

Annual Audit and Inspection Letter

Oxfordshire County Council

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Reference:	OX006 Annual Audit and Inspection Letter
Date:	January 2005

Executive summary

The purpose of this letter

This is our audit and inspection 'Annual Letter' for Members which is presented by the council's Relationship Manager and District Auditor.

The letter summarises the conclusions and significant issues arising from our recent audit and inspections of the council.

We have issued a number of separate reports during the year, which are listed at Appendix 1 for information, together with information about the fees charged. Appendix 2 sets out the scope of audit and inspection.

Key messages

CPA Assessment 2004

Oxfordshire County Council continues to be a fair council. This result is subject to review.

It has shown progressive improvement in the standard of its services, and most of its performance indicators are above average. Better outcomes have been delivered that people and users can see, and the council's track record in cross cutting areas such as sustainable development is improving.

The education service is highly satisfactory overall, and has increased its performance rating to three stars – the highest rating. In contrast, social care has received a decrease in overall star rating due to some slow progress in children's services.

The council's corporate capacity to improve is stronger. It has put in place many building blocks to provide the foundation for progress, including increased political stability, changed ways of working and the quality of its staff. This has helped increase its standing as a community leader and local partner.

Based on Oxfordshire County Council's current plans, the council is now well placed to improve the way it works and the services it provides to local people.

Other performance work

The fire and rescue service has been assessed as making 'some progress' in implementing the government's modernising agenda.

Management arrangements to take forward implementation appear robust.

The council has made a good start, but recognises that it has more to do if it is to develop a best practice procurement function.

Good progress has been made in moving towards a more effective overview and scrutiny function.

Weaknesses identified as part of a review of IT security and access controls need to be addressed as part of the SAP Revitalisation Project.

The opinion on the council's BVPP was qualified on the basis that it does not currently comply with statutory guidance to include accurate BVPI values.

Other Audit Commission inspections

The council is providing a 'good' sustainable development service which offers promising prospects for further service improvement.

Your corporate approach to community safety has improved significantly since March 2003, both in the effectiveness of partnership working and in mainstreaming community safety. However, while the direction of travel is positive, some issues remain to further improve the mainstreaming of community safety across the council.

Social and Healthcare client finance system failures

The council has experienced significant financial control failures in its social and healthcare directorate, which have in turn exposed weaknesses in control at the corporate centre. As a result, around 30 per cent of its vulnerable clients have either been over- or under-billed for the services they have received.

Since this problem was identified the council has made substantial progress in putting things right for the future, and has taken action to be open and transparent about its failures and to learn from them in a very public way.

Looking forwards, we are satisfied that sufficient and appropriate arrangements have now been or are being introduced. If operated effectively, this should ensure robust financial control in the future. This applies both in the social and healthcare directorate, and also in terms of improved monitoring arrangements at the corporate centre.

Looking backwards, we have now issued an unqualified opinion on the council's 2003/04 accounts, which provide appropriately for estimated liabilities arising from over-billing of clients, and also the possible write-off of under-billed amounts.

Based on the information available to us at this time, we are satisfied that the council has taken all reasonable steps to address this matter effectively, and providing the council takes the actions agreed by the Best Value and Audit Committee on 19 January no further formal audit action is proposed at this time.

Accounts

We issued a qualified opinion on the council's 2002/03 financial statements as a result of weaknesses in the Social and Health Care directorate income and collection systems.

The council has worked since then to improve overall control and we were able to issue an unqualified opinion on the council's main 2003/04 accounts on 30 November 2004.

We also issued an un-qualified opinion on the 2003/04 Pension Fund accounts on 1 November 2004.

Financial position

Revenue balances increased in 2003/04. Based on information at the end of October 2004, the council remains on course to deliver the planned improvement to the level of revenue balances envisaged in its Medium Term Financial Plan (MTFP).

However, it currently envisages further limited calls on balances before the end of the financial year and will need to monitor this position closely.

The funding level of the pension fund continues to give cause for concern. The council is developing its future funding strategy that will

determine the level of contribution rates required to address the shortfall.

Other governance issues

Significant weaknesses continue to exist in the council's systems of financial control, particularly within the Social and Health Care Directorate. The council has taken action to strengthen its arrangements. In particular, it has invested significantly in the overall control environment within the directorate by:

- developing detailing procedural guidance;
- ensuring staff are appropriately trained; and
- tightening its reconciliation processes.

Internal Audit does not comply with the CIPFA Code of Practice. The proposed strengthening of the internal audit function and the establishment of the audit working group are key elements of the council's response to strengthening its control environment. The priority is to maintain the momentum and ensure that the actions identified are delivered as quickly as possible to ensure an efficient and effective internal audit function.

Action needed by the council

- Maintain your focus on identifying and rectifying errors on individual client accounts in the social and healthcare directorate.
- Complete your strategy and make a reality of your intention to introduce a best practice approach to procurement.
- Reinvigorate your approach to improving the quality of performance indicator information, especially in the social care areas identified.
- Maintain your resolve to increase general fund balances to the minimum acceptable level.
- Ensure that your increased investment actually results in much needed and sustained improvements to overall financial control.
- Maintain your focus on the improvement of internal audit and the effectiveness of your audit committee.

Council performance

The fire and rescue service has been assessed as making 'some progress' in implementing the government's modernising agenda. Management arrangements to take forward implementation appear robust.

The council has made a good start, but recognises that it has more to do if it is to develop a best practice procurement function.

Good progress has been made in moving towards a more effective overview and scrutiny function.

Weaknesses identified as part of a review of IT security and access controls need to be addressed as part of the SAP Revitalisation Project.

