
London Borough of Harrow

Audit Letter 2002/3

January 2004

This report has been prepared on the basis of the limitations set out on page 31.

The Members
London Borough of Harrow
Civic Offices

29 January 2004

Dear Members

2002/3 Annual Audit Letter

We have pleasure in submitting our 2003 Audit Letter to you, which summarises the main results and conclusions from our audit work over the last year, our first as the Authority's external auditors.

As you will know, our audit work is performed in accordance with the Audit Commission's Code of Audit Practice for Local Authorities and the National Health Service in England and Wales ("the Code of Practice"). Section 1 of this letter shows how we have covered the requirements of the Code of Practice and the key issues arising from our work that we consider the Trust Board needs to address as priorities over the coming months.

During the year, we have liaised with the Audit Commission's Relationship Manager, Ms Jackie Barrie-Pursell, specifically on the joint 2003 audit and inspection plan, and on the Qualitative Assessment. We have also been engaged to pilot inspection work at your Authority as part of the Audit Commission's attempts for more "joined-up" audit and inspection activity. The inspection work we are to undertake has not yet taken place as this was scheduled to be done in early 2004.

The prioritised action plan in Appendix 1 pulls together all the recommendations within this letter. This should assist you in monitoring the implementation of our recommendations. An update to our audit risk assessment advised in our Audit Plan is attached at Appendix 2.

We look forward to developing further our audit relationship with your Authority in the coming year and express our gratitude for the co-operation we have received in our first year as your auditors.

Yours faithfully

Deloitte & Touche LLP

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1. Key points

1.1. Summary of audit findings and conclusions

We summarise below the key audit findings and conclusions from our audit.

Code of Practice area	Audit findings and conclusions
Overall financial standing	<p>During 2002 and 2003, the Council has first reviewed and improved its budget monitoring and reporting arrangements and then tackled historical problems with underlying budgets. It is managing its finances in an increasingly strategic manner and in the current budget cycle is strengthening links with service planning. Financial performance over the last twelve months has been satisfactory and recent windfall gains has enabled the Council to build-up reserves above the minimum level it have set itself and to earmark funds for 'invest to save' schemes. As a result of Central Government funding and legislative changes, together with the need to invest to fund the Council's ambitious improvement plans, Harrow increased Council Tax bills by 19.8% for 2003/4, placing the Council in the upper quartile of authorities. The Council now anticipates a Council Tax increase of 3.87% (depending on the results of consultation) for 2004/5.</p> <p>The Housing Revenue Account currently sits outside the Council's general budget processes. It needs to be included within recent developments in financial management practices at Harrow and to link to corporate priorities and prudential indicators.</p> <p>There has been substantial slippage on capital budgets. The Council needs to improve its management of its capital programme.</p>

Code of Practice area	Audit findings and conclusions
Performance management	<p>Our audit programme reflected a joint work programme agreed with the other inspection agencies to monitor and test the progress made against the Council's own improvement plans.</p> <p>A study looking at the corporate performance management framework has been deferred until the Council's project to review and upgrade its arrangements in this area has been completed. We have recently agreed terms of reference for a small study looking at the ICT strategy considered by members in late October 2003.</p> <p>We concluded from our review of aspects of financial management practices that Harrow had responded to all of the key points raised by the Corporate Assessment in this area and is developing processes further to deal with limitations in the original exercise caused by the tight timetable for the production of the first Strategy.</p> <p>We have issued an unqualified audit opinion on the Council's Best Value Performance Plan. The Council has improved its data collection arrangements in respect of performance indicators.</p> <p>The Council is regularly monitoring progress against the improvement plan it set itself. The outcome of the Audit Commission's qualitative assessment published in December confirmed that improvements have been made and emphasised the need for Harrow to continue with its improvement plans.</p>

Code of Practice area	Audit findings and conclusions
Statement of accounts	<p>We met with a sub-committee of the Overview and Scrutiny Committee on 18 December 2003 to discuss the outcome of our audit of the statement of accounts. We issued an unqualified audit opinion on the 2002/3 accounts of the Authority, although there were changes made to the original accounts prepared for audit.</p> <p>The Council needs to examine its arrangements for the accounts and audit process to ensure it is able to comply with the phased acceleration of the statutory timetable for the approval and publication of the statement of accounts over the next three years. It also needs to prepare for other possible accounting changes which will be necessitated by the government initiative to produce aggregated accounts for the whole of central and local government.</p>

Code of Practice area	Audit findings and conclusions
Internal control and risk management	<p>We have commented in separate reports on specific areas of weakness which we wish to bring to the attention of officers and summarised the main points in Section 5 of this Letter.</p> <p>We discussed issues relating to the role of internal audit, strategic financial planning processes and resourcing with Internal Audit managers and with senior management at the Council. We recommend members consider their proposals carefully and support the continued development of an effective and adequately resourced internal audit function.</p> <p>We recognise the progress made by Harrow in developing its risk management practices.</p> <p>We note that the Council continues to keep its governance structures under review. Given the imminent requirement on the Council for publishing a Statement of Internal Control and the enhanced audit reporting responsibilities to those charged with governance, we encourage the Council to give serious consideration to the establishment of an Audit Committee.</p>

