

AUDIT COMMITTEE

12 JANUARY 2016

ANNUAL AUDIT LETTER 2014/15

Report from: Phil Watts, Chief Finance Officer

Author: Phil Watts, Chief Finance Officer

Summary

This report and attachment reflects the work carried out by BDO, our external auditors, in respect of the 2014/15 financial year.

1. Budget and Policy Framework

1.1 The receipt of the Annual Audit Letter is a matter for the Audit Committee.

2. Annual Audit Letter 2014/15

2.1 Independent external auditors are responsible for preparing an annual audit letter for all councils. The letter is designed to communicate their key messages and conclusions to the council and external stakeholders, including members of the public.

2.2 The annual audit letter for 2014/15, produced by BDO, is attached as Appendix 1 to this report. The letter summarises the key issues arising from the work BDO have carried out during the year ending 31 March 2015 and relates to their responsibilities in both finance and governance matters.

2.4 Set out below is an overview of the key findings contained within the 2014/2015 Annual Audit Letter:

2.4.1 Statement of Accounts

- An unqualified true and fair opinion was given on the financial statements for the year, which were properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 and the accounts were published in accordance with the 30 September 2015 deadline.
- BDO found no material misstatements, one material misclassification and also required a number of amendments that the Council corrected. There were also two unadjusted audit differences and these are detailed in the appendix.

2.4.2 Use of Resources (Value for Money)

- BDO issued an unqualified value for money conclusion
- Although BDO recognised a funding gap in the Medium Term Financial Strategy (MTFS), they were satisfied that the Council has appropriate arrangements to continue to remain sustainable over the period of the MTFS.

2.4.3 Other Matters

- BDO were satisfied that the Annual Governance Statement was not misleading or inconsistent with other information they were aware of from their audit.
- The audit of the Whole of Government Accounts return and the audit of grant claims and other Government returns was progressing and would be reported separately

2.5 BDO's detailed findings and recommendations were also reported to the Audit Committee on 24 September 2015 within the Annual Governance Report.

3. Financial and Legal Implications

3.1 There are no legal and financial implications arising from this report.

4. Risk Management

4.1 As the majority of the issues identified within the Audit Letter relate to activities of the Council during 2014/15 no risks are identified. However, value for money is one of the two core values for the Council and, in an ever more demanding financial environment, is of prime importance in ensuring that service delivery remains as effective as the letter portrays.

5. Recommendation

5.1 The Audit Committee note the content of the Annual Audit Letter for 2014/15.

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Appendices:

Appendix 1 – Annual Audit Letter 2014/15

Background papers

Annual Governance Report to Audit Committee 24 September 2015
<http://democracy.medway.gov.uk/mgConvert2Pdf.aspx?ID=8819&T=9>

MEDWAY COUNCIL

Annual Audit Letter 2014/15

27 October 2015

EXECUTIVE SUMMARY

Background

This Annual Audit Letter summarises the key issues arising from the work that we have carried out during the year. It is addressed to the Council but is also intended to communicate the significant issues we have identified to key external stakeholders and members of the public.

Responsibilities of auditors and the Council

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for.

Our responsibility is to plan and carry out an audit that meets the requirements of the Audit Commission's Code of Audit Practice (the Code). Under the Code, we are required to review and report on:

- the Council's financial statements
- whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We are also required to review and report on the Council's Annual Governance Statement, Whole of Government Accounts (WGA) submission, whether we have exercised our statutory powers under the Audit Commission Act 1998 in any matter, and our grant claims and returns certification work.

We recognise the value of your co-operation and support and would like to take this opportunity to express our appreciation for the assistance and co-operation provided during the audit.

BDO LLP
27 October 2015

FINANCIAL STATEMENTS

1

We issued an unqualified true and fair opinion on the financial statements on 30 September 2015.

No material misstatements were identified as a result of our audit work which had an impact on the reported deficit. However a material misclassification was identified on the face of the Comprehensive Income and Expenditure Statement (CIES) whereby internal recharges relating to the non-distributed income and expenditure had been incorrectly shown gross rather than net resulting in an amendment of £31.6m to reduce both income and expenditure. This was corrected by Management.

There were two unadjusted differences identified by our audit which would decrease the deficit on the provision of services by £2.4 million to £95.8 million. There were also two unadjusted disclosure issues in relation to the Senior Officer Remuneration Note and the Related Party Transaction Note which are not disclosed in line with the Code due to over disclosure.

We noted one significant deficiency in internal control which related to the preparation of the financial statements.

USE OF RESOURCES

2

We issued an unqualified value for money conclusion on 30 September 2015.

While there is a recognised funding gap in the Medium Term Financial Strategy (MTFS), we are satisfied that the Council has appropriate arrangements to continue to remain financially sustainable over the period of the MTFS.

