



# MEDWAY COUNCIL

FINAL REPORT TO THE AUDIT COMMITTEE  
Audit for the year ended 31 March 2013

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# OVERVIEW

## Key audit findings

The purpose of this report is to communicate to you the significant findings from our audit of the financial statements of Medway Council for the year ended 31 March 2013. This overview covers those matters we believe to be significant in the context of our work. However, you should read the entirety of this report, as there may be other matters raised that you consider important.

We have largely completed our audit work and anticipate issuing an unqualified opinion subject to the outstanding matters listed on page 4.

AREA OF AUDIT	SUMMARY
Financial statements	<p>We have not identified any material misstatements during the course of the audit. A number of non-material misstatements were identified as part of the audit that management has corrected. These are included in the Key audit and accounting matters section of the report. The more significant items are shown below.</p> <p><b>Errors affecting fixed asset disclosures</b></p> <ul style="list-style-type: none"><li>• our audit identified two issues affecting the way the Council presents its grant income and expenditure on Academy Schools in the financial statements. The issues arose because of the timing difference between incurring expenditure and the receipt of grant from the Government under the Academies programme. As a consequence, the Council:<ul style="list-style-type: none"><li>- reduced the amount of capital grants unapplied and increased accrued income by £478,000</li><li>- increased accrued income and capital additions by £1,117,000 to ensure capital expenditure retention amounts were appropriately included in the accounts at 31 March 2013.</li></ul></li><li>• expenditure of £4.9 million on Academy schools was incorrectly classified as 'revenue expenditure funded capital under statute' (REFCUS). The amount is now correctly disclosed as additions to other land and buildings (£2 million) and assets under construction (£2.9 million)</li><li>• a school achieving Academy status in the year was accounted for as a downward revaluation rather than a disposal when the Council issued the long term lease. Management has corrected this error by reducing Education and Children's Service gross expenditure by £1,039,000 and reclassifying the same amount as a loss on disposal within Other Operating Expenditure</li><li>• in prior years the Council did not depreciate Infrastructure fixed assets. The Council has now amended the accounts to account for such depreciation. It has reduced the value of Infrastructure assets by £3.3 million and increased expenditure on Highways Services. Relevant adjustments to capital accounting transactions have also been made</li><li>• four fixed assets with a net book value of £2.8 million were incorrectly classified as community assets. The assets have now been correctly classified as other land and buildings</li><li>• the assets held for sale amount was reduced by £345,000 because an upward revaluation of the assets was included in error</li></ul> <p>In the light of the errors which continue to affect the operation of the 'Logotech' fixed asset system, it is recommended the closure of accounts process includes a critical review of the capital accounting transactions produced at the period end.</p>

AREA OF AUDIT	SUMMARY
Financial Statements	<p><b>Other errors</b></p> <ul style="list-style-type: none"> <li>Housing Revenue Account Income and Expenditure was incorrectly consolidated into the Comprehensive Income and Expenditure Statement (CIES). The CIES was adjusted to reduce expenditure by £769,000 and to increase income by £59,000. The majority of the amendment (£687,000) involved interest payable which is now correctly classified as other operating expenditure</li> <li>the collection fund was adjusted to reduce the amount payable to the national non-domestic rates (NDR) pool by £337,000. The amendment was required to ensure consistency with the NDR return to the Government</li> </ul> <p>Some areas of work are still outstanding at the time of drafting this report. Should these result in any significant issues, we will provide an update to the Audit Committee. Subject to satisfactory completion of the outstanding work, we anticipate issuing an unqualified true and fair opinion on the financial statements for the year ended 31 March 2013.</p>
Unadjusted audit differences	<p>We have not identified any unadjusted audit differences. Should any further matters arise from our outstanding audit work we will update the Audit Committee accordingly.</p>
Internal controls	<p>Significant deficiencies in internal controls are evident in the following areas:</p> <ul style="list-style-type: none"> <li>adult social care panel authorisations</li> <li>adult social care financial assessments and related checks of these assessments</li> <li>payroll authorisation records.</li> </ul>
Use of resources	<p>We note the following based on our audit:</p> <ul style="list-style-type: none"> <li>the Council has effective arrangements in place for financial governance, financial planning and financial control and there are strengths in the Council's arrangements for managing its budgets. Financial risks were managed effectively throughout the year and the overall budget was achieved</li> <li>the medium term financial strategy indicates that the financial position is balanced for the 2013/14 period. Significant resource gaps have been identified in 2014/15 (£16 million) and in 2015/16 (£34 million). Further pressure is being placed on the Council's general and earmarked reserves. Ensuring financial balance over the medium term planning horizon will continue to require strong action by the Council</li> <li>the Council will need to ensure the additional investment in those services identified for improvement is sustainable and that the required improvement in performance is secured</li> <li>progress towards the Council's improvement plans for those Children's services judged by the external regulator to be inadequate will continue to require strong leadership and management action within the Council, and through the work of the Children's Improvement Board</li> <li>the Council will need to keep those primary schools identified by the external regulator as underperforming under close review and take appropriate action to improve performance</li> <li>further action may be required to ensure the achievement of pupils at 'Key Stage 2' meets the Council's targets and national benchmarks</li> <li>action has been taken to strengthen corporate procurement arrangements and savings from the 'Category Management' programme are in line with the Council's plans</li> <li>the Joint Health and Wellbeing Board was established with key strategic partners in line with the Government's timetable. The Board has continued to work towards the public health priorities the Council and its partners agreed for the Medway area</li> <li>the Council reported positive performance in many areas in 2012/13 and 44 out of 78 Council Plan key measures of success met or exceeded the published target in the year.</li> </ul>

AREA OF AUDIT	SUMMARY
Value for Money Conclusion	<p>Our value for money conclusion is based on considering our overall risk assessment, focusing on the two criteria set by the Audit Commission, and the results of risk based audit work, as well as consideration of the processes underpinning your review of the effectiveness of your controls as described in your Annual Governance Statement.</p> <p>We are satisfied that, in all significant respects, the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2013. We will be issuing an unqualified value for money conclusion.</p> <p>The Audit Commission requires us to report by exception where significant matters come to our attention, which we consider to be relevant to proper arrangements to secure economy, efficiency and effectiveness in the Council's use of resources. We consider the findings of the Ofsted inspection into services for the protection of children (reported in January 2013) and the inspection of services for looked after children (reported in July 2013) to be significant matters which we have reported in our Value for Money conclusion.</p>
Annual Governance Statement	<p>We are in the process of reviewing the Annual Governance Statement and will update the Audit Committee with our findings at the meeting on 25 September 2013.</p>
Whole of Government Accounts (WGA)	<p>We have not yet completed the audit of the Council's WGA return. The findings from our review of the consistency of this return with the audited financial statements will be circulated to members of the Audit Committee before the 4 October 2013 submission deadline.</p>
Audit Certificate	<p>A local elector has exercised his right to object to the financial statements. I have completed my work and agreed my conclusions on this matter with officers. I will be notifying the elector accordingly and may not issue my certificate on the 2012/13 financial statements by 30 September 2013.</p>

**We would like to thank staff for their co-operation and assistance during the audit and throughout the period.**

# Audit status and timetable to completion

We set out below the current status of the audit and our timetable to completion.

## AUDIT STATUS

We have largely completed our audit work in respect of the financial statements, and anticipate issuing an unqualified opinion on the financial statements.

The following matters are outstanding at the date of this report and we will update you on their current status at the Audit Committee meeting on 25 September 2013:

- review of the proposed adjustments for the errors identified in relation to the amalgamation of some schools
- completion of grant income testing
- completion of the review of a sample of leases held by the Council, and the related disclosures within the financial statements
- review of the revised movement in reserves statement provided by management to correct the £547,000 imbalance in the transfers to/from earmarked reserves
- review of the updated cash flow statement
- receipt of final version of financial statements following agreed amendments
- technical clearance and concurring partner sign off
- subsequent events review
- completion of the review of the annual governance statement
- management representation letter, as attached in Appendix VIII to be approved and signed.

## TIMETABLE TO COMPLETE

The anticipated timetable to complete is as follows:

ACTIVITY	DATE
Completion of outstanding audit work on the financial statements	20 September 2013
Audit Committee meeting	25 September 2013
Signing of financial statements	30 September 2013
Completion of audit work on the WGA return and circulation of audit findings	30 September 2013
Signing deadline for WGA audit certificate	4 October 2013

# INDEPENDENCE

## INDEPENDENCE

Under Audit Commission Standing Guidance and Auditing and Ethical Standards, we are required as auditors to confirm our independence to ‘those charged with governance’. In our opinion, and as confirmed by you, we consider that for these purposes it is appropriate to designate the Audit Committee as those charged with governance.