The opinion on the council's BVPP was qualified on the basis that it does not currently comply with statutory guidance to include accurate BVPI values.

Fire service pay and conditions agreement: local verification

The national agreement on fire service pay and conditions, finalised on 13 June 2003, included a condition that:

'the pay award at Stages 2 and 3 are subject to: ...verification by the Audit Commission ...that the intended benefits (including savings) of the various national changes are being delivered locally.'

This review has been undertaken in two phases corresponding to Stages 2 and 3 of the pay award. The aim of the review was to assess progress in the following specific areas:

- Integrated Risk Management Planning (IRMP);
- changing from rank to role;
- the Integrated Personal Development System (IPDS);
- pre-planned overtime;
- alternative duty systems;
- part-time working and other conditions of service;
- the modernisation agenda; and
- the financial aspects of modernisation.

The Audit Commission has now published its national report setting out the result of Phase 2 of the verification work. Local reports have set out the overall progress made, setting out key messages, and identifying good practice and barriers to progress.

The detailed fieldwork in Oxfordshire was undertaken by the council's new external auditors (KPMG).

Overall, Oxfordshire Fire Service (the service) has been assessed as having made **some progress** in taking forward the modernisation agenda.

Its Integrated Risk Management Plan was approved by the Executive in March 2004, setting out ten potential options for change.

The service is now working to implement these options, whilst continuing to develop its data and risk analysis as part of its work towards the next IRMP.

Key actions taken to date include a piloted change in the remuneration package offered to retained fire fighters and a change in the use of the training reserve.

Management arrangements to take forward implementation appear robust. Quarterly progress reports are produced for the senior management team which are supported by detailed action plans, timescales, responsible officers and performance indicators.

The service has recently finalised its IPDS Strategic Implementation Strategy which outlines the management reporting structure and key actions to be completed going forward. It has also launched IPDS Fire Fighter Phase 3 into the retained section of the service, taking into account lessons learned from the completed roll out to whole time staff.

The council now needs to:

- review its action plans and associated performance measures to ensure that they are fully outcome focussed and that the expected benefits are measured; and
- further improve its approach to data management particularly agreeing at a strategic level the data that should be shared across agencies in Oxfordshire.

Procurement

Procurement in Oxfordshire has traditionally been devolved to directorates. In 2004/05, the council will spend over £360 million on the procurement of goods and services. It estimates that good procurement can have an impact on £110 million of this annual spend.

Over the last few years the council has addressed procurement in some of its services, notably by commissioning best value reviews on:

- fire service procurement;
- transport capital programme procurement;
- buildings; and
- special educational needs transport.

The aim of our review was to assess progress made by the council in developing a best practice approach to procurement.

It has made sound progress, but has more to do, notably in adopting the prepared procurement strategy and then in making a reality of its intentions.

In particular, the council needs to ensure that it:

- agrees a procurement strategy that is clear about what good procurement in Oxfordshire will look like, with a good balance of making cost savings, cost avoidance and procuring better quality goods and services at the right price;
- has good basic information on council procurement;
- develops good governance arrangements and processes that provide a balance between enforcing good procurement practice and the ability to procure the goods and services needed at the right time.
This should also include procurement partnerships and e-procurement ;
- has robust change management and project management arrangements to implement the new arrangements and to support the approach to best value agreed by the Best Value and Audit Committee; and
- has adequate capacity to develop its procurement strategy and arrangements at the same time as procuring value for money goods and services.

Our work was undertaken in early summer 2004. Since then we understand significant progress has been made by the council including:

- development of a procurement strategy;
- establishment of a Strategic Procurement Board;
- continued development of procurement partnerships;
- developed management arrangements (such as the Efficiency Savings Steering Group) to oversee the work; and
- agreement to strengthen the capacity of the procurement function.

Our draft report including an outline action plan which identifies the key issues the council has to address is currently being discussed with the council.

Overview and scrutiny

Our work this year focussed on councillor understanding of the Overview and Scrutiny function, its operation in practice and the extent to which the scrutiny function has improved.

The council has made significant progress in developing a more effective overview and scrutiny function. The key areas for improvement are:

- review the progress and outcomes of Health Scrutiny over the next year to ensure that it is effective;
- address agenda management and information overload;
- if call-in is not the main way of holding the Executive to account, ensure that challenge is present in other ways;
- look at ways of involving the public more effectively; and
- continue learning, reflecting and evaluating.

Our detailed recommendations have been discussed with officers and an action plan agreed.

Access controls in a management information system

We reviewed the council's IT security, and controls within each of the MIS modules to prevent unauthorised access to data.

We made a number of recommendations which have been discussed with officers and an action plan agreed. Key actions include:

- the security policy is updated and issued to appropriate staff;
- corporate guidelines and standards for access controls are formulated;
- separation of duties between the person responsible for creating permissions and those using them;
- failed log-in attempts and changes to permissions are reported and monitored;
- permission rights to leavers are rescinded promptly;
- ITnet staff have appropriate security clearance;
- separation of duties between data entry and authorisation;
- appropriate reconciliation of feeder systems and SAP; and
- MIS support is appropriately structured and resourced.

The council has acknowledged that it is not using its management information system (SAP) to its full potential and is investing additional resources to rectify the shortcomings. The SAP Revitalisation Project will be the key forum for taking forward our recommendations.

Performance management and partnership arrangements

Last year's Letter referred to our preliminary findings in respect of our work within the Social and Health Care directorate. We have now finalised our report and discussed our findings with officers. The final report was issued in June 2004. Overall our findings showed a directorate committed to a sharper internal focus on performance.

