

AUDIT COMMITTEE

25 SEPTEMBER 2014

ANNUAL GOVERNANCE REPORT 2013/14

Report from: Mick Hayward, Chief Finance Officer

Author: Andy Larkin, Finance Support Manager

Summary

This report considers the issues raised in the Council's External Auditor's Annual Governance Report, which incorporates the findings following the 2013/14 audit of the Statement of Accounts.

The Accounts and Audit Regulations 2011 (as amended) require that the Audit Committee consider these issues prior to publication by 30 September 2014.

1. Budget and Policy Framework

- 1.1 The Audit Commission's Code of Audit Practice and International Standard of Auditing (ISA 260) requires the results of the audit to be reported to those charged with governance. This Committee has been delegated with the responsibility for considering these reports and agreeing the Council's response. In addition, the Committee, on behalf of the Council, must explain reasons for not adjusting the Statement of Accounts for the issues raised within the auditor's report, all factual adjustments have been adjusted.
- 1.2 The Accounts and Audit Regulations 2011 (as amended) require that the Audit Committee consider these issues prior to 30 September 2014. A revised set of the Statement of Accounts will be sent to Members once the ongoing work with the Council's External Auditor is concluded.

2. Background

- 2.1 The draft Statement of Accounts for 2013/14 were considered and approved by this Committee on 17 July 2014. At that stage the accounts were subject to final verification and Members were advised that any proposed changes as a result of the audit would be reported at a later stage.
- 2.2 The audit commenced in mid July and together with the audits of various grant claims has continued to September. A number of issues are still being reviewed by the Council's External Auditor, BDO and these are detailed within the Auditor's Annual Governance Report attached at Appendix 1 to this report. The Auditor will update Audit Committee on progress at the meeting on 25 September 2014.

3. Auditors Report 2013/14

3.1 The Auditor's Annual Governance Report (AGR) is attached at Appendix 1 and contains the Auditor's review of:

- Financial Statements;
- Control Environment;
- Governance Reporting;
- Whole of Government Accounts (WGA);
- Use of Resources; and
- Associated appendices.

3.2 The Council's response to the issues identified, as proposed by officers, will be circulated separately.

4. Financial Statements

4.1 The overview of the AGR states that, subject to satisfactory conclusion of outstanding work as detailed within the AGR, an **unqualified** audit opinion will be issued in relation to the financial statements. The main issues arising from the audit are summarised in paragraph 4.2 below.

4.2 Accounting practices and financial reporting

4.2.1 Material errors. There were no material errors within the Statement of Accounts.

4.2.2 Non-Trivial errors. There were a number of non-trivial errors within the Statement of Accounts which have, for the most part, now been corrected.

4.2.3 Trivial errors The AGR does not set out trivial errors found during the audit. However, officers have adjusted the accounts to recognise all trivial errors.

4.2.4 A revised set of the Statement of Accounts (Appendix 2 to this report) will be sent to Members once the ongoing work with the Council's External Auditor is concluded. Significant amendments will be highlighted. We have not highlighted all the changes within the statements, as the trivial errors would result in an unmanageable quantity of alterations to disclosures as well as the main Statement of Accounts. The agreed adjustments to the statements have not altered the underlying underspending of £267,000 for the year nor the General Fund balances.

4.3 Medway Harbour Board

4.3.1 Following the audit of last year's accounts BDO made us aware that the Department for Transport (DfT) classified Medway Council as a Harbour Board. This requires the Council to file accounts to the DfT and have these audited. This was a surprise to the Council as the 'Harbour' in question is Gillingham Pier with a revenue receipt of some £30,176 for 2013/14. Management took advice from the Department for Transport who confirmed that as Medway Harbour Board is considered a "Small Entity" then the accounts would not require auditing and as other authorities were asking similar questions issued a "Draft" guidance note confirming this. A disclosure note has been incorporated in the accounts (note 41) and in accordance with the advice a statement will be forwarded to the DfT. BDO's view is that as the guidance was "draft" it is not valid against the requirements of the Harbours Act

1964. As a consequence Management have contacted the DfT for further clarification. At the time of writing this report clarification has not been received.

4.4 Annual Governance Statement

4.4.1 The auditors are satisfied that the Annual Governance Statement is consistent with the financial statements and complies with “Delivering Good Governance in Local Government” (CIPFA/SOLACE)

5. Use of Resources

5.1 Auditors are required to review the Council's arrangements to secure economy, efficiency and effectiveness in the use of resources (value for money). This is based upon the following two Audit Commission 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.

5.2 BDO will be issuing an unqualified value for money conclusion as indicated at page 31 of the AGR.

6. Management Representations Letter

6.1 To comply with regulations, the Chief Finance Officer of each local authority must provide the external auditors with a signed declaration which supports their work in relation to the audit of the annual accounts.

6.2 The Draft Management Representations Letter is attached at Appendix VI of the AGR and the Committee is required to consider the content of the letter in the context of the issues raised in this report. Once agreed, the letter will be submitted to BDO.

7. Audit Fees

7.1 The final audit fee is £204,801 consisting of £188,460 Audit fees and £16,341 certification fees. The certification fee has reduced from the anticipated figure as set out within the External Audit Annual Audit Plan 2014/15 (reported to this Committee on 20 March 2014), due to the removal of Council Tax Benefit subsidy element of the Housing Benefits Subsidy Grant Claim and the Teachers' Pensions Return.

8. Financial and Legal Implications

8.1 The financial implications are contained within the body of the report.

8.2 Auditors are required to comply with the Statement of Auditing Standards, and thus provide an opinion on the Council's Statement of Accounts.

8.2 The legal implications are set out in the body of the report.

9. Audit Completion

- 9.1 Work to complete the audit outlined in Section 4 is ongoing. However, BDO have indicated that the audit certificate will be given by 30 September 2014.

10. Risk Management

- 10.1 There remains a low risk that the Auditor may find material errors or misstatements in the accounts as a result of the continuing work highlighted in Section 4 of this report, which may not be identified prior to the adoption by this committee. Due regard has been had to the regulations and accounting requirements in producing the statements and the position put before the Audit Committee is the officers' interpretation of these requirements.

11. Recommendations

- 11.1 That the Audit Committee notes the issues raised and judgements made by the Auditor as presented in Appendix 1, and agrees the proposed response as set out at Appendix IV to the External Auditor's Annual Governance Report.
- 11.2 That the Audit Committee agrees the revised Statement of Accounts as set out in Appendix 2 (to follow).
- 11.3 That the Audit Committee agree the Management Representations Letter, attached at Appendix VI of the AGR.

Background papers

Medway Council's Draft Statement of Accounts for 2013/2014
Report on Draft Statement of Accounts to this Committee 17 July 2014
<http://democracy.medway.gov.uk/ieListDocuments.aspx?CId=121&MId=2943&Ver=4>

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MEDWAY COUNCIL

FINAL REPORT TO THE AUDIT COMMITTEE
Audit for the year ended 31 March 2014

September 2014

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OVERVIEW

Significant audit findings

This summary covers the significant findings from our audit of Medway Council ('Council') for the year ended 31 March 2014. However, you should read the entirety of this report, as there may be other matters raised that you consider important.

AREA OF AUDIT	SUMMARY
Financial statements	<p>The Council did not meet the Government's deadline for the Chief Finance Officer to certify the financial statements by 30 June. The 2013/14 financial statements were submitted to us for audit on 4 July 2014. The Council will be named by the Audit Commission in its national report 'Auditing the Accounts' because the deadline was not met.</p> <p>We have substantially completed our work, although there are a number of outstanding items to be received and/or completed at the time of drafting this report. Further detail on the status of our work is set out on the following page.</p> <p>Our final audit materiality is £12,300,000 (see appendix III) and we have reported all non-trivial unadjusted audit differences greater than £246,000.</p> <p>No material misstatements were identified as a result of our audit work.</p> <p>There are two unadjusted audit differences identified by our audit work which would increase the draft deficit on the provision of services in the CIES by £1.156 million to £39.875 million (from £38.719 million).</p> <p>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 2014.</p>
Control environment	<p>We are required to report to you the significant deficiencies we found in internal controls during the course of our audit. We did not identify any significant control weaknesses however a number of other areas for improvement were identified which we have discussed with management. These can be seen from page 22.</p>
Governance reporting	<p>We are satisfied that the annual governance statement is not inconsistent or misleading with other information we were aware of from our audit of the financial statements and complies with "Delivering Good Governance in Local Government" (CIPFA / SOLACE).</p>
Whole of Government Accounts (WGA)	<p>Our review of the Council's WGA Data Collection Tool (DCT) has not yet commenced (as at 17 September 2014). The Council encountered difficulties in submitting the draft form and has not yet updated the revised draft for the errors identified by our audit of financial statements. The Government's deadline for submitting the audited DCT is 3 October 2014.</p>
Use of resources	<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 ended 31 March 2014.</p>

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

OVERVIEW

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 substantially completed our audit work in respect of the financial statements. The following matters are outstanding at the date of this report:

- We received amended financial statements from officers on 17 September and are currently checking these. We will update the Committee on the outcome of our review
- Clearance of outstanding issues raised with management regarding:
 - Allocation of non-distributed costs within the net cost of services
 - Amounts reported for resource allocation decisions disclosure note
 - Finalising an adjustment to the Collection Fund Adjustment Account.
- Final review of our audit work at engagement partner level, and clearance of any review points arising
- Subsequent events review (standard audit procedure)
- Management representation letter, as attached in Appendix VI, to be approved and signed.

We will update you on their current status at the Audit Committee on 25 September 2014

TIMETABLE TO COMPLETE

The anticipated timetable to complete is as follows:

ACTIVITY	DATE
Audit Committee meeting	25 September 2014
Signing of financial statements	30 September 2014
Submission of WGA assurance report	TBA

INDEPENDENCE

Integrity, objectivity and independence and appropriate safeguards

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. We have considered such matters in the context of our audit for the year ended 31 March 2014.

FEES AND NON AUDIT SERVICES

A summary of fees for audit and non-audit services for the period from 1 April 2013 to date is set out below:

	£
Audit fees	188,460
Certification fees	⁽¹⁾ 16,341
TOTAL FEES	204,801

⁽¹⁾ The published scale fee takes into account the removal of the council tax subsidy element of the Housing Benefits Subsidy Grant Claim and the Teachers’ Pensions Return which has been removed from the Audit Commission regime from 2013/14. We are still required to certify the Teachers’ Pensions Return and we are currently liaising with Teachers’ Pensions, which administers the scheme on behalf of the Department for Education, to agree an appropriate work programme. We will agree a separate engagement letter and fee for this work in due course.

