



Havant

BOROUGH COUNCIL

Annual Audit Letter to Members 2002/03

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Statement of Responsibilities of Auditors and Audited Bodies

Our audit letters and reports are prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies, issued by the Audit Commission.

Reports 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.

1. Introduction

1.1 The purpose of this report

As the Council's appointed auditors, we are required, under the Audit Commission's Code of Audit Practice (the Code), to issue an annual Audit Letter to Members on completion of each year's audit. The purpose of the Audit Letter is to demonstrate that the audit objectives of the Code have been addressed and to summarise issues of significance arising from our work.

The Audit Letter is structured in line with the Code and describes our work in relation to the three audit objectives, namely:

- Financial Aspects of Corporate Governance
- Auditing the Accounts.
- Performance Management

It is the responsibility of the Council to identify and address its operational and financial risks and to develop and implement proper arrangements to manage them, including adequate and effective systems of internal control. In planning and performing our work, we considered the significant risks that are relevant to our responsibilities under the Code and tailored our work accordingly. The 2002/03 programme of work was discussed and agreed with your Officers in March 2003 and subsequently reported to the Financial Strategy & Audit Working Party.

The outputs from our 2002/03 audit programme are summarised below:

Audit opinions	Date	Reference in Audit Letter
Statement of Accounts	16 December 2003*	Section 3
Best Value Performance Plan	28 November 2003	Section 4
Best Value Performance Indicators	30 September 2003	Section 4
Certification of grant claims & returns	By 31 December 2003*	Section 2
Reports to Management	Date issued	Reference in Audit Letter
Financial Aspects of Corporate Governance	August 2003	Section 2
Statement of Accounts	December 2003*	Section 3
Best Value Performance Plan/Best Value Performance Indicators	November 2003	Section 4

(* anticipated dates at time of issuing the Annual Audit Letter)

1.2 Key messages

The past year has been a period of significant change for the Council. Following the appointment of the new Managing Director in November 2002, there has been a fundamental review of the Council's management structure with the creation of new

corporate director posts and a realignment of roles and responsibilities throughout the Council. Coupled with this has been the development of new performance appraisal and review processes that are being rolled out to all staff. During the year a new five-year Corporate Strategy has been produced, together with a Medium Term Financial Strategy and a number of other strategies and plans have been developed or reviewed.

During September 2003, the Council, together with other borough and district councils in Hampshire, was the subject of a comprehensive performance assessment (CPA) by the Audit Commission. The draft results of the CPA review have recently been issued to the Council for consideration and the publication of the final report and assessment is due in January 2004.

The challenge for the Council in the coming year will be to continue to take forward its current initiatives, whilst taking on board the recommendations arising from the CPA through the development of an improvement plan. The key messages arising from our external audit work, which are summarised below, need to be considered in this wider context.

Financial Aspects of Corporate Governance

- The Council has adequate arrangements in place to satisfy itself that its systems of internal control are both adequate and effective (Section 2.2).
- Further action is required to address a number of internal financial control matters, particularly in relation to business continuity planning (Section 2.2).
- Good progress is being made in relation to meeting e-government targets (Section 2.2)
- Financial performance in 2002/03 has demonstrated the continuation of strong financial control (Section 2.5).
- The Council is continuing to face significant financial pressures. The introduction of the medium term financial strategy should help the Council to focus on the key priorities when determining the level of Council Tax for 2004/05 (Section 2.5).

Accounts

- We anticipate that we will issue an unqualified opinion on the Statement of Accounts in December 2003. (Section 3.2)
- There are no matters that require reporting under Statement of Auditing Standard (SAS) 610. (Section 3.2)

Performance management

- The Council has taken steps to address the weaknesses identified in our review of last year's Best Value Performance Plan (BVPP) and we have issued an unqualified audit opinion (Section 4.2).
- There has been significant progress in the development of the corporate planning arrangements, linked to Best Value and the requirements of CPA. However we identified scope to improve the arrangements for reporting progress on achieving the action plans arising from Best Value reviews (Section 4.3).
- There has been a marked improvement in the arrangements for the production and reporting of Best Value Performance Indicators (BVPIs). There is a need to ensure that a similarly robust approach is adopted for all local PIs (Section 4.4).