Our internal procedures are designed to ensure that all partners and professional staff are aware of relationships that may be considered to bear on our objectivity and independence as auditors. The principal statements of policies are set out in our firm-wide guidance. In addition, we have embedded the requirements of the Standards in our methodologies, tools and internal training programmes.

The procedures require that audit engagement partners are made aware of any matters which may reasonably be thought to bear on the firm’s independence and the objectivity of the audit engagement partner and the audit staff. This document considers such matters in the context of our audit for the year ended 31 March 2013.

A summary of our fees for audit and non-audit services for the period from 1 April 2012 to date is set out on this page.

We confirm that we are not aware of any relationships that may bear on our independence and objectivity as auditors of the financial statements and that our independence declaration, included in the Audit Plan for 2012/13, has remained valid throughout the period of the audit.

	£
Code Audit fee	188,460
Additional risk based work	19,000
Grants certification fees	23,950
Fees for non-audit services	-
<b>TOTAL FEES</b>	<b>£231,410</b>

# AUDIT SCOPE AND OBJECTIVES

## SCOPE AND OBJECTIVES

The audit scope is determined by the Audit Commission's Code of Audit Practice for Local Government and covers the audit of the financial statements in accordance with International Standards on Auditing (UK and Ireland), Practice Note 10: audit of public sector bodies in the United Kingdom (October 2010), and guidance issued by the Audit Commission.

This requires that we form an opinion on whether:

**1** The financial statements give a true and fair view of the state of the Council's affairs as at 31 March 2013 and of the income and expenditure for the year then ended

**2** The financial statements have been properly prepared in accordance with statutory requirements and proper practices have been observed in their compilation

**3** The financial statements have been prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting

**4** The information given in the Statement of Accounts and Explanatory Foreword is consistent with the financial statements

**5** The Annual Governance Statement is not inconsistent with our knowledge and complies with relevant guidance

**6** The audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources

**7** The Whole of Government Accounts return is consistent with the audited financial statements and that it is properly prepared

## Materiality

In carrying out our work we determine and apply a level of materiality. Materiality is the expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole, or individual elements of the financial statements as appropriate. Consequently, the audit cannot be relied upon to identify all risks or potential or actual misstatements. Materiality may relate to both quantitative and qualitative matters, and for quantitative considerations the numerical level materiality is assessed at may be different for different information in the financial statements. Nevertheless, within this context, Appendix III gives an indication of the quantitative levels used for planning purposes. Materiality is re-assessed every year in the context of authoritative audit practice.

We are required to report to you all uncorrected misstatements that relate to the current financial year (including those arising in previous periods that have an effect on the current year financial statements) and the effect that they have individually, or in aggregate, on the opinion in the auditor's report, except for those that are clearly trivial. For reporting purposes, we consider misstatements of less than £180,000 to be trivial and have not reported them, unless the misstatement is indicative of fraud.



# FINANCIAL STATEMENTS

## Key audit and accounting matters

### Significant and other audit risks of material misstatement

We reported our risk assessment, which brought to your attention areas that require additional or special audit consideration and are considered a significant audit risk, in the 2012/13 Audit Plan issued in March 2013. Our audit approach was designed to address these significant risks and any relevant issues arising have been set out in the remainder of this report.

**Key:** ■ Normal risk ■ Significant risk

### AUDIT RISK AREAS

RISK	RELATED CONTROLS	WORK PERFORMED	CONCLUSION
<b>MANAGEMENT OVERRIDE OF CONTROLS / JOURNAL AUTHORISATION</b>	ISA (UK&I) 240 requires us to presume that a risk of management override of controls is present and significant in all entities. By its nature, there are no controls in place to mitigate the risk of management override.	We reviewed the appropriateness of journal entries and other adjustments made in the preparation of the financial statements. We also reviewed accounting estimates for evidence of possible bias.	No issues have been identified by our review of the appropriateness of journal entries and other adjustments made in the preparation of the financial statements.
<b>REVENUE RECOGNITION - HOUSING AND COUNCIL TAX BENEFIT SUBSIDY INCOME</b>	<p>The benefits team ensures the correct version of the benefits software and year end subsidy extract programme has been used. Patch upgrades provided by the software supplier are loaded on to the system throughout the year and (supplier) recommended validation checks performed. The standard claim reconciliation methodology is followed and validation checks undertaken. In order to ensure the correct amount of subsidy has been claimed the software is designed to include the correct cut-off payment run in accordance with the Subsidy Order definition for 2012/13. The output report and Department of Work and Pension (DWP) claim form automatically calculates the subsidy income.</p> <p>This is checked against the cash received on account in the year and the corresponding receivable / payable amount at the year end agreed (being the difference between total subsidy income and interim subsidy received from DWP as at 31 March).</p>	We completed detailed testing of a sample of benefit payments to confirm that subsidy income has been claimed at appropriate amounts.	Testing in respect of the audit of the DWP subsidy return, including benefits paid and subsidy claimed, has not identified any significant errors.

## Key audit and accounting matters (continued)

AUDIT RISK AREAS			
RISK	RELATED CONTROLS	WORK PERFORMED	CONCLUSION
<b>REVENUE RECOGNITION - GRANT INCOME</b>	<p>The finance team review agreements and other documentation from the grant paying body to determine whether there are conditions attached to the grant. Expenditure incurred in respect of specific grants is coded to separate cost centres in the nominal ledger and this is reviewed by the finance team to determine whether grant conditions have been met for the recognition of the income or to defer the recognition as a liability.</p>	<p>We substantively tested an extended sample of grants received to ensure that the recognition of income was appropriate and completely and accurately recorded.</p>	<p>We are currently finalising the grant income testing and will provide an update to the Audit Committee at the meeting on 25 September 2013.</p>
<b>PROPERTY, PLANT &amp; EQUIPMENT</b>	<p>Since the introduction of IFRS in 2010/11, the Council has implemented new systems and procedures to ensure the accuracy of Property Plant and Equipment (PPE) balances. The Council has made good progress in implementing the new asset management system (Logotech) to assist in the production of the financial statements.</p> <p>This year, the Council has carried out data cleansing exercises to improve the quality and accuracy of the data held on the fixed asset register. This included reconciliation of the fixed asset register used by the finance team and records held by the Council's property management team, and also a review of fully depreciated assets held by the Council.</p> <p>As a result of this work the Council has been able to place more reliance upon the balances generated by Logotech in closing the financial statements, and this has reduced the need for the manual spreadsheet adjustments which have been required in previous years.</p> <p>In the light of the errors which continue to affect the operation of the 'Logotech' fixed asset system, it is recommended the closure of accounts process includes a critical review of the capital accounting transactions produced at the period end.</p>	<p>In 2011/12, we found a number of significant errors and inconsistencies which related to:</p> <ul style="list-style-type: none"> <li>• ownership of fixed assets</li> <li>• revaluations</li> <li>• expenditure incurred on Academy schools.</li> </ul> <p>In order to address these issues we have substantively tested an extended sample of assets to confirm the Council owns the rights to them. We have also tested an extended sample of assets to confirm the accuracy of balances and appropriateness of accounting treatment in relation to Academy schools.</p>	<p><b>ADDITIONS</b></p> <p>Our testing found that £4,932,000 has been incorrectly accounted for as revenue expenditure funded from capital under statute (REFCUS). This relates to three schools: Bishop of Rochester (£598,000), Brompton (£2,901,000), and Strood (£1,433,000) where Special Education Needs units (for Bishop of Rochester and Brompton) and Strood's Inspiration centre were not included within PPE balances as capital additions. Management has corrected this error by:</p> <ul style="list-style-type: none"> <li>• increasing asset under construction additions by £2,901,000</li> <li>• increasing other land and building additions by £2,031,000</li> <li>• reducing the REFUS amount by £4,932,000</li> </ul> <p>The amendments do not affect the Council's reported deficit for the year.</p> <p>Our testing identified inconsistencies in the way the Council has accounted for retention amounts on capital projects. The Council currently does not have a formal policy to determine how such amounts should be accounted for, but has agreed that accruals should be raised where retention amounts are known. Management has agreed to correct this error in respect of three capital projects: Bishop of Rochester Academy (£638,000), Brompton Academy (£449,000), and Mercury Abatement Works (£84,000), by:</p>