OTHER RELATIONSHIPS

We are not aware of any financial, business, employment or personal relationships between the audit team, BDO and the Council.

LONG ASSOCIATION THREATS

The Audit Commission’s Standing Guidance requires that the audit engagement partner should not act for more than five years and the audit manager for 10 years.

Key audit staff	Years involved
Robert Grant - Audit Engagement Partner	⁽¹⁾ 7
Kerry Barnes - Audit Manager	3

⁽¹⁾ The Audit Commission’s Standing Guidance makes provision for the appointment period of the audit engagement partner to be extended to a maximum of seven years provided that there are no considerations that compromise, or could be perceived to compromise, the auditor’s independence or objectivity. The Commission approved such an extension in respect of Robert Grant in September 2012.

INDEPENDENCE DECLARATION AND APPROPRIATE SAFEGUARDS

We have not identified any potential threats to our independence as auditors.

AUDIT SCOPE AND OBJECTIVES

SCOPE AND OBJECTIVES

The audit scope is determined by the Audit Commission's Code of Audit Practice for local government (2010), International Standards on Auditing (UK and Ireland) and other 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 financial position as at 31 March 2014 and of the income and expenditure for the year then ended.
- 2** The financial statements have been prepared properly 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 Whole of Government Accounts return is consistent with the audited financial statements and that it is properly prepared.
- 7** The audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

FINANCIAL STATEMENTS

Key audit and accounting matters

SIGNIFICANT AND OTHER 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 2013/14 Audit Plan issued in March 2014. We have since undertaken a more detailed assessment of risk following our review of the draft financial statements, and we have not identified any additional significant risks.

We report below our findings of the work designed to address these significant risks, our review of significant accounting estimates and management judgements, and any other relevant audit and accounting issues arising.

Key: ■ Significant risk/issue ■ Significant accounting estimates and management judgements ■ Other relevant audit and accounting issue

SIGNIFICANT AUDIT RISK AREAS

RISK	RELATED CONTROLS / RESPONSE TO RISK	WORK PERFORMED	CONCLUSION
MANAGEMENT OVERRIDE OF CONTROLS	<p>ISA (UK&I) 240 requires us to presume that a risk of management override of controls is present and significant in all entities.</p> <p>By its nature, there are no controls in place to mitigate the risk of management override.</p>	<p>We reviewed the appropriateness of significant journal entries and other adjustments made in the preparation of the financial statements. We also reviewed accounting estimates for evidence of possible bias.</p>	<p>No issues have been identified in our review of the appropriateness of journal entries and other adjustments made in the preparation of the financial statements.</p> <p>Our work on accounting estimates has not identified any evidence of bias.</p>

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

SIGNIFICANT AUDIT RISK AREAS (CONTINUED)			
RISK	RELATED CONTROLS / RESPONSE TO RISK	WORK PERFORMED	CONCLUSION
REVENUE RECOGNITION	<p>ISA (UK&I) 240 presumes that there are risks of fraud in relation to revenue recognition. These risks may arise from the use of inappropriate accounting policies, failure to apply the Council's stated accounting policies or from an inappropriate use of estimates in calculating revenue.</p>	<p>We substantively tested a sample of fees, charges and other service income transactions to supporting documentation to confirm that income had been accurately recorded and earned in the year.</p>	<p>No issues have been identified from our testing of income streams and review of transactions for recognition of revenue in the relevant financial year.</p>
	<p>We identified that the areas of greatest risk were grant income, and fees, charges and service income. The Council has put into place a number of controls to mitigate the risk in these areas, including daily reconciliations between the receipting system and the general ledger, a debtor requisition authorisation process, and monthly debtor control account reconciliations.</p>	<p>We substantively tested an extended sample of receipts in the period after year end to ensure that income was complete and accounted for in the correct period.</p> <p>Audit procedures have been carried out to review an extensive sample of grants and other contributions to ensure that they have been recognised correctly in the financial statements or deferred where applicable.</p>	

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

SIGNIFICANT AUDIT RISK AREAS (CONTINUED)			
RISK	RELATED CONTROLS / RESPONSE TO RISK	WORK PERFORMED	CONCLUSION
PROPERTY, PLANT AND EQUIPMENT (PPE)	<p>In the prior year, we identified a number of errors and proposed a high number of amendments to PPE balances and related accounting entries.</p> <p>This year, finance staff carried out a critical review of accounting entries relating to PPE prior to the submission of accounts to audit.</p>	<p>We carried out substantive testing with increased sample sizes across all PPE balances and related transaction streams.</p> <p>In particular, we substantively tested a sample of revaluations to ensure that the value was correctly accounted for, with the correct entries being made to the revaluation reserve and the comprehensive income and expenditure statement.</p> <p>We also substantively tested a sample of PPE additions to ensure these had been appropriately capitalised.</p> <p>We substantively tested a sample of leases to ensure these had been appropriately classified as operating or finance leases and that finance leases had been correctly included in the fixed asset register.</p>	<p>From our focussed testing of PPE, we found substantially fewer errors than in the previous year. The errors found by our work are set out below:</p> <ul style="list-style-type: none"> - We found that two new Academies with a carrying value of £28.4 million were incorrectly included within assets under construction at year-end, despite having been brought into use in the year. Management agreed to reclassify these assets as other land and buildings. - Eleven schools transferred to Academies in the year, and the associated land and buildings were assigned on long leases. The Council correctly treated the building elements of these leases as disposals, but treated the land elements as downwards valuations. Management agreed to adjust the accounts to include the value of land (£1.4 million) as disposals in year. - We noted that non-dwelling assets within the HRA (e.g. garages) are correctly disclosed as other land and buildings within the HRA itself, but were erroneously included within the 'Dwellings' column in the PPE note. The carrying value of these assets at year-end was £4.4 million, and management agreed to transfer these assets into other land and buildings. <p>The above errors will be corrected by management within the final financial statements, and the impact of these adjustments has been reported within Appendix II. In addition, two assets were transferred from surplus assets to assets held for sale in the year. However, the assets were not revalued immediately prior to reclassification, as required by the CIPFA Code. As a result, a net downwards revaluation of £2.391 million was classified within non-current assets held for sale, rather than surplus assets. Management agreed to correct this error, although there is no impact upon the primary statements.</p>

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

SIGNIFICANT AUDIT RISK AREAS (CONTINUED)			
RISK	RELATED CONTROLS / RESPONSE TO RISK	WORK PERFORMED	CONCLUSION
PROPERTY, PLANT AND EQUIPMENT VALUATIONS	<p>Under the 2013/14 Code there is a requirement for the revaluation of PPE to be carried out with sufficient regularity to ensure the carrying amount does not differ materially from the fair value at the end of the reporting period, and for all items in a class of assets to be revalued simultaneously.</p> <p>The Council has adopted a five year rolling programme of valuations for its property assets, which in itself is insufficient to meet these Code requirements.</p> <p>However, the Council has supplemented this process with additional procedures, including a 100% review of the property asset register by the Council's internal valuers at year-end, and a review of the annual valuers' report to identify any classes of asset which may show a material movement in value.</p>	<p>We reviewed the valuer's annual revaluation report in respect of both Housing Revenue Account (HRA) and non-HRA property. We discussed with the valuer the methods used and assumptions applied to ensure these were in line with Code requirements.</p> <p>We examined the Council's year end impairment review and review of the property asset register.</p> <p>Where possible, we also compared the Council's findings to externally available evidence of property valuation, such as a report provided to auditors by the Audit Commission about the annual movement in asset values..</p>	<p>For HRA property, the Council had carried out its valuation as at 1 April 2013 in line with its accounting policies, but had not updated this valuation at year-end. Our review of external evidence (e.g. the annual report provided by the Audit Commission, the Nationwide house price index, and the Halifax house price index) indicated a potentially significant increase in housing valuations during 2013/14. We discussed this with management, who agreed to carry out a review, and as a result increased the value of HRA dwellings as at 31 March 2014 by £7.5 million. We are satisfied that the revised valuation is not materially misstated at year-end. The effect of this adjustment is reported at Appendix II.</p> <p>For non-HRA property we were satisfied that the carrying amount of PPE at year-end did not differ materially from its fair value.</p>
	<p>In the prior year we identified a high number of non-trivial errors in the accounts submitted for audit and subsequently, in the accounts that were amended as a result of the audit.</p> <p>This year management planned to build more time into the closedown timetable to ensure the effective preparation of the accounts and processing of audit adjustments (as necessary).</p>	<p>We have held regular progress meetings with management throughout the course of the audit to ensure that audit queries and issues arising could be raised as early as possible to give management as much time as possible for the processing of any audit adjustments.</p>	<p>The Council did not meet the Government's deadline for the Chief Finance Officer to certify the financial statements by 30 June. The 2013/14 financial statements were submitted to us for audit on 4 July 2014. Amendments to the financial statements were then tabled at the Audit Committee meeting on 17 July. Working papers were generally made available to us at the start of the audit as requested, although there were some exceptions which we followed up over the course of the audit.</p> <p>We are still in the process of agreeing and auditing adjustments to be made to the final financial statements.</p>

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

SIGNIFICANT ACCOUNTING ESTIMATES AND MANAGEMENT JUDGEMENTS		
RISK	WORK PERFORMED	CONCLUSION
PENSION LIABILITY (LOCAL GOVERNMENT PENSION SCHEME)	<p>We agreed all accounting entries in respect of the Local Government Pension Scheme back to supporting documentation, including the actuary's report.</p> <p>We reviewed the assumptions made by the scheme actuary to ensure that they appear reasonable and are in line with those being applied to other pension funds.</p> <p>Where appropriate we challenged management around the assumptions made to ensure that they are satisfied with, and understand the entries in the actuary's report.</p> <p>We reviewed the 'Review of IAS 19 reporting at 31 March 2014' report produced by PwC and circulated to auditors by the Audit Commission, and carried out additional audit procedures where appropriate.</p>	<p>We obtained the necessary assurance from the work of management's expert (i.e. the scheme actuary) in respect of the valuation of the pension liability at year-end, and related accounting entries.</p> <p>From our review of the actuarial report and the PwC report, we are satisfied that the assumptions used in the calculation of the pension liability are appropriate.</p> <p>From our discussions with management we have noted that management rely upon the work of the actuary, and do not provide the level of detailed challenge which we would expect. We recommend that management carry out sufficient work, and evidence this, to satisfy themselves that the assumptions used by the actuary are appropriate.</p> <p>During our review of accounting entries relating to pensions, we noted that the Council had not fully restated the prior year financial statements as a result of changes to the Code in year, which require changes to the way in which pension movements are accounted for through the Comprehensive Income and Expenditure Statement.</p> <p>Whilst the Council has shown the impact of this change within the pensions disclosure note (Note 34), the primary statements were not restated to show the impact of this change.</p> <p>We also noted some errors relating to the restatement within Note 34, as several adjusting entries had been made the wrong way around.</p> <p>Management has agreed to correct this error in the final accounts. The impact was to increase the prior year deficit on the provision of services by £3.796 million, and to increase the prior year other comprehensive income by the same amount.</p>