Code of Practice area	Audit findings and conclusions
Standards of conduct and fraud and corruption	<p>As auditors we are required by the Code of Audit Practice to assess the arrangements put in place by Harrow to prevent and detect fraud and corruption and promote high standards of financial conduct. As this is our first year as auditors to the Council, we carried out an assessment, focusing on overall arrangements.</p> <p>Our overall assessment showed that Harrow had in place the key corporate arrangements that we would expect to find in a similarly sized authority.</p> <p>There are areas for further development, in particular in the area of benefits to respond to points raised by the Benefit Fraud Inspectorate (BFI).</p>
Legality	<p>The Council takes steps to ensure the legality of transactions which have a financial consequence. Our assessment of the Council's arrangements in this area, which we provided to the Audit Commission for the purposes of the Corporate Performance Assessment Refresh, scored this at Level 4, the top level. We have not received any formal objections since our appointment and there are no outstanding objections in respect of prior year periods of account.</p>

2. Overall financial standing

2.1. *Financial performance*

Key highlights:

- ❑ Net revenue expenditure in 2002/03 was underspent by £2.6 million compared to the original re-priced budget of £203.6 million, with contributions to earmarked reserves of £1.3 million and an increase in general fund reserves of £2.2 million achieved. The original budget was for a planned use of general fund reserves of £0.5 million.
- ❑ The latest revenue monitoring report for the current year shows a predicted underlying performance which is close to budget (net predicted outturn overspend of £0.3 million). General Fund balances have improved through the release of £0.3 million from amounts earmarked to fund the implementation of single status and a windfall £0.8 million from backdated reductions in business rates paid on Council properties. An additional £0.5 million has been earmarked to fund management change.
- ❑ The Housing Revenue Account recorded a deficit of £0.9 million in 2002/03, against a budgeted deficit of £2.0 million. In the current financial year the Council has budgeted for a deficit of £2.5 million against an opening balance of £2.8 million.
- ❑ The capital budget slipped by a net £3.9 million during 2002/03. Forecast slippage for 2004/5 is now in excess of £12 million.

Harrow received criticism during the 2002 Corporate Performance Assessment (CPA) process for weak budgetary control leading to the need to take in year action to prevent overspending. During 2002 and 2003, the Council first reviewed and improved its monitoring and review arrangements and then tackled historical problems with underlying budgets (see section 3.2). This appears to be delivering improvements in control over spending over the twelve months and the Council has recently been able to earmark amounts for 'invest to save' schemes and to build-up General Fund balances.

The Housing Revenue Account currently sits outside the Council's general budget processes and, as a consequence, has not been included within recent developments in financial management practices at Harrow (see section 3.2). Unlike the Council's other revenue budgets, financial planning for the HRA has not yet been extended to cover a

three year planning horizon – budgets continue to be prepared for a single year only. Also, unlike other Council plans and budgets, no full review of the HRA has been undertaken for a number of years.

Spend on the capital programme during 2002/3 amounted to £21.2 million, against a budget in June 2002 of £25.1 million, with slippage and reductions of £10.9 million and new schemes of £7.1 million. Slippage or re-phasing for 2004/5 of £12.8 million has so far been identified out of a total capital programme of £44.7 million. Whilst there are sometimes good reasons for slippage on individual projects, the Council should ensure as far as possible that projects are included in the capital programme where there is a firm commitment to the project proceeding and improve the overall management of the capital programme. Slippage in the capital programme may mean that the Council is unable to deliver its key priorities linked to its Capital Strategy and Asset Management Plan and can have knock-on effects on the revenue plans, making it difficult to accurately forecast for the revenue effect of the capital programme.

Forecast resources are available to complete schemes starting in 2003/4, although the position is dependent on assumptions over forecast future capital receipts.

Recommendations

Develop a three year HRA budget linked to the Council's Medium Term Budget Strategy and prudential indicators and undertake a thorough review of the HRA budget, looking at how this supports corporate priorities.

Review the Council's current procedures and processes for managing and monitoring the capital programme and ensure the Council has adequate procedures and processes in place to effectively manage and monitor its capital programme.

2.2. Overall levels of expenditure and balances

Key highlights:

- ❑ General reserves rose compared to the internally set minimum prudent reserves level of £4 million, standing at £5.2 million at 31 March 2003. The latest revenue monitoring report anticipates a further increase in 2003/4 to £5.7 million, principally through a windfall business rate rebate of £0.8 million. The internally set preferred reserves level is £7 million.
- ❑ Schools reserves increased again, from £4.6 million to £5.8 million. This is not available for general expenditure purposes.
- ❑ Housing Revenue Account reserves stood at £2.8 million at 31 March 2003.
- ❑ Earmarked reserves to fund future revenue or capital projects rose by £2.1 million to £6.2 million at 31 March 2003, the largest element being to fund single status implementation.

Council Tax bills for 2003/4 rose by 19.8%, placing the Council in the upper quartile for Council tax increases. The underlying budget requirement increased by 13.1%. The majority of the increase within the Council's control related to the members' investment in aspects of the New Harrow Project.

The Council anticipates a Council Tax increase of 3.87% (depending on the results of consultation) for 2004/5, representing a reduction from the 14.4% increase forecast as part of the original exercise in February 2003. We understand that officers' initial assessment of the recent settlement announcement is that it is in line with assumptions made in the refreshed Medium Term Budget Strategy.

Pressure on reserves has reduced with contributions made last year and anticipated this year and with improvements to financial management practices mitigating the need for holding larger balances.

2.3. *Capital financing developments*

2.3.1. *PFI projects*

During the year we were requested by management to review the proposed accounting treatment for the underlying assets in an Education PFI project which covers the design, build, finance and operation of the Kingsley, Woodlands and Little Stanmore Schools. This reached financial close in September 2003. Based on the information provided to us, we were not minded to challenge the Council's view that, under the Treasury Taskforce Technical Note No. 1 (the basis on which the Council sought advice from its financial advisers), the new capital assets being created under the Education PFI Project should be accounted for as 'off-balance sheet' for the Council.

