Annual Audit Letter

Metropolitan Police Authority

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The purpose of this Letter

This Annual Audit Letter (AAL) to the Metropolitan Police Authority (MPA) is issued in accordance with the requirements of the Audit Commission’s Code of Audit Practice.

The AAL summarises for Members the more important matters arising from our audit for 2001/2002 and comments on other current issues. We have produced separate reports during the year on completion of specific aspects of our work, which have been discussed in detail with staff of the MPA and the Metropolitan Police Service (MPS). The reports are listed at the end of this Letter for Members’ information.

The Audit Commission has, in recent years, 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.

Audit objectives

Audit work is based on the significant financial and operational risks that the MPA and the MPS face and is structured around the three main elements set out below.

EXHIBIT 1

The three main elements of the audit

Our integrated audit covers

Accounts
- Opinion

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

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

Our audit has addressed the requirements of the Code of Audit Practice and we have worked with the MPA and the MPS to maximise the benefits of the integrated audit approach. We have reviewed your arrangements for dealing with risks and we have undertaken more detailed work in selected areas of higher audit risk. Wherever possible we have liaised with other review agencies, both internal and external and in particular, with Her Majesty’s Inspector of Constabulary (HMIC) and your own Internal Audit Service.
Overview

This is our second AAL to the Authority. In our first Letter, we had commented on the commitment of Members and senior staff to the changes that were taking place at the MPA/MPS and the clear desire to translate the vision for policing in London into reality, while also highlighting the enormity of the task ahead, given the extent of the weaknesses in the infrastructure of the organisation. We had concluded that the change programme needed was unlikely to be achieved for some time, but that we expected to see stepped improvements.

Our overall conclusion this year is that the change programme is beginning to take effect in a number of key areas, for example, the financial position has improved and police recruitment is running at record levels. There is much to praise in the achievements so far and we refer to these in more detail elsewhere in the Letter.

Nevertheless, there is no room for complacency, a significant amount still remains to be done to strengthen the infrastructure of the MPA/MPS and deliver further tangible improvements. Some of the more difficult improvements to achieve, for example devolved financial accountability, will require substantial cultural change. Given the size and complexity of the organisation, these will not readily be achieved within short time scales. Efforts to achieve these changes should be continued and we will expect to see further stepped improvements in the coming year.

The key messages from our work are set out in the paragraphs below.

KEY MESSAGES

Accounts

The financial statements for 2001/2002 were prepared to a tighter timescale than last year. This is a considerable achievement which allowed us to conclude our audit of the MPA’s financial statements by ** December 2002.

We have qualified our opinion on these statements because of reservations about the adequacy of the provisions set aside to meet third party and police pension liabilities and weaknesses in the arrangements for valuing fixed assets.

Financial aspects of corporate governance

Financial standing

Tighter budgetary control arrangements have strengthened the Authority’s financial position. However it remains fragile and will continue to require close monitoring, with working balances still only the equivalent of five days net expenditure. Cultural change initiatives that support local accountability and financial control remain an essential pre-requisite to driving forward the improvement agenda. The budget round for 2003/2004 will be difficult and hard decisions about levels of service will need to be taken.

Systems of internal financial control

We recognise the efforts being made to strengthen financial controls and systems within the MPA/MPS. At present, the systems of internal financial control still require further development and continue to leave the MPA/MPS vulnerable to criticism and potential loss. The effective management of the move to a more devolved structure will be key to further improvements in this area.

Legality of financial transactions

The Authority’s arrangements for ensuring the legality of transactions with financial consequences have been strengthened but still need further development.

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

Arrangements for maintaining standards of conduct, and for preventing and detecting fraud and corruption, are improving.
Performance management

Best Value Performance Plan

Our opinion on the Best Value Performance Plan (BVPP) was unqualified this year. The quality of the performance information in the plan was higher but does require further improvement.

The MPA has demonstrated a strong commitment to Best Value and some progress has been made towards a comprehensive performance management framework. The challenge now is to ensure that both completed and future Best Value reviews deliver tangible service improvements.

Use of Resources

We have assessed the MPA/MPS’s management arrangements for ensuring the effective use of resources across a range of activities. They demonstrate good practice in a number of the areas we have looked at. Efforts need to be continued to secure greater consistency in applying good practice across the organisation.
Accounts

The financial statements for 2001/2002 were prepared to a tighter timescale than last year. This is a considerable achievement which allowed us to conclude our audit of the MPA’s financial statements by ** December 2002.

