

Annual Audit Letter

Royal Borough of Kensington and Chelsea

Audit 2009/10

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As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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Key messages

This letter summarises my findings from the 2009/10 audit. My audit comprises two elements:

- **the audit of the Royal Borough's financial statements (pages 4 to 6); and**
- **my assessment of the Royal Borough's arrangements to achieve value for money (VFM) in its use of resources (pages 7 to 10).**

I have included only significant recommendations in this letter. The Royal Borough has accepted these recommendations.

Financial statements

1 I issued unqualified opinions on the 2009/10 financial statements of the Royal Borough and its pension fund on 29 September 2010. I also issued an unqualified opinion on the Royal Borough's whole of government accounts (WGA) submission to Communities and Local Government on 30 September 2010. I have also certified completion of the 2009/10 audit, following my predecessor's certification of the 2008/09 audit.

Value for money

2 I issued an unqualified conclusion on 29 September 2010 stating the Royal Borough had proper arrangements to secure economy, efficiency and effectiveness in its use of resources during 2009/10.

Current and future challenges

3 The Royal Borough, in common with other public sector bodies, is facing significant financial constraints. Action has already been taken to reduce costs and increase efficiency. Financial plans have been revisited to respond to the reduction in future income announced in the recent spending review (SR), requiring planned savings from 2012/13 and the longer term to be brought forward. Maintaining financial management disciplines will remain critical as the Royal Borough continues to respond to this challenging agenda.

4 The implementation of International Financial Reporting Standards (IFRS) presents a new challenge in 2010/11 for the preparation of the Royal Borough's financial statements. The Royal Borough has made good progress to date. However, challenges remain, in particular with regard to group accounting requirements.

Audit fees

5 I report at appendix 1 the out-turn audit fees for the 2008/09 and 2009/10 audits:

- out-turn fees for 2009/10 are in line with the proposed fees; and
- out-turn fees for 2008/09 reflect the additional fees for the audit work required in response to the 2008/09 objections on aspects of waste management and to issues raised by members of the public about Members' expenses. Both pieces of work are reported in this letter.

Financial statements

The financial statements and annual governance statement are an important means by which the Royal Borough accounts for its stewardship of public funds.

Main financial statements

6 I reported the findings of my audit of the Royal Borough's main 2009/10 financial statements to the Audit Committee on 14 September 2010 in my annual governance report. My report was updated on 27 September 2010 for my final conclusions.

7 I issued an unqualified opinion (and certified the completion of the audit) on 29 September 2010. The Royal Borough prepared its financial statements on a timely basis and provided appropriate working papers. The key issues arising from the audit were in respect of the accounting treatment of the Royal Borough's sale of land on the Holland Park School site. This is a complex, material transaction, the key elements of which are as follows.

- A deposit of 10 per cent at completion.
- A leaseback to the Royal Borough for a period of 3.5 years.
- The balance of the purchase price, receivable on the handover of the lease.
- Rights to overage in respect of the development of the site.

8 Two main issues were identified at audit:

- A required adjustment to account for the deferred capital receipt as a reserve rather than a long-term creditor in accordance with revised CIPFA guidance.
- A required adjustment to account for the value of the leaseback, offset by an adjustment to discount the deferred capital receipt to present value that would have reduced the value of the debtor as at 31 March 2010, together with associated disclosures, including of related accounting policies and the valuation and risks associated with the deferred capital receipt.

9 Only the adjustment to account for the deferred capital receipt as a reserve was made. The Royal Borough is intending to obtain external accounting advice to inform its approach to accounting for the other issues identified in its 2010/11 financial statements.

Recommendation

R1 Review the accounting treatment of the Royal Borough's sale of land on the Holland Park School site in the 2010/11 financial statements having regard to the accounting advice to be obtained.

Pension fund financial statements

10 I also reported the findings of my audit of the Royal Borough's 2009/10 pension fund financial statements to the Audit Committee on 14 September 2010. I reported that the financial statements presented for audit did not balance by some £2 million. As such, a number of errors requiring adjustment were identified in the course of my audit, reflecting weaknesses in the processes for the production of the financial statements rather than ongoing internal control failures. The errors were raised with - and adjusted by - officers. The revised financial statements were therefore much improved and I issued an unqualified opinion on 29 September 2010. Nevertheless, the arrangements for compiling the pension fund financial statements and supporting audit trails require improvement in 2010/11.