# Key audit and accounting matters (continued)

AUDIT RISK AREAS			
RISK	RELATED CONTROLS	WORK PERFORMED	CONCLUSION
<b>PROPERTY, PLANT &amp; EQUIPMENT</b>			<ul style="list-style-type: none"> <li>• increasing other land and buildings additions by £638,000</li> <li>• increasing asset under construction additions by £533,000</li> <li>• increasing accruals (capital additions and accrued income) by £1,171,000.</li> </ul> <p>Our testing identified instances where expenditure on asset components was accounted for as REFUCS because the expenditure was below the Council's de minimis of £25,000 for capitalising expenditure. We believe the de minimis amount should be used when reviewing additions as a whole for an individual asset rather than on a component basis. Whilst we have concluded this issue is not significant to the financial statements, we do recommend that the Council reviews its approach to identifying REFUCS on component expenditure going forwards.</p> <p>Our testing identified some instances where expenditure had been capitalised but should have been accounted for as revenue. Whilst we concluded this was not significant to the financial statements, we do recommend that officers coding expenditure to the ledger, are aware of items which should and should not be capitalised to avoid any potential significant errors in the future.</p> <p><b>DISPOSALS</b></p> <p>Our testing found that Greenacre Academy had been accounted for as a downward revaluation rather than a disposal when the Council issued the long term lease as a result of the school achieving Academy status. Management has corrected this error by reducing Education and Children's service gross expenditure by £1,039,000 and reclassifying the same amount as a loss on disposal below the net cost of services line within Other Operating Expenditure.</p>

# Key audit and accounting matters (continued)

AUDIT RISK AREAS			
RISK	RELATED CONTROLS	WORK PERFORMED	CONCLUSION
<b>PROPERTY, PLANT &amp; EQUIPMENT</b>			<p><b>ASSETS HELD FOR SALE</b></p> <p>Our testing of non-current assets held for sale identified one land asset (part of the Temple School site) for which an incorrect valuation methodology had been applied.</p> <p>Under IFRS 5, Authorities are required to value non-current assets held for sale at the lower of carrying value and fair value less costs to sell, where the carrying value is calculated according to the previous use of the asset. In this case, the Council has incorrectly used market value (£500,000) to value the asset, rather than existing use value (£155,000). This means that the value of the land was overstated by £345,000 in the financial statements. Management has corrected this error by reducing the revaluation reserve gains and the carrying amount of the asset by £345,000</p> <p><b>ASSET CLASSIFICATIONS</b></p> <p>Our testing identified that four assets, with a net book value of £2,759,000 had been incorrectly classified as community assets. The assets are buildings within a park (café, toilets and changing rooms), and an area of land, all of which are held for commercial use and should be therefore classified as Other Land and Buildings. Management has corrected this misclassification error within the PPE disclosure.</p> <p>Our testing identified that the classification of some assets had been inconsistently applied, for example, some allotments have been classified as community assets whilst others are included within the Other Land and Buildings balance. We have concluded that this is not significant for the financial statements but recommend the Council review the fixed asset register to ensure asset classifications are consistently applied.</p> <p><b>Conclusion</b></p> <p>In the light of the errors which continue to affect the operation of the 'Logotech' fixed asset system, it is recommended the closure of accounts process includes a critical review of the capital accounting transactions produced at the period end.</p>

## Key audit and accounting matters (continued)

AUDIT RISK AREAS			
RISK	RELATED CONTROLS	WORK PERFORMED	CONCLUSION
<b>HERITAGE ASSET VALUATIONS</b>	In our 2011/12 annual governance report, we reported the valuation of Heritage Assets was the previously obtained insurance value uplifted each year using an index determined by the Council's Insurers. The calculation was used to determine the valuation of Heritage Assets as at 1 April 2011 and 31 March 2012 for inclusion in the 2011/12 financial statements. We also reported that a formal valuation of Heritage Assets had not been undertaken for a number of years and that the Council should obtain a full valuation of its Heritage Assets as at 1 April 2012 to in producing the 2012/13 accounts. The Council has now obtained expert valuations for most Heritage Asset buildings. Insurance valuations continue to be used as a reasonable estimate for a small number of buildings. Other Heritage Assets (not buildings) are due to be valued by an expert based on a five year rolling programme. Until this time the valuation will be based on insurance records.	<p>We have assessed the work of the valuers to confirm they are independent, objective and have relevant experience. We have also reviewed the reasonableness of assumptions used in deriving the valuation amounts.</p> <p>We have substantively tested the valuations disclosed in the accounts to ensure these are fairly stated based on the valuations provided by the expert for buildings and insurance values for other assets.</p>	<p>No issues were identified by our audit testing.</p> <p>As part of the 2011/12 audit we recommended that the Council ensured that Heritage Assets were appropriately valued. Most buildings have now been valued by an external valuer for the purposes of the 2012/13 accounts and a rolling programme is being established for other assets.</p> <p>We recommend that the rolling programme is implemented in 2013/14 to ensure the first tranche of assets are appropriately valued.</p>
<b>ADULT SOCIAL CARE INCOME</b>	Care Director is the Council's adult social care information system. Throughout the year the Council experienced significant difficulties processing information from the system in order to generate accurate invoices within the sales ledger.	We substantively tested an extended sample of Care Director income to ensure the invoice amount was based on the correct financial assessment and the correct calculation of income contribution.	No issues have been identified by our extended testing of adult social care income derived from the Care Director system.
<b>EXPENDITURE AUTHORISATION</b>	Deficiencies in authorisation controls in the previous year meant some officers were approving invoices to be paid in excess of their approved limits. Since we reported such deficiencies, management stated that with effect from 1 September 2012, the Council improved its processes and controls in this area.	We tested the authorisation controls on a sample of invoices between 1 September 2012 and 31 March 2013 to ensure the controls and processes described by management had been implemented and were effective. We tested a sample of expenditure items between 1 April 2012 and 31 August 2012 to ensure such expenditure was valid.	Our testing confirmed that appropriate controls and processes have now been implemented and are effective in relation to expenditure authorisation.

## Key audit and accounting matters (continued)

AUDIT RISK AREAS			
RISK	RELATED CONTROLS	WORK PERFORMED	CONCLUSION
<b>SUNDRY DEBTOR AUTHORISATION</b>	In 2011/12 we reported the deficiencies in controls over requests for, and subsequent authorisation of, sundry debtor accounts and that controls should be implemented in accordance with financial operating procedures. Since we reported these deficiencies in controls management stated that, with effect from 1 September 2012, the Council established improved processes and controls in this area.	We tested the authorisation controls on a sample of requisitions between 1 September 2012 and 31 March 2013 to ensure the controls and processes described by management had been implemented and were effective. We tested a sample of income items between 1 April 2012 and 31 August 2012 to ensure valid services had been provided by the Council.	Our testing confirmed that appropriate controls and processes have now been implemented and are effective in relation to sundry debtor authorisation.
<b>JOURNAL AUTHORISATION</b>	We reported deficiencies in journal authorisation controls (including schools) in 2011/12 and management agreed to improve procedures in this area with effect from 1 April 2012.	We tested the authorisation controls on a sample of journals between 1 April 2012 and 31 March 2013 to ensure the controls and processes had been implemented and were effective.	Our testing confirmed that appropriate controls and processes have now been implemented and are effective in relation to journal authorisation.
<b>ACCOUNTING POLICIES</b>	The Council's accounting policies are designed to ensure compliance with relevant CIPFA guidance and accounting standards.	<p>We considered the effect of the Council's accounting policies on the transactions subject to audit testing to assess compliance with relevant guidance. We specifically reviewed the following changes introduced by the 2012/13 Code of Practice on Local Authority Accounting in the United Kingdom (the 'Code') resulting in changes in accounting practice:</p> <ul style="list-style-type: none"> <li>the objective of the financial statements and the qualitative characteristics of financial information as a result of the publication of the first phase of the International Accounting Standards Board's (IASB's) The Conceptual Framework for Financial Reporting 2010 (the Conceptual Framework)</li> <li>encouraging local authorities to prepare the Explanatory Foreword taking into consideration the requirements of the Government's Financial Reporting Manual (FRoM)</li> <li>including amendments in relation to IFRS 7 Financial Instruments: Disclosures (transfers of financial assets).</li> </ul>	We did not identify any issues for our testing of the Council's accounting policies.