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

OTHER RELEVANT AUDIT AND ACCOUNTING ISSUES		
RISK	WORK PERFORMED	CONCLUSION
NON-DOMESTIC RATE (NDR) APPEALS PROVISION	<p>From 1 April 2013, local authorities have assumed responsibility for funding NDR appeals. As a result, the Council has created a provision in respect of backdated appeals.</p> <p>We have reviewed the Council's methodology for estimating the provision and the assumptions used. We also carried out a review of appeals resolved after the year-end and compared the amounts included in the provision with the final outcome.</p>	<p>We found that the Council had based its provision upon a list of outstanding appeals provided by the Valuation Office Agency. For most appeals, the Council has assumed a reduction in rateable value of either 5% or 6% depending upon the building type, although where the Council is aware of specific evidence in relation to appeals this has been taken into account (for example demolished buildings provided for at 100%). The percentages used take into account the fact that not all appeals are successful. On the basis of this work the Council has calculated a total provision of £9.2 million, of which Medway Council's share is 49% of the total amount, i.e. £4.5 million. The remaining provision in the Collection Fund Statement relates to the central government (50%) and preceptors' (1%) shares, but these are not reflected in the Council's balance sheet.</p> <p>We are satisfied that the Council's methodology for estimating the provision and assumptions used are reasonable to support the £9.2 million provision disclosed in the accounts.</p>
DEPRECIATION	<p>Our testing of property, plant and equipment (see above) included a review of the Council's depreciation policy and the ranges adopted for the useful economic lives of its assets.</p> <p>We carried out a review of non-depreciated and fully depreciated assets within the fixed asset register to ensure that these were being appropriately treated, and that there were no indications that assets were being depreciated over inappropriate useful economic lives.</p> <p>We also tested a sample of assets substantively to ensure that depreciation had been correctly charged.</p>	<p>We have gained sufficient assurance that both accumulated depreciation and the depreciation charge in year are not materially misstated, and that the Council is applying its accounting policy consistently.</p> <p>We have found no evidence that the useful economic lives the Council is using for its assets are inappropriate.</p>

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

OTHER RELEVANT AUDIT AND ACCOUNTING ISSUES		
RISK	WORK PERFORMED	CONCLUSION
ACCUMULATED ABSENCE ACCRUAL	We reviewed the Council's methodology and assumptions for estimating the year-end accrual for employee annual leave, to ensure that it is reasonable and complies with the Code and associated guidance notes.	<p>We found a number of errors in the calculation of the annual leave accrual, as follows:-</p> <ul style="list-style-type: none"> - For teachers, the Council has not taken into account that some teachers may have taken sick leave or maternity leave during the year, as required by the Code guidance - The Council has not adjusted the accrual for teachers who left during the month of April, as required by the Code guidance - For non-teachers, no adjustments have been made for overtime or other pay elements on which annual leave will not accrue - For all staff, it has not been possible to fully reconcile the underlying evidence for the accrual calculation to payroll records, although the unreconciled difference is not material and would result in a trivial change to the provision <p>As a result, it is likely that the total accrual is misstated, although it is difficult to quantify the level of this misstatement in the context of a management estimate, and without carrying out additional analysis. We are however satisfied that any misstatement will not be material in the current year due to the value of the total accrual (£2.5 million). However we would recommend that the Council reviews its methodology in future years to ensure that it is fully compliant with the Code and results in a reasonable estimate.</p>
OTHER ACCRUALS	We carried out substantive testing of a sample of accruals to ensure that these were as accurate as reasonably possible, and that there was no evidence of management bias.	<p>Within our initial sample we identified one error in relation to an accrual for adult social care expenditure. In this case we found that the Council had accrued an amount of £250,000 for unbilled amounts for a particular supplier, but the actual outturn after the year-end was £428,000. The reason for the under-accrual was that the Council had used expenditure in January 2014 to estimate monthly expenditure going forwards, but had not taken into account that a significant proportion of the January 2014 expenditure had not been billed at the time of calculating the accrual.</p> <p>As a result of this error we extended our sample and our extended testing identified one trivial error where an amount of £3,000 had not been accrued. Based on the results of the testing we have extrapolated the known error across the remaining population of creditor accruals. We have calculated the extrapolated error to be an under accrual of £1,155,796 and this has been recorded as an unadjusted error at Appendix II.</p>

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

OTHER RELEVANT AUDIT AND ACCOUNTING ISSUES		
RISK	WORK PERFORMED	CONCLUSION
BAD DEBT PROVISION	<p>We have reviewed the Council's bad debt provision in relation to the significant categories of debtors, including council tax, NDR, housing rents, overpayment of housing benefits, adult social care, and sundry debtors. For each type of debtor we have reviewed the assumptions used and re-performed the appropriate calculations to ensure that the provision is not materially misstated.</p> <p>We also reviewed the provision in the context of the aged debtor analysis, the historic collection profile, and the Council's accounting policies on bad debt provisions.</p>	<p>We found that the Council applies various assumptions in calculating the provision in respect of different types of debtor, as in previous years.</p> <p>We are satisfied that the bad debt provision is not materially misstated.</p>
ALLOCATION OF OVERHEADS	<p>The Council carries out an exercise to reallocate certain overhead costs across various service lines and directorates.</p> <p>We have reviewed the Council's working papers in respect of these allocations, to ensure that the methodology and assumptions used are appropriate, and have also re-performed a sample of calculations to ensure that the reallocation has been performed accurately.</p>	<p>As a result of this work we have identified that the Council has overstated both income and expenditure within the non-distributed costs line on the Comprehensive Income and Expenditure Statement, as a result of accounting for internal recharges on a gross, not net basis. The Council agreed to adjust for this error, although work is still ongoing to ascertain the size of this adjustment. There will be no effect on the net cost of services. A similar adjustment will be required in respect of the prior year.</p>
RECOGNITION OF CREDITORS AND DEBTORS	<p>We reviewed a sample of creditors and debtors on the Council's balance sheet to ensure that these represented valid liabilities or assets at the year-end.</p>	<p>We found two creditors had been recognised in respect of goods and services received during 2014/15, where payment had been made post year-end. These were not valid creditors at the year-end. However, the Council had also recognised prepayments against these amounts, meaning that both creditors and debtors are overstated by approximately £104,000 at year-end.</p> <p>When extrapolated across the whole creditors population, the extrapolated error is an estimated overstatement of both creditors and debtors of £1,098,000. This has been recorded as an unadjusted error at Appendix II.</p>

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

OTHER RELEVANT AUDIT AND ACCOUNTING ISSUES		
RISK	WORK PERFORMED	CONCLUSION
NON-DOMESTIC RATE DEBTORS AND CREDITORS	<p>As a billing authority the Council acts as an agent, collecting non-domestic rates (NDR) on behalf of major preceptors and central government, and, as principals, collecting rates for themselves.</p> <p>As such the Council should separately account for the following debtor and creditor balances:</p> <ul style="list-style-type: none"> • An attributable share of non-domestic rates debtors (net of the impairment allowance for doubtful debts) • An attributable share of creditors for overpaid/pre-paid non-domestic rates • A debtor for each major preceptor and central government for cash paid to them in advance of receipt from non-domestic rate payers, or a creditor for NDR collected and not paid over • A debtor/creditor for the difference between safety net payments made on account and the actual safety net payment due • A creditor for the actual levy payment due. <p>We reviewed the breakdown of debtors and creditors on the balance to ensure these had been disclosed correctly and at the correct amount.</p>	<p>Our audit testing found that the required debtor and creditor balances had been incorrectly netted off against each other to show a £1,644,954 negative debtor balance in the accounts.</p> <p>Management has corrected this error by increasing debtors by £3,089,103 and creditors by the same amount to ensure the final debtor and creditor balances are correctly disclosed in the accounts (the correct position being £1,444,149 and £3,088,978 respectively).</p>

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

OTHER RELEVANT AUDIT AND ACCOUNTING ISSUES		
RISK	WORK PERFORMED	CONCLUSION
PUBLIC HEALTH EXPENDITURE	In 2013/14, the Council took on new responsibilities for public health. As a result, Public Health has been included as a separate service line within the Comprehensive Income and Expenditure Statement in line with the requirements of the Service Reporting Code of Practice 2013/14. We have audited this expenditure as part of our wider testing of the cost of services.	No comparative information was provided for Public Health expenditure in 2012/13. Following discussions with management, it was agreed that there would have been some expenditure on public health objectives during 2012/13, and management have agreed to restate their comparatives accordingly. The effect of this adjustment in the prior year will be to show net expenditure on Public Health of £284,000, with corresponding reductions in net expenditure on Environmental and Regulatory Services (£249,000) and Planning Services (£35,000).
CAPITAL GRANTS AND CONTRIBUTIONS	We tested a sample of capital grants and contributions to ensure they had been accounted for correctly and recognised in the correct period.	<p>Our audit testing identified three capital grants amounting to £1,299,609 that had been received and recognised as income in 2013/14 and that these contained conditions within their grant terms. These conditions had not yet been met by the Council in the year therefore the grants should not have been recognised as income and should have been accounted for as income received in advance (capital grants received in advance) on the balance sheet as at 31 March 2014. When the grant conditions are met the Council will then be able to release the amounts as income to the comprehensive income and expenditure statement.</p> <p>Management has agreed to correct this error in the final accounts by removing £1,299,609 grant income from the CIES and increasing capital grants received in advance on the balance sheet.</p>

