

# Annual Audit Letter

Brentwood Borough Council

Audit 2010/11



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**Traffic light explanation**

Red  Amber  Green 

# Key messages

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

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

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

## Audit opinion and financial statements

I issued a qualified 'except for' opinion on the financial statements on 14 February 2012. The qualified 'except for' opinion relates to historical issues. There were no other issues arising from my audit of the 2010/11 statements which gave rise to a further qualification on my opinion for those statements.

The changes arising from the introduction of International Financial Reporting Standards (IFRS) impacted on both the Council's preparation and my audit of the financial statements. The complexity of converting the accounts to IFRS format combined with the workings of the Council's financial ledge being complex and difficult to understanding, contributed to the issues arising during the audit.

My audit highlighted a significant number of errors in the draft accounts. The extent of the issues identified during my audit resulted in the statements and notes being significantly reworked. Combined with numerical, typographical and presentational issues, this resulted in:

- the audit opinion not being issued by the statutory 30 September 2011 deadline; and
- a significant additional audit fee to be levied to cover the additional audit cost as set out in appendix 1.

The delays to the completion of the financial statements have also meant that I was not able to certify the Council's Whole of Government Accounts (WGA) submission by 30 September 2011. This work is ongoing. I am not able to formally conclude my audit and issue my audit certificate until I have completed my work on WGA.

## Value for money

The Council met the required standards in each of the two criteria assessed. I therefore concluded that Council has proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources. I issued an unqualified value for money conclusion on 14 February 2012.

This represents an improvement over the qualified 'adverse' conclusion that I gave in respect of the Council's arrangements in 2009/10.

## **Current and future challenges**

The Council faces significant change and challenge. The Localism Bill allows for Housing Revenue Accounts (HRA) self financing proposals. Furthermore, the Welfare Reform Bill means significant changes to the welfare system.

The continued economic downturn is placing increasing pressure on the public sector as a whole. The Council continues to respond to these challenges by identifying cost reductions and challenging spending and investment decisions.

The final out-turn position for 2010/11 indicates a stable financial position. However, the position for 2011/12 and future years remains challenging and needs to be kept under review. The planned legislative changes to housing finance, housing benefits and planning will have significant service and budgetary implications that will need to be considered as part of the ongoing development of the Medium Term Financial Plan.

# Financial statements and annual governance statement

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**The Council's financial statements and annual governance statement are an important means by which the Council accounts for its stewardship of public funds.**

## **Overall conclusion from the audit**

I issued a qualified 'except for' opinion on the financial statements on 14 February 2012. The qualification arises from the disclaimer of audit opinion on the 2008/09 financial statements and the qualified 'except for' audit opinion on the 2009/10 financial statements. These meant that I did not have full assurance regarding the accuracy of the comparative balances as at 1 April 2009 and the comparative income and expenditure for 2009/10 that are disclosed as part of the 2010/11 statements. The qualified 'except for' opinion therefore relates to historical issues previously reported. There are no other issues arising from my audit of the 2010/11 statements which gave rise to a further qualification on my opinion for those statements.

The move to International Financial Reporting Standards (IFRS) gave all local government bodies, including district councils, the difficult task of reviewing their past accounting policies and accounts and restating items in the format required by IFRS. This has been particularly challenging for Brentwood due to the 2008/09 accounts opinion being disclaimed and the workings of the Council's financial ledger being complex and difficult to understand. The extent of the general challenge of introducing IFRS is reflected in the significant number of other authorities that failed to meet the statutory deadline of 30 September for publishing their audited accounts. There has also been an impact on quality, with a significant increase in the number of bodies needing to make material accounts adjustments following the audit.

The main reasons for the delay in completing the audit were:

- the financial statements presented to the Audit Committee on 29 June 2011 were not of the expected standard as:
  - they were not in the correct format or IFRS-compliant;
  - there were disclosure notes that were missing or incomplete and numerous other disclosure and qualitative errors; and
  - they also contained many internal inconsistencies and numerical errors.
- the Movement in Reserves Statement (MIRS), Cash Flow Statement and associated notes were incorrect, contained material balancing figures and needed to be significantly reworked;

- there were significant issues identified with the Collection Fund resulting from the lack of understanding on how to compile the detailed entries to support the Collection Fund accounts. This also affected figures in the Balance Sheet and Comprehensive Income and Expenditure Statement (CIES). There remains an uncertainty of £290,000 within the Collection Fund which has not been resolved;
- a number of changes were required to the 2010/11 financial statements and their comparative figures to correct account for IFRS, mainly due to the treatment of:
  - Council as lessor;
  - investment properties;
  - grant accounting;
  - Council as lessee;
  - restatement for IFRS compliant opening balances; and
  - other non trivial, non material errors for misclassification of transactions.
- I identified three material misstatements in the core financial statements with a total value of £9.753 million, two of which related to incorrect accounting treatment under IFRS from previous years;
- a significant number of amendments were needed to the notes to the accounts, either because of the issues identified above or because the notes were not originally IFRS compliant. The majority of notes have been amended either in terms of disclosure or amounts; and
- I also identified eight non trivial errors and uncertainties which management decided not to amend.