Recommendation

R2 Ensure the 2010/11 pension fund financial statements presented for audit are quality assured by officers and Members, reconciled to the general ledger and underlying records and supported by comprehensive working papers.

Whole of government accounts

11 I was also able to certify the Royal Borough's WGA return on 30 September 2010, in advance of the submission deadline of 1 October 2010.

Objections to the 2008/09 financial statements

12 My predecessor, Kash Pandya, received objections to the Royal Borough's 2008/09 financial statements in September 2009 with regard to the alleged collection of commercial waste without charge and the alleged overcharge of street traders for waste management.

13 Mr Pandya considered the submissions from the objectors, their representative and the Royal Borough and all material documents. He issued his decision and statement of reasons on 29 July 2010. Mr Pandya decided not to exercise his statutory powers. However, he made a number of recommendations for improvements in the Royal Borough's systems and processes for collecting commercial waste and levying market waste collection charges, including the following.

- Officers should report to Members the progress made to minimise the level of commercial waste collected without charge over recent years.

- Members should be asked to consider and approve the cost and VFM implications of the policies adopted for commercial waste collections.
- Officers should continue to work closely and as a matter of priority with the Portobello and Golborne Management Committee to identify an appropriate model for assessing waste collection charges to the Street Markets Trading Account.

14 Following his decision, Mr Pandya certified completion of the 2008/09 audit on 19 August 2010. His decision and statement of reasons was considered by the Audit Committee on 14 September 2010.

Recommendation

R3 Report progress to the Audit Committee on the implementation of the audit recommendations made with regard to the objections on commercial waste collection and market waste collection charges.

Value for money

I considered whether the Royal Borough was managing and using its money, time and people to deliver VFM. I assessed the Royal Borough's performance against the criteria specified by the Audit Commission and have reported the outcome as the VFM conclusion.

Use of resources' assessments

15 At the end of May 2010, the Commission wrote to all chief executives to inform them that, following the government's announcement, work on the comprehensive area assessment would cease with immediate effect and the Commission would no longer issue scores for its use of resources' assessments.

16 I am still, however, required by the Code of Audit Practice to issue a VFM conclusion. I have therefore used the results of the work completed on the use of resources' assessment up to the end of May 2010 to inform my 2009/10 conclusion.

Value for money conclusion

17 I assessed the Royal Borough's arrangements to achieve economy, efficiency and effectiveness in its use of money, time and people against criteria specified by the Audit Commission. The Audit Commission specifies each year which key lines of enquiry (KLOEs) are the relevant criteria for the VFM conclusion at each type of audited body.

18 A summary of my findings is shown overleaf.

Criteria	Proper arrangements?
Managing finances	
Planning for financial health	Yes
Understanding costs and achieving efficiencies	Yes
Financial reporting	Yes
Governing the business	
Commissioning and procurement	Yes
Use of information	Yes
Good governance	Yes
Risk management and internal control	Yes
Managing resources	
Strategic asset management	Yes
Workforce	Yes

19 I issued an unqualified conclusion on 29 September 2010 stating the Royal Borough had proper arrangements to secure economy, efficiency and effectiveness in its use of resources during 2009/10. To reach this conclusion, I used my 2008/09 assessment as a baseline and focused on changes in the Royal Borough's arrangements and performance during 2009/10, informed by other ongoing audit work reported in this letter.

20 The Royal Borough has continued to deliver strong performance across the KLOEs assessed during 2009/10, demonstrating innovative practice, in particular with regard to planning its finances effectively to support its strategic priorities and in the commissioning of quality services and supplies, tailored to local needs that deliver sustainable outcomes and VFM.

21 Enhancements in arrangements and outcomes achieved during 2009/10 include the following.

- Demonstrating a good understanding of costs and continuing reductions in unit costs across services. Overall, where areas of high spend occur in key services such as children's services and adult social care, the Royal Borough can demonstrate high outcomes. Indeed, outcomes remain amongst the best in London. While the Royal Borough continues to look to new ways to reduce costs, for example through its 'cost-challenge' pilots, it is important given the increasing financial constraints the Royal Borough faces that savings are achieved from the small number of services which remain comparatively higher cost/lower quality.