Performance information

This year's work on the council's BVPIs and BVPP was undertaken by KPMG, the council's new external auditors.

The council's arrangements include a number of good practices including:

- named officers with responsibility for calculating individual PIs and for achieving performance targets;

- a formalised mechanism designed to manage information flows to the Performance Review team; and
- a quality control review in advance of the formal audit; within the Environment and Economy Directorate.

However, opportunities for further improvement were identified:

- the role of departmental coordinators could be strengthened to provide a greater degree of quality assurance over indicator values;
- whilst a systematic mechanism has been designed to manage the collation of indicator values for the BVPP, officers in directorates often did not use this mechanism to communicate indicator values to the Performance Review team; and
- the council needs to ensure that appropriate action is taken to address the reservations placed on BVPIs in 2004.

The audit identified six reservations (five on 2003/04 values and one on 2002/03) and resulted in amendments to 37 indicators (28 to 2003/04 values and nine to 2002/03 values).

The BVPP itself was found to comply with statutory guidance. However, scope for further improvement was identified to increase ease of use to members of the public.

In addition to the reservations, six instances were identified where there was a significant difference between the value published in the BVPP and the final agreed outturn. In particular, within Social and Health Care, there were three reservations and two significant differences, representing 36 per cent (five out of 14) of the indicators applicable to the Directorate.

As a consequence, the opinion on the council's BVPP was qualified on the basis that the BVPP does not currently comply with statutory guidance to include accurate BVPI values.

The findings of the audit offer clear opportunities for the council to develop its performance management system further.

Other Audit Commission inspections

The council is providing a 'good' sustainable development service which offers promising prospects for further service improvement.

Your corporate approach to community safety has improved significantly since March 2003, both in the effectiveness of partnership working and in mainstreaming community safety across council services. However, while the direction of travel is positive, some issues remain to further improve the mainstreaming of community safety across the council.

Sustainable development

Our inspection examined the way the council is delivering the national sustainable development agenda and local sustainability needs.

Overall, we concluded that the council is providing a 'good', two-star service that has 'promising' prospects for improvement.

The council has high-level aims that broadly recognise national sustainable development priorities and is addressing sustainability issues across the county, particularly in the areas of environmental protection and prosperity.

It has a strong track record of delivering improvements in the quality of life of local people, through individual service areas and key partnerships. It has contributed to Oxfordshire's strong economy, attractive environment and healthy population and is delivering strong sustainability outcomes, for example, in planning, transportation and in its management of waste.

The emerging community strategy is helping to set a powerful sustainable development agenda and the council is starting to use this to develop sustainable development policies across service boundaries.

To rise to the challenge of continuous improvement, councils need inspection reports that offer practical pointers for improvement. In this context, the inspection team recommended that the council:

- explains what outcomes will result from its strategic objectives, including its sustainable development objectives, so council staff and partners can understand the context of their work;

- consolidates its understanding of the needs of people and communities in Oxfordshire, engaging with local communities to develop integrated programmes which show how services can work together and in partnership with other agencies, to meet community needs;
- responds more clearly to the community strategy cross-cutting theme of community development and the Government's (draft) sustainable development priorities of social and environmental justice;
- reviews partnerships to ensure that they have enough capacity and support to work effectively to support the council's priorities;
- sets clear targets to improve the council's own sustainability performance with particular emphasis on areas of high impact, such as management of its own property; and
- develops the performance management system so it recognises strategic, service and community priorities, and can show whether the council is achieving its strategic objectives.

Community safety

Last year's Letter referred to the council's overall approach to community safety. This year we assessed the level of mainstreaming and awareness across the council of community safety issues.

Your corporate approach to community safety has improved significantly since March 2003, both in the effectiveness of partnership working and in mainstreaming community safety across council services. However, while the direction of travel is positive, community safety has not yet been fully mainstreamed across council services.

The role and effectiveness of the council's new safer communities unit is growing and partnership structures are developing to meet new policing arrangements. Recommendations to further improve the mainstreaming of community safety are set out in our detailed report.

Working with other inspectorates and regulators

An important aspect of the role of the Relationship Manager is to work with other inspectorates and regulators who also review and report on the council's performance.

These include:

- Ofsted;
- Commission for Social Care Inspection (CSCI);
- Benefits Fraud Inspectorate (BFI);
- DfES; and
- Local Government Office contact.

We share information and seek to provide 'joined up' regulation to the council.

The council received a major inspection from Ofsted at the same time as our own Comprehensive Performance Assessment. Our objective was to work with Ofsted to minimise duplication between the two reviews, and therefore the impact on council resources. The Ofsted review has subsequently reported that the council was highly satisfactory overall. In addition, Ofsted completed an inspection of the council's youth service and concluded that the service was very good and provides very good value for money.

Social and Healthcare client finance issues

The council has experienced significant financial control failures in its social and healthcare directorate, which have in turn exposed weaknesses in control at the corporate centre. As a result, around 30 per cent of its vulnerable clients have either been over- or under-billed for the services they have received.

Since this problem was identified the council has made substantial progress in putting things right for the future, and has taken action to be open and transparent about its failures and to learn from them in a very public way.

Looking forwards, we are satisfied that sufficient and appropriate arrangements have now been or are being introduced. If operated effectively, this

should ensure robust financial control in the future. This applies both in the social and healthcare directorate, and also in terms of improved monitoring arrangements at the corporate centre.

Looking backwards, we have now issued an unqualified opinion on the council's 2003/04 accounts, which provide appropriately for estimated liabilities arising from over-billing of clients, and also the possible write-off of under-billed amounts.

