

Government and Public Sector

January 2005

Worcestershire County Council

2003/04 Joint Audit and Inspection Letter

The Members
Worcestershire County Council
County Hall
Spetchley Road
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WR5 2NP

20 January 2005

Ladies and Gentlemen

Joint Audit and Inspection Letter 2003/04

We are pleased to present our Joint Audit and Inspection Letter for 2003/04. We hope that the information contained in this report provides a useful source of reference for Members. The Cabinet will consider the Letter at its meeting on 8 February 2005.

Yours faithfully

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Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies

We perform our audit in accordance with the Audit Commission's Code of Audit Practice (the Code), which was last issued in March 2002. This is supported by the Statement of Responsibilities of Auditors and Audited Bodies, which was last issued in April 2000. Both documents are available from the Chief Executive of each audited body.

The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end, and what is to be expected of the audited body in certain areas.

Our reports and audit letters are prepared in the context of this statement and in accordance with the Code.

Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the audited body, and no responsibility is taken by auditors to any Member or officer in their individual capacity, or to any third party.

Executive summary

The purpose of this report

We are required, under the Audit Commission's Code of Audit Practice (the Code), to issue an annual Audit Letter to the Council on completion of our audit, demonstrating that the Code's objectives have been addressed and summarising all issues of significance arising from our work. Our Audit Letter also includes a summary of the results of the inspection work undertaken during 2003/04 by the Audit Commission in accordance with their responsibilities as detailed in section 10 of the Local Government Act 1999.

The joint reporting of audit and inspection work in this format recognises the steps that the Audit Commission has taken to integrate more closely audit and inspection regimes, whilst recognising and maintaining their separate statutory responsibilities. The Audit Commission has appointed 'relationship managers' for all local authorities to co-ordinate planning and delivery of inspection work alongside the statutory audit work.

Worcestershire County Council (the Council) are also a pilot site where we as appointed auditors undertake the Audit Commission's planned inspection work alongside the audit work to develop this more integrated approach. This pilot started in the 2003/04 audit and inspection year and is subject to review by the Audit Commission.

The new approach is intended to provide a more proportionate and integrated approach to performance audit and inspection work.

The main area for an integrated approach has been in respect of performance review work, based on the improvement plan developed by the Council, following the Audit Commission's Comprehensive Performance Assessment process (CPA).

Our Audit Plan set out the risks that we identified as part of our audit planning, together with the targeted work that we planned to perform in order to address these risks. The inspection work undertaken this year was a result of the Council's Improvement Plan.

We have issued a number of reports during the audit year, detailing the findings from our work. A list of these reports is included at Appendix A to this Joint Audit and Inspection Letter.

We have set out below what we consider to be the key issues arising from the audit and inspection work.

The Council has made significant progress over the year in terms of its improvement agenda and has moved from a 'good' to an 'excellent' rating in terms of its CPA category in December 2004. This has resulted from improved scores in its corporate assessment inspection in June 2004, along with a significant improvement in performance across some of its service areas, particularly, for education, social services and environment. The Council is considered to be well placed to continue this trend and must now focus on sustaining improvement in its priority areas.

The Council approved its 2003/04 Statement of Accounts much earlier than in prior years and we commend the Council in achieving this. We issued an unqualified opinion on the accounts following the completion of the audit.

The Council's overall financial position remains sound and the increased level of revenue balances in particular, provides the Council with greater flexibility to manage any adverse change in the Council's financial position.

Negotiations are still ongoing to enable the Council's joint waste management PFI contract to achieve the government's new targets for recycling and diversion from landfill using alternative technology to the waste to energy plant. Members will need to consider the financial implications for the Council's medium term strategy if the negotiations are not concluded successfully.

The Council published a Statement on Internal Control (SIC) for the first time in the 2003/04 Statement of Accounts. Arrangements for the management of risk are still being embedded across the Council. Next year, a report setting out the findings of the annual review of effectiveness of internal controls should be prepared at the year end to support the statements made in the SIC. The Chief Executive will need to determine the Council's approach to conducting and documenting this review.

We have issued an unqualified opinion on the Council's Best Value Performance Plan (BVPP) and our audit work has not identified any 'reservations' with the Council's Best Value Performance Indicators (BVPIs).

Our review of the Council's corporate parenting arrangements identified a number of opportunities for the Council to strengthen its arrangements for fulfilling its responsibilities for looked after children. These are summarised below and set out in our detailed report.

Our inspection of transportation and road safety at the Council concluded that the Council is providing a 'good' two-star service that has promising prospects for improvement. The key issues arising from the inspection are summarised below and explained in detail in the inspection report.

Council performance

Key issues

The Council underwent a Corporate Assessment Inspection in June 2004 and maintained its overall rating as a 'good' authority while improving on its 2002 score against a raised threshold.