We have qualified our opinion on these statements because of reservations about the adequacy of the provisions set aside to meet third party and police pension liabilities and weaknesses in the arrangements for valuing fixed assets.

The production of this years’ accounts to the earlier timetable set by the Treasurer was a significant achievement, given the limited skilled resource available. The accounts presented for audit were of a generally good standard and were substantially compliant with required accounting practice. Furthermore, compliance with the CIPFA Best Value Accounting Code of Practice was achieved, which is a major improvement on last year.

We concluded our accounts audit and issued our opinion audit on ** December 2002, which was earlier than last year. There are though, still a number of areas where significant improvements are required. Our opinion was qualified in three respects:

- the provision made against the third party liabilities carried by the MPA at 31 March 2002 is inadequate at £13.3m, given that the total liability is estimated to be some £45m
- the accounts contain a provision of £27.7m in respect of police pension liabilities for officers over the age of 55 or who can retire with one month’s notice. However, at 31 March 2002, the potential pension liability for these officers stood at £50.8m
- the lack of robust valuation arrangements for fixed assets, included in the accounts at a value of £717m, mean we cannot gain assurance that these are correctly stated or that the appropriate amount of depreciation has been charged on them.

In addition, there are a number of material outstanding debtor and creditor balances in the accounts relating to the affairs of the former Inner London Probation Service and the Inner London Magistrates Court Service. These need to be promptly resolved with the successor bodies and their impact, if any, on reserves quantified.

Despite these issues, we do recognise that considerable progress has been made in building up the two provisions referred to above to the levels they are now at.

Future accounting developments, including the new accounting standard FRS17, on pension liabilities, will have a significant impact on the disclosures in the accounts. Your Treasurer and his finance staff are working on these matters at present.

Financial aspects of corporate governance

We have considered the arrangements in place in the following areas:

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

Financial standing

Tighter budgetary control arrangements have strengthened the Authority’s financial position. However it remains fragile and will continue to require close monitoring, with working balances still only the equivalent of five days net expenditure. Cultural change initiatives that support local accountability and financial control remain an essential pre-requisite to driving forward the improvement agenda. The budget round for 2003/2004 will be difficult and hard decisions about levels of service will need to be taken.

General Fund net expenditure for the 2001/2002 financial year was £8.8m (0.4%) lower than the total budget of £2,040m. This was a considerable
achievement but was the result of both under and over spendings on a number of budget heads. The main areas of overspend were police overtime (again), police pay and forensic analysis. An underspend occurred on civil staff pay and income from partnerships and other sources was higher than anticipated. These variances demonstrate the continued volatility of the overall budget.

The disciplines imposed through the ‘star chamber’ process, introduced as a result of the overspendings identified during the early part of the financial year, showed what can be achieved. The lessons learned can usefully be applied in further strengthening budgetary control in the organisation. Rigorous monitoring of the 2002/2003 budget for the reminder of the financial year remains vitally important.

The volatility of the budget and the difficulties experienced in controlling it make it more essential, than would be the case in organisations with more effective budgetary control systems, to maintain an adequate level of general reserve.

The overall underspend in 2001/02 allowed the MPA to transfer additional sums to the general reserve and to provisions. The reserve stood at some £22.3 million (just over 1% of budget or the equivalent of around 5 days total expenditure) at 31 March 2002 (£13.5m at 31 March 2001).

While this is an improvement, there is no room for complacency. The Authority must take action to ensure that future plans and budgets allow for, at the very least, further contributions to be made to the inadequate provisions referred to earlier. Making a full provision for third party liabilities, on its own, would eliminate the current general reserve in its entirety.

In addition, the age profile of the organisation means that there a couple of significant peaks in likely retirement profiles as a result of past recruitment drives, which will increase the total provision required for pensions in the medium term.

Given the matters outlined above, decisions on the 2003/2004 budget and service levels will be difficult. Concerted efforts by all of those involved with policing in London will be required if further progress is to be made in improving the MPA’s financial health position. Members will also need to continue to ensure that proactive steps are being taken to move the culture of the organisation towards one which places greater emphasis on financial and budgetary management and control.