Based on the information available to us at this time, we are satisfied that the council has taken all reasonable steps to address this matter effectively, and providing the council takes the actions agreed by the Best Value and Audit Committee on 19 January no further formal audit action is proposed at this time.

Members will be aware that the scope of the audit opinion on your 2002/03 accounts was limited as we were unable to gain any assurance regarding income collection and debtor systems for clients within the social and healthcare directorate.

Although the council is responding to the concerns about control weaknesses in the directorate, we are commenting in this letter because we believe that there have been significant failings/shortcomings in the council's arrangements.

Of particular concern has been the extent of under- and over-billing of clients over past years, many of whom were elderly, and some of whom represented the most vulnerable in the community, having their financial affairs managed on their behalf by the council.

This letter is therefore a means of communicating our views on a high profile issue of concern to the public as well as taking the opportunity to raise awareness of the council's response to these unsatisfactory events. It is also intended to provide local taxpayers with some assurance that the council is learning from its past mistakes.

In its report to the Best Value and Audit Committee (BVAC) of 19 January 2005, the council has set out the latest position on its ongoing investigation, including the:

- work undertaken by the council to assess the likely value of errors and potential repayments required to correct past over-billing to clients;
- work still to be completed;
- the reasons for the breakdown in internal control and how these errors came about; and
- action subsequently taken by the council to prevent a re-occurrence.

An extract from that report sets out the council's view as to how this breakdown in control came about:

'The management investigation set up by the Director for Social and Health Care found that charges were wrongly applied, the use of direct debits and financial assessments were poorly controlled and Credit Control system was weak. Management controls were not robust which allowed these errors to occur and this was exacerbated by the complexity of the calculations behind client charges and the lack of adequate system reports and controls in place.'

Based on the sample of cases reviewed to date, this breakdown in control has resulted in under- and over-billing which has affected 30 per cent of individual clients. The latest estimate of the total effect is summarised in the following table.

EXHIBIT 1

Analysis of under/over charging

	No. of clients	% of clients	Value (£)
Clients over-billed	2,471	17	869k
Clients under-billed	1,861	12	1,020k

During the course of the year we have worked closely with your officers to review the progress being made, and have been consulted on matters relating to the preparation of the 2003/04 accounts. Whilst this matter is commented on in various parts of this Letter, for clarity, we set out below our own views on:

- how this happened;

- the adequacy of the council's response to ensure that this situation does not happen again, both within the directorate and corporately; and
- the approach taken to addressing past over- and under-billing, and the prudence of accounting entries in the 2003/04 accounts.

How did this happen?

In our view there has been a failure at two levels which allowed this control failure to occur.

- As set out in the council's own report, there was an absence of appropriate procedural and managerial controls within the directorate itself. This resulted in a culture which did not fully recognise the importance of such controls.
- There have also been failures at the corporate centre to appropriately monitor arrangements within directorates.

Adequacy of the council's response

Since the council identified this problem it has invested significantly in the introduction of improved financial and managerial controls both within the social and healthcare directorate and within the corporate centre.

The council's report to BVAC on 19 January sets out those improvements and we are satisfied that effective implementation of the improvements adopted will result in effective financial control, and prevent recurrence of the errors identified. However, we have not tested the correct operation of those controls as this is to be reviewed by internal audit in the period to March 2005. The results of this work will be reviewed as part of the coming year's external audit.

A major lesson from this process has been the importance of a robust central finance and internal audit function, and also of an effective audit committee. The council has recognised this and has taken action to improve overall control.

The council has invested significantly in improving financial control, and the newly introduced audit panel should be the main mechanism through which it demonstrates a return on that investment.

Over- and under-billing and the 2003/04 accounts

The council has reduced significantly the uncertainty of the financial consequences surrounding internal control within the directorate and has also worked extensively to identify the extent of under- and over-billing on a client by client basis.

Much remains to be done, but on the basis of progress so far, that uncertainty has been reduced sufficiently to enable an unqualified opinion to be issued on the 2003/04 accounts:

- the abacus system has now been fully reconciled to the ledger, and to the accounts;
- your estimates of over- and under-charging to clients is reasonable based on the evidence provided; and
- you have been prudent in setting aside monies for the repayment of liabilities and in your assumptions about debt collection.

By issuing an unqualified opinion on your accounts we are not signalling that this matter has been satisfactorily resolved. This is clearly not the case, and much has yet to be done in clearing individual client accounts. At the time of issuing the audit opinion, 22 per cent of client files had been reviewed, which means of course that 78 per cent had yet to be addressed. Resolving individual client accounts will be a primary objective for the coming months.

Accounts

We issued a qualified opinion on the council's 2002/03 financial statements as a result of weaknesses in the Social and Health Care directorate income and collection systems.

The council has worked since then to improve overall control and we were able to issue an unqualified opinion on the council's main 2003/04 accounts on 30 November 2004.

We also issued an un-qualified opinion on the 2003/04 Pension Fund accounts on 1 November 2004.

2002/03 accounts

Following the identification of weaknesses within the Social and Health Care directorate income and collection systems the council appointed an external consultant to validate the transactions within the Abacus system. This work was extremely time-consuming and extended beyond the initial estimates.

Because of this on-going work within the Social and Health Care directorate we were unable to obtain sufficient information and explanations that we considered necessary in respect of income, cash, debtors and provision for bad debt. As a consequence, we issued a qualified opinion on the council's 2002/03 accounts on 11 May 2004.

