of employee costs; Increase over 04/05 - £1m
- 2006/07 – 372% of employee costs; Increase over 04/05 -1.9m cumulative
- 2007/08 – 398% of employee costs; Increase over 04/05 - £2.8m cumulative



# Legality of financial transactions

We are required to review the arrangements that the Council has in place to identify whether transactions that might have a significant financial consequence, and contracts that are entered into, are legally sound. We considered the impact of matters identified during our audit planning and others that arose during the audit, and reviewed the Council's overall arrangements

Our audit work has involved an ongoing assessment of the Council's compliance with the applicable legal and regulatory framework. We have held discussions with the Council's Monitoring Officer and are not aware of issues that might affect the Council's compliance with the applicable legal and regulatory framework

*Based upon the work we have undertaken the Council has adequate arrangements for ensuring the legality of its financial transactions.*

*There are a number of issues that the Authority is continuing to keep under review, as follows:*

## **Sale of land at Island Farm**

A legal case is in progress and is expected to be heard shortly

## **Maesteg PFI Scheme**

Negotiations with the project's contractors have been on going for 18 months. Points of contention have been related to cost and affordability and also legal risk assignment between the Authority and the contractor e.g. Construction or land reclamation faults.

A third financial proposal has now been put on the table which meets the Authority's affordability criteria. Contracts are now undergoing a legal review.

The Authority has continued to review the status of the procurement process as they are currently negotiating with a single remaining tenderer.

## **Compliance with Disability Discrimination Act**

This Act came into force in October 2004. The Council are not yet compliant. A pilot disabled access audit has been carried out so far but not a full audit. The Council are in a position of not being aware of all works that may be needed nor the financial impact, and there is a risk that they will be failing to provide the appropriate access to citizens and staff. We recommend that the Council reviews the status of this project.

## **Other**

Management has reported to us and the Council on alleged irregularities in one of its departments. An independent barrister has been appointed to investigate the case, and we understand that work is ongoing.

# Fraud and Corruption

We are required to review the adequacy of the Council's arrangements to manage its affairs in accordance with proper standards of financial conduct and to prevent and detect fraud and corruption. In our assessment we reviewed the Council's overall arrangements

It is management's responsibility to ensure that there are appropriate controls in place to prevent loss through fraud and error and to ensure that appropriate governance arrangements are in place.

*Based upon the work we have undertaken, the Authority has maintained effective controls over the prevention and detection of fraud and corruption.*

*We repeat last year's recommendation that the Authority drafts and agrees a fraud response plan to deal with any issues that might arise in the future.*

The Authority takes part in the National Fraud Initiative which aims to assist in the detection of potential benefit fraud. Returns made to date have not identified any significant frauds, although a number of cases have been submitted to the Department of Work and Pensions (DWP) for further investigation. Progress does not seem to be as rapid as some neighbouring authorities and we are continuing to monitor the position.

Management have informed us that the DWP plan to dedicate additional resources to this area over the coming year, which will help to speed up the resolution of queries.

Internal Audit are planning to look more closely at controls over benefit fraud in their next audit plan.

Management have informed us that there have been no other cases of fraud this year, and we have not identified any such circumstances during the course of our audit.

In last year's annual audit letter we recommended that the Authority produce a formal fraud response plan. This has not yet been drafted, however we understand that plans are in place to produce and implement a response plan during 2005/06.

# Systems and controls

---

We considered whether Bridgend County Borough Council has in place adequate arrangements to satisfy itself that systems of internal financial control are both adequate and effective in practice. These arrangements include:

- The overall control environment, including internal audit;
- The identification, evaluation and management of operational and financial risks; and
- Standing orders, financial regulations, and supporting procedure notes.

The following sections deal with specific issues:

- Risk management
- Internal audit
- IT controls
- Other issues

*Based upon the work we have undertaken, the Authority has overall maintained sound systems of internal financial control, although there are areas where control could be strengthened or made more effective.*

*There has been continuing progress in risk management procedures, although there are further improvements needed to make risk management part of everyday activities. Audit Committee has received a presentation on the Authority's risk management process. The resilience of the system has been strengthened in the year. Internal Audit resource levels have improved. We recommend that the Authority agrees a standard framework for monitoring and controlling activities carried out in partnership with other bodies.*

# Risk management

---

The Authority adopted a more formal approach to measuring corporate risk in the current year, using a scoring system based upon impact and likelihood.

Internal Audit planned to perform a review of the appropriateness of the scoring system used, but, due to resource constraints, were unable to undertake the work. This would be an important source of assurance for management, particularly since the risk assessment drives the Corporate Improvement Plan, which should drive the budget.

