

Annual governance report

Cheshire East Borough Council

Audit 2011/12

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We also help public bodies manage the financial challenges they face by providing authoritative, unbiased, evidence-based analysis and advice.

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Key messages

This report summarises the findings from the 2011/12 audit which is now 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

I have completed most of my audit work and expect to issue an unqualified opinion on the Council's financial statements on 28 September 2012.

The Council has improved its closure of accounts process this year. The statements received on 30 June 2012, were supported by much better audit trails and working papers. The finance team implemented the recommendations from the last two audits including important improvements to quality assurance arrangements. This has all helped to reduce the number of errors identified during the audit and improve the overall quality of the accounts.

The accounts presented for audit contained no material errors and far fewer other errors than in previous years. The accounts were amended for seven reclassification errors and a number of changes to disclosures within the supporting notes. A full list of the changes to the accounts is included at appendix 3.

Value for money (VFM)

I have completed most of my audit work and expect to be able to issue my VFM conclusion on the 28 September.

I have some concerns about whether Cheshire East Council has proper arrangements to secure value for money in its use of resources. I expect to issue a qualified opinion that draws attention to weaknesses identified in the Council's arrangements for securing value for money.

While the Council has adequate arrangements in place to secure financial resilience my work has identified areas where further improvements can be made. I also conclude that the Council has adequate arrangements for securing economy efficiency and effectiveness except for:

- weaknesses in its arrangements to develop business proposals and manage significant projects. These weaknesses undermine the Council's ability to show that it is prioritising resources within budgets and achieving sustainable cost reductions alongside greater efficiencies and improved productivity.

With the exception of these matters, I am satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2012.

The Council continues to face financial pressures and now needs to review and improve its own arrangements for securing financial resilience. Since its inception in April 2009 the Council has had to manage unplanned budget pressures each year. This pattern is continuing in 2012/13 – in its first quarter report the Council identified pressures of £22 million. While savings plans are in place to address this pressure a budget gap of £7.7 million still remains.

Over this same period the Council used its reserves to manage its overall financial position. General fund reserves are no longer adequate to support in year pressures and are now below the Council's own assessment of the financial risks it faces. While the use of reserves to date has been planned it is clear that their continued use to support budget pressures is not sustainable.

In the past two years the Council planned to deliver savings of £50 million. To help identify robust plans to deliver those savings the Council revised its business planning process. This, together with the Council's budgeting process, is the main mechanism for identifying savings and growth areas. But weaknesses in the application of these processes are undermining the Council's ability to show that it provides value for money. In summary, the Council approves too many small projects that are not clearly aligned to its stated priorities. It is also clear that the translation of ideas and proposals into approved schemes is not robust. Used appropriately, effective business planning and budget setting processes should help the Council to develop robust proposals.

The Council has started to implement a gateway process which should address the problems identified in its project and programme management arrangements. It is also revisiting the business proposals agreed as part of the 2012/13 budget to ensure they remain appropriate and are supported by robust delivery plans.

In January 2012 the Council's, (then), Chief Executive and Leader commissioned internal audit to do a review of the decision to build a waste transfer station at Lyme Green, Macclesfield.

A number of the issues raised in the critical internal audit report on Lyme Green link directly to the weaknesses in the Council's business planning and budget setting process set out in this report. It is also clear that internal audit identify a number of important governance and internal control issues – including compliance with the Council's constitution, its corresponding standing orders and financial procedure rules. The Council accepted all of the recommendations in the critical internal audit report. In June 2012 the Council's staffing committee also approved the appointment of an independent investigator to consider the actions of the officers involved. That investigation should be concluded later this year.

I have reviewed the actions taken by the Council since the Lyme Green issues emerged in January 2012. I am satisfied that the Council is strengthening its governance and internal control processes. At this time I do not plan to take any further action. I will however ensure that the incoming auditor is aware of the issues raised – including the conclusions of the independent investigator.

I have agreed a small number of high level recommendations, with the interim Chief Executive, to improve the Council's arrangements to secure value for money (page 16 and appendix 5). Some of my recommendations link closely to those made by internal audit on Lyme Green which the Council is in the process of implementing.

The most significant of my recommendations is the need for Members to provide clearer strategic direction and political leadership when agreeing priorities, taking difficult decisions and supporting officers to deliver agreed plans.