2003/04 accounts

Matters arising from the final accounts audit

The published accounts are an essential means by which the council reports its stewardship of the public funds at its disposal and its financial performance in the use of those resources. The council's Best Value and Audit Committee approved the statement of accounts on 31 August 2004.

We have worked with your officers to review progress made in improving overall financial control and in improving client financial records, and have advised where appropriate on the approach to be taken to accounts closedown issues. This work has been on-going throughout 2004.

Our objective in so doing has been to gain assurance as to the reliability of entries in the statement of accounts, including key system reconciliations, and to agree any further adjustments to the accounts for the period ended 31 March 2004. We have not reviewed the ongoing operation and reliability of newly introduced financial controls in 2004/05, which falls to be considered as part of next year's audit.

We have now concluded our work and issued an un-qualified opinion on the council's accounts on 30 November 2004. However we have not yet issued a formal certificate of closure of the 2003/04 audit as we have not yet determined whether any further formal audit action is

required in respect of the outcome of the review of the Cornmarket project.

Report to those with responsibility for governance in the council

We are required by professional standards to report to those charged with governance (in this case the Best Value and Audit Committee) certain matters before we give an opinion on the financial statements. Our report was discussed at the Best Value and Audit Committee on 25 November 2004.

Key issues raised were the:

- significant financial control weaknesses within the Social and Health Care directorate which are discussed elsewhere within this Letter;
- lack of a detailed working paper demonstrating that all bank accounts held in the name of the council have been properly accounted for in the statement of accounts or suitable explanations provided for their non-inclusion;
- inconsistencies within the draft accounts;
- lack of full compliance with the CIPFA Code of Practice on Local Authority Accounting;
- continued problems with the quality of working papers produced to support the statement of accounts particularly within the Social and Health Care directorate; and
- incomplete responses from members in respect of related party transaction disclosures.

Our detailed report has been discussed with officers who have provided a response taking the issues forward.

Financial standing

Revenue balances increased in 2003/04. Based on information at the end of October 2004, the council remains on course to deliver the planned improvement to the level of revenue balances envisaged in its Medium Term Financial Plan (MTFP).

However, it currently envisages further limited calls on balances before the end of the financial year and will need to monitor this position closely.

The funding level of the pension fund continues to give cause for concern. The council is developing its future funding strategy that will determine the level of contribution rates required to address the shortfall.

Financial performance 2003/04

Previous letters have commented on the extremely low level of council balances, and the resultant lack of flexibility to meet unforeseen circumstances or commitments. The council's Medium Term Financial Plan (MTFP) proposed increasing balances to 2 per cent of expenditure over the period 2003/04 to 2006/07.

The final outturn for 2003/04 shows an underspend by Directorates of £4 million.

The Learning and Culture Directorate had an in-year overspend of £3.2 million increasing its carried forward deficit to £4.9 million. This was principally due to the planned overspend on the City Schools re-organisation which is recoverable from the savings on the fixed costs of the closed schools. This was offset by an in-year surplus of £5.3 million for the Social and Health Care Directorate improving its carried forward position to a surplus of £2.6 million. The remaining Directorates all reported underspends.

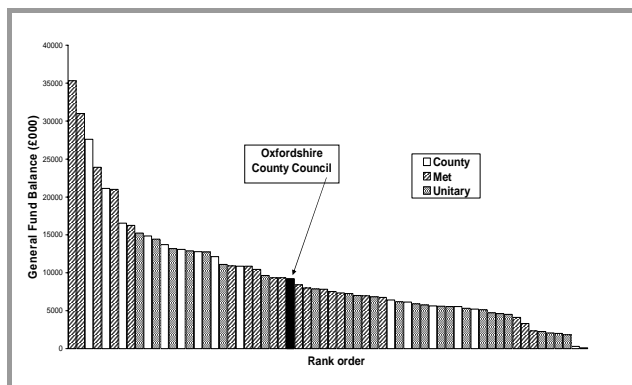
Exhibit 2 below shows that revenue balances have increased.

EXHIBIT 2

Revenue balances have improved

Fund/reserve	31 March 2003 (£000s)	31 March 2004 (£000s)
County Fund	4,746	6,563
C/fwd reserve	(1,348)	2,645
Budget reserve	0	0
Total	2,226	9,208
LMS	5,444	3,618
Other Earmarked Reserves	4,650	5,412
Grand Total	13,492	16,407

The council's general fund balances as a percentage of net operating expenditure has improved and compares reasonably well with other authorities (Exhibit 3 below).

EXHIBIT 3**General Fund Balances (including carry forward reserve) have improved****School balances**

School balances reduced from £5.4 million to £3.6 million in 2003/04. This represents a better position when earlier in the year schools were reporting an overall forecast deficit position. Exhibit 4 gives an analysis of the numbers of schools in a surplus or deficit position.

EXHIBIT 4**School balances**

	2002/ 03	2003/ 04
Numbers in deficit	73	75
Numbers in surplus	219	208
Total	292	283

Financial performance 2004/05

Following a 13.4 per cent increase in Council Tax in 2003/04 the council sought to minimise its budget requirement in 2004/05, resulting in a reduced increase in Council Tax of 6.25 per cent. Based on information at the end of October 2004 the council is forecasting a decrease in its revenue balances at the year-end, excluding LMS and other ear-marked reserves, from £9.2 million to £7.2 million (Exhibit 5). The decrease in balances is due primarily to:

- additional investment into the council's main accounting system;
- funding to meet costs associated with Social and Health Care project team; and
- contribution to cost of broadband.

However, despite this fall the council remains on course to deliver the level of balances envisaged in its MTFP.