Scores in three of the four service blocks improved. These were for Education, Social Services and Environment, moving the overall service score up to a 4 out of a potential 4. The service block score for Libraries and Leisure moved down for this period from a 4 to a three.

The score for the Use of Resources remained the same at 4.

Between 2002/03 and 2003/04, 69% of performance indicators have improved. This included 79% of performance indicators for Education and 100% of performance indicators for Social Services.

Since 2002/03

Key PIs

PIs that have improved
 PIs that have not improved
 Data only for one year

PIs in 'Best' Quartile	19
	3
	2
33%	
PIs in 2 nd Quartile	12
	2
	7
29%	
PIs in 3 rd Quartile ^{Note 14}	8
	8
	5
29%	

PIs in 'Worst' Quartile

1
5
1

10%

69%
31%

Not available for comparison

6

A proportionate corporate assessment was also carried out in November 2004 to confirm the Council's eligibility to progress from a 'good' to an 'excellent' CPA score. The findings confirmed the Council's eligibility to rise to 'excellent' status on receipt of its 2004 performance and external assessment scores.

A number of issues were raised from this inspection that the Council will need to address in the way it moves forward. These included: the ranking of priorities to guide resource allocation, the further development of the Council's Medium Term Financial Strategy, the need to refine the corporate risk register to include all major risks for the Council, continued development of the scrutiny function and improved member training and engagement in performance management.

We have completed our audit of the Council's BVPP and we have issued an unqualified audit opinion. The Council has taken appropriate action on prior year recommendations arising from our BVPP audit.

Our audit of the Council's BVPIs did not identify any 'reservations' over the accuracy or reliability of the underlying data.

Our review of the Council's corporate parenting arrangements identified a number of opportunities for the Council to strengthen its arrangements for fulfilling its responsibilities for looked after children. These include establishing a corporate parenting group; training for councillors and relevant partners; and joint working with district councils to promote the take-up of their services by looked after children.

Our inspection of transportation and road safety at the Council concluded that the Council is providing a 'good' two-star service that has promising prospects for improvement. The main areas for improvement were identified as the need to: resolve the Worcester City transport policy and partnership arrangements; focus on the development of school travel plans; and investigate comparative performance on pedestrian/cyclist injuries. The Council has agreed an action plan in response to the report.

Comprehensive Performance Assessment (CPA)

The Council's CPA scorecard was published on 16th December 2004 on the Audit Commission's website. The Council's overall performance was set out in the 2003 CPA scorecard as 'Good'. The overall rating this year has improved to 'Excellent' and was reached by looking at how the Council's main services perform and how the Council is run.

The Council's main services were scored on a scale of 1 to 4, with 1 being the lowest and 4 the highest. Education and social care are given more importance in reaching the overall service score than the other service areas. The service scores are set out below:

Education	4 out of 4
Social Care (Children)	3 out of 4
Social Care (Adults)	3 out of 4
Environment	4 out of 4
Libraries and Leisure	3 out of 4
Use of Resources	4 out of 4
Overall service performance	4 out of 4

Corporate capacity to improve 3 out of 4

The Audit Commission carried out a corporate assessment of the way the Council is run for the second time in June 2004. The score for this assessment was rated as 'Good' but with an improved overall score on the corporate assessment of 2002.

The CPA scorecard includes a brief summary of our assessment of the progress made by the Council in the last year. This summary is reproduced below.

“Worcestershire County Council has made significant improvements to education, social services and environment services, over the last year.

The corporate assessment, in June 2004, found that improvement activity since 2002 has been impressive and that the Council has refined the way it works. There has been marked progress in priority areas. Inspection results in the last year rated: the education service as ‘good’; social services as a ‘two star’ service, with ‘significant improvement in children’s services outcomes’ and ‘excellent prospects for further improvement’; and the transportation and road safety service as ‘good with promising prospects for improvement’. Overall, sixty nine percent of performance indicators have improved with particularly good performance in education and social services. The pace of improvement in some areas, such as waste management, has been slower but the council is working effectively with partners to tackle this.”

This summary is based on a qualitative assessment of the Council's progress, revised external inspection scores and Government Office Ratings and assessment of the Council's PI performance, along with the results of a proportionate corporate assessment inspection carried out in November 2004. The key issues arising from this recent corporate assessment are highlighted below.

Corporate assessment

From the November 2004 assessment, the Council was rated as a 'good' authority which continues to translate many of its plans and areas for investment [identified as part of the June 2004 assessment], into positive achievements which, in turn, improve the quality of life for local people. A number of key strengths were

identified from the inspection, including that the Council:

- has maintained its focus on its agreed improvement priorities;
- is managing performance effectively and has achieved significant improvement as a result, for example, in Education and Social Services;
- is an outward looking and effective community leader;
- is very effective in its partnership working, particularly with the districts and this has helped to deliver national and local targets effectively;
- has clear priorities and has effectively communicated these to local people;
- has improved its scrutiny function and strengthened its capacity to achieve tangible results; and
- has developed a learning culture and used learning groups and scrutiny to undertake research and review the impact of cabinet decisions to inform future action.