As external auditors of Harrow, we will be required to form an opinion on the 2003/4 Statement of Accounts. This will require us to consider the transaction under Financial Reporting Standard 5 ('FRS 5') as required by the current Statement of Recommended Practice ('SORP') for Local Government. It is our view that under FRS5, without considering the Treasury Taskforce Technical Note No. 1 methodology, the assessment for some schemes can result in an 'on-balance sheet' conclusion. It should be noted that the current intention in the United Kingdom is to align Accounting Standards with that of International Accounting Standards, as soon as 2005, which is before the construction phase of this Project is to be completed. This could result in a fundamental change in the way in which PFI projects are accounted for.

2.3.2. *Prudential Code*

From 1 April 2004 the existing capital controls regime will be swept away and replaced with the new prudential borrowing system. This is a more modern way of financing capital based on whether your plans are prudent, affordable and sustainable, as assessed against indicators specified by the CIPFA Prudential Code. New forms of external borrowing will be possible to fixed investments but only within specific constraints. Setting the boundaries for these indicators in a meaningful way will be challenging for all authorities as they will require at least three years of revenue and capital forecasts. Harrow now has a medium term revenue forecast, but will need to extend the planning horizon used in developing its capital programme. Monitoring against some of the limits will also require more robust short and medium term cashflow forecasting than many authorities have in place.

As the new system comes into force on 1 April 2004 it will be necessary for Members to set the relevant limits and indicators at the same time as they approve the budget and council tax for next year. We recommend that proposals on how to set these indicators are tabled before Members to ensure that they are aware of the issues and in a position to take informed decisions on the indicators for 2004/5. Proposals for further development of plans and indicators should then be developed early in the next financial year to enable sensible indicators to be set for 2005/6.

The new regime also implements "pooling" of HRA capital receipts. A portion of HRA receipts, less amounts reinvested in affordable housing and regeneration, will need to be paid over to the ODPM in order to be redistributed to the areas of greatest need. The Council will need to consider the loss of these capital receipts, current plans for spending on affordable housing and regeneration, and the effect on future capital plans.

Recommendations

Call for and consider a report on implications of, and the risks and opportunities provided by the Prudential Code by 31 March 2004 so that the Council is positioned to work within this new financing regime.

2.3.3. Local Improvement Finance Trust Company (LIFTCO)

The Council is working with local Primary Care Trusts on establishing a new LIFTCO which will be the investment vehicle through which local health and social care facilities in both Harrow and Brent will be modernised over the next decade. The Council's involvement in this LIFTCO needs careful consideration as there are several risks that are specific to this type of arrangement, not least how the LIFTCO governance arrangements dovetail with those of the Council, how conflicts of interest are identified and addressed and how the financial aspects of LIFTCO are managed.

Recommendations

Ensure reports to members set out details of planned arrangements and risk assessment in respect of the new LIFTCO so that appropriate governance and financial management arrangements are put in place by the Council.

3. Performance management

3.1. *Status of our programme*

Our audit programme reflected a joint work programme agreed with the other inspection agencies to monitor and test the progress made against the Council's own improvement plans, specifically considering developments in:

- Financial management practices
- Corporate performance management framework
- ICT strategy
- Collating, analysing and acting on performance information
- Establishing the Council's new corporate structure.

The Council's work on reviewing and upgrading the corporate performance framework has slipped from its original timetable and the project is not yet complete. Our planned desktop review of the Council's new arrangements has therefore been deferred until next year. We understand that the Council is looking to earmark £0.6 million to invest in the management change programme, business and service planning processes and the purchase of performance management software.

The ICT strategy was presented to members on 24 October 2003. We have agreed the detailed scope of our review of the strategy document with officers.

The new senior management structure is in place and appointments have been made to all but two of the second tier posts. The Chief Executive announced a review of middle management in October 2003 and has engaged consultants to assist in this process. We will keep abreast of developments as changes are extended through the organisation and bed down.

3.2. *Financial management practices*

The lack of medium term budget strategy was raised in the Audit Commission's 2002 Corporate Assessment, together with a number of historic 'budget difficulties' in the annual budget process which needed to be addressed if planned improvements elsewhere were to be delivered. In particular, Harrow's base budget bore 'little resemblance' to actual spending and was 'at least £2 million less than its current service commitments' leading to 'go/stop' budget management in order to contain overall expenditure within the total budget, 'resources were not linked to priorities' and service delivery was 'under consistent pressure to deliver more savings'. In addition, initial budgets were not cash limited, with a provision for inflation held centrally making budgetary control difficult. We carried out a review of the process used to develop medium term budget strategy and plans and output therefrom in early Summer 2003.

Against a tight timetable, Harrow agreed its first formal three year budget forecast in February 2003, together with a 2003/4 annual budget which included an additional £1.7 million to correct for historic differences between budgets and service commitments, with cash limited departmental budgets and which included budget reprioritisations of £1.8 million as a contribution to the funding of growth areas.

Our view is that Harrow has responded to all of the key points raised by the Corporate Assessment on this aspect of its financial management practices. The Council had already started on the process of updating its Initial Medium Term Budget Strategy at the time of our work. Officers were aware of limitations in the original exercise caused by the tight timetable for the production of the first Strategy and have made further developments to the Council's processes to deal with these.

Key points discussed in our report on the Council's Medium Term Budget Strategy

- ❑ We believe the 'packaging' of the forecast could be improved to enable members who are less close to the budget process to better understand the forecast and some of the key sensitivities around the numbers. This would include carrying out a systematic risk assessment of the main income and expenditure streams, summarising the results in the committee report accompanying the forecast and integrating this within the risk management framework as it develops. In areas of material uncertainty, it may be useful to illustrate this information numerically in the form of a sensitivity analysis. A new pack for completion by service managers has been developed by the Executive Director (Business Connections) to systematically collect information on risks to inform this process.