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

OTHER RELEVANT AUDIT AND ACCOUNTING ISSUES		
RISK	WORK PERFORMED	CONCLUSION
HERITAGE ASSET DISCLOSURES	<p>The Code requires authorities to disclose the policy for the acquisition, preservation, management and disposal of heritage assets, including a description of the records maintained by the authority of its collection of heritage assets and information on the extent to which access is permitted.</p> <p>We reviewed the Council’s disclosures for compliance with the Code.</p>	<p>Although the Council has provided such disclosure in respect of its museum assets at Note 39, no disclosure has been given in respect of other classes of heritage assets, including buildings.</p> <p>We recommend that the Council consider making these disclosures in future years.</p> <p>We also noted there was no disclosure of whether or not an external valuer was used for heritage asset valuations, and the name and professional qualifications of the valuer. Management have agreed to make this disclosure in the final accounts.</p>
PENSION DISCLOSURES	<p>We reviewed the pension disclosure notes against the CIPFA disclosure checklist in order to ensure that the disclosures were complete and in accordance with Code requirements.</p>	<p>We found a number of omissions from the pensions disclosure note in the draft financial statements. In particular, the Council did not disclose the following in respect of its pension plans:-</p> <p><u>LGPS</u></p> <ul style="list-style-type: none"> - A description of the regulatory framework within which the plan operates - A description of the risks to which the plan exposes the Authority, focused on any unusual, Authority-specific or plan-specific risks, and of any significant concentrations of risk - A sensitivity analysis for each significant actuarial assumption as at the end of the reporting period, showing how the defined benefit obligation would have been affected by changes in the relevant actuarial assumption that were reasonably possible at that date, the methods and assumptions used in preparing such a sensitivity analysis, and any changes from the prior period in this respect. - A description of any funding arrangements and funding policy that affect future contributions, the expected contributions to the plan for the next annual reporting period, and information about the maturity profile of the defined benefit obligation. <p><u>Teachers’ Pensions (TP)</u></p> <ul style="list-style-type: none"> - The expected contributions to the plan for the next annual reporting period, information about any deficit or surplus in the plan that may affect the amount of future contributions, including the basis used to determine that deficit or surplus and the implications, if any, for the Authority, and an indication of the level of participation of the authority in the plan compared with other participating

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

OTHER RELEVANT AUDIT AND ACCOUNTING ISSUES		
RISK	WORK PERFORMED	CONCLUSION
		<p>entities</p> <p><u>Both (LGPS and TP)</u></p> <ul style="list-style-type: none"> - A description of the extent to which the Authority can be liable to the plan for other entities' obligations under the terms and conditions of the multi-employer plan, and a description of any agreed allocation of a deficit or surplus on the authority's withdrawal from the plan. <p>We are still in discussion with management to agree the extent to which the above information is available and can be disclosed within the final financial statements.</p>
FINANCIAL INSTRUMENT DISCLOSURES	We reviewed the financial instrument disclosures within the draft Statement of Accounts to ensure accuracy and compliance with the Code.	<p>We identified a number of errors in the financial instrument disclosures, as follows:-</p> <ul style="list-style-type: none"> - There were a number of errors within the figures disclosed at note 10 (Financial Instruments), including the omission of cash from financial assets, and the erroneous inclusion of statutory debt - Within the interest rate risk section of note 37, there was no disclosure of summary quantitative data about exposure to risk at the reporting date - Within the credit risk section of note 37, the total historical experience of default percentage had been incorrectly calculated. Upon discussion with management it was agreed that it is not possible to provide a total percentage, and instead separate percentages have been provided for each type of financial asset - The disclosure of the aging profile for debtors only covered one type of receivables (i.e. 'Customers'), whilst the Code requires this information to be provided for all receivables. In addition, there was no separate disclosure of receivables which are past due but not impaired, and those which are considered to be impaired at year-end. The factors taken into account in determining whether receivables are impaired also need to be disclosed - There should be a maturity analysis of financial liabilities based upon undiscounted contractual cash flows - Within the market risk and interest rate risk sections of note 37, no sensitivity analysis was included as required by the Code. <p>Management has agreed to adjust all of the above issues in the final accounts.</p>

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

OTHER RELEVANT AUDIT AND ACCOUNTING ISSUES		
RISK	WORK PERFORMED	CONCLUSION
EXIT PACKAGES	We reviewed the Council's exit packages note to ensure completeness and accuracy of the disclosure made. We tested a sample of exit packages back to supporting documentation to ensure that the correct amounts had been disclosed in year.	<p>Through our testing we found that payments in respect of compensation for loss of office had not been included within the exit packages note. The total value of these payments was £306,000. This also meant that the total number of exit packages disclosed within the draft financial statements was understated by 26.</p> <p>Management has agreed to correct this error in the final accounts.</p>
OFFICERS' REMUNERATION	We agreed the Council's Officers' Remuneration note back to supporting information and checked the format of the note against Code requirements.	<p>We found a small number of errors within the draft note, as follows:-</p> <ul style="list-style-type: none"> - The fees and allowances for one officer were overstated by £3,077. - The expenses for one officer were understated by £25. - One senior officer was omitted from the original disclosure of Senior Officers' Remuneration. - There were a number of banding errors within the table disclosing other employees receiving more than £50,000 remuneration for the year. <p>Management have agreed to correct these errors in the final accounts.</p>
RELATED PARTY TRANSACTIONS	<p>We reviewed the Council's related party transactions note and agreed the figures disclosed back to supporting documentation.</p> <p>We made enquiries of management as to the processes and controls in place to ensure that disclosures in respect of related party transactions are complete and accurate.</p> <p>We reviewed related party declarations returned by members and senior officers, and carried out our own searches of Companies House to gain further assurance over the completeness of the related party transactions note.</p>	<p>We noted that, whilst the Council does collect declarations of interest from all Members and senior officers, there is no further work carried out by management to assess the completeness of these, for example by reference to Companies House records. We have noted this as a control deficiency below.</p> <p>Within the related parties note itself, we identified the following disclosure errors:</p> <ul style="list-style-type: none"> - Whilst some disclosure was made in relation to transactions with central government bodies, this was not complete as it did not include details of the nature and amount of individually significant transactions, or a qualitative or quantitative indication of the extent of other transactions which are collectively, but not individually, significant. - There was no reference to transactions with other government bodies outside of central government (e.g. other local authorities and NHS bodies) - The Code requires disclosure of all balances held with related parties at year-end, which was omitted from the draft financial statements - Two minor disclosure errors were noted in respect of the number of members connected to the

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

OTHER RELEVANT AUDIT AND ACCOUNTING ISSUES		
RISK	WORK PERFORMED	CONCLUSION
		<p>Chatham Historic Dockyard Trust and the Medway Ethnic Minority Forum.</p> <p>Management has agreed to correct these errors in the final accounts.</p>
ACCOUNTING POLICIES	<p>We reviewed the Council’s accounting policies to ensure that they are appropriate, comply with Code requirements, and are consistent with the prior year unless a change is required or permitted by the Code.</p>	<p>We found a number of omissions from the accounting policies, as follows:-</p> <ul style="list-style-type: none"> - There was no disclosure made of the assumptions the Council makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year - The ‘Estimation Techniques’ policy made no reference to depreciation or accruals, both of which are significant management estimates within the Council’s accounts - The ‘Capital Grants Received in Advance’ policy did not fully explain the accounting treatment for those grants held as creditors at year-end - There was no accounting policy disclosed in respect of the spreading of the backdated NDR appeals provision over a five year period, as permitted by the Code. Whilst the treatment is correct, we would expect to see an accounting policy explaining this - An accounting policy is needed in respect of the NHS Pension Scheme (in relation to staff transferred as a result of the Council’s new Public Health responsibilities). <p>Management has agreed to amend the final accounts.</p>
CAPITAL FINANCING	<p>We reviewed the Council’s working papers to support the Capital Financing note, and examined the journal entries in respect of capital financing.</p>	<p>We found that, although the capital financing note (Note 29) agreed to the underlying working paper, the journal entries posted in respect of capital financing did not agree. The Council had funded some £1.9 million more of capital expenditure from revenue than disclosed in the note, and an equivalent amount less from grants.</p> <p>Management has agreed to amend the final accounts to show the correct amounts from each funding source.</p>

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

OTHER RELEVANT AUDIT AND ACCOUNTING ISSUES		
RISK	WORK PERFORMED	CONCLUSION
LEASES	We reviewed the Council's leases note and agreed the disclosures back to supporting documentation. We also checked the note against the CIPFA Disclosure Checklist to ensure that the disclosure requirements of the Code had been met.	<p>The disclosures relating to operating leases where the Council is a lessee were incomplete, and did not include disclosure of lease and sublease payments recognised as an expense during the period, with separate amounts for minimum lease payments, contingent rents and sublease payments.</p> <p>We also found that a number of errors had been made within the Operating Leases disclosures when transferring information from the underlying working paper into the financial statements, although the working papers themselves were accurate.</p> <p>Management has agreed to correct these errors in the final accounts.</p>
PROVISIONS DISCLOSURE	We reviewed the Council's provision note to ensure that the disclosure requirements of the Code had been met. We also agreed the figures back to supporting working papers.	<p>We found that the Council had not fully complied with Code disclosure requirements in respect of provisions, due to the following omissions for each class of provision:</p> <ul style="list-style-type: none"> - A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits or service potential - An indication of the uncertainties about the amount or timing of those outflows (where necessary including the major assumptions made concerning future events). <p>Management has agreed to include these disclosures in the final accounts in respect of the NDR Appeals provision, which is the largest amount.</p>
SEGMENTAL REPORTING DISCLOSURES	We reviewed the Council's disclosure of Amounts Reported for Resource Allocation Decisions to ensure that this complied with Code requirements, and agreed to other parts of the financial statements and underlying working papers.	<p>The total cost of services within the Amounts Reported for Resource Allocation Decisions note (Note 21) did not agree with the total cost of services within the Comprehensive Income and Expenditure Statement. This was identified by management and corrected by way of amendment tabled at the 17 July Audit Committee meeting.</p> <p>Additionally, the Reconciliation to Subjective Analysis within this note is required to show interest payments as a separate line. Management has agreed to correct this error in the final accounts.</p>
ACCOUNTS DISCLOSURES	We reviewed the draft financial statements against the CIPFA Disclosure Checklist to ensure compliance with the Code in terms of the format of the accounts and related disclosures. We also agreed any disclosure	<p>In addition to the areas covered above, we identified a number of minor disclosure errors and issues within the accounts which management have agreed to correct. These are set out below:-</p> <ul style="list-style-type: none"> - Within Grant Income note 27, the total amount of Capital Grants and Contributions recognised was