1.3 Acknowledgement

During the course of the year, we have received considerable support and assistance from officers and we would like to take this opportunity to thank them for the time they have made available to help us complete the audit programme.

2. Financial Aspects of Corporate Governance

2.1 Introduction

It is the responsibility of the Borough Council to put in place arrangements to ensure the proper conduct of its financial affairs and to monitor their adequacy and effectiveness in practice. The Code requires us to review and, where appropriate, to report on the financial aspects of the Council's corporate governance arrangements as they relate to:

- The systems of internal financial control, including internal audit;
- Standards of financial conduct and the prevention and detection of fraud and corruption;
- The legality of financial transactions, and
- The financial standing of the Council.

2.2 Systems of internal financial control

We have reviewed the key controls in the major financial systems and undertaken a programme of tests to satisfy ourselves that the controls are operating effectively. This included consideration of the Council's budgetary control and monitoring arrangements, the overall control environment (including the computer environment within which the financial systems operate) and compliance with taxation legislation (PAYE/VAT).

We concluded that, in overall terms, the Council has adequate arrangements in place to satisfy itself that its systems of internal financial control are both adequate and effective in practice, and that they can be relied upon for the purpose of our opinion on the Statement of Accounts. In particular, we would highlight the significant amount of work that has been undertaken by the Head of Resources and former Head of Internal Audit to develop and progress the approach to risk management within the Council.

There were a number of matters arising from our audit work, which were reported to management. The main issues arising (and our understanding of the action taken to date) are as follows:

- There has been significant slippage in the finalisation of business continuity planning arrangements. At the time of issuing last year's Audit Letter it was understood these arrangements would be in place by 31 March 2003. However, this was delayed due to staff restructuring. We recommended that these arrangements be finalised as a matter of urgency. (This matter was considered by the extended Management Team in November 2003 and BCPs are to be completed for each service by the end of March 2004).
- There is a need for formal documentation within the constitution to address all known requirements regarding employee conduct, which should be updated, as appropriate, in the future, to comply with any national guidelines. (A draft officer code of conduct has now been considered by the Standards Committee in September 2003 and, subject to the results of consultation, will be formally confirmed at the next meeting).

- There is a need to build responsibility for budgetary performance into the staff performance and development process. (This is now being considered as the process is being rolled out to all staff).

Internal Audit

As part of our annual assessment of the overall control environment, we consider the adequacy and effectiveness of internal audit. In our view, the quality and scope of the Internal Audit Section's work is of a satisfactory standard and accords with relevant auditing guidelines.

As in the previous year, we have sought to place reliance, where appropriate, on the work undertaken by Internal Audit. This is in line with the approach advocated in the Audit Commission's publication on the "Managed Audit" and is designed to limit the duplication of work and to make the most efficient use of the overall audit resources. The main areas of reliance have been in relation to the financial systems, including fraud risk areas.

E-government

One of the potential risk areas for the Council which we highlighted in our audit plan was failure to achieve the Government's targets for e-government. We are pleased to note that good progress has continued to be made in this area, with the approval of the IEG3 statement on 29 October 2003.

An IEG Strategy is in place and a recent presentation to Members has reported on the progress to date and plans for future development. The availability of adequate funding is crucial if the necessary infrastructure changes and enhancements are to be made to enable the strategy to be delivered. We are aware that funding of £359,000 has been identified to enable necessary projects to be undertaken for 2004/05. However, the Council remains highly dependent on the availability of IEG grant funding from the Office of the Deputy Prime Minister (ODPM), which will contribute over half of the total funding.

2.3 Standards of Financial Conduct, prevention and detection of Fraud and Corruption

The primary responsibility for the prevention and detection of fraud and irregularities rests with the Council and its Officers, who are required to institute an adequate system of internal control that incorporates security, segregation of duties, proper authorisation procedures, and an effective internal audit function.

On the basis of our audit work, we are satisfied that the overall arrangements for preventing and detecting fraud are adequate. In undertaking our audit work, we compared the Council's anti-fraud and corruption arrangements with nationally identified good practice. We noted some areas where there was scope for further development of the Council's arrangements, in particular, the formal evaluation of staff roles, to identify those roles most susceptible to fraudulent or corrupt activities from internal and external sources, which we understand will be undertaken by Internal Audit.