Key points discussed in our report on the Council's Medium Term Budget Strategy (continued)

- ❑ The MTBS process commenced in November 2002. A refresh of the initial MTBS was presented to members in October 2003. This will enable a longer period of debate and consultation and an agreed context for the development of the annual budget later in the year.
- ❑ Although further interviews would be needed to properly gauge this, within service departments service managers have been involved in the budget setting process and, in some areas, we have been told this involvement has increased from the previous 2003/4 budget setting round. Given the gap between service commitments and the base budget prior to 2003/4 and the practice of holding inflation changes centrally, we were initially concerned at what we would find in terms of service manager buy-in to the resulting budget and involvement in the budget setting process generally. The Interim Director of Social Services commented that further work is needed, and is ongoing, to fully align social services budgets with operational responsibilities. A formal acknowledgement that budgets have been reviewed, checked and are adequate to deliver current service plans is not sought from service managers, but we believe this would be useful in confirming service manager buy-in.
- ❑ Estimates in some areas have needed to be included in some areas in advance of policy decisions. We recommended that such cases involving material expenditure are flagged up in the commentary of the MTBS. Amounts were included in the original MTBS as a means of highlighting the variability of expenditure in that area. We recommended that these issues be dealt with in the commentary on the MTBS, rather than incorporating amounts into estimates. We understand this approach has been taken in the refresh of the MTBS.
- ❑ It was clear from our review that relatively large sums had been added to, or moved around, to reshape the budget to align it more to Council priorities – this represents a significant achievement for the Council. However, the approach in most areas remained incremental. As part of the current budgeting cycle, the Executive Director (Business Services) has developed a pack for completion by services which assists in the process of understanding the balance struck between service performance and cost and in linking service and financial plans. Also, the Council is currently reviewing and upgrading its corporate and service planning and performance management systems and framework which will provide the opportunity and tools to further align budgets with Council priorities across the range of services.
- ❑ The capital budget is set out in full for only one year. The planning horizon needs to be extended to at least three years to ensure revenue and capital budgets are properly aligned.

Recommendations

Continue to develop financial management practices, taking account of our report recommendations and in particular extend the capital budget horizon to at least three years.

3.3. Best Value Performance Plan and performance information

The Council's 2003/4 Best Value Performance Plan (BVPP) was qualified by our external audit predecessors on the basis that a number of the performance indicators in the Plan either could not be substantiated or were materially incorrect. This year arrangements provided for greater scrutiny of performance information, including testing of a sample of indicators by internal audit and a wider cross-departmental team of officers prior to submission to us for audit. These arrangements led to the identification of some errors. The Audit Commission recognises that it will not always be possible for local authorities to have actual BVPI data available in all cases to meet the 30 June publication deadline and accepts that some estimates would need to be included in the Plan. The Council proposes to publish errata on the Council's website as well as sending this information to the original recipients of the BVPP.

We were able to conclude in our private report to the Audit Commission on the Council's outturn Best Value Performance Indicators that the Council had put arrangements in place which, as far as practicable, are producing indicator information that is accurate and complete. We are advised by the Audit Commission, based on our report, no current year indicators will be qualified, but an additional prior year indicator, BVPI 175, will be qualified.

The Audit Commission advised auditors that audit reports on BVPPs should not be issued until after publication of the results of the 'CPA Refresh' exercise to ensure that consistent judgements had been reached. We are pleased to report that we were able to issue an unqualified audit opinion with no recommendations for improvement in our statutory report. Our more significant comments to the Council to consider in drawing-up future years' plans are as follows.

Comments on the 2003/4 BVPP to be considered in drawing-up future plans

- ❑ At the time the 2003/04 BVPP was finalised, the Council had not formulated its Community Strategy and Corporate Plan which are key components of the Council's overall performance management framework and the mechanism for translating national and local priorities into the Council's day-to-day service planning process. Next year's BVPP will need to demonstrate a clear linkage between these two key documents (which are being progressed) and Council's service and improvement planning priorities.
- ❑ There is an expectation that prior year targets will be included in the BVPP and a commentary included on any revision to the target if this has proved necessary because priorities have changed, or the Council's resource position has altered. Sections in the BVPP on service plans provide information on past/planned improvement measures but the reasons for not achieving some targets in 2002/03 are not always explained.
- ❑ The 2003/04 BVPP makes reference to just 6 local performance indicators. However, as the majority of the detailed work on performance management has been carried out after the publication of the BVPP and is ongoing, we anticipate the Council will have a much more comprehensive set of local indicators and will be reporting on actual performance against target in next year's BVPP.
- ❑ Although the BVPP includes commentary on some of the performance indicators, the use of colour coding (good, average, needs to improve etc) or arrows indicating trends in performance would enable users to gain a better understanding of Council's performance. There should also be more discussion on how the Council proposes to implement these improvements.
- ❑ The Council's outline improvement plan is included in the BVPP as is the inspection and audit plan for the current year. The Council's response to the Annual Audit Letter is provided, but does not make reference to the recommendation made by the auditors on the need for the Council to improve its quality assurance processes over performance indicators and supporting documentation. Given that the underlying concern led to a qualified audit opinion on last year's BVPP, the omission of this recommendation (and the Council's response) does, in our view, give an incomplete assessment of the auditor's views.
- ❑ More information is required on a consistent basis on the outcome of the consultation process and the options considered (but maybe dismissed) as part of the review process. For example, the discussion on the Council's First Contact review sets out the conclusions from the consultation process but this is not referred to in the commentary on other reviews which tend to just make reference to who was consulted as part of the process.
- ❑ The BVPP does not include an update on all action plans, targets and whether the identified savings and efficiencies have been achieved in practice.