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

OTHER RELEVANT AUDIT AND ACCOUNTING ISSUES		
RISK	WORK PERFORMED	CONCLUSION
	<p>notes not audited elsewhere to underlying working papers, and carried out additional audit testing where necessary to gain assurance over significant disclosure items.</p>	<p>incorrectly stated as £33,063,000. The correct figure is £30,695,000. There is no impact upon the prime statements</p> <ul style="list-style-type: none"> - The disclosure of vacant possession value of Council dwellings within the notes to the HRA Statement had not been updated from the prior year, and also erroneously included the value of HRA non-dwellings (e.g. garages). - Dedicated Schools Grant disclosure note 26 had a number of errors, including the note not agreeing to the prior year audited financial statements, casting errors, and incorrect years being included within the narrative line descriptions as some of these had not been updated from the prior year - The Property, Plant and Equipment note did not include information about the dates of revaluations - The Property, Plant and Equipment note gave the wrong figure for the value of schools transferred to Academy status in year. - We recommended separate disclosure of HRA Earmarked reserves within the Movement in Reserves Statement to aid transparency. We also recommended renaming the 'Earmarked General Fund Reserves' column 'Other Earmarked General Fund Reserves', and moving this to the right of the 'HRA' column - We recommended removal of lines within Note 1 (Adjustments between Accounting Basis and Funding Basis under Regulations) where there are no entries in the current or prior year, in order to remove clutter from the accounts - The Insurance Fund reserve was omitted from the Transfers to/from Earmarked Reserves note - We requested additional disclosure within the Explanatory Foreword in respect of the reduction in investments during the year, and how these had been utilised - Within the non-current assets section of the Explanatory Foreword, the figures given for capital investment and revaluation increases were inconsistent with the notes to the financial statements - Prior year comparatives were omitted from two areas within the notes to the accounts, which were within the PPE note (schools transferring to academies), and the exit packages note (amount payable

FINANCIAL STATEMENTS

Key audit and accounting matters (continued)

OTHER RELEVANT AUDIT AND ACCOUNTING ISSUES		
RISK	WORK PERFORMED	CONCLUSION
		<p>due to redundancy)</p> <ul style="list-style-type: none"> - A number of rounding and casting errors were identified within the notes to the accounts <p>A small number of typing and formatting errors were identified within the draft Statement of Accounts and Explanatory Foreword.</p>
INTERESTS IN COMPANIES AND OTHER ENTITIES	<p>Note 41 contains information about the Council's operations as a Harbour Authority. The Harbours Act 1964 requires Medway to prepare an annual statement of accounts relating to harbour activities (section 42[1] refers). The Act expressly states that this requirement is not satisfied by the preparation of a statement of accounts that covers matters in addition to harbour activities. This means that the inclusion of harbour activities within Medway's general accounts does not satisfy section 42(1) and a standalone annual statement of accounts relating to harbour activities, drawn from the Council's accounting records, is required.</p>	<p>Medway has not yet met the requirements of the Harbours Act 1964 and should prepare the standalone statement of accounts for the financial periods ended 31 March 2013 and 31 March 2014 to enable us to meet the audit requirements to prepare a report to the Secretary of State for Transport to accompany the annual statement of accounts relating to harbour activities as submitted by Medway Harbour Authority as required by the Harbours Act 1964.</p>

FINANCIAL STATEMENTS OPINION

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 2014.

CONTROL ENVIRONMENT

Significant deficiencies and other observations

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. We did not identify any significant deficiencies in internal controls.

As the purpose of the audit is for us to express an opinion on the 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 only restate weaknesses already reported by internal audit where we consider these to be significant deficiencies.

Key: ■ Significant deficiency in internal control ■ Other deficiency in internal control ■ Other observations

AREA	OBSERVATION	IMPLICATION	RECOMMENDATION
RELATED PARTY TRANSACTIONS	We found that the Council relies entirely upon Members and senior officers to declare related party transactions through the annual declaration process. There is no additional work carried out by management to ensure that declarations are complete.	There is a risk that related party transactions may remain undeclared and undisclosed, either through fraud or error.	We recommend that the Council considers implementing additional controls around the annual declaration process to gain assurance over the completeness of the related party transaction disclosure. For example, by carrying out Companies House searches on members and senior officers, reviewing website profiles for relevant information, or comparing returns with prior year declarations to identify any omitted transactions.
COUNCIL TAX AND NDR - 10% CHECKING OF EXEMPTIONS, RELIEFS AND DISCOUNTS	In previous years the Council has operated a 10% sample check of all new claims for Council Tax or NDR reliefs, exemptions and discounts. However, this check was only in place for 5 months of the current year, as it was stopped in August 2013 as a result of resource constraints.	There is potentially an increased risk that erroneous or fraudulent claims for reliefs, exemptions and discounts may remain undetected, leading to a financial loss for the Council. However, we note that there are other controls in place, including a 1% check of all accounts on an ongoing basis, and we have been able to take some assurance from these compensating controls.	We recommend that management reviews the controls in place around new claims for exemptions, discounts and reliefs for both council tax and NDR to assess whether these remain appropriate.
PAYROLL - EMPLOYEE RECORDS	During our substantive testing of payroll we found a number of issues relating to missing or inadequate documentation in respect of payments to or	There is a risk that, if full records are not retained, the Council could be liable if a dispute were to arise with an employee at a later date. For example, if there is no evidence	We recommend that full payroll records are retained for all employees, and that additional payments or deductions are not authorised until such documentation is on file.

AREA	OBSERVATION	IMPLICATION	RECOMMENDATION
	<p>deductions from employees.</p> <p>Of 49 items tested:-</p> <ul style="list-style-type: none"> - There were two employees for whom there was no supporting evidence for union deductions. - There was one employee for which there was no evidence on file for the employee's pension status (i.e. opted out). 	<p>on file that an employee has authorised union deductions, the Council may have to repay these if challenged.</p>	<p>If documentation relating to current employees is to be archived, the Council should ensure that this remains available for management or audit purposes.</p>
PAYROLL - HMRC RETURNS	<p>From our discussions with payroll we note that copies of HMRC returns are not retained by the Council. Since returns are now submitted electronically, notification of submission is emailed to the accountant responsible for payroll matters when submitted - however no copy of the actual return is retained.</p>	<p>Failure to retain a copy of electronic submission poses a number of risks to the Council. In the event of an HMRC investigation, for example, the Council may be unable to evidence the details returned, or even the fact that a return was made at all.</p>	<p>We strongly recommended that HMRC forms are printed off and retained following electronic submission.</p>
PAYROLL - AUTHORISED SIGNATORIES	<p>When examining Internal Audit's testing on permanent changes to payroll records (in particular changes to post and pay details), we noted that some of the people who were authorising the forms were not included on the payroll Authorised Signatory list. This mirrors one of our findings from the prior year's external audit, although the number of incidences does appear to have decreased.</p>	<p>Although we have been able to obtain sufficient assurance that the individuals involved are suitable individuals to approve payroll changes (by obtaining confirmation from the relevant Assistant Directors), there remains a risk that payroll changes could be authorised by inappropriate individuals if the checking process is not robust enough to detect this. This could result in the Council becoming committed to inappropriate expenditure, and increased risk of fraud and error.</p>	<p>We recommend that the Council continue the work they have started this year to cleanse and update the payroll authorised signatory list.</p> <p>Management may also wish to consider whether the current level of checking undertaken within the payroll department is sufficient to cover the risk of inappropriate authorisation of payroll changes.</p>
TIMELINESS OF RECONCILIATIONS	<p>We noted that a number of key control reconciliations were not always being completed or reviewed on a timely basis, as follows:-</p> <ul style="list-style-type: none"> - Internal audit noted in March 2014 that the January 2014 housing benefit payment run reconciliation had not yet been carried out. - At the time of our systems audit (April 2014), we noted that the reconciliations of IWorld to 	<p>There is a risk that if reconciliations are not completed and reviewed in a timely way, that any errors may not be detected, and the control will become less effective. This may be particularly important in areas such as Council Tax or housing benefit where the opportunity for the Council to rectify any errors, for example by recovering overpayments, may reduce over time.</p>	<p>We recommend that the Council reviews its key control reconciliation processes, to check that the frequency of the reconciliations is appropriate. Management may then wish to consider whether the current timetable for reconciliations is sufficient, or whether some reconciliations should be prepared or reviewed on a more timely basis.</p>

AREA	OBSERVATION	IMPLICATION	RECOMMENDATION
	<p>Integra for Council Tax for January, February and March 2014 had not yet been reviewed (although they had been prepared).</p> <p>- Four treasury reconciliations related to investments and long-term borrowing were not completed in September 2013 due to workload. The accounts were reconciled in October 2013.</p>	<p>However, it is recognised that this needs to be balanced with other priorities, such as the preparation of the financial statements. It may also be the case that some reconciliations may not need to be done monthly (for example long-term investments and borrowing where there is little or no movement from month to month).</p>	

We made the observations reported to you above during the course of our normal audit work. Management responses to our recommendations are included in appendix IV.

GOVERNANCE REPORTING

Governance matters and quality of reporting

FINANCIAL STATEMENTS PREPARATION

The draft financial statements, within the statement of accounts, was prepared and provided to us for audit on 4 July 2014.

As part of our planning for the audit, we prepared a detailed document request which outlined the information we would require to complete the audit. As in previous years, a file of audit working papers has been provided to us on the first day of the audit. There were a small number of working papers which were not available at the start of the audit, and these followed separately.

ANNUAL GOVERNANCE STATEMENT

We are required to review the draft annual governance statement and to be 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.

STATEMENT OF ACCOUNTS

We are required to read all the financial and non-financial information in the explanatory foreword to the financial statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit.

CONCLUSIONS AND AUDIT ISSUES

We note that the draft statement of accounts was presented for audit four days after the 30 June deadline. Further amendments were made to the Statement of Accounts and tabled at the Audit Committee meeting on 17 July.

Some of the working papers received at the start of the audit were incomplete, or did not provide all of the information originally requested. However, we are pleased to report that management and finance staff have generally been proactive in resolving these issues as quickly as possible, and we are grateful for this assistance.

Some delays were encountered in obtaining supporting documentation for our sample testing of adult social care income and expenditure, and other service income. Unfortunately this did result in some delays to the audit process.

CONCLUSIONS AND AUDIT ISSUES

We are satisfied that the annual governance statement is not inconsistent or misleading with other information we were aware of from our audit of the financial statements and complies with "Delivering Good Governance in Local Government" (CIPFA / SOLACE).

We have identified a small number of typing errors in the draft Statement which we have reported to management for correction in the final version.

CONCLUSIONS AND AUDIT ISSUES

We are satisfied that the information given in the explanatory foreword for the financial year for which the financial statements are prepared is consistent with the financial statements, subject to our review of the final version, and the adjustments reported under 'Key Audit and Accounting Matters' above.

WHOLE OF GOVERNMENT ACCOUNTS

Consistency of the Data Collection Tool

SCOPE OF THE REVIEW OF THE DATA COLLECTION TOOL

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.

CONCLUSION AND AUDIT ISSUES

Our review of the Council's WGA Data Collection Tool (DCT) is due to commence.