The need to amend the financial statements for the above issues resulted in substantial changes to the figures within, and the presentation of, the financial statements. The cumulative impact of all agreed adjustments is to reduce the balance on the Council's General Fund.

Many of the issues that have caused significant problems and delays in completing the audit relate to changes and restatements because of the introduction of IFRS. These issues should have been resolved by the Council much earlier. All were identified in my first review of the Council's preparations for the introduction of IFRS in March and April 2011. Other errors were due to the workings of the Council's financial ledger being complex and difficult to understand.

Working papers to support the financial statements were provided late and many were found to be inadequate. I received numerous versions of the accounts incorporating to various degrees, the required changes. A final version of the accounts incorporating all agreed adjustments was approved by the Audit Committee on 13 February 2012. I highlighted a number of qualitative issues in my interim Annual Governance Report and made some recommendations on how the Council could address the weaknesses set out in the report. An action plan containing the Council's response was considered by the Audit Committee on 17 January 2012.

## **Delay in audit certificate**

I am not able to formally conclude my audit and issue my audit certificate until my work on the Whole of Government Accounts consolidation pack is complete. I am satisfied that these matters do not have a material effect on the financial statements or a significant impact on my value for money (VFM) conclusion. I therefore issued my opinion and VFM conclusion on 14 February 2012. However, I have delayed the issue of my certificate, which

closes the audit and certifies that I have fulfilled all my statutory responsibilities for the 2010/11 financial year. I will issue this once I have received and audited the revised Whole of Government Accounts consolidation pack.

### **Questions raised by a member of the public**

I have been asked questions raised by a member of the public in respect of the Council's taxi licensing arrangements, and a formal objection was made to the Council's 2010/11 Statement of Accounts. The grounds for the Objection were similar to those of the Objection that I considered in respect of the 2009/10 Statement of Accounts. I will be reviewing the Council's response to the findings and recommendations from my determination of the 2009/10 Objection as part of my 2011/12 audit and I will report the results of this review to the appropriate Council committees. On this basis, the 2010/11 Objection has been withdrawn.

### **Significant weaknesses in internal control**

There were two weaknesses in internal control I reported to the Audit Committee in my interim Annual Governance Report. Neither indicated a material error on the Council's accounts and management reported their response and progress made in rectifying these weaknesses to the January 2012 Audit Committee.

# Value for money

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**I considered whether the Council is managing and using its money, time and people to deliver value for money. I assessed your performance against the criteria specified by the Audit Commission and have reported the outcome as the value for money (VFM) conclusion.**

I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against two criteria specified by the Audit Commission. My overall conclusion is that the Council has adequate arrangements to secure, economy, efficiency and effectiveness in its use of resources.

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

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## Value for money criteria and key messages

Criterion	Key messages
<p><b>1. Financial resilience</b></p> <p><b>The organisation has proper arrangements in place to secure financial resilience.</b></p> <p>Focus for 2010/11:</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>	<ul style="list-style-type: none"><li>■ I issued an unqualified value for money conclusion for the arrangements for securing financial resilience. This reflects the improvements the Council has made in that I qualified the Council's arrangements for planning for financial health, financial reporting; risk management and internal control in 2009/10.</li><li>■ The Council has taken steps to improve its financial governance.....</li><li>■ An effective Medium Term Financial Plan (MTFP) has been developed which has been used to support and develop the budget for future years. Overall budget monitoring has improved.</li><li>■ Financial and corporate processes are now integrated and the Council has evaluated key risks likely to affect the implementation of the Corporate Strategy. A risk management strategy also in place.</li><li>■ Internal control weaknesses are being addressed by the Council.</li><li>■ For 2010/11, the Council delivered a balanced budget and the final out-turn position shows a</li></ul>