Internal audit has, however, recently carried out a review over the risk assessment process. We are informed that the review is likely to be finalised early in 2006, and that it is likely to include some recommendations for improving the process.

The final corporate risk assessment was undertaken in May 2005 by the Cabinet and Corporate Management Team Working Group. We considered that the risk assessment process undertaken was robust but would encourage the Authority to arrange meetings for the 2006/09 risk assessment process as soon as possible.

We have started to see risk assessments included within some individual project plans within the Authority. This is best practice and we recommend that it should be encouraged for all projects, action plans and business plans. The benefits are that:

- risk management becomes embedded in the culture of the organisation, and
- it gives decision-makers the opportunity to see the potential downsides of decisions, and assess any planned actions to mitigate those risks.

# Internal Audit

Internal Audit is one of the high level controls which management rely upon for assurance that other controls are soundly designed and operating reliably.

We have reviewed the work programme and reports of the Internal Audit department for the year, used them to give assurance to our external audit and liaised with them to ensure we were not duplicating any work.

## Prior year issues

The department brought to our attention two issues in the prior year:

- Delays in completing audit work caused by slow responses from operational management
- Lack of resources within the Internal Audit department due to a high turnover of staff, leading to the planned work programme not being completed

## Progress in current year

### Resources

The department has been operating at less than full capacity once again this year due to staff turnover and a general shortage of appropriately qualified staff within the market.

Temporary staff were employed during the first quarter of 2005 to help complete a number of audit reports.

Since the year end, additional full-time staff have been employed, resulting in the department reaching its full complement.

We recommend that management continue to monitor the position.

### Management responses

Internal Audit have informed us that there has been some improvement in the speed of receiving responses from operational management during the year, although the process is still slow.

There is generally a high acceptance of Internal Audit's recommendations by management within the directorates. However, there is often a delay in implementing the recommendations.

We recommend that all action points are formally logged onto a database and regularly monitored to ensure implemented on a timely basis.

# Information and Communication technology

Our review of IT within the Authority considered both general IT issues and IT based controls over the key Cedar Financials system.

## General IT issues

### *Investment in added resilience*

The Council has invested in its central computer hardware and infrastructure to provide a far more resilient platform to help staff deliver services to the public. The corporate IT department has recently completed a new secondary computer room, which allows IT services to resume quickly if there are problems in the primary computer room, and implemented Blade server technology and Storage Area Networks. Blade servers are high-powered but small in size, and can be replaced easily, adding to the flexibility of the system. Management predict that the new set-up will also save running costs of c£175k per annum.

### *e-Government*

Bridgend's "Access to Services" project has been designed to provide better service and greater efficiency to the public, including the use of IT. The project meets the Authority's obligations in terms of e-Government, and there are also a number of internal efficiency and operational benefits.

Many of these projects are still in their planning phase. We recommend that the Authority looks closely at the potential benefits from using ICT to generate efficiencies. For example, the Authority has started a pilot study in home-working, with the aim of improving the operational effectiveness of field staff by giving them remote access to systems.

## Cedar Financials issues

In general, the controls in place around the Cedar Financials system are good. Controls are well documented and evidenced and any issues followed up by the system administration team on a timely basis. We have also reviewed controls over the interfaces into Cedar financials. Again these controls are well documented and evidenced, and appear to be operating effectively.

### *System audit logs*

Cedar Financials has the facility for audit logging all, or certain aspects of, user activity. However, BCBC have currently elected not to switch on this facility.

System audit logs provide management with the ability to identify and follow-up on unusual incidents or patterns of behaviour that might indicate deliberate or accidental access to, or alteration of, financial information. This is a powerful control. We appreciate management's concerns that the current level of resources in the system administration team does not allow for the full review of all audit logs. However, we would recommend that BCBC investigate the feasibility of switching on the audit log facility for high-risk, sensitive or business critical transactions. If there is insufficient resource in the system administration team to review these logs, appropriate independent staff should be used.

### *Powerful user IDs*

"Super user" profiles allow some IT staff access to a wide number of facilities. Every additional super-user increases the risk of deliberate or accidental access or amendment to sensitive financial or business critical information.

We recommend that BCBC considers the appropriateness and necessity of providing all members of the system administration team with super-user access. If access is needed, system audit logs should be switched on for these users.

# System & Control issues

This section summarises a number of other system and control issues that we identified during our audit.

## Treasury management reporting

Reports to Cabinet on treasury management issues contain a full review of the year. It is important that future treasury requirements are also identified, planned and communicated in advance. This will be particularly important when dealing with the LOBO loans (see pages 8 & 9) as the Authority may only have a short time to react if and when the banks choose to exercise their option.