**Systems of internal financial control**

We recognise the efforts being made to strengthen financial controls and systems within the MPA/MPS. At present, the systems of internal financial control still require further improvement and continue to leave the MPA/MPS vulnerable to criticism and potential loss. The effective management of the move to a more devolved structure will be key to further improvements in this area.

Wherever possible we rely on Internal Audit to avoid duplication of effort where responsibilities overlap. To form a judgement on the extent to which we could rely on them, we undertook a detailed assessment of Internal Audit’s performance against the standards set out in CIPFA’s Code of Practice last year.

We identified some areas for improvement but concluded that reliance could be placed on the work of Internal Audit. We have followed up our review this year and can confirm our original conclusion about Internal Audit’s overall adequacy. There has been progress on the action plan we agreed with Internal Audit. They need to continue their work on improving the speed with which they deliver and continue to monitor the resources they consume in delivering audit products. In addition, the definitions used in reporting progress to Members could be more tightly defined.

We have agreed action against these recommendations with Internal Audit and will continue to work closely with them to ensure you receive a cohesive internal and external audit service.

We have also reviewed the key systems which underpin the integrity of the MPA/MPS’s financial affairs. We have again concluded that the systems of internal financial control were adequate to cover some, but not all, of the key financial risks faced by the organisation. Progress has been made but much remains to be done.
Our principal concern is still the relative lack of high level controls, such as detailed budget reports and system reconciliations, on which management can rely to gain assurance on the effective operation of the key financial systems. In their absence management often rely solely on the effective operation of detailed low level controls, such as multiple authorisation of invoices, with a resultant higher level of bureaucracy. This also means that senior management cannot provide assurance that all key risks are being covered. This is partly due to a scarcity of financial skills, although we welcome the significant recent investment in additional finance staff. The effective management of the move to a more devolved structure will be key to further improvements in this area.

This year’s work has also highlighted the need to strengthen the client management controls operated over the externalised payroll and pension provider. Given the high value and volume of payments processed on behalf of the MPS, more robust client checks and monitoring is required. MPS staff are currently considering our recommendations for improvements to existing arrangements.

**Legality of financial transactions**

*The Authority’s arrangements for ensuring the legality of transactions with financial consequences have been strengthened but still need further development.*

We reviewed the overall arrangements for ensuring the legality of transactions and did not identify any areas of major concern. During the year, we liaised with the Monitoring Officer (MO) and the MPS legal team. Greater clarity and understanding of the respective roles has been achieved since last year, which is useful progress.

It is important that the MO has access to independent advice in carrying out the statutory functions implicit in the role. This should be firmly established through a formal arrangement with external solicitors or by the appointment of a legally qualified deputy.

This year’s audit included specific consideration of the steps taken to address the legislative requirements of the Race Relations (Amendments) Act 2000. We found that the MPA has arrangements in place which are set out in its Race Equality Scheme. The MPS has its own scheme and there has been good co-operation between the two parties to ensure uniformity and consistency of approach. The Equal Opportunities and Diversity Board provides a key focal and monitoring function. The Authority now needs to continue its efforts to publicise its role in monitoring and mainstreaming this important initiative.

The MPA/MPS will be aware of the increasing emphasis on information governance and the need to comply with the Freedom of Information Act 2000. We propose to undertake an early review in next year’s audit to assess the adequacy of your arrangements for compliance.

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

*Arrangements for maintaining standards of conduct, and for preventing and detecting fraud and corruption, are improving.*

Our work in this area has shown that arrangements are generally satisfactory although improvements are required to some controls. The introduction of the Standards Committee should assist in further strengthening arrangements.

Internal Audit undertake a number of initiatives designed to raise the profile of anti-fraud measures and a large part of the MPA’s arrangements in this area lie within the role of Internal Audit. Their work, on a number of profile cases, has again found weak controls which have exposed the organisation to additional risk.

The MPA has still to finalise an anti-fraud and corruption policy although a memorandum of understanding exists between Internal Audit and the MPS Directorate of Professional Standards. This sets out their respective roles in respect of how cases of irregularity are to be addressed.