## Key audit and accounting matters (continued)

AUDIT RISK AREAS			
RISK	RELATED CONTROLS	WORK PERFORMED	CONCLUSION
PENSION LIABILITY	<p>The net pension liability comprises Medway's share of the market value of assets held in the Kent County Pension Fund and the estimated future liability to pay pensions. An actuarial estimate of the pension fund liability is calculated by an independent firm of actuaries with specialist knowledge and experience. The actuarial estimate has regard to local factors such as mortality rates and expected pay rises along with other assumptions around inflation. Management has agreed the assumptions made by the actuary to support the estimate and these are disclosed in the financial statements.</p>	<p>The Audit Commission has obtained an independent review of the work of all local government pension scheme actuaries and circulated the outcome for auditors to consider. The guidance includes an assessment of independence, objectivity and experience of the actuary, as well as the reasonableness of the assumptions used in the calculation of the scheme liabilities. We have reviewed such guidance and checked that the assumptions used for the Council's scheme liabilities are within reasonable levels.</p> <p>We have also sought assurances from the auditor of the pension fund over the information on membership data and scheme assets provided to the actuary.</p>	<p>We are satisfied that the actuary is suitably independent, objective and experienced to undertake this work and that the assumptions used in the calculations are reasonable.</p> <p>There are adequate controls over the submission of data from the pension fund to the actuary.</p> <p>No issues have been identified from our testing.</p>
VALUATION OF LAND AND BUILDINGS	<p>Land and buildings are required to be carried at fair value which is either existing use value, depreciated replacement cost for specialised properties or open market value. The Council revalues land and buildings over a five year rolling programme and does not adjust for price indices between formal valuations unless there is indication of material changes. The Council reviewed all material assets as at 31 March 2013 for impairment.</p> <p>Management adjusts the value of land and buildings based on valuation reports and useful economic lives provided by an independent firm of valuers with specialist knowledge and experience valuing local authority estates, which has regard to local prices and building tender indices in the public sector.</p>	<p>We have assessed the work of the valuer to confirm they are independent, objective and have the relevant experience. We have also reviewed the reasonableness of assumptions used in deriving the valuation amounts.</p>	<p>We are satisfied that the valuer is suitably independent of the Council, objective and experienced in undertaking valuation work. Our review of the valuations provided, when compared to other price index information available, and useful economic lives allocated to buildings and significant components showed that they are not unreasonable.</p>

## Key audit and accounting matters (continued)

AUDIT RISK AREAS			
RISK	RELATED CONTROLS	WORK PERFORMED	CONCLUSION
INFRASTRUCTURE ASSETS	<p>In 2011/12 we reported that the Council was depreciating infrastructure assets over an average life of 13 years rather than the 15 to 20 years expected by the accounting policy.</p> <p>We also reported that nine infrastructure assets with a carrying amount of £19,944,000 had not been depreciated in the year but should have been depreciated in line with the Council's accounting policy. We reported an unadjusted error of £1,140,000 relating to the estimated depreciation that should have been charged for these assets.</p> <p>Officers agreed our recommendation to obtain a valuation and UEL for these assets as at 1 April 2012 in preparing the 2012/13 financial statements to rectify these issues.</p>	<p>We reviewed CIPFA guidance and publications in relation to the emerging issues around valuing infrastructure assets.</p> <p>We also reviewed infrastructure assets that had not been depreciated to determine if they should have been depreciated.</p>	<p>There has been on-going consultation (by CiPFA) in relation to the valuation of infrastructure assets and it is expected that the change to the CIPFA 'Code' will take effect from 2014/15. With this in mind the Council has not revalued these assets until final guidance is circulated. We recommend that the Council keeps up-to-date with any changes in the Code in the future to ensure infrastructure assets are appropriately valued.</p> <p>We have reviewed all infrastructure assets recorded in the asset register and identified nine assets (identified in prior year), with a carrying value of £20,749,000 had not been depreciated in year but should have been depreciated in line with the Council's accounting policy. The carrying amount has increased compared to the prior year because of additional expenditure added to those assets previously identified. Since producing the draft version of the accounts the Council has reviewed these assets and calculated the impact of not depreciating the asset since their addition to the asset register over the last five years. The total impact on the CIES for this period is an understatement of expenditure amounting to £3,320,000, and of this £1,070,000 relates to 2012/13. Management has corrected this error by increasing highways and transport service gross expenditure by £3,320,000 in 2012/13 and reducing the assets carrying value as at 31 March 2013 by the same amount.</p>



## Key audit and accounting matters (continued)

AUDIT RISK AREAS			
RISK	RELATED CONTROLS	WORK PERFORMED	CONCLUSION
MOVEMENT IN RESERVES STATEMENT	<p>This Statement shows the movement in the year on the different reserves held by the Council, analysed into “usable” reserves (those that can be applied to fund expenditure or reduce local taxation) and other reserves.</p> <p>The “Surplus or (Deficit) on the provision of services” line shows the true economic cost of providing the Council’s services, more details of which are shown in the Comprehensive Income and Expenditure Statement. These are different from the statutory amounts required to be charged to the General Fund balance and Housing Revenue Account (HRA) for Council Tax setting and dwellings rent setting purposes.</p> <p>The “Net increase/decrease before transfers to Earmarked Reserves” line shows the statutory General Fund balance and HRA balance before any discretionary transfers to or from Earmarked Reserves undertaken by the Council.</p> <p>Finance staff prepared the statement using guidance and the model provided by CIPFA.</p>	<p>We reviewed the movement in reserves statement to ensure its consistency, completeness and accuracy compared with other areas of the accounts and supporting documentation.</p> <p>We also reviewed the transfers to and from reserves for validity and compliance with guidance and regulations.</p>	<p>We are currently reviewing the revised movement in reserves statement provided by management to correct the £547,000 imbalance in the transfers to/from earmarked reserves.</p> <p>Our testing of schools balances identified the total balance as at 31 March 2013 was understated by £139,000. The error is trivial, and arose when three schools federated, and the merger of the balances was not correctly processed in the ledger. Management has since corrected this error.</p>
NNDR DEFERRED PAYMENTS	<p>The NNDR deferral scheme provides rate payers with the option of spreading the Retail Price Index increase in 2012/13 bills over three years, to help businesses manage their cash flow during the economic downturn. The Head of Revenues and Benefits ensures deferred payments are correctly calculated by following guidance issued by the Government and also ensures the deferred amounts are included within the NNDR3 return and adjusted for when calculating the Council’s payment to the national pool within the collection fund.</p>	<p>We tested deferral schemes to ensure that reductions had only been made where there was an application from the ratepayer by 31 March 2013 and that 3.2 per cent of the 2012/13 annual rates bill was deferred in accordance with relevant guidance.</p>	<p>Our testing did not identify any issues with deferral schemes reductions made by the Council and disclosed with the NNDR 3 return to the Government. However, we found that because the collection fund had been finalised before the NNDR 3 return was completed, deferred payments amounting to £337,000 had not been reflected in the payment to the national pool within the collection fund disclosed in the draft accounts. Management reduced the payment to the national pool by £337,000 because the amounts are not collectable until the year in which the deferral ends.</p>

## Key audit and accounting matters (continued)

AUDIT RISK AREAS			
RISK	RELATED CONTROLS	WORK PERFORMED	CONCLUSION
HRA CONSOLIDATION INTO THE CIES	<p>The ledger is set up by the finance team to ensure that gross income and expenditure and income and expenditure falling below the net cost of HRA services line within the HRA income and expenditure statement is consolidated with the correct line in the comprehensive income and expenditure statement (CIES).</p>	<p>We compared the HRA income and expenditure and the CIES to ensure each line had been consolidated correctly.</p>	<p>Our testing found that gross income and expenditure lines within the CIES were overstated by £59,000 and by £769,000 respectively compared to corresponding HRA entries.</p> <p>The majority of the error related to £687,000 of interest payable and similar charges being included as expenditure in the net cost of services within the CIES, which should have been included within financing and investment income and expenditure below the service line. The residual amount relates to rechargeable repairs income being netted from expenditure in the HRA (£36,000), and IAS 19 adjustment difference between the two statements (£47,000). Management corrected the errors to reduce income and expenditure in the CIES to match that reported in the HRA. This does not impact on the deficit reported in the CIES.</p>
CAPITAL GRANTS UNAPPLIED ACCOUNT	<p>Capital grants and contributions are credited to the Comprehensive Income and Expenditure Statement when they are received and then reversed from the General Fund Balance in the Movement in Reserves Statement. Where the grant has yet to be used to finance capital expenditure, it is posted to the Capital Grants Unapplied Account. Where it has been applied, it is posted to the Capital Adjustment Account (CAA). Amounts in the Capital Grants Unapplied Account are transferred to the CAA when applied to fund capital expenditure.</p> <p>The finance team maintain a grants register to record capital grants and contributions brought forward from previous years and any amounts received in-year. This then allows officers to account for grants that have been received and applied in-year; and other grants applied in-year but where the income was set aside in previous years and thereby transferred to the CAA from the Capital Grants Unapplied Account.</p>	<p>We substantively tested a sample of capital grants and contributions to ensure the grant had been received and utilised correctly.</p>	<p>Our testing identified that £478,000 in excess of the balance in the Capital Grants Unapplied Account relating the Strood Academy Grant had been transferred to the Capital Adjustment Account.</p> <p>Management has corrected the accounts to remove the amount from the Capital Grants Applied Account and increase accrued income.</p>