Recommendations

Consider, with officers, potential improvements to the format and content of the Council's BVPP in light of our comments on the 2003/4 BVPP.

3.4. CPA 'Refresh'

In December 2002, the Audit Commission published the results of its first Comprehensive Performance Assessment. Harrow was judged to be 'weak' in the services it provided to its citizens. This year the Audit Commission has carried out a limited 'refresh' of this exercise, publishing a service scorecard for each relevant authority alongside a qualitative assessment of the progress made over the last year against its key priorities. The outcome of this was that the authority moved from "weak" to "fair".

This qualitative assessment recognises the progress we have seen over the last year in improvements to services, including, from a low base, improvements to the environment of parts of the Borough, social services and housing. It also recognises the importance of ongoing investment in the organisational infrastructure and capacity of the Council to support further service improvements, including developing more robust financial management practices (see section 3.2), development of an ICT strategy and the restructuring of senior and middle management. The qualitative assessment also makes it clear that Harrow needs to continue with its challenging agenda, agreeing its corporate plan and developing its corporate performance management systems, extending improvements in the environment to the remainder of the Borough, bringing benefits administration up to national standards and continuing improvements in other service areas.

The Council has an improvement plan to address these issues and has monitored progress against the plan through the year.

Our contribution to the CPA Refresh has been to provide 'scored judgements' about the adequacy of arrangements put in place by the Authority in the categories of financial standing, internal financial control, standards of financial

conduct and the prevention and detection of fraud and corruption, the financial statements and the legality of significant financial transactions. This followed a methodology developed by the Audit Commission aimed at producing consistent and objective judgements by auditors. The table below summarises the Council's scores in these categories and, where appropriate, the principal reasons why the maximum score of four was not obtained.

Category	Score this time	Score last time	Areas for improvement
Financial standing	3	3	<p>Whilst there is evidence that a risk assessment has been carried out, this has not been costed (see section 3.2).</p> <p>The links with corporate priorities and corporate and service planning processes for the most recently completed budget process are not systematic and pervasive (see section 3.2).</p> <p>The capital budget is set out in full for only one year. The planning horizon needs to be extended to at least three years to ensure revenue and capital budgets are properly aligned (see section 3.2).</p> <p>Providing members with the option of assessing financial monitoring information on-line.</p> <p>Establishing a longer track record in meeting financial targets and monitoring of performance against targets set for all categories of income collection and arrears, with reporting to managers and members and action taken when needed.</p>
Standards of financial control and prevention and detection of fraud and corruption	3	3	<p>Embedding anti fraud and corruption and new corporate governance arrangements.</p> <p>Operation of new treasury management arrangements not evaluated at the time of our submission.</p>

Category	Score this time	Score last time	Areas for improvement
Internal financial control	3	3	<p>Wider use of performance measures by those who manage the system to monitor the operation of financial systems.</p> <p>Proposed arrangements for risk identification, assessment and management not yet fully implemented (see section 5.3).</p> <p>Risk register not in place which is reviewed and updated (see section 5.3).</p> <p>Embedding of risk management processes (see section 5.3)</p>
Financial statements	3	2	<p>Accounts presented for audit contained errors which, whilst immaterial, were not 'trifling' in nature (see section 4).</p> <p>Not all of the working papers requested by the auditor were available at the start of the audit, but were provided during the audit (see section 4).</p>
Legality of significant financial transactions	4	3	<p>Harrow do not actively (e.g. provide some form of training or prompt to these documents) make available to staff and members internal documents setting out roles and responsibilities of the monitoring officer and section 151 officer.</p>

Recommendations

Agree and monitor action plan to secure improvements in areas where the maximum score was not obtained in the 'auditor scored judgements' forming part of CPA.

4. Statement of accounts

We met with a Sub-committee of the Overview and Scrutiny Committee on 18 December 2003 to discuss the outcome of our audit of the statement of accounts. It is a new requirement of Auditing Standards (Statement of Auditing Standards No 610 – ‘SAS 610’) to discuss certain matters with those charged with governance prior to issuing our audit opinion. In the past, it was general practice in local government to discuss these matters solely with officers, briefing members on the more significant issues following closure of the audit.

The key points we included in our report to the Sub-committee are as follows.

Key points reported in connection with our audit of the Council’s Statement of Accounts

- Our first year audit had challenged several areas of the accounts and changes arising were reported.
- Officers have agreed to look at a few items in the 2003/4 accounts process.
- We planned to issue an unqualified audit opinion.
- We reported unadjusted errors. Management judged these amount to be not material, both individually and in aggregate, and did not propose to process correcting journals. We sought and obtained confirmation from the Sub-committee of this assessment.
- A separate report was issued to management on weaknesses in the general IT control environment. Weaknesses in other systems have been reported separately by internal audit. A formal action plan from officers on the IT control environment points was still awaited.
- We confirmed that we have adequate arrangements in place to maintain our independence of the Council.

We make three observations concerning the accounts and audit process:

- The Accounts and Audit Regulations require approval of the draft Statement of Accounts by either full council or by a committee of the council. For the 2002/3 accounts, this approval needed to be given by 30 September

2003. As a result of a misunderstanding, approval was obtained from Cabinet who, by law, are not able to perform this function. Full council ratified Cabinet approval in October, i.e. after the deadline.