Before I give my opinion and conclusion

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 not aware of any relationships that may affect the independence and objectivity of the Audit Commission, the audit team or me, that I am required by auditing and ethical standards to report to you.

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

Next steps

I ask the Audit Committee to:

- take note of the adjustments to the financial statements included in this report (appendices 2 and 3);
- approve the letter of representation (appendix 4), on behalf of the Council before I issue my opinion and conclusion; and
- Agree the Council's response to the proposed action plan (appendix 5).

Financial statements

The Council's 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.

I have yet to complete my work in the following areas at 20 September:

- receive sufficient information to complete my work on the cash flow statement;
- collection fund;
- final review procedures; and
- agree the final changes to the financial statements with officers.

In addition, I have not completed my work on the Council's whole of government accounts return.

I will update the Audit and Governance Committee on 27 September 2012. At this stage I do not expect to need to issue an updated report in advance of those meetings.

Uncertainties and uncorrected errors

I found three uncertainties in the accounts. I have accepted the Director of Finance and Business Services' decision not to amend the accounts for these issues.

- The Council assumes a 99 per cent collection rate in respect of current year Council Tax and NNDR debtors. No doubtful debt provision has been raised in respect of the balance. If such a provision was made the total money set aside would increase by £225,000.

- The second uncertainty relates to the inclusion of debts, and the associated doubtful debt provision of £580,000, in respect of Highways debtors inherited from Cheshire County. Some of these debts date back to 2001 and may no longer be collectable. The Council should review its provision for these debts and consider writing them off where appropriate.
- The doubtful debt provisions for Council Tax and NNDR debtors may be understated. The Council does not have a complete age analysis of these debts and is therefore unable to assess the adequacy of these provisions.

I also found two errors that I have not asked the Council to correct.

- Investment properties are understated by £325,000 for assets previously omitted from the asset register.
- Surplus assets are overstated by £318,000 because no depreciation was charged in the year.

While these items are not significant I draw them to your attention as the amounts involved exceed my trivial reporting threshold.

Corrected errors

My audit identified no material errors in the accounts presented for audit. Officers amended the accounts for seven reclassification errors. A number of other amendments were made to disclosures within the supporting notes. The quality of the accounts presented for audit was much improved from previous years. This contributed to the significant reduction in the volume of errors identified during the audit. (I reported five material and 59 other corrected errors last year.)

Summaries of the uncertainties, uncorrected and corrected errors are attached at appendices 2 and 3.

Significant risks and my findings

In my January 2012 Audit Plan I identified one significant risk relevant to my audit of your financial statements. Table 1 summarises my work to address that risk.

Table 1: **Risks and findings**

Risk	Finding
<p>In year financial pressures and their potential impact on reserves increased the risk of financial misreporting which may impact on the true and fair presentation of the financial statements.</p> <p>As a consequence I am also unable to rebut the presumption of fraud in income recognition.</p>	<p>I reviewed the effectiveness of management controls in place to reduce the risks of financial misreporting and fraud in income recognition. I undertook extended testing on material journals and income and expenditure cut-off.</p> <p>My testing did not find any material errors.</p>

Risk	Finding
	I also reviewed the application of significant accounting treatments used in preparing the accounts against the Council's stated accounting policies. There are no matters that I wish to bring to your attention.

Significant weaknesses in internal control

It is the responsibility of the Council 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 the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

I have tested the Council's controls only to the extent necessary for me to complete my audit. I am not expressing an opinion on the overall effectiveness of internal control. The weaknesses I have identified during the audit are only those that are relevant to preparing the financial statement. I also reported these weaknesses to you last year.

I explain in table 2 the Council's response to the weaknesses and the action I took at my audit to reduce the risks to acceptably low levels. The Director of Finance and Business Services is giving priority to resolving the control issues in 2012/13.