A number of areas were flagged up for improvement, including:

- continued development of the scrutiny function;
- improved member training and engagement in performance management;
- the further development of the Councils medium term financial strategy; and
- to ensure that the Corporate Risk Register includes all major risks, such as the waste PFI.

Direction of travel statement

As the Council has undergone a recent corporate assessment, a full and formal Direction of Travel Statement is not required for this year. The Council has made significant progress since its last formal CPA inspection in 2002 and Qualitative Assessment in 2003, particularly within the following areas.

Priorities

The Worcestershire Partnership agreed its community strategy in 2003, addressing a weakness which was highlighted in the CPA in 2002. The

completion of the strategy and progress in partnership working overall has provided clearer ambitions and long term vision for the county and strengthened the Council's community leadership role. The Council is clear about its priorities, which have been informed by consultation with local people, and has a strong focus on delivering them.

Capacity

The Council has progressed a number of initiatives to improve capacity over the past year, for example in the area of organisational development with staff recruited into key areas and improved internal and external communication. New arrangements for scrutiny have been put in place, which have begun to support future improvement and performance management, although the impact of these has not yet been fully tested. However, there are still areas for improvement including councillor training and the development of corporate workforce planning. It is important that these areas are addressed to ensure that the Council has the strategic capacity to deliver future ambitions.

The Council has adequate financial management and monitoring processes. The Council's financial position remains sound and consistent with its medium term financial strategy (MTFS). A key challenge for the Council will be in terms of sustaining, and progressing, improvement within the constraints of limited available resources.

Performance management

This has been a significant area of improvement since the CPA 2002 and over 2003, as a performance management culture continues to develop across the Council. Performance monitoring and reporting has improved and there are clearer links between plans. Variances from targets in the corporate plan are reported quarterly with a brief explanation of the proposed corrective action. There is demonstrable evidence that the approach is driving improvement particularly in areas such as recycling, social services and education. In addition, a risk management strategy is now in place although the Council needs to ensure that the Corporate Risk Register includes all key risks to the Council's financial, legal, performance and reputational standing, such as the waste PFI.

Though the performance management arrangements are generally working well, further improvements could be made such as ensuring a consistent approach to target setting and risk management.

Investment

The Council is clear about its priorities and is providing additional resources to support improvements in services to local people. The Council has added capacity in priority areas, for example additional posts have been put in place to support e- government and internal communication development and £10.7 million is being invested over the next three years to deliver the Council's ICT strategy.

The Council has developed a joint municipal waste strategy with the districts and has also invested in training. Work has begun on workforce planning, for example, to deliver the modernisation and integrated services agenda for social services. The Council has also invested in corporate processes that support continuous improvement. A strengthened approach to procurement has resulted in savings in excess of £1million in 2003/04.

Achievement

Education

The education service is rated as good. In January 2004, an Ofsted inspection of Worcestershire local education authority (LEA) found all elements of the service to be performing to at least satisfactory standards and many were 'good' or 'very good'. In particular there has been progress in the school improvement function and the special educational needs service, which were areas of relative weakness. The prospects for further improvement were judged to be 'very promising'. The service is developing a track record of significant improvement with 80 percent of its PIs improving in 2002/03 and 79 percent improving in 2003/04.

Social Services

Overall, Social Services has been rated as a '2 star' service in the recent performance assessment review and is considered to have 'very promising prospects for improvement' with the underpinning leadership, strategic partnerships and performance management systems in place.

One hundred percent of PIs have improved in 2003/04 increasing from 58 per cent in 2002/03. There has been a particularly significant improvement in children's services PIs, raising comparative performance to a position equivalent to 11th from 111th in the country with this element of the service having 'excellent prospects for further improvement'. In addition, the Council's commitment to partnership working and willingness to provide leadership to drive major improvement strategies has been recognised. There has been marked progress

on joint working with the health and education services. New partnership initiatives such as the Fairfield Centre are delivering accessible social and health care services for local people.

Waste management

Waste management is an area where the Council has had considerable problems. It has had difficulty in establishing definitive plans for the future of waste disposal in the county, often for reasons beyond its control. New plans are well developed to improve recycling and waste minimisation through the use of new technology but planning issues are still unresolved. Therefore the situation remains uncertain and represents a significant risk for the Council.

Despite this, the Council has managed to retain its focus on improvement and has worked effectively with district councils to put in place alternative arrangements to improve recycling and waste minimisation. It has achieved its recycling target for 2003/04. However, circumstances have meant that, in general, improvement is occurring from a lower base in this service and at a slower rate.