OTHER MATTERS (REPORT BY EXCEPTION)

3

We have not exercised our statutory powers and have no matters to report.

It was necessary to delay the issue of our audit certificate to close the audit for the year ended 31 March 2015 because the WGA return was not complete at 30 September 2015. The audit of the WGA is still not complete at the point of drafting this Letter.

GRANT CLAIMS AND RETURNS CERTIFICATION

4

Our review of grant claims and returns is in progress and the results will be reported upon completion of this work.

FINANCIAL STATEMENTS

1

OPINION

We issued an unqualified true and fair opinion on the financial statements on 30 September 2015.

Financial performance

The Council reported a deficit on the provision of services of £98.206 million.

After adjusting for items in the Movement in Reserves Statement (MiRS), the Council reported a surplus on the General Fund of £8 million before transfers to earmarked revenue reserves of £8 million, resulting in no overall increase to the General Fund balance. The HRA reported an increase of £266,000.

Financial statements

The draft Statement of Accounts was prepared and provided to us for audit on 30 June 2015. However, some amendments were required to some of the main statements and Management did not provide a reworked and balanced Movement in Reserves Statement (MiRS), Cash Flow Statement and Collection Fund Statement until early September 2015. Arrangements for ensuring a balanced set of accounts need to be improved to allow the Council to move towards the much accelerated preparation and audit timetable due to be introduced from 2017/18, when the audit completion deadline will be 31 July.

No material misstatements were identified as a result of our audit work which had an impact on the reported deficit. However, a material misclassification was identified on the face of the CIES whereby internal recharges relating to the non-distributed income and expenditure had been incorrectly shown gross rather than net resulting in an amendment of £31.6m to reduce both income and expenditure. This was corrected by Management.

We continue to identify a high number of non-trivial errors, although it is important to recognise that the amount of errors has reduced compared to the previous year. We raised the preparation of the financial statements as a significant risk area within our Audit Plan. We consider that the significant risk had not been mitigated during the year and we expect this significant risk to recur in 2015/16. We raised some recommendations around to the preparation of the financial statements to assist in making improvements in this area, including ensuring that any immaterial and irrelevant accounting policies are removed.

There were two unadjusted audit difference identified in the current year which would reduce the draft deficit on the provision of services in the CIES by £2.406 million to £98.5 million. These related to the following:

- **Housing Benefit Overpayments (current year error):** Our testing identified that the Council accounts for debtor balances relating to housing benefit overpayments on a cash basis, which is not in line with the accruals concept. The debtors balance is off-set by a 100% provision, resulting in a net £nil debtor balance within the balance sheet. We concluded that the Council should be applying a provision of approximately 75% and therefore a debtor balance of £1.25million should have been recognised in the balance sheet.
- **Accruals testing (prior year error):** In the prior year we identified an understatement of accruals of £1.156 million. This error impacted on the current year because current year expenditure was overstated by this amount (in not accruing for it in the previous year, it was therefore accounted for in the current year).

There were also two unadjusted disclosure issues in relation to the Senior Officer Remuneration Note and the Related Party Transaction Note which are not disclosed in line with the Code due to over-disclosure (for example, for Senior Officers a simple pay level was applied rather than considering whether or not the officers has relevant decision-making roles).

We consider that these misstatements did not have a material impact on our opinion on the financial statements.

FINANCIAL STATEMENTS

Internal controls

We noted one area where deficiencies in internal controls should be improved in relation to the preparation of the financial statements.

The Chief Finance Officer completes a review of the financial statements before being passed to audit. However this review is not detailed and is not evidenced to confirm the checks that have been performed to ensure the accuracy of the financial statements.

As this area was identified as a significant risk of material misstatement within our Audit Plan and there is a lack of evidence of controls in place, we are required to report this as a significant control deficiency.

Management has agreed to review and strengthen these internal controls.

Annual Governance Statement

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

Narrative reporting

Local authorities are required to include an explanatory foreword in the Statement of Accounts to provide an explanation of the financial position and to assist in the interpretation of the financial statements.

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.

CIPFA is considering the how local authorities can develop its narrative reporting requirements, such as including management commentary or strategic reporting, but has postponed this review until the legislative requirements for the sector are resolved. However, CIPFA's consultation on 'Telling the Story' will propose introducing a reconciliation from the reported outturn in the financial statements to the Council's management accounts.

USE OF RESOURCES

2

CONCLUSION

We issued an unqualified value for money conclusion on 30 September 2015.

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:

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

Financial resilience

The Council has a Medium Term Financial Plan (MTFP) in place covering the four year period to 2016/17. We have reviewed the assumptions made in the latest version of the MTFP (dated September 2014) and considered the level of savings the Council is required to make during the period covered by the strategy and found these to be reasonable. The MTFP details the planned use of resources and the expected funding gaps up until 2016/17.