Table 2: Internal control issues and my findings

Description of weakness	Findings
Access to the general ledger Some staff have access to main financial systems without effective controls being in place. This increases the risk of unauthorised and inappropriate entries being made in the general ledger and other key financial systems.	As in 2010/11 multiple access privileges for some staff to main financial systems remain an issue. It reduces the effectiveness of segregation of duty controls and increases the risk of unauthorised access to the Council's financial systems. Together with Cheshire West, the Council improved access controls in 2011/12 and further changes have been made since 1 April. Internal Audit performed substantive testing in these risk areas and concluded that transactions were processed correctly. I have reviewed and re-performed a small sample of Internal Audit's work to gain the assurance I need for my audit. I found no instances of inappropriate access. The Council still needs to bring the risk of unauthorised access down to an acceptable level.

Description of weakness	Findings
<p>Reporting differences between Oracle and Northgate (the Council Tax and NNDR systems).</p> <p>The Council introduced the Northgate system in December 2010 – replacing the three systems operated by the former district councils. Northgate are working with the Council to resolve the remaining implementation issues.</p>	<p>Last year, I identified differences between the cash receipts and refunds balances reported by Northgate for NNDR and Council Tax and those reported in Oracle.</p> <p>There were also differences between Northgate reports used to support the NNDR3 claim and the collection fund. The finance team carried out work during 2011/12 to improve the quality of the year end reports.</p> <p>This year, my testing of the collection fund and NNDR3 claim found improvements in these areas with two exceptions:</p> <ul style="list-style-type: none"> ■ the aged Council tax and NNDR debtors list does not agree to the arrears total on the system; and ■ the year end Control Summary report includes significant adjustments incorrectly classified as write offs. <p>The Council should continue to review year end reports to ensure that reports are accurate and complete.</p>

Other matters

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

Quality of your financial statements

There were marked improvements in the quality of the accounts presented for audit and in the working papers. In addition the response time to audit queries and the quality of supporting evidence was significantly better than in previous years. These improvements resulted from stronger quality assurance arrangements around the production of the accounts which helped to reduce delays in the progress of the audit. The finance team needs to continue to develop its closedown and ongoing audit support arrangements so that the overall process can be completed efficiently.

Annual Governance Statement

The Council's Annual Governance Statement meets CIPFA's requirements. During 2011/12 the Council's Corporate Governance Group strengthened the processes for compiling the statement and for obtaining assurance from service managers. The disclosures set out in the statement are consistent with the information I am aware of from my audit of the financial statements and also from my value for money work.

Letter of representation

Before I issue my opinion, auditing standards requires me to ask you and management for written representations about your financial statements and governance arrangements. The draft letter of representation is attached, appendix 4.

Internal Audit

During the year, I have been able to place reliance on the work of internal audit in respect of controls and substantive testing on a number of financial systems. Before placing reliance, I reviewed the scope and adequacy of the testing to check that it met appropriate standards.

Where relevant I have reviewed other pieces of their work to inform my VFM conclusion.

Whole of Government Accounts

Alongside my work on the financial statements, I have also reviewed and reported to the National Audit Office on your Whole of Government Accounts return. The extent of my review and the nature of my report were specified by the National Audit Office. I have no matters to report at this stage. If necessary, I will update members on the outcome of my work in this area on 27 September.

Value for money

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.

I assess your arrangements against the two criteria specified by the Commission. In my Audit Plan dated January 2012, I reported to you a small number of risks that were relevant to my conclusion. I updated my assessment of those risks and my planned work in June 2012. I set out below my conclusion on the two criteria, including the findings of my work addressing each of the risks I identified.

I have some concerns about whether Cheshire East Council has proper arrangements to secure value for money in its use of resources. I expect to issue a qualified opinion that draws attention to weaknesses identified in the Council's arrangements for securing value for money.

I conclude that:

- while the Council has adequate arrangements for securing financial resilience I have also identified areas for improvement; and
- the Council has adequate arrangements for securing economy efficiency and effectiveness except for:
 - weaknesses in its arrangements to develop business proposals and manage significant projects. These weaknesses undermine the Council's ability to show that it is prioritising resources within budgets and achieving sustainable cost reductions alongside greater efficiencies and improved productivity.

My opinion will, however, conclude that with the exception of these matters, I am satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2012. I include my draft conclusion in appendix 1.

Securing financial resilience

In my Audit Plan, and subsequent update, I identified the risk that the Council fails to deliver its planned budget and savings proposals. In response to this risk I reviewed the Council's arrangements for:

- ensuring the robustness of underlying budget assumptions;
- monitoring and reporting core budget and savings proposals; and
- compilation, monitoring and reporting of the capital programme.