- Leading work with partners to reduce costs, for example, the joint work to provide supported living services for those service users with complex mental health needs who would otherwise remain in semi-secure hospital settings.
- Demonstrating continued high levels of customer satisfaction, with 83 per cent of residents in the annual survey of Londoners 2010 saying the Royal Borough is doing a good job, with 77 per cent agreeing that the Royal Borough is efficient and well-run.
- Improving its understanding of the ownership, use and cost of all public assets in the borough, working jointly with NHS Kensington and Chelsea, the police, fire service, Transport for London and registered social landlords. Some services have already been located with those of partners, for example, several social work teams are based within the PCT estate.

22 This year, for the first time, I also reviewed how the Royal Borough manages its staff to meet current and future needs and deliver VFM. I found the Royal Borough has a productive and skilled workforce and a workforce strategy setting out clear aims for the next three years.

Members' expenses

23 During the course of my audit, I have considered matters drawn to my attention by members of the public concerning alleged weaknesses in controls exercised by the Royal Borough in its arrangements for administering and disclosing expenses paid to Members. My findings were reported to the Audit Committee on 22 June 2010.

24 I concluded that the Royal Borough's arrangements for the payment of Members' allowances, through its Members' allowance scheme, were in accordance with the governing Regulations. I also concluded that the vast majority of Members' expenses were reimbursed in accordance with the scheme. However, a small number of exceptions were identified, in part reflecting the absence of the detailed consideration by the Royal Borough of its arrangements for the reimbursement of incidental expenses and travel and subsistence expenses incurred on Members' training and development and attendance at conferences. The costs - and incidental expenses - of such activities are small, representing a fraction of the Royal Borough's expenditure on Members' expenses. The Royal Borough has clarified and documented its arrangements in this regard for 2010/11.

25 My report contained a number of recommendations to assist the Royal Borough in maintaining sound governance arrangements going forward that were agreed by officers and the Audit Committee.

Approach to local value for money work from 2010/11

26 Given the scale of pressures facing public bodies in the current economic climate, the Audit Commission has been reviewing its work programme for 2010/11 onwards. This review has included discussions with key stakeholders of possible options for a new approach to local VFM audit work. The Commission aims to introduce a new, more targeted and better value approach.

27 My work will be based on a reduced number of reporting criteria, specified by the Commission, concentrating on:

- Securing financial resilience.
- Prioritising resources within tighter budgets.

28 I will design a local programme of VFM audit work based on my audit risk assessment, informed by these criteria and my statutory responsibilities. I will no longer be required to provide an annual scored judgement relating to my local VFM audit work. Instead, I will report the results of my local VFM audit work and the key messages for the Royal Borough in my annual report to those charged with governance and in my annual audit letter.

Current and future challenges

While the main focus of this letter is financial year 2009/10, I also consider current and future challenges facing the Royal Borough in the context of my responsibilities.

Financial health

29 The wider financial outlook continues to be challenging for the public sector. Public sector bodies are less able to fund service delivery and capital programmes, reflecting increasing pressures on income streams. Challenges to policy priorities are occurring as patterns of demand for services are changing. Local government has also had to respond to a significant drop in its grant income from central government following the outcome of the SR announced on 20 October 2010.

30 The Royal Borough has continued to manage its budget well over recent years. For 2010/11, the latest budget-monitoring review as reported to Cabinet in October 2010 shows a forecast net underspend of £2.7 million. However, this outcome is not without risk, in particular with regard to the delivery of savings plans and the pressures on income streams over the remainder of the year.

31 The Royal Borough is also implementing plans to freeze the pay of its top 800 staff, together with reducing management costs by 15 per cent. In addition, other Royal Borough initiatives, such as the SPACE initiative, are designed to generate further cost efficiencies.

32 In the medium term, the Royal Borough had originally estimated that budget savings of nearly £8 million would be required for 2011/12 to bridge an assumed grant reduction of six per cent in real terms and to deliver no increase in council tax, assuming some additional contribution from government to fund this. Financial plans have now been revised to reflect the drop in future income following the recent SR, bringing forward planned savings from 2012/13 and the longer term. Funding implications for the Royal Borough will be clarified following the Finance Settlement in December 2010.