# Key audit and accounting matters (continued)

## AUDIT RISK AREAS - Key audit and accounting matters (continued)

RISK	RELATED CONTROLS	WORK PERFORMED	CONCLUSION
<p>DISCLOSURE REQUIREMENTS</p>	<p>Finance staff prepared the financial statements using the model provided by CIPFA.</p>	<p>We reviewed the detailed disclosure requirements with our knowledge and understanding of the transactions of the Council.</p>	<p>The following amendments have been made by management to the financial statements:</p> <ul style="list-style-type: none"> <li>• reclassified £655,000 of 'negative' short term creditors to debtors</li> <li>• separately disclosed impairments from other revaluations within the impairment losses note</li> <li>• amendments to the HRA notes to correctly disclose the number of council dwellings, the valuation of the dwellings and inclusion of further narrative to clarify the disposal of Shalder House previously reclassified to a surplus asset</li> <li>• prior year exit package and property, plant and equipment comparative figures amended to agree to the prior year audited accounts</li> <li>• classification of exit packages between compulsory and other redundancies amended to agree to underlying records</li> <li>• Members allowances and exit package disclosure increased by £1,363 and £8,886 respectively to agree to expenditure disclosed in the CIES</li> <li>• pension disclosure updated to correctly show the liabilities for the current year</li> <li>• council tax base disclosure amended to reflect the base used to determine the 2012/13 council tax amount</li> <li>• related party transaction disclosure updated to include Kent, Fire and Recue and Frindsbury Extra Parish Council</li> <li>• financial instruments disclosure updated to reconcile to respective areas of the accounts</li> <li>• amounts reported for resource allocation decisions amended in order to reconcile back to the CIES and grant income included within note 26.</li> </ul>

### BDO CONCLUSION

Subject to satisfactory completion of the outstanding work, we anticipate issuing an unqualified true and fair opinion on the financial statements for the year ended 31 March 2013.

# CONTROL ENVIRONMENT

## Significant deficiencies

We are required to report to you, in writing, significant deficiencies in internal control that we have identified during the audit. These matters are limited to those which we have concluded are of sufficient importance to merit being reported to you.

As the purpose of the audit is for us to express an opinion on the Council's financial statements, you will appreciate that our audit cannot necessarily be expected to disclose all matters that may be of interest to you and, as a result, the matters reported may not be the only ones which exist. As part of our work, we considered internal control relevant to the preparation of the financial statements such that we were able to design appropriate audit procedures. This work was not for the purpose of expressing an opinion on the effectiveness of internal control.

We would highlight that in this report we do not provide a comprehensive statement of all weaknesses that may exist in the financial and operational systems, but only those matters which have come to our attention as a result of the audit procedures performed. We only restate weaknesses already reported by Internal Audit where we consider these to be significant deficiencies. Recommendations in response to the key findings identified by our audit of the financial statements are provided in the action plan at Appendix V. These recommendations have been discussed with appropriate officers and their responses are included.

AREA	OBSERVATION	IMPLICATION	RECOMMENDATION
<b>ADULT SOCIAL CARE PANEL AUTHORISATIONS</b>	Our testing found the Council's procedures are open to interpretation on when adult social care panel authorisations are required.	We believe that this issue exposes the Council to a risk of committing to inappropriate or incorrect expenditure if correct authorisation procedures have not been followed.	We recommend that procedures are updated to ensure officers involved in the authorisation process apply such rules consistently.
<b>ADULT SOCIAL CARE FINANCIAL ASSESSMENTS PROCESS AND CHECKS</b>	Our testing found that three from a sample of 15 adult social care clients had not received a financial assessment when they should have. We also found that the Council's 10 per cent check of financial assessments had identified a high error rate when comparing the outcome of the financial assessments to the information recorded within the adult social care information system (Care Director). We also found that when errors had been identified these were not always followed up and rectified.	We believe that this issue exposes the Council to a risk of over or under paying adult social care clients.	We recommend that the Council improve procedures for checking financial assessments and increasing the number of checks performed when a high number of errors are identified.
<b>PAYROLL AUTHORISATION RECORDS</b>	Our testing identified that central records to confirm authorised signatories for starters, leavers, masterfile changes and temporary payments was not up to date.	We believe that this exposes the Council to a risk of payroll payments being made without confirming the appropriate signatory has been sought.	We recommend that the Council update central authorised signatory records and review these on a regular basis to ensure they are kept up-to-date.

## MATTERS REQUIRED TO BE REPORTED BY OTHER AUDITING STANDARDS

### Whole of Government Accounts

We are required to perform tests with regard to the WGA return prepared by the Council for use by the Department of Communities and Local Government for the consolidation of the local government accounts, and by HM Treasury at Whole of Government Accounts level. This work requires checking the consistency of the WGA return with the audited financial statements, and reviewing the consistency of income and expenditure transactions and receivables and payable balances with other government bodies.

### Audit issues and impact on opinion

We have not yet completed the audit of the Council's WGA return. The findings from our review of the consistency of this return with the audited financial statements will be circulated to members of the Audit Committee before 4 October 2013 submission deadline.

### Annual Governance Statement

We currently reviewing the draft Annual Governance Statement to ensure we are satisfied that it is not inconsistent or misleading with other information we are aware of from our audit of the financial statements, the evidence provided in the Council's review of effectiveness and our knowledge of the Council.

### Audit issues and impact on opinion

We are in the process of reviewing the Annual Governance Statement and will update the Audit Committee with our findings at the meeting on 25 September 2013.

# USE OF RESOURCES

## Scope of the review

We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources (value for money). In accordance with our audit plan, our principal work in arriving at our value for money conclusion was comparing the Council's performance against the requirements specified by the Audit Commission in its guidance to auditors. This is based on the following two reporting criteria:

- the organisation has proper arrangements in place for securing financial resilience
- the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

The focus of the criteria for 2012/13 is:

- the organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future
- the organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity undertaking other local risk-based work, as appropriate.

## Financial resilience

### Work performed and key findings

Our financial resilience risk assessment considered the Council's arrangements for financial governance, financial planning and financial control. Our detailed work also considered the Council's arrangements for managing financial risks and opportunities and securing future financial stability. Our risk based planning identified that the Council may not identify or achieve the significant savings and efficiencies required in the medium term to respond to the reduction in government funding and other financial pressures.

#### KEY FINDINGS

The Council's financial governance arrangements enable strong leadership on financial matters through the work of the Cabinet and the Senior Management Team. The Council's financial performance and associated financial risks are consistently understood across the organisation through the quarterly reports reviewed (and published) by the Cabinet and the four Overview and Scrutiny Committees. Among officers, financial responsibilities are clearly assigned and the Senior Management Team oversees the corporate response to expenditure pressures and other financial risks emerging in the year, and the overall achievement of the annual budget. Financial risks are reported to the Cabinet and action required to address such risk is agreed.

### Audit issues and impact on conclusion

The Council will need to ensure the additional investment in those services identified for improvement is sustainable and that the required improvement in performance is secured.

Significant resource gaps have been identified in 2014/15 (£16 million) and in 2015/16 (£34 million). Further pressure is being placed on the Council's general and earmarked reserves. Ensuring financial balance over the medium term planning horizon will continue to require strong action by the Council.

## Financial resilience (continued)

### Work performed

Financial Planning is embedded across the organisation through the annual budget setting process. The medium term financial plan (MTFP) covers a four year period and is updated annually. While the financial position is balanced in the period to 31 March 2014, significant resource gaps have been identified in 2014/15 (£16 million) and in 2015/16 (£34 million). The Cabinet is developing various options to address the resource gap, including further reducing expenditure, opportunities for joint working with other local authorities, securing further procurement efficiencies and increasing income streams. However, further pressure is being placed on the Council's general and earmarked reserves and there remains little room for manoeuvre in the event that demand-led expenditure pressures emerge over the remainder of the financial year.