ASSURANCE STATEMENT

Our review of the Council's WGA Data Collection Tool (DCT) is due to commence.

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).

AUDIT COMMISSION SPECIFIED CRITERIA

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 focus of the criteria is that the Council 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 has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

The focus of the criteria is that the Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

We draw sources of assurance relating to their value for money responsibilities from:

- the Council's system of internal control as reported on in its annual governance statement
- the results of the work of the Commission, other inspectorates and review agencies
- any work mandated by the Commission
- any other locally determined risk-based value for money work that auditors consider necessary to discharge their responsibilities.

FOCUS OF REVIEW

We have reviewed the Council's arrangements against risk indicators and key issues facing the sector including the Government's spending review, funding over the medium term, risks arising from welfare reform, and risks from the localisation of business rates.

In our audit plan we reported the follow significant risks to the Council:

- Government continues to reduce funding for local government, and combined with additional pressures arising from demographic and other changes, will have a significant impact on the financial resilience of the Council in the medium term.
- 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). An improvement plan has been developed and the Council is currently working towards achieving the actions within this plan. We also review the Council's relative performance against the VfM Profile Tool and Financial Ratios Analysis Tool produced by the Audit Commission, issues arising from VfM Briefings provided by the Audit Commission, and the key assumptions in the Medium Term Financial Strategy.

USE OF RESOURCES

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 planning identified the risk that the Council may not fully identify or achieve the significant savings and efficiencies required in the medium term to respond to the expected further reduction in government funding and other emerging financial pressures.

Key findings

The Council continues to provide clear leadership on financial governance matters through the work of the Cabinet and the Senior Management Team. Financial responsibilities are clearly assigned and the Senior Management Team oversees the corporate response to expenditure pressures, other financial risks emerging in the year and the overall achievement of the annual budget. The Cabinet and Overview and Scrutiny Committees continue to challenge financial performance and the delivery of the Council's capital programme, effectively.

In 2013/14, the overall financial position was monitored closely throughout the year and the Council reported a General Fund surplus of £267,000 as at 31 March 2014. The general reserve was maintained at the level recommended by the Chief Finance Officer (£5 million) and total Earmarked General Fund Reserves (those held for specific purposes) increased from £20.9 million to £29.9 million (non-General Fund Earmarked Reserves reduced from £38.5 million to £30.7 million).

At the detailed level, the Council established a new Earmarked Reserve in the year (the Collection Fund Holding Account) and this amounts to £1.7 million. The reserve manages the variance between the statutory and actual call on the collection fund. Other Earmarked General Fund reserves increased as at 31 March 2014 in accordance with the Council's medium term financial plan and to meet Medway's priorities for investment. The Council therefore earmarked an additional revenue contribution (£2 million) to invest in capital schemes for the Children and Adult Services department and a further £1.9 million has been earmarked to drive the improvement required in Children's Social Care services following the adverse Ofsted reports received in 2013. A further £1.9 million has been earmarked as a result of the underspent budget for Public Health services and is expected to meet expenditure planned in 2014/15.

In September 2013, the Council decided to transfer £2 million from the Housing Revenue Account (HRA) balance to general fund reserves. The Council's legal advice confirmed the transfer was allowed under existing regulations. We considered the basis of the Council's decision and wrote to the Chief Finance Officer highlighting our view that the statutory basis for the transfer was unclear. The Department for Communities and Local Government (DCLG) is aware a number of Councils completed transfers of resources in this way and further information was sought from the Council in March 2014 on this matter and officers have told us no further comment has been made by the DCLG since. As at 31 March 2014, the HRA reported a surplus for the year of £1.3 million against a budgeted surplus of £1 million. A revenue contribution to capital expenditure of £1.7 million and the contribution of £2 million towards general reserves highlighted above meant that the balance on the account reduced to £2 million as at 31 March 2014. The balance remains in excess of the minimum level recommended by the Chief Finance officer (£450,000) and meets the requirements of 30 year HRA

AUDIT ISSUES AND IMPACT ON CONCLUSION

There is no impact on the VFM conclusion from our financial resilience work.

USE OF RESOURCES

Financial resilience (continued)

WORK PERFORMED AND KEY FINDINGS

AUDIT ISSUES AND IMPACT ON CONCLUSION

Business Plan.

The Medium Term Financial Plan (MTFP) covers a four year period and is updated annually. The MTFP for the period 2014 to 2017 provides a comprehensive analysis of the financial challenges the Council is facing. It also supports achievement of Medway's priorities and considers the impact of major changes planned to Council services, available resources and local need, including the impact of the Government's Academies programme, changes in resources retained from business rates, the introduction of the Council Tax support scheme and the views of local people and service users.

While the MTFP financial position is balanced in the period to 31 March 2015, significant resource gaps have been identified in 2015/16 (£12.2 million) and in 2016/17 (an additional £8.1 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.

USE OF RESOURCES

Challenging economy, efficiency and effectiveness

PRIORITISING RESOURCES

We have reviewed whether the Council has prioritised its resources to take account of the tighter constraints it is required to operate within. Based on our assessment of risk, we have reviewed the Council's:

- arrangements for the protection of children and looked after children in the light of adverse Ofsted reports
- achievement of targets and priorities set for 2013/14
- partnership working (specifically the Health and Wellbeing Board but also other developing partnerships for service delivery)
- Innovations/developments in services including the Medway Norse Joint Venture
- Cost/benefit analysis and options appraisal in decision making

Arrangements for the protection of children and for looked after children

The Council is taking action to address the inadequate judgements reported by Ofsted following its inspection of arrangements for protecting children (February 2013) and for looked after children services (August 2013). The Ofsted review of arrangements for the protection of children concluded that in all four focus areas the Council's arrangements were inadequate (the areas reviewed were overall effectiveness of the service; the effectiveness of the help and protection provided to children, young people, families and carers; the quality of practice; and leadership and governance). The inspection of looked after children's services concluded that in four of the five judgement areas (overall effectiveness of the service; outcomes for looked after children and young people; quality of provision and leadership and management) arrangements were inadequate. The inspectors concluded that the capacity of the service to improve was adequate.

Since the inspections, the Council has identified additional resources of £1.9 million per annum to invest in its children's services and has made progress to establish structures and processes to address the weaknesses identified by inspectors. The Medway Safeguarding Children's Board, which is led by an independent chair, receives reports from the External Improvement Board on the delivery of the improvement plan agreed with the Department for Education. There is clear evidence of progress in implementing all of the actions agreed and there have been positive outcomes following the Council's investment in a new workforce strategy and the implementation of an effective performance and quality assurance framework.

A detailed independent audit of cases where a child protection plan is in place found many examples of good practice. Other reviews have found better practice towards looked after children and the more consistent implementation of care plans.

AUDIT ISSUES AND IMPACT ON CONCLUSION

There is no impact on the VFM conclusion from our prioritising resources work.

USE OF RESOURCES

Challenging economy, efficiency and effectiveness

PRIORITISING RESOURCES (continued)

AUDIT ISSUES AND IMPACT ON CONCLUSION

The involvement of Partners in the strategic approach to children's social care services is increasing and this is improving access to services for those children who need it (such as Child and Adolescent Mental Health Services). The Council recognises much remains to be done to achieve its objectives for safeguarding children's services and has identified the investment, and is providing the leadership necessary to achieve this.

Partnership working (Heath and Wellbeing Board)

The Health and Well Being Board continues to oversee the joint approach to the assessment of need for the Medway area and has led the development of the joint approach to the Government's Better Care Fund and other pooled budgets. A major review of health inequalities and the future investment required for the Medway area was published by a task group led by the Chairman of the Health and Adult Care Overview and Scrutiny Committee in the year. The Group consulted with the Council's key strategic partners and published its findings in May 2014. The work of the Health and Well Being Board is now being developed further to improve access to primary care (through partnership working with Medway Clinical Commissioning Group); overcome barriers to engagement and outreach services; identify the scope for undertaking health equity audits may be of assistance in identifying and addressing health inequalities

The Health and Well Being Board is also responsible for aspects of the Children's Services improvement plan and has integrated such actions with its regular performance management arrangements.

USE OF RESOURCES

Challenging economy, efficiency and effectiveness

IMPROVING EFFICIENCY AND PRODUCTIVITY

Medway Norse Joint Venture Company

The Medway Norse Joint Venture Company was established on 1 April 2013. The Council initially agreed that contracts for facilities management services such as cleaning, buildings maintenance and catering should be transferred to the joint venture with the transfer of 158 council employees under TUPE arrangements. The initial value of services transferred was £6.7 million with an anticipated profit share of £316,000 (100%) returned to the Council in Year 1. The Joint Venture accounts showed the Council in receipt of all of the company profits amounting to £285,000 as at 31 March 2014 (which was above the revised target of £266,000). The Council published its review of the first trading year in July 2014 and noted that governance arrangements were working well and that the Operational Liaison Board (which includes nine senior council managers) had overseen the transfer of contracts and human resources effectively. The Council has evaluated other services for inclusion in the joint venture and decided that with effect from 1 April 2014, grounds maintenance contracts (value £3 million and involving 76 employees under TUPE) and aspects of special education needs transport services should be transferred. The joint venture now employs about 400 people, with over 95% living in the Medway area. The company has set a target to incur 40% of its expenditure with local companies in Medway by 2018. As at 31 March 2014, expenditure of £1.4 million is delivered in this way and represents 26% of total expenditure.

A strategic aim of the company is that it should win contracts for the provision of services to other public and private sector organisations. There has been only limited success in securing such additional work though the Council believes this is understandable in the first year of operation as the company established itself and prepared for the transfer of additional services on behalf of Medway. The Council has not proposed the transfer of any of its services without completing a full financial evaluation of the costs, benefits and risks involved. A key challenge for the company will be to secure further growth in the scope and extent of services it provides to other organisations. Through the work of the Board of Directors, the Council has established arrangements to monitor such outcomes through the work of the Operational Liaison Board in place to oversee the operation of Medway contracts.

Council efficiency programme

The MTFP considers the progress and expected outcomes from the 'better for less' ('BfL') efficiency programme. The programme is transforming Council services and the way they are delivered including the new Category Management approach to procurement. Services now being delivered through a joint venture company (known as 'Medway Norse') include facilities management, grounds maintenance and aspects of Special Education Needs Transport (see above).

The four phases of the category management of procurement programme completed to date are designed to deliver savings of approximately £4.5 million per annum by 2016/17, with the Council reporting that 82 per cent of these savings have been secured and service budgets reduced accordingly. A further £2.6 million has been profiled to reduce budgets in 2014/15 and 2015/16. The programme has the stated potential to deliver up to £10 million of savings through the more effective commissioning and procurement of services over the MTFP period. New contracts for Homecare Services were

AUDIT ISSUES AND IMPACT ON CONCLUSION

There is no impact on the VFM conclusion from our improving efficiency and productively work.