2.4 Legality of financial transactions

It is the responsibility of the Council to act within its specific legal powers and to take appropriate legal advice where necessary. Our work in relation to this area included consideration of the Council's approach to legality, its response to major legislation and any matters of legality that arose during the course of the audit. On the basis of our audit work, we are satisfied that the arrangements the Council has in place for ensuring the legality of financial transactions are adequate.

In our audit plan, we highlighted the potential risk from a failure to comply with new legislation, in particular the requirements of the Race Relations (Amendment) Act 2000. We note the progress that has been made in relation to this particular matter during the year, which was summarised in a report to the Executive on 9 July 2003. The report identified a number of areas for further development, which had been delayed by other priorities and it will be important for these to be addressed in the coming months.

Following the reorganisation of the senior management structure, the post of Director of Legal and Administration was deleted and the current post holder was made redundant. Under the new structure, the role of Monitoring Officer, which had previously been the responsibility of the Director of Legal and Administration, was to be undertaken by an officer below director level. The Council faced a short term problem as it was unable to fill this post. An innovative approach was adopted by the Managing Director by piloting a partnership arrangement with East Hampshire District Council, whereby the legal manager of the partnership now acts as monitoring officer for both authorities. We have been kept informed of developments in this area and are satisfied that the Council has taken appropriate steps to ensure that this arrangement meets statutory requirements.

We are required by the Audit Commission Act 1998 to observe the rights of local government electors to raise matters with us, or to ask questions or make objections in relation to the accounts. No matters have been raised with us this year.

2.5 Financial Standing

2002/03 financial performance

Financial performance in 2002/03 has demonstrated, in overall terms, the continuation of strong financial control within the Council. Details of the actual expenditure were reported to Members in July 2003. The key points are summarised below.

General Fund revenue expenditure for the year was £14.43m, compared to the budget of £14.75m. A number of factors contributed to the underspending, including savings resulting from operational changes. As a consequence, the Council was able to set aside £133,000 to meet the costs of the local planning enquiry and transfer £134,000 to the capital reserve for new acquisitions, in accordance with the budget strategy.

Capital expenditure in 2002/03 amounted to £8.6m, compared to £5.0m in the previous year. The main sources of finance were usable capital receipts (£3.2m), the reserved capital receipts available for investment as a consequence of the Council's debt free status (£1.8m) and grants and contributions (£1.8m).

Reserves and balances

As a consequence of the surplus in the year, the General Fund balance increased from £1.5m at 31 March 2002 to just over £1.8m at 31 March 2003. This included a provision for approved carry forward/brought forward budgets of £184,000 (£110,000 at 31 March 2002). The overall reserve level remains in line with the minimum balance of 10% of revenue expenditure included in the medium term financial strategy.

Other reserves at 31 March 2003 had reduced to £2.8m compared to £4.8m at 31 March 2002. The main reason was the use of the available balance of the usable capital receipts reserve and an element of the capital reserve to fund capital expenditure in the year.

In addition to these reserves, and because the Council is debt free, Government rules allow receipts of grant for Social Housing schemes to be used for general fund purposes. The amount available was £5.1m at 31 March 2003 (£3.1m at 31 March 2002). The majority of these resources are committed to financing the Council's approved capital programme. However, the Social Housing Grant scheme has ceased from 1 April 2003, so no further funding will be available from this source.

Income collection

In last year's Audit Letter we highlighted the need for close monitoring of Council Tax arrears. At 31 March 2002, the arrears (net of provision for bad debts) stood at £3m (8.2% of gross Council Tax income). During 2002/03, action was taken to improve the position, by agreeing new incentives with the contractors responsible for Council Tax collection. The position improved during the year and at 31 March 2003 the net arrears had reduced to £2.1m (5.5% of gross income). We are aware that the Head of Resources still considers the arrears position to be higher than desirable and that further action is being taken in conjunction with the contractors to address the position. There is a continuing need to monitor the situation.

Financial outlook

Last year the Council was faced with some difficult choices in setting its Council Tax for 2003/04. In the end, a decision was taken to increase it by 9%, about half of which was for service enhancements linked to corporate objectives and the remainder to meet additional costs, including increases in insurance costs and employers' pension contributions.