EXHIBIT 5**Forecast position at end of October 2004**

Directorate	£000s
Learning & Culture	(5,849) *
Social & Health Care	737
Environment & Economy	1,807
Community safety	(180)
Resources	645
Total C/Fwd	(2,840)
County Fund	10,014
Revenue Balances	7,174

* *The Learning and Culture forecast position includes £3.65 million in respect of the planned overspend on the City Schools re-organisation. An action plan to address the remaining in-year deficit has been developed.*

Looking forward

The council continues to face significant financial pressures including the need to deliver 2.5 per cent efficiency savings (of which 50 per cent are required to be cash-releasing) in 2005/06 in line with the Gershon review: *Releasing Resources for the Frontline*.

The provisional local government finance settlement for Oxfordshire represents an increase of 6.9 per cent compared to 2004/05 and is in line with the assumptions in its Medium-Term Financial Plan.

The council's Medium-Term Financial Plan envisages increasing balances to two per cent of its net budget requirement by the beginning of the financial year 2006/07. Its latest projections indicate that it is on course to achieve that target.

Pension fund

Last years Letter referred to a fall in the funding level of the Oxfordshire Pension Fund from 96 per cent in 1998 to 91 per cent.

The Funding Strategy Statement considered by the Pension Fund Committee on 27 August 2004 identified a further potential shortfall in the

future funding of the Fund. A substantial future shortfall has been identified (Exhibit 6).

EXHIBIT 6

Analysis of funding levels of Pension Fund

Funding level at	Funding Level
1998	96 per cent
2001	91 per cent
2004	65 per cent

The Office of the Deputy Prime Minister has provided guidance on the need to ensure pension funds are placed on an affordable and sustainable basis including:

- increasing the level of employers contributions over a number of years;
- adopting appropriate assumptions about future inflation, price increases and other actuarially sensitive variables;
- extending the recovery period from the current 12 years up to a maximum of 30 years; and
- avoiding the need for expensive, early retirements.

The final figures were received from the actuary in December 2004.

Other governance issues

Significant weaknesses continue to exist in the council's systems of financial control, particularly within the Social and Health Care Directorate. The council has taken action to strengthen its arrangements. In particular, it has invested significantly in the overall control environment within the directorate by:

- *developing detailing procedural guidance;*
- *ensuring staff are appropriately trained; and*
- *tightening its reconciliation processes.*

Internal Audit does not comply with the CIPFA Code of Practice. The proposed strengthening of the internal audit function and the establishment of the audit working group are key elements of the council's response to strengthening its control

environment. The priority is to maintain the momentum and ensure that the actions identified are delivered as quickly as possible to ensure an efficient and effective internal audit function.

Systems of internal financial control

In recent years we have commented on weaknesses in the council's internal financial control environment and particularly continued weaknesses within the Social and Health Care Directorate.

As a result of ongoing concerns around financial control systems in the social and healthcare directorate, the council appointed a consultant in September 2003 to look in some detail at controls in place.

It has subsequently invested significantly in the improvement of its internal control procedures by:

- undertaking a full reconciliation between the Abacus subsidiary system and the main accounting system;
- compiling detailed procedural guidance for all aspects of the management of clients finances;
- providing training to all staff involved in carrying out client assessments; and
- ensuring data from the Abacus subsidiary system is regularly transferred to main accounting system.

The council also commissioned an external review of financial management. The report concluded that the council's financial management arrangements were below the standards set out in the new CIPFA model, issued in May 2004, and need to be materially strengthened.

The council has responded positively to the recommendations and has already implemented a number of measures designed to address the weaknesses. In particular it has identified a number of priority areas which are being monitored through the council's Best Value and Audit Committee (Exhibit 7).

EXHIBIT 7**Key findings**

Key Finding	Priority area for improvement
Making sure the infrastructure to support devolved financial management is robust.	Policies and procedures. Scheme of financial delegation. Financial training.
Integrating performance and financial management.	Reliable financial information – linkage to SAP project. Appropriate structures for financial staff at the centre and within directorates.
Developing the medium-term financial plan so that it is based on robust projections and risk assessments.	Improved budget and financial reporting. Reliable financial information – linkage to SAP project.
Effective risk management and internal control arrangements.	Integrated risk management. Policies and procedures. Appropriately resourced internal audit function. Core weaknesses removed from financial systems. Financial training.
Putting in place corporate guidelines.	Policies and procedures. Financial training.
Provision of good quality information.	Reliable financial information – linkage to SAP project. Improved budget and financial reporting.
Ensure that the finance function has the capacity and capability.	Appropriate structures for financial staff at the centre and within directorates. Performance management of staff.
Effective project and change management arrangements.	Clear action plans linked to related plans. Identify and secure the extra resources to achieve the plans on time.

It is too early to assess the impact of the actions taken by the council to strengthen its arrangements.

Internal Audit

In 2002/03, we completed a full review of the Audit and Risk Management Service (ARMS) against the CIPFA Code of Practice for Internal Audit. The review concluded that the service did not comply fully with the Code, and made a number of recommendations to enhance the status, independence and day to day running of the service. In addition it considered the relationship between the service and the best value committee which acts as the audit committee.

Our work in 2003/04 audit sought to provide an assessment of progress against recommendations in last years report as well as provide for a refocusing on the key issues internal audit now face.

While some improvements had been seen in the day-to-day running and reporting of the service, the service is still not in full compliance with the Code. Further issues were identified (Exhibit 8).