USE OF RESOURCES

Challenging economy, efficiency and effectiveness

IMPROVING EFFICIENCY AND PRODUCTIVITY (continued)

AUDIT ISSUES AND IMPACT ON CONCLUSION

introduced at the end of 2012/13 and this resulted in reduced contract costs of £1.9 million per annum. Further savings for Facilities Management, Agency Staff and High Cost Placements are anticipated to yield an additional £2.2 million of reduced costs in 2014/15 and there is a programme of work planned to secure further savings

Cost/benefit analysis and options appraisal in decision making

The Council continues to use data and analysis effectively to inform its procurement decisions. The 'Gateway' procurement process ensures the Cabinet considers relevant procurement decisions based on analysis of costs, benefits and risks undertaken by service managers. Examples of successful procurements progressed using the Gateway approach in 2013/14 include:

- the purchase of retail units for the Rochester Riverside development
- agreement of a procurement process involving an alternative delivery model for the management of the Medway Control Centre service (including the CCTV Partnership, out-of-hours and associated personal safety services such as telehealthcare) agreeing contracts with a local charity for the delivery of Medway's Local Welfare Provision.

Achievement of targets and priorities set for 2013/14

The Council's performance management arrangements remain effective. The Council Plan is the published business plan, setting out the Council's commitment to achieving agreed outcomes. The Plan is reviewed and adjusted each year to take account of financial performance and service developments and links Council priorities to available resources. It also sets out key performance measures and actual performance (using agreed performance indicators measured over time as well as customer satisfaction indicators). Progress is reported quarterly to the Cabinet and scrutiny committees using the embedded performance management system. The Council Plan 2013 to 2015 is a key part of the budget and policy framework which is developed alongside annual capital and revenue budget proposals. Based on consultation with local people and strategic partners, the Plan was updated in the year and the number of key performance indicators was reduced from 102 to 62. As at the end of March 2014, in terms of Medway's key measures of success, the Council reported:

- 50% of indicators achieved target compared with 56% in 2012/13
- 31% of indicators were significantly under-performing compared with 28% in 2012/13.

USE OF RESOURCES CONCLUSION

On the basis of our work, and having regard to the guidance on the specified criteria published by the Audit Commission, we are satisfied that the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2014.



APPENDICES

APPENDIX I: DEFINITIONS

TERM	MEANING
The Council	Medway Council
Management	<p>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:</p> <ul style="list-style-type: none"> the financial statements (including designing, implementing, and maintaining effective internal control over financial reporting) putting in place proper arrangements to secure economy, efficiency and effectiveness in the use of resources and to ensure proper stewardship and governance, and regularly to review the adequacy and effectiveness of them.
Those charged with governance	<p>The person(s) with responsibility for assurance and the Council's arrangements for governance, managing risk, maintaining an effective control environment, and reporting on financial and non-financial performance. This includes overseeing the financial reporting process.</p> <p>Those charged with governance for the Council are the Audit Committee.</p>
ISAs (UK & Ireland)	International Standards on Auditing (UK & Ireland)
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards as adopted by the European Union
Materiality	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.
Code	Code of Practice on Local Authority Accounting in the United Kingdom issued by CIPFA / LASAAC
SeRCOP	Service Reporting Code of Practice for Local Authorities issued by CIPFA / LASAAC
CIES	Comprehensive Income and Expenditure Statement

APPENDIX II: AUDIT DIFFERENCES

We are required to bring to your attention audit differences identified during the audit, except for those that are clearly trivial, that the Audit Committee is required to consider. This includes: audit differences that have been corrected by management; and those that remain uncorrected along with the effect that they have individually, or in aggregate, on the opinion in the auditor's report.

CORRECTED AUDIT DIFFERENCES

Management has made corrections in the revised draft financial statements which have reduced the deficit for the year by £7,341,000. These are set out on the following page.

AUDIT DIFFERENCES

Adjusted audit differences

ADJUSTED AUDIT DIFFERENCES	£'000	INCOME AND EXPENDITURE		BALANCE SHEET	
		Dr £'000	(Cr) £'000	Dr £'000	(Cr) £'000
CIES (surplus) or deficit on the provision of services before adjustments	44,830				
Dr Property, Plant and Equipment - Dwellings - Cost	(7,498)			4,448	
Dr Property, Plant and Equipment - Dwellings - Accumulated Depreciation				3,050	
Cr Expenditure - Local Authority Housing (HRA)			(7,498)		
<i>Being the indexation of HRA dwelling valuations to reflect a significant valuation movement in year (estimation misstatement)</i>					
Dr Other Operating Expenditure - Losses on disposal of non-current assets	157	1,403			
Cr Expenditure - Children's and education services			(1,246)		
Cr Unusable Reserves - Capital Adjustment Account					(157)
<i>Being the treatment of long lease assignments to academies as disposals rather than downwards revaluations (factual misstatement)</i>					
Dr Property, Plant and Equipment - Other Land and Buildings - Cost	0			28,362	
Cr Property, Plant and Equipment - Assets Under Construction - Cost					(28,362)
<i>Being the reclassification of two Academies which were held in assets under construction despite having been brought into use (factual misstatement)</i>					
Dr Property, Plant and Equipment - Other Land and Buildings - Cost	0			4,584	
Dr Property, Plant and Equipment - Dwellings - Accumulated Depreciation				195	
Cr Property, Plant and Equipment - Dwellings - Cost					(4,584)
Cr Property, Plant and Equipment - Other Land and Buildings - Accumulated Depreciation					(195)
<i>Being the reclassification of non-dwelling HRA assets into other land and buildings (factual misstatement)</i>					
Dr current Debtors	0			3,089	
Cr Current creditors					(3,089)
<i>Being the reclassification of NDR debtors and creditors to correct the negative NDR debtor (factual misstatement)</i>					
Dr CIES service income	1,230	1,230			
Cr Capital grants received in advance					(1,230)
<i>Being the recognition of capital grants received in advance and reduction in CIES service income (factual misstatement)</i>					
TOTAL ADJUSTED AUDIT DIFFERENCES	(6,111)	1,403	(8,744)	43,728	(36,387)
CIES (surplus) or deficit on the provision of services after adjustments	38,719				

AUDIT DIFFERENCES

Unadjusted audit differences

UNADJUSTED AUDIT DIFFERENCES

There are two unadjusted audit differences identified by our audit work which would increase the draft deficit on the provision of services in the CIES by £1.156 million to £39.875 million (from £38.719 million, after taking account the adjusted audit differences set out above). A schedule of uncorrected audit differences is included on the following pages, with misstatements recorded as factual misstatements, judgemental / estimation misstatements, or projected misstatements. We request that you correct these misstatements. Deliberate misstatement of known issues is not acceptable and identified misstatements should, where practicable, be corrected even if not material.

Management has stated that it considers these identified misstatements to be immaterial in the context of the financial statements taken as a whole.

There are no brought forward prior year uncorrected misstatements that would impact on the current year performance.

UNADJUSTED AUDIT DIFFERENCES	£'000	INCOME AND EXPENDITURE		BALANCE SHEET	
		Dr £'000	(Cr) £'000	Dr £'000	(Cr) £'000
CIES (surplus) or deficit on the provision of services (after adjusted audit differences)	38,719				
Dr Short-term Creditors	0			1,098	
Cr Short-term Debtors					(1,098)
<i>Being the recognition of creditors and matching debtors at year-end in respect of goods and services provided after year-end (extrapolated misstatement)</i>					
Dr CIES service expenditure	1,156	1,156			
Cr Short-term creditors					(1,156)
<i>Being the recognition of creditor accruals and related CIES service expenditure (extrapolated misstatement)</i>					
TOTAL UNADJUSTED AUDIT DIFFERENCES	1,156	2,724		1,098	(3,822)
CIES (surplus) or deficit on the provision of services after adjustments	39,875				

UNADJUSTED DISCLOSURE MATTERS

The Code requires authorities to disclose the policy for the acquisition, preservation, management and disposal of heritage assets, including a description of the records maintained by the authority of its collection of heritage assets and information on the extent to which access is permitted.

Although the Council has provided such disclosure in respect of its museum assets at Note 39, no disclosure has been given in respect of other classes of heritage assets, including buildings.

APPENDIX III: 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, we provide an indication of the quantitative levels used for planning purposes. Materiality is re-assessed every year in the context of authoritative audit practice.

MATERIALITY

Planning materiality	£12,700,000
Final materiality	£12,300,000
Clearly trivial threshold	£246,000

Planning materiality of £12,700,000 was based on 2% of prior year gross expenditure in the Comprehensive Income and Expenditure Statement excluding non-recurrent expenditure.

Final materiality of £12,300,000 was revised based on 2% of gross expenditure in the Comprehensive Income and Expenditure Statement excluding non-recurrent expenditure reported in the draft financial statements submitted for audit.

APPENDIX IV: RECOMMENDATIONS AND ACTION PLAN

CONCLUSIONS FROM WORK	RECOMMENDATIONS	MANAGEMENT RESPONSE	RESPONSIBILITY	TIMING
FINANCIAL STATEMENTS				

Actuarial Assumptions

From our discussions with management we have noted that management rely upon the work of the actuary in estimating the year-end pension liability and related accounting entries, and do not provide the level of detailed challenge which we would expect around the assumptions used. It is management’s responsibility to ensure that appropriate assumptions are used by the actuary.

We recommend that going forwards management carry out sufficient work to satisfy themselves that the assumptions used by the actuary are appropriate, for example by providing challenge (and retaining evidence of this challenge), particularly where assumptions may fall outside of expected parameters. Evidence of this process should be retained.

Annual Leave Accrual

We found a number of issues with the Council’s annual leave accrual, as follows:-

- For teachers, the Council has not taken into account that some teachers may have taken sick leave or maternity leave during the year, as required by the Code guidance
- The Council has not adjusted the accrual for teachers who left during the month of April, as required by the Code guidance
- For non-teachers, no adjustments have been made for overtime or other pay elements on which annual leave will not accrue
- For all staff, it has not been possible to fully reconcile the inputs to the accrual calculation back to payroll records although the unreconciled difference is not material and would result in a trivial

We recommend that the Council reviews its methodology for calculating the employee annual leave accrual in future years to ensure that it is compliant with the Code and results in an estimate which is as accurate as reasonably possible.