- There is a requirement introduced by the new Accounts and Audit Regulations (which came into force with effect from 1 April 2003) for the accounts to be signed and dated by the chair of the council/committee which approved the accounts. This had not been done.
- The Accounts and Audit Regulations 2003 bring forward the date of approval of the accounts and publication of the financial statements by a month each year through to 2005/6 when the Council will need to approve its accounts by 30 June and publish by 30 September. In order to achieve this the Council will need to ensure it:
 - Brings forward its accounts preparation and approval process by approximately two months. This year the accounts were not approved by Cabinet until 9 September 2003.
 - Improves arrangements for collation of schedules and working papers to support the draft financial statements and to respond to additional requests for information and explanations from its external auditors. The audits this year and last year were significantly lengthened by delays in receiving information, including this year many working papers originally included on an information request we agreed with officers in April 2003. Staff absences and temporary staffing arrangements contributed to these delays, with the Housing department causing particular difficulties.
 - Take steps to mitigate the effect of moving the accounts and audit process into the main holiday season.
 - Ensure there is a good 'fit' between the accounts and audit timetable on the one hand and the committee cycle on the other.

Recommendations

Call for and consider a report on the Council's plans to ensure compliance with new statutory timetables for the approval and publication of the Statement of Accounts.

5. Internal control and risk management

5.1. Internal audit

In order to prevent duplication of effort, our normal practice is to place some reliance on the work of internal audit. The extent of that reliance depends both on the quality of internal audit's work and the relevance of their annual work plan to our own audit objectives. We carry out an annual assessment of internal audit and carry out a review of their working papers in areas where we plan to place direct reliance.

In our audit plan, we proposed to place reliance principally on internal audit's review of key controls within the Council's main financial systems. Based on our review of general internal audit arrangements, including auditor independence, and a review of relevant working paper files, we were able to confirm our decision to place reliance on Internal Audit's work in the planned areas of reliance.

As part of our review, we discussed issues relating to the role of internal audit, strategic planning processes and resourcing with Internal Audit managers and with senior management at the Council. Key developments planned or which are being examined include:

- Development of a strategic internal audit plan which will cover the three years commencing 1 April 2004. The draft plan has been considered by CMT and is due to be presented to members shortly once the level of internal audit resources has been confirmed. Recent internal audit plans have been annual operational plans.
- Defining the role. We understand that the draft strategic plan gives greater clarity both to what is within the scope of internal audit activity and, as important, what falls outside. We encourage members to consider these terms of reference carefully and to confirm, in agreeing this document, that they meet their requirements and the needs of the organisation.
- A bid as part of the current budget cycle to increase resources by three full time equivalents. Internal Audit's own benchmarking has shown that the current team is underresourced compared to other London Boroughs. This is consistent with our own experience.

Recommendations

Consider and confirm terms of reference for Internal Audit and ensure that Internal Audit is adequately resourced to deliver against the strategic plan that flows from those terms of reference.

5.2. *Internal financial controls*

Internal audit's work identified a number of key controls where operation of the control was either not documented or where documentation retained was only partial. In addition, their work identified a number of other areas for improvement, in particular over the reconciliation of the opening business rates and council tax debits through to independent information from the Valuation Office. These have been reported in internal audit reports and summarised in the Statement of Internal Financial Controls included in the Council's Statement of Accounts.

In addition to internal audit activity, our computer audit specialists undertook a review of general computer controls which identified a number of significant concerns.

High priority areas for development of the computer control environment

- ❑ We found 206 users had been given the ability to "self-authorise" both orders and invoices on the eFinancials system.
- ❑ There was no documented procedure to guide the installation of updates to existing software. Documentation relating to the testing of the updated software is not retained. Similarly, documentary evidence of testing before the upgrade from CFACS to eFinancials was not retained. Without an audit trail of test documentation there is a risk that any testing performed is incomplete or insufficient, or that significant errors remain unaddressed prior to live use of modified or new systems.
- ❑ Due to the administrative overhead required to give access rights to Oracle Discoverer on an individual basis, user access is via a single shared account and password, with no restrictions on the data that can be viewed. There is an increased risk that employees may attempt to view or record sensitive personal details without authorisation, such as home addresses, next of kin or pay and benefits details.

High priority areas for development of the computer control environment (continued)

- ❑ Current arrangements give a number of Analyst Programmers, Senior Analyst Programmers and Project Leaders access to change program code without appropriate testing or authorisation.

Recommendations

Monitor action taken in response to key internal and external audit recommendations on internal controls.

5.3. Risk management

Harrow's progress in developing risk management arrangements has attracted criticism from external audit and inspection agencies in the past.

The Council has some arrangements in place for the identification and management of key financial and operational risks. These include a risk assessment as part of all key projects (as required by the project management standard agreed in April 2003), the risk assessments carried out by internal audit for the purposes of their plan and the collection of information on service risks through the strategic position statement document which was developed over the summer.

These are all new or relatively new processes. The Council has also agreed a programme of work to systematically document strategic risks and service risks and to map them to controls. This commenced late October with a detailed timetable through to March 2004, against which there has been some slippage. The process of embedding risk management processes and culture has not yet been planned in detail.

Members have some involvement in the current processes, in particular through the receipt of reports on risk before approving large projects. They are expected to have a greater role going forward as the risk management process becomes more developed.

More than insurance risks are currently assessed, but a risk register is not yet in place.

In the scored judgement we provided to the Audit Commission as part of the 'CPA Refresh', we assessed that the Council had achieved Level 2 (out of four levels) as the Council has a programme of work in place to develop a comprehensive strategic and service based risk management framework, but this is at an early stage, with pockets of current practice in place. Next year the Council will have to publish a Statement of Internal Controls as part of its Statement of Accounts. The Council's progress in developing its risk management practices will form a key part of its assessment in making this Statement.