We reported last year that further work was being undertaken to ensure that the ‘Right Line’ whistleblowing arrangements complied with the requirements of the Public Interest Disclosure Act. Procedures have now been strengthened to allow for complaints to the Police Complaints Authority.
Last year we also highlighted the need to improve the level of control exercised over the receipt of gifts and hospitality and declarations of pecuniary interests. Only one Member has declared an acceptance of hospitality this year. The MPA needs to satisfy itself that Members are aware of what they have agreed to, in terms of disclosures, in signing the Code of Conduct.

During the year we undertook specific probes on confiscated property and the issue of firearm licences. The controls over confiscated property are adequately designed but are not effectively operated, as has previously been reported by Internal Audit. In particular all prisoner property stores should undertake a ‘spot check’ from time to time to verify the continuing existence of the property being held. Management need to ensure that appropriate action is being taken on this matter. An adequate control framework for firearm licences is in place.

A framework for Best Value is in place and is continuing to develop. However, the culture of continuous service improvement required by Best Value has still not been universally integrated into management arrangements across the organisation. Despite the considerable resources that are being input to the process, it is not clear whether Best Value reviews are delivering change or that progress on delivering improvements against agreed action plans resulting from the reviews is being robustly monitored.

Our experience from elsewhere shows that the culture of an organisation can have a marked effect on the benefit it derives from review activity. Learning organisations tend to be open about issues requiring attention which, although leading to uncomfortable messages in the short term, have obvious longer term benefits. Organisations that try to ‘pre-empt’ external challenge with internal reviews often do not secure the same long term benefits.

We have encountered both of these approaches in our two years of work at the MPA/MPS and achieving a consistently open approach in this area is one of the key challenges the organisation faces in moving to a culture that genuinely seeks continuous improvement (a key part of Best Value) in all that it does.

During our work on Best Value, and the rest of the audit, we have noted a perception within some parts of the MPS that it is subject to too much scrutiny. The need to review the level of external regulation and scrutiny has been recognised by the Audit Commission and efforts are being made at a national level to co-ordinate such activity and improve its effectiveness.

Equally, through our participation at MPS workshops and seminars on improving the co-ordination and effectiveness of review activity throughout the MPS, it has become clear that a significant proportion of such scrutiny is generated internally. This is, in part, for the reasons discussed above. However, we welcome the efforts being made in this area and will continue to work with the MPA/MPS to effect improvements.

Performance management

We considered:

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

Best Value Performance Plan

Our opinion on the Best Value Performance Plan (BVPP) was unqualified this year. The quality of the performance information in support of the BVPP was higher this year but does require further improvement.

The MPA has demonstrated a commitment to Best Value and some progress has been made towards a comprehensive performance management framework. The challenge now is to ensure that both completed and future Best Value reviews deliver lasting service improvements.

The 2002/2003 BVPP was a well presented and useful document. The statutory audit report issued on XX December 2002 was unqualified. The BVPP was substantially compliant with legislation.
**Performance information**

This year we were required to audit and certify the accuracy of the 31 Best Value performance indicators (BVPIs) for 2001/2002. Despite the efforts of MPS staff in improving the quality of the indicators submitted for audit we had to report reservations about 3 of them, either because the MPS could not produce the BVPI in question or was unable to satisfy us on its accuracy. A further seven of the BVPIs submitted for audit were amended as the result of our audit work. We have decided not to qualify our overall opinion on the BVPP in respect of the performance indicators as a result of the improving position.

The MPA/MPS now need to strengthen co-ordination and quality assurance processes to further improve the quality of BVPIs and supporting documentation submitted for future audits. Such improvements would also lead to better information being available for management purposes.

**Use of resources**

*We have assessed the MPA/MPS’s management arrangements for ensuring the effective use of resources across a range of activities. They demonstrate good practice in a number of the areas we have looked at. Efforts need to be continued to secure greater consistency in applying good practice across the organisation.*

We have undertaken a range of reviews, the most important being those covering IT management arrangements, abstractions and internal inspections. The key messages from our work are summarised in the following exhibit. We have again identified areas of good practice and where the infrastructure requires strengthening.