33 Capital resources are also increasingly constrained. The Royal Borough has a significant current and forward capital programme. The latest forecast 2010/11 out-turn of £76 million, as reported to the Cabinet in October 2010, shows £23 million slippage into 2011/12, mainly on the Holland Park School project and the SPACE programme. The economic climate presents challenges to the Royal Borough's future capital plans through the reduced availability of funding streams and other related risks, such as changes in property values. The Royal Borough will therefore need to continue to manage these challenges effectively.

Local priorities and challenges

34 The Royal Borough has revisited its priorities in response to changes in the national agenda, prioritising:

- reviewing its medium term financial strategy to respond to budget changes and the outcome of the SR;
- responding to the government's agenda on the 'Big Society';
- determining its response to national initiatives on local government transparency and trust; and
- rethinking the fundamentals of public service delivery.

35 The Royal Borough also reviewed its Vital Improvements Programme in July 2010, updating its priorities for the local area. Revised priorities were agreed to:

- organise efforts to regenerate North Kensington, including schemes covering an academy, leisure centre and a Crossrail station;
- support the delivery of the Wornington Green redevelopment;
- respond to plans for the redevelopment of the Earl's Court Exhibition Centre site; and
- review and improve customer services and processes within Planning and Borough Development.

36 In response to the challenging financial climate, the Royal Borough is continuing to focus on maintaining strong financial management processes and the identification of efficiencies. Key to its plans is its work with the City of Westminster Council and the London Borough of Hammersmith and Fulham to achieve closer collaboration and integration. The Royal Borough needs to ensure that this innovative development is underpinned by appropriate governance arrangements, for example to:

- manage the transition;
- maintain the roles and responsibilities of statutory officers;
- avoid actual and/or perceived conflicts of interest;
- maintain constitutional integrity;
- address legal, financial and risk management requirements; and
- allow for and manage potential termination/withdrawal.

Recommendations

R4 Maintain focus on reviewing financial strategies and financial management processes, incorporating the continued identification of efficiencies.

R5 Underpin closer collaboration and integration with the City of Westminster Council and the London Borough of Hammersmith and Fulham with appropriate governance arrangements.

International Financial Reporting Standards

37 Local authorities will prepare their financial statements under the new IFRS based Code of Practice on Local Authority Accounting from 2010/11. The move to IFRS does not mean wholesale change, but where changes do occur, a significant amount of work is needed to assess the impact on the financial statements. Much of that work needs doing now as the 2009/10 financial statements will need to be restated to provide the prior-year balances in the 2010/11 financial statements.

38 I have undertaken two surveys that assess the Royal Borough's preparations for reporting under IFRS in 2010/11. I have concluded that the Royal Borough has made steady progress to date. It has an IFRS project team and an action plan in place against which progress is monitored regularly by the Audit Committee. However, challenges remain, in particular to conclude the Royal Borough's assessment of the requirements for group accounting, where CIPFA guidance is awaited. I will continue to work closely with the Royal Borough as it prepares for the move to IFRS in 2010/11.

Recommendation

R6 Continue to deliver the IFRS action plan, reporting progress to the Audit Committee on an ongoing basis.

Closing remarks

39 I have discussed and agreed this letter with the Executive Director for Finance, Information Systems and Property. I will present the letter to the Audit Committee on 5 January 2011 and Cabinet on 6 January 2011. Copies will be provided to all Royal Borough Members.

40 Detailed findings, conclusions and recommendations in the areas covered by my audit were included in the reports issued to the Royal Borough during the year.

Report	Date issued
Certification of claims and returns - annual report	February 2010
Opinion audit plan	March 2010
Review of arrangements for Members' expenses	May 2010
Decision and statement of reasons on 2008/09 objections	July 2010
Certificate 2008/09	August 2010
Annual governance report on the main 2009/10 financial statements	September 2010
Annual governance report on the pension fund 2009/10 financial statements	September 2010
Opinions (main financial statements, pension fund financial statements and WGA) and VFM conclusion 2009/10	September 2010
Certificate 2009/10	September 2010

The abolition of the Audit Commission

41 The Secretary of State for Communities and Local Government announced in August 2010 the proposed abolition of the Audit Commission from 2012. The government has announced its plan to seek legislation in this session of Parliament to effect this.

42 The Audit Commission's Managing Director, Local Government and Community Safety has written to the Town Clerk and Chief Executive to confirm there is no immediate change to the audit arrangements for the Royal Borough. My focus remains on maintaining the high-quality audit service the Royal Borough expects.