## Bank Reconciliations

In our previous letter, we recorded that bank reconciliations were not being prepared on a frequent basis. We can now report that the Authority has dealt with this issue, and has been preparing the reconciliations each month since December 2004. The reconciliations for the five main bank accounts are prepared together on a consolidated template. The complex nature of the template reduced its operating effectiveness, and was not fully understood by finance staff. We recommended that the Central Finance team revise the template to make it clearer, quicker to complete and more effective as a control. We also recommended that the Authority carries out a housekeeping exercise on the General ledger codes relating to the bank accounts. This is to be performed during 2005/06.

## Year end expenditure

Expenditure levels recorded in the March general ledger are seasonally high. Part of this is because Directorates make an effort at the end of the year to post all expenditure. This is especially marked in the Environment & Planning directorate where there is a push on suppliers to produce invoices for work under construction. There may also be an impact of the budget monitoring process where the key driver is how much of the year's budget is left.

There are a number of issues:

- Delays in receiving and processing invoices means that the management accounts need to contain more estimates – which potentially reduces their accuracy and slows down the accounts production process.
- VAT reclaims in March are very high, (March 2005: £1.43m, which was almost double February at £0.76m. If invoices were posted to the general ledger more quickly, then the VAT could be reclaimed more quickly.
- The larger than normal workload at the year end could add pressure to the processing team and risk supplier invoices being posted and paid incorrectly or inaccurately.

This issue should improve as quarterly accounting discipline improves (see page 28).

## Purchase Ledger and payroll issues

A number of minor issues were noted in the purchase ledger and payroll systems. These mainly involved:

- Evidence of authorisation in certain (smaller) departments
- Controls over payment security, where inappropriate staff had the ability to change suppliers' bank details.
- Segregation of payroll and personnel duties.

## System and control issues (continued)

### Procurement

We had recommended in the previous year that the Council consider the opportunities for improving the procurement process. The WAO undertook a review of procurement in the year as part of its Corporate Culture Review. It was encouraging to note that the Council has taken this initiative forward with procurement being one of the three flagship projects. There is great potential in procurement for saving the council money. In other authorities we have seen savings created by:

- Centralising procurement, so that the Council maximises the economies of its own scale
- Working with national procurement framework contracts

### Partnerships

In 2003/4 we reported that Bridgend had a number of working partnerships but there was no standard framework in place for partnership working or a register set up and maintained of all partners.

One of the risks of partnership working is potential for partners to fail to deliver services to standards set by the Council. The Council faces the risk of reputation damage.

Bridgend deferred work on this area during the merger of the policy and performance units. Protocols and generic policies for partnership working were to be drawn up following the merger process.

These should include areas such as:

- Governance arrangements, including accountability and representation on steering committees or similar
- Service Level Agreements
- Periodic monitoring and challenge, with a focus on outcomes

We recommend that the Council looks at best practice working in a sample of neighbouring authorities to speed up the process.



# Questions from the public

---

Sections 15 and 16 of the Audit Commission Act 1998 provide local electors with the opportunity each year to inspect the accounts of a local authority and subsequently, to put questions and/or objections relating to those accounts to the auditor. Any such representations must be resolved prior to the closure of the audit.

## **Contracting**

During the year we received a query from a local elector who had been involved in a tendering process for a Council contract and was dissatisfied with the final outcome.

In response to the query, we reviewed the procedures followed, and the documentation held, by the Council in respect of the awarding of this particular contract.

Our work concluded that the Authority had followed appropriate procedures and identified no significant deficiencies.

We did, however, identify a number of minor improvements that could be made to the documenting of the Authority's tendering procedures in the future.

## **Other**

We received a number of questions from another local elector concerning local development issues. We are currently discussing these with management.

# Use of Resources

We are required to consider the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources.

Our work in respect of use of resources included:

- Wales Programme for Improvement – "WPI"
- Corporate Culture Review
- Children's Services
- Decision making in Leisure
- Budget Monitoring and linkage between the Corporate Improvement Plan and the Budget

*During the year, the Authority undertook a Corporate Culture Review with the Wales Audit Office. This identified a number of matters needing to be resolved to facilitate performance improvement, and an action plan has been drawn up to deal with them. In September 2005, the Social Services Inspectorate Wales identified serious concerns over the Authority's performance in the delivery of Children's Services, and consequently have implemented the protocol for securing performance improvement. In September 2005, we reported that we were not recommending referral to the Wales Audit Office or Welsh Assembly Government on the basis that these significant issues had been identified and appropriate action plans were being prepared for implementation. We will review the position during our 2005/6 audit. We refer readers to that report.*

*The Corporate Culture review should help the Authority to move its performance management agenda forward, although there remain a number of recommendations from previous improvement audits yet to be implemented. Preparing a three year corporate improvement plan for 2005/8 was a big step forward, and an opportunity for aligning the plan with budgets and driving change across the services. The Authority must grasp that opportunity now or risk losing momentum.*

*The Authority has accepted our recommendations for improving the quarterly management accounting process – and we understand it will be implemented from December 2005. This should help to improve financial management going forward.*

# Use of Resources – Other issues

---

## **Corporate Culture Review and Central Services Review**

KPMG assisted the Council and the Wales Audit Office in these two important assignments. The conclusions are dealt with elsewhere in the WAO's reports to Council and elsewhere in the WAO's Relationship Manager's Annual Letter.