CONCLUSIONS FROM WORK	RECOMMENDATIONS	MANAGEMENT RESPONSE	RESPONSIBILITY	TIMING
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FINANCIAL STATEMENTS

movement within the provision.

As a result, it is likely that the total accrual is misstated though the amount is not material.

Heritage Assets

The Code requires authorities to disclose the policy for the acquisition, preservation, management and disposal of heritage assets, including a description of the records maintained by the authority of its collection of heritage assets and information on the extent to which access is permitted.

We recommend that the Council expands its disclosures in respect of the acquisition, preservation, management and disposals of heritage assets to cover all non-trivial classes of heritage assets.

Although the Council has made these disclosures in respect of its museum assets at Note 39, it has not made any disclosure in respect of other classes of heritage assets.

CONTROL ENVIRONMENT

Related Party Transactions

We found that the Council relies entirely upon members and senior officers to declare related party transactions through the annual declaration process. There is no additional work carried out by management to ensure that declarations are complete.

We recommend that the Council considers implementing additional controls around the annual declaration process to gain assurance over the completeness of the related party transaction disclosure. For example, by carrying out Companies House searches on members and senior officers, reviewing website profiles for relevant information, or comparing returns with prior year declarations to identify any omitted transactions.

Council Tax and NDR - 10% Checking of Exemptions, Reliefs and Discounts

In previous years the Council has operated a 10% sample check of all new claims for Council Tax or NDR reliefs, exemptions and discounts.

We recommend that management reviews the controls in place around new claims for exemptions, discounts and reliefs for both council tax and NDR to

CONCLUSIONS FROM WORK	RECOMMENDATIONS	MANAGEMENT RESPONSE	RESPONSIBILITY	TIMING
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FINANCIAL STATEMENTS				
However, this check was only in place for five months of the current year and ceased in August 2013.	assess whether these remain appropriate. Ultimately this is a matter of management judgement.			

Payroll - Employee Records

During our substantive testing of payroll we found a number of matters relating to missing or inadequate documentation in respect of payments to or deductions from employees.

We recommend that full payroll records are retained for all employees, and that additional payments or deductions are not authorised until such documentation is on file.

Of 49 items tested:-

If documentation relating to current employees is to be archived, the Council should ensure that this remains available for management or audit purposes.

- There were two employees for whom there was no supporting evidence for union deductions
- There was one employee for which there was no evidence on file for the employee's pension status (i.e. opted out).

Payroll - HMRC Returns

From our discussions with payroll we note that copies of HMRC returns are not retained by the Council. Since returns are now submitted electronically, notification of submission is emailed to the Payroll Operations Manager when submitted - however no copy of the actual return is retained.

We recommend that HMRC forms are printed and retained following electronic submission.

Payroll - Authorisation of Changes

When examining Internal Audit's testing on permanent changes to payroll records (in particular changes to post and pay details), we noted that some of the people who were authorising the forms were not included on the

We recommend that the Council continue the work they have started this year to cleanse and update the payroll authorised signatory list.

Management may also wish to consider whether the

CONCLUSIONS FROM WORK	RECOMMENDATIONS	MANAGEMENT RESPONSE	RESPONSIBILITY	TIMING
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FINANCIAL STATEMENTS				
payroll Authorised Signatory list.	current level of checking undertaken within the payroll department is sufficient to cover the risk of inappropriate authorisation of payroll changes.			

Timeliness of Reconciliations

During our systems work we noted that a number of key control reconciliations were not always being completed or reviewed on a timely basis, as follows:-

- Internal audit noted in March 2014 that the January 2014 housing benefit payment run reconciliation had not yet been carried out
- At the time of our systems audit (April 2014), we noted that the reconciliations of IWorld to Integra for Council Tax for January, February and March 2014 had not yet been reviewed (although they had been prepared)
- Four treasury reconciliations related to investments and long-term borrowing were not completed in September 2013 due to workload. The accounts were reconciled in October 2013.

We recommend that the Council reviews its key control reconciliation processes, to check that the frequency of the reconciliations is appropriate. Management may then wish to consider whether the current timetable for reconciliations is sufficient, or whether some reconciliations should be prepared or reviewed on a more timely basis.

Interests in companies and other entities

Medway has not yet met the requirements of the Harbours Act 1964 and should prepare the standalone statement of accounts for the financial periods ended 31 March 2013 and 31 March 2014 to enable us to meet the audit requirements to prepare a report to the Secretary of State for Transport to accompany the annual statement of accounts relating to harbour activities as submitted by Medway Harbour Authority as required by the Harbours Act 1964.

Officers should ensure the requirements of the Harbours Act 1964 are met.

APPENDIX V: STATUTORY AND PROFESSIONALLY REQUIRED COMMUNICATIONS

COMMUNICATION REQUIRED	DATE COMMUNICATED	TO WHOM	METHOD
Accounting practices, accounting policies, estimates and judgements and financial statement disclosures (ISA 260)			Financial statements section of this report
Significant difficulties encountered during the audit (ISA 260)		No issues	
Significant matters discussed or subject to correspondence with management (ISA 260)		No issues	
The final draft of the representation letter (ISA 260)		Appendix VI	
Independence (ISA 260)			Independence section of this report
Fraud and illegal acts (ISA 240)		No issues	
Non compliance with laws and regulations (ISA 250)		No issues	
Significant deficiencies in internal control (ISA 265)		No issues	
Misstatements, whether or not corrected by the entity (ISA 450)			Financial statements section and Appendix II of this report
Significant matters in connection with related parties (ISA 550)			Financial statements section of this report
Events or conditions that may cast significant doubt on the entity's ability to continue as a going concern (ISA 570)		No issues	
Expected modifications to our audit report or inclusions of emphasis of matter / other matter (ISA 705 / 706)		No issues	
Material inconsistencies with other information in documents containing audited financial information (ISA 720)		No issues	
Objections from the public or exercise of statutory powers under the Audit Commission Act 1998		No issues	

APPENDIX VI: DRAFT REPRESENTATION LETTER

TO TYPED ON CLIENT HEADED NOTEPAPER

BDO LLP
55 Baker Street
London
W1U 7EU

XX September 2014

Dear Sirs

Financial statements of Medway Council for the year ended 31 March 2014

We confirm that the following representations given to you in connection with your audit of the Council's financial statements (the 'financial statements') for the year ended 31 March 2014 are made to the best of our knowledge and belief, and after having made appropriate enquiries of other officers and members of the Council.

The Chief Finance Officer has fulfilled his responsibilities for the preparation and presentation of the financial statements as set out in the Accounts and Audit Regulations 2011 and Statement of responsibilities of auditors and of audited bodies local government (March 2010) issued by the Audit Commission, and in particular that the financial statements give a true and fair view of the financial position of the Council as of 31 March 2014 and of its income and expenditure and cash flows for the year then ended in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the Code) and for making accurate representations to you.

We have fulfilled our responsibilities on behalf of the Council, as set out in the Accounts and Audit Regulations 2011, to make arrangements for the proper administration of the Council's financial affairs, to conduct a review at least once in a year of the effectiveness of the system of internal control and approve the annual governance statement, to approve the Statement of Accounts (which include the financial statements), and for making accurate representations to you.

We have provided you with unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence. In addition, all the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Council have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of all management and other meetings have been made available to you.

Laws and regulations

In relation to those laws and regulations which provide the legal framework within which the Council's business is conducted and which are central to our ability to conduct our business, we have disclosed to you all instances of possible non-compliance of which we are aware and all actual or contingent consequences arising from such instances of non-compliance. In particular, we have discussed the DCLG's enquiries regarding the transfer of amounts from the Housing Revenue Account to the General Fund. We are satisfied, based on advice taken, the transfer complies with relevant regulations in place at the time of the transfer.

Subsequent events

There have been no events since the balance sheet date which either require changes to be made to the figures included in the financial statements or to be disclosed by way of a note. Should any material events of this type occur, we will advise you accordingly.

Financial statements preparation

We are responsible for adopting sound accounting policies, designing, implementing and maintaining internal control, to, among other things, help assure the preparation of the financial statements in conformity with generally accepted accounting principles and preventing and detecting fraud and error.

Fraud

We have considered the risk that the financial statements may be materially misstated due to fraud and have identified no significant risks.

To the best of our knowledge we are not aware of any fraud or suspected fraud involving councillors, management or employees. Additionally, we are not aware of any fraud or suspected fraud involving any other party that could materially affect the financial statements.

To the best of our knowledge we are not aware of any allegations of fraud or suspected fraud affecting the financial statements that have been communicated by councillors, employees, former employees, analysts, regulators or any other party.

Unadjusted audit differences

We attach a schedule showing accounting adjustments that you have proposed, which we acknowledge that you request we correct, together with the reasons why we have not recorded these proposed adjustments in the financial statements. In our opinion, the effects of not recording such identified financial statement misstatements are, both individually and in the aggregate, immaterial to the financial statements.

Related party transactions

We have disclosed to you the identity of all related parties and all the related party relationships and transactions of which we are aware. We have appropriately accounted for and disclosed such relationships and transactions in accordance with the applicable financial reporting framework.

Fair value measurements

We have no plans or intentions that may materially affect the carrying value and where relevant, the fair value measurement, or classification of assets or liabilities reflected in the financial statements.

Significant assumptions

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

(a) Council dwelling valuation

In estimating the value of Council dwellings as at 31 March 2014, we have applied the Nationwide House Price Index for 2013/14 to the values determined by our internal valuers as at 1 April 2014. This has resulted in an increase in valuation of between 9.28% and 10.22% across our different types of housing stock. We confirm that we are satisfied as to the reasonableness of this index and its applicability to Medway's housing stock, and that the value of Council dwellings is not materially misstated at 31 March 2014.

(b) 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) 2.8%
- Rate of increase in salaries 4.6%
- Rate of increase in pensions 2.8%

- Rate for discounting scheme liabilities 4.5%

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

After making appropriate enquiries of other members of the Council and other officers regarding disclosure of information to you as auditors, we confirm that so far as we are aware, there is no relevant audit information needed by you in connection with preparing your audit report of which you are unaware.

We confirm that the above representations are made on the basis of enquiries of councillors, management and staff with relevant knowledge and experience (and, where appropriate, of inspection of supporting documentation) sufficient to satisfy ourselves that we can properly make each of the above representations to you.

We confirm that the financial statements are free of material misstatements, including omissions.

Yours faithfully

Mick Hayward

Chief Finance Officer


XX September 2014

Councillor C Mackinlay

Chairman of the Audit Committee

Signed on behalf of the Audit Committee

XX September 2014



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 organisation and may not be quoted nor copied without our prior written consent. No responsibility to any third party is accepted.

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