We are aware that, at the time the 2003/04 budget was set, the Council still had to identify a further £303,000 in savings to ensure it could be achieved and these were not confirmed until early in the financial year. This situation highlights the problem the Council has faced in recent years where conflicting pressures on resources have made it difficult to identify priorities.

We are pleased to note the action that has been taken in the current year to address this situation, with the introduction of a medium term financial strategy linked to the revised Corporate Strategy. We are also aware that a detailed presentation was made to Members in October highlighting the current issues impacting on revenue and capital finance. These measures should help the Council to focus attention on the key priorities at an early stage in the budget process for 2004/05. However, in view of the continuing financial pressures faced by the Council, it is clear that in the coming months Members will once again be faced with some difficult choices.

The Prudential Code

A significant change is to be made in the arrangements for controlling capital expenditure with effect from 1 April 2004. The present capital control system has been recognised as limiting local financial freedom and becoming an obstacle to effective capital investment. A new prudential framework is to be introduced with effect from 1 April 2004, a key feature of which is that local authorities will be able to set their own capital spending limits and determine their own programmes for capital investment, with greater integration of revenue and capital decisions and more choice between procurement options.

Each Council is required to take steps to ensure its financial planning will meet the requirements of the new arrangements. The chief financial officer has a significant responsibility to ensure that the Council takes into account the matters specified in the Prudential Code and monitors continuing compliance with the limits it establishes.

The implications of the changes that will result from the introduction of the Prudential Code were outlined to Members by the Head of Resources at the October presentation. There will be an initial requirement for the Council to set a number of estimates and targets and these will form part of the budget reporting process. However, at this stage, it is unclear to what extent the Prudential Code will enhance the Council's ability to incur capital expenditure, as any increased borrowing will necessarily impact on the revenue budget.

2.6 Auditor Judgements

In undertaking this year's audit work on the Financial Aspects of Corporate Governance we also obtained evidence to support our 'Auditor Judgements' which fed into the CPA assessment for the Council. We were pleased to note the prompt action that was taken to address a number of matters highlighted in our discussions with senior management, including formal adoption of the requirements of the CIPFA Code of Practice on Treasury Management in Public Services, reporting to Members on progress made in implementing accepted Internal Audit recommendations and obtaining formal Member approval of the Risk Management Strategy. Matters arising from this aspect of our audit work were included in our report on the Financial Aspects of Corporate Governance.

3. Audit of the Accounts

3.1 Introduction

The annual statement of accounts is the principal means by which the Council accounts for its stewardship of the resources at its disposal and its financial performance in the use of those resources. It is the responsibility of the Council to:

- Ensure the regularity of transactions
- Maintain proper accounting records
- Prepare a Statement of Accounts

The Code requires us to audit the financial statements and to give an opinion as to whether the Statement of Accounts presents fairly the financial position of the Council and its income and expenditure for the year in question, and has been prepared in accordance with relevant legislation and applicable accounting standards. This section summarises the results of our audit work in relation to the Council's Statement of Accounts for the year ended 31 March 2003.

3.2 Audit Opinion

We have substantially completed our audit work in relation to the Council's Statement of Accounts and we anticipate that we will be in a position to issue an unqualified opinion in the week commencing 15 December 2003.

SAS 610

The financial year ended 31 March 2003 is the first year that the requirements of Statement of Auditing Standards (SAS) 610, 'Communication of audit matters to those charged with governance' have been applicable to the audit of the Council's accounts. SAS 610 requires us to report findings from the audit to those charged with governance (as distinct from management). In the case of the Council, we agreed that all communications required under SAS 610 will be with the Executive. In relation to the accounts, the aspects to be communicated are:

- Expected modifications to the auditors' report.
- Unadjusted misstatements.
- Material weaknesses in the accounting and internal control systems identified during the audit.
- Qualitative aspects of accounting practices and financial reporting.
- Matters required by other auditing standards to be reported to those charged with governance, including:
 - where we suspect or detect fraud
 - in respect of the conclusion that the Council is a going concern
 - where there is inconsistency between the Council's financial statements and other information in documents containing the financial statements.
- Any other relevant matters relating to the audit.

We do not consider that there were any matters that required reporting under SAS 610 in relation to the 2002/03 accounts. However, a number of detailed matters arising from the audit work have been discussed with the Head of Resources and included in a formal management report.