Recommendations

Agree and monitor progress against plans for the further development and embedding of risk management processes and culture.

6. Standards of conduct and fraud and corruption

As auditors we are required by the Code of Audit Practice to assess the arrangements put in place by Harrow to prevent and detect fraud and corruption and promote high standards of financial conduct. As this is our first year as auditors to the Council, we have carried out an in-depth risk assessment, focusing on overall arrangements.

Our overall assessment showed that Harrow had in place most of the arrangements that we would expect to find in a similarly sized authority. We have noted a few areas where improvements could be made.

Areas for improvement in fraud and corruption arrangements

- ❑ A corporate business continuity plan should be developed to sit over the plans for individual services, including consideration of the impact of fraud and corruption.
- ❑ Hospitality registers should be maintained by Chief Officers and the system for maintaining them reviewed by Internal Audit.
- ❑ Following the appointment of the new IT manager, plans should be put in place to bring the existing information security policy into line with BS 7799 and develop processes and procedures to implement the policy.
- ❑ Officers within Internal Audit should be designated to specialise in the investigation of fraud and corruption (other than Housing Benefit Fraud which is already dealt with by a dedicated team). We understand that research is being carried out into the establishment of an anti-fraud team at Harrow.
- ❑ Whilst staff training has covered the legal aspects of investigation included in the Human Rights Act and the need to carry out interviews in accordance with the Police and Criminal Evidence Act, this should be extended to cover the Regulation of Investigatory Powers Act for staff involved in fraud investigation work.
- ❑ Anti-fraud and corruption and financial conduct issues should be considered as part of the Council's wider efforts to improve risk management.

This year Harrow has also been inspected by the Benefits Fraud Inspectorate (BFI). Their report, issued in August 2003, raised a number of concerns about internal security and counter-fraud arrangements, including the need for

improvements in basic areas such as post-opening and cheque security. Of more concern are their recommendations relating to:

- the need for fraud awareness training
- improvements required in the investigation process including timeliness and level of management review
- working with the Counter-Fraud Investigation Service.

In future years we will update our assessment and consider the need to carry out work in specific areas, which is likely to include follow-up work on Housing and Council Tax Benefit to gauge progress on implementing recommendations made by the BFI.

Recommendations
<i>Agree and monitor progress against plans in response to external audit and BFI recommendations relating to counter fraud and corruption arrangements.</i>

7. Legality

Under the Audit Commission's Code of Audit Practice, we are required to assess the adequacy of the Council's arrangements for ensuring the legality of transactions that might have a financial consequence. Our work comprises:

- review of Council minutes
- review of any national issues raised by the Audit Commission
- overview of arrangements
- responding to specific issues raised with us by the Council or by members of the public.

Based on our work, nothing has come to our attention which we wish to draw to the attention of Members. In the CPA refresh exercise, using the Audit Commission's methodology, we scored this area at Level 4 (the highest level) as there was evidence that the impact of new legislation and the legality of significant financial transactions are considered in a formal way. The only area for improvement identified from this exercise is that information about the roles and responsibilities of the monitoring officer and section 151 officer is actively made available to staff and Members (see section 3.4).

We received no formal questions or objections from residents.

8. Next year's audit plan

Last year the Audit Commission published fee and audit activity information for the seventeen months ended 31 March 2004 and invited auditors to draw up audit plans covering the same period. As this was a new audit appointment and in view of the expected pace of change at the Council in 2003, we considered it inappropriate to draw up plans for this length of period. As a result, we will be issuing an audit plan, which will be brought to members in the New Year, covering the remaining five months of this seventeen month period. This will cover the audit of the 2003/4 financial statements and other regularity aspects of our Code audit. It will also include any studies to be carried out in this short period and will reflect the joint audit and inspection working arrangements already put in place.

We will issue a further audit plan in the Spring which will cover the year ended 31 March 2005. This plan will be driven in part by the "roundtable" meetings with the Council scheduled in late January 2004 discussing the appropriate audit and inspection activity in light of progress on your improvement plan.

9. Independence and audit fees

Our audit engagement with the Audit Commission for your Council requires us to confirm and maintain our firm's independence from the Council and its members and officers. Our checks on appointment have not revealed any conflicts that either prevent us from acting for the Council, or require specific arrangements to ensure our ongoing audit independence. We ask that the Council, its members and officers to alert the Appointed Auditor as to any new relationship with Deloitte & Touche LLP or any of its staff so that this can be considered in this context.

On completion of our 2002/3 audit and grants work, parts of which are currently in progress, we will discuss and finalise fees with officers and report actual outturn fees to members in our audit plan for next year.

10. Statement of responsibility

We take responsibility for this report which is prepared on the basis of the limitations set out below.

Deloitte & Touche LLP
January 2004

Contact Persons:

Nigel Johnson – Partner	01727 885178
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Angus Fish – Senior Manager	01727 885038
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Our review work has been performed in accordance with the Audit Commission's Audit Code of Practice. The limitations of our work and the respective responsibilities of auditors and the Audited Body in respect of the work are set out in the Audit Commission's publication "Statement of Responsibilities of Auditors and of Audited Bodies".

The matters raised in this report are those that came to our attention during the review. However, we would emphasise that our review should not be relied on to detect all errors and weaknesses that might exist. You should assess our recommendations for improvement for their full implications before they are implemented. In particular we would emphasise that we are not responsible for the adequacy and appropriateness of the audit methodology as they are derived solely from the Audit Commission.

Our comments have been prepared for your private use. Please do not quote or refer to its contents, in whole or in part, to any third party without our prior written consent. We accept no responsibility to any third party, as our report has not been prepared and is not intended for any other purpose.