E- Government

The Council is working effectively with partners in the public and private sectors resulting in improvements in services for local people. For example a network of "one stop shops" across the county has been developed to allow a multi- agency approach to service delivery and better access to services for local people.

Future plans

The Council has clear plans linked to its stated priorities and internal processes and will be strengthened by the development of a new corporate plan. These plans address the key areas of improvement for the Council and are being increasingly informed by community consultation and engagement with residents. Most are underpinned by the necessary investment and identified delivery arrangements. For example, the Council now has an ICT strategy which has funding of £10.7 million over the next three years to improve services.

However, in other areas projects are still in the development phase such as developing shared services with district councils within the county. A significant example of this is the planned joint approach to waste management with the district councils and private sector partners.

Future of CPA

An Audit Commission consultation paper entitled 'Proposals for Comprehensive Performance Assessment from 2005' was launched on 9th December 2004. This paper proposes that, from 2005, single tier and county council CPA will have:

- four categories of scoring reduced from the current five (merging the 'poor' and 'weak' categories);
- a corporate assessment inspection based on a reduced number of themes (ambition for the community, prioritisation, capacity, performance management and achievement);
- the annual updating of service block scores by assessment of performance data/ information rather than inspection;
- some areas of the overall assessment weighted more than others (namely 'use of resources', 'children and young people' and 'social care- adults');
- a different scoring system for service blocks based on the level of service that is provided for service users.

It is also proposed that Joint Area Reviews of children's services will be carried out at the same time as the corporate assessment inspection so that information is shared between the two teams and demands on staff and members is minimised.

The Council has until 18th February 2005 to respond to this consultation with its views on the proposed changes.

Best Value

Under the Local Government Act 1999 we are required to carry out an audit of the Council's Best Value Performance Plan (BVPP). We issued, and reported upon, our audit work in relation to the BVPP issued in June 2003 as part of our prior year audit letter.

We have completed our audit work on the Council's BVPP for the year ended 31 March 2005 and we have issued an unqualified audit opinion on the plan. This work included audit testing of a sample of the Council's best value performance

indicators (BVPIs). We are pleased to report that there were no significant issues arising from this work and we were able to complete our submission of audited BVPIs to the Audit Commission without any 'reservations' on any of the indicators.

Targeted audit and inspection work

As part of the 2003/04 audit we have completed the following targeted audit and inspection work:

- Review of corporate parenting arrangements
- Inspection of Transportation and Road Safety

Corporate parenting arrangements

This report, commissioned at the request of the Cabinet Member for Social Services, Health and Wellbeing, reviews the current arrangements in place within the Council in terms of corporate parenting and makes recommendations, based on best practice, on improving the role Members have in relation to looked after children.

Interviews were conducted with County Councillors, District Councillors, Officers and external agencies for example Connexions to gain a good understanding of the current arrangements in place within the Council; and a documentation review carried out. Internet searches then focused on gathering examples of best practice.

There are a number of operational initiatives in place within Worcestershire specifically targeted at looked after children. However, the review of the current arrangements found that direct involvement in corporate parenting is restricted to a limited number of Councillors, namely the Cabinet Members for Social Services and Education, and that since the loss of the Children and Young People's Panel there is no specific committee or panel to focus exclusively on corporate parenting. Furthermore, the majority of Councillors interviewed felt that Councillors in general would benefit from more information/training to increase awareness of the Council's responsibilities as corporate parent and the measures in place to discharge those responsibilities.

This report makes a number of recommendations including:

- setting up a Corporate Parenting Group;
- annual training for all Councillors on their role as corporate parent, which could be extended to non-executive members of PCT Boards, School Governors and District Councillors;
- active encouragement to District Council partners to identify ways of promoting the take up of leisure, sport, housing and other relevant services by looked after children; and
- holding a one-off awareness raising session for the Council and all stakeholders for example, the PCTs, District Councils, schools; to 'kick start' the programme.

Recommendations are made throughout the detailed report, providing narrative both in terms of existing arrangements within the Council and best practice from other parts of the country.

Inspection of transportation and road safety

A transportation and road safety best value review was carried out by the Council during 2003. The review covered:

- transport policy and strategy;
- sustainability and traffic reduction;
- road safety, including accident studies and school crossing patrols; and
- the delivery of schemes including transportation improvement and road safety, but excluding highways maintenance and public transport.