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**EXHIBIT 2**

**Key findings from our work are outlined below**

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<thead>
<tr>
<th>Service reviewed/key findings</th>
<th>Further action</th>
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<tbody>
<tr>
<td><strong>IT management arrangements</strong></td>
<td>There is a need to ensure that resources are applied to effectively challenging external providers to demonstrate value for money.</td>
</tr>
<tr>
<td><strong>C3i project</strong></td>
<td>A number of risks exist which will need to be addressed. In particular, the scale of the business change that will result should not be underestimated. The MPA/MPS needs to continually review the implications of the project on the rest of the business, to ensure that it supports overall objectives. There is also a potential funding gap of some £15m.</td>
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<tr>
<td><strong>Abstractions</strong></td>
<td>Insufficient information on abstractions makes it difficult to measure and assess the full impact across the MPS. The introduction of the new Personal Development Review (PDR) system may increase the level of abstractions as a result of the additional training identified. This will require careful monitoring and demand management.</td>
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<tr>
<td><strong>Internal Inspection</strong></td>
<td>There is a need to increase the impact of the reports produced by Internal Inspection to ensure that they are having the desired effect. This includes greater clarity on the relative performance of OCUs that have been inspected. Work needs to be undertaken to assess the costs and benefits and provide assurance that the outputs produced justify the inputs to the process.</td>
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Activity Based Costing

The National Activity Based Costing (ABC) Model has been developed by the MPS to incorporate its national and international functions. So far, only five BOCUs and one SO branch have been involved in activity surveys.

The MPS needs to develop a plan for the full implementation of ABC, including service wide activity surveys. Reliance on BOCUs volunteering themselves to be involved in the project has resulted in limited take up. Senior officers within the MPS/MPA need to be more proactive in leading the implementation of ABC.

Staff Appraisals

The new PDR system has recently been introduced for police officers and will be rolled out to civilian staff next year. Our work did not identify any major weaknesses in the PDR system itself but we did highlight some issues for consideration to ensure its long term success.

The MPS must continue to encourage all line managers to engage with the new system. This will require a cultural change in some parts of the organisation. In addition, the MPS needs to continue monitoring the extent to which staff have the necessary IT skills to guarantee its long term success.

Follow up of previous Audit Reports

We have followed up progress against a number of our past recommendations as outlined earlier in this Letter. We have also finalised action plans this year where responses from the MPA/MPS were outstanding. We will follow up progress on those during next year’s audit.

The Efficiency Plan

To support HMIC’s assessment of the MPA’s Efficiency Plan we reviewed the outturn cashable savings that the Authority identified as efficiency gains in the 2001/2002 Plan. We feedback our findings to the HMIC, who subsequently certified that the Authority had achieved its efficiency target for the year.

Future audit work

The Audit Commission has decided to change its audit year end from (October to March) to help authorities with their financial planning. In future the annual work programme and associated fee scales will be consulted on in advance of the financial year so provisions can be made in budgets for any changes in workload and fee scales. In order to achieve this change the audit years 2002/2003 and 2003/2004 will be covered by one audit plan for work that will largely be undertaken between November 2002 and March 2004.

The Audit Commission is currently finalising the Annual Letter of Guidance. We are currently considering the significant operational and financial risks that face the MPA/MPS that will need to be addressed by the audit. We will discuss our risk assessment with Members and officers before producing an audit plan.

Closing remarks

We hope that the messages in this Letter will assist the process of improvement that the MPA/MPS has embarked upon and the delivery of the joint vision to make London the safest major city in the world. We will continue to monitor the progress made.

Members may wish to note that Regulation 16A of the Accounts and Audit Regulations require the MPA to:

- publish the AAL as soon as is practicable following receipt
- keep copies available for purchase by any person on payment of such sum as the MPA may reasonably require.

Finally, I would like to take this opportunity to express my appreciation for the assistance received from members and officers during the course of our work. Our aim is to provide a high standard of audit service that makes a practical and positive contribution to the work of the MPA/MPS. We recognise the value of your cooperation and support.

Kash Pandya
District Auditor
Date: December 2002
**Reports issued during the audit**

- Financial Systems (June 2002)
- Appraisals (August 2002)
- Internal Inspection (August 2002)
- C3i project (September 2002)
- Financial Aspects of Corporate Governance (October 2002)
- Abstractions (October 2002)
- Review of BVPIs (October 2002)
- IT Management Arrangements and E-Governement (November 2002)
- Best Value Performance Plan (November 2002)
- Audit Opinion on Financial Statements (November 2002)
- Activity Based Costing (December 2002)
- Procurement (December 2002)