## **Children's Services**

Our planned work for 2004/5 involved following up the action plan prepared by Personal Services in response to the 2003 Joint Review. The Authority made progress with this issue, developing a framework for reporting the project status to Scrutiny.

Further work in the year by the Social Services Inspectorate Wales identified other issues, and in September 2005 the Chief Inspector initiated the protocol for responding to serious concerns in the Authority's Children's Services. This matter is dealt with in more detail in the Relationship Manager's Annual Letter.

## **Leisure**

We undertook a review of the decision making process for setting a strategy for leisure centres. The Authority faces the considerable challenge of planning for future leisure and community services provision in the light of reduced funding and deteriorating buildings and higher maintenance costs.

The directorate issued a report to Cabinet during August 2005, setting out in detail the issues facing the Authority and providing estimated costings for the refurbishment of a number of leisure facilities. A second report, detailing the various operational and funding options available, is due to be submitted to Cabinet in December 2005.

The decision making process therefore appears robust, with the intention of providing members with all the relevant information, although the project is progressing slowly. This is an indication of the importance placed by the Authority on the fundamental provision of leisure services and the need ultimately to make the correct decision following all necessary consultation.

# Use of Resources – Other issues

## Budget Monitoring

The aim of our work was to review the effectiveness of the budgetary control function with the Council.

Our key findings are as follows:

- Positive improvements have been made in recent years, with budget monitoring reports now produced on a quarterly basis, supplemented by monthly exception and 'hotspot' reports
- Manual adjustments are made to accounting system figures by some, but not all, directorates leading to a lack of consistency in accounting between directorates when compiling the monitoring reports.
- Calculation of accruals and provisions is only performed at the year end, resulting in 'actual' figures in the budget monitoring reports being significantly understated and meaningless for the majority of the year.

The Authority's management use a series of complex spreadsheets that compare estimated full year spend against budget as their primary monitoring tool, and have not been relying upon the 'actuals'. The "estimated full year spend" approach creates a higher risk that departments or individuals may incur expenditure in the final months of a financial year because there is budget left, rather than because the goods or service is needed.

Using actual figures recorded on a consistent accruals basis is clearly best practice. It:

- makes proper accounting a "business as usual" matter;
- helps to drive improvement in accounting control and management's understanding of the results;
- speeds up the processing of transactions into the general ledger;
- reduces the need for large numbers of spreadsheets (with the consequent risk of spreadsheet error);
- allows central financial management the ability to see what is happening across the Authority,
- speeds up the year end reporting process; and
- ultimately improves the potential for good financial management.

We have recommended that accurate actual figures be calculated and reported against budget on a quarterly basis so that expenditure can be monitored more closely. The Central Finance team have agreed to start this from December 2005.

# Use of Resources – Other issues

## **Linkage of budget to Corporate Improvement Plan (CIP)**

The objective of our work was to review whether there is a robust link between the budget and the CIP, which will allow the Authority to redirect resources towards areas of greatest priority.

Our key findings are:

- The Authority did consider the priorities of the 2004 CIP while preparing the 2005/6 budget, but was unable to identify at that time enough efficiency or other savings to be able to recycle resources to the prioritised risk areas
- Budget setting was based primarily on the prior year figures with little evidence of “zero-based” or challenging budgeting methods being adopted. This has been partially addressed by the base budget review conducted between June and September 2005. however it is also recommended that Internal Audit examine the budget-setting process on a rolling basis
- The budget-setting process is currently very directorate based, with little evidence of funds being channelled to the top ten risks from a central level. There is also evidence of budgets being controlled within directorates; so, for example, over-spends on one service can be funded by under-spends on another service within the same directorate.

The Authority has made positive progress during the year and their process for prioritising risks has evolved. The 2006/7 budget currently underway is another huge opportunity for the Council to use the budget – which is one of its most powerful tools – to redirect resource towards the areas of greatest need. We also understand that plans are in place to engage with members at an earlier stage than 2004/5 to ensure there is adequate time available for political debate.