The Council has agreed to invest further resources to implement the improvement plans agreed following the inspection of services by external regulators. The Council will need to ensure such investment is sustainable and that anticipated improvement in services is secured.

The Council's arrangements for ensuring financial control remain effective. The overall financial position was monitored closely throughout the year and the risk of a forecast overspend of about £1 million was addressed through strong corporate action. The Council reported a surplus of £2.8 million as at 31 March 2013 and the general reserve was increased by £1.6 million when the original budget anticipated reducing the general reserve £1.2 million. The base budget was achieved through planned savings and other efficiencies amounting to £13.5 million

### Audit issues and impact on conclusion

# Challenging economy, efficiency and effectiveness

## Work performed

Our risk assessment and review of economy, efficiency and effectiveness has considered the Council's arrangements for prioritising resources within tighter budgets and improving efficiency and productivity.

### KEY FINDINGS

#### Children's Services

##### *Reports by the external regulator*

In January 2013, Ofsted carried out an unannounced inspection of the Council's services for the protection of children and concluded that the overall effectiveness of the service was inadequate (below minimum requirements). The review considered the effectiveness of the help and protection provided to children and young people, families and carers; the overall quality of practice; and the leadership and governance provided by the Council. Ofsted specified action the Council should implement immediately and over the next six months (commencing February 2013) and issued an improvement notice the Council responded to. The Council has established a Children's Improvement Board under the leadership of an independent Chairperson and involving senior management including the Chief Executive.

There is wide representation on the Board among strategic partners including schools, the local Clinical Commissioning Group and the Police Service. The Lead Member for Children's Services also attends and reports progress and outcomes to the Cabinet. The Council has prepared an improvement plan with measurable outcomes and milestones and has identified the additional resources needed to deliver it.

A further unannounced inspection of services for looked after children (LAC) was undertaken by Ofsted in July 2013. Ofsted reviewed the Council's capacity to improve LAC services; the outcomes for looked after children and young people; the quality of service provision and the Council's leadership and management. Overall, Ofsted considered the LAC service to be inadequate but did conclude the capacity of the service to improve was adequate. The Council is considering its response to the report.

## Audit issues and impact on conclusion

#### Children's Services

##### *Significant matter reported by exception*

The Audit Commission requires us to report by exception on any significant additional matter that comes to our attention and which we consider to be relevant to the establishment of proper arrangements to secure economy, efficiency and effectiveness in the use of resources. We consider the findings of the Ofsted inspections in January 2013 and July 2013 to be significant matters which we have reported in our Value for Money conclusion.

Progress towards the Council's improvement plans for the services judged by the external regulator to be inadequate will continue to require strong leadership and management action within the Council and through the Children's Improvement Board



# Challenging economy, efficiency and effectiveness (continued)

## Work performed

### Schools performance

Ofsted completed a co-ordinated review of 10 primary schools in July 2013. The review was planned because Ofsted considered the quality of education provided in certain primary schools to be behind national benchmarks. Ofsted's interim report on eight schools concluded two were performing at a 'good' level and that six required further improvement. The Council is considering the further action required in the light of the inspection reports received to date.

The Council has kept the performance of pupils at 'Key Stage 2' under close review through the work of the Children and Young People Scrutiny Committee and regular reports to the Cabinet. In 2012, Medway schools reported that:

- level 4 achievement in both English and mathematics increased to 72 per cent
- two levels of progress in English increased to 87 per cent - a rise of five percentage points but two percentage points below the national average
- two levels of progress in mathematics increased to 82 per cent - a rise of five percentage points but five percentage points below the national average of 87 per cent
- 62 per cent of disadvantaged pupils (the group represents 29 per cent of the Medway cohort for 2012) gained level 4 or better in both English and mathematics - an increase of 11 percentage points on 2011.

### Schools Key Stage 2 performance

The Council is continuing to work with schools towards the improvement plan agreed to address the underperformance at Key Stage 2 and to raise performance towards the national average.

## Audit issues and impact on conclusion

The Council will need to keep those primary schools identified by the external regulator as underperforming under close review and take appropriate action to improve performance.

Further action may be required to ensure the achievement of pupils at 'Key Stage 2' meets the Council's targets and national benchmarks.

# Challenging economy, efficiency and effectiveness (continued)

## Work performed

## Audit issues and impact on conclusion

### OTHER FINDINGS

We have no matters to report.

#### Joint Health and Well Being Board

Medway has a strong track record of achievement with NHS Partners to deliver effective joint outcomes. The Health and Well Being Board worked in shadow form throughout the year and became fully operational on 1 April 2013.

Examples of continuing, positive outcomes include the work of the Integrated Care Team under the supervision of a Medway Council Assistant Director. The Team is working in agreed priority areas to tackle a number of long term conditions affecting Elderly People and those with physical and learning disabilities. The Council has also agreed a delivery plan, based on priorities agreed with its NHS Partners to invest the resources now provided under the Public Health Resource Allocation and a delivery plan is in place. The full integration of public health staff into the Council was achieved before the 1 April 2013 deadline set by the Government.

As at 31 March 2013, the Council reported the following performance towards its targets and priority actions:

- no delayed transfers of care
- take up of personal budget and direct payments was 62% per cent and ahead of the target of 60 per cent
- a new commissioning for carers strategy was published based on consultation with carers.

#### Category Management and Procurement

The Category Management approach has continued to develop and embed across the Council. In 2012/13, 22 FTE posts were assigned to the central team to co-ordinate procurement activity across the Council and to secure further efficiencies. The more significant procurements and savings achieved in the year and expected in future years involve the Homecare service (£1.4 million secured in 2012/13 and a further £500,000 expected in 2013/14); Facilities management (£200,000 expected in 2013/14); Agency staffing (£250,000 expected in 2013/14) and High cost social care placements (£600,000 expected in 2013/14).

## Challenging economy, efficiency and effectiveness (continued)

### Work performed

A new procurement strategy was published in July 2013 and was developed in consultation with the local business community. The Council believes the strategy is a more outward looking document and supports Medway's aims to procure more goods and services from local businesses, especially Small and Medium sized Enterprises (SMEs). The strategy should also assist in achieving Medway's priorities for assisting local people into work and ensuring the local population secures the maximum benefit from Council decisions.

### Performance towards corporate priorities

The Council reported positive performance in many areas in 2012/13 and 44 out of 78 Council Plan Key measures of success met or exceeded the published target in the year. This compares with 42 out of 68 targets met or exceeded in 2011/12. Some 34 out of 62 of Council Plan Key measures of success improved compared to the previous year, with higher satisfaction levels reported by service users and other people contacting the Council through its website.

### Audit issues and impact on conclusion

## Value for money conclusion

### Work performed

### BDO CONCLUSION

Our value for money conclusion is based on considering our overall risk assessment, focusing on the two criteria set by the Audit Commission, and the results of risk based audit work, as well as consideration of the processes underpinning your review of the effectiveness of your controls as described in your Annual Governance Statement.

We are satisfied that, in all significant respects, the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2013. We will be issuing an unqualified value for money conclusion. We will report the significant matter regarding the conclusions of the external regulator (Ofsted) by exception.

### Audit issues and impact on conclusion



# APPENDICES

# APPENDIX I: DEFINITIONS

TERM	MEANING
<b>The Council</b>	Medway Council
<b>Management</b>	The person(s) responsible for achieving the objectives of the Council and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management is responsible for the financial statements, including designing, implementing, and maintaining effective internal control over financial reporting.
<b>Those charged with governance</b>	<p>The person(s) with responsibility for overseeing the strategic direction of the Council and obligations related to the accountability of the entity. This includes overseeing the financial reporting process.</p> <p>Those charged with governance for the Council are the Audit Committee.</p>
<b>ISAs (UK &amp; Ireland)</b>	International Standards on Auditing (UK & Ireland)
<b>IAS</b>	International Accounting Standards
<b>IFRS</b>	International Financial Reporting Standards as adopted by the European Union
<b>Materiality</b>	The size or nature of a misstatement that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable user of the financial statements would have been changed or influenced as a result of the misstatement.
<b>Code</b>	Code of Practice on Local Authority Accounting in the United Kingdom 2012/13
<b>CIES</b>	Comprehensive Income and Expenditure Statement
<b>SeRCoP</b>	Service Reporting Code of Practice for Local Authorities 2012/13
<b>WGA</b>	Whole of Government Accounts

## APPENDIX II: MATERIALITY

MATERIALITY	
Planning materiality	£6,000,000
Final materiality	£6,000,000
Clearly trivial threshold	£180,000

Planning materiality of £6,000,000 for the Council was based on 1% of gross expenditure.