The Cabinet is continuing to develop various options to address the resource gap, including further reducing expenditure, reviewing service operations e.g. the transformation of the Customer Contact and Administration service area and securing further procurement efficiencies. However, further pressure is being placed on the Council's general and earmarked reserves.

The Council continues to maintain a healthy level of earmarked reserves and balances, with the level of reserves remaining within the minimum level of reserves set by the Chief Finance Officer of £5 million. As at 31 March 2015, the general fund balance was £5 million and earmarked reserves were £34.5 million.

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.

Challenging economy, efficiency, effectiveness

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. The Council has continued to develop annual budgets which reflect the priorities outlined in its Corporate Plan.

Key performance indicators were developed at the beginning of 2014/15, with 53 KPIs covering each of the Council's key priority areas. Progress against these has been reported to the Cabinet and Scrutiny Committees on a quarterly basis, allowing members to identify areas where performance may require improvement and providing the opportunity to challenge officers where necessary.

The Council is continuing to take 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).

Since the inspections, the Council continues to identify additional resources required to invest in its children's services and has established 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 continues to be 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.

An Ofsted inspection has recently been completed to review the service and a report is expected in the coming months.

OTHER MATTERS

3

REPORT BY EXCEPTION

Our work on the WGA is underway and as a result we have delayed the issue of the audit certificate.

Whole of Government Accounts

Auditors are required to review Whole of Government Account (WGA) information prepared by component bodies that are over the prescribed threshold of £350 million in any of: assets (excluding property, plant and equipment); liabilities (excluding pension liabilities); income or expenditure.

Our audit of the WGA is underway. The Government's deadline for submitting the audited return (2 October 2015) was not met. The delay has been caused due to a significant number of amendments being required to the Department Consolidation Tool (DCT).

Use of statutory powers

We have not exercised our statutory powers and have no matters to report.

Audit certificate

It was necessary to delay the issue of our audit certificate to close the audit for the year ended 31 March 2015 because the WGA return was not complete at 30 September 2015. The audit of the WGA is still not complete at the point of drafting this Letter.

GRANT CLAIMS AND CERTIFICATION

4

CERTIFICATION WORK

Our review of grant claims and returns is in progress and the results will be reported upon completion of this work.

Housing benefit subsidy claim

Public Sector Audit Appointments Ltd has a statutory duty to make arrangements for certification by the appointed auditor of the annual housing benefit subsidy claim.

Our audit of the 2013/14 housing benefits subsidy claim found a number of errors in relation to:

- The benefit software reconciliation not being reconciled
- Misclassification of overpayments in relation to non-HRA rent rebates
- Incorrect earnings being used in benefit calculations for claimants in receipt of non-HRA rent rebates
- Misclassification of expenditure for non-HRA cases

Our work on the 2014/15 housing benefits subsidy claim is currently in progress and will be completed ahead of the submission deadline of 30 November 2015.

Other claims and returns

A number of grant claims and returns that were previously included within the scope of the audit have since been removed, but Departments may still seek external assurance over the accuracy of the claim or return.

These assurance reviews are undertaken outside of our appointment by the Audit Commission or Public Sector Audit Appointments Ltd, and are covered by tripartite agreements between the Council, sponsoring Department and the auditor.

The Council has requested that we undertake a 'reasonable assurance' review, based on the instructions and guidance provided by the Departments, for the following returns for 2014/15:

- Pooled housing capital receipts (deadline 30 November 2015)
- Teachers' pensions return (deadline 30 November 2015)

On work on these returns is currently in progress.

APPENDIX

Reports issued

We issued the following reports in respect of the 2014/15 financial year.

REPORT	DATE
Planning letter	March 2014
Grant Claims and Returns Certification Report (2013/14)	February 2015
Audit Plan	March 2015
Final Audit Report	September 2015
Annual Audit Letter	October 2015


Fees update

We reported our original fee proposals in our Audit Plan issued in March 2015. Our fees to date and any variance to the original proposal are shown below.

AUDIT AREA	PROPOSED FEES £	FEES UPDATE £
Code audit fee	189,934	189,934
Certification of housing benefit subsidy claim	12,250	⁽¹⁾ 12,250
Total fees for audit services	202,184	202,184
Audit related services		
- Pooled housing capital receipts return		⁽²⁾ 3,200
- Teachers' pensions return		⁽²⁾ 4,200
Non audit services fees		
- None	0	0

Note 1 - Our work on the assurance reviews of the grant claims and other returns for 2014/15 is in progress and we will report the findings from this work and the final fees separately.

Note 2: The certification of both the Pooled capital receipts return and the Teachers' Pensions return have fallen outside of the Audit Commission/PSAA arrangement and so were not included within planned fees. The values quoted are estimates and the work is not yet completed.



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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