More than 84 per cent of the Council's highways service is contracted out, including a £1.5m per annum contract for professional and technical consultancy

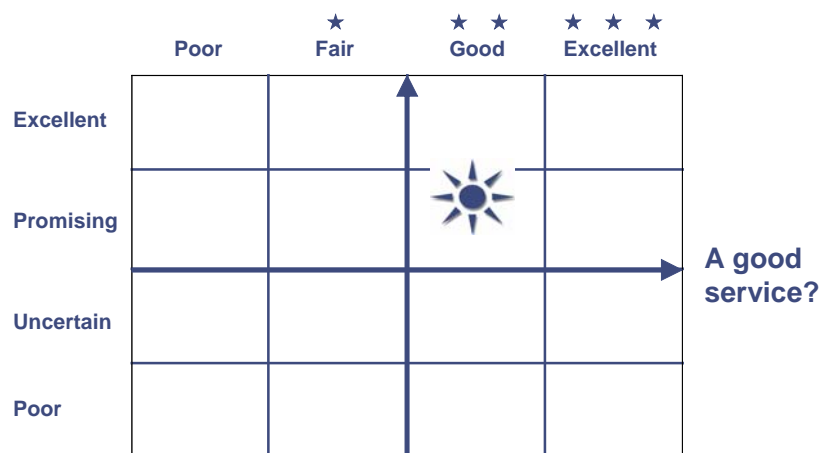
services. The in-house transportation and road safety unit revenue budget was £1.547m in 2003/04 compared to £1.390m in 2002/03. The transportation and road safety unit employed 48 staff in 2003/04.

Our inspection of the service was undertaken in March 2004. We have assessed the Council as providing a 'good' two-star service that has 'promising' prospects for improvement. Our judgements are based on the evidence obtained during the inspection and are outlined below.

- the Council has introduced innovative working practices and is prepared to take measured risks to find new ways of improving services;
- there are good working relationships between the Council and its contractors, as well as a number of other partners in the districts, health sector and community groups; and
- overall the Council has a strong record on road safety.

However, we identified some areas of weakness, as follows:

Prospects for improvement?



- there are areas where target setting and monitoring are weak;
- progress is needed on implementing school travel plans;
- the Council has spread its resources too thinly in some areas and has not maximised the impact of some schemes;
- there are areas where comparative performance on key indicators is lower than average and other areas where performance is not improving.

We judged the service to be 'good' because:

- there are clearly defined aims for the service that are consistently addressed throughout the various levels of community, corporate and service planning;
- there are challenging targets set in many areas and the Council can demonstrate strong delivery against many of these;
- delivery against schemes identified in the local transport plan (LTP) is good;

We judged the prospects for improvement for the service to be promising because:

- there has been a marked improvement in the delivery of the Council's LTP programme in the last two years;
- many important improvement activities are already in hand and the Council has made good progress on 29 of its top 30 improvement actions since the best value review;
- the Council has developed an improvement plan that includes clear actions, identifies how improvement will be measured and defines what impact the actions will have on service users;
- there is clear commitment from members and the corporate management team to support the improvement of this service area;

- the Council was successful in its bid under the “Showcase Transport Town” initiative and additional investment of £3.5m will be available to implement improved transport links in Worcester City. Further investment is also being made to implement school travel plans.

However:

- during the best value review the Council did not consult widely on the service or fundamentally challenge the way in which it is delivered;
- there are pressure points affecting service delivery in working relationships with some partners, particularly Worcester City Council on transport strategy and West Mercia Police on speed limits.

To rise to the challenge of continuous improvement, councils need inspection reports that offer practical pointers for improvement. In this context, we made the following recommendations to the Council:

- focus on the development of school travel plans to support the good work done on safer routes to school;
- review the Council’s approach to communication to ensure that partners, stakeholders and the public are clearly informed about the objectives of specific improvement schemes;
- work with Worcester City Council to find an agreed resolution, as a matter of priority, to the disagreements on transport policy and the structure and management of the transportation partnership unit;
- establish why comparative performance is poor in areas such as pedestrians killed / seriously injured and cyclist slight injuries and identify measures to address this.

The inspection report was published in June 2004. The Council has prepared a detailed action plan in response to the recommendations made in the report.

Accounts and governance

Key issues

The Council prepared the 2003/04 Statement of Accounts in May 2004 which is significantly earlier than in prior years. The Council is well placed to achieve compliance with the Accounts and Audit Regulations which require the Council to approve the Statement of Accounts prior to 30 June by 2006.

We issued an unqualified audit opinion and certificate on the 2003/04 Statement of Accounts in September 2004.

As a result of the introduction of FRS 17, the Council was required to produce more detailed information in 2003/04 than in prior years regarding future pension liabilities. The triennial valuation of the Pension Fund was undertaken at 31 March 2004 and the Council will need to budget for increased employers contribution rates to the Pension Fund in future years.

In 2003/04, the Council managed its expenditure within budget although there were cost pressures in some areas, offset by favourable variances elsewhere. The 2003/04 accounts disclosed a favourable variance of £9.2 million which reflects increased use of borrowing approvals and release of the magistrates courts PFI reserve.