## APPENDIX III: INDEPENDENCE

### INDEPENDENCE - ENGAGEMENT TEAM ROTATION

SENIOR TEAM MEMBERS	NUMBER OF YEARS INVOLVED	ROTATION TO TAKE PLACE IN YEAR ENDED
ROBERT GRANT - Audit engagement partner	6	2013/14
KERRY BARNES - Audit manager	5	2017/18
JODY ETHERINGTON - Assistant manager	1	2017/18

### INDEPENDENCE - THREATS TO INDEPENDENCE AND APPROPRIATE SAFEGUARDS

We have not identified any potential threats to our independence as auditors of the 2012/13 financial statements.

We confirm that the firm complies with the APB Ethical Standards and, in our professional judgement, is independent and objective within the meaning of those Standards.

In our professional judgement the policies and safeguards in place ensure that we are independent within the meaning of all regulatory and professional requirements and that the objectivity of the audit engagement partner and audit staff is not impaired.

Should you have any comments or queries regarding this confirmation we would welcome their discussion in more detail.

## APPENDIX IV: ACTION PLAN

FINANCIAL STATEMENT RECOMMENDATIONS				
CONCLUSIONS FROM WORK	RECOMMENDATION	MANAGEMENT RESPONSE	RESPONSIBILITY	TIMING
<p><b>Fixed Asset Register</b></p> <p>In the light of the errors which continue to affect the operation of the 'Logotech' fixed asset system, it is recommended the closure of accounts process includes a critical review of the capital accounting transactions produced at the period end.</p>	<p>Ensure the closedown timetable includes a critical review of balances produced by the fixed asset register.</p>	<p>We agree that a critical review of Logotech accounting entries will be built into the closedown timetable</p>	<p>Finance Support Manager</p>	<p>31 March 2014</p>
<p><b>Revenue expenditure funded from capital under statute (REFCUS)</b></p> <p>Our testing identified instances where expenditure on asset components was being accounted for as REFCUS because the expenditure fell below the Council's de minimis of £25,000 for capitalising expenditure. We consider that the de minimis should be used when reviewing additions as a whole for an individual asset rather than on a component basis.</p>	<p>We recommend that the Council reviews the treatment of REFCUS on component expenditure going forward.</p>	<p>During 2013/14 a review of the treatment of REFCUS on component expenditure will be carried out with particular focus on the use of the £25,000 de minimis for capitalising expenditure.</p>	<p>Finance Support Manager</p>	<p>31 March 2014</p>
<p><b>Capital and revenue expenditure</b></p> <p>Our testing identified some instances where expenditure had been capitalised but should have been accounted for as revenue.</p>	<p>We recommend that officers, coding expenditure to the ledger, are aware of what can and can not be capitalised to avoid any potential significant errors in the future.</p>	<p>During 2013/14 clear guidance will be produced on defining Capital and Revenue expenditure and issued via the relevant accountants to Capital budget managers</p>	<p>Finance Support Manager, Community Services Manager, Corporate Accountant</p>	<p>31 March 2014</p>
<p><b>Classification of property, plant and equipment (PPE)</b></p> <p>Our testing identified that the classification of some PPE assets had been inconsistently applied, for example, some allotments have been classified as community assets whilst others sit within other land and buildings.</p>	<p>We recommend the Council reviews the asset register to ensure asset classifications are being consistently applied.</p>	<p>During 2013/14 the asset register will be reviewed to ensure correct classification of assets</p>	<p>Finance Support Manager</p>	<p>31 March 2014</p>



**FINANCIAL STATEMENT RECOMMENDATIONS (continued)**

CONCLUSIONS FROM WORK	RECOMMENDATION	MANAGEMENT RESPONSE	RESPONSIBILITY	TIMING
<p><b>Heritage Asset valuations</b></p> <p>As part of the 2011/12 audit we recommended that the Council ensured that Heritage Assets were appropriately valued. We are pleased to note that buildings have been valued by an external valuer for the purposes of the 2012/13 accounts and that a rolling programme is being established for non-buildings assets.</p>	<p>We recommend that the rolling programme is implemented in 2013/14 to ensure the first tranche of assets are appropriately valued.</p>	<p>The rolling programme will be introduced for 2013/14 to ensure the first tranche of assets are appropriately valued</p>	<p>Risk, Insurance, systems and exchequer Manager</p>	<p>2013/14</p>

**INTERNAL CONTROL RECOMMENDATIONS**

<p><b>Adult Social Care Panel Authorisations</b></p> <p>Our testing found the Council's procedures are open to interpretation on when adult social care panel authorisations are required. We believe that this issue exposes the Council to a risk of committing to inappropriate or incorrect expenditure if correct authorisation procedures have not been followed.</p>	<p>We recommend that procedures are updated to ensure officers involved in the authorisation process apply such rules consistently</p>	<p>With the implementation of the new computer system (Framework), the panel process will cease and authorisation of placements will be effected through clear delegations within the system, in line with the scheme of delegated authority.</p>	<p>Deputy Director, Children &amp; Adults Services</p>	<p>Oct 2013</p>
<p><b>Adult Social Care Financial Assessments Process and Checks</b></p> <p>Our testing found that three from a sample of 15 adult social care clients had not received a financial assessment when they should have. We also found that the Council's 10 per cent check of financial assessments had identified a high error rate when comparing the outcome of the financial assessments to the information recorded within the adult social care information system (Care Director). We also found that when errors had been identified these were not always followed up and rectified</p>	<p>We recommend the Council improve procedures for checking financial assessments and increasing the number of checks performed when a high number of errors are identified.</p>	<p>With the introduction of Framework I improved procedures will be in place to identify and rectify any errors</p>	<p>Martin Garlick</p>	<p>Oct 2013</p>
<p><b>Payroll Authorisation Records</b></p> <p>Our testing identified that central records to confirm authorised signatories for starters, leavers, 'masterfile' changes and temporary payments was not up to date. We believe that this exposes the Council to a risk of payroll payments being made without confirming the appropriate signatory has been sought.</p>	<p>We recommend that the Council update central authorised signatory records and review these on a regular basis to ensure they are kept up-to-date</p>	<p>Steps have already been taken to update the list of Authorised Signatures for Managers who have delegated responsibility to sign Payroll documents. This includes liaison with Medway Councils Internal Audit Manager to determine the appropriate way forward.</p>	<p>Stuart Bull</p>	<p>End of November 2013</p>

## USE OF RESOURCES RECOMMENDATIONS

CONCLUSIONS FROM WORK	RECOMMENDATION	MANAGEMENT RESPONSE	RESPONSIBILITY	TIMING
<b>Financial Resilience</b>				
The medium term financial strategy indicates that the financial position is balanced for the 2013/14 period. Significant resource gaps have been identified in 2014/15 (£16 million) and in 2015/16 (£34 million).	Ensuring financial balance over the medium term planning horizon will continue to require strong action by the Council.	The MTFP identifies a cumulative resource gap to 2020 of £72m. The Council has a proven record of strong financial management and is focussed on meeting this challenge.	Chief finance Officer	February 2014
Further pressure is being placed on the Council's general and earmarked reserves.	The Council will need to ensure the additional investment in those services identified for improvement is sustainable and that the required improvement in performance is secured.	Additional funding requirement is identified in the MTFP to support the improvement requirements. The Children's Improvement Board is monitoring progress against the improvement plan.	Director of Children and Adult services	On-going
<b>Economy, efficiency and effectiveness</b>				
<b>Children's Services.</b>				
The external regulator (Ofsted) judged services for the protection of children to be inadequate in January 2013. A further review of services for looked after children found these to be inadequate overall though the capacity of the service was found to be adequate (in July 2013).	Progress towards the Council's improvement plans for those children's services judged by the external regulator to be inadequate will continue to require strong leadership and management action within the Council and through the work of the Children's Improvement Board	The Improvement Plan has been agreed and formally signed-off. Implementation is underway. The leadership team are focused on driving this transformation forward and there is robust monitoring in place.	Director of Children and Adult Services	Immediate and on-going
The Council is aware performance in certain schools is below target levels and Ofsted completed a review of 10 primary schools in the year.	The Council will need to keep those primary schools identified by the external regulator as underperforming under close review and take appropriate action to improve performance.	Focused action is required to address under performance, with close support for Head Teachers to ensure sustained improvement. The Schools Forum has approved creation of a £200,000 fund which will be available for schools to bid against in order to fund school improvement initiatives.	Director of Children and Adult Services	Immediate and on-going

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**Economy, efficiency and effectiveness**

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**Children's Services.**

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Progress towards achievement of 'Key Stage 2' was behind target in the year	Further action may be required to ensure the achievement of pupils at 'Key Stage 2' meets the Council's targets and national benchmarks.	School's leadership are focused on addressing this and there are signs of improvement. Support and challenge from the Local Authority is necessary to continue to make sustained improvement at pace. The Schools Forum has approved creation of a £200,000 fund which will be available for schools to bid against in order to fund school improvement initiatives.	Director of Children and Adult Services	On-going
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## APPENDIX V: FEES SCHEDULE

The Audit Commission's *Standing Guidance for Auditors* requires us to report the outturn fee position for the year against the budgeted fee included within our Audit Plan.