The findings from my work are set out below.

The Council continues to face financial pressures and now needs to review and improve its own arrangements for securing financial resilience. Since its inception in April 2009 the Council has had to take remedial action each year to manage significant in year budget pressures. This has involved restructuring departments and a repeated focus on reducing costs. In 2010/11 the Council also had to react to the emergency budget set by the new Government.

In its mid-year performance report for 2011/12 the Council reported budget pressures of £16 million. In the report to November Cabinet officers identified remedial action to reduce the forecast overspend to £9.4 million. By quarter three officers were reporting pressures of £11 million with remedial action to reduce the over spend to £7 million. At the year end the Council reported an over spend of £10.5 million (including abortive costs on the Waste and Housing PFI projects of £1.7 million). This pattern is continuing in 2012/13 – in its first quarter report the Council identified pressures of £22 million. While savings plans are in place to address this pressure a budget gap of £7.7 million still remains.

In part, the additional pressures arise because of the high volume of proposals approved by the Council during its business planning and budget setting processes. In summary the Council approves too many small projects that are not clearly aligned to its stated priorities. It is also clear that the translation of ideas and proposals into approved schemes is not robust. In turn, savings intended to flow from the Council's business planning process are delayed and in some cases not delivered. This places additional pressure on managers to find savings on other areas and is not sustainable.

Weaknesses in the application of the Council's business planning processes also impact upon its capital programme. The Council reported slippage of £20 million in its 2011/12 capital programme. The original programme totalled £76 million – based on the business proposals prepared during the business planning cycle. At the year end, officers carried out a review to identify which schemes to carry forward into 2012/13. This exercise highlighted a number of reasons for slippage including:

- delays in scoping schemes;
- revisions to business cases; and
- insufficient resources to deliver planned schemes in year.

The Council's arrangements for reporting and monitoring revenue and capital spend continued to develop this year. While quarterly Cabinet reports agree to the Council's underlying financial systems there are weaknesses in forecasting in some areas. The responsibility for accurate forecasting lies with the service and project managers. Some of the variability in the quality of forecasting may be due to time pressures or lack of experience. I note that financial reports have changed for 2012/13 so that they are now consistent with the layout of the budget and focus on key areas.

Although the capital programme was revised during the year, the volume of slippage was significant. Clearly the business planning process needs to ensure that as business cases and delivery plans are developed, capital monitoring reports are updated with budget and profiling changes on a timely basis. I make further comments on the Council's business planning processes below.

Since 2009 the Council has recognised the need to increase the level of resources allocated to key areas including adult services. It has also used its reserves to manage its overall financial position. The Council has a reserves strategy in place, supported by an annual assessment of the strategic risks it faces. Over the last three years that strategy has included the planned use of reserves to support the costs of restructuring the Council. In 2009, reserves totalled £47 million, (General Fund £23 million). At 31 March 2012 reserves total £19.7 million, (General Fund £11.4 million).

General fund reserves are no longer adequate to support in year pressures and are now below the Council's assessment of the financial risks it faces. While the use of reserves to date has been planned, it is clear that their continued use to support in year pressures is not sustainable beyond this financial year.

During 2011/12 the Council continued to develop its financial management and monitoring arrangements. The Council's business planning process was refreshed during the year with further changes planned for 2012/13.

While I have concluded that the Council has adequate arrangements for securing financial resilience I have also identified areas for improvement. These are summarised as recommendations on page 16.

The Council has recognised the need to improve its arrangements to secure financial resilience. A recent presentation to Cabinet began to outline the key areas for change including the need to plan over a longer timescale and to agree what services to deliver and at what cost. The Council is also introducing a 'gateway' process for approving and monitoring significant projects.

Securing economy efficiency and effectiveness

In my Audit Plan, and subsequent update, I identified the risk that the Council's planned changes in services would not deliver the anticipated efficiencies and/or savings. In response to this risk I carried out work to assess the Council's arrangements for:

- developing business proposals – including project management and project governance; and
- ensuring that those plans are managed and monitored effectively to achieve the savings within agreed timescales.