As a result, the Council's revenue balances have increased to £13.6 million at the year end. The Council's overall financial position remains sound. The increased

level of revenue balances in particular, provides the Council with greater flexibility to manage any adverse change in the Council's financial position.

Negotiations are still ongoing to enable the Council's joint waste management PFI contract to achieve the government's new targets for recycling and diversion from landfill using alternative technology to the waste to energy plant. Members will need to consider the financial implications for the Council's medium term strategy if the negotiations are not concluded successfully.

The Council published a Statement on Internal Control (SIC) for the first time in the 2003/04 Statement of Accounts. Arrangements for the management of risk are still being embedded across the Council. Next year, a report setting out the findings of the annual review of effectiveness of internal controls should be prepared at the year end to support the statements made in the SIC. The Chief Executive will need to determine the Council's approach to conducting and documenting this review.

Accounts

The purpose of our accounts work was to perform an audit of the Council's Statement of Accounts, in accordance with approved Auditing Standards.

The Accounts and Audit Regulations 2003 required local authorities to approve the 2003/04 Statement of Accounts by 31 August 2004 which was one month earlier than the prior year. The regulations also require authorities to make further progress in the next two years such that accounts receive Council approval by 30 June each year from 2006.

We are pleased to report that the Council has reacted positively to this new requirement and has been successful in achieving its target to bring forward the timetable for approval of the accounts by two months in 2004, with a view to achieving the three month target 12 months early in 2005. The detailed planning required to achieve this objective should not be underestimated and we commend the performance of the Finance Directorate in particular, in leading this initiative and the contribution of service directorates to achieving the timetable.

We discussed the matters arising from our audit of the Statement of Accounts with the Director of Financial Services in June 2004. We agreed a number of relatively minor changes to the draft accounts arising from the audit and the Director of Financial Services presented our SAS 610 report (setting out the issues arising from our accounts work) to the Cabinet in July 2004. There were no matters in that report that we need to bring to your attention in this letter. The Statement of Accounts was subsequently approved by the Council in July 2004.

The statutory process for local government electors' to inspect the 2003/04 accounts took place in August 2004. We did not receive any questions or objections on the 2003/04 accounts. We issued an unqualified audit opinion and certificate on the 2003/04 Statement of Accounts in September 2004.

We have detailed the specific recommendations arising from our audit work in our Audit Issues Report. Finance staff have agreed an action plan in response to the recommendations we have made. There are no issues we wish to raise with Members.

Financial Reporting Standard (FRS) 17: Retirement Benefits

2003/04 was the first year of full implementation of FRS 17. The FRS is concerned with identifying the real underlying financial position of an authority with

regard to its participation in pension schemes.

Preparation of the disclosures has required the Council to commission expert advice from actuaries and present information about the Council's longer-term financial position than required under previous accounting treatments. We are satisfied that the new pensions disclosures made in the 2003/04 accounts, which do not impact on the revenue account, are consistent with FRS 17.

The local government pension scheme is a funded scheme, meaning that the Council and employees pay contributions into a fund, calculated at a level intended to balance the pension liabilities with invested assets. As at 31 March 2004, the Council's accounts disclosed that Pension Fund assets and liabilities attributable to the Council were in deficit by £99 million, as measured under FRS 17.

The triennial valuation of the Worcestershire County Council Pension Fund undertaken as at 31 March 2004, will inform the Council of its future employer's contribution rates. The results of this valuation will require an increase in employers contribution rates, with effect from 1 April 2005, of 3.7% in total, phased in at 0.6% per annum. This is a significant cost pressure on the Council's revenue budget going forward.

Financial standing

In this section we comment upon the Council's general financial standing taking into account both its performance during the last year and its ability to meet known financial obligations.

The Council's budget for 2003/2004 was set at £437.823 million. The budget reflected the Council's commitment to growth in priority areas such as education, social services, roads, e.government and libraries. This budget reflected an increase of £49.7 million on the prior year and required a council tax increase of 12.97%. Despite this budget increase, the Council remained one of the lowest spending County Councils in the country.

During the year the Council faced additional cost pressures from children's residential placements, increased transport costs and a number of schools facing potential deficits. All these pressures were contained using a combination of in and between year budget flexibility and a favourable variance on money market activity. In aggregate, the Council's final revenue expenditure for the year was £428.579 million, a favourable variance of £9.244 million (2% of budget).

This variance arose because the Council took the opportunity to borrow an additional £4.5 million to finance capital expenditure rather than finance this from the revenue budget, as originally planned. In addition, a £4 million balance relating to grant funding received over the last three years for the Magistrates Courts PFI scheme, was returned to the revenue account. This action followed the government's decision to move responsibility for magistrates courts into a new government agency from April 2005.