We will carry out a detailed comparison of actual audit costs incurred against planned costs when we have completed the audit and discuss any impact on the planned fee of £207,460 with management, before we report the final fee outturn.

## APPENDIX VI: STATUTORY AND PROFESSIONALLY REQUIRED COMMUNICATIONS

COMMUNICATION REQUIRED	DATE COMMUNICATED	TO WHOM	METHOD
	25 September 2013	Management and those charged with governance	Report to Audit & Finance Committee
Potential effect on the financial statements of any material risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements.	Not an issue	Not an issue	Not an issue
Misstatements, whether or not recorded by the entity	✓	✓	✓
The final draft of the representation letter	✓	✓	✓
Material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern	Not an issue	Not an issue	Not an issue
Disagreements with management about matters that, individually or in aggregate, could be significant to the entity's financial statements or our audit report	Not an issue	Not an issue	Not an issue
Expected modifications to our audit report or inclusions of emphasis of matter / other matter	✓	✓	✓
Significant deficiencies in internal control	✓	✓	✓
Any other matters warranting attention by those charged with governance, such as questions regarding management integrity, and fraud involving management	Not an issue	Not an issue	Not an issue
Management judgements and accounting estimates	✓	✓	✓
Other information in documents containing audited financial information	✓	✓	✓
Consultation with other accountants	Not an issue	Not an issue	Not an issue
Major issues discussed with management	Not an issue	Not an issue	Not an issue

# APPENDIX VII: DRAFT REPRESENTATION LETTER

*The following draft letter of representation covers the Council's Statement of Accounts. Representations for the preparation of the Statement of Accounts will be sought from the Chief Finance Officer and from Members on behalf of the Council in relation to its responsibility to approve the Statement of Accounts and the Annual Governance Statement.*

BDO LLP  
55 Baker Street  
London  
W1U 7EU

25 September 2013

Dear Sirs

## **Financial statements of Medway Council for the year ended 31 March 2013**

This representation letter is provided in connection with your audit of the financial statements of Medway Council for the year ended 31 March 2013 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view, have been properly prepared in accordance with the relevant financial reporting framework and have been prepared in accordance with the requirements of applicable law.

I confirm to the best of my knowledge and belief, and having made appropriate enquiries of directors and officers of the Council, the following representations given to you in connection with your audit of the Council's financial statements:

### **FINANCIAL STATEMENTS**

#### **Responsibility for financial statements**

I acknowledge as the Chief Finance Officer and s151 Officer my responsibilities for the Statement of Accounts, which include the financial statements, and for ensuring that these are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom and have been prepared in accordance with the requirements of applicable law.

#### **Significant assumptions**

I confirm that the significant assumptions used in making accounting estimates, including those measured at fair value, are reasonable.

##### **(a) Pension fund assumptions**

I confirm that the actuarial assumptions underlying the valuation of the Local Government Pension Scheme (LGPS) scheme liabilities, as applied by the scheme actuary, are reasonable and consistent with my knowledge of the business. These assumptions include:

- |   |      |
|---|------|
| • Rate of inflation (RPI)                 | 2.6% |
| • Rate of increase in salaries            | 4.8% |
| • Rate of increase in pensions            | 2.6% |
| • Expected return on assets               | 5.8% |
| • Rate for discounting scheme liabilities | 4.6% |

I also confirm that the actuary has applied up-to-date mortality tables for life expectancy of scheme members in calculating scheme liabilities.

##### **(b) Carrying value of land and buildings**

I am satisfied that the carrying value of land and buildings is materially consistent with the fair value at 31 March 2013, and that no adjustment is required to those assets that were revalued as part of the revaluations carried out as at 1 April 2012.

#### **Accounting policies**

I confirm that the selection and application of the accounting policies used in the preparation of the financial statements are appropriate.

#### **Plans or intentions**

I confirm that the Council has no plans or intentions that may materially alter the carrying value and, where relevant, the fair value measurements or classification of assets and liabilities reflected in the financial statements.

#### **Litigation and claims**

I have disclosed to you all known actual or possible litigation and claims, the effects of which should be considered when preparing the financial statements and these have been accounted for and disclosed in accordance with the applicable financial reporting framework.

#### **Related parties**

I confirm that related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of the applicable financial reporting framework.

#### **Subsequent events**

All events occurring subsequent to the date of the financial statements for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

#### **Going concern**

I confirm that I am satisfied that it is appropriate for the financial statements to have been drawn up on the going concern basis. In reaching this conclusion I have taken into account all relevant matters of which I am aware and have considered a future period of at least one year from the date on which the financial statements will be approved.

### **INFORMATION PROVIDED**

#### **Completeness of information**

All the accounting records have been made available to you for the purpose of your audit. I have provided you with all other information requested and given unrestricted access to persons within the Council from whom you determined it necessary to obtain audit evidence. All other records and related information, including minutes of all management and Committee meetings held during the year and up to the date of this letter have been made available to you.

All transactions undertaken by the Council have been recorded in the accounting records and are reflected in the financial statements.

There is no relevant audit information needed by you in connection with preparing your audit report of which you are unaware.

#### **Internal Control**

I acknowledge my responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.

I have communicated to you all significant deficiencies in internal control of which I am aware.

#### **Fraud**

I have disclosed to you the results of my assessment of the risk that the financial statements could be materially misstated as a result of fraud.

I have disclosed to you my knowledge of fraud or suspected fraud affecting the Council involving management, employees who have significant roles in internal control or others where the fraud could have a material effect on the financial statements

I have disclosed to you my knowledge of any allegations of fraud, or suspected fraud affecting the financial statements communicated to me by employees, former employees, analysts, regulators or others.

**Compliance with laws and regulations**

I am not aware of any actual or possible instances of non-compliance with laws and regulations whose effects should be considered when preparing the financial statements of the Council.

**Related parties**

I confirm that I have disclosed to you the identity of the Council's related parties, related party relationships and transactions of which I am aware.

**Liabilities, contingent liabilities or guarantees**

There are no liabilities, contingencies or guarantees to third parties other than those disclosed in the financial statements.

**Title to assets**

The Council has satisfactory title to all assets and there are no liens or encumbrances on the assets except for those disclosed in the financial statements.

**Contractual agreements**

The Council has complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance.

Yours faithfully

**Mick Hayward**  
Chief Finance officer (s151 officer)



## **Representations of the Council**

We confirm to the best of our knowledge and belief, and having made appropriate enquiries of other officers and members of the Council, the following representations given to you in connection with your audit of the Council's financial statements.

## **Responsibility for the financial statements**

We acknowledge our responsibilities to make arrangements for the proper administration of the Council's financial affairs and to approve the Statement of Accounts, which include the financial statements. The Chief Finance Officer is responsible for the preparation of the Statement of Accounts, which include the financial statements, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom.

## **Annual Governance Statement**


We confirm that the Council has conducted a review during the year of the effectiveness of its system of internal control. We are satisfied that the Annual Governance Statement appropriately reflects the circumstances of the Council and includes an outline of the actions taken, or proposed, to deal with significant internal control issues.

Yours faithfully

**Councillor Craig Mackinlay**

**Chairman of the Audit Committee**

For and on behalf of Medway Council



The matters raised in our report prepared in connection with the audit are those we believe should be brought to your attention. They do not purport to be a complete record of all matters arising. This report is prepared solely for the use of the council and may not be quoted nor copied without our prior written consent. No responsibility to any third party is accepted.

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