EXHIBIT 8**Key findings**

Finding	Recommendation
Following the restructuring of Financial Services internal audit were line managed by an Assistant Head of Finance with responsibility maintaining financial systems.	Consider how internal audit independence can be supported by organisational structure and reporting lines.
63 per cent of areas identified are not scheduled for review within the three year period of the strategic plan.	Consider the implications of not completing reviews on internal audit's statutory responsibilities and make the best value committee aware.
At the start of quarter four 44 per cent of jobs included in the operational plan for 2003/04 were either cancelled or delayed.	Ensure that the reasons for delays and cancellation are reported to the best value committee.

EXHIBIT 8 CONTINUED

Key findings

Finding	Recommendation
Currently there is no discussion at the best value committee on: <ul style="list-style-type: none"> adequacy of resources to ensure statutory duties are fulfilled; changes to the strategic plan; and the adequacy and quality of internal audit work. 	Expand the terms of reference of the best value committee to include: <ul style="list-style-type: none"> agreement of audit budget and significant changes to the audit plan; and performance review of internal audit.

Since the time of our review the council has taken a number of steps to improve its overall financial management and governance, including:

- re-badging the Best Value Committee to become the Best Value and Audit Committee and increasing its remit;
- establishing an audit working group which meets in private, which makes recommendations to the council's Best Value and Audit committee;
- producing a charter for internal audit;
- proposals to strengthen internal audit by the addition of an Assistant Head of Finance specifically for audit; and
- preparing an action plan to ensure full compliance with the CIPFA Code of Practice for internal audit in local government.

The proposed strengthening of the internal audit function and the establishment of the audit working group are key elements of the council's response to strengthening the control environment. The priority is to maintain the momentum and ensure that the actions above are delivered as quickly as possible to ensure an efficient and effective internal audit function.

Standards of financial conduct and the prevention and detection of fraud and corruption

We have not identified any significant weaknesses in your arrangements to prevent and detect fraud and corruption.

Legality of transactions

We have not identified any significant weaknesses in the framework established by the council for ensuring the legality of its significant financial transactions.

However, during the year we have had on-going discussions with officers on a number of issues including:

- Client finances in Social and Healthcare – see separate section; and
- Cornmarket Street – paving works.

On the latter, the county council and Oxford City Council have established a joint overview and scrutiny panel with an independent chair to undertake a review of the implementation of the scheme, including the reasons for the escalation of costs. We are awaiting the outcome of that review before deciding whether any further action is required on our part.

Other work

Additional voluntary work

At your request, we undertook additional work under Section 35 of the Audit Commission Act 1998.

The work was delivered through a workshop designed to:

- raise the awareness and general understanding of value for money issues amongst service and middle managers in the Learning and Culture directorate; and
- stimulate thought on how individual education service areas can identify whether or not they are providing value for money.

Grant claims

Over recent years the number of claims requiring audit certification has grown and audit fees have risen in line with this growth. In accordance with Strategic Regulation, the Audit Commission has adopted a more risk-based approach to the certification of grant claims. With effect from 2003/04 the smaller claims have not been subject to audit or have received a lighter touch. The approach to larger claims has been determined by risk and the adequacy of the council's control environment.

The council's arrangements for managing and quality assuring grant claims submitted for audit has improved in recent years. However, there is still scope for further improvement. Grant claims and returns in some cases are not seen as high priority and adequate staff resources are not always made available. Our key findings are summarised in Exhibit 9 below.

EXHIBIT 9

Management of Grant Claims

Key area	2001 %	2002 %	2003 %
Submitted for audit after the due date	38	33	34
Report issued/amended	51	33	34
Initial working papers inadequate	62	80	41

We have issued a detailed report which makes recommendations to secure further improvement.

National fraud initiative

The Council took part in the Audit Commission's national fraud initiative (NFI) 2002/03. The NFI, which is undertaken every two years, brings together data from local authorities, NHS bodies, government departments and other agencies, to detect a wide range of frauds against the public sector. Total savings from the 2002/03 exercise exceeded £83 million.

The Commission are repeating the exercise this year and will again collect payroll, pensions, housing benefits, student loan and housing rents data from Authorities. Alongside the core exercise a number of pilot initiatives are being undertaken at selected sites. These are focused

on risk areas that were highlighted by Authorities and include payments made to privately run care homes, abuse of blue badge parking permits, serial insurance claimants and duplicate payments to suppliers. These pilot areas, if they prove effective, will be incorporated into future NFI exercises.

Looking forward

Future audit and inspection work

The council's new auditors (KPMG) will be responsible for the 2004/05 audit. This combined letter includes elements of their work already carried out (Fire service pay and BVPIs). The remaining elements of the plan, including the 2004/05 accounts, will be reported in next year's combined Annual Letter.

When planning our combined programme for 2005/06, jointly with KPMG, we will seek to reconsider your improvement priorities in the light of the latest CPA assessment and develop an agreed programme by 31 March 2005. We will continue to work with other inspectorates and regulators to develop a coordinated approach to regulation.

Revision to the Code of Audit Practice

The Audit Commission has consulted on a revised Code of Audit Practice for application to the audit of the 2005/06 accounts. The new Code, which will be laid before Parliament in January 2005, is designed to secure:

- a more streamlined audit, which is proportionate to risk and targeted on areas where auditors have most to contribute to improvement;
- a stronger emphasis on value for money, focussing on bodies' corporate performance and financial management arrangements (rather than individual services and functions); and
- better and clearer reporting of the results of audits.

Further details will be provided in the Audit and Inspection Plan 2005/06.