Expenditure on capital schemes totalled £46.8 million in 2003/2004 against an original budget of £55.5 million, which was subsequently increased to £65.9 million. This underspend was caused by slippage across a number of schemes. The resources necessary to fund the slippage will be carried forward and spent in the current financial year.

We have continued to review the Council's overall financial position and in particular:

- the level of general balances as a cushion against unforeseen events;
- the level of earmarked reserves set aside to fund future projects or commitments;
- the adequacy of provisions against known liabilities and losses.

The Council's overall level of revenue balances and reserves increased again year on year, from £47.6 million to £62.1 million, primarily as a result of the favourable variance against the revenue budget (£9.2 million) outlined above. As at 31 March 2004, revenue balances totalled £13.6 million and earmarked reserves totalled £48.5 million. Earmarked reserves include £14.2 million of balances which are controlled directly by schools' governing bodies.

The level of revenue balances is equivalent to approximately 3% of the Council's 2004/05 revenue budget or 5% of the budget excluding school's expenditure. This represents a reasonable level of balances to act as a cushion against unforeseen events and is in line with the 5% benchmark suggested by the Audit Commission in its methodology for auditors scored judgements of financial standing, used in the CPA process.

In our view the Council continues to pursue a sensible financial strategy and the overall financial position of the Council remains sound. The increased level of revenue balances in particular, provides the Council with greater flexibility to manage any adverse change in the Council's financial position.

Financial outlook

The Council has set a revenue budget of £453.345 million for 2004/05 which allowed further investment in the Council's key priority areas. This resulted in a Council Tax increase of 5.1%.

Budget monitoring in the first six months of the current financial year has identified several budget pressures including social services residential placements, the education music service and the impact of the local government staff pay award. Favourable variances continue to arise from treasury management activities. Based on the reporting to date, it seems likely that expenditure will be managed within the budget for the financial year, without having to call on revenue balances.

Waste management private finance initiative contract

In 1998 the Council, in partnership with Herefordshire Council, entered into a joint waste management PFI contract over 25 years. The contract transferred ownership of all existing waste management facilities from the Council's waste disposal company to the contractor (Mercia Waste) and in turn, required the contractor to invest in new facilities and technologies in order to achieve specified government targets for recycling. The contractor planned to achieve this by constructing and operating a waste to energy incineration facility. However, planning consent for this facility was declined on appeal in 2002.

Since the planning permission for the waste to energy plant was refused, the Council has worked with the contractor to seek alternative solutions which will allow the Council to meet the new targets while remaining affordable and providing value for money. The proposed solution involves engaging a sub-contractor who will operate a number of steam sterilisation treatment facilities using the autoclave process which will recover recyclable materials and also produce a residual fibre which can be used in the manufacture of other products.

Since the PFI contract was signed in 1998, government targets for recycling at a higher level than specified in the contract have been introduced and also targets for diversion of waste from landfill sites have been announced. Variations to the contract are therefore required to ensure that these targets are reflected in the contract. Variations are also required to reflect the proposed autoclave solution and, in particular, to protect the Council's interests in connection with the viability of the sub-contractor and their funding banks. In July 2004, the Cabinet authorised officers to enter into these variations, although the contract has not been changed, pending the outcome of further negotiations with the contractor.

Until the discussions with the contractor are finally concluded, there remains a risk that the contract could terminate. Contract termination could have a significant impact on the financial standing of the councils, because:

- termination clauses in the original contract will require the councils to repay the contractors shareholder equity in exchange for bringing waste management assets and facilities back in-house;
- the councils are likely to have to enter into a new contract in order to achieve the objectives of the Waste Management Strategy. Re-procurement costs are likely to be significant and the councils would be unlikely to secure the level of government PFI funding that was made available for the existing contract;
- the inherent delay in putting new contract arrangements in place would expose both councils to potential future financial penalties under the Waste Emissions and Trading Act for failing to meet landfill diversion targets.

Members need to be mindful of these significant financial risks in particular, in considering the Councils medium term financial strategy.

We have agreed to hold a further meeting with officers to discuss progress and the resolution of outstanding issues, prior to the finalisation of the variations to the contract that are currently being negotiated. This meeting will include the auditors of Herefordshire Council to ensure that a consistent audit view is taken on any issues arising.

Prudential Framework for capital expenditure

From 1 April 2004, the Council has been able to plan its capital expenditure under the new Prudential Framework, which focuses on the Council's ability to afford the consequences of spending decisions from future years' revenue accounts and allows it to set its own limits on the borrowing needed to achieve an affordable capital strategy.

We have reviewed the steps the Council took in 2003/04 to prepare for the implementation of the Prudential Framework, including the process for setting limits and indicators under the CIPFA Prudential Code. We are satisfied that the Council has made good progress in implementing the Prudential Framework, although going forward, we will need to review the effectiveness of the Council's monitoring arrangements for the Prudential Framework, following the first full year of operating the new system.