43 The Audit Commission is in discussion with Communities and Local Government about the proposed legislation and the details that will need to be worked through. I will keep the Royal Borough informed about progress.

Acknowledgement

44 The Royal Borough has taken a positive and helpful approach to my audit. I would like to thank officers and Members for their support and cooperation during the course of my audit work.

Michael Haworth-Maden
District Auditor

November 2010

Appendix 1 – Audit fees

Main audit	2009/10 £000	2008/09 £000
Financial statements	184	181
Value for money	86	86
Additional audit fee: 2008/09 objections	-	76
Additional audit fee: Members' expenses	-	26
Total audit fees	270	369

Pension fund audit	2009/10 £000	2008/09 £000
Financial statements	35	38
Total audit fees	35	38

The planned fee for the main 2009/10 audit was some 14.5 per cent below the Audit Commission's scale fee, amongst the lowest in London. The planned fee for the pension fund 2009/10 audit was in line with the scale fee for London Borough pension funds. Fees for the 2009/10 audits reported above are in line with the planned fees.

The two additional 2008/09 fees arose from the consideration of issues raised by members of the public. The results of these two pieces of work are set out in this letter and have been reported to the Audit Committee during 2010.

The 2009/10 grant certification programme is in progress. I will provide an update on the outturn fee at the Audit Committee on 5 January 2011.

Appendix 2 – Glossary

Annual governance statement

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

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

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

Audit opinion

On completion of the audit, auditors must give their opinion on the financial statements, including:

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

Financial statements

The annual accounts and accompanying notes.

Qualified

The auditor has some reservations or concerns.

Unqualified

The auditor does not have any reservations.

VFM conclusion

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of money, people and time.

Appendix 3 – Action plan

Recommendations

Recommendation 1

Review the accounting treatment of the Royal Borough's sale of land on the Holland Park School site in the 2010/11 financial statements having regard to the accounting advice to be obtained.

Responsibility	Head of Financial Services
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Priority	High
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Date	January 2011
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Comments	We are in the process of obtaining independent advice on the accounting treatment of this transaction and expect to conclude this matter well before the end of this financial year, having had discussions with external audit and agreed any adjustment required.
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Recommendation 2

Ensure that the 2010/11 pension fund financial statements presented for audit are quality assured by officers and Members, reconciled to the general ledger and underlying records and supported by comprehensive working papers.

Responsibility	Head of Financial Services
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Priority	Medium
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Date	March 2011
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Comments	An action plan has been put in place and is being monitored on a monthly basis to ensure that these issues do not recur for the 2010/11 accounts. Satisfactory progress is being made in all areas.
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Recommendation 3

Report progress to the Audit Committee on the implementation of the audit recommendations made with regard to the objections on commercial waste collection and market waste collection charges.

Responsibility	Director of Waste Management, Culture and Leisure
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Priority	Medium
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Date	March 2011
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Comments	We have conducted another waste audit, overseen by the Chairman of the Portobello and Golborne Management Committee (PGMC). We are close to appointing a waste consultant to review the facts and give advice to the Council and PGMC. We expect to report to the Audit Committee on 23 March 2011.
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Recommendation 4

Maintain focus on reviewing financial strategies and financial management processes, incorporating the continued identification of efficiencies.

Responsibility	Executive Director for Finance, Information Systems and Property
Priority	High
Date	Continuing at least annually
Comments	Our usual processes will be adapted and complemented by tri-borough work.

Recommendation 5

Underpin closer collaboration and integration with the City of Westminster Council and the London Borough of Hammersmith and Fulham with appropriate governance arrangements.

Responsibility	Executive Director for Finance, Information Systems and Property
Priority	High
Date	February 2011
Comments	The three Council Cabinets will determine the scale of the programme and will receive advice then on governance.

Recommendation 6

Continue to deliver the IFRS action plan, reporting progress to the Audit Committee on an ongoing basis.

Responsibility	Head of Financial Services
Priority	High
Date	May 2011
Comments	We are continuing to make progress with the changes that will be required for the 2010/11 accounts to be IFRS compliant. We will be working closely with external audit to ensure that this is the case. Progress towards compliance will be reported to the Audit Committee on a quarterly basis.

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