Criterion	Key messages
<p><b>2. Securing economy efficiency and effectiveness</b></p> <p><b>The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.</b></p> <p>Focus for 2010/11:</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>fairly stable financial position. However, the financial position for 2011/112 and beyond remains challenging and needs to be kept under review.</p> <ul style="list-style-type: none"> <li>■ I issued an unqualified value for money conclusion for the arrangements for securing economy, efficiency and effectiveness. This reflects the improvements the Council has made in that I qualified the Council's arrangements for good governance in 2009/10.</li> <li>■ The Council's Corporate Plan has been redrafted and a Priority Resource Planning Project is being undertaken.</li> <li>■ Processes have improved through closer budgetary control to ensure resources are matched to the delivery of priorities and a strategic modernisation programme is also being undertaken.</li> <li>■ A range of services are delivered through shared services or partnership arrangements and the Council has developed a Partnership Framework.</li> <li>■ There is no regular use of benchmarking and comparative information with other councils which could increase self-awareness and improve efficiency and productivity.</li> <li>■ An asset management plan is in place, however there is scope for improvement in the Council's asset management arrangements.</li> </ul>

# Current and future challenges

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Economic downturn and pressure on the public sector

The continued economic downturn is placing increasing pressure on the public sector as a whole. This is demonstrated through the:

- challenging comprehensive spending review settlement;
- increasing demand for key services; and
- reduced ability of the public to pay for services.

In addition, there are challenges arising from HRA self financing, reduction in Revenue Support Grant and decreases in locally generated income. Taken together, these challenges will put increasing pressure on the Council's finances. So far the Council has responded well to these challenges.

Joint arrangements and shared services

Central government has identified joint arrangement and shared services as a key element for council to consider in identifying ways to reduce their overall costs. The Council is working with partners, other service providers and external sources of support to improve its processes, costs and outcomes. The Council continues to explore shared service options with a variety of potential partners, for example entering in to a strategic partnership with Essex County Council for the delivery of the finance function.

Housing Revenue Account (HRA) self financing

Under the existing housing subsidy system, councils with housing stock have to prepare a notional HRA using a set of predetermined factors. These include items such as maintenance costs and rental income to reflect the mix and age of the housing stock. If this notional account shows a surplus, this is payable to central government. However, if there is a shortfall, an equivalent payment is made to the Council to support their housing landlord role.

The current year, 2011/12, is to be the last year of the existing system. Under a new financing regime, councils will be responsible for financing of the HRA, and the existing system of grants and payments will end. To fund this Central Government will pay some councils and for others that currently contribute to the scheme, they will transfer a debt liability. Early modelling shows the Council will be obliged to take on a significantly higher level of debt in return for keeping council house rents in the future. Over the long term, the Council anticipates that it and residents are likely to benefit from the new arrangements, but there will be associated risks relating to debt

repayment.

The debt liability transfer to Brentwood of £64.166 million will take place on 28 March 2012. The Council have developed a 30 year business plan which looks to set aside money to a savings fund and repay the principal by the end of the borrowing period. Consultants have been engaged to review borrowing requirement, potential options and undertaken scenario analysis.

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#### Localism Bill

This Bill is expected to receive Royal Assent in early 2012 to allow the HRA self financing proposals to go ahead. However, the Bill has far-reaching implications for local authorities including:

- granting of a 'general power of competence', to provide councils with the legal power to do what is not specifically prohibited;
- new rights and powers for communities, including:
  - 'community right of challenge', which allows voluntary and community groups to express and interest in taking over and running local authority services; and
  - 'community right to buy', whereby local authorities who hold community-value assets and who wish to dispose of them, must allow community groups time to put together bids and finance.
- planning for reforms, including changes to the community infrastructure levy, with part of it going to neighbourhoods affected by the developments.

The full implementation of the Bill will have significant service implications and may therefore impact on the Council's budget.

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#### Welfare reform

The Welfare Reform Bill was introduced in Parliament in February 2011. The Bill means significant changes to the welfare system. It introduced a 'universal credit' to replace existing means-tested benefits and tax credits for people of working age, starting from 2013. These include housing benefit and council tax benefit, which are managed by councils. The Bill follows the November 2010 White Paper, 'universal credit: welfare that works', which set out the coalition government's proposals for reforming welfare to improve work incentives, simplify the benefits system and tackle administrative complexity.

As well as introducing universal credit and related measures, the Bill makes other significant changes to the benefits system. The changes that specifically affect councils include:

- limiting housing benefit entitlement for social housing tenants whose accommodation is larger than they need;
- up-rating local housing allowance rates by the consumer price index; and

- capping the total amount of benefit that can be paid.