Appendix 1: Action Plan

Section reference	Recommendations	Priority	Management comments	Responsibility	By when
2.1	Develop a three year HRA budget linked to the Council's Medium Term Budget Strategy and prudential indicators and undertake a thorough review of the HRA budget, looking at how this supports corporate priorities.	2	Agreed by management.	T Lear	3 year budget by February 2004 Review completed by September 2004
2.1	Review the Council's current procedures and processes for managing and monitoring the capital programme and ensure the Council has adequate procedures and processes in place to effectively manage and monitor its capital programme.	2	Agreed by management.	N Bell	November 2004
2.3.2	Call for and consider a report on implications of, and the risks and opportunities provided by the Prudential Code by 31 March 2004 so that the Council is positioned to work within this new financing regime.	2	Information report already done in January 2004, with Code indicators to go to Cabinet in February 2004.	N Bell	February 2004
2.3.2	Ensure reports to members set out details of planned arrangements and risk assessment in respect of the new LIFTCO so that appropriate governance and financial management arrangements are put in place by the Council.	2	Cabinet have considered early risk areas.	G Wingrove	Ongoing
3.2	Continue to develop financial management practices, taking account of our report recommendations and in particular extend the capital budget horizon to at least three years.	2	Accepted.	N Bell	Ongoing

Section reference	Recommendations	Priority	Management comments	Responsibility	By when
3.3	Consider, with officers, potential improvements to the format and content of the Council's BVPP in light of our comments on the 2003/4 BVPP.	2	Accepted	J Rothwell	June 2004
3.4	Agree and monitor action plan to secure improvements in areas where the maximum score was not obtained in the 'auditor scored judgements' forming part of CPA.	2	Accepted.	N Bell	Ongoing
4	Call for and consider a report on the Council's plans to ensure compliance with new statutory timetables for the approval and publication of the Statement of Accounts.	1	Accepted. Report will be prepared for May 2004 Council meeting.	N Bell	May 2004
5.1	Consider and confirm terms of reference for Internal Audit and ensure that Internal Audit is adequately resourced to deliver against the strategic plan that flows from those terms of reference.	2	Three year Internal Audit plan now approved and additional resources approved.	N Bell	2004
5.2	Monitor action taken in response to key internal and external audit recommendations on internal controls.	2	Report on revised governance and committee structures will be put to the May Council meeting.	G Balabanov	May 2004
5.3	Agree and monitor progress against plans for the further development and embedding of risk management processes and culture.	1	External advisers have been engaged to prepare risk material and no action plans are being developed to cover these key risks.	D Ward	Ongoing

Section reference	Recommendations	Priority	Management comments	Responsibility	By when
6	Agree and monitor progress against plans in response to external audit and BFI recommendations relating to counter fraud and corruption arrangements.	2	Accepted.	N Bell	Ongoing

Key to prioritisation:

1 -Strategically Important and Urgent

2 – Important

3 – Desirable, but not urgent

Appendix 2: Update on risk assessment

We set out below an update to the risk assessment contained in our audit plan.

Residual risks identified in our audit plan	Update
<p>Performance management</p> <p>Development of corporate performance management framework.</p> <p>Arrangements for collating, analysing and acting on performance information across departments.</p> <p>Building ICT strategy.</p> <p>Successful implementation of the Council's improvement plan.</p> <p>Establishment of new corporate structure and recruitment of new key senior officers.</p>	<p>A study looking at the corporate performance management framework has been deferred until the Council's project to review and upgrade its arrangements in this area has been completed.</p> <p>Our testing of Audit Commission Best Value Performance Indicators found that the Council had made progress with these processes, though this needs to continue.</p> <p>We have recently commenced a small study looking at the ICT strategy agreed in late October 2003.</p> <p>The Council is regularly monitoring progress against the improvement plan it set itself. The Audit Commission's qualitative assessment confirms that improvements have been made and the need for Harrow to continue with its plans.</p> <p>The new senior management structure is in place and appointments have been made to all but two of the second tier posts. The Chief Executive announced a review of middle management in October 2003 and has engaged consultants to assist in this process. We will keep abreast of developments as changes are extended through the organisation and bed down.</p>

Residual risks identified in our audit plan	Update
<p>Financial standing</p> <p>Development of financial management practice, including:</p> <ul style="list-style-type: none"> • Agreeing medium term financial strategy and plans • Agreeing cash limited budgets • Correcting base budgets in certain areas. <p>Agreeing funding for the New Harrow Project, taking into account central government spending guidelines and the results of consultation on budget options.</p>	<p>We carried out a review of the initial MTBS in July/August 2003 and concluded that the Council had responded to all of the key points raised by the Corporate Assessment in this area and is developing processes further to deal with limitations in the original exercise caused by the tight timetable for the production of the first Strategy.</p> <p>Harrow agreed a Council Tax rise which fell in the upper quartile. It currently estimates that it can contain the rise for the current year below the level projected in the initial MTBS.</p>
<p>Internal financial controls</p> <p>Availability of appropriate audit work to cover financial control systems.</p>	<p>A review of key controls was included in Internal Audit's 2003/4 programme (looking at 2002/3 transactions) and was completed within the timetable we agreed with them. We were able to place reliance on their work.</p>
<p>Statement of accounts</p> <p>Requirement to prepare a statement of internal financial control effectiveness for the first time.</p>	<p>The Council elected to prepare a statement of internal financial control, rather than the other options of internal control or full governance statement. The Council needs to develop its plans and processes in preparation of publishing a Statement of Internal Control with its 2003/4 accounts.</p>