In the past two years the Council planned to deliver savings of £50 million. To help identify robust plans to deliver those savings the Council revised its business planning process. For 2011/12 this led to a range of proposals including a £10 million investment in Adults and Children's Services – offset by reductions in other areas.

The main mechanism for identifying savings – as well as growth areas – is the Council's business planning and budget setting process. The business proposals are prepared by officers and cover a wide range of projects. They are then scrutinised as part of the business planning process, designed in part, to test their relevance against corporate objectives. Approved projects are then included in the annual budget. Officers subsequently prepare more detailed delivery plans. For large transformational schemes, or major capital projects, this should include drawing up detailed business cases – including option appraisal analysis – supported by comprehensive project plans. Used appropriately, this process should help the Council to develop robust proposals. However, ongoing pressures to find additional in year savings together with significant slippage in the capital programme demonstrate weaknesses in this process.

I reviewed a sample of business proposals covering a range of service areas. The information provided to support the proposals is inconsistent and I found many examples of projects with limited information at both the initial and later stages. Without clear consistent arrangements for developing business cases, options appraisals and delivery plans the Council continues to struggle to deliver its budget proposals.

Strengthening the links between projects and corporate objectives, coupled with post implementation reviews and more emphasis on benefits realisation will require changes in the performance information reported to Cabinet and Corporate Management Team (CMT). To date Cabinet receive quarterly performance reports based on national performance indicators, (PIs). There is no direct link between these PIs and the Council's corporate objectives and agreed programmes of work. Reports to CMT include some details on benefits realisation – focusing entirely on the achievement of savings. The Council needs to improve its performance reporting at both member and officer level. For example, the Council needs to agree a set of relevant local performance indicators that reflect its priorities. Those indicators should then be integrated with robust financial forecasting information to support member and officer decision making.

In early 2012, the Council commissioned an internal review of its project and programme management arrangements. The review found that the Council needs to:

- improve how it articulates what it wants out of projects and programmes and establish clear links with their corporate objectives;
- strengthen the scrutiny of business cases;
- ensure that resource planning captures the true costs of the project – failure to define all resource implications at an early stage can lead to delays and bottlenecks in delivery;

- ensure that services use agreed project management tools effectively; and
- undertake post implementation reviews to check that planned project benefits are delivered.

The Council has started to implement a gateway process which should address the problems identified in its project and programme management arrangements. The planned improvements should ensure that projects only proceed on the basis of robust plans. The Council is also revisiting the business proposals agreed as part of the 2012/13 budget to ensure they remain appropriate and are supported by robust delivery plans. The gateway process is intended to cover major projects above £250,000. It will also include other projects – dependent upon assessed risk. The Council still needs to consider how it will ensure that the management of smaller projects also improves.

In January 2012 the Council's, (then), Chief Executive and Leader commissioned internal audit to do a review of the decision to build a waste transfer station at Lyme Green, Macclesfield. The critical internal audit report concluded that:

in the main, appropriate Council procedures are in place to prevent financial and legal irregularities, achieve compliance with Officer Delegations, Standing Orders, EU procurement Rules and ensure effective reporting to Members, in this instance there is evidence that officers failed to comply with many of these arrangements.

The Council accepted all of the recommendations in the report. In June 2012 the Council's staffing committee also approved the appointment of an independent investigator to consider the actions of senior officers. That investigation should be concluded later this year. I note also that the Audit and Governance Committee will monitor the implementation of the agreed action plan – the first update report will be considered on 27 September 2012.

The Lyme Green project raises a number of project governance and internal control issues that link directly to the weaknesses set out in this report in the Council's business planning and budget setting process. Lyme Green is also one of the significant governance issues identified in the Council's Annual Governance Statement for 2011/12.

I have reviewed the actions taken by the Council since the Lyme Green issues emerged in January 2012. In addition, I undertook specific testing on delegated decisions in 2011/12. My work did not find any further evidence of non compliance with EU requirements. However the guidance available to officers setting out when and how to use decision notices is unclear. I note also that the Council is strengthening its governance and internal control processes by:

- updating its processes to clarify the circumstances in which officers can use delegated decisions. More detailed schemes of delegation within service areas have also been revisited and updated. These changes will be reflected in the Constitution as necessary;
- introducing procedures to ensure that non compliance is reported to the Corporate Management team for action;
- recognising the need to improve officer awareness of financial procedure rules and the associated schemes of delegation; and
- strengthened arrangements to ensure that in-house planning advice is robust and separate from the Council's statutory planning responsibilities.