CPA 2005 and beyond

The Audit Commission has also consulted on a new framework for CPA in 2005 and beyond. The main changes proposed are as follows:

- rationalisation of service blocks;
- 'achievement' assessment element of Corporate Assessment to be driven by review of Community Plan and shared priority themes;
- move away from rigid numerical model, to one based on rules;
- Corporate Assessments to be undertaken on rolling programme, integrated with Joint Area Reviews of children and young people;
- stronger focus on service delivery for users and customers; and
- more robust and explicit view of vfm and cost-effectiveness.

Closing remarks

This letter has been discussed and agreed with the Director of Resources and Head of Finance and Procurement and separately presented to leading Members in January 2005.

A final version of the Letter will be presented to the Best Value and Audit Committee on 9 March 2005.

The council has taken a positive and constructive approach to our audit and inspection I would like to take this opportunity to express my appreciation for the council's assistance and cooperation.



A P Burns
District Auditor and Relationship Manager

January 2005

Availability of this letter

This letter will be published on the Audit Commission's website at www.audit-commission.gov.uk, and also on the council's website at www.oxfordshire.gov.uk.

Status of our reports to the council

Our annual audit and inspection letter is prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission. Annual audit and inspection letters are prepared by relationship managers and appointed auditors and addressed to members and officers. They are prepared for the sole use of the audited and inspected body, and no responsibility is taken by the Audit Commission or its appointed auditors to any member or officer in their individual capacity, or to any third party.

Audit and Inspection reports issued during 2003/04

Report	Date issued
Audit plan	May 2003
Up-dated Review of ARMS and Member involvement	March 2004
Review of 2002/03 Grant Claims	April 2004
Certification of Grant Claims and Returns: Audit Plan	May 2004
Review of Overview and Scrutiny	May 2004
Pension Fund – communication to those charged with governance	October 2004
Statement of accounts – issues arising	Not yet released
Performance management and partnership working – Social and Health Care Directorate	June 2004
Audit of Best Value Performance Plan and BVPIs	October 2003
Procurement	August 2004 (draft)
Asylum Seekers – follow-up review	April 2004
Access controls in a management information system	March 2004
Community safety	October 2004
Waste management services	May 2003
Whole Service Inspection – Cultural and lifelong learning	August 2003
Sustainable Development Inspection report	August 2004
Corporate Performance Assessment	

KPMG reports

Report	Date issued
Fire Service Pay and Conditions agreement – verification phase 1	February 2004
Fire Service Pay and Conditions agreement – local verification report phase 2	July 2004
Findings of the audit of Best Value	November 2004

Audit and inspection fee

Audit fee update

Audit area	Plan 2003/04 £000s	Actual 2003/04 £000s
Accounts	69	90
Financial aspects of corporate governance	81	81
Performance	94	73
TOTAL CODE OF AUDIT PRACTICE FEE	244	244
Inspection, excluding ODPM Grant	65	65
Grant Claim certification	112	105(est)
Additional Voluntary work (under Section 35)	-	2

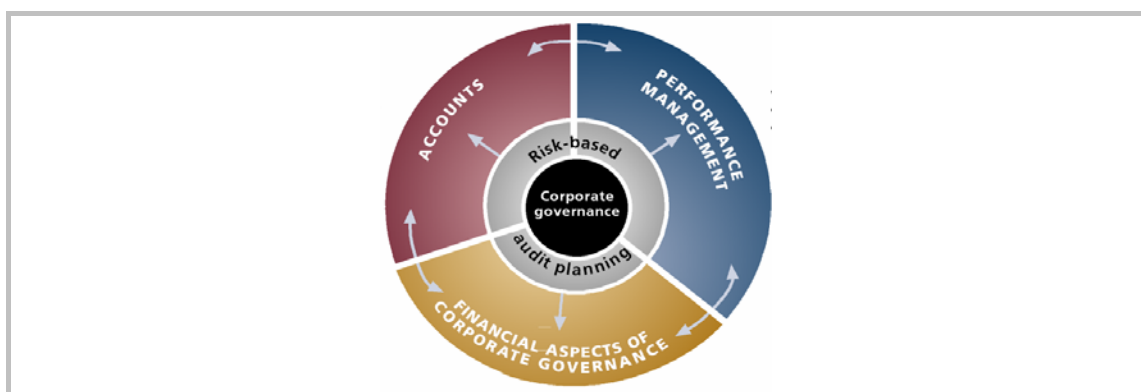
Scope of audit and inspection

Audit

Our main objective as your appointed auditor is to plan and carry out an audit that meets the requirements of the Code of Audit Practice. We adopt a risk-based approach to planning our audit, and our audit work has focused on your significant financial and operational risks that are relevant to our audit responsibilities.

Central to our audit are your corporate governance arrangements. Our audit is then structured around the three elements of our responsibilities as set out in the Code and shown below.

THE THREE MAIN ELEMENTS OF OUR AUDIT OBJECTIVES



Accounts

- Opinion.

Performance management

- Use of resources.
- Performance information.
- Best Value Performance Plan.

Financial aspects of corporate governance

- Financial standing.
- Systems of internal financial control.
- Standards of financial conduct and the prevention and detection of fraud and corruption.
- Legality of transactions

Inspection

Inspection work is based around Section 10 of the Local Government Act 1999, which requires us to carry out inspections and deliver reports that will:

- enable the council and the public to judge whether best value is being delivered;
- enable the council to assess how well it is doing;
- enable the Government to assess how well its policies are being implemented; and
- identify failing services where remedial action may be necessary.

The Audit Commission has circulated to all audited bodies a statement that summarises the key responsibilities of auditors. Our audit has been conducted in accordance with the principles set out in that statement. What we say about the results of our audit should be viewed in the context of that more formal background.