The government has yet to confirm the detailed timescale over which the full move from the existing housing benefit and council tax benefit systems to universal credit will take place. However, this will have significant operational and resource implications for the Council.

More recently the coalition government released a consultation paper on local support for council tax. This stated that council tax support would not form part of universal credit and would remain a local authority responsibility. The paper also set out the need for a 10 per cent cut in existing support.

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# Closing remarks

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I have discussed and agreed this letter with the Managing Director and the Director of Finance. I will present this letter at the Audit Committee on 6 March 2012 and will provide copies to all members.

Further detailed findings, conclusions and recommendations in the areas covered by our audit are included in the reports issued to the Council during the year.

Report	Date issued
Audit and inspection fee letter	March 2010
Audit opinion plan	February 2011
Interim audit report	June 2011
Interim annual governance report	October 2011
Final annual governance report	February 2012
Auditor's report giving the opinion on the financial statements and value for money conclusion	February 2012
Annual audit letter	March 2012

The Council has taken a positive and constructive approach to our audit, notwithstanding the difficult circumstances of the audit and the issues set out in this letter. I wish to thank the Council staff and Council Members for their support and co-operation during the audit.

Paul King

District Auditor

February 2012

# Appendix 1 - Fees

	Proposed	Actual	Variance
Audit fee	£157,500	£234,950 (estimated)	£77,450
<b>Total</b>			

The proposed audit fee for 2010/11 was £157,500, as set out in my detailed audit plan issued in early 2011. I raised a number of issues in my Annual Governance Report, which have been summarised in this letter. In particular, the extend of issues around the transition to IFRS, the quality of the draft financial statements presented for audit and the number of diverse and complex queries, which have led to material technical adjustments.

This has resulted in significant additional audit work being undertaken to gain sufficient assurance for opinion purposes. The fee for the audit will therefore be higher than proposed within the audit plan. As my audit is not yet complete because of the need to complete my work on the Council's WGA Return, I cannot yet confirm the exact level of the additional fee. I will discuss and agree the final fee with the Managing Director following the formal conclusion of the audit.

However, separately the Council has received two rebates in respect of 2010/11 totalling £8,346 directly from the Audit Commission. This total rebate comprised £6,667 for the extra audit costs from the transition to IFRS and £1,667 for a reduction in the work on the value for money conclusion.

The final audit fee charged for the 2009/10 audit was £197,000.

I have also issued a separate report on the certification of claims and returns which shows the actual fees for this work reduced from some £190,502 in 2009/11 to some £101,417 in 2010/11 – a reduction of some £89,085 between the two years.

# Appendix 2 - Glossary

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## **Annual governance report**

This report identifies the key messages that members should consider before I issue my financial statements opinion, value for money conclusion, and audit closure certificate. It includes only matters of governance interest that have come to my attention in performing my audit. As members have final responsibility for the Council's financial statements and annual governance statement, it is important that members consider my findings before adopting the financial statements and annual governance statement.

## **Annual governance statement**

Governance is about how local government bodies ensure that they are doing the right things, in the right way, for the right people, in a timely, inclusive, open, honest and accountable manner.

It comprises the systems and processes, cultures and values, by which local government bodies are directed and controlled and through which they account to, engage with and where appropriate, lead their communities.

The annual governance statement is a public report by the Council on the extent to which it complies with its own local governance code, including how it has monitored the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period.

## **Audit closure certificate**

A certificate that I have completed the audit following statutory requirements. This marks the point when I have completed my responsibilities for the audit of the period covered by the financial statements.

## **Audit opinion**

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

## **The Code**

The Code of Practice on Local Authority Accounting in the United Kingdom (the Code) specifies the principles and practices of accounting required to give a 'true and fair' view of the financial position and transactions of a local authority, including group financial statements where a local authority has material interests in subsidiaries, associates or joint ventures. The Code sets out the proper accounting practices required by section 21(2) of the Local Government Act 2003.

## **Housing Revenue Account (HRA)**

A statutory account included within the financial statements in which the revenue costs of providing, maintaining and managing Council dwellings are charged. These are financed by rents charged to tenants and subsidies received from the Government.

## **International Financial Reporting Standards (IFRS)**

Guidelines and rules set by the International Accounting Standards Board (IASB) that companies and organisations can follow when compiling financial statements. The creation of international standards allows comparison of financial statements with greater ease.

## **Opinion**

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

## **Value for money conclusion**

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

## **Weaknesses in internal control**

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

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