Since January 2012 I have received letters and emails from members of the public concerned about Lyme Green. While I was not involved in the detail of the internal audit investigation the Council kept me fully informed of emerging issues and its response to those issues. I am satisfied that the Council will strengthen its governance and internal control processes as set out above and that it will continue to implement internal audit's recommendations. I have carefully considered whether to take any further audit action in response to the issues raised by Lyme Green. I have concluded that I do not. I will however ensure that the incoming auditor is aware of the issues raised – including the conclusions of the independent investigator.

Recommendations

I have agreed the following high level recommendations, with the interim Chief Executive, to improve the Council's arrangements to secure value for money. Some of them link closely to the recommendations made by internal audit on Lyme Green – which the Council is in the process of implementing.

Recommendations

- R1** Members need to provide clearer strategic direction and political leadership when agreeing priorities, taking difficult decisions and supporting officers to deliver agreed plans.
 - R2** The Council needs to implement planned improvements in business planning and programme/project management processes providing a clear link to agreed priorities – including robust option appraisal and financial analysis before projects begin. This should also include relevant aspects of recognised effective programme/project management arrangements for all projects.
 - R3** The Council needs to develop longer term financial plans clearly aligned to business priorities and supported by deliverable savings plans. These plans should also ensure that reserves are used appropriately and are maintained in line with the Council's own assessment of the financial risks it needs to manage. The quality of financial forecasting in some areas also needs to improve.
 - R4** The Council needs to improve performance monitoring and reporting. This should include agreeing a set of relevant local performance indicators that reflect its priorities. Those indicators should then be reported alongside the national indicators and integrated with robust financial forecasting information to support member and officer decision making.
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Fees

I reported my planned audit fee in the January 2012

Audit Plan.

I have agreed with the Director of Finance and Business Services a revision to the fee because of the matters highlighted in this report relating to the completion of my value for money conclusion.

Table 3: **Fees**

	Original scale fee (£)	Planned fee 2011/12 (£)	Expected fee 2011/12 (£)
Audit	£358,650	£341,750	£341,750
Claims and returns		£97,994	£50,172
Additional fee			£20,000
Total		£439,744	£411,922

The Audit Commission has paid a rebate of £27,340 to reflect attaining internal efficiency savings, reducing the net amount payable to the Audit Commission to £314,410.

Appendix 1 Draft independent auditor's report

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CHESHIRE EAST COUNCIL

Opinion on the Council financial statements

I have audited the financial statements of Cheshire East 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 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 Council Accounting in the United Kingdom 2011/12.

This report is made solely to the members of Cheshire East 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 Business Services and auditor

As explained more fully in the Statement of the Director of Finance and Business Services Responsibilities, the Director of Finance and Business Services 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 Council 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 financial 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 Council's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Director of Finance and Business Services and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the

explanatory foreword 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 Cheshire East 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 Council Accounting in the United Kingdom 2011/12.

Opinion on other matters

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

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

Respective responsibilities of the Council and the auditor

The Council 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 Council 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 Council 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 Council'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 Council 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 Council 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 Council had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Basis for qualified conclusion

In considering the Council's arrangements for challenging how it secures economy, efficiency and effectiveness, I identified weaknesses in its processes to develop business proposals and manage significant projects. These weaknesses undermine the Council's ability to show that it is prioritising resources within budgets and achieving sustainable cost reductions alongside greater efficiencies and improved productivity.

Qualified conclusion

On the basis of my work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2011, with the exception of the matter reported in the basis for qualified conclusion paragraph above, I am satisfied that in all significant respects Cheshire East Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2012.

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, Cheshire East Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2012.