3.3 Certification of grant claims

We are required to certify a range of grant claims and returns prepared by the Council for submission to the appropriate Government departments or to other agencies. The deadline for the submission of our certificate for the majority of claims is 31 December. Our audit work is currently in progress, but we do not envisage any problems in completing the necessary work by the deadlines. There are no matters from our audit work that require drawing to the attention of Members.

4. Performance management

4.1 Introduction

It is the responsibility of the Borough Council to put in place proper arrangements to manage its performance, in order to secure economy, efficiency and effectiveness in its use of resources. We are required to consider the adequacy of these arrangements. In our audit plan, we confirmed that our audit work would focus on the Council's arrangements for:

- Preparing and publishing the annual Best Value Performance Plan (BVPP);
- Producing Best Value Performance Indicators (BVPIs), and
- Developing the overall approach to performance management, linked to Best Value and in preparation for CPA.

4.2 The audit of the Best Value Performance Plan

The Local Government Act 1999 (the Act) places a statutory duty on Councils to achieve Best Value in the provision of services. This is defined as a requirement to ensure that arrangements are in place to secure continuous improvement in the way in which the Council's functions are exercised, having regard to a combination of economy, efficiency and effectiveness. The Act also requires the Council to publish a Best Value Performance Plan (BVPP) which summarises the Council's assessment of its performance and position in relation to Best Value.

As the Council's auditors, we are required under the Act to carry out an audit of the BVPP, to certify that we have done so, and to report whether we believe it has been prepared and published in accordance with the requirements of the Act and other statutory guidance. Where appropriate, we are required to recommend how the BVPP should be amended so as to accord with statutory requirements.

Last year, it was necessary for us to qualify our audit opinion on the BVPP. This was due to the fact that a significant number of the statutory Best Value Performance Indicators (BVPIs) included within the plan contained material inaccuracies and that the BVPP did not include the results of the Best Value inspection completed in the previous year or report the action taken in response to recommendations from that inspection or progress in relation to inspections undertaken in previous periods.

In undertaking our audit work on the 2003/04 BVPP, we were pleased to find that appropriate action had been taken to address these issues. We were satisfied that in all significant respects the BVPP was prepared and published in accordance with statutory requirements and we issued an unqualified audit opinion on 28 November 2003.

In our report to management, we have highlighted a number of areas where there is scope to develop the BVPP further. In particular, consideration should be given to:

- Improving the transparency of reporting on the progress made in addressing "key actions" identified within Service Plans in the previous year's BVPP. It would be helpful to provide a clear trail, which identifies what steps have been taken to address these key actions (i.e. whether they have been addressed, carried forward to the next year, or 'parked' because they are no longer considered to be a service priority), and

- Including action plans for all completed Best Value reviews, as has been done for the elements of the 'Making a Safer Community' review in 2003/04. As with the Service Plan "key actions", this should highlight the actions completed and identify the areas where action is in progress or yet to be taken. These could also be included within relevant Service Plans.

4.3 Use of resources

In accordance with our audit plan, we have continued to monitor the development of the Council's overall corporate approach to performance management, linked to our work on the BVPP.

The initial peer review at the end of 2002 highlighted a number of development areas and we note that a significant amount of work has been undertaken since then to address these concerns. In view of the pending publication of the CPA report, it would not be appropriate for us to comment on the adequacy of the overall performance management arrangements. However, from our work, we would highlight a number of developments that have taken place during the year:

- Revision of the Council's Corporate Strategy;
- Recognition of the importance of the BVPP within the strategic planning approach. This will need to be developed further following CPA, as it will be a key document in relation to improvement planning;
- Adoption of a medium term financial strategy, which recognises the link between financial planning and the corporate and service priorities;
- Strengthening of the corporate performance management arrangements, with creation of three performance and development officers under the Head of Customer Care and Performance Management, and
- Overall restructuring and development of Corporate Groups and the identification of new roles and responsibilities throughout services.

From our audit of the BVPP, we are also aware that there are now well established arrangements for reporting on BVPI performance during the course of the year. However, we noted that similar arrangements are not in place for reporting in-year on the progress being made to address the action plans arising from best value reviews or inspections. In our opinion, it would be appropriate for this progress to be reported on a regular basis during the course of the year (in conjunction with the quarterly reporting of PI performance), to provide Members and senior management with timely information and ensure that corrective action can be taken when appropriate.