Statement of internal control

The Accounts and Audit Regulations 2003 included a new requirement that the statement of accounts should contain a statement on internal control (SIC) from 2003/04. The SIC refers to much wider systems of control than purely financial systems and requires the Council to have in place such systems of control. Local authorities are required to conduct an annual review of the effectiveness of the system of internal control, which will provide the findings to support the SIC.

The Council's SIC describes the purpose of the system of internal control and in particular, the link to the Council's risk management arrangements. These arrangements were subject to further review and development during 2003/04 and as such the arrangements were not fully embedded for the whole of the year. We will review progress with this again as part of our 2004/05 audit.

The Council's SIC also refers to an annual review of effectiveness of the Council's system of internal control. This is a new concept and in 2003/04 it was conducted based on cumulative knowledge. For 2004/05 we would expect to see a formal year end report prepared, setting out the findings of the annual review. This would need to set out the sources of assurance in relation to the principal risks in each operational area. The purpose of such a report is to provide the basis for the Chief Executive and Council Leader to sign off the SIC and to consider whether there are any significant internal control issues that require disclosure. The Chief Executive should determine the Council's approach to conducting and documenting this review.

The results of our review of systems of internal financial control at the Council are set out in our Audit Issues Report, referred to above. There were no significant issues that need to be reported in this letter. Overall we concluded that the operation of the Council's systems was sufficient to support our planned audit approach.

Internal audit

In accordance with the 'managed audit' approach we worked closely during the year with internal audit to ensure that between us we achieved appropriate coverage of the Council's key financial systems.

In addition, we undertook a specific review of the Council's internal audit function to assess compliance against the CIPFA's Internal Audit Code of Practice published in November 2003. It is expected that all local authorities should comply with the best practice guidance set out in the Code of Practice.

Our review identified the need in some areas to strengthen compliance with the Code and we have made a number of recommendations in our Audit Issues Report. We will follow up progress being made by the Council in implementing our recommendations as part of our 2004/05 audit work.

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

We are pleased to report that there are no issues arising from our audit work in relation to financial conduct and the prevention and detection of fraud and corruption that we wish to bring to your attention.

The legality of financial transactions

We are pleased to report that there are no issues arising from our audit work in relation to the legality of financial transactions that we wish to bring to your attention.

Auditors' scored judgements

Under the Code of Audit Practice each year we are required to submit 'auditor scored judgements' to the Audit Commission as part of the Comprehensive Performance Assessment (CPA). Based on set criteria we are required to 'score' the Council under each of the five categories for assessment. The results of our assessment are set out below.

Category	Score
Financial standing	4
Internal financial control	3
Standards of financial conduct and prevention of fraud	4
Financial statements	4
Legality of significant financial transactions	4

1= inadequate; 2= adequate overall/some weaknesses; 3= adequate; 4= better than adequate.

These scores are consistent with last year.

Grant claims certification

As the appointed auditor to the Council, we are required to certify a number of the Council's grant claims on behalf of the Audit Commission. This certification work does not form part of our audit work, and is subject to separate fees. Following the completion of our grant certification work for 2002/03, we discussed with the Council areas where both we and the Council could improve the efficiency and effectiveness of this work, particularly as the Audit Commission has introduced new certification arrangements for 2003/04.

A number of improvements to processes have been put in place and we will review the position again on completion of grants certification work for 2003/04 claims and returns.

Audit and inspection plan 2004/05

Audit Plan 2004/05

We have issued our Audit Plan for 2004/05 and we are discussing the scope of the proposed work with officers. Given the dynamic environment within which you operate, we have revisited our Audit Plan to ensure that it remains appropriate for the 2004/05 financial year and that it reflects the range of risks facing the Council.

Inspection Plan 2004/05

As the Council has achieved 'excellent' status in CPA 2004, there will be no planned Audit Commission inspection work for 2005/06. Neither will there be a requirement for a formal Qualitative Assessment of progress against the Council's improvement priorities over 2004/05, unless the Council requests this.

Fees update for 2003/04

We reported an update to our audit plan for 2003/04 to the Cabinet in March 2004. We can confirm that our actual fees for the 2003/04 audit were in line with this estimate (£214,000). In addition, there were further fees for the certification of grant claims and returns on behalf of the Audit Commission (£118,000)

Fees for statutory inspection work, payable to the Audit Commission, for 2003/04 were £34,000.

Appendix A: Audit and inspection reports issued in relation to the 2003/04 financial year

- Update to audit service plan
- Grants report
- SAS 610 report
- Audit issues report
- Audit opinion on the 2003/04 statement of accounts
- Opinion on the 2004/05 BVPP
- CPA auditor scored judgements
- Review of corporate parenting arrangements
- Inspection report on transportation and road safety
- Inspection report on corporate assessment

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