Appendix 2 Uncorrected errors and uncertainties

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

		Statement of comprehensive income and expenditure		Balance sheet	
Item of account	Nature of uncertainty	Dr £	Cr £	Dr £	Cr £
Council Tax and NNDR doubtful debt provision (Note 21)	Potential understatement of provision resulting from incomplete aged debts analysis.	£0 - £1.5m			£0 - £1.5m
Council Tax and NNDR doubtful debt provision (Note 21)	No provision for % of CT and NNDR debtors assumed uncollectable in current year	£225,000			£225,000
Debtor impairment	Very old debts now provided for – query collectability			£580,000	£580,000
Investment Properties (Note 14)	To recognise assets previously omitted from the asset register	£325,000	£325,000		
Property Plant & Equipment (Note 12)	Depreciation not charged on surplus assets	£318,000			£318,000

Appendix 3 Corrected errors

I identified the following errors during the audit which management have addressed in the revised financial statements.

		Statement of comprehensive income and expenditure		Balance sheet	
Item of account	Nature of error	Dr £'000s	Cr £'000s	Dr £'000s	Cr £'000s
Investments (Note 19a)	Reclassification from short term to long term investments			1508	1508
Defined benefit pension schemes (Note 47)	Reclassification from past to current service costs			2946	2946
Revaluation Reserve (Note 26a) and PPE (Note 12)	Correction of overstatement of impairments recognised in both the revaluation reserve and PPE			1188	1188
Note 21 Current debtors: Benefits Claimants comparative	Correction of misclassification			351	351
Grant Income (Note 42)	Correction to amount disclosed of DSG credited to services in year			1486	1486

The accounts were also corrected for:

- Cashflow – amendments to analysis of adjustments to deficit on provision of services for non cash movements; and
- Grant Income (Note 42) – corrections to analysis of capital grants.

Appendix 4 Draft letter of management representation

Cheshire East 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 [insert relevant details directors of Cheshire East Council] the following representations given to you in connection with your audit of the Council'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 Council Accounting in the United Kingdom which give a true and fair view of the financial position and financial performance of the Council, 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.

Supporting records

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

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 Council. The Council 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.

Specific Representations

Academy Conversions

Within Cheshire East, there are eight schools which have converted to Academy status, and one school which has converted to Free School status as at 31 March 2012.

Knutsford High School converted to Academy status on 1 April 2012 and an Academy order has been received for Eaton Bank High School, which is expected to convert to Academy status on 1 September 2012. Changes as a result of these Academy conversions from 1 April 2012 will be captured in the 2012/13 financial accounts as appropriate.

Apart from the specific governance issues listed in the Annual Governance Statement there are no other issues to bring to your attention.

Related party transactions

I confirm that I have disclosed the identity of the Council'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 Cheshire East Council

I confirm that this letter has been discussed and agreed by the Audit & Governance Committee on 27 September 2012.

Signed

Name: Lisa Quinn

Position: Director of Finance and Business Services

Date

Appendix 5 Action plan

Recommendations

Recommendation 1

Members need to provide clearer strategic direction and political leadership when agreeing priorities, taking difficult decisions and supporting officers to deliver agreed plans.

Responsibility

Comments

Recommendation 2

The Council needs to implement planned improvements in business planning and programme/project management processes providing a clear link to agreed priorities – including robust option appraisal and financial analysis before projects begin. This should also include relevant aspects of recognised effective programme/project management arrangements for all projects.

Responsibility

Comments

Recommendation 3

The Council needs to develop longer term financial plans clearly aligned to business priorities and supported by deliverable savings plans. These plans should also ensure that reserves are used appropriately and are maintained in line with the Council's own assessment of the financial risks it needs to manage. The quality of financial forecasting in some areas also needs to improve.

Responsibility

Comments

Recommendation 4

The Council needs to improve performance monitoring and reporting. This should include agreeing a set of relevant local performance indicators that reflect its priorities. Those indicators should then be reported alongside the national indicators and integrated with robust financial information to support member and officer decision making.

Responsibility

Comments

Appendix 6 Glossary

Annual Audit Letter

Letter issued by the auditor to the Council 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 conclusion].

Annual Governance Statement

The annual report on the Council's systems of internal control that supports the achievement of the Council'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 Council is required to prepare, which report the financial performance and financial position of the Council in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Council Accounting in the United Kingdom.

Group accounts

Consolidated financial statements of a Council and its subsidiaries, associates and jointly controlled entities.

Internal control

The whole system of controls, financial and otherwise, that the Council 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 Council. This term includes the members of the Council 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 Council must submit a consolidation pack to the department for Communities and Local Government which is based on, but separate from, its financial statements.

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- any third party.



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