4.4 Performance Information

Best Value Performance Indicators

In undertaking our audit work on the 2003/04 BVPP, we are required to assess the adequacy of the systems that the Council has put in place to collect and record the BVPIs and to provide a report to the Audit Commission on the results of our work.

As noted in section 4.2 above, it was necessary for us to qualify our opinion on the 2002/03 BVPP because a significant number of the BVPIs included within it

contained material inaccuracies. This year, we were pleased to note a marked improvement in the arrangements relating to the production of the BVPIs, which demonstrated an increased understanding and ownership of the BVPI requirements by line managers.

Our audit work did identify some errors to the BVPI outturn results for 2002/03 which were reported in the BVPP. These have been discussed with officers and amendments were agreed for submission to the Audit Commission and for subsequent inclusion in national comparative data to be published by the ODPM. Our detailed findings have been included in a report to management. We are satisfied that corrective action is being taken to ensure these errors will not be repeated and that there are no significant matters that require drawing to Members' attention.

We completed our audit work in September 2003, so that our findings could be made available to the CPA team. Our report was issued to the Audit Commission on 30 September 2003.

Development of local performance indicators

In last year's Audit Letter, we had commented on the lack of local PIs. There have been significant developments in this area during 2003 and a wide range of local PIs were included within the Service Plans which formed part of the BVPP. We understand that a key role is being played by the Performance and Development Officers in their development, in conjunction with line managers. In our report to management, we have highlighted the need to ensure that PI definitions are clear and unambiguous, that robust systems are in place for collection of relevant data and that responsibilities for data collection and reporting on performance to senior management and Members are identified.

We would also stress the importance of developing arrangements for external evaluation and monitoring of performance. This will be particularly important where performance against locally determined PIs becomes a key element of an individual's or a team's performance agreement/targets. Such arrangements could involve the Performance and Development Officers, or potentially the internal and external auditors. In this context, we would also highlight the need to revisit the PI targets for future years, in the light of experience during 2003/04, to ensure that these are achievable but challenging.

5. Audit Plan 2002/04 and 2004/05

5.1 2002/04 Audit Plan

Whilst our Audit Plan would normally cover only one financial year, we were required by the Audit Commission to prepare a single Audit Plan to cover the work we will undertake in relation to the 2002/03 and 2003/04 financial years. This was a transitional arrangement, to align the Audit Commission's audit year with the local government financial year. For this reason, our current audit plan includes further work that we will undertake in relation to the financial year ending 31 March 2004 (this includes the audit of the 2003/04 accounts, which takes place after the year end). We will be reviewing our risk assessment for the remaining aspects of our audit work and will discuss any amendments with the Council, if appropriate.

Audit fee

At this stage, we do not envisage that there will be any change to the overall audit fee for the period covered by our Audit Plan. The fees for undertaking the various elements of our audit work under the Code of Audit Practice are as follows:

Code objective	2002/04 agreed fee £
Performance Management (mainly in relation to the 2003/04 BVPP and 2002/03 BVPIs)	33,050
Financial Aspects of Corporate Governance (2002/03 and 2003/04)	38,000
Audit of the statement of accounts (2002/03 and 2003/04)	71,100
Total audit fee	142,150

(NB The audit fee excludes fees charged for the certification of grant claims and returns)

Independence and objectivity

In our Audit Plan we referred to the requirement (under SAS 610) to communicate, at least annually, all relationships that may bear on the Firm's independence and the objectivity of the audit engagement partner and audit staff. We are able to confirm that we are not aware of any relationships that may bear on the independence and objectivity of the audit engagement partner and audit staff that require disclosure.

5.2 2004/05 Plan

In response to concerns raised by local authorities in recent years over the increasing burden of audit and inspection, the Audit Commission is keen to ensure that all audit and inspection work undertaken is commensurate with the risks associated with individual authorities. Following the results of the CPA process, we will start the planning for the 2004/05 audit, in consultation with the Council's nominated Relationship Manager. We envisage that, from 2004/05 onwards, the work we propose to undertake will be presented to the Council as part of a combined audit and inspection plan. We will work closely with